March 31, 2002

MCT DAIRIES, INC.

MCT COMPASS

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

Dairy's protein problem

Every day, USDA's pile gets bigger. On average, 65-75 loads of nonfat dry milk (NFDM) are shipped to some government warehouse daily, joining the millions and millions of bags already there getting old and useless.

Uncommitted inventories in late March stood at 889.8 million lbs. – and at the current rate it'll top a billion lbs. by mid-May. To be fair, the anticipation of a reduction in the powder support price has driven processors to move surpluses to the government even more aggressively than usual, rather than hold it themselves. Manufacturers' stocks of NFDM on Jan. 31 were 119.8 million lbs., down 18% from a year earlier. Meanwhile, sales to CCC were up 25% during the first quarter of the year. The degree of surplus hasn't really changed, despite perceptions to the contrary. We've just shifted more of the burden onto the government.

But that still leaves the dairy industry with two issues to resolve:

- How do we deal with a perpetual surplus of 15 million lbs. of powder per week?
- And what is the government going to do with all the powder it already has in storage?

Boosting demand for solids

A support price reduction, expected to take place after Farm Bill discussions are concluded, could help boost domestic demand and alleviate some of the chronic surplus. Last year, commercial disappearance of NFDM jumped 26% to reach its highest level since 1996. Some of that can be attributed to a rare and brief parity between U.S. and world powder prices in 2001, which enabled some commercial export sales and forestalled imports of milk protein concentrates (MPC) that often displace domestic nonfat solids.

In both the domestic and international market, milk proteins compete with vegetable (primarily soy) proteins in a variety of processed food and drink applications. Reduced prices for milk proteins would make dairy ingredients more competitive and could boost sales of milk powder.

Salvation may also come in the

Continued on page 2

KEN'S CORNER

by Ken Meyers
President
MCT Dairies, Inc.

The industry's chronic surplus of nonfat dry milk has reached epic proportions. It simply isn't efficient, orderly or economical to regularly produce 40-50% more of anything than the market can bear.

Efforts to make powder more price-competitive and to divert some of the milk stream toward production of MPC and casein – two products the market has emphatically decided it wants to use – are steps in the right direction. A support price tilt of at least a dime is called for, and 15¢ would be even better to move in the direction of balancing this market.

Now that we have the technology to take milk apart and sell it by its components, global food marketers have become more exacting in their requirements. Off-the-shelf commodity products don't cut it with global food companies. They want ingredients – dairy or otherwise – customized for their application.

The U.S. dairy industry has to adapt to serve this changing market. ❑

Product price gains called for May

Spring doldrums are prevalent in the dairy markets, and we expect prices to remain soft for the next 4-6 weeks. Excess production is causing a build-up of inventories.

By the second half of May, seasonally rising demand for cheese and fat should buoy prices higher. By August, we look for cheese prices to climb into the mid-$1.40s, while butter approaches $1.50. Given current heifer shortages, milk production gains will be difficult to sustain throughout the year. ❑

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
MAR	1.2130	1.1809	10.65	1.2473	11.45
APR	1.2300	1.2050	10.87	1.2400	11.35
MAY	1.2750	1.2500	10.99	1.3075	11.42
JUN	1.3450	1.3200	11.75	1.4175	11.67
JUL	1.3750	1.3500	12.35	1.4950	12.16
AUG	1.4425	1.4175	12.69	1.5000	12.30

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

Protein problem...

Continued from page 1

form of domestically produced MPC, which will pull milk away from the dryers. Dairy Farmers of America (DFA) and Fonterra Cooperative Group, through their U.S. joint venture DairiConcepts, will expand DFA's Portales, N.M., facility to produce MPC and other dairy ingredients later this year. Output from this plant is expected to displace a portion of the roughly 90 million lbs. *(6-year average)* of imported MPC that enters the United States annually and absorb some of the excess milk solids hanging over the market. It also is likely to open the door to new customers. For instance, imported MPC can't be used in Grade A plants. The new domestic supply could find ready customers among U.S. yogurt and cottage cheese processors.

To encourage domestic MPC production, the Alliance of Western Milk Producers (AWMP) is spearheading a drive to add a MPC-subsidy pilot program provision to the Farm Bill. The idea would be for USDA to pay processors enough to make it profitable to produce MPC for sale on the domestic market. AWMP contends this would be considerably less costly to the government than buying up powder for which there is no market.

These three developments are a good start to stemming the tide of NFDM flooding into government warehouses. But what to do about the mountain already out there?

Trimming the stockpiles

If anyone's come up with a workable solution yet, they've kept it to themselves. To this point, USDA's only options have been to dabble with trials to convert stored powder into various marketable products.

In December, USDA initiated a field test, selling 1.2 million lbs. of 18-30 month old NFDM for 10¢/lb. to 10 companies willing to convert it to edible dry casein or caseinate. USDA is still compiling the results, but if the test is successful, it will invite bids to move more significant volumes.

The department also continues to offer 3.2-5.0 million lbs. of powder per month back to the trade for use as animal feed. However, since December, only 16% of the bids have been accepted, relieving USDA of just 2.4 million lbs. of its burden. These sorts of volumes are just grains of sand in a desert compared to the stockpiles cluttering USDA's caves.

Whether either of these initiatives can put a dent in the powder mountain remains to be seen. Unfortunately, it seems more likely a substantial volume in storage will go bad before it ever sees the inside of a processing facility. ❑

 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.