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MCT COMPASS

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The Squeeze is on

Milk production in the United States fell below the prior year in August 2012 for the first time since January 2010. The last sustained period of year-over-year declines in milk production began in June 2009 and lasted eight months until January 2010. During this period, farm-level profitability, as reflected in the milk-feed price ratio, was the lowest in history—until now. USDA's milk-feed price ratio represents the pounds of 16% mixed dairy feed equal in value to 1 lb. of milk at test. In 2009, the ratio hit a low of 1.47 in June. This year, the ratio has been under 1.48 every month since April with the July ratio at an all-time low of 1.34.

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Rising feed costs have driven this year's exceptionally low milk-feed price ratio. Each of the commodity feed prices used to calculate the August milk-feed price ratio of 1.36 were at record highs. The U.S. average price received for corn in August was $7.63, up 49 cents vs. the prior month, the soybean price was $16.20/bu., up 70 cents, and alfalfa hay at $203/ton was $5 higher. USDA announced the preliminary September milk-feed ratio at 1.46 today, which marks some improvement due primarily to a $1/cwt. increase in the all-milk price.

Unfortunately, it is unlikely feed costs will fall significantly over the next 12 months. Thus, producers who purchase a significant portion of their feedstuffs will most likely face a greater margin squeeze than their counterparts who raise their own feed. However, many dairy producers with significant crop acreage faced less than ideal growing conditions in 2012. As a result, competition for feed, particularly forage, is expected to remain keen in coming months, and rationing of supply is also expected.

Rationing of the feed supply typically entails feeding inferior rations and culling. Since April 2012, the U.S. dairy herd has contracted by 51,000 head, and it is very likely that the U.S. dairy herd will be down 100,000 cows by Jan. 1, 2013, compared to Jan. 1, 2012. This means that even if milk per cow is unchanged, U.S. milk production will be down 1.1% due to the drop in the dairy herd alone. However, it is unlikely that milk per cow will be unchanged. Gains in milk per cow vs. the prior year exceeded 3% during Q1 2012, due in part to very favorable weather.

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

The last time producers were in a severe margin squeeze (2009), milk prices were very low relative to feed costs. This year, milk prices are increasing while feed costs are moderating.

The CME Cheddar block price is above $2/lb., CME butter is just under $1.95/lb., and nonfat dry milk prices used in milk price formulas are on the rise. Meanwhile, corn and soybeans are trading off their highs. As a result of softer feed prices and higher milk prices, margins should improve but for how long, and will they return producers to profitability? That depends on the strength and resilience of dairy product prices.

The longest the CME monthly average Cheddar block price was above $2/lb. was two months: November-December 2007, May-June 2008, and June-July 2011. The CME monthly average butter price remained above $2/lb. for the first eight months of 2011. U.S. butter and butterfat exports this year trail last year's levels by 26%, but cheese exports are 20% higher through July 2012. The outlook for cheese exports is worsening because U.S. cheese prices now exceed global prices by about 20 cents per pound.

Problems in the European Union and a slowdown in the global economy threaten to derail economic progress at home. However, if U.S. consumers continue to feel better about their economic future, robust domestic demand could support milk prices at levels producers can cling to. **MCT**

Demand Strong for Now...

The latest stocks report shows American cheese inventories totaled 615.1 million pounds as of Aug. 31, 2012, which is 3.1% less than the prior month and the strongest drawdown for August since 2006. American cheese stocks are 5% lower than last year. Lighter stocks going into the seasonally strong demand period should support prices.

MCT Forecast							
	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Sep	1.9270	1.8800	19.00	1.8800	17.55	0.5890	1.3900
Oct	2.0500	1.9600	20.85	1.9500	18.45	0.6145	1.4725
Nov	2.0100	1.8750	21.10	1.8700	18.85	0.6265	1.5300
Dec	1.9600	1.8750	20.70	1.8000	18.90	0.6300	1.5525
Jan	2.0050	1.8500	20.65	1.7500	18.55	0.6300	1.5400
Feb	1.9500	1.8050	20.55	1.7000	18.10	0.6250	1.5150

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

Butter stocks as of Aug. 31 totaled 204.5 million pounds, down 13% vs. last month, which is similar to the historical drawdown rate but 7.8 million pounds greater than last year. Butter stocks are 23.5% stronger than last year, thus stocks appear to be ample, but this could change as milk production falls in key butter-producing states. **MCT**

Western Culling...

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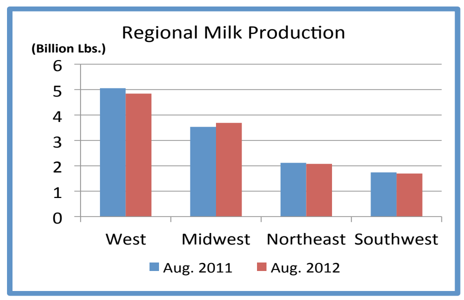
Given the current feed and forage situation, milk per cow is likely to be down 1.5% to 2.5% during the first quarter of 2013 vs. the prior year.

During the 2009 margin squeeze, the California dairy herd, the largest in the nation, fell from 1.832 million cows in January 2009 to 1.76 million head by January 2010. The 72,000-head decline in the California herd accounted for nearly one-third of the drop in the U.S. dairy herd during that period. Conversely, the Wisconsin dairy herd, the nation's second largest, increased 5,000 head from 1.255 million to 1.26 million.

Looking forward, California and other western states are expected to be the first to feel the brunt of the 2012-13 herd contraction, but other states will not be unscathed as feed and forage availability will be an issue for any dairy producer without 100% feed and forage coverage. This is already evident in the latest Milk Production report. The Arizona dairy herd is down by 10,000 head since April 2012, followed by Iowa with a 4,000-head decline, Washington and Pennsylvania with 3,000-head declines, and California and Utah with 2,000-head declines. Meanwhile, the Wisconsin dairy herd expanded by 1,000 cows.



August milk production shows year-over-year milk production fell in all regions except the Midwest. Milk production in the West, which includes California, Idaho and Washington, accounts for one-third of U.S. milk production and was down 4.3% vs. last year (see chart). In addition, this region is the leading producer of butter and nonfat dry milk in the United States. Milk production in the Southwest (Arizona, New Mexico, and Texas), which is home to two of the largest cheese plants in the United States, was down 2.7%. Conversely, milk production in the Midwest (Michigan, Minnesota and Wisconsin) was up 4.5%. Many producers in this region produce a large portion of their own feedstuffs and most were not as severely impacted by the drought as producers elsewhere.

However, gains in the Midwest will not be strong enough to offset losses elsewhere. **MCT**

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