

The KDM Dairy Report – May 4th, 2012

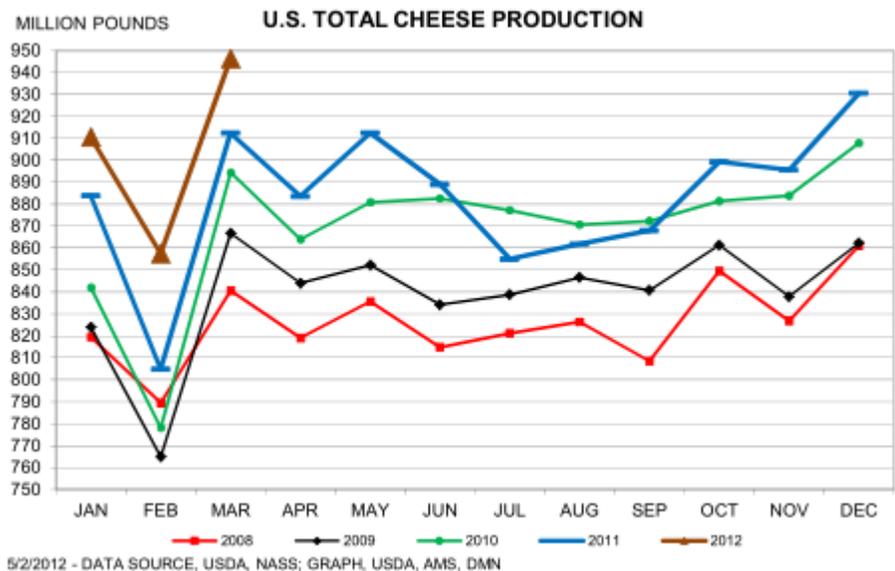
What's Bullish:

- Spot Market: Blocks settled unchanged for the week at \$1.53½/lb on just 8 trades. Barrels gained 3½¢ to close at \$1.47/lb on 14 sales. Butter lost 5¢ to settle at \$1.31/lb on 13 trades.
- Ag Prices Report: The April milk-feed ratio fell to 1.45, tying a record low set in June 2009. Higher feed prices and falling milk prices contributed to the decline and should signal contraction of the milk supply.
- Fluid Milk Southeast: Florida's milk production has begun to decline with smaller herd production declining more rapidly than larger herds. Heat and humidity are forecast for the coming week, which will degrade cow comfort levels. Severe drought conditions and wildfires continue to be a problem in the central and northern areas of the state. Spot loads of milk exported out of state this week totaled 190, down 10 loads from last week. Southeast milk production has moved past the peak of the spring flush. Class I demand increased this week lessening the number of loads going to auxiliary manufacturers.
- Fluid Milk Central: Milk handlers indicate they are having an easier job of finding homes for all the milk because of higher interest from some end users. They note that ice cream plants are pulling harder on milk supplies as the calendar indicates consumer interest should start building for ice cream and frozen novelty items. Initial reports indicate prices on spot loads of milk are moderately higher compared to last week. Cream supplies tightened somewhat this week. This, too, is also viewed as a result of the ice cream plants increasing production seasonally.
- Exports: Demand remains good, aided by export assistance sales. A number of plants are making 82% butter for export orders, and Cooperatives Working Together (CWT) has accepted 13 requests for export assistance to sell 866,417 lbs of Cheddar and Monterey Jack cheese and 1.57 million lbs of butter 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 46.9 million lbs in export cheese sales and 40.8 million lbs in export butter sales.

Futures Month	Class III 05/04	Class III 04/27	Change	Dry Whey 05/04	Dry Whey 04/27	Change	Cheese 05/04	Cheese 04/27	Change
May-12	\$15.10	\$14.88	\$0.22	53.50¢	53.50¢	0.00¢	\$1.504	\$1.491	\$0.013
Jun-12	\$14.09	\$14.20	(\$0.11)	43.50¢	44.00¢	(0.50¢)	\$1.464	\$1.475	(\$0.011)
Jul-12	\$14.18	\$14.70	(\$0.52)	40.50¢	42.25¢	(1.75¢)	\$1.487	\$1.538	(\$0.051)
Aug-12	\$14.71	\$15.35	(\$0.64)	40.25¢	42.03¢	(1.78¢)	\$1.552	\$1.608	(\$0.056)
Sep-12	\$15.31	\$15.88	(\$0.57)	41.00¢	42.03¢	(1.03¢)	\$1.610	\$1.660	(\$0.050)
Oct-12	\$15.41	\$16.05	(\$0.64)	41.50¢	42.00¢	(0.50¢)	\$1.630	\$1.672	(\$0.042)
Nov-12	\$15.50	\$15.94	(\$0.44)	41.50¢	41.50¢	0.00¢	\$1.622	\$1.672	(\$0.050)
Dec-12	\$15.39	\$15.73	(\$0.34)	41.00¢	41.25¢	(0.25¢)	\$1.626	\$1.660	(\$0.034)
Jan-13	\$15.40	\$15.61	(\$0.21)	41.00¢	41.00¢	0.00¢	\$1.650	\$1.663	(\$0.013)
Feb-13	\$15.43	\$15.70	(\$0.27)	39.00¢	39.00¢	0.00¢	\$1.652	\$1.714	(\$0.062)
Mar-13	\$15.60	\$15.84	(\$0.24)	37.90¢	37.90¢	0.00¢	\$1.694	\$1.750	(\$0.056)
Apr-13	\$15.84	\$16.10	(\$0.26)	37.95¢	37.95¢	0.00¢	\$1.724	\$1.760	(\$0.036)
12 Mo Avg	\$15.16	\$15.50	(\$0.33)	41.55¢	42.03¢	(0.48¢)	\$1.601	\$1.639	(\$0.037)

What's Bearish:

- Dairy Products Report: Cheddar cheese output in March was up 5.2% vs. a year ago, and up 8.7% from Feb. Total cheese output jumped 3.7% year over year, while butter production increased 6.4% over the same period.
- Most Class III components were lower in this week's National Dairy Product Sales Report. Butter decreased 1.3¢ to average \$1.43/lb and 40-lb block cheddar inched 0.2¢ lower to \$1.50/lb. 500-lb barrels were 0.1¢ higher to average \$1.49/lb, but dry whey lost 2¢ to 57.1¢/lb and nonfat dry milk decreased 2.4¢ to average \$1.22/lb.
- Dairy cow slaughter for the week ended 04/21 totaled 57,000 head, up from 55,900 a year ago, but the third consecutive week of falling slaughter numbers.
- Fluid Milk Northeast: Milk production in the Northeast has leveled off, but increases are expected as pastures grow more rapidly after recent snows and rains improved soil moisture conditions. Milk production in the Mid-Atlantic region increased this week after recent rains and warmer temperatures promoted good pasture growth. Manufacturing facilities in both regions continue to operate at near capacity levels.
- Fluid Milk West: California milk production trends are uneven across the state, but remain at higher than year ago levels in all areas. Milk base plan restrictions have helped some processors better manage processing and marketing of milk and products,



yet supplies are above current needs. Some cheese producers are pushing back milk supplies to better balance their production and holdings against trade needs. The current supply and demand environment is not conducive to finding a new home for extra milk in or around the state. Processors in Arizona and New Mexico continue to operate on moderate to heavy schedules, while Class I demand is flat. Western cream supplies remain heavy and continue to be hard to clear. Milk volumes in the Pacific Northwest continue to push manufacturing capacities in the region. The increased supplies are causing some cooperatives to rethink pricing strategies to members. Excess milk that is shipped out of the region is being discounted significantly in addition to added transportation costs.

- Butter: Prices continue to show weakness under heavy production schedules. Alternative uses for cream supplies are limited with the bulk of the supplies going to the churn. Retail sales of print butter are as expected, but the increased inventories of butter are overwhelming the demand. Often, buyers are hesitant and cautious with their orders as the cash prices ease. Most orders that are being placed are for short term or immediate needs.
- Dry Whey East: Cheese production remains at increased levels, due to heavy milk intakes, maintaining expanded dry whey production. Current production is adding to inventories, keeping downward pressure on prices. Demand remains at reduced levels as buyers are purchasing for immediate needs only. The market undertone remains weak.
- Dry Whey Central: Prices in the region were lower this week. With strong milk intakes into cooperatives and independent manufacturers with supply agreements, cheese and dry whey production are active.
- Dry Whey West: Prices were mostly unchanged this week, but spot market activity was slow. Increased milk supplies are finding their way to cheese plants. This is increasing the whey stream and adding to inventories.
- Cheese East: Milk intakes to cheese plants continue to keep production at near capacity levels. Domestic demand for cheese remains at seasonally lower levels as many colleges and universities will soon be ending their spring terms.
- Cheese Midwest: Lower than desired retail interest for cheese continued to frustrate a number of cheese manufacturers. This has led to some manufacturers making sales last week and this week, at lower than optimal prices, just to clear inventory. Manufacturer's beliefs that retailers are not working to advance retail cheese sales as much as hoped for, were affirmed by this week's Dairy Market News National Dairy Retail Report survey which found that total ads for cheese declined in number by 22% from two weeks ago.
- Cheese West: Cheese prices are uneven in the face of heavy production. Cheese factories continue to be offered additional volumes of milk for processing. Manufacturers are reluctant to add to inventories without seeing discounts in milk pricing. Recent price increases in blocks and barrels have added interest from cut and wrap buyers as well as process cheese manufacturers. Heavy production is tempering demand as some buyers feel that inventories will move prices lower.

Recommendation:

Another week of heavy losses, this time in Q3 contracts, as sellers become more convinced the oversupply of milk will last well into and through the summer. In addition to heavy output in the U.S., the EU and Oceania have strong production as well. Domestically, the Pacific Northwest appears to be the worst off in dealing with excess milk at this point, with the Northeast and Midwest still capable of producing a lot of milk before truly warmer weather (if we get any) arrives. Multiple buyers in the spot market continue to provide support for the market, but when there's any sign of weakness, futures seem to want to sell off hard. The July-Dec average made a new contract low this week, which is bearish. With heavy cheese output, as confirmed in this week's Dairy Products Report, a big question has to be what is the right price for dry whey. This week's price survey put it at 57¢, but June futures are at 43½¢. And is it possible that with heavy production and a market that is trending lower, could we see prices fall into the 30's? This is why making predictions is so difficult right now. Current spot prices work out to about \$15.15 Class III, but drop whey to 43½¢ and you get a little over \$14.50. Now drop it to 33¢ and we're at \$13.94. With June Class III settling today at \$14.09, a combination of falling whey and cheese prices appears to be the consensus. We see little opportunity for a price rally over the next 30-60 days, with it more likely that prices continue to grind lower. However, if buyers in the spot market are able to keep cheese prices above \$1.40 (\$64,000 question right now) and exports stay strong, we'd expect to eventually grind out our low and head higher. At this point, we'd hang on to any remaining hedges you have. In hindsight, we were probably too early to exit some of these. The July-Dec average is \$15.11. If this is a price you can live you and you have no coverage on at all, consider marketing some of your milk here. The oversupply situation is not going to be solved soon, giving us a negative bias going forward.

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