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The KDM Dairy Report – April 20th, 2012

What's Bullish:

Futures Month	Class III 04/20	Class III 04/13	Change	Dry Whey 04/20	Dry Whey 04/13	Change	Cheese 04/20	Cheese 04/13	Change
Apr-12	$15.77	$15.80	($0.03)	59.00¢	58.00¢	1.00¢	$1.544	$1.544	$0.000
May-12	$15.15	$14.97	$0.18	51.50¢	50.48¢	1.03¢	$1.515	$1.520	($0.005)
Jun-12	$14.65	$15.05	($0.40)	45.00¢	47.25¢	(2.25¢)	$1.516	$1.541	($0.025)
Jul-12	$15.19	$15.69	($0.50)	43.50¢	44.00¢	(0.50¢)	$1.570	$1.637	($0.067)
Aug-12	$15.90	$16.35	($0.45)	43.00¢	43.50¢	(0.50¢)	$1.644	$1.700	($0.056)
Sep-12	$16.25	$16.42	($0.17)	43.00¢	43.50¢	(0.50¢)	$1.690	$1.710	($0.020)
Oct-12	$16.20	$16.40	($0.20)	42.00¢	43.00¢	(1.00¢)	$1.695	$1.710	($0.015)
Nov-12	$16.13	$16.37	($0.24)	41.50¢	42.00¢	(0.50¢)	$1.690	$1.705	($0.015)
Dec-12	$16.03	$16.32	($0.29)	41.50¢	42.00¢	(0.50¢)	$1.680	$1.700	($0.020)
Jan-13	$15.90	$16.17	($0.27)	41.00¢	41.00¢	0.00¢	$1.684	$1.700	($0.016)
Feb-13	$15.85	$16.04	($0.19)	39.00¢	39.00¢	0.00¢	$1.729	$1.750	($0.021)
Mar-13	$15.90	$16.29	($0.39)	37.90¢	37.90¢	0.00¢	$1.750	$1.750	$0.000
12 Mo Avg	**$15.74**	**$15.99**	**($0.25)**	**43.99¢**	**44.30¢**	**(0.31¢)**	**$1.642**	**$1.664**	**($0.022)**

- Spot Market: Blocks gained 4¢ on the week to settle at $1.52¾/lb, while barrels were unchanged at $1.46/lb. No blocks exchanged hands, but buyers took on 31 loads of barrels to hold prices steady. Butter lost 1¼¢ to close at $1.41¼ on just 4 trades.
- Over the first 16 days of April, cheese stocks at USDA selected storage centers have declined 3.1 million lbs, or 2%. This is anti-seasonal.
- Livestock Slaughter Report: 278,000 dairy cows exited the milking herd in March, up 9,900 head, or 3.7% from a year ago. Jan-Mar the 2012 cull is up 22,200 head, or 2.8%.
- Dairy cow slaughter continues to be aggressive. 63,100 head were culled for the week ended 04/07, compared to 58,200 during the same period last year. YTD the cull is 13,700 head higher than in 2011.
- Fluid Milk East: The Florida drought not only continues, but the effects are very tangible as smoke from 29,000 acres of wild fires covers a good portion of the state. Spot loads of milk exported out of state this week dropped to 190, from 250 last week.
- Fluid Milk West: California milk output is mostly steady, with some areas were seeing the effects of wet conditions tempering the milk flow. Temperatures have been favorable for cow comfort in the state, however, and green chop feeding is giving a boost to production. Processing plants are working through the heavy milk supply. Arizona milk production is moving slightly lower. Hotter weather conditions are developing. Temperatures are in the 90's this week and are forecast to be 100 degrees this weekend. The heat is expected to affect the milk flow slightly; yet that decline is welcomed by the processors who have been running on extended schedules.
- Cheese West: Production remains heavy as farm milk volumes continue to stress production capabilities, but demand for cheese is reported good at current price levels. Retail features of cheese are lower after Easter promotions have ended. However, wholesale demand from processors and some aging programs have kept barrel inventories manageable. Export sales are good as U.S. prices are favorable in comparison to prices from the Oceania region.
- Grain: July beans broke into new contract highs, hitting $14.58¾. Now there's talk of meal hitting $440/ton.
- International: In a statement about Fonterra's long-term strategy last month, CEO Theo Spierings said the rise of the middle classes in what are now emerging markets will underpin demand. People buy dairy products when they can afford it even when they don't have a cultural history of consuming them. If New Zealand can boost output by 5 billion liters by 2020 it will only meet 5% percent of the forecast growth in global demand.
- International: In a country where pork is a culinary staple, the demand for a protein-rich diet is growing faster than Chinese farmers can keep up. While Americans cut back on meat consumption to the lowest levels seen in two decades, the Chinese now eat nearly 10% more meat than they did five years ago. China's solution: to super-size its supply by snapping up millions of live animals raised by U.S. farmers as breeding stock - capitalizing on decades of cutting edge agricultural research in America. By taking this step, say breeders and exporters, China will move from small-scale backyard farms, to the Westernized tradition of large consolidated operations to keep up with demand. But the impact of a vastly larger, more efficient, livestock sector in China would cause a major shift in the global market, particularly for grain demand. China could need an incremental 20 million to 25 million tons of corn in the next few years just to keep up with the growth of the swine industry, according to a recent research report by Rabobank.

What's Bearish:

- Milk Production Report: March milk output in the U.S. was up 4.2% vs. last year and USDA revised Jan and Feb output higher as well. Cow numbers increased 12,000 head from Feb to March while output per cow jumped 59 lbs to 1,910. Gains were led by Utah up 7.8%, MI up 7.3%, CO up 7.1%, AZ up 6.6% and CA up 6.2% (yikes!). WI output increased 4.2%.
- Cold Storage Report: Butter holdings in cold storage in March were up 46% vs. a year ago and American cheese stocks were up 2% due to very heavy milk output. Total cheese stocks were actually 2% lower than last March.
- Livestock, Dairy and Poultry Outlook Report: Cow numbers and yield per cow continue above expectations despite poor producer returns. The higher production results in further price reductions for cheese, butter, and nonfat dry milk. Whey prices, which had been rising, are beginning to soften. As a result, USDA reduced their 2012 Class III price forecast 30¢/cwt from last month, and now expects it to average $16.35.
- Global Dairy Trade Auction: Prices for all dairy products fell by an average 9.9% from just two weeks ago in the GDT auction held this week. Cheddar cheese dropped the most, declining 12.1% with an average winning bid of $2,937 per metric ton. That works out to about $1.34/lb. Milk powder slumped to its lowest level since 2009 on concern purchases from China, the world's biggest buyer, may decline as favorable weather boosts global supply.
- All Class III components were lower in this week's AMS National Dairy Products Sales Report. 40-lb blocks declined 2.4¢ to average $1.52/lb while 500-lb barrels lost 3¢ to $1.51/lb. Butter decreased 2.7¢ to average $1.45 and dry whey gave up 2¢ to 59.4¢/lb, but nonfat dry milk managed a small 0.7¢ increase to average $1.27/lb.

- Fluid Milk East: Milk production increases have off set and exceed improved Class I demand, keeping manufacturing milk supplies near capacity levels in the Northeast and Mid-Atlantic regions. The combination of greening pastures, good cow comfort levels, plus cows and heifers beginning to calve are causing the increases in milk supplies. Some unloading delays are occurring as numerous plants are being inundated with milk. Florida's milk production is declining, but only at a "snail's pace". Milk production continues to expand in the Southeast region with no end in sight. Milk is being shuffled from area to area as needed and where possible to maximize all auxiliary manufacturing plants. Price discounts on spot loads of whole milk are significant with some discounts at $2.00-$4.00 under Class. Cream supplies remain at increased levels with significant volumes going to churns. Demand for cream has declined and spot sales are limited with numerous loads having difficulty finding a home.
- Fluid Milk Central: Balancing facilities indicate farm milk intakes remain pinned to the high side of the dial as North Central region cows continue to outpace 2012 milk production estimates and historical volumes. Spot loads of milk are reportedly trading at $2-5 under Class. Cream availability is steady within the region, but running into price competition from Eastern cream spot loads. Fluid milk sales into bottled milk accounts are tepid even as schools reopen for full class schedules after the spring break. Features at retail stores for various sizes of bottled milk containers have been infrequent, thus stalling demand from that market sector.
- Fluid Milk Pacific Northwest: Milk production in the region continued to outpace last year and is causing some difficulties as manufacturing plants are running extended schedules in many cases to handle the increased volumes. Class I demand has returned to expected levels as schools return to normal schedules. Milk continues to be moved to adequately handle current production with some excess being shipped out of the region.
- Butter: Cream volumes remain plentiful to the churn and many churns are running at or very near capacity levels. Churning continues to generate print butter for current and near term needs, but much churning is being directed toward bulk volumes which are clearing to inventory. Butter demand has slowed considerably. Many buyers feel that further price weakness will develop as milk and cream volumes increase seasonally.
- Dry Whey East: Dry whey production continues at increased levels as milk production increases have expanded the volumes of milk going into cheese production. Most dry whey manufacturers are near their drying capacity and current production is adding to inventories. Potential buyers are aware of the increases in supply and are anticipating price discounts when they're looking for additional loads. Spot market activity is fairly active, but numerous buyers continue to sit on the sidelines waiting for prices to move lower. The overall undertone of the market remains weak.
- Dry Whey Central: Dry whey prices in the region declined for the eighth consecutive week as the market seeks a floor. Various manufacturers indicate spot market activity increased during the last few weeks as a result of slow/cancelled pickups of Q1 dry whey loads. Resale offers continue to surface from brokers, traders and end users. Spot load interest remains slow as buyers cite various reasons, including: lagging end product orders; ample inputs on hand; and continued dry whey market degradation in the near term.
- Dry Whey West: Whey production continues at increased levels as cheese plants are busy with increased milk intakes. The market tone is uneven as spot buyers look at increased supplies and weaker prices. Spot export prices are lower as international prices are weak. Manufacturers and resellers are keeping a close eye on inventories and appear willing to discount product to move current supplies.
- Nonfat Dry Milk: Prices for nonfat dry milk are lower and the market tone continues to be weak. Lower prices and weaker trends for the international skim milk powder markets are noted by the trade as "a window" to where the U.S. market is heading. Buying interest is slower, mainly because buyers are anticipating further weakness in the market and they are willing to wait. Export sales are moving under established contracts, but new business has slowed. Drying remains heavy to process available milk and condensed skim in the region. Stocks are moderate to heavy.
- Cheese East: Increased milk supplies are continuing to keep cheese production at increased levels. Domestic demand has declined following the holiday, causing increases in cheese inventories.
- Cheese Midwest: Milk continues to be available to cheese manufacturers in quantities greater than production needs. Milk continues to be available to cheese manufacturers in Wisconsin at below class prices. The volume of cheese production has now resulted in some cheese manufacturers offering sales into retail channels at under market prices, undercutting other manufacturers, to move product.
- Dairy Market News reports fluid milk sales in February were down 3.4% vs. last year, after adjust for leap day.
- International: February cheddar cheese output in Australia was up 33% compared to a year ago. YTD output has increased 3.9%. Total cheese output is up 20.5% and 5% respectively.

Recommendation:

Lots of news and reports out this week, but little that seems to be impacting prices. True, Class III prices finished mostly lower across the board, but we're starting to feel that the bottom is getting put in. The supply situation remains much the same as last week; however we are starting to see some declines out West and in the deep South. A cheese plant we work with in the Midwest indicated they ran an extra day to process surplus milk, but that the cheese was all sold. Heavy milk production will likely limit how high both milk and cheese prices can go in the near term, but export demand and a recovering economy seem to put a brighter light on demand in the medium/long term. Add in some summer heat and what looks to be expensive protein for the TMR and it could be enough to start turning prices around. Blocks were able to climb 4¢ higher this week without a trade, while buyers seem able to support barrels for the time being in the mid $1.40's. Clearly blocks are in shorter supply than barrels, which we think limits the downside for cheese. Current spot prices work out to about $14.90 for May and $14.50 for June. We're trading Class III at a premium in those months, but not by much. If blocks continue to push higher next week and barrels are able to hold, we could see quite a short-covering rally next week. For more aggressive producers, we would continue to lift hedges in Q2 andQ3 to take profits. We would not advise selling Q2-Q4 at current levels. We would look for opportunities to buy CALL options July-Dec to protect milk already sold or to use as selling targets at a later date.