

Midwest Advantage Closing

Cheese vats are overflowing due to strong gains in Midwest milk production. A closer look at the regional economics of milk production sheds light on why some regions are faring better than others.

The income-over-feed calculation, based on



The farm-level economics for Wisconsin dairy producers look remarkably different from those in California.

USDA's milk-feed price ratio, is calculated by subtracting the per hundredweight value of a feed ration—consisting of 51% corn, 41% alfalfa, and 8% soybeans—from the all-milk price. Based on USDA's Agricultural Prices report, which reflects prices received by farmers for corn, soybeans, and alfalfa, Q2 2012 had the lowest U.S. income-over-feed of the year at \$4.47/cwt., followed by Q3 at \$5.44. In general, when income-over-feed drops below \$5.50/cwt., the nation's herd begins to contract and when it is above \$8/cwt., the herd expands. However, there are significant regional differences.

California, the top milk-producing state and the second largest cheese producer in the United States, experienced seven consecutive months in 2012 with income-over-feed below \$4/cwt., five of those months were below \$3/cwt., which coincides with the rapid slowdown in milk production and herd contraction. For the year, California's income-over-feed averaged \$4.14/cwt., which cut into milk production, particularly in the second half of 2012.

During the first half of the year, California milk production was 4% stronger than the prior year. By July, California's milk output trailed the previous year by 5.6%. Most recently, California's December production came in 2.3% lower than the prior year. Despite the Golden State's slowdown in milk production, California cheese production is modestly above the prior year. This was largely due to very strong production gains posted in early 2012.

Recent data for November 2012 show California cheese production down 2.0% vs. the previous year.

The farm-level economics for Wisconsin dairy producers look remarkably different from those in California. During 2012, Wisconsin's income-over-feed ranged from a low of \$6.59 in June to a high of \$12.10 in October, and averaged \$8.56 for the year. Just to

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Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

The U.S. dairy industry is no longer a national industry; it's part of a much larger global industry. Yet, regional differences within the country are still very much at play and continue to impact national milk prices and production.

As we point out, Wisconsin dairy producers enjoyed a wide margin advantage over their counterparts in California in 2012. That advantage helped keep national milk production above year-earlier levels and cheese production strong. It also likely extended to all producers east of the Mississippi, where the main style of dairying includes ownership of cropland.

The country's multi-year drought threatens to further tighten U.S. alfalfa supplies in 2013. Producers who can grow their own alfalfa will continue to have the advantage over those who rely on purchased supplies of alfalfa and other forages.

It wasn't that long ago, though, that dairies that relied on purchased feeds had the advantage over those that grew their feed, demonstrating how quickly competitive advantage can change.

Looking globally, the competitive advantage appears to have shifted to the United States, where a diversity of dairying styles has provided a cushion in the face of weather issues around the globe. **MCT**

Butter Output to Slip...

As the first month of 2013 comes to a close, dairy markets are in flux. Ample milk supplies from Q4 2012 contributed to year-end stock building. Butter stocks

grew 30.3 million pounds to 152.9 million pounds as of Dec. 31, 2012. That is 46 million pounds more than last year. Manufacturers and end users are supporting spot

butter near the mid-\$1.50 level due to expectations that 2013 butter production will not exceed 2012 levels. Year-end American cheese stocks of 604.9 million pounds are 23.8 million pounds larger than the prior month but about 6 million less than last year. Cheese production, however, is expected to increase vs. the prior year due to on-farm economics in the Midwest that are more favorable than in the West. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jan	1.6965	1.6395	18.14	1.4933	17.63	0.6503	1.5601
Feb	1.6775	1.6250	17.30	1.5800	17.85	0.6400	1.5710
Mar	1.7000	1.6750	17.60	1.6300	18.15	0.6350	1.5725
Apr	1.7700	1.7400	17.90	1.6675	18.50	0.6200	1.5900
May	1.8350	1.8100	18.25	1.7300	18.90	0.6000	1.6100
Jun	1.8500	1.8250	18.80	1.7550	19.25	0.5950	1.6300

* CME prices.

**NASS prices.

Wisconsin advantage..

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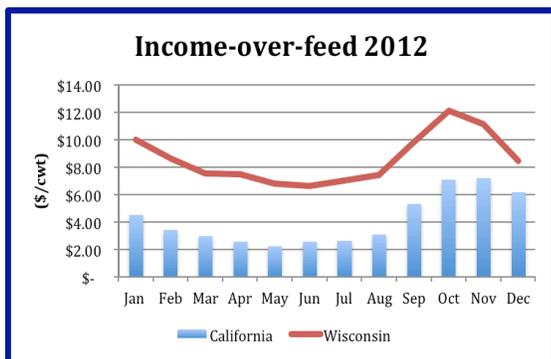
be clear, Wisconsin's lowest monthly income-over-feed was \$2.80 higher than California's average income-over-feed. In contrast to California's woes, the Wisconsin herd expanded by a modest 5,000 head during the year, but output per cow was up 3.9%. Greater milk production leads to one thing in Wisconsin—more cheese. Total cheese production in Wisconsin is expected to top 2.75 billion pounds in 2012, up 4.6% vs. last year.

So what's driving the difference in income-over-feed between the two states? The short answer is

milk prices. About 60% of the difference in income-over-feed between the two states is due to milk prices. For example, the Wisconsin all-milk price averaged \$19.39/cwt. compared to California's at \$16.62. At 40%, feed is still a major contributor to income-over-feed. Alfalfa prices between the two states showed the greatest variance of any of the feeds monitored.

The alfalfa hay price reported by USDA represents hay that includes at least 10% alfalfa. During the first half of 2012, the Wisconsin alfalfa hay price received by Wisconsin growers averaged \$133/ton compared with California's \$235. That's right, California's average alfalfa price was more than \$100/ton greater than Wisconsin's. More recent data shows that Wisconsin's cost advantage on alfalfa is closing. In December 2012, Wisconsin alfalfa prices soared to \$235, while California's average alfalfa price fell to \$209/ton.

Looking forward, income-over-feed in both states is expected to contract during Q1 2013, largely due to lower milk prices and rising alfalfa prices. The Class III milk price averaged \$20.17/cwt. during Q4 2012, about \$2.50 higher than the anticipated Class III price for Q1 2013. The combined impact of the lower milk and higher alfalfa prices could cut Wisconsin's income-over-feed to less than \$5.00/cwt. during the first half of 2013. **MCT**



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