



MCT COMPASS

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An Analysis of the Factors

A factor is something that contributes to or has an influence on the outcome of something else. In the 1980s, the factors that influenced the price of cheese were limited to production and government stocks. In the 1990s, the number of factors grew to include production, stocks (both commercial and government), domestic demand, and risk management. Now in the second half of the first decade of the new millennium, milk producers, cheese manufacturers, and end-users face of a myriad of factors including but not limited to:

- Use or nonuse of milk production enhancing rBST.
- Effective supply management tools that capped milk production growth in California, the largest milk producing state in the United States.

- Use of alternative feed rations that maximize profit not production.
- Value of corn correlated to the price of crude oil.
- Cheese manufacturers making to order, rather than maximizing capacity and building inventories.
- Growth in dairy product exports.
- The massive purchasing power created by the weakness of the U.S. dollar and record-high prices for crude oil.
- The resilience to date of the domestic dairy product markets to rising costs.

On the milk production side of the equation, dairy producers across the United States are faced with rising costs of production, largely driven by higher feed and energy costs. Some dairy producers are naturally hedged by raising their own corn to feed their dairy cows. A Purdue University

agricultural economist estimates that the cost of producing corn has increased to \$4.00/bu., which is lower than the market price of \$6.00/bu., but significantly more than the \$2.50/bu. (or lower) market price enjoyed by dairy producers in the past. Rising feed costs in tandem with the discontinued use of rBST have resulted in lower output per cow. Growth in milk production per cow has been on a steady decline since mid-2007. Historically, milk production per cow has increased by approximately 2% annually; however, during the first quarter of 2008, output per cow did not even increase 1% versus the prior year.

Dairy producers have offset the decline in milk per cow by adding cows to their dairy herds. Since January 2007, 131,000 cows have been added to the U.S. dairy

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KEN'S CORNER



*by Ken Meyers
President
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Our industry is challenged daily to make sense out of the myriad of factors that are impacting our businesses today. We can't say we understand them all, but we recognize that we're not

doing business as usual either.

More than ever before, it's important to realize there has been a paradigm shift in the global food marketplace. Although the prices we see today may mitigate export sales, there is still a major convergence between world dairy product prices and the U.S. dairy markets.

In many months during the year, we expect the United States

to be the price setter for global dairy markets. With that in mind, a new set of risks emerge including, but not limited to, price volatility credit risk, lack of protection from U.S. laws, maritime peril, and just the naivete of being new to the world market. In essence we don't know what we don't know. **MCT**

Cheese uncertainty...

The CME block market climbed 35 cents during the month of May, and it is questionable whether this price level can be sustained through June. Market predictions range from the block cheese market returning to the \$1.80 or \$1.90 price level, which would continue to stimulate exports, to predictions north of

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
May	2.0950	2.0700	1.4750	0.2698	1.304	18.20	15.35
Jun	2.1200	2.0900	1.5175	0.2800	1.370	20.40	16.25
Jul	2.1500	2.1250	1.5350	0.2900	1.410	20.15	16.75
Aug	2.2200	2.1900	1.5400	0.3150	1.440	21.00	17.00
Sep	2.2500	2.2250	1.5500	0.3300	1.450	21.60	17.05
Oct	1.9500	1.9250	1.5500	0.3500	1.450	21.05	17.05

* Block, barrel and butter are monthly averages of CME prices.
 **Whey and NFDM are monthly averages of NASS prices.

\$2.50/lb., which would keep product onshore. Perhaps the

equilibrium price level lies someplace in between. **MCT**

Multiplying factors..

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herd, which totaled 9,266,000 head in April 2008. Replacement heifer prices that range between \$2,200 and \$2,400/head are pricey and reflect dairy producer sentiment that milk prices will stay strong though the second half of 2008 when these animals calve.

One key factor that is supporting milk producer optimism is the growth in U.S. Cheddar cheese exports. During March 2008, Cheddar cheese exports soared to 6.5 million pounds and represented

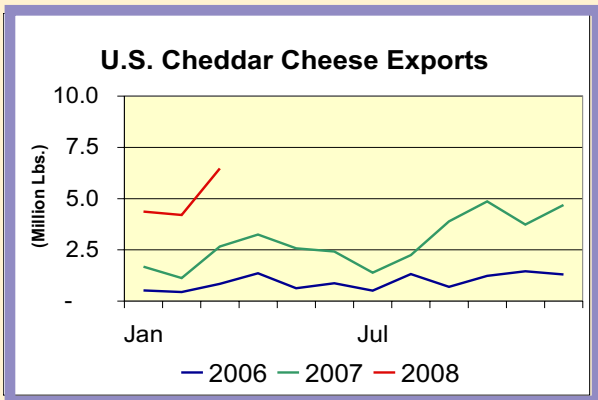
2.4% of total Cheddar cheese production during the month. Almost 25% of U.S. Cheddar cheese exports during the first quarter were sent to Mexico, followed by Egypt at 16%, the Netherlands at 14%, and Australia at 7%. Exports to Mexico are double last year's, while exports to Egypt are nearly fourfold greater.

But it's not just increased Cheddar cheese exports that are supporting the cash Cheddar cheese market. Lower production of Cheddar cheese and fewer stocks versus last year are also factors. Cheddar cheese production through March 2008 declined 12.4 million pounds and exports rose by 15.0 million pounds, resulting in a domestic shortfall of 27.4 million pounds. Lower production and greater exports have contributed to lower stocks of American cheese (USDA does not report a separate

Cheddar cheese stocks number). As of April 30, 2008, stocks of American cheese totaled 544.8 million pounds, down 41.4 million pounds versus last year.

It seems counterintuitive that despite ample milk supplies, Cheddar cheese production is down. One factor resulting in lower Cheddar cheese production is the closing of Golden Cheese in Corona, Calif. Another factor is the unwillingness of manufacturers to produce speculative cheese. In other words, if a manufacturer does not have a home for the cheese, it is unlikely to be produced.

With cheese prices near \$2.20/lb., the stakes are just too high to produce uncommitted cheese. So far this year, the CME block Cheddar cheese market has ranged from \$1.650 to \$2.285/lb. While a dime correction on a speculative load of cheese hurts the pocket book, a 35-cent correction to the price level at the beginning of the month could put a company out of business. **MCT**



Source: MCT Dairies, Inc.



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