

The KDM Dairy Report – Jun 8th, 2012

What's Bullish:

- Dairy prices in Fonterra's twice-monthly Global Dairy Trade auction jumped an average 13.5% from the prior auction just two weeks earlier. Anhydrous milk fat shot up 24.4%, followed by skim milk powder up 21.3%. Cheddar prices increased 9.4%.
- Dairy cow slaughter for the week ended 05/16 totaled 57,100 head, up 4,600 head from a year ago. YTD slaughter is at 1.31 million head, up 30,000 head from a year ago.
- Fluid Milk East: Throughout the East

Futures Month	Class III 06/08	Class III 06/01	Change	Dry Whey 06/08	Dry Whey 06/01	Change	Cheese 06/08	Cheese 06/01	Change
Jun-12	\$15.55	\$15.62	(\$0.07)	51.50¢	50.75¢	0.75¢	\$1.557	\$1.563	(\$0.006)
Jul-12	\$16.45	\$15.93	\$0.52	52.78¢	49.60¢	3.18¢	\$1.635	\$1.608	\$0.027
Aug-12	\$16.60	\$15.80	\$0.80	52.50¢	47.50¢	5.00¢	\$1.667	\$1.618	\$0.049
Sep-12	\$16.69	\$15.98	\$0.71	52.00¢	46.70¢	5.30¢	\$1.675	\$1.649	\$0.026
Oct-12	\$16.60	\$16.12	\$0.48	51.00¢	45.75¢	5.25¢	\$1.677	\$1.670	\$0.007
Nov-12	\$16.47	\$16.00	\$0.47	50.48¢	45.00¢	5.48¢	\$1.685	\$1.664	\$0.021
Dec-12	\$16.35	\$15.95	\$0.40	48.00¢	43.50¢	4.50¢	\$1.673	\$1.667	\$0.006
Jan-13	\$16.15	\$15.96	\$0.19	43.00¢	42.50¢	0.50¢	\$1.670	\$1.670	\$0.000
Feb-13	\$15.84	\$15.58	\$0.26	40.00¢	40.00¢	0.00¢	\$1.665	\$1.645	\$0.020
Mar-13	\$15.85	\$15.69	\$0.16	39.50¢	39.50¢	0.00¢	\$1.665	\$1.660	\$0.005
Apr-13	\$15.91	\$15.88	\$0.03	38.50¢	38.50¢	0.00¢	\$1.680	\$1.680	\$0.000
May-13	\$16.16	\$16.15	\$0.01	38.00¢	38.00¢	0.00¢	\$1.713	\$1.713	\$0.000
12 Mo Avg	\$16.22	\$15.89	\$0.33	46.44¢	43.94¢	2.50¢	\$1.664	\$1.651	\$0.013

- from the Mid-Atlantic States south, there are reports of milk truck load sizes dropping. "Tightening" is the characterization of milk supplies in this area where heat is beginning to have an impact. Florida has been in the 90's during the day and 70's at night, leading to production dropping at the farm level. This has contributed to shipments out of the state declining by 20 since last week. Manufacturing activity in mid to southern areas is slower this week, with less milk to deal with. Some mid-Atlantic plants have ceased drying and churning and are using available milk to meet obligations for condensed milk sales. Resumption of drying and/or churning is not expected until around November. Cream supplies are tightening. Less cream from milk standardization coupled with increasing demand for cream cheese pre-production looking toward fall, as well as continuing ice cream manufacturing are factors. Yogurt manufacturing in the Northeast is robust and milk plants report that milk sales for yogurt remain active and growing.
- Fluid Milk Central: Several cheese plant operators indicated their patron milk intakes are steadily decreasing and spot loads are unobtainable, even with price premiums tacked on as an inducement. Most milk handlers view this as the end result of localized weather-related breeding complications that took place during the summer of 2011. Sales into Class II operations are steady to higher, with dips and sour cream production increasing strongly.
- Fluid Milk West: Arizona milk production took a hit with the recent heat wave pushing daytime highs over 110 degrees last weekend. Conditions have moderated with temperatures in the 90's and milk cows are under less stress. Production has rebounded slightly. Plants are running well to handle the current milk supplies. There appears to be stronger pulls from retail fluid customers who are promoting milk in ads. Western cream markets are steady to slightly firmer. School accounts milk needs have declined sharply and there is less standardized cream available. There have been incremental demand improvements for cream from ice cream accounts both in and out of the region. In the Pacific Northwest, milk output seems to be on a plateau. This is likely due to some supply controls, less of a prominent spring flush, and poor margins impacting feeding rations. Less milk has to move to find processing capacity.
- Dry Whey Central: Prices are unchanged as the market seems to be finding support for current pricing levels. Sales activity is reportedly more active, especially into some East Asian markets. Various cheese/dry whey manufacturers indicate seasonally lower patron milk intakes are decreasing weekly output of those products. Availability of spot loads of milk to Class III is tighter, offering fewer opportunities to run cheese vats at weekly capacities.
- Dry Whey West: Producers seem to be more comfortable with stock levels at this time. Export sales are definitely helping this trend. Production levels are also backing off some as patron milk supplies are beginning to ease lower seasonally along with component tests. Some whey supplies continue to be shifted into production of higher protein whey products.
- Butter: Cream supplies are sufficient to maintain near capacity or capacity schedules, but the surplus volumes of recent weeks have declined. Class II operations, especially ice cream producers, are absorbing increasing volumes of available cream as ice cream and mix production attains summer levels. Current churning schedules are generating sufficient volumes of print and bulk butter for needs with some volumes clearing to inventory, but inventory clearances are lighter. Domestic butter demand is good, stimulated by scattered retail features as low as \$0.99 per pound. Food service orders are steady at good levels as restaurants and food service outlets prepare for the summer vacation season.
- Nonfat Dry Milk: Prices are trending higher. In the past couple of weeks, nearby powder has been committed and this has tightened up current offering volumes. Some buyers are looking for coverage after missing the recent market lows. In the Eastern region, high heat prices also increased at both ends of the range, with some manufacturers now being sold out and other manufacturers having tight supplies. Low heat NDM is more available than high, but some plants have reduced drying to less than five days a week. The seasonal easing of milk production is reducing milk available to be dried. With NDM prices having trended lower much of the year until recent weeks, the trend reversal has caused more "possible" buyers to become "actual" buyers as the feeling sets in that renewed market strength may be with us in the immediate future.

- Cheese Midwest: Milk flowing to regional cheese plants is steady to slightly lower in most locations. Discounted milk seems to have faded away and in some instances, milk brokers are receiving slight premiums for loads to some plants. Cheese inventories are deemed "decent" by a number of manufacturers. Cooperatives Working Together (CWT) has accepted requests for export assistance to sell a total of 1.938 million lbs (879 metric tons) of Cheddar and Monterey Jack cheese to customers in Asia, North Africa and the Middle East. The product will be delivered June through November 2012.
- Cheese West: Suppliers indicate that offerings of current cheese are relatively tight. Some are still surprised at the gyrations at the CME Group in recent days. Export sales remain relatively good and this fact continues to help the market.
- International: For the most part, Western European milk production has peaked and declines of varying rates are being reported. Overall milk production in Western Europe is reported to be slightly ahead of last year at this time, but not significantly. Traders and handlers are stating that producer stocks are in close balance with needs and they are comfortable with this situation. Currently, stocks are basically committed with sourcing potential needs challenging for some traders. Dairy products prices are starting to show more signs of strength and buyers, especially international buyers, are returning to the marketplace for their needs.
- International: For the most part, the Oceania milk production season is finished. Traders and handlers are indicating that buyer interest is limited as buyers are fully aware of limited offerings at this time. Traders do indicate that commitments for the upcoming third quarter of the year are well in place and order books are starting to be filled. They also report that overall commercial pricing is starting to show signs of strength, and that this firmness will once again re-energize buyer interest. Traders and handlers were also projecting firmer g/DT prices since all contracting periods will be in the new milk production season which resumes July 1.

What's Bearish:

- Spot Market: Blocks lost 3½¢ for the week, settling at \$1.61½/lb on 7 trades. Barrels fell a penny to \$1.52¼/lb on 5 trades. Butter gained 1¼¢ to settle at \$1.41¼/lb and Grade A NDM increased 2½¢ to \$1.21/lb.
- Dry Whey East: Prices moved down at each end of the range. Some buyers this week only bought as much whey as they needed for now and plan to purchase on a weekly basis in the immediate future due to a feeling that the market has some weakness.
- Fluid Milk West: California milk output remains strong at near peak levels. Production limits, base plans, sell offs, and optimizations have led to more moderate growth for the milk supply in the state, but conditions are conducive to the milk flow. Some local areas are seeing a boost due to feeding of new crop feedstuffs. Lower milk prices and relatively high feed costs remain big concerns for dairy producers in the state. Processing plants are running on heavy schedules but have space. They hope the worst is over. Cheese plants are taking some additional down days and therefore more milk is staying in the butter/powder plants for processing. New Mexico milk production patterns are steady to slightly lower and are at or above year ago levels. Dry conditions are prevalent across the state but temperatures are manageable for dairy cows with heat abatement and other measures in place. Processing plants are running on heavy schedules to handle the incoming milk supplies. More milk is moving into manufacturing as fluid needs are lower with more schools and colleges now off for the duration.
- Cheese East: No changes in the milk supply available for cheese manufacturing, cheese sales from plants, or cheese inventory levels could be identified by manufacturers as factors leading to the magnitude of CME price movement, either up or down. One manufacturer attributed matters to the adage "perception turns into reality".
- An article in Agrimoney this week cautions against expectations of a sustained recovery in dairy prices. Analysts at Rabobank say demand still has not caught up with production and that it may be a few months before market tightening will take effect.

Recommendation:

Despite a weekly loss in spot cheese prices, Class III futures were sharply higher, especially in the Q3 months. The initial move happened on Tuesday, when the results from the Global Dairy Trade auction showed a 13.5% increase from just 2 weeks ago. Domestically, we're suddenly in a situation where our weakest components, butter and powder, are suddenly starting to show some strength. Cream supplies are tightening as ice cream production increases and standardized cream supplies decrease due to reduced fluid consumption from schools. Dry whey futures were sharply higher for the week, and even nonfat dry milk prices showed some strength. Cheese supplies remain in question with the volatile spot market (up and down this week), but the update from the West indicated current supplies were tightening. Warm weather has hit the Midwest, with temps in the mid 80's to 90's forecast for the next 5-10 days. Tankers are getting lighter. We're not calling for an all-out rally straight to \$20, but the market does appear to have been repressed long enough and is showing signs of moving from a bear to a bull trend, at least medium term. Producers looking to get coverage on their production should start eyeing the \$17.00 number July-Sep, or \$16.75 July-Dec. Alternatively, if we get futures that high, the \$16.00 x \$18.00 fence (min/max) should become quite inexpensive. Or, just look for \$15.00 PUT options and get a floor under your production! We called for more volatility, and it appears we have it. Expect more of the same next week!

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