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The KDM Dairy Report – April 27th, 2012

What's Bullish:

Futures Month	Class III 04/27	Class III 04/20	Change	Dry Whey 04/27	Dry Whey 04/20	Change	Cheese 04/27	Cheese 04/20	Change
Apr-12	$15.73	$15.77	($0.04)	59.60¢	59.00¢	0.60¢	$1.540	$1.544	($0.004)
May-12	$14.88	$15.15	($0.27)	53.50¢	51.50¢	2.00¢	$1.491	$1.515	($0.024)
Jun-12	$14.20	$14.65	($0.45)	44.00¢	45.00¢	(1.00¢)	$1.475	$1.516	($0.041)
Jul-12	$14.70	$15.19	($0.49)	42.25¢	43.50¢	(1.25¢)	$1.538	$1.570	($0.032)
Aug-12	$15.35	$15.90	($0.55)	42.03¢	43.00¢	(0.98¢)	$1.608	$1.644	($0.036)
Sep-12	$15.88	$16.25	($0.37)	42.03¢	43.00¢	(0.98¢)	$1.660	$1.690	($0.030)
Oct-12	$16.05	$16.20	($0.15)	42.00¢	42.00¢	0.00¢	$1.672	$1.695	($0.023)
Nov-12	$15.94	$16.13	($0.19)	41.50¢	41.50¢	0.00¢	$1.672	$1.690	($0.018)
Dec-12	$15.73	$16.03	($0.30)	41.25¢	41.50¢	(0.25¢)	$1.660	$1.680	($0.020)
Jan-13	$15.61	$15.90	($0.29)	41.00¢	41.00¢	0.00¢	$1.663	$1.684	($0.021)
Feb-13	$15.70	$15.85	($0.15)	39.00¢	39.00¢	0.00¢	$1.714	$1.729	($0.015)
Mar-13	$15.84	$15.90	($0.06)	37.90¢	37.90¢	0.00¢	$1.750	$1.750	$0.000
12 Mo Avg	**$15.47**	**$15.74**	**($0.28)**	**43.84¢**	**43.99¢**	**(0.15¢)**	**$1.620**	**$1.642**	**($0.022)**

- Through the first 23 days of April, cheese stocks at USDA selected storage centers have declined 2%, or 2.4 million lbs, according to the Weekly Cold Storage Holdings Report.
- Several news stories covering the first reported Mad Cow case in the U.S. in six years, predict the discovery will do little to prevent beef shipments from surging to a record for a second straight year. Because detection happened before it entered the food chain, it should bolster confidence that U.S. meat is safe.
- Fluid Milk East: Milk production continues to increase in the Northeast, but is showing signs of leveling off in the Mid-Atlantic region. Manufacturing facilities in both regions continue to operate at near capacity levels. Florida's milk production has leveled off in response to recent cooler weather patterns. Class I demand increased this week after last week's lackluster activity. Many areas of the state are under severe wildfire warnings as severe drought conditions continue. Over 39,000 acres have been charred by wild fires. Supplemental hay feeding continues as 80% of the pastures in the state are rated as either fair or poor. There are some indications that milk production is at its apex and leveling off in the Southeast. Most all auxiliary manufacturing facilities are being utilized with couple of plants receiving less milk than in previous weeks.
- Exports: Export interest for butter continues to be a bright spot in the market with a number of plants making 82% and filling export orders, which were prompted by export assisted sales. Cooperatives Working Together (CWT) has accepted 11 requests for export assistance to sell 0.752 million pounds of butter and 2.615 million pounds of Cheddar and Monterey Jack cheese to customers in Asia, Africa, the Middle East and South America. Delivery of product will be from May through July 2012. To date in 2012, CWT has assisted with 39.2 million pounds in export butter sales.
- Grains: Beans remain on a tear with both the May and July contracts trading over $15/bu. Meal is well over $420/ton.

What's Bearish:

- Spot Market: Blocks gained ¾¢ for the week to settle at $1.53½/lb, while barrels lost 2½¢ to close at $1.43½/lb. Trading was heavy with 28 loads of blocks and 25 loads of barrels exchanging hands. Butter lost 5¼¢ to settle at $1.36/lb on just 2 trades. Grade A NDM declined 2¢ on no trades, closing at $1.14¾/lb.
- All Class III components were lower in this week's National Dairy Products Sales Report. 40-lb blocks fell 1.5¢ to average $1.50/lb while 500-lb barrels shed 2.2¢ to $1.49/lb. Butter decreased 0.7¢ to average $1.44/lb, dry whey lost less than a penny to 59.3¢/lb and nonfat dry milk fell 2.6¢ to average $1.24/lb.
- Dairy cow slaughter for the week ended 04/14 totaled 59,200 head; up from 58,300 a year ago, but the first time in ten weeks the weekly cull has been below 60,000.
- Hearing from some producers in the Pacific Northwest that large co-ops are struggling with handling all the milk. Emergency meetings, talk of severe price deductions on over-base production, to flat out not picking up the milk under discussion.
- Fluid Milk Central: Central milk handlers indicate milk intakes are steady to somewhat higher for the week. Spot milk loads are readily available, with prices reported in the $2-5 below Class range.
- Fluid Milk West: California milk production levels are uneven, but overall levels remain well above a year ago. Processors continue to operate plants on extended schedules. Supplies of milk and components remain heavy. The added volumes of finished dairy products are creating more supplies that are not readily clearing the market. Milk supplies in the Pacific Northwest continue to be burdensome. Manufacturing plants in the region are working extended schedules in many cases to handle the increased milk volumes. Excess milk is being moved out of the region where needed. These sales are typically at a discount. Coops in the region are warning dairy farmers of possible penalties for excess milk produced above their established basis.
- Butter: Churning schedules across the country remain seasonally strong as cream supplies are readily available. In most instances, current churning is surpassing demand, thus clearances to inventory are strong. Butter producers and handlers are indicating that buying interest is fair at best with most buyers cautious with their purchases and procuring for near term needs. Retailers are stating that butter feature activity has slowed significantly since the recent holiday period.
- Dry Whey East: Prices declined on both ends of the range this week. Production of dry whey continues at increased levels as milk volumes going to cheese plants are very near their seasonal peak. Demand has declined as buyers are purchasing for immediate needs only, unwilling to expand supplies on a downward trending market. Spot market activity is fairly active with sales at discounted prices. The market undertone remains weak.

- Dry Whey Central: Prices declined this week as the number of spot sales in the region increased. Various manufacturers indicate some of the cheese and dry whey production is speculative in nature, but there is no other outlet for the milk intakes as butter/powder plants are running close to capacity. Dry whey inventories continue to build alongside active cheese production.
- Dry Whey West: Prices were lower this week. Price incentives are needed in many cases to move larger blocks of product. Heavier than usual cheese production is adding to dry whey and condensed whey offerings. The increased supplies of available whey are giving buyers a chance to shop around for best prices. End users of whey are taking advantage of the lower prices to purchase ahead of immediate needs.
- Nonfat Dry Milk: Prices continue to trend lower in generally light trading. The market tone is weak. Buying interest is light on the domestic front. There are heavy offerings of milk and condensed skim that are often being priced at more competitive levels to users of NDM. Export interest is tapering off and new business is slow to develop. Bids are coming in lower and at levels that producers/marketers are not aggressively embracing. Pricing trends are moving lower from other exporting countries. Drying schedules are active and heavy in the region. Producers' stocks are moderate to heavy.
- Cheese East: Cheese production continues to be near capacity levels at many plants. Domestic demand for cheese has declined as many buyers reduce orders ahead of colleges and universities ending their spring terms next month.
- Cheese Midwest: Some regional manufacturers are quietly offering cheese to wholesalers, retailers or storage facilities, a bit below list prices. Many cheese manufacturers and cold storage operators believe that retail cheese sales remain sluggish due to a lack of robust retail price promotions. Cold storage facilities in Wisconsin and states close by, are full of cheese. "Snug" is a term used to describe inventory levels.
- Cheese West: Cheese production continues to be heavy as large volumes of milk are entering the marketplace. The market tone is mostly steady with barrels showing some weakness, while blocks are steady to firm. Inventories are manageable, but are building in many cases.
- International: Dairy Market News reports the European milk production season is off to a strong start, with milk volumes running 2.5-3% ahead of last year. In Eastern Europe, milk output is running as much as 9% stronger in many regions. Heavy milk volumes are arriving at manufacturing facilities and many operations are already challenged to handle the milk flow. In most instances, churns, dryers, and cheese vats are nearly maxed out on capacity and current output is far exceeding demand, thus clearances of manufactured dairy products to inventory programs are heavy. Traders and handlers are reporting that sales activity is occurring, but is slow as most buyers are cautious with their purchases and only procuring for near term needs.
- International: The Oceania milk production season continues to wind down, but remains positive for this time of the season, according to Dairy Market News. In New Zealand, end of season milk production projections are still running between 9-10% ahead of last season. In Australia, a positive end continues to be reported for the country and annual milk output is pegged around 4% ahead of last year.

Recommendation:

A lot of red ink again this week as dairy futures contemplate the heavy fundamental picture. Dairy Market News tells us Oceania cheese prices reached their lowest level since Q3 2009, international milk output is high and inventories are building in Europe and the U.S. is still awash with the white stuff. June milk touched a new contract low of $13.95 before bouncing off. All pretty bearish, right? Well, there are some encouraging signs. First, while processors across the country are running near capacity, we're starting to see reports of milk output leveling off. Hopefully the peak is in soon. With temperatures bound to be on the rise throughout most of the country over the coming 30-60 days, it should help slow the flow. Second, despite the bearish fundamental picture, multiple buyers in the spot market have stubbornly supported cheese in the $1.40's for barrels and $1.50's now for blocks. Why do this if not for anticipation of higher prices later? Third, cheese is moving and exports are solid. Fourth, dairy margins are very red right now and getting worse. Feed is expensive and getting more pricey. We don't see the deep equity to "hang on" as in years past. Fifth, dry whey on the weekly survey remains stubbornly high. Sixth, low prices cure low prices! The market does feel like it is coiling up to make a move. We could be dead wrong; if we break substantially lower in cheese, we will see a hard sell-off into the $13's and maybe the $12's. But if buyers continue to hold the spot market near current levels, in 30-60 days we'd expect higher prices in the 2nd half of the year. Our rec remains the same from last week. Only sell on a substantial rally, continue to lighten existing hedges, taking profits now. Look for opportunities to buy CALL options July-Dec to protect milk already sold or to use as selling targets at a later date.