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The KDM Dairy Report – Feb 10th, 2012

What's Bullish:

Futures Month	Class III 02/10	Class III 02/03	Change	Dry Whey 02/10	Dry Whey 02/03	Change	Cheese 02/10	Cheese 02/03	Change
Feb-12	$16.08	$16.15	($0.07)	64.50¢	63.50¢	1.00¢	$1.544	$1.550	($0.006)
Mar-12	$15.63	$15.89	($0.26)	57.00¢	56.25¢	0.75¢	$1.535	$1.560	($0.025)
Apr-12	$15.80	$15.94	($0.14)	53.75¢	48.98¢	4.78¢	$1.575	$1.615	($0.040)
May-12	$16.12	$16.42	($0.30)	51.00¢	46.50¢	4.50¢	$1.620	$1.664	($0.044)
Jun-12	$16.46	$16.67	($0.21)	49.75¢	46.00¢	3.75¢	$1.672	$1.705	($0.033)
Jul-12	$16.65	$16.95	($0.30)	47.25¢	43.50¢	3.75¢	$1.700	$1.742	($0.042)
Aug-12	$16.73	$16.97	($0.24)	47.28¢	43.25¢	4.03¢	$1.712	$1.757	($0.045)
Sep-12	$16.80	$17.08	($0.28)	46.25¢	45.98¢	0.27¢	$1.730	$1.757	($0.027)
Oct-12	$16.83	$16.97	($0.14)	45.00¢	45.98¢	(0.98¢)	$1.722	$1.760	($0.038)
Nov-12	$16.62	$16.84	($0.22)	46.00¢	46.50¢	(0.50¢)	$1.721	$1.760	($0.039)
Dec-12	$16.66	$16.83	($0.17)	45.95¢	45.98¢	(0.02¢)	$1.730	$1.760	($0.030)
Jan-13	$16.50	$16.73	($0.23)	40.00¢	40.00¢	0.00¢	$1.721	$1.721	$0.000
12 Mo Avg	**$16.41**	**$16.62**	**($0.21)**	**49.48¢**	**47.70¢**	**1.78¢**	**$1.665**	**$1.696**	**($0.031)**

- Dairy Market News reports milk production in Florida is still increasing, but at a slower rate than previous weeks. Minimal rainfall covered only portions of the state, causing pasture conditions to deteriorate further. Pasture conditions are now rated as 64% poor or very poor, which is a 9% increase compared to the previous week. Many pastures are not in use due to their poor condition, causing producers to increase their hay purchases and supplies. Class I demand has increased over last week, causing export spot loads to decline to91 this week vs. 100 last week.
- Anticipated lower farm milk prices combined with high feed costs are restraining expansion plans for many dairies in the Pacific Northwest, according to Dairy Market News. Hay supplies are very tight and priced accordingly.
- Dairy Market News reports lower cheese prices have increased export interest, especially those eligible for CWT assistance. Barrels are showing some strength with more aggressive buying seen in the CME spot market.
- International: World dairy demand is expected to grow at 2.5% a year for the next 5 years, according to Rabobank dairy analysts. It's something the bank described as the envy of the food world. There is a question about whether the market will deliver that percentage, but there is no doubt there is a market there. Globally there is strong demand and plenty of opportunity for the industry to grow again.

What's Bearish:

- Cash Market: Blocks and barrels both fell a penny from last week, to settle at $1.47½/lb and $1.48½/lb respectively. 9 loads of blocks exchanged hands while a heavy 29 loads of barrels traded. Butter lost 6¢ on the week to close at $1.43¼/lb with just 4 trades.
- World Ag Supply & Demand Report: USDA lowered their 2012 Class III price forecast to $17.05/cwt, down 45¢/cwt from last month's estimate. They cite higher milk production in 2012 and lower cheese and butter prices as reasons for the change.
- All Class III components were lower in this week's NASS survey. 40-lb blocks were down 2.5¢ to average $1.56/lb while 500-lb barrels lost 3.7¢ to $1.54/lb. Dry whey gave up 1¢ to average 66.5¢/lb, nonfat dry milk decreased 0.8¢ to $1.39/lb and butter shed 4.3¢ to average $1.55/lb.
- Dairy cow slaughter for the week ending 01/28 totaled 59,200 head, down 3,300 head during the same period last year.
- Fluid Milk East: Manufacturing milk supplies are continuing to increase in the Northeast and Mid-Atlantic regions. The increases in manufacturing milk supplies are due to a combination of milk production increases, brought about by the mild winter weather, and sluggish Class I demand. The Southeast region is also experiencing milk production increases with Class I demand remaining sluggish in most areas. The additional milk supply is prompting the utilization of some auxiliary manufacturing facilities. Cream supplies are described as "sloppy" with some loads being shipped to the Central region and heavy volumes going to churns. Demand for cream continues to be weak.
- Fluid Milk Central: Farm milk volumes in the Central region are moving steadily higher due to seasonally strong farm milk intakes. Central cream is readily available to butter makers, with Western and Eastern cream loads also adding to the raw inputs for Central butter churns. Churning operations outside the Central region are reportedly close to capacity. Central cream multiples are under some pressure from the abundance of cream in the marketplace. Sales to fluid accounts are steady to lower for some plants, adding to the milk volumes available to plants. Spot loads of milk are a tough sell, according to operators in that part of the industry, because of the burgeoning native milk supplies in the Central region; some sold for $4 under class.
- Fluid Milk West: California milk output continues to build both seasonally and because of good conditions. More milk is moving into processing plants and more challenges are taking place to balance the milk supplies. Arizona milk production continues to move higher on a weekly basis. Weather conditions remain ideal for milk cows. Plant intakes are heavy and processing plants are working on extended schedules. New Mexico milk production is building at levels above a year ago. Processing levels are above planned amounts for this period. Sales of fluid milk and components are limited. The cream situation in the West remains "sloppy" and is characterized by heavy offerings and lower prices. Butter production is very heavy to handle the cream supplies. Interest from ice cream producers is slow to develop. Fluid milk supplies in the Pacific Northwest are above year ago levels and higher than expected in many cases for this time of year. The increased supplies of milk are being handled mostly within the region, but there are some concerns as to manufacturing capacity in the near future.

- Butter: Churning activity across the country remains strong. Cream supplies are plentiful to churns with some cream volumes clearing from one region to another to secure a buyer or processing capacity. Current churning activity continues to surpass demand and clearances to inventory continue. Domestic buying interest is fair. Reports indicate that overall orders have slowed, which is typical for a time when the cash price is weak and declining.
- Dry Whey East: Milk production increases, prompted by the mild winter weather, are maintaining increased levels of cheese and dry whey production. There have been rumors of excess supplies and second quarter dry whey futures are significantly below the current market. Some loads are showing up in resale offers at prices just under the current market. The uncertain nature of the current market has end users and brokers taking a wait and see attitude. Export demand has softened with additional competition coming from Europe and as the U.S. dollar strengthened against other currencies.
- Dry Whey Central: Offers to buyers from brokers are increasing in frequency, with some price discounts offering purchasing incentives. Buyer interest in dry whey spot loads, which was aggressive in recent weeks, has retreated to moderate levels. With market conditions mixed, buyers are satisfying needs on a just-in-time basis and waiting for clearer market indications before shoring up dry whey inventories.
- Dry Whey West: Dry whey prices are lower this week. Contract sales are providing the bulk of the trade, although increased spot loads are finding their way to the market. There is some pushback to contracted prices on the high side with buyers looking for lower priced offerings. Export prices are below domestic pricing in many cases. Manufacturers are finding they need to price product lower to move quantity sales in the export market.
- Nonfat Dry Milk: Nonfat dry milk prices are unchanged to lower on a weak market. Spot load interest is flat according to many in the industry. Buyers are aware of the seasonally building NDM inventories at production locations, as well as the weaker tone to the domestic and international markets. With these things in mind, some buyers are delaying purchasing decisions from week to week. Nonfat dry milk production is at near capacity at several plants as farm milk intakes increase seasonally.
- Cheese East: The mild winter weather continues and so do the increases in milk and cheese production. Domestic demand remains sluggish, causing inventories to expand.
- Cheese Midwest: Weakness prevails in cheese markets. Many cheese manufacturers report strong milk supply availability, at discount prices well under Class prices. In some cases, milk is so readily available at a favorable price that cheese for inventory building and aging programs is being manufactured to ease capacity demands on powder plants by firms which both manufacture cheese and operate drying operations. With slower retail ordering, cheese inventories are building. Some retail ordering is believed to have been delayed by prospective buyers who have decided to step back in expectation of some further price weakness. There is little current reported cheese export interest. One source characterized export interest as being in the doldrums.
- Cheese West: Production of cheese in the West is heavy as milk is readily available. Plants are keeping a close eye on inventory levels as stocks are building.
- International: December milk production in Australia was up 6.4% vs. December 2010, according to Dairy Australia statistics. The current milking season is up 3.6% YTD.

Recommendation:

After getting perhaps a little oversold, dry whey futures rebounded this week. It's looking more like the bottom will be in the low 50's vs. low 40 cent range. However, there's little else to cheer about this week. The mild winter continues to put the "flush" ahead of schedule in all parts of the country. Both cheese and milk futures took hits this week, with hedgers now starting to go after the 2nd half of 2012. Export interest is starting to pick up with these lower prices. Barrel buyers in particular were more aggressive this week, signaling a bottom may be getting close. But on the flipside, with strong milk output ahead for the next 2-3 months, or at least until the West and South start heating up, we see limited upside. Lower milk prices are going to start hurting the checkbook soon. The California 4b price is sub $14. With tight hay supplies, it's going to start hurting pocketbooks soon. We would continue to sell rallies Mar-Jun, as the recovery just looks like it will take quite some time with most manufacturers being forced to increase schedules to handle all the milk. Current CME spot prices work out to about $15.25 Class III, so target Mar and Apr just under $16.00, May at $16.50 and June at just under $17.00. July-Dec, consider the 15.00 x 19.00 fence at net cost of zero premium. Taking the floor of 15.00 is not ideal, but it's a whole lot better than accepting 12.00 or under in a worse-case scenario.