July 30, 2009

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Recovery to be Slow but Sure

Last year at this time, the Class III milk price was near $18, dairy product exports were booming, the U.S. government was saying that any recession would be mild, and input costs for dairy producers appeared as if they would provide an elevated floor under milk prices. What happened?

High milk prices in 2007 and 2008 set off a nearly worldwide round of dairy cow expansion that resulted in a flush of milk. Then the nearly unthinkable occurred. World credit seized up and demand for almost all types of products, including dairy, collapsed on both the domestic and world markets. The meltdown in crude oil prices from over $140/barrel to less than $50/barrel also reduced the purchasing power of key dairy importers. For the United States, the loss of dairy export sales meant that more than 3% of the nation's milk supply would begin backing up on the domestic market.

Last summer, food prices, including dairy product prices, had also skyrocketed following several months of record-high commodity prices. Consumers, faced with declining home values, started to cut back and trade down on food purchases. Then GDP tumbled, both here and abroad, to levels not seen in decades. The ranks of the unemployed grew. Restaurant traffic slowed, as did cheese sales, sending cheese stocks higher and prices to near government support levels.

To get an idea of where markets are headed from here, *MCT Compass* once again collected midyear forecasts from six of the nation's top dairy analysts: Bill Brooks, e-Dairy Inc.; Bob Cropp, University of Wisconsin; Wilson Gray, University of Idaho; Mary Ledman, Keough Ledman Associates; Alan Levitt, Levitt Communications; and Mark Stephenson, Cornell University. Their forecasts were then added to futures prices for July 20 when applicable and merged into a consensus forecast.

All of the experts agree that a milk production contraction leading to substantially higher milk prices is on tap, but not until mid- to late-2010. "A modest rebound in third-quarter 2009 milk prices will give some breathing room to producers. Some relief will also come

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KEN'S CORNER

by Ken Meyers
President
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It truly is amazing how much has happened since we talked with our analysts a year ago. Federal Reserve Chair Ben Bernanke said last week that had the government not taken steps beginning last fall to stabilize the banking system, the U.S. economy could have plunged into a downturn that might have rivaled the Great Depression.

Over the past few years, markets have demonstrated that the health of the U.S. dairy industry depends on the global market, which remains weak. Our team of analysts is not betting on a "V" or "W" shaped recovery in milk prices simply because world supplies continue to outpace demand and it will take time to clear the excess.

As this issue of *Compass* goes to press, government-owned stocks of skim milk powder/nonfat dry milk continue to build in Europe and the United States. Both Europe and the United States have reinstated subsidies to try to move some of the excess product. When that clears, recovery will begin. For now, though, it appears we are in a sustained "L" shaped downturn.

However, the impact of a weaker dollar on exports deserves watching. And if lenders force too many producers to call it quits, economic recovery kicks in, consumers go back to their old habits of eating out, and emerging markets start to boom again, the horizontal portion of that "L" could turn up rather quickly to once again blindside an industry that has proven nearly as volatile as the stock market. MCT

Recovery muted..

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through lower feed prices," says one of the experts. "However, it will not be enough to stop farm exits."

The group's average Class III consensus forecast for the remainder of 2009 is $11.73. The most bullish expects the Class III price to hit $14.15 in December, which is less than the December futures price on July 20 of $14.42. Looking ahead, the consensus forecast for the 2010 Class III average improves to $14.68, but the range in predictions swings from $14.00 to $15.35. The analysts' forecasts for the average NASS cheese price for 2009 range between $1.28 and $1.64.

Class IV prices will remain substantially below Class III prices, according to our analysts. Their average forecast places the July through December Class IV price at $10.74, but the forecast range varies between $10.25 and $11.10.

A lot needs to happen for prices to recover. Our analysts will be watching for signs of improvement in consumer confidence and credit availability, lower dairy product inventories, contraction in cow numbers, and lower milk production in Europe and Oceania, along with a number of other indicators.

Unfortunately, for many milk producers, the worst is yet to come. U.S. cow numbers need to drop to 9 million for recovery to begin. "Watch for additional rounds of CWT and heavy participation as lenders help producers make hard decisions to eliminate cows," concludes one economist. MCT

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	NFDM
July	1.1551	10.04	1.1890	10.23	28.97	0.85
Aug	1.1972	10.67	1.2403	10.47	30.16	0.86
Sept	1.2629	11.54	1.2846	10.69	30.99	0.86
Oct	1.3274	12.29	1.3200	10.94	30.88	0.88
Nov	1.3755	12.78	1.3329	11.07	30.44	0.89
Dec	1.3904	13.06	1.3208	11.06	29.63	0.90
Avg	1.2831	11.73	1.2813	10.74	30.17	0.87
2010	1.5616	14.68	1.4353	12.70	29.73	0.96

* Whey in cents

What the experts are saying...

Bill Brooks: Producers will continue to struggle with profitability through the rest of 2009, but 2010 looks better. Processors need to prepare for less milk; however, the pending milk contraction may not result in a milk shortage because global demand looks like it will be slow to rebound.

Bob Cropp: In 2008, on a total solids basis, the United States exported 10.8% of its milk production. First-quarter 2009 exports dropped about 51% on a value basis. On a volume basis, exports of NFDM fell 52%, cheese dropped 29%, and butterfat fell 79%, leaving 3% or 4% more milk to clear the market.

Wilson Gray: Once the economy bottoms, the growing U.S. budget deficit could cause rising prices. Higher interest rates would be needed to halt inflation. Historically, the Federal Reserve hasn't gotten ahead of this. The political will to raise interest rates may not be there. Hopefully, we won't face a "lost decade" as Japan did in the 1990's.

Mary Ledman: As the United States and European Union broaden their export subsidies and stocks programs, global prices are likely to stay lower longer. However, keep in mind that even though government stocks here and in Europe are growing, they are significantly lower than in the first half of this decade.

Alan Levitt: Over the next six months, cow numbers will drop dramatically. The Dairy Export Incentive Program (DEIP) should help keep NFDM from going to the Commodity Credit Corp (CCC). Domestic demand hasn't been too bad. Rising production has been the culprit and that's about to change.

Mark Stephenson: Whether we like it or not, we are now a significant player in world markets, which complicates milk prices for us. This is not a bad thing, and we shouldn't consider backing away from those markets. Recovery will take time and probably a change in our global market strategy, but just like we were too optimistic last year, we are undoubtedly too pessimistic now.

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