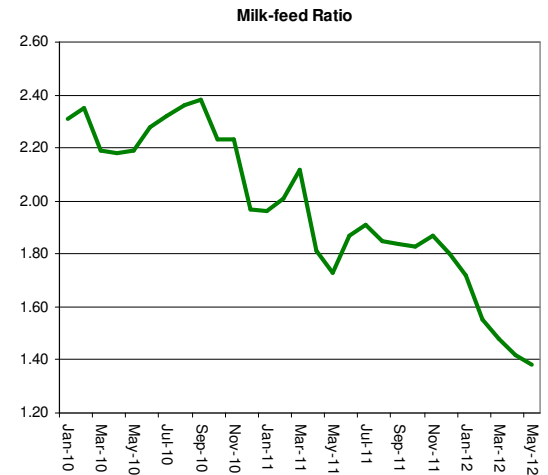


The KDM Dairy Report – Jun 1st, 2012

What's Bullish:

- Spot Market: Blocks rallied 8¢ on the week to close at \$1.65/lb with just 2 trades for the week. Barrels managed a 6¼¢ gain to settle at \$1.53¼/lb with 4 trades exchanging hands. Butter increased 1¼¢ to \$1.40/lb, while Grade A NDM was bid 3¼¢ higher to \$1.18¼/lb. 6 loads of butter and 11 loads of NDM exchanged hands.
- Ag Prices Report: The milk-feed ratio for May is 1.38, a new all-time low. A ratio below 3.0 is generally thought to inhibit herd expansion and milk production growth.
- Outlook for U.S. Ag Trade Report: USDA increased their dairy export forecast by \$300 million on stronger global demand and larger exportable supplies. Fiscal 2012 dairy exports are now expected to total \$4.7 billion, up from \$4.4 billion in their last forecast in February.
- Fluid Milk East: As is typical of a holiday weekend, manufacturing milk supplies increased in the Northeast and Mid-Atlantic regions. Class I demand is declining as numerous schools in both regions are ending their spring terms. However, milk production has leveled off in the Northeast and is declining in the Mid-Atlantic region. Dairy manufacturers are concerned about their future milk supplies as they look to the fall. In Florida, milk production is declining at a faster rate as temperatures and humidity levels are increasing across the state. The July-like heat over the Memorial Day holiday has increased the frequency of load rejections due to unacceptable temperatures. Demand for cream is at increased levels as ice cream and ice cream mix production have increased significantly. Some cream cheese manufacturers are also contributing to the increase in cream demand by purchasing an extra load here and there.
- Fluid Milk Northwest: Milk production in the region has leveled out with some handlers feeling the spring flush of milk has already happened. A combination of coops trying to limit production with quotas and farmers wanting to reduce feed costs has slowed milk production. Milk supplies are said to be currently manageable with some milk still moving out of the region. Utah and Idaho milk supplies are at expected levels. Milk processors are able to handle current supplies. Some plants are reporting reduced milk solid yields.
- Butter Northeast: Domestic demand remains fairly good from food service and retail outlets. Most butter manufacturers in the East are very comfortable with their current inventories. Export demand remains active.
- Butter Central: Butter producers and handlers are indicating that the expected heavier volumes of surplus cream during the past Memorial Day holiday weekend did not develop as heavily as projected. It appears that some Class II ice cream manufacturers continued to absorb regular cream volumes for ice cream needs through the weekend. Some ice cream producers are indicating that the ice cream season got off to a faster and earlier pace than is typical. Food service orders are picking up, especially in resort and vacation areas of the Midwest.
- Butter West: Western butter prices are steady to firm. Butter production levels are remaining at a high level with some excess production ending up as inventory, but more manufacturing demand reentered the market. Print sales are reported good as retail and club sales are moving increased amounts of butter.
- Dry Whey East: Production increased marginally as some cheese plants increased output over the holiday period. However, demand for dry whey has improved as ice cream production has increased. Some manufacturers are becoming more comfortable with their current inventory levels after recent multiple load sales. The improved supply situation has prompted some manufacturers to lessen their discounts on spot sales. There is the feeling by some in the industry that excess supplies are declining fairly fast.
- Dry Whey Central: Many market participants in the region indicate interest in dry whey is resurfacing. Some end users who pushed back F.O.B. dry whey loads or worked with their suppliers to stem the arrival of contract shipments are once again

Futures Month	Class III 06/01	Class III 05/25	Change	Dry Whey 06/01	Dry Whey 05/25	Change	Cheese 06/01	Cheese 05/25	Change
Jun-12	\$15.62	\$15.80	(\$0.18)	50.75¢	51.00¢	(0.25¢)	\$1.563	\$1.584	(\$0.021)
Jul-12	\$15.93	\$16.35	(\$0.42)	49.60¢	50.50¢	(0.90¢)	\$1.608	\$1.645	(\$0.037)
Aug-12	\$15.80	\$16.23	(\$0.43)	47.50¢	47.60¢	(0.10¢)	\$1.618	\$1.660	(\$0.042)
Sep-12	\$15.98	\$16.20	(\$0.22)	46.70¢	46.00¢	0.70¢	\$1.649	\$1.660	(\$0.011)
Oct-12	\$16.12	\$16.12	\$0.00	45.75¢	45.00¢	0.75¢	\$1.670	\$1.665	\$0.005
Nov-12	\$16.00	\$15.97	\$0.03	45.00¢	45.50¢	(0.50¢)	\$1.664	\$1.645	\$0.019
Dec-12	\$15.95	\$15.90	\$0.05	43.50¢	44.00¢	(0.50¢)	\$1.667	\$1.655	\$0.012
Jan-13	\$15.96	\$15.90	\$0.06	42.50¢	41.00¢	1.50¢	\$1.670	\$1.655	\$0.015
Feb-13	\$15.58	\$15.59	(\$0.01)	40.00¢	40.50¢	(0.50¢)	\$1.645	\$1.645	\$0.000
Mar-13	\$15.69	\$15.64	\$0.05	39.50¢	39.50¢	0.00¢	\$1.660	\$1.660	\$0.000
Apr-13	\$15.88	\$15.65	\$0.23	38.50¢	38.50¢	0.00¢	\$1.680	\$1.680	\$0.000
May-13	\$16.15	\$15.95	\$0.20	38.00¢	38.00¢	0.00¢	\$1.713	\$1.713	\$0.000
12 Mo Avg	\$15.89	\$15.94	(\$0.05)	43.94¢	43.93¢	0.02¢	\$1.651	\$1.656	(\$0.005)



accepting dry whey loads on schedule because their inventories have dwindled. Resellers indicate their sales to customers now incorporate market plus premium pricing.

- Dry Whey West: Production of higher concentrated whey protein products continues to limit increases in whey manufacturing. Supplies of whey are adequate for current needs with additional product available in the resale market. Export sales are reported to be good.
- Nonfat Dry Milk: Nonfat dry milk prices moved significantly higher on the low end of the range as inventories are becoming more balanced. An increase in manufacturing milk supplies over the holiday weekend channeled increased volumes to dryers. The increase in nonfat dry milk production is adding to supplies, however, most manufacturers are very comfortable with their current inventories and are not inclined to offer price discounts.
- Cheese East: Milk supplies were readily available over the holiday period and some cheese plants marginally increased production to take care of their milk supply. However, Eastern inventories are not considered to be burdensome by most cheese makers. Concern remains regarding fluid milk availability in the fall and decisions will need to be made soon whether to increase inventories or rely on fall milk supplies.
- Cheese West: Western cheese manufacturers were busy over the Memorial Day weekend with some additional milk supplies. However, cheese inventories are not considered burdensome. Demand is good into retail outlets, especially where featured. CWT assistance is being used to move some cheese into international markets.
- International: Despite the large number of dairy heifers being exported to China, demand for Australian dairy product is expected to remain strong. Rabobank dairy analyst Michael Harvey said the increasing gap between Chinese milk production and consumer demand would remain for some years. This was despite fears that China might become a dairy exporter rather than importer. Mr Harvey told farmers at a meeting in Tangambalanga recently that the Chinese market needed 9% more milk each year over the next five years.

What's Bearish:

- Most Class III components were lower in this week's Nation Dairy Products Sales Report. Butter increased 1¢ to average \$1.35/lb, but dry whey gave back 1.8¢ to 52.4¢/lb and nonfat dry milk lost 1.3¢ to average \$1.13/lb. 500-lb cheddar barrels increased 0.5¢ to average \$1.49/lb, but 40-lb blocks decreased 0.6¢ to \$1.52/lb.
- Fluid Milk Central: Farm milk intakes at many locations in the Central region are steady to modestly lower for the week. Despite daytime temperatures above 90 degrees in many areas of the Central region, cow comfort reportedly suffered very little and farm milk pickups were just slightly lower due to seasonality rather than cow distress. The decreases in farm milk intakes have not lessened Class II/III/IV manufacturing, though, according to many milk processors. Manufacturing milk was readily available throughout the extended weekend because some end user plants closed for 1 - 3 days, freeing up many loads of milk. Also, because of bottled milk demand trending lower due to school closures, manufacturers benefited from the push back from those facilities. With slowing fluid milk demand, the availability of spot loads of milk is growing compared to the previous week. The push toward Class plus pricing on spot loads lost momentum this week as bottled milk demand slowed.
- Fluid Milk West: California milk production is trending lower, but total volumes remain at seasonal high levels. Processing plants were working at capacity levels to handle the milk supplies. April 2012 pool receipts of milk in California totaled 3.53 billion pounds, 4.7% higher than last year. In Arizona, milk output is trending lower, but weather conditions have cooled and cow stress levels are lower. Processing plants were running on extended schedules to handle local and other milk and components over the holiday weekend.
- Cheese Midwest: Milk remains readily available to cheesemakers for at least two reasons. First, some milk is being pushed back from bottlers, with fewer "class plus" milk sales being made. Secondly, milk volume being diverted from nonfat dry milk, into cheese manufacturing, is increasing in the region. Slow sales of mozzarella have caused some multiple plant manufacturers to shift milk into cheddar plants away from mozzarella plants.
- International: April milk production in Australia jumped 7.7% compared to a year ago, and was up 4.3% vs. the previous milking season, according to Dairy Australia. April cheddar cheese output increased 7.1% over last April, while total cheese output was 1% higher over the same period. Finally, butter production registered a 15.9% gain vs. April 2011.

Recommendation:

Despite a cash market showing some strength, Q3 Class III finished the week with a substantial loss. The combination of substantial milk output with declining outside markets (energy, grains, metals, stock market, etc.) and the uncertainty in Europe (the euro made new multiyear lows this week, with the USD strongly higher) hasn't won over any believers. The block-barrel spread in the spot market is up to 11¼¢, with barrels having a hard time following the lead of blocks. On the positive side, the dry whey market is showing some good strength with supplies tightening up, ice cream output is picking up and even cheese inventories are looking in better shape. All that spells for a more volatile market next week. We would focus on protecting Q3 with either PUT options or fence trades. Call us next week for quotes on specific options. Hang on!!

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