

**The KDM Dairy Report – May 18<sup>th</sup>, 2012**

**What's Bullish:**

- Milk Production Report: April milk output was up 3.2% vs. a year ago and cow numbers increased 5,000 head from March. While these are bearish numbers, most analysts had expected close to a 4% increase and higher cow numbers. The report is likely neutral to a little friendly to Class III futures.
- Spot Market: Blocks were unchanged for the week at \$1.50/lb with just 1 trade, while barrels increased a penny to \$1.46/lb on just one trade. Butter gained 3½¢ to settle at \$1.35½/lb on 7 trades.
- Cheese prices were higher in this week's AMS price survey. 40-lb blocks increased 1¢ to average \$1.53/lb while 500-lb barrels were \$1.49/lb, up a penny.

Futures Month	Class III 05/18	Class III 05/11	Change	Dry Whey 05/18	Dry Whey 05/11	Change	Cheese 05/18	Cheese 05/11	Change
May-12	\$15.17	\$15.26	(\$0.09)	53.50¢	55.75¢	(2.25¢)	\$1.513	\$1.513	\$0.000
Jun-12	\$15.39	\$14.89	\$0.50	50.13¢	51.25¢	(1.13¢)	\$1.551	\$1.495	\$0.056
Jul-12	\$15.26	\$14.89	\$0.37	47.98¢	48.00¢	(0.02¢)	\$1.556	\$1.513	\$0.043
Aug-12	\$15.45	\$15.22	\$0.23	46.00¢	46.00¢	0.00¢	\$1.579	\$1.560	\$0.019
Sep-12	\$15.85	\$15.55	\$0.30	46.00¢	44.00¢	2.00¢	\$1.620	\$1.619	\$0.001
Oct-12	\$15.90	\$15.59	\$0.31	45.00¢	44.00¢	1.00¢	\$1.643	\$1.630	\$0.013
Nov-12	\$15.89	\$15.70	\$0.19	43.00¢	43.00¢	0.00¢	\$1.655	\$1.625	\$0.030
Dec-12	\$15.79	\$15.68	\$0.11	43.50¢	43.50¢	0.00¢	\$1.652	\$1.635	\$0.017
Jan-13	\$15.59	\$15.53	\$0.06	41.00¢	41.00¢	0.00¢	\$1.650	\$1.650	\$0.000
Feb-13	\$15.45	\$15.50	(\$0.05)	40.50¢	39.00¢	1.50¢	\$1.645	\$1.652	(\$0.007)
Mar-13	\$15.55	\$15.65	(\$0.10)	39.50¢	37.90¢	1.60¢	\$1.660	\$1.685	(\$0.025)
Apr-13	\$15.51	\$15.65	(\$0.14)	38.50¢	37.95¢	0.55¢	\$1.680	\$1.715	(\$0.035)
<b>12 Mo Avg</b>	<b>\$15.57</b>	<b>\$15.43</b>	<b>\$0.14</b>	<b>44.55¢</b>	<b>44.28¢</b>	<b>0.27¢</b>	<b>\$1.617</b>	<b>\$1.608</b>	<b>\$0.009</b>

- Dairy cow slaughter for the week ended 05/05 totaled 55,800 head, up 2,400 head from a year ago. The increase broke a string of 4 consecutive weeks of lower slaughter numbers.
- Fluid Milk East: Milk production has leveled off in the Northeast and is marginally declining in the Mid-Atlantic region. Some milk loads are being shipped to the South as milk production declines in that region. The fear of there being too much milk is beginning to subside, but manufacturers are bracing for heavy volumes when schools close. A major dairy cooperative in the Northeast is imposing a temporary price cut this month in payments to producers, because of the heavy milk volumes experienced since the beginning of the year. Florida's milk production is declining at a faster pace as higher temperatures and humidity levels are combining to decrease cow comfort levels. Drought conditions remain severe in all dairy producing areas. Class I demand remains good. Spot loads of milk exported out of state this week totaled 180, down from a revised 220 last week. Increased heat and humidity in the Southeast has also brought about declines in milk production. Only a few auxiliary manufacturing plants are being used to handle the milk supply. Class I demand remains fairly strong for this time of year. The cream market is in transition with supplies declining and demand increasing. Ice cream and ice cream mix production are expanding as increased retail ice cream features are coinciding with warmer weather patterns, resulting in good sales activity.
- Fluid Milk Central: Fluid milk demand in the Central region is steady to notching lower seasonally. Milk haulers in some areas describe decreasing on-farm pickup volumes as the month advances, while other North Central haulers expect pickup volumes to peak by the end of the month. Spot milk pricing centers around flat Class, as milk tightens regionally and across regional boundaries. A few spot milk sales garnered \$ .50 - \$1.00 above Class.
- Fluid Milk West: California milk production is trending steady, and the general consensus is that the peak may have passed and the current high level will maintain for a while. The implementation of penalties for milk produced over milk bases and incentives to depopulate have resulted in changes that have affected milk output in the state. With lower milk prices and high feed prices, changes have also been made in rations that are affecting milk output. Processing plants continue to run on heavy schedule to handle the current milk supplies, however. Arizona milk production is being impacted by hot weather conditions, as temperatures are topping 100 degrees. New Mexico milk output is off slightly from recent levels. Heat and milk prices are thought to be two factors in the change. Spot shipments of milk to other areas are minimal. Cream markets are steady to firm, and trading levels at the bottom end of the market have tightened up. There is less surplus and distressed cream available. Milk production in the Pacific Northwest continues to be above year ago levels, but handlers report that supplies have leveled off. Recent impositions of quotas and discounts for overproduction by some coops are having their desired effects. Some excess milk solids are being moved out of the region, but supplies are said to be more manageable.
- Butter: Prices firmed this week. Cream supplies remain ample with significant volumes going to churns, but not as much as in recent weeks, due to increased cream demand. Print sales into retail markets have improved, and some plants are making 82% butter to fill export orders.
- Dry Whey East: Production has declined as milk volumes going to cheese production decreased. Current dry whey supplies are moving through contracts with only minimal amounts being added to inventories. Current inventories are in much better balance, compared to recent weeks as contracted load pickups have been more on schedule. Demand for dry whey is improving as ice cream production is significantly increasing. There is a feeling among contacts that the recent downward price trends are leveling off as milk production is beginning to decline and reducing cheese and dry whey production.
- Dry Whey West: Prices are currently in a two tier structure with domestic and export prices. Domestic prices are exhibiting a steady to firmer undertone as supplies are said to be tightening up. Export sales are steady and typically below domestic prices to remain competitive. Whey stream supplies are increasingly being channeled into higher protein concentrated products.
- Nonfat Dry Milk: Although there are lower prices working through the system and the indices, there are indications/hopes that for the spot market, the bottom price levels may be maintaining. A tender in the world market is being filled, clearing substantial quantities of U.S. NDM. That information along with milk production in most of the country entering the seasonal post-flush descent established some light support for the NDM market. Other sales have committed other producers for the short term. There are still holdings and stocks available, yet those levels are lower.
- Cheese East: Milk production is past the peak in the East, which is lessening milk volumes being channeled to cheese plants and as a result cheese production has declined. However, cheese inventories are continuing to expand as demand remains fairly weak. Domestic demand for

cheese remains fairly weak, but retailers have increased their promotional efforts and features of 8 ounce blocks and shredded packages, hoping to increase sales. Export demand continues to be good, aided by export assistance sales.

- Cheese West: Production schedules are considered heavy as milk supplies are ending up at manufacturing plants. However, milk supplies are said to be leveling off, and retail featuring at the grocery level has helped to move some of the increased production. Inventories are large but most plants are comfortable with current stocks. Export sales are good and CWT assistance continues to aid in making sales.

#### What's Bearish:

- Livestock, Dairy & Poultry Outlook Report: USDA lowered their 2012 Class III price forecast 30¢/cwt from last month, expecting milk to average \$16.05. Despite weakening returns, higher than expected cow numbers indicate producers are not reducing herds as quickly as expected. In addition, weaker than expected domestic demand led to lowering of price forecasts for other major dairy products, except whey.
- With the exception of cheese, all other Class III components were lower in this week's AMS price survey. Butter lost 3.9¢ to average \$1.38/lb, dry whey gave up 3.7¢ to 53¢/lb and nonfat dry milk fell 7¢ to average \$1.15/lb.
- Dairy Market News reports packaged fluid milk sales in March 2012 were 3.6% lower than March 2011.
- Weekly cold storage numbers indicate butter stocks are up 7% and cheese stocks are up 1% at USDA selected storage centers over the period 05/01 through 05/14.
- Butter: Production schedules remain heavy as cream continues to find its way to the butter churn. Butter inventories continue to build with manufacturers content to put more product into storage. Many butter producers are preparing for the upcoming Memorial Day holiday weekend, but question how much additional cream that they will be able to process when they are already running at or very near capacity levels. Current butter demand is fair at best.
- Cheese Midwest: There are signs that milk production has peaked in many areas. However, the fact remains that there is still a lot of milk flowing through the dairy system. Some manufacturers are adding nonfat dry milk during cheese production to increase yields. While some extra loads have been manufactured to meet demand for natural cheese, lower bulk cheese interest has led to slightly reduced manufacturing schedules for that category. There remains concern with the sluggish sales and higher inventory/storage aspects of cheese.
- International: Dairy prices fell to their lowest levels in 3 years during this week's Global Dairy Trade Auction. The overall price index fell 6.4% from just two weeks ago, led by an 11.9% drop in anhydrous milk fat and an 8.9% decline in whole milk powder. Cheddar cheese fell 0.2% to a US equivalent \$1.30/lb. Blame is placed on a global milk supply glut as milk production soared in Oceania, while a tame winter and herd expansion increased output in the U.S. and European Union.
- International: March cheddar cheese output in Australia was up 6.1% compared to a year ago and up 4.1% for the current production year, according to Dairy Australia. Better than expected, late-season output has allowed for additional manufacturing milk supplies.

#### Recommendation:

Milk production and cow numbers came in below expectations. The dry whey market appears to be firming as inventories tighten slightly. In the spot market, sellers have been mostly silent. Ice cream production is on the increase, temps are rising and cream is starting to tighten across the country. Milk receipts have peaked. We'll repeat the mantra that "we're not out of the woods yet", by any stretch, yet the factors above should work to limit further dramatic downside. While we are past the peak, production is still holding at high levels in many parts of the country, and will likely do so for several more weeks before we see any meaningful reductions. All the same, futures prices this week showed more signs of putting in a bottom. On the flip side, we'd warn against expecting \$20 milk any time soon either. The macro picture does not look good for commodities in general. A default by Greece looks increasingly likely, which has huge implications for the other euro-zone countries. The USD has been steading rising vs. the euro, Aussie dollar and New Zealand dollar over the past two weeks. Should it break-out to the upside, commodity prices across the board would likely fall. A strong dollar will make our powder and cheese exports non-competitive compared to the euro-zone. Consider the following sell targets should prices continue to strengthen: June 15.77, July 15.70 and 15.95, Aug 15.80 and 16.10. Or, consider the July-Dec avg currently at 15.65. Enter orders to sell up to 10% of your production at 15.95 avg and another 10% at 16.20.

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