

The KDM Dairy Report – Mar 9th, 2012

What's Bullish:

- Cash Market: Buyers pushed blocks up 1¼¢ and barrels up 2¼¢ by week's end, settling at \$1.49/lb and \$1.50/lb respectively. Just 9 loads of blocks and 7 loads of barrels exchanged hands. Butter was unchanged at \$1.45/lb on no trades.
- Dry whey prices remained stubbornly resistant in this week's NASS survey, while other Class III components were down just slightly. Dry whey averaged 60.6¢/lb, down just 0.5¢ from last week, while butter actually increased 0.5¢ to \$1.42/lb. 40-lb block cheddar averaged \$1.49/lb, down just 0.7¢ while 500-lb barrels averaged \$1.51/lb, down 0.8¢. Finally, nonfat dry milk edged 0.3¢ lower to average \$1.36/lb.

Futures Month	Class III 03/09	Class III 03/02	Change	Dry Whey 03/09	Dry Whey 03/02	Change	Cheese 03/09	Cheese 03/02	Change
Mar-12	\$15.42	\$15.36	\$0.06	58.28¢	56.00¢	2.28¢	\$1.505	\$1.522	(\$0.017)
Apr-12	\$15.24	\$14.99	\$0.25	51.50¢	49.50¢	2.00¢	\$1.538	\$1.515	\$0.023
May-12	\$15.21	\$14.95	\$0.26	48.00¢	46.00¢	2.00¢	\$1.566	\$1.540	\$0.026
Jun-12	\$15.64	\$15.49	\$0.15	46.50¢	46.00¢	0.50¢	\$1.605	\$1.602	\$0.003
Jul-12	\$16.17	\$15.95	\$0.22	43.50¢	43.50¢	0.00¢	\$1.670	\$1.657	\$0.013
Aug-12	\$16.42	\$16.22	\$0.20	43.00¢	44.00¢	(1.00¢)	\$1.705	\$1.684	\$0.021
Sep-12	\$16.50	\$16.34	\$0.16	44.98¢	42.00¢	2.98¢	\$1.710	\$1.703	\$0.007
Oct-12	\$16.47	\$16.31	\$0.16	44.68¢	40.50¢	4.18¢	\$1.718	\$1.710	\$0.008
Nov-12	\$16.28	\$16.24	\$0.04	42.95¢	40.00¢	2.95¢	\$1.694	\$1.700	(\$0.006)
Dec-12	\$16.25	\$16.16	\$0.09	42.50¢	40.00¢	2.50¢	\$1.694	\$1.697	(\$0.003)
Jan-13	\$16.06	\$15.96	\$0.10	40.00¢	40.00¢	0.00¢	\$1.692	\$1.692	\$0.000
Feb-13	\$16.10	\$15.96	\$0.14	38.50¢	38.50¢	0.00¢	\$1.754	\$1.754	\$0.000
12 Mo Avg	\$15.98	\$15.83	\$0.15	45.36¢	43.83¢	1.53¢	\$1.654	\$1.648	\$0.006

- Weekly dairy cow slaughter stayed above 60,000 head for the 4th consecutive week. 61,100 head were culled for the week ending 02/25.
- Cream East: Cream supplies remain readily available, but are less than in recent weeks. Supplies continue to be in close balance with demand and those having to make last minute changes are finding prices outside the range. Yogurt production continues to be active and ice cream manufacturers are increasing their production schedules.
- Butter: Butter prices have stabilized this week and the market tone is steady to firmer as demand has improved for bulk and print butter. Domestic butter orders are increasing as Passover and Easter are only a month away, while export interest is improved. Print orders have improved for retail accounts. With wholesale prices lower than a year ago, attractive retail prices are expected to clear additional butter.
- Cheese West: Cheese production is above expected levels due to increased milk supplies. However, export sales are aiding in handling of the excess production. Domestic prices are currently lower than reported prices from Oceania.

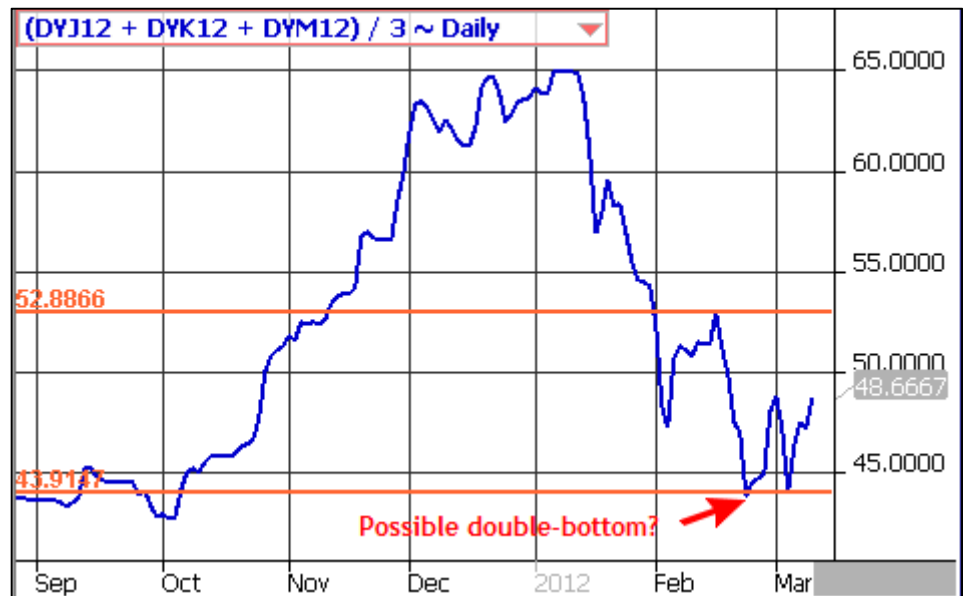
What's Bearish:

- World Ag Supply & Demand Report: USDA raised their milk production forecast for 2012. Cow numbers are increasing more rapidly than expected and the milk weather in the early part of the year is supporting higher levels of milk production. As a result, prices for cheese, butter, nonfat dry milk, whey were all lowered. Class III is now forecast to average \$16.65/cwt, down 40¢ from last month's estimate.
- Fluid Milk East: Manufacturing milk supplies continue to be heavy in the Northeast and Mid-Atlantic regions, prompted by increased milk production and sluggish Class I demand. The mild weather in the Mid-Atlantic with temperatures in the 60's has started to green up pastures in the region. Florida's milk production showed significant increases, this week and last. Last week's exports were revised upward to 150, while this week saw a decline to 110 as Class I demand increased. Florida has seen some improvement in pastures as rains covered the panhandle region of the state this past week. Manufacturing milk supplies in the Southeast region are heavy as a result of the increases in production and static Class I demand. All auxiliary manufacturing facilities are being utilized to clear the heavy milk volumes.
- Fluid Milk Central: Farm milk intakes increased this week at many plants in the Central region. With farm milk production steadily increasing across the Northern tier of states, Central milk loads continue to compete with some out of area spot milk loads clearing into the Central at discounted prices, reportedly hanging in the -\$3 to -\$4 range.
- Fluid Milk West: Milk production in California is trending higher on a week-to-week basis and total levels are running well above year ago marks. Processing plants are being operated at high levels to handle the available milk and components. Arizona milk output remains strong at what is thought to be at or almost near the peak level for the season. Temperatures are moderate and there are no issues stressing the milk cows. Plants are working on extended and strategic schedules to handle the milk supplies. Milk production in the Pacific Northwest is well above year ago levels as favorable weather continues. Many feel that the spring flush is still to come. Manufacturing plants are running heavier than expected schedules.
- Dry Whey East: Prices moved significantly lower on the low end of the range due to spot sales activity. Buyers are hesitant to make purchases beyond current needs, due to the uncertainty of the market. The current market uncertainty has caused whey inventories to build as many buyers delay March contract deliveries for later in the month hoping for lower prices and a clearer market picture. The net result of this market situation is that whey is more readily available now than it has been in over a year.

- Dry Whey Central: Spot market interest in dry whey has dried up according to many market participants. With price uncertainty represented in the ranges of both the Central and West markets, end users are delaying sizeable purchases and feeding end product production needs via just in time purchases.
- Dry Whey West: Dry whey prices are weak to lower this week. The market is unsettled as contract priced sales are lower. Production of whey has increased as cheese plants are running heavy schedules. Demand for additional whey above contract needs is lighter as buyers look for lower priced product.
- Nonfat Dry Milk: The NDM market tone remains weak. Prices continue to move lower under the pressure of heavy and increasing inventories, caused by the influence of milk production increases and expanding manufacturing milk supplies. The downward trend in prices has caused increased buyer hesitancy to purchase product beyond their immediate needs. There continues to be some marginal increases in domestic demand, most notably from expanded ice cream production, but increases in production quickly exceed the growth in demand. Export interest has lessened as competition from other countries has increased.
- Cheese Midwest: Cheese production is steady to higher as various plants report they have decreased demand from their fluid milk customers for regular milk loads. For some operations with multiple dairy commodity products, increasing cheese production is the result of higher plant milk intakes that could not be utilized in other end uses. Process cheese production is increasing at some plants as is cream cheese production for the upcoming holidays.

Recommendation:

Buyers of dairy products are seeing value at current prices. With cheese and butter both under \$1.50/lb, despite heavy milk production across the country, purchasers are not waiting around for lower prices and are building their aging programs and inventories. In the spot market this week, sellers appeared more reluctant to let go of product as bidders steadily moved blocks and barrels higher on only light trading. One cheese plant we talked to this week said they were sold out. U.S. cheese prices are well below international levels and exports are helping manage inventories. The bottom line is cheese inventories don't appear to be excessive, despite heavy production levels, due to both good domestic and international demand. That doesn't mean we're headed straight to



\$1.80 cheese, but it looks more and more like we're putting in a bottom here. As a result, we would look to aggressively buy call options for Q2 milk you have sold in the last few weeks, or, if you are able and willing to take the risk, buy your sold hedges back early and book the profit. Another positive is the dry whey market refusing to give much ground. Granted, we've read about some spot loads trading as low as 30¢/lb, but those were most likely the exception. The past two weeks we were wondering when dry whey would buckle, but it may not. Dry whey futures were sharply higher today, and if buyers, who have been delaying purchases, are forced to jump back in, we could see dry whey back up in to the 70 or even 80 cent ranges. The Apr-Jun dry whey chart to the right, suggests a double-bottom may have been put in. Several farms we talked to this week also mentioned about the low numbers of cows that will be calving this spring, due to poor success getting them pregnant in 2011. Our spring flush may not be as overwhelming as previously anticipated. Grains/feed costs are going to cut into cash flow, while the February California 4b price of \$13.42 is \$2.64/cwt below Class III settlement, causing further pain for CA producers. The U.S. economy continues to take baby steps in improvement, potentially fueling more domestic demand. In summary, while there is still much uncertainty in terms of milk production, cheese output and other factors, it appears the market is putting in a bottom.

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