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The Weighty Question of Powder

Since the beginning of August, the U.S. nonfat dry milk (NFDM) market lost about one-third its value as high prices dampened global demand and exports declined, stocks continued building, and production capacity expanded.

The chart on page two illustrates the significant decrease in U.S. NFDM exports in July. It appears as if end users reviewed their stocks position at that time and then decided to hold off replenishing stocks waiting for price concessions. They haven't had to wait long.

Nearly a year ago, NFDM prices exceeded \$2.00/lb. Current spot prices are nearly half that and within 20 cents of the government support price of 80 cents per pound. Several factors point to the inevitable sale of NFDM into government support. To start, inventories continue to build. According to

USDA, commercial stocks of NFDM exceeded 140.5 million pounds in July. These figures do not include privately held stocks. Therefore, some speculate that the stocks figure is closer to 250 million pounds. In addition to growing stocks both in the United States and Europe, southern hemisphere output is coming on line as is new processing capacity in the United States.

In the United States, California Dairies Inc. brought a new plant on line in first quarter 2008, and High Desert Milk Producers Inc. is expected to start-up its Idaho plant in November 2008. In Oceania, the dairy herd has expanded by 5% and milk production is expected to exceed the prior year by 7% to 10% (after last year's 3.5% decline vs. the prior year). And the EU Commission approved a 2% increase in the EU milk quota in the spring of 2008, setting the stage for higher milk production there.

High skim milk powder (SMP) prices during the second half of 2007 set the stage for increased milk production in 2008 in many milk-producing regions around the world, including the United States, Europe, and Oceania. But just like dairy producers expanded milk production in response to high milk prices, some producers will also cutback milk production in response to low milk prices. The significant reduction in NFDM prices will result in lower-than-expected milk prices around the globe during fourth-quarter 2008.

Rising feed and energy costs have contributed to a cost of production in excess of \$16.50/cwt. A nonfat dry milk price of \$1.00/lb., and a butter price of a \$1.60/lb. results in a butter/powder milk

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KEN'S CORNER



*by Ken Meyers
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Perhaps the greatest attribute that the dairy industry has is the wholesome, nutrient-rich

content of nature's most perfect food "milk." Unfortunately, the repercussions from the actions of a few bad actors put any

company using any dairy ingredients on the defensive.

The Chinese government recently announced that it will create 400 product-testing centers over the next two years with 80 dedicated to food testing to restore consumer confidence. While this is a good first step, tremendous oversight is needed to prevent the existing melamine-tainted products from falling into unscrupulous hands. Several countries have implemented bans on Chinese dairy products while others have

issued recalls of suspected products.

Establishing and maintaining the safety of dairy products in China and around the world is vital to the long-term growth of our industry. Whether this is accomplished through WTO negotiations, CODEX, or another global forum, it is imperative that we protect the wholesome, nutritional benefits of milk, or we might just as well sell belly-wash. **MCT**

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Powder surplus

The downward price pressure in the milk powder markets as well as consumer price sensitivity will drive the cheese market lower. We expect surplus powder to clear to the government some time soon, and then find a new market equilibrium to serve both the domestic and global powder markets. However, the butter

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Aug	1.8842	1.8625	1.6935	0.2183	1.208	16.25	15.40
Sep	1.8650	1.8400	1.7500	0.2031	1.095	17.30	14.60
Oct	1.8250	1.8100	1.6850	0.2075	0.925	16.50	13.00
Nov	1.7750	1.7500	1.6200	0.2100	0.950	16.20	12.90
Dec	1.7250	1.7000	1.5500	0.2250	1.000	15.60	13.00
Jan	1.6800	1.6500	1.5500	0.2300	1.050	15.45	13.40

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

market is expected to remain strong through the holiday buy-in

period due to low stock levels and good demand. **MCT**

Powder's drag...

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price near \$13.20/cwt. If the NFDM price were to fall to support, however, the butter/powder milk price would fall to \$11.50/cwt. That is significantly less than the cost of milk production. Granted, most dairy producers receive a weighted average price for their milk. So, the lower butter/powder price will be offset by higher fluid milk and cheese milk prices. To prevent milk prices from falling below the \$16.50 cost of production level, the cheese milk value would have to exceed \$18.00/cwt. Such a disparity

between the value of milk used in butter/powder production and cheese production is not sustainable.

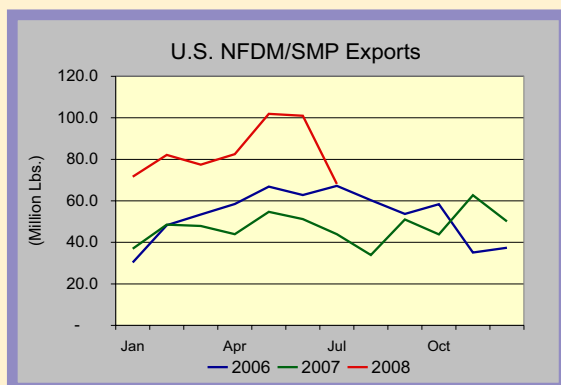
In April through June 2004, the difference between the butter/powder milk price and the cheese milk price averaged \$5.04/cwt. Within four months, the cheese milk price collapsed to provide a more sustainable differential of an average of \$2.00/cwt. Therefore, if the value of milk used in butter/powder is near \$13.20/cwt., then a cheese milk price of no more than \$15.20 is sustainable. And, in reality, these prices are not sustainable because they are at least \$1.00/cwt less than the producer cost of production.

What can we expect? It is likely that a large quantity of NFDM will be offered to the government in hopes of taking more than 150 million pounds off the market in a very timely manner rather than dribbling 10 million pounds to the government each week for several weeks. Once the

surplus is off the market and into government coffers, it is possible the spot NFDM price will trade in the \$1.10 to \$1.20/lb. range.

That said, it is still too early to tell what the long-term fallout will be from the melamine-adulterated milk scandal in China. In the short-term, China has significantly increased imports of milk powder products. But this is not viewed as a long-term solution because imported infant formula sells at nearly three times its lower-cost domestic rival.

China's domestic consumption of nonfat dry milk powder is about 90,000 metric tons, with about half coming from domestic production and half from imports. There is currently ample milk powder on the world market to fill this need. The bigger question is whether the scandal has tainted the reputation of dairy products enough to cause even more substitution of soy-based products, assuming that these products have not been tainted with melamine. **MCT**



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