January 31, 2014

MCT COMPASS

A complimentary service of MCT Dairies, Inc. www.mctdairies.com

The Era of Margin Protection

The long and contentious fight over the farm bill appears to be over. The House and Senate agricultural committees reached a bipartisan agreement earlier this week. The House passed the bill on Wednesday by a 251–161 margin, which included 162 Republicans and 89 Democrats voting in favor of the bill. The Senate has scheduled a vote for the first week of February.

Dairy producers who operate more than one dairy farm can register each facility separately to participate in the program.

The Congressional Budget Office estimates that direct spending for authorized programs will total $956 billion over 10 years. Nearly 80% of the cost, or $756 billion, is attributed to nutrition programs.

Perhaps the biggest change in the farm bill for the U.S. dairy industry is the elimination of the Dairy Product Price Support Program (DPPSP). Implemented in 1950, the DPPSP has long served as the safety net for U.S. milk prices. In recent years, it has also hindered the export competitiveness of the U.S. dairy sector. Replacing the DPPSP is the Margin Protection Program (MPP). The newly formed MPP is designed to protect farm revenue in periods of low margins and recognizes that milk margins are driven by both milk revenue and feed costs.

How it works

All dairies, regardless of the size of operation, are eligible to participate in the MPP for an annual administration fee of $100. Dairy operations with more than one producer, such as a multiple-family operation, are treated as a single operation. Dairy producers who operate more than one dairy farm can register each facility separately to participate in the program.

All producers are eligible for a zero-premium, catastrophic coverage of a $4/cwt. margin on up to 90% of their annual marketings or 4 million pounds of milk. The margin is calculated by subtracting a national average feed cost (derived from corn, soybean, and alfalfa prices) from the U.S. All-Milk price. Payments will be made when

Continued on page 2

Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

The three-year wait for a farm bill was worth it. Fortunately, Congress had the foresight to not include the Dairy Security Act, a form of supply management championed by the National Milk Producers Association. The Dairy Security Act could have hurt dairy exports by keeping supplies of milk and dairy products artificially low.

To address the legitimate concern that the Margin Protection Program (MPP) could result in greater than anticipated milk and dairy product production, leading to periods of low prices, Congress also had the foresight to include the Dairy Production Donation Program. This program will begin no later than 120 days after implementation of the MPP.

Under the donation program, USDA will purchase and distribute dairy products to low-income consumers. The program, which is only implemented when the milk margin falls below $4/cwt. for two consecutive months, requires USDA to purchase dairy products for three successive months, or until margins move above $4/cwt. or U.S. prices exceed international prices by more than 5%.

These safeguards will ensure our competitive standing in world markets, help feed low-income consumers, and ensure a viable milk supply. **MCT**

Uncharted Territory ...

CME Group cash Cheddar block and barrel prices continue to post new record highs on a daily basis. At $2.355 and $2.32, respectively, block and barrel prices are a nickel higher than previous highs posted in May 2008. Export commitments made in the second half of 2013 at much lower price levels and unanticipated lower milk and cheese production from key-cheese producing states have tightened the supply of cheese less than 30 days of age. Year-ending American cheese stocks of 619 million pounds are 2.6% less than 2012 ending stocks. Year-ending butter stocks of 111 million pounds are 27% lower and likely to buoy prices through Q2 2014. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jan	2.2225	2.1727	21.15	1.7761	22.45	0.6025	2.0320
Feb	2.0875	2.0625	23.45	1.8800	23.40	0.6190	2.0500
Mar	1.8800	1.8500	20.50	1.9300	22.90	0.6200	1.9800
Apr	1.7800	1.7500	19.50	1.8300	21.65	0.6200	1.8550
May	1.7000	1.6750	18.50	1.7500	20.35	0.6150	1.7500
Jun	1.7000	1.6750	18.15	1.7500	20.25	0.6000	1.7500

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

More attractive for some...

Continued from page 1

the margin falls below $4/cwt. for two consecutive months (defined as January-February, March-April, May-June, July-August, September-October, and November-December). Under this methodology, on 4 million pounds, dairy producers would have received five months of payments in 2009 totaling nearly $16,000 and four months of payments tallying $11,000 in 2012.

For a fee dairy producers have the option to increase their coverage level from $4/cwt. to up to $8/cwt. on up to 90% of their historical production base. The historical production base is the highest level of annual milk production during 2011, 2012, or 2013. In succeeding years, annual base adjustments will be limited to the national average growth rate in U.S. milk production as estimated by USDA.

What's the best coverage

The coverage premiums are particularly attractive on marketings of less than 4 million pounds, which represent approximately 90% of the milk output from a 200-cow dairy (based on 60 lbs. of milk per cow per day). Fee-based coverage begins at $4.50 at a cost of a penny per hundredweight up to 47.5 cents per hundredweight to protect a margin of $8/cwt. While the $4-margin coverage would have kicked in just nine times from 2008 to 2013, the $8-margin coverage would have triggered payments in 32 out of the 72 months during this period, with a net payment (indemnity minus premium) of over $250,000.

For producers with more than 4 million pounds of annual milk production, the premiums are significantly higher. For example, the premium rate for a $6.50-margin protection on less than 4 million pounds is 9 cents per hundredweight, while the premium on more than 4 million pounds is 29 cents. At the highest coverage level, the premium for more than 4 million pounds is $1.36/cwt. compared to 47.5 cents for less than 4 million. It is unlikely that many large dairy operations will opt to protect an $8 margin, but the $6.50-margin coverage still provides a healthy payback based on MCT analysis. **MCT**

The information contained in this newsletter is for general guidance only. It is not intended to constitute or substitute investment, consulting or other professional advice or services. The information presented is not an offer to buy or sell commodities. Compass accumulates then distributes opinions, comments and information from and based upon other public and reliable sources, but it cannot warrant or guarantee the accuracy of any of the data included in the newsletter. From time to time MCT Dairies, Inc. may hold futures positions in commodities discussed in the newsletter. Always contact a registered financial advisor before making any decisions. MCT Dairies, Inc. shall not be held liable for any improper or incorrect use of the information contained in the Compass or for any decision made or action taken in reliance on the information in this newsletter. Reproduction with permission only. **MCT Dairies, Inc., 15 Bleeker St., Millburn, NJ 07041 (973) 258-9600 fax: (973) 258-9222 www.mctdairies.com.** For more information, email info@mctdairies.com.