

**The KDM Dairy Report – May 11<sup>th</sup>, 2012**

**What's Bullish:**

- National Dairy Product Sales Report has 40-lb cheddar blocks up 1.4¢ from last week's survey, at \$1.52/lb. 500-lb barrels declined 0.7¢ to \$1.48/lb. Dry whey remains resilient, increasing 0.1¢ to average 57¢/lb. Butter lost 1.4¢ to average \$1.41/lb and nonfat dry milk inched 0.1¢ lower to \$1.22/lb.
- Fluid Milk East: Milk production in the Northeast and Mid-Atlantic regions has leveled off and indications are the two regions are at or near the seasonal peak, though manufacturing milk supplies remain heavy. Pastures in the Northeast are open as some producers were prompted to open their pastures due to dwindling feed supplies.

Futures Month	Class III 05/11	Class III 05/04	Change	Dry Whey 05/11	Dry Whey 05/04	Change	Cheese 05/11	Cheese 05/04	Change
May-12	\$15.26	\$15.10	\$0.16	55.75¢	53.50¢	2.25¢	\$1.513	\$1.504	\$0.009
Jun-12	\$14.89	\$14.09	\$0.80	51.25¢	43.50¢	7.75¢	\$1.495	\$1.464	\$0.031
Jul-12	\$14.89	\$14.18	\$0.71	48.00¢	40.50¢	7.50¢	\$1.513	\$1.487	\$0.026
Aug-12	\$15.22	\$14.71	\$0.51	46.00¢	40.25¢	5.75¢	\$1.560	\$1.552	\$0.008
Sep-12	\$15.55	\$15.31	\$0.24	44.00¢	41.00¢	3.00¢	\$1.619	\$1.610	\$0.009
Oct-12	\$15.59	\$15.41	\$0.18	44.00¢	41.50¢	2.50¢	\$1.630	\$1.630	\$0.000
Nov-12	\$15.70	\$15.50	\$0.20	43.00¢	41.50¢	1.50¢	\$1.625	\$1.622	\$0.003
Dec-12	\$15.68	\$15.39	\$0.29	43.50¢	41.00¢	2.50¢	\$1.635	\$1.626	\$0.009
Jan-13	\$15.53	\$15.40	\$0.13	41.00¢	41.00¢	0.00¢	\$1.650	\$1.650	\$0.000
Feb-13	\$15.50	\$15.43	\$0.07	39.00¢	39.00¢	0.00¢	\$1.652	\$1.652	\$0.000
Mar-13	\$15.65	\$15.60	\$0.05	37.90¢	37.90¢	0.00¢	\$1.685	\$1.694	(\$0.009)
Apr-13	\$15.65	\$15.84	(\$0.19)	37.95¢	37.95¢	0.00¢	\$1.715	\$1.724	(\$0.009)
<b>12 Mo Avg</b>	<b>\$15.43</b>	<b>\$15.16</b>	<b>\$0.26</b>	<b>44.28¢</b>	<b>41.55¢</b>	<b>2.73¢</b>	<b>\$1.608</b>	<b>\$1.601</b>	<b>\$0.006</b>

- Class I demand in the two regions is steady. Florida's milk production continues to decline as heat and drought conditions are taking their toll. Hay supplements are being fed due to the poor pasture conditions. Drought conditions are so severe in some areas that water ponds and wells have gone dry and producers are hauling water to cattle. Heat in the Southeast with temperatures in the mid 80's has brought about fairly significant declines in milk production, lessening the need to use auxiliary manufacturing plants. Increases in Class I demand have also helped reduce the manufacturing milk supplies. Ice cream production is beginning to increase as warmer weather covers much of the Southeast and Mid-Atlantic regions.
- Fluid Milk Central: Various milk handlers report their farm milk intakes are steady to dropping slightly for the week compared to the previous week. Some dairy farmers indicate hot weather in July of 2011 decreased conception rates and some cows did not breed back in that month. Many of those cows required additional AI/servicing attempts, and those lagging pregnancies are expected to foster a "mini flush" in June/July of this year. Component values are also starting a slow, seasonal decline. Spot milk availability in the Central region declined this week. Milk handlers point to increasing sales into Class II accounts as well as steady to higher intakes at a few powder plants which are ramping up production. Discounts on most milk spot loads diminished, with prices centering near flat Class for the week. Sales into ice cream and ice cream mix facilities increased for the week.
  - Fluid Milk West: Milk production in California remains uneven. The effects of base plans at the farm level and a processor backing off on milk purchases are influencing the amount of milk and where milk is being processed. With lower finished product prices, processors would rather not build inventories. Arizona milk production is trending lower, moving away from the recent seasonal peak. Processing plants continue to work on extended schedules to handle the milk supplies, but they are welcoming the drop in milk supply to help better manage finished product stocks. Temperatures are forecast to move towards the 100 degree mark. Milk production in the Pacific Northwest is reported to still be heavy, although this week showed some relief from excess production in the region.
  - Dry Whey East: Current production is expanding inventories keeping downward pressure on prices, however, demand for dry whey is marginally improving as ice cream and ice cream mix production is increasing. There is a sense among some in the industry that the recent downward price trends may be leveling off as milk production appears to be at the tipping point and may soon start to decline. Warmer weather patterns are hastening milk production declines in the Southeast and prompting expanded production schedules for ice cream and increased use of dry whey.
  - Dry Whey Central: Central dry whey prices on the mostly series are unchanged for the week. Some in the industry expressed the belief that some Central manufacturers' holdings moderated during the last few weeks and the pressure to clear inventories via spot sale price reductions may taper off in the near term. The availability of deeply discounted milk to Class III plants decreased from last week. Various cheese plant operators report they are now only using their contract-based supplies of milk. This is decreasing overall cheese production on a week to week basis, with a few plants shaving one day of production off the weekly schedule. Central dry whey inventories are steady at some plants and the pace of inventory accretion has decreased compared to a few weeks ago.
  - Dry Whey West: Western dry whey prices are mostly steady. The market continues to adjust to increased production of whey and whey concentrate products. Cheese plants are operating at higher than expected levels as excess milk continues to find its way to manufactured products. Demand for whey is good and buyers are looking for lower prices to fill any additional purchases above immediate needs. Export sales continue to help clear inventories from manufacturers with added supplies.
  - Cheese West: Western wholesale cheese prices firmed slightly last week, except for Swiss. Cheese manufacturers are careful to match available milk supplies to a softer trending market and hope to control inventories without overproducing. Export sales are helping to clear supplies with assistance from the CWT program again this week.
  - International: European whey powder markets and prices remain weak, but reports of firmer pricing in Eastern Europe are starting to develop. Some traders and handlers feel that a bottom to the recent price decline might be at hand. Currently supplies are tightening, while domestic and international buyer interest is keeping whey powder stocks in check.

**What's Bearish:**

- World Ag Supply & Demand Report: USDA lowered their 2012 Class III price forecast 30¢/cwt from last month, due to higher than expected milk output. They now expect Class III to average \$16.05.

- Dairy cow slaughter for the week ended 04/28 totaled just 52,700 head, the lowest weekly total since the first week of Jan and the 4<sup>th</sup> consecutive week of declining numbers.
- Presenters at the U.S. Dairy Export Council's spring meet predict swelling milk production and rising inventories will put downward pressure on dairy markets in the second half of 2012. Near perfect weather and previously strong prices have spurred milk production from the five major exporters (the European Union, United States, New Zealand, Australia and Argentina), which is up a collective 3% in the current production season.
- Butter: Butter producers and handlers are indicating that churning schedules are seasonally strong. Cream offerings to the churn remain plentiful. Many butter producers are stating that cream offerings are surpassing their capacity. Current churning is generating butter stocks that are outpacing demand, thus clearances to inventory are occurring. Butter demand is fair at best. Most orders being placed are for short term or immediate needs, with minimal longer term orders being negotiated and finalized. Cooperatives Working Together (CWT) continues to accept butter export assistance requests and during the week announced that they recently accepted requests totaling nearly 518,086 pounds (235 MT), the lightest weekly acceptances thus far this year.
- Nonfat Dry Milk: Pricing levels continue to move lower. The market undertone remains weak and untested in generally light trading. Many buyers are sitting on the sidelines in anticipation of further weaker pricing levels. Movements into export channels remain slow as those buyers have many choices of supply and pricing levels to choose. The resale market is also offering NDM at lower prices than several of the indices and providing an option for buyers. On the supply side, the amount of milk remains high and is keeping dryers full and causing inventories to build beyond projections.
- Cheese East: Milk volumes to cheese plants remain heavy as milk production is at or near its seasonal peak. Current cheese production is adding to inventories. Domestic demand for cheese remains at lower levels as many colleges and universities will soon be ending their spring terms. Export demand remains fairly good, aided by export assistance sales, but volumes going to export are declining.
- Cheese Midwest: Cheese demand overall has been soft, with reports of larger than desired cheese inventories throughout the region. Upper Midwest cheese manufacturers have noted milk moving from Class IV (butter/nonfat dry milk) into cheese production, driven more by milk seeking a home than cheese manufacturers scouring the region for more milk to manufacture more cheese. Continuing recent offers of surplus milk in the range of \$6 under Class III being offered to cheese plants, supports this notion. Coupled with global indications of increased milk production in the EU, Australia and New Zealand, this leaves a prevailing feeling of "bearish" cheese markets. There has been a feeling among some manufacturers that recent CME cash trading in cheese has generated prices not in tune with manufacturing-sales-retail realities
- International: The Oceania milk production season continues to run stronger than milk producers and handlers had previously projected for this time of the season. Milk volumes in both New Zealand and Australia are finishing the production year very positively. In New Zealand, milk output continues to run between 9-10% higher than last year at this time and is 4-5% higher in Australia. Late season milk volumes, thus additional manufactured dairy product stocks, are providing for some late season supply/demand cushioning and also additional volumes are being offered at the Global Dairy Trading auction.
- International: The European milk production season is nearing peak levels, which are arriving or have arrived earlier than usual. Although temperatures have been cool, grass growth is very lush and plentiful. Heavy milk volumes are providing plenty of milk for manufacturing facilities to handle. In most instances, manufacturing capacities are at maximum levels, thus additional milk volumes will be challenging to process. Stocks of manufactured dairy products in Europe are heavy.

#### Recommendation:

While we're not out of the woods yet, it appears more likely that we've put in a bottom on milk prices. We're definitely past peak production now in nearly every part of the country and heat is moving into the South and Southwest. The next few weeks could be critical as schools close and Class I demand falls, but it also signals the start of grilling season. The supply side is still bearish, but technically, Dry Whey futures broke a longstanding downward trend line (see chart) and Class III had a very strong day today. As we've discussed the previous few weeks, we would lean back towards lifting existing hedges and taking profits now. Consider also buying call options in the 2<sup>nd</sup> half of the year to protect existing hedges or to use as price points to sell in to. The July-Dec 1750 calls averaged about 30¢ each. That's maybe not a bad place to start.



Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.