



MCTCOMPASS

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The Golden State's Shift

California is the largest milk producing state in the United States accounting for more than 40 billion pounds of milk annually and 21% of the nation's milk supply. From 1988 through 2008, the California dairy herd expanded every year between 21,000 and 63,000



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head. On average the herd increased by 37,000 annually during this period, and milk production more than doubled from 18.6 billion pounds to 41.2 billion pounds.

It seemed as if the California milk production machine was unstoppable, but a slowdown in the rate of growth was already evident by 2005. In 2000 and 2001, the California dairy herd increased by 61,000 head and 63,000 head, respectively. By 2005, the annual increase in the dairy herd had slowed to 30,000 head. Rising energy and feed costs were key factors impeding California's rate of growth.

In 2008, California's milk production topped out at 41.2 billion pounds. A severe downturn in milk prices during the latter half of 2008 and into 2009 contributed to a 48,000-head reduction in the California dairy herd in 2009 followed by an additional 42,000-head contraction in 2010. As the midyear approaches, the California dairy herd stands at 1.769 million cows, down 78,000 head from the peak of 1.847 million in 2008.

In 2010, California was fortunate to experience a very mild summer. Favorable weather conditions, lower feed costs, and higher milk prices contributed to exceptionally strong gains in milk production per cow during the April through September period. For example, milk production per cow increased from 4.4% in May 2010 to 8.4% in September 2010 vs. the prior year. However, the rate of gain in milk per cow declined to 3.2% in December 2010, and to 2.1% in the first quarter of 2011, compared with

the comparable periods a year earlier. While the gain is still positive, the trend line is down and it is likely that California milk production will drop below last year's level by midyear 2011—unless there's a 50,000-head infusion into the state's dairy herd.

However, based on a stable dairy herd, and the downward trend in the growth in milk per cow, California is likely to produce 3.0% less milk in the third quarter of this

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Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

California's milk production may have slowed, but the state remains a dairy powerhouse due to the sheer size of its milkshed. For years, dairy management experts recommended that dairy producers take advantage of economies of scale—the more cows one milked, the better.

Then came a change in U.S. energy and monetary policy. The change in energy policy resulted in rising feed costs as well as higher transportation costs to get feed from the Midwest to the West. In addition, higher freight costs have reduced the competitiveness of California's domestic sales, especially east of the Rockies. Meanwhile, the change in monetary policy has resulted in a lower dollar value (vs. competitor currencies) and has had a positive impact on California's ability to export.

Drought in New Zealand and flooding in Australia opened the door to U.S. exporters of dairy products in late 2010 and early 2011. That door has yet to close. However, it does not appear the United States will escape the impact of Mother Nature this year. Much of the southern United States is mired in a moderate to extreme drought, while the eastern Corn Belt, Upper Midwest and Northeast are receiving copious amounts of rainfall. These weather problems point to higher feed costs, reduced cow comfort, and lower milk per cow. As a result, milk production growth will be stagnant, which points to a continuation of firm dairy markets. **MCT**

Something has to give...

The nearly \$3.00/cwt. difference between the Class III and Class IV prices in March and April is not sustain-

able. A slowdown in American cheese production during March and a corresponding lower inventory build are

being felt in the marketplace as CME spot cheese prices move steadily higher during the second half of May. Adverse weather conditions in key cheese-producing states are also supporting the market. The nonfat dry milk market appears to have topped out near \$1.65/lb., which is consistent with the global market. Meanwhile, the global butter remains firm and continues to buoy U.S. prices. **MCT**

MCT Forecast							
	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
May	1.6620	1.6600	16.50	2.0600	20.30	0.4930	1.6100
Jun	1.8250	1.8100	18.25	2.2150	21.00	0.5250	1.6150
Jul	1.8600	1.8450	19.10	2.2500	21.25	0.5575	1.6175
Aug	1.8900	1.8650	19.40	2.2950	21.30	0.5525	1.6100
Sep	1.9000	1.8750	19.52	2.3100	21.20	0.5475	1.5800
Oct	1.9150	1.8600	19.30	2.3400	20.70	0.5250	1.5200

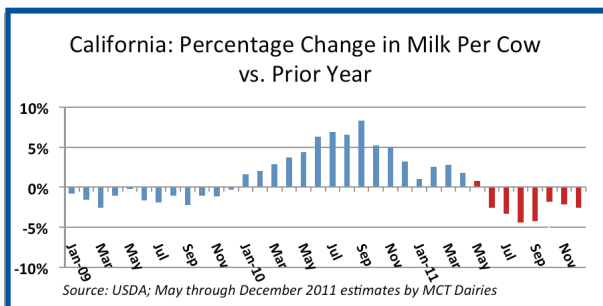
* CME prices.
**NASS prices.

Who will step in...

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year compared with a year earlier. Given that California accounts for 21% of the nation milk supply, a 3.0% decrease translates into 0.6% less milk production for the entire United States.

Lower milk production in the top milk-producing state means other states need to pick up the slack. However, this is easier said than done. For example, the second largest milk-producing state is Wisconsin, which accounts for 13% of the nation's milk supply, followed by Idaho with a 6.6% share. Thus if California output is down 3.0%, Wisconsin would need a 4.5% gain to make up the difference and Idaho would have to increase production by at least 9.0% to compensate for California's slowdown.



Currently neither state is on track to post such robust gains. A delayed, wet spring in Wisconsin contributed to the state's 0.1% year-over-year decline in production in April. And milk production in Idaho was up 4.6% in April, only half the rate of growth needed to make up for the expected 3.0% decline in California.

Why California matters

Whatever happens in California has a ripple effect across the rest of the domestic market and even the global dairy markets. More than half of the country's nonfat dry milk is produced in California. More than one-third of the nation's butter and one-fifth of its cheese are produced in the state. A downturn in California's milk production is likely to result in less production, as well as fewer exports, of nonfat dry milk and skim milk powder. Even with a 2.0% year-over-year increase in milk production in the state in the first quarter of this year, California's combined nonfat dry milk and skim milk powder production is up just 0.8% while butter production is 2.5% higher and total cheese production is up 5.8%, according to the most recent California Dairy Information Bulletin. Thus California's stagnating milk supply is shifting into cheese production, which has contributed to tight global and domestic butter and powder markets. **MCT**



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