February 2009

Northeast Dairy Foods Association, Inc.

Dairy Industry News

Special points of interest:

- Raw Milk Farm Prices Fall
- Raw Milk Production is Up
- Milk Consumption Stalls

Inside this issue:

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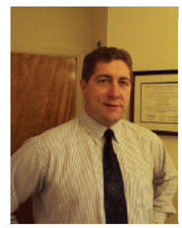
Hello, let me introduce ourselves….

I would like to introduce our association to you and your staff. Northeast Dairy Foods Association, Inc. is a full service trade association representing dairy product food processors, manufacturers and distributors since 1928. Our member's are the dairy farmer's customers.

This newsletter is intended to help you better understand the dairy industry from farmer to consumer. As you may know the dairy industry is complex, interwoven with both federal and sometimes state government regulations working within marketplace supply and demand influences. Other goals of this newsletter are to give you timely and factual information to provide you with a good perspective of our industry. Our association supports a strong producer community. Should you or any of your staff have questions regarding our information or about the dairy industry in general, please do not hesitate to contact myself or our staff members. It is our goal to be a resource for you whenever possible.

Thank you,



Bruce W. Krupke
Executive
Vice President

Northeast Federal Milk Market Order 1 - Dairy producers selling milk into this area participate in the system to create fair milk pricing.

Lets Talk Raw Milk Pricing…Federal Milk Marketing Orders

Dairy farmers, known as producers are paid for raw milk their dairy cows make on the farm. The customers of dairy farmers are dairy plants, known as processors or manufacturers. Processors are strictly regulated by both federal and state governments. The United States Department of Agriculture (USDA) oversees the Federal Milk Market Order (FMMO) system.

There are two basic components that regulate the U.S. dairy industry, a FMMO system and a dairy product price support program. The Federal milk marketing order system regulates the markets for Grade A fresh fluid milk. This system has been in place since the passage of the Agricultural Adjustment Act of 1937. There are 10 FMMOs in the U.S., our local office is located in Boston, MA with a satellite office in Albany, NY. The blue areas in the map above depict the Northeast FMMO 1. Dairy farmers who ship milk into this area are paid according to the FMMO formula system. We encourage you to visit their website to review more raw milk production and timely pricing information at: www.fmmone.com

Did you Know?

Pasteurized versus Ultra-Pasteurized Milk - Why Such Long Sell-By Dates?

Pasteurization and Ultra-Pasteurization are heat processes that are designed to kill bacteria (germs) in milk that may be harmful and/or may cause spoilage of milk products. These bacteria are sometimes found in raw milk from the farm, which is why drinking raw milk is not recommended.

Pasteurization:

"Pasteurized" means that the milk has been heated to a minimum of 161°F for a minimum of 15 seconds (or 145°F for 30 minutes for equivalent kill of bacteria), and packaged under clean and sanitized conditions. Some bacteria will survive pasteurization in very low numbers, though they are not considered harmful and will not spoil milk under normal refrigerated holding conditions.

Ultra-Pasteurized Milk:

"Ultra-Pasteurized" means that the milk is heated to a minimum of 280°F for a minimum 2 seconds. This temperature and time combination is much more lethal to bacteria, killing virtually all of concern in milk. Ultra-pasteurized milk is also packaged under near sterile conditions, which makes recontamination with spoilage bacteria unlikely and rare. Though Ultra-Pasteurized milk is processed to be free of spoilage and harmful bacteria, it is not considered sterile because it is not hermetically sealed (i.e. canned), thus, it requires refrigeration.

How Does the FMMO Work?

Under the first component of the FMMO system, Grade A milk is priced according to its end use, or how it is consumed. Fluid milk is known as Class I;, ice cream, yogurts Class II; Cheeses Class III; Butter and Milk Powders Class IV. Farmers receive higher prices if raw milk is used for fluid consumption rather than for milk used for manufactured products. Individual fluid milk prices have been established for various regions of the United States. The farther from Wisconsin, the higher the price paid to producers.

The regulations that set prices for specific regions are called milk marketing orders. They establish minimum prices for 80 percent of the Grade A milk sold in the United States and also establish the methods by which farmers are reimbursed for Grade A milk. Farmers receive a "blend price," which is a weighted average of prices *paid for* different classes of milk in their region. FMMOs, which regulate milk prices, are created by the region's dairy farmers and can only be added, removed or changed by their majority vote. Producers essentially control the pricing system that USDA oversees for which they are paid for raw milk.

The second component is the dairy product price support program, authorized by Congress, it is administered by the USDA. Excess raw milk production is made into butter and milk powders. The Commodity Credit Corporation (CCC) clears the market of excess dairy products through purchases of butter, cheese, and nonfat dry milk at announced support prices. The U.S. government purchases stores and eventually distributes the excess products to food and school lunch programs of these products as needed. The dairy product support program is a price stabilization mechanism that serves as a safety net for dairy farmers. It is paid for by the U.S. taxpayer.

MILC, (Milk Income Loss Contract) Let's Talk Safety Nets …

The Milk Income Loss Contract (MILC) Program is a taxpayer fully funded safety net program that benefits dairy farmers when their price drops. The MILC program has been in existence since the 2002 Farm Bill passed by Congress. It has been reauthorized and improved under the 2008 Farm Bill. The program provides direct monthly payments to dairy producers for raw milk whenever the price announced by the FMMO each month falls below a targeted level, ($16.94/ cwt.). A cwt. is a hundredweight of milk, or about a total of 11.6 gallons.

One of the major improvements to the MILC program approved by Congress in the 2008 Farm Bill has been the inclusion of a feed adjuster to the target price. The agricultural feed prices considered are corn, alfalfa, and soy beans. When feed prices are higher than average, the MILC payout is higher. In addition to the feed cost

(Continued on bottom pg 3)

What is the Producer Price?

When talking about the price dairy farmers receive, it is very important to understand what price are we talking about. News reporters will sometimes talk about the Class I milk price, mailbox, blend or uniform price. They'll sometimes refer to a location price such as the Boston, Suffolk County price. Dairy producers receive a price based on a wide number of factors. You can have two producers on the same road only a mile apart with the same number and type of cows and they can receive a different price. There are many differences between dairy farmer businesses and how they operate. Some are more efficient, utilize better technologies and could be more productive.

The price producers receive could be based on volume, quality and or location to the processing plant. They are paid on the components in milk such as protein and butterfat.

The final price the dairy farmer receives is known as the mailbox price, blend or statistical uniform price, they are generally the same. It is not the same as the Class I or other class prices. Producers are paid twice a month based on a number of factors outlined by FMMO regulation. It is a minimum price but is not the final price they receive. They receive extra money called voluntary premiums paid by dairy processors and manufacturers. The premiums are negotiable and are subject to supply and demand factors.

How the price is determined and the formulas used are complicated and will be discussed in later newsletters. Suffice it to say the system is setup to average out the price for all classes of products based on utilization in the marketplace for all dairy farmers in the Order, what is known as a pool. Although it is generally true the farther a dairy farmer is located from the center of the state of Wisconsin, they are paid more. A dairy producer in Florida is paid more than one located in Indiana. The farmer closer to Boston will make more than a dairy farmer located in Syracuse, NY. These are called zone differentials and the distance difference within FMMO 1 is $1.15/cwt.

Four out of the past 5 years the uniform price paid to dairy farmers has been on average all time record high prices. Since the system in which producers are paid is based on supply and demand, when there is too much raw milk produced in the country, the price producers are paid is lower. When demand is greater than the raw milk supply the dairy producer uniform price is higher. For the past 10 years or so raw milk prices have been more volatile than in the previous decades. A 30-35 month cycle of highs and lows has emerged.

adjuster, the improved MILC program increases both the payment dollar rate and raw milk production eligibility among small and medium size dairy farms.

When the price paid to dairy producers is below the target price of $16.94/cwt. the program makes payments to dairy farmers at 45% of this difference.

With market milk prices falling, the new MILC program is an excellent opportunity that provides additional dairy farm income over the coming months. Since the program has milk production eligibility caps, MILC should be particularly attractive to the northeast's smaller size farms that can take a fuller advantage of the payments. MILC payouts for the northeast have been estimated by dairy economists to be $1.45 for February, $1.97 for March, and $1.84 for April. There is no cost to producers to participate in this program. For full MILC details, click here: http://www.fsa.usda.gov/Internet/FSA_File/milc2008.pdf

FACTS:

- In Dec. 2008, 2,217,619,256 lbs. of raw milk was produced in all of FMMO 1.
- 1,012,331,247 lbs. were used in Class I products
- 346,381,705 lbs. were used in Class II products
- 446,903,020 lbs. used in Class III products
- 404,665,721 lbs. used in class IV products
- 100 pounds of milk equals abut 11.6 gallons.
- One gallon weighs 8.63 lbs.

Raw Milk Price to Decrease in Early 09, Rebounds Later in Year

Over the last 8 years, milk prices paid to dairy farmers have been at or near record highs 5 times. Prices have been sufficiently high to carry dairy farmers over in leaner years when the price dipped. High milk prices helped to offset a good deal of the rising input costs associated with dairy farming and added incentive for capital investments which led to farm expansions and continued growth in cow numbers in early 2007.

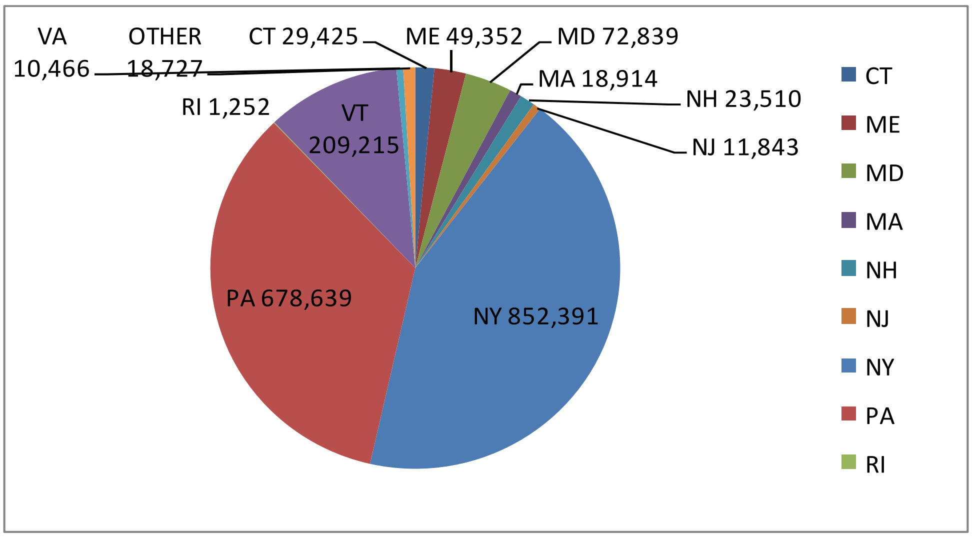
Farm expansions led to continued growth in milk supplies. The lower value of the U.S. dollar, and strong international demand for U.S. dairy products, resulted in sizable exports overseas as other suppliers to the international market suffered droughts and supply problems. Emerging nations were looking to the U.S. to supply a good part of their growing needs for dairy in their diet.

Domestic demand here at home remained healthy and also helped to absorb the continued growth in milk production. Prices in 2007 and in 2008 were very good for dairy farmers. Year 2007 was likely the best price year ever experienced by dairy farmers and helped to continue driving agricultural land values higher.

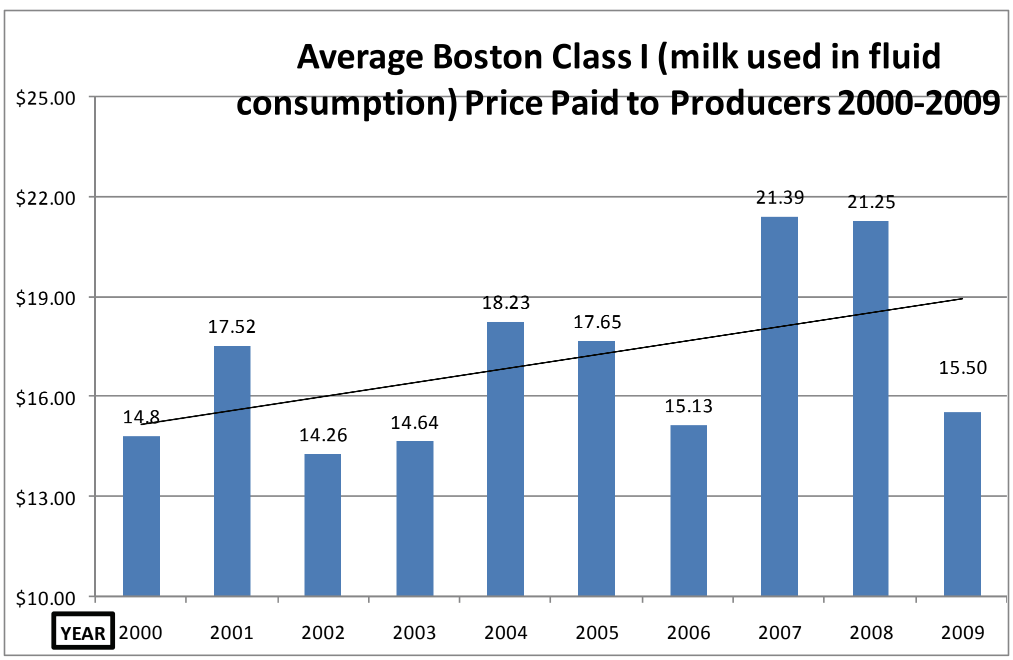
The Chinese melamine scandal and a collapse of international demand due to a severely weakened world economy resulted in a decrease in demand for U.S. products in 2008. At the same time, other dairy exporting countries were recovering and again were players in the global market.

The weaker U.S. economy has led to a drop in domestic dairy product demand particularly in the restaurant foodservice sector. This decrease in domestic demand, combined with the drop-off in exports, has led to a supply-demand imbalance that caused dairy prices to fall dramatically from the record highs of previous years.

A market correction is necessary to bring supplies more closely into balance with demand. Culling of the national cow herd will have to take place. Lower dairy product prices will stimulate demand again and recovery in farm milk prices is forecast by our nation's dairy cooperative economists to start late in the 2nd Quarter and into the third quarter of 2009. Recovery is also forecast to lead once again to much higher raw milk prices by the end of the 4th Quarter and perhaps to extremely higher prices in 2010.



Milk Production by State into FMMO/Northeast Order 1, in Thousand lbs., Source: USDA/FMMO 1 Dec. 08 Report



Increasing Line Shows Alligator Mouth Effect of Increasing Prices Paid to Dairy Producers from 2000 to 2009 Fluid Class I Milk.