

**The KDM Dairy Report – Mar 2<sup>nd</sup>, 2012**

**What's Bullish:**

- Ag Prices Report: The milk-feed ratio declined to 1.58 in Feb, the lowest number since July, 2009. Falling milk prices and steady grain prices eroded the ratio.
- Commercial Disappearance: The final numbers are in for 2011 and for the most part, it was a good year. Commercial disappearance of milk-in-all products was up 1.6% over 2010. Use of American cheese increased 0.9%, while use of other-than-American cheese jumped 4.2%. Commercial use of butter soared 10.8% over 2010, but use of nonfat dry milk fell 3.5%.

Futures Month	Class III 03/02	Class III 02/24	Change	Dry Whey 03/02	Dry Whey 02/24	Change	Cheese 03/02	Cheese 02/24	Change
Feb-12	\$16.06	\$16.08	(\$0.02)	64.00¢	64.50¢	(0.50¢)	\$1.541	\$1.544	(\$0.003)
Mar-12	\$15.36	\$15.28	\$0.08	56.00¢	55.50¢	0.50¢	\$1.522	\$1.519	\$0.003
Apr-12	\$14.99	\$15.12	(\$0.13)	49.50¢	47.23¢	2.28¢	\$1.515	\$1.546	(\$0.031)
May-12	\$14.95	\$15.15	(\$0.20)	46.00¢	43.75¢	2.25¢	\$1.540	\$1.570	(\$0.030)
Jun-12	\$15.49	\$15.43	\$0.06	46.00¢	42.50¢	3.50¢	\$1.602	\$1.612	(\$0.010)
Jul-12	\$15.95	\$15.92	\$0.03	43.50¢	41.60¢	1.90¢	\$1.657	\$1.662	(\$0.005)
Aug-12	\$16.22	\$16.10	\$0.12	44.00¢	41.75¢	2.25¢	\$1.684	\$1.676	\$0.008
Sep-12	\$16.34	\$16.31	\$0.03	42.00¢	41.00¢	1.00¢	\$1.703	\$1.694	\$0.009
Oct-12	\$16.31	\$16.33	(\$0.02)	40.50¢	40.00¢	0.50¢	\$1.710	\$1.706	\$0.004
Nov-12	\$16.24	\$16.19	\$0.05	40.00¢	40.00¢	0.00¢	\$1.700	\$1.700	\$0.000
Dec-12	\$16.16	\$16.18	(\$0.02)	40.00¢	40.00¢	0.00¢	\$1.697	\$1.700	(\$0.003)
Jan-13	\$15.96	\$16.04	(\$0.08)	40.00¢	40.00¢	0.00¢	\$1.692	\$1.692	\$0.000
<b>12 Mo Avg</b>	<b>\$15.84</b>	<b>\$15.84</b>	<b>(\$0.01)</b>	<b>45.96¢</b>	<b>44.82¢</b>	<b>1.14¢</b>	<b>\$1.630</b>	<b>\$1.635</b>	<b>(\$0.005)</b>

- In Florida, a few rains have not improved the state's overall drought conditions and no significant improvement has been noted in forage growth or pasture conditions. Hay supplies remain tight and feed prices are high.
- Dairy Market News reports the Western cream market remains weak, but not with the pressure noted in recent weeks. Other fat users are beginning to ramp up production based on the season and the upcoming holidays. Therefore, the volume moving through the churn is not quite as heavy. Some also note that demand for print butter is above expectations.
- Butter inventories in the East have declined with recent major sales as well as good export demand, according to Dairy Market News. Bulk sales to food processors have recently increased as the Easter/Passover holiday approaches.
- Dry Whey East: Dry whey prices were only marginally lower this week. Product is primarily moving through contracts with only a few loads showing up on the spot market. Inventories are marginally expanding, but manufacturers indicate they are very comfortable with their inventory levels.
- Cheese East: Cheese production continues at a steady pace, however, mozzarella and aged cheddar sales are keeping inventories in balance. Export interest remains fairly good.

**What's Bearish:**

- Cash Market: Blocks, barrels and butter all finished higher than a week ago, but failed to hold gains made earlier in the week. Blocks 1¼¢ higher than last Friday, settling at \$1.48/lb today, but gave up ¾¢ in today's spot session with sellers letting go of 13 loads. For the week, 21 loads exchanged hands. Barrels also settled at \$1.48/lb, up a penny from last week, but gave up 2¢ in today's spot session on 8 trades, which was also the total for the week. Butter settled at \$1.45/lb, up 3¼¢ from last week, but down 1½¢ in today's cash session. 7 trades exchanged hands; 18 for the week.
- Dairy Products Report: American cheese output in January was 3.1% higher than a year ago, according to USDA figures. Total cheese output increased 2.9% over the same period. Butter production jumped 8.5% vs. Jan 2010 and was up 9% from Dec.
- Most Class III components were lower again in this week's NASS survey. 40-lb cheddar blocks declined 1.1¢ to average \$1.49/lb and 500-lb barrels lost 1.1¢ to \$1.51/lb. Butter decreased 2.2¢ to average \$1.42/lb and dry whey gave up 2.9¢ to 61.1¢/lb, although this was less of a decline than expected. NDM was up slightly to average \$1.37/lb.
- Weekly cold storage numbers indicate butter stocks at USDA selected storage centers increased 18% over the period 02/01 through 02/27. Cheese stocks increased 1% over the same period.
- Dairy cow slaughter for the week ending 02/18 was a solid 60,500 head, but it was 4,400 fewer than a year ago, while YTD the cull is 13,800 head behind 2011.
- Fluid Milk East: Milk production in the Northeast and Mid-Atlantic regions remains above year ago levels and continues to account for the heavy manufacturing milk volumes. Class I demand has not improved and remains flat. Florida's milk production continues to increase. Continued sluggish Class I demand has prompted 130 spot loads of milk to be exported this week. Milk production in the Southeast region is also increasing. The heavy milk supplies have necessitated the utilization of nearly all auxiliary manufacturing facilities. Requests from other regions to import milk into the Southeast had to be denied, because of the heavy milk volumes.
- Fluid Milk Central: Farm milk production remains seasonally strong this week. A few processors remarked they are concerned about farm milk increases yet to come with the flush as facilities are presently operating close to capacity.
- Fluid Milk West: Milk output in California continues to be rated as strong for this time of the year, with the availability of fresh forage and hay on the way. January 2012 milk receipts totaled 3.50 billion pounds, 7.9% higher than last year. Milk production in

the Pacific Northwest is reported to be heavier than expected for this time of year. The weather has been mild and is helping to increase cow comfort levels. This is translating into higher production per cow and more milk is available for processing.

- Dry Whey Central: The Central dry whey market registered prices as low as 30¢/lb this week on a few spot sales. Buyer interest is light, as their impression is that the dry whey market will continue to weaken. Dry whey production continues to outstrip projections at many locations as the farm milk supply arriving at plants is well above expectations for late February/early March. With average seasonal interest from most bottlers and Class II facilities, several cheese plants indicate their chances to divert milk from the cheese vats are limited.
- Dry Whey West: Western dry whey prices continued their retreat from January's most recent higher price ranges. The market is very unsettled as prices are spread in a wide range. Spot sales have been reported as low as 30¢/lb in both the domestic and export markets. Whey production is reported to be increasing as cheese plants continue to process higher than expected volumes of milk.
- Nonfat Dry Milk: NDM prices are mostly lower on a weak market. Steady to higher production and tepid end user interest in NDM are keeping the NDM market sluggish. Market participants indicate several resellers are offering discounts to the market, but buyers are content to wait. Manufacturers are looking to decrease inventories. Export interest has lessened as competition from other countries has increased. The overall expansion in NDM production and inventories, combined with sluggish demand, gives the market a definitive weak undertone.
- Cheese Midwest: Continuing heavy cheese manufacturing and some evidence of buyers expecting prices to continue lower for awhile, is giving the market a heavy tone. Some cheese manufacturers experienced bulk cheese customers this week "pushing back" scheduled deliveries for the month, leaving unanticipated higher inventory levels for manufacturers to handle. Milk supply increases and dwindling options for balancing milk intakes by manufacturing in other dairy products is resulting in a very heavy volume of cheese manufacturing. Auxiliary seasonal cheese plants in the Southeast continue to receive some Midwest milk supplies which Midwest cheese plants are not able to handle.
- Cheese West: Cheese production continues at a heavier than expected pace for this time of year. Excess milk is finding its way to cheese plants and is building inventories in many cases.
- International: Dairy Market News reports milk output levels are above quota in the Netherlands, Germany, Austria, Denmark and several other EU countries. Exports are limited and whey prices are trending lower in a weaker market. Export buyers are less aggressive as they see lower prices in other world markets.
- International: Milk production in both New Zealand and Australia continues to outpace year ago levels and processing plants are working well to handle the volumes, according to Dairy Market News. Butter markets are under pressure from lower fat price offerings in other regions of the world. Cheddar cheese prices are trending lower with the market tone steady to weaker. Cheese production is active and reflective of the volumes of milk available in the region. Current supplies are moderate to robust for current and upcoming needs.
- International: Cheddar cheese production in Australia for the month of January was up 26.8% vs. a year ago, according to Dairy Australia statistics. Total cheese output increased 17.6% over the same period.

#### **Recommendation:**

Cheese sellers in the spot market appeared to have stepped away for most of the week, but returned with plenty of product on Friday. The April Class III contract in particular had been sitting on a 60¢ gain for the week as futures rallied with the spot market, only to see it erased in a single day as it touched limit down several times today. Fundamentally, nothing has changed in the last few weeks. We're still producing an early and large amount of milk that processors are struggling to deal with. Dry whey prices are hanging in there, more strongly than we expected. This week's NASS survey still had it up at 61.1¢. But we wonder how long that will last before prices finally break. There is so much milk that there is little ability to balance the supply by shifting to butter or powder. Cheese plants, whether they want to or not, are running extended schedules just to keep up with supply. That bodes poorly for 2<sup>nd</sup> quarter and maybe even 3<sup>rd</sup>. The next milk production report is due out in two weeks, and it looks to be a whopper. Considering the production we're hearing about and the fact that smaller milk checks have yet to make any impact, it will most certainly be a bearish report. In addition, we had an extra day in Feb due to leap year, which will only make the Feb output look even higher. This week's rally, followed by Friday's reversal and rejection of higher prices, shows how nervous the market is. Current spot cheese prices and dry whey futures works out to about \$15.15 milk in Mar and just \$14.75 in April. We would continue to sell rallies in Q2. Target April at 15.50, May at 15.40 and June at \$15.50. Unless we see a surge in export demand, we don't see dairy products rallying much until we get some heat.

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