Cow uptick dims prices

Dairy Outlook

By **JOHN OTTE**

Key Points

- Higher corn, protein and forage prices erode milk profits.
- Market has factored strong international product demand into price structure.
- Milk needs more demand or fewer cows and smaller supply to lift prices further.

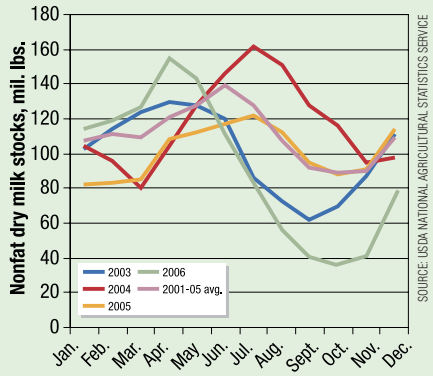
THE milk market is assimilating higher feed costs and strong international demand for protein into price expectations.

"Higher corn and soybean prices will boost costs for concentrates as well as corn silage in 2007," says Ken Bailey, Penn State University economist. "Feed costs alone could rise 60 cents to $1 per cwt. Plus, strong international demand for skim milk powder, whey and whey protein concentrates are buoying Class III and IV futures prices.

"If milk producers locked in late 2006 milk and feed prices, few dollars would be left to encourage further expansion," says Bailey. "So will milk prices rise further as 2007 progresses? My guess is no. I've already factored in peak Western nonfat dry milk prices of $1.15 per pound and dry whey prices of 47 cents.

"Cheese and butter would need to rally sharply in early 2007 before Class III and IV prices advance any further," he says. "But that likely won't happen if milk supply grows 1.3% as I expect."

Plunging NFDM stocks help milk prices



Watch cow numbers

Strong mid-2004 milk prices launched a buildup in milk cow numbers that peaked in June 2006.

Dairy cow numbers declined in July, August and September 2006. The shrinking herd fueled optimism that milk output growth rate would drop back in line with milk use growth. Milk cow numbers resumed an upward trend in October and through December.

"A continued decline in milk cow numbers is important for stronger milk prices," says Bob Cropp, University of Wisconsin economist.

Compounding the issue, summer 2006 dairy cow slaughter was up about 16% from 2005. But last fall's slaughter was barely higher than a year earlier.

Bailey projects the 2007 Class III milk price at $14.23. That compares with the five-year average of $12.89. He projects the Class IV annual average at $13.73.

"Basically, I'm not expecting any big rally in either cheese or butter prices," Bailey says. He has a couple of reservations. If the milk supply grows at a slower rate or if cheese manufacturers don't get enough milk solids, 2007 cheese prices could rise above current expectations.

Dry milk product exports help U.S.

STRONG international demand for dry proteins bid up prices for both skim milk powder — called nonfat here — and dry whey.

U.S. exports of skim milk powder and dry whey have been steady, whereas exports of whey protein concentrate have been strong. Our market is short of product. In late 2006, monthly U.S. stocks of nonfat dry milk skidded to less than half their average level of the previous five years. So it's no wonder buyers bid up nonfat dry milk and dry whey prices.

"The United States is now in the driver's seat with regard to setting prices and providing surplus skim solids to world markets," says Ken Bailey, economist at Penn State. "We are simply exporting all the surplus protein that we have. The next step is to start to develop more value-added protein products that global customers are demanding."

Examples show how flexible leases work

By **TOM J. BECHMAN** and **JOHN OTTE**

WOULD a flexible cash lease help you and your landowner over time? Check these examples, then plug your own numbers into the Flexible Lease Agreement Worksheet.

Thanks to William Edwards, Iowa State University ag economist, for providing background information.

Share gross income

Suppose you agree cash rent will be 35% of gross crop value per acre. Flexible leases typically run between 30% and 40%. If corn yields 160 bushels per acre, and price is $3 per bushel, then:

Gross income = (160 x $3) = $480

Cash rent = 35% x $480= $168/acre

The worksheet on this page shows how to include base rent in figuring the percentage multiplier. Both parties must agree on how and when yield and price are determined, plus decide whether to include farm program direct payments as gross income.

Since other farm program payments tied to price are likely to be zero, they wouldn't figure into this example.

Weight tickets, yield monitor output or bin capacity can determine actual yield. Adjust corn to 15% moisture. For price, settle on cash price at a specified elevator on a certain date or averaged over several dates. Or you can use the futures contract price minus normal basis for your location.

Base rent plus bonus

First, agree upon a base rent. Suppose it's $75 per acre. The bonus may be one-half of gross income above the cost of seed, fertilizer, pesticides, labor and machinery. Both parties must agree how to determine this figure.

Suppose actual yield is 52 bushels of soybeans at $6 per acre. Total costs, using custom rates to determine machine costs, are $170.

Profit = (52 x $6) = $312 - $170 cost = $142

Rent/acre = $75 base rent + ($142/2 = $71) = $146 per acre

Yield adjustment only

Tenant bears all of the price risk — a big unknown in 2007. Here's a base rent plus bonus based upon yield example

Suppose cash rent is $120, plus $3 for each bushel of soybeans over 45. Actual yield is 57.5.

Rent/acre = $120 + [$3 x (57.5 - 45) = $3 x 12.5 = $37.50] = $157.50. Rent will be binding regardless of actual selling price.

Flexible Lease Agreement Worksheet

Basic information:

	Corn	Soybeans
Expected yield--bushels per acre	_____bu.	_____bu.
Expected price--$ per bushel	$_____	$_____
Base rental rate--$ per acre	$_____	$_____
Expected U.S.D.A. direct payments--$ per acre	$_____	$_____

Type of agreement (check one):

		Corn	Soybeans
1. ____	**Share of Gross Income** Percent of gross income to equal rent (base rent, divided by price x yield plus direct payments)	_____%	_____%
2. ____	**Base Rent plus Bonus** Base rent per acre	$_____	$_____
	Minimum gross income or tenant's costs per acre	$_____	$_____
	Percent of gross income over the minimum to be added to the rent	_____%	_____%
3. ____	**Yield Adjustment Only** Fixed price per bushel of actual yield	$_____/bu.	$_____/bu.
	Or, minimum yield,	_____bu.	_____bu.
	and fixed price to pay for each bushel over minimum	$_____/bu.	$_____/bu.
4. ____	**Price Adjustment Only** Number of bushels on which to pay the actual price	_____bu.	_____bu.

Explanations:

1. How will the price be determined (types 1, 2, and 4)?
2. How will the yield be determined (types 1, 2, and 3)?
3. How will the tenant's costs be determined (type 2)?
4. What U.S.D.A. farm payments will be included (types 1 and 2)?
5. Will crop insurance payments be included (types 1 and 2)?
6. Will there be a minimum rent? A maximum rent?

Price adjustment only

This time tenant bears all of the yield risk. Suppose parties agree cash rent will be 55 bushels of corn multiplied by the local elevator cash price, Nov. 1. Suppose it's $2.90 per bushel.

Rent/acre = 55 bushels x $2.90/bushel = $159.50 per acre. Rent will be binding regardless of actual yield.

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