

The KDM Dairy Report – April 13th, 2012

What's Bullish:

- After a substantial drop a week ago, dry whey prices increased 1.9¢ in this week's National Dairy Products Sales Report to average 61.3¢/lb. 40-lb blocks inched 0.4¢ higher to \$1.54/lb.
- Dairy cow slaughter for the week ended 03/31 totaled a solid 63,100 head, up 7,000 head from the same period a year ago.
- Fluid Milk West: California milk production is mostly steady to slightly higher. There are some impacts likely being seen because of coops implementing producer base plans. Some processors are receiving less milk, and adjustments in feeding rations are causing some herds to make less milk. However, processing plants in the state are still working on extended schedules to process the milk supplies. Arizona milk output is trending slightly lower and retreating from what likely was the seasonal peak recorded early in the week. In the Pacific Northwest, Class I demand is expected to increase now that schools are back in session. As spring weather is arriving in the region, dairy farmers are looking at feed supplies and assessing production plans for summer. Many farmers are content to put any expansion plans on hold until milk prices begin to show some improvement. Those farmers that are planning on exiting the dairy business in the near future are finding very favorable cull cow prices and decent demand for replacement cows.
- Butter: Butter feature activity in recent weeks was very good and cleared heavy volumes of print butter. Many restaurant and food service buyers do indicate that overall traffic flow through their operations has been more favorable this year than in recent years
- Cheese West: Increased milk production in the West has added to cheese manufacturing. However, the increased inventories are moving well as the price remains well below a year ago. The current price has helped to improve export sales. Additional help from the CWT program assisted in sales of 3.7 million lbs of cheese this week. Current stocks are said to be manageable.
- Exports: Total cheese exports through February were up 3.4% vs. last year, with help from a 26% increase in Cheddar cheese, according to the U.S. Dairy Export Council. Exports of milk powder were up 4% over the same period.

Futures Month	Class III 04/13	Class III 04/05	Change	Dry Whey 04/13	Dry Whey 04/05	Change	Cheese 04/13	Cheese 04/05	Change
Apr-12	\$15.80	\$15.50	\$0.30	58.00¢	53.95¢	4.05¢	\$1.544	\$1.559	(\$0.015)
May-12	\$14.97	\$15.31	(\$0.34)	50.48¢	49.50¢	0.98¢	\$1.520	\$1.550	(\$0.030)
Jun-12	\$15.05	\$15.35	(\$0.30)	47.25¢	46.00¢	1.25¢	\$1.541	\$1.580	(\$0.039)
Jul-12	\$15.69	\$16.03	(\$0.34)	44.00¢	45.40¢	(1.40¢)	\$1.637	\$1.664	(\$0.027)
Aug-12	\$16.35	\$16.65	(\$0.30)	43.50¢	46.00¢	(2.50¢)	\$1.700	\$1.730	(\$0.030)
Sep-12	\$16.42	\$16.74	(\$0.32)	43.50¢	43.00¢	0.50¢	\$1.710	\$1.740	(\$0.030)
Oct-12	\$16.40	\$16.67	(\$0.27)	43.00¢	43.00¢	0.00¢	\$1.710	\$1.742	(\$0.032)
Nov-12	\$16.37	\$16.52	(\$0.15)	42.00¢	43.00¢	(1.00¢)	\$1.705	\$1.720	(\$0.015)
Dec-12	\$16.32	\$16.50	(\$0.18)	42.00¢	42.00¢	0.00¢	\$1.700	\$1.720	(\$0.020)
Jan-13	\$16.17	\$16.24	(\$0.07)	41.00¢	41.00¢	0.00¢	\$1.700	\$1.720	(\$0.020)
Feb-13	\$16.04	\$16.11	(\$0.07)	39.00¢	39.00¢	0.00¢	\$1.750	\$1.750	\$0.000
Mar-13	\$16.29	\$16.33	(\$0.04)	37.90¢	37.90¢	0.00¢	\$1.750	\$1.750	\$0.000
12 Mo Avg	\$15.99	\$16.16	(\$0.17)	44.30¢	44.15¢	0.16¢	\$1.664	\$1.685	(\$0.021)

What's Bearish:

- World Ag Supply & Demand Report: USDA raised their 2012 milk production forecast due to increased milk cow numbers, gains in milk per cow and weaker demand. As a result, the Class III price forecast was reduced 30¢ from last month and is now expected to average \$16.35/cwt.
- 500-lb barrel cheese fell 4.8¢ in this week's National Dairy Products Sales Report to average \$1.54/lb. Butter decreased 2.5¢ to average \$1.48/lb and nonfat dry milk lost 1.4¢ to \$1.26/lb.
- Fluid Milk East: Manufacturing milk supplies have reached levels comparable to the Christmas/New Year's holiday period in most areas of the Northeast and Mid-Atlantic regions. Class I demand has picked up after the holiday, but can only make a small dent in the milk supplies coming into manufacturing plants. The spring flush milk intakes are causing unloading delays with some delays reportedly reaching 24 hours. Manufacturing plants are at or near capacity with the real possibility of additional milk volumes in the coming weeks. Florida is the only area that has seen milk production declines, due to periods of hot humid weather, but a cool front moved through the state earlier this week causing some bounce back in milk production. 250 loads of Grade A milk were shipped out of the state this week, up from 230 last week. Milk supplies in the Southeast continue to maximize utilization of all auxiliary manufacturing plants. Hauling logistics are becoming a problem as unloading delays are occurring at numerous manufacturing plants. Cream supplies continue to be readily available and demand has decreased for most cream based dairy products. Demand for condensed skim milk remains very sluggish.
- Fluid Milk Central: No letup in Central farm milk production is in sight for the near term, according to many milk handlers. Farm milk intakes continue to build in most areas of the Central region, especially in the North Central area. Fluid milk sales are mostly steady and continue to underperform compared to year ago Class I sales. Some bottlers point to lower sales into school lunch programs as part of the reason that overall bottled milk sales are lower for 2012. Central spot milk loads are reportedly clearing at prices ranging from \$3 to \$5 below Class, but interregional spot load prices reportedly found processing room when prices dipped below the -\$5 mark. Various Central cheese plants indicate they are offering the spot loads of milk because of stagnant cheese orders and farm milk intakes outpacing projections.

- Butter: Churning schedules are seasonally strong and in many instances, butter churns are already running at or very near capacity levels. Cream offerings leading up to the Easter/Passover weekend were heavy. Churning outpaced demand, thus much of holiday production ended up clearing to inventory. Butter demand late last week and early this week was slow.
- Dry Whey East: Increasing milk volumes, channeled to cheese production, are increasing dry whey production and inventories and pressuring prices lower. Domestic demand has declined as buyers continue to purchase for immediate needs only, waiting to see if the downward price trends will continue. Some manufacturers are offering discounts on multiple load sales in order to clear some inventory. The overall market undertone is weak.
- Dry Whey Central: Central dry whey prices are unchanged to lower on a weak market. Production continues above projected volumes. Most buyers are disinterested in obtaining dry whey unless prices reflect the current market condition of strong supplies.
- Dry Whey West: Western dry whey prices continued to show weakness this week. The market is still exhibiting weakness due to larger inventories finding their way to the spot market. Heavier than usual milk supplies to cheese plants have increased the whey stream supply.
- Nonfat Dry Milk: Nonfat dry milk prices are lower on a weak market. Buyer interest is light as the expectation is that time is on their side. With the historical farm milk production apex still several weeks away for most areas, processors expect dryers to be pushed hard throughout that time period. Some spot loads of farm milk are putting on miles while looking for processing room as plants near capacity. Nonfat dry milk inventories are building steadily and holdings are ahead of schedule for several manufacturers.
- Cheese East: Increases in the milk supply are forcing cheese makers to expand production to near capacity levels. Cheese production quickly exceeds demand and inventories are expanding. Domestic demand has dropped off after the holiday, but export interest remains fairly good.
- Cheese Midwest: Milk supplies continue to increase and cheese manufacturing approaching capacity has resulted. Even discounted milk offers are not accepted in some areas because machinery, men and women can only work so many hours before needing a break.
- International: Milk production trends remain positive throughout most of Europe. Weather conditions have been nearly ideal for cow comfort and milk production development. As milk volumes increase, so is manufacturing. Overall, prices for most manufactured dairy products are easing and in some instances, starting to align themselves with other international offerings. As milk production expands, manufacturing increases and overall sales remain slow and inventories continue to build.
- International: Whey markets in Europe are weak with prices generally trending lower. Cheese production is building as milk volumes increase, thus is whey output. Currently, whey powder is generally being absorbed within an internal or domestic market, with international sales slow.
- International: Milk production continues to trend seasonally lower in New Zealand and Australia, but is finishing the season in a very positive fashion. The additional, unforeseen, milk volumes are providing additional late season manufacturing that is providing some cushioning to supply/demand balance. In New Zealand, milk output on both the North and South Islands is running stronger than the previous year with output for the country running very near 10% ahead of last season. In Australia, weather conditions remain quite favorable for early fall. Overall milk output continues to register about a 4% increase over last season. Traders and handlers are indicating that sales activity is quiet.

Recommendation:

Much of the country is still under heavy milk production with processing facilities struggling to keep up. That doesn't bode well for the near term, but from West moving East, we're starting to see milk output peaks getting put in. With feed costs high, we're hearing \$17.00 or thereabouts as breakeven for many Western operations, so current futures prices for the entire year are not profitable, with heavier losses possible through June. As temperatures warm, peak production, will continue to move East as the Midwest and Eastern regions of the country hit and pass their peaks. With all the doom and gloom out there from a production standpoint, one might be surprised Class III prices are as high as they are! Solid exports may have something to do with it. Cheddar exports through Feb are up 26% vs. last year (see bull item above), while cheese inventories in the West don't appear to be burdensome. No doubt, over the next month or two prices up front are vulnerable (dry whey looks weak here too), but on the other hand, we're seeing a willingness for end users to buy cheese more aggressively in the low \$1.40's. On Thursday, barrels fell 5¢ to \$1.40, only to be bid right back to \$1.46 today. This was the opposite of what everyone expected (which was for blocks to come down to meet the barrel price). The markets are getting more volatile and we could see both blocks and barrels fall next week, but it was an important psychological move for cheese today. Our advice remains the same as last week: 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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