

The KDM Dairy Report – April 5th, 2012

What's Bullish:

- Dairy cow slaughter for the week ending 03/24 totaled 61,500 head, up 5,300 head from a year ago. After a slow start, the YTD cull is now ahead of 2011 for the first time at 791k vs. 789k last year.
- Dairy Market News reports hot and humid weather is the usual daily forecast now in Florida, increasing cow discomfort and lowering milk production. Hay supplies are very tight as forages have been slow to develop, because of the ongoing drought conditions.

Futures Month	Class III 04/05	Class III 03/30	Change	Dry Whey 04/05	Dry Whey 03/30	Change	Cheese 04/05	Cheese 03/30	Change
Apr-12	\$15.50	\$15.66	(\$0.16)	53.95¢	58.50¢	(4.55¢)	\$1.559	\$1.540	\$0.019
May-12	\$15.31	\$15.66	(\$0.35)	49.50¢	51.50¢	(2.00¢)	\$1.550	\$1.577	(\$0.027)
Jun-12	\$15.35	\$15.91	(\$0.56)	46.00¢	49.00¢	(3.00¢)	\$1.580	\$1.616	(\$0.036)
Jul-12	\$16.03	\$16.40	(\$0.37)	45.40¢	46.00¢	(0.60¢)	\$1.664	\$1.664	\$0.000
Aug-12	\$16.65	\$16.76	(\$0.11)	46.00¢	46.00¢	0.00¢	\$1.730	\$1.724	\$0.006
Sep-12	\$16.74	\$16.78	(\$0.04)	43.00¢	45.00¢	(2.00¢)	\$1.740	\$1.721	\$0.019
Oct-12	\$16.67	\$16.66	\$0.01	43.00¢	44.35¢	(1.35¢)	\$1.742	\$1.731	\$0.011
Nov-12	\$16.52	\$16.51	\$0.01	43.00¢	43.00¢	0.00¢	\$1.720	\$1.710	\$0.010
Dec-12	\$16.50	\$16.46	\$0.04	42.00¢	42.00¢	0.00¢	\$1.720	\$1.702	\$0.018
Jan-13	\$16.24	\$16.19	\$0.05	41.00¢	41.00¢	0.00¢	\$1.720	\$1.700	\$0.020
Feb-13	\$16.11	\$16.05	\$0.06	39.00¢	39.00¢	0.00¢	\$1.750	\$1.754	(\$0.004)
Mar-13	\$16.33	\$16.33	\$0.00	37.90¢	37.90¢	0.00¢	\$1.750	\$1.755	(\$0.005)
12 Mo Avg	\$16.16	\$16.28	(\$0.12)	44.15¢	45.27¢	(1.13¢)	\$1.685	\$1.683	\$0.003

- Cheese Midwest: People in varied segments of the cheese industry do not vocalize expectations of significant price movement in the immediate future, following the recent downward price adjustment two Friday's ago. Some manufacturers experienced increased orders from institutional customers over the last week, particularly for Mozzarella and provolone. Increased retail cheese promotions are hoped to help move the volume of cheese manufacturing. Midwest regional supermarket advertising volume and price incentives have increased notably over levels two weeks ago, according to a Dairy Market News Survey of thousands of regional supermarket ads. Overall cheese retail advertising in the Midwest has increased by 86%.
- Cheese West: Cheese plants are facing above average volumes of milk and are running at capacity in many cases. However, the increased production is moving at a comfortable pace with inventories said to be manageable. Lower prices have allowed more featuring of cheese at the retail level. Export sales are being assisted again by the CWT program.
- International: The risk of food price inflation in 2012 is not over, according to a Reuters news article released this week. Global food prices rose in March for a third straight month with more hikes to come. Rising oil prices are affecting everything from grains to dairy, while coarse grains stocks are at their lowest level since 2008.

What's Bearish:

- USDA's new weekly National Dairy Products Sales Report (replacing the NASS survey) started with a bang, showing a 5.7¢ drop in dry whey, the biggest week-to-week drop ever recorded. Prices averaged 55.5¢/lb. Nonfat dry milk declined 0.4¢ to \$1.30/lb, while both block and barrel cheese were up less than a penny each, to \$1.54/lb and \$1.59/lb respectively. Butter was also largely unchanged, inching 0.5¢ higher to \$1.50/lb.
- Dairy Products Report: Cheddar cheese output in Feb was up a leap-year adjusted 2.5% vs. Feb 2011, while total cheese output was also up 2.5% over the same period. Butter output increased 10% while nonfat dry milk output shot 49% higher.
- Fluid Milk East: Manufacturing milk supplies are heavy in the Northeast and Mid-Atlantic regions, due to increases in milk production and the decline in Class I demand. Most manufacturing plants are at or near capacity with the spring flush only in the beginning phase. Florida is beyond the peak of the flush, but managed to export 230 spot loads of milk, up from 190 last week. Milk production is rapidly increasing in the Southeast with all auxiliary manufacturing plants being utilized to capacity. Unloading delays are occurring at numerous manufacturing plants, due to the number and size of incoming loads. Class I demand remains sluggish ahead of the Easter holiday. Cream supplies are readily available and demand is declining as Easter cream based product production is winding down quickly.
- Fluid Milk Central: Farm milk production is steady to higher, and a few milk handlers expressed the belief the flush has yet to fully materialize in the North Central region. Delays in tanker unloading increased this week at several locations and delays are cumulatively moving through the system and back to the farm level in some areas. Spot milk loads are readily available within the region. Milk handlers indicate they are getting some pushback from regular Class II customers as milk from other sources, both within and outside the region, at discounts to Class prices can be obtained readily.
- Fluid Milk West: California milk production is still trending higher, although some milk handlers indicate that the increases compared to last year are tapering off. Farm milk intakes at most processing plants are pinned at capacity. Farm milk production in Arizona is nearing the peak. Some plants anticipate peak flush will occur within the next 6 - 10 days. Milk production in the Pacific Northwest continues to trend well above last year, while in Utah and Idaho, it is still building towards peak levels. There is more milk available for manufacturing than was the case a year ago.
- Butter: Demand for butter has declined now that the vast majority of Easter orders are in place. Current churning activity is surpassing need, thus clearances to inventory are increasing. Buyers are reluctant to order above immediate needs. Bulk sales of butter are slower as buyers anticipate lower prices.

- Dry Whey East: Expanding dry whey inventories pressured prices lower this week. Production of dry whey has followed the expansion of cheese production, caused by the seasonal rise in milk production. Domestic demand has declined as buyers are purchasing for immediate needs only, unwilling to build inventories on a downward trending market. Some manufacturers are pricing spot sales at a discount in order to avoid increases in inventories.
- Dry Whey Central: Prices for Central dry whey are lower on a weakening market. Dry whey spot load availability increased this week, the beginning of Q2, due, in part, to lighter contracting of dry whey by some end users for this quarter. With the current market showing a downward price trend and production outpacing year ago levels, some end users expect the spot market will be able to supply most of their Q2 dry whey needs.
- Dry Whey West: Whey production is above year ago levels as milk is plentiful and cheese plants are busy with the extra production. Stocks are building and resellers are anxious to keep whey moving. More spot loads are finding their way to the market.
- Nonfat Dry Milk: Nonfat dry milk prices moved lower on a weak market. Buyer interest is strongly linked to near term need fulfillment only. Nonfat dry milk production continues unabated at plants throughout the region as milk intakes put pressure on plant capacities. With several Class II and III plants on hiatus for some patches during the week, milk processors have shifted specialty products to the back of the line and are concentrating on clearing farm milk intakes in the most efficient way, namely condensed skim and low heat NDM. Manufacturers' NDM inventories are building steadily.
- Cheese East: Production is increasing, due to the continuing increase in the milk supply. Inventories are building as demand has not kept pace with supply. Many retail chains are expanding their cheese features for 8 ounce chunks of cheddar and 1 pound chunks of mozzarella. Cheese export interest continues, but at a slower pace as sales volumes for export assistance has declined.

Recommendation:

Dry whey prices are finally under pressure and much of the country is still dealing with very heavy milk production, but we may not see a complete blowout to the downside in milk prices. It appears that much of the milk "overproduction" is being diverted to butter and powder as much as possible, and not as much to cheese; important, because we're dealing with Class III milk, which we know as "manufacturing milk", is so closely tied to cheddar cheese prices. This week's Dairy Products report, while negative, did reveal sharp increases in butter and nonfat dry milk production, but only a modest gain in cheddar cheese output. Indeed, with the exception of the Northeast, cheese inventories in the Midwest and West do not appear to be burdensome at this point. That could change if demand slows further and milk production remains strong, so our front months of May and June remain vulnerable. But there are other developments as well that are encouraging for the longer term. Feed is expensive and hay is tight in most of the country. Drought and heat in Florida will begin making more of an impact, while we're hearing reports out of California that herd reduction programs and over-base production penalties are already taking out significant numbers of animals / milk output. We would hold off on further milk sales July-Dec and look for opportunities to buy call options to protect milk already contracted/sold. May and June could still be sold on rallies above \$15.75.

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Note: Our offices will be closed tomorrow, in observance of Good Friday. U.S. financial markets will be closed as well. We everyone a Happy Easter!

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