

The KDM Dairy Report – Mar 30th, 2012

What's Bullish:

- Commercial Disappearance: Use of American cheese by commercial companies in Jan increased 5% from a year ago, according to USDA numbers released this week. Use of other-than-American cheese increased 4.7%. Butter use fell 9.4%, but use of milk in all products increased 2.8% over the same period.
- Ag Prices Report: The March milk-to-feed ratio came in at 1.48, the lowest number since Jun, 2009. In addition, the Feb ratio was revised .03 lower to 1.55.

Futures Month	Class III 03/30	Class III 03/23	Change	Dry Whey 03/30	Dry Whey 03/23	Change	Cheese 03/30	Cheese 03/23	Change
Apr-12	\$15.66	\$15.68	(\$0.02)	58.50¢	57.33¢	1.18¢	\$1.540	\$1.537	\$0.003
May-12	\$15.66	\$15.11	\$0.55	51.50¢	48.00¢	3.50¢	\$1.577	\$1.540	\$0.037
Jun-12	\$15.91	\$15.44	\$0.47	49.00¢	47.28¢	1.73¢	\$1.616	\$1.577	\$0.039
Jul-12	\$16.40	\$15.98	\$0.42	46.00¢	44.50¢	1.50¢	\$1.664	\$1.647	\$0.017
Aug-12	\$16.76	\$16.48	\$0.28	46.00¢	43.50¢	2.50¢	\$1.724	\$1.710	\$0.014
Sep-12	\$16.78	\$16.66	\$0.12	45.00¢	43.50¢	1.50¢	\$1.721	\$1.718	\$0.003
Oct-12	\$16.66	\$16.65	\$0.01	44.35¢	44.98¢	(0.63¢)	\$1.731	\$1.730	\$0.001
Nov-12	\$16.51	\$16.44	\$0.07	43.00¢	42.50¢	0.50¢	\$1.710	\$1.715	(\$0.005)
Dec-12	\$16.46	\$16.41	\$0.05	42.00¢	42.50¢	(0.50¢)	\$1.702	\$1.705	(\$0.003)
Jan-13	\$16.19	\$16.14	\$0.05	41.00¢	40.00¢	1.00¢	\$1.700	\$1.690	\$0.010
Feb-13	\$16.05	\$16.08	(\$0.03)	39.00¢	38.50¢	0.50¢	\$1.754	\$1.754	\$0.000
Mar-13	\$16.33	\$16.38	(\$0.05)	37.90¢	37.90¢	0.00¢	\$1.755	\$1.755	\$0.000
12 Mo Avg	\$16.28	\$16.12	\$0.16	45.27¢	44.21¢	1.06¢	\$1.683	\$1.673	\$0.010

Ratio's this low should encourage a cut in milk production/cows.

- Most Class III components were higher in this week's NASS survey. 40-lb blocks increased 1.8¢ to average \$1.51/lb while 500-lb barrels jumped 4.9¢ to \$1.55/lb. Butter inched 0.9¢ higher to average \$1.45/lb and dry whey gained 0.5¢ to 61.1¢/lb, but nonfat dry milk decreased 2.2¢ to average \$1.30/lb.
- Weekly cold storage numbers indicate cheese stocks at USDA selected storage centers fell 1%, or 1.37 million lbs, over the period 03/01 through 03/26. Butter stocks on the other hand, increased 9%, or 731,000 lbs.
- Dairy cow slaughter for the week ending 03/17 totaled 60,000 head, up 2,500 head from a year ago and the 7th consecutive week of 60k+ culling.
- Dairy Market News reports dairy producers in the Northeast are seeing inventories of feed and grain declining, while tight cash flows are limiting their ability to purchase additional supplies. In Florida, hot humid weather is beginning to settle in, lowering cow comfort levels and beginning to lower milk production. Feed and hay supplies are tight and purchasing additional supplies are expensive. Drought conditions continue to limit forage growth with many pastures not yet suitable for grazing.
- Butter East: Butter makers continue to operate churns at increased levels as they fill current orders. Private label and food service orders continue at increased levels, supporting domestic demand, while export interest remains strong, due to the efforts of export assistance programs. The good demand has limited butter inventories in the East.
- Cheese West: Heavy milk supplies continue to be directed to cheese plants. Manufacturers report inventories above recent levels, though not burdensome. Export sales have helped to reduce supplies, especially with CWT assistance.
- Grains: Corn stocks on March 1st totaled 6.01 billion bushels, down 8% from a year ago and 141 million bushels below expectations. Prospective plantings have corn acres up 4% to 95.9 million acres, the highest since 1937, but bean acres down 1% to 73.9 million acres.
- International: Surging dairy demand from Asia helped Fonterra increase profitability on record dairy exports, according to a Bloomberg article this week. China's purchases of milk powder jumped 45% in February as demand for protein in Asia has increased.

What's Bearish:

- Spot Market: Blocks were down ½¢ from last Friday to settle at \$1.49/lb on just 5 trades. Barrels were unchanged at \$1.46/lb on only 3 trades. Butter lost 6¢ to close at \$1.46¼/lb on no trades.
- Fluid Milk East: Milk production continues to increase in the Northeast region due to the mild spring weather. Manufacturing plant managers in the Mid-Atlantic region are commenting that the spring flush is beginning. The flush period is starting approximately 4 weeks early and may be extended as cows usually calve in late April and early May. Class I demand continues to be sluggish as numerous schools are cycling through their spring break periods. Increased milk production in the Southeast has maximized auxiliary manufacturing plants to the fullest extent possible.
- Fluid Milk Central: Farm milk production continues the upward trend in most Central areas. Mild weather conditions supporting cow comfort throughout the region are translating into topped off milk loads leaving the farms. The strong milk production trends have milk handlers exploring all options to find processing room. Within the Central region, changes in Class I supply agreements in some states reportedly resulted in a number of milk loads that historically clear to Class I instead transitioning to Class III use. Central processors expect milk handling to continue at near capacity levels over the next few weeks.
- Fluid Milk West: California milk production remains at high, seasonal levels. Processing plants are working on long schedules to handle the milk supplies. Some processors are moving milk and components out of state to alleviate the pressure on local plants. The milk supply growth is heavier than plant capacity and will be more problematic at the seasonal peak. Arizona milk output is

trending higher and resuming at the levels of a few weeks ago. The expectations are that the milk supplies will hit the seasonal peak within the next few weeks. Plants are working on heavy schedules to handle the milk intakes. New Mexico milk production continues to trend seasonally higher. Processing plants are adding to schedules to process additional milk supplies. Cream markets are unsettled, but overall, supplies are heavy. Milk production in the Pacific Northwest continues to run well above year ago levels. Milk handlers are busy routing milk to plants with available capacity. Both Class III and IV plants are busy with added supplies. Excellent cull dairy cow prices are contributing to higher culling rates. Cows are being replaced with heifers at advantageous ratios.

- Butter Central/West: Heavy production schedules due to increased milk supplies are building inventories. Butter demand has slowed as most Easter/Passover orders have been placed and shipped. Food service orders have been good, but have also slowed as most upcoming holiday needs have been filled.
- Dry Whey East: Prices for dry whey were mixed with the average of the range slightly lower. Production of dry whey remains fairly steady with recent weeks with some increases as cheese production has expanded in some areas, due to increased milk volumes. Overall, production of dry whey is exceeding demand and inventories are increasing. Product is moving through contracts with some manufacturers being flexible on price and willing to entertain lower priced bids as they attempt to keep their inventories at manageable levels. The market is still feeling the effects of recent price declines in other regions with some potential buyers remaining on the sidelines or only buying hand to mouth, believing prices might decline in the future.
- Dry Whey Central: Prices decreased this week while intermittent spot sales occurred at lower prices. Various manufacturers report it is tough to generate interest in spot market loads as buyers remain committed to buying on a just in time basis. For some manufacturers, attempts to finalize second quarter contract agreements are on hold for the near term as some buyers feel time is on their side as the dry whey market seeks a new floor.
- Dry Whey West: Western dry whey prices are weaker this week. The market tone is somewhat unsettled as cheese plants in the West are dealing with heavy production schedules and whey solids are plentiful. Increased interest from ice cream accounts is helping to clear inventories. Stocks are mostly in balance with some spot loads finding their way to the market at near steady prices.
- Nonfat Dry Milk: Prices continue to trend lower and the market undertone remains weak. Drying schedules are heavy to process the high milk output. Plants are running at or near capacity and the volumes are challenging processors. Domestic demand is light to moderate. There are also plentiful offerings of milk and condensed skim that are often discounted to buyers that are competing for NDM needs. Export interest for NDM and SMP is light for new business. Pricing trends are lower in other countries. The buyer sentiment has softened as pricing trends have weakened and as offering volumes have increased.
- Cheese East: Easter orders are in and made and demand has slowed. Some cheese makers are building mozzarella inventories for later in the year, while others are moving cheddar into aging programs. Cheese export interest continues, prompted by export assistance programs.
- Cheese Midwest: Last Friday's drop in the spot market is causing some delay in ordering by entities which price based on weekly averages. Many cheese plants are operating at capacity or very close to capacity. The same story about heavy milk supplies seeking a home continues for another week. Many plants are not able to accept more milk even at a discount. A few plants have purchased discounted surplus milk, which has driven overall cheese production even closer to regional capacity. Sales reports are uneven among manufacturers. Some feel output is moving out acceptably but others are disappointed with sales, resulting in some inventory build-up. The general sentiment over recent weeks of there being "a lot of cheese" was quantified just prior to last week's CME price decline.

Recommendation:

The spot market was quiet this week, especially considering the fireworks from last Friday. Prices were basically flat with little push from buyers or sellers. Milk continues to slosh from coast to coast in what should be adding up to a very bearish fundamental picture, at least in the near term. However, dry whey actually increased in this week's NASS survey, proving it is a pesky little creature and may stay better supported than dry whey futures are giving it credit for. June futures are beyond are below 50¢/lb, so it will be interesting to see who wins the battle, NASS or futures, as eventually they will have to reconcile with each other. Today's Grain Stocks and Prospective Plantings reports lit a fire under the grain markets, with sharply higher corn and bean prices likely supporting today's Class III contracts. The milk-feed ratio in this week's Ag Prices reports reflects the growing cost of producing milk. It all probably means that despite the very bearish short-term fundamental picture, in the mid to long term, milk prices will be well supported. We've been recommending you sell Q2 rallies. Despite the strong move higher today, we still think that is sound advice. Current spot prices work out to about \$15.25 for April and \$14.75 for May and June, with current futures prices substantially higher than that. It appears commercial disappearance has been strong, but we have to remember that data is from Jan, whereas the situation now is one of slowing cheese demand and growing inventories. Unless exports are much stronger than we think and grains shoot to the moon, we still believe cheese prices have not put in their lows and that Class III will eventually head lower. We could be wrong, of course. **Stay connected** to the dairy market during the day! With your cell phone, text to 404040 and type "follow kdmtrading" in the message to receive our live Twitter feed for free!

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