October 31, 2012

MCT COMPASS

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Just How Bad is It?

High feed costs and lack of quality feed have forced U.S. dairy producers to increase the cow cull rate dramatically, and the epicenter of this year's dairy crisis is reportedly in California, the nation's number one milk-producing state.

According to recent reports, some analysts expect California to lose 100 of its 1,675 dairies by the end of 2012 due to forced and voluntary exits. Feed companies and hay brokers have reportedly shut down the accounts of some dairies and are limiting available credit to others or accepting up-front payments only.

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USDA's Livestock Slaughter figures confirm that cull rates are high, particularly in the West. USDA's latest report shows that 251,000 dairy cows were slaughtered at federally inspected plants in September. That's a 24,000-head drop from August's 275,000 cows and only 4,000 head more than the 247,000 cows slaughtered in September 2011. However, for the January through September period, 2.288 million dairy cows have been slaughtered, which is 6% ahead of the comparable period in 2011. Thus, even though culling seems to be slowing, cull rates are high.

What the numbers show

Whenever margins have been negative for an extended period of time, the nation's dairies have historically become quite vocal. While no one believes that dairies are doing well at the moment as evidenced by the string of near-record and record-low milk-feed price ratios, other data don't fully support the naysayers either.

U.S. milk production in September fell 0.5% below year-earlier levels, far less than what many in the industry had expected. In California, output fell 3.9% in September, also less than what the most pessimistic had been anticipating. California's drop in output was the result of both falling production per cow (down 95 lbs.) and lower cow numbers (down 3,000 head), compared with August levels. The numbers support recent reports that California producers have both culled their herds and adjusted their rations to include lower-cost—thus lower-performing—feeds.

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

Rumor has it that many dairies in California are filing for bankruptcy. But what does that mean?

There are three basic types of bankruptcy. The first and most serious is a Chapter 7, which occurs when a business is liquidated. All assets of a business are sold and the money is used to pay creditors, first secured creditors then unsecured.

The second type is Chapter 11, which is basically reorganization. The business develops a plan to reduce its debts and emerges stronger but typically smaller. This plan for restructure is used by corporations, partnerships, and also by individuals in business.

The third is Chapter 12, which is also a reorganization plan. This bankruptcy is often used by farms, but is limited to those farms that have debt of less than about $4 million. Typically it does not work on large dairies similar to those in California.

While no statistics are available at this time, those in the banking field say most of the dairy bankruptcies are Chapter 11. So unless cow numbers start to decline significantly and the world economy picks up, milk production should be able to keep pace with demand. **MCT**

Demand Peaking...

Dairy product markets are stable to higher due to seasonal demand and supply. The fourth quarter is typically the highest demand period for dairy products and milk production is at its seasonal low. American cheese stocks as of Sept. 30, totaled 608.4 million pounds, down 0.9% vs. the prior month and 4.8%, or 30.7 million pounds, less than last year. Lower stocks have helped push the spot Cheddar cheese market above $2/lb. Butter stocks are more ample, but there is also more concern regarding future butter production. Butter stocks totaled 195.4 million pounds at the end of September, down 3% vs. August, but are still 29% more than September 2011. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Oct	2.0725	2.0250	21.02	1.9100	18.54	0.6215	1.4725
Nov	2.0300	2.0050	21.20	1.8700	18.85	0.6350	1.5350
Dec	1.9800	1.9550	20.90	1.8000	18.90	0.6300	1.5525
Jan	2.0250	2.0000	20.20	1.7500	18.55	0.6300	1.5400
Feb	1.9700	1.9450	19.90	1.7000	18.10	0.6250	1.5150
Mar	1.9700	1.9450	19.55	1.8000	18.20	0.6250	1.5150

** CME prices.*
***NASS prices.*

Still growing..

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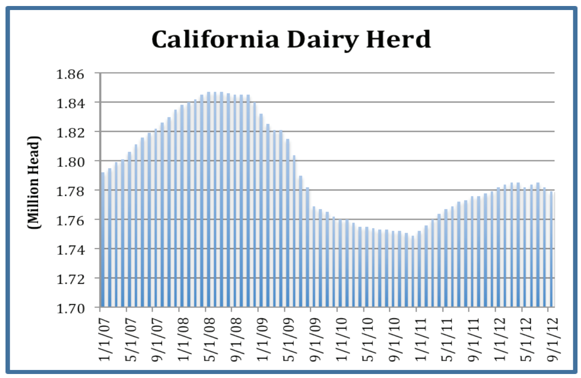
USDA's Livestock Slaughter reports also point to more culling in the West compared with cull rates in other parts of the country, but even with the increased culling, the California dairy herd in September was still 3,000 head stronger than it was last year in September.

The fallout from the last dairy crisis, which had its roots in mid-2008, was long lasting in California. The California herd peaked in the April–June 2008 period at 1,848,000 head. Since then, California's milk herd has mostly continued to contract, hitting a low of 1,749,000 cows by December 2010. The Golden State's herd recovered into the March-April 2012 flush, hitting 1,785,000 million head but has since declined by 6,000 head to 1,779,000.

Meanwhile, the dairy herds in Arizona, New Mexico, and Texas, where producers also buy a majority of their feeds, also fell below prior-month levels in September, showing declines of between 8,000 head in Arizona and 2,000 head in Texas, illustrating that Californians are not the only producers having trouble making ends meet.

Farm numbers also shed some light on current dairy farm economics. Since 1992, U.S. dairy farm numbers have dropped by 80,028 farms to 51,481, which is an average annual decline of 6.1%. Over the last four years, the annual drop in U.S. dairy farm numbers has been between 1,651 and 2,195, with the largest decline occurring in 2009 following financial conditions similar to today. At the end of 2011, California had 1,675 dairy farms, down 40 from the end of 2010. If California does lose 100 dairy farms this year, a 6% decline, it will be a much sharper drop than 2011's decrease of 2.4% but similar to the U.S. annual average over the past decade. **MCT**



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