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The KDM Dairy Report – Jun 22nd, 2012

What's Bullish:

Futures Month	Class III 06/22	Class III 06/15	Change	Dry Whey 06/22	Dry Whey 06/15	Change	Cheese 06/22	Cheese 06/15	Change
Jun-12	$15.67	$15.61	$0.06	50.50¢	50.00¢	0.50¢	$1.577	$1.570	$0.007
Jul-12	$16.66	$16.18	$0.48	51.05¢	51.30¢	(0.25¢)	$1.672	$1.610	$0.062
Aug-12	$17.19	$16.60	$0.59	53.50¢	52.03¢	1.48¢	$1.720	$1.648	$0.072
Sep-12	$17.15	$16.85	$0.30	52.50¢	52.00¢	0.50¢	$1.720	$1.674	$0.046
Oct-12	$17.10	$16.81	$0.29	52.50¢	52.50¢	0.00¢	$1.720	$1.686	$0.034
Nov-12	$17.05	$16.55	$0.50	52.75¢	51.38¢	1.38¢	$1.708	$1.686	$0.022
Dec-12	$16.90	$16.55	$0.35	51.80¢	50.90¢	0.90¢	$1.700	$1.676	$0.024
Jan-13	$16.70	$16.44	$0.26	45.00¢	45.00¢	0.00¢	$1.686	$1.686	$0.000
Feb-13	$16.51	$16.20	$0.31	42.00¢	42.00¢	0.00¢	$1.671	$1.671	$0.000
Mar-13	$16.25	$16.05	$0.20	39.50¢	39.50¢	0.00¢	$1.665	$1.665	$0.000
Apr-13	$16.25	$16.10	$0.15	38.50¢	38.50¢	0.00¢	$1.675	$1.675	$0.000
May-13	$16.35	$16.25	$0.10	40.25¢	40.00¢	0.25¢	$1.713	$1.713	$0.000
12 Mo Avg	**$16.65**	**$16.35**	**$0.30**	**47.49¢**	**47.09¢**	**0.40¢**	**$1.686**	**$1.663**	**$0.022**

- Spot Market: Blocks finished just a penny higher for the week, settling at $1.62½/lb on only 3 trades, but barrels picked up 6¼¢ to close at $1.63½/lb on just 1 trade. Butter was down 2¢ to $1.52/lb on active trading of 21 loads for the week.
- Milk Production Report: U.S. milk output in May was up 2% vs. a year ago, the smallest increase since last September and well below most analyst expectations. Cow numbers fell 4,000 head from April, which is the first monthly decrease since September 2010.
- Livestock Slaughter Report: 251,300 dairy cows were removed from the milking herd in May. That's the biggest May total since before 2006 and a big 14.2% increase over 2011.
- Most Class III components were higher in this week's National Dairy Product Sales Report. 40-lb cheddar blocks increased 3.6¢ to average $1.59/lb while 500-lb barrels gained 1.8¢ to $1.55/lb. Butter was up 2¢ to average $1.39/lb and dry whey inched 0.5¢ higher to 50.8¢/lb, but nonfat dry milk decreased 0.2¢ to average $1.10/lb.
- For the first 18 days of June, cheese stocks at USDA selected warehouses have declined 907,000 lbs, or 1%.
- Dairy cow slaughter for the week ended 06/09 totaled 55,200 head, up a strong 8,700 head from a year ago.
- Fluid Milk East: A closer look at May milk production data provides some interesting facts. The Pennsylvania dairy herd declined 7,000 head, the largest herd decline in any of the 23 major producing dairy states. Numerous industry contacts have indicated that the reason for the sharp decline in Pennsylvania's dairy production is linked to the drilling and fracking for natural gas. The sharp declines in Pennsylvania are a result of numerous dairy producers electing to sell off their herds and retire from dairy production after having secured significant windfalls from their energy leases and royalties. Manufacturing milk supplies are more than adequate in the Mid-Atlantic region, but increases in heat and humidity levels are lowering cow comfort levels and milk production. Florida's milk production continues to rapidly decline. Faced with narrowing margins, many producers are drying off and culling cows. Drought conditions are beginning to intensify with the onset of a hot dry weather pattern. Class I demand was strong this week and lowered spot export loads to 150, down 30 loads form last week. Southeast milk production continues to decline with very little need for auxiliary manufacturing. The frequency of load rejections due to high DMC counts and temperature issues are increasing. Spots sales of cream are above contract prices, an indication that overall cream demand is good. The seasonal decline in milk production has reduced the supply of condensed skim milk. Demand for condensed skim has increased with the increase in ice cream production and, for the first time this year, some spot sales were above contract pricing.
- Fluid Milk Central: Daytime temperatures inched into the 90's across much of the Central region. While it is too soon to determine if the hot weather will diminish milk production, several milk handlers indicate progress in the calendar translates into reduced farm milk volumes taken to processing facilities.
- Fluid Milk West: Conditions are beginning to warm up, touching 100 degrees, in California, but nights remain quite cool, reducing the herd stress. Manufacturing plants are fine with the decline in milk output, but milk is still ahead of last year. Financial stress related to lower milk prices and continued high feed costs are having an impact on production per cow, which was up only 20 pounds or just 1% from last year. This is much lower than through the winter. Plants are running efficiently at this time in the state. Conditions are much warmer in Arizona and New Mexico. Temperatures are touching 113 in some areas. Night time conditions are much cooler and there is not much humidity yet, but that may begin to change this weekend. Temperatures are running 5-11 degrees above normal in the two states. Milk components are declining seasonally. Western cream markets continue to firm. Demand for cream is reducing the flow to the churns and fat tests are declining seasonally. Pasture and Range Conditions according to NASS for the week ending June 17 indicate that the situation is the worst in the Southwest with much less severity noted in other states of the West. Adding the "very poor" and "poor" categories together for selected Western states indicates the following: Arizona 67%, California 60%, Colorado 58%, Idaho 7%, Nevada 55%, New Mexico 85%, Oregon 4%, Utah 35%, and Washington 3%.
- Butter: Producers and handlers are indicating that cream supplies have tightened. Some butter producers are stating that surplus cream offerings as recent as 3 - 4 weeks ago are gone, while others are comfortable with spot availability. Class II cream demand continues to build as ice cream and mix production keeps pace with needs. Some butter operations are considering selling a portion of their cream volumes versus churning at this time. This is often a trend that is realized in July and August, but this year, is occurring much earlier. Currently, churning schedules are often being geared to need, thus clearances to inventory are much

lighter, if at all. Some butter producers continue to indicate that traders are actively buying butter and hopefully positioning themselves in good standing for upcoming fall needs. Overall butter demand is holding steady at good levels for both retail and food service. CWT announced Thursday the acceptance of requests for export assistance to sell a total of 1.512 million pounds (686 metric tons) of butter to customers in Asia, Central America and the Middle East. The product will be delivered July through December 2012.

- Dry Whey East: Production of dry whey remains steady as cheese makers are comfortable with their current inventories and are not inclined to increase production. Dry whey inventories are being worked lower with product moving through contracts and spot sales. Demand for dry whey has improved as ice cream and ice cream mix production increases. Some buyers are beginning to take a position, building inventories, in light of the declining milk production and the likely hood that whey production will not increase in the near term.
- Dry Whey Central: Various brokers indicate they are unable to buy additional loads above their contract volumes from suppliers. Resellers indicate interest for branded dry whey loads from established customers is re-emerging, and premiums to the market on reseller/end user transactions are nearing customary levels. Dry whey inventories are stepping lower at several locations and getting closer to comfortable volumes. Several plant operators expect patron milk and spot milk availability will decrease rapidly in the next few weeks, thus limiting opportunities for dry whey production.
- Cheese Midwest: Cheese manufacturers are beginning to notice a fall-off in milk production during the prolonged spell of heat and below normal rain in parts of the Upper Midwest. Discounted milk seems to have disappeared and is replaced by premiums ranging from $1.00 up to $1.40 over Class III. Some cheese manufacturers are running six "long" days a week and are "sold out" through July. Demand for varietal cheese remains strong, generally higher than Cheddar and well higher than Mozzarella at this time.
- Cheese West: Wholesale cheese prices have firmed in the West. Milk intakes have leveled off across the West and cheese plants are facing less pressure to clear milk. Cheese stocks are heavy but not burdensome.
- International: Hot weather in the U.S. may be underpinning prices in the global dairy market, according to an article this week in AgriMoney. Much of the U.S. is lacking moisture too. 84% of California is rated as abnormally dry, compared to just 1% a year ago. At the same time heat is beginning to affect the milk flow, demand has remained resilient. Cheese exports have exceeded forecasts and are likely to remain good for the remainder of 2012.
- International: Milk production in Western Europe peaked about 3-4 weeks ago and volumes are declining at varying rates. Although milk volumes are sufficient to maintain strong production schedules, some handlers are classifying their supply situation as well booked, with minimal uncommitted volumes available for spot sale. Sales activity continues to center around internal demand, although international buyers are returning to the market place for Q3 needs.
- International: In Oceania, traders and handlers are indicating that prices are starting to firm. Many feel that recent price levels might have been at the bottom of the current cycle and now prices are trending higher as suppliers look forward to the new milk production season and marketing year. Currently, some international buyers are looking to the Oceania region for spot availability, but are finding uncommitted volumes quite limited. Manufacturers, handlers, traders and potential buyers are in the negotiation stages for Q3 and Q4 needs. A significant portion of first half milk production has already been committed to regular and ongoing customer needs.

What's Bearish:

- Dry Whey West: Western dry whey prices are mostly steady. The two tiered pricing of export whey versus domestic whey continues. Manufacturers are supplying export customers with product at lower than domestic prices to remain competitive in those markets. Whey production in the West is strong as cheese plants are running heavy schedules. Inventories of whey are described as manageable.
- International: May milk production in Australia was up 3.9% vs. May 2011, according to Dairy Australia. That brings the 2011-12 milking season up 4.3%.
- International: The Oceania milk production season officially comes to an end at the end of the month and is finishing on a very positive side. Milk output during the current season (July - June) developed much stronger than early projections, especially during the second half of the season. In New Zealand, end of season figures are pointing to a 9-10% increase over the previous season.

Recommendation:

While trade volume this week was fairly quiet, the spot market made all the noise. We went from a large block spread over barrels, to now an inverted spread with barrels above blocks. Milk continues to tighten and cheese is moving well. If barrels continue to march higher next week, expect blocks to move along for the ride and repair the spread. We're certainly not out of the woods, but strong grain markets and heat are helping put a floor under milk prices. We would start looking at July-Dec fence trades for cheap insurance. Enter orders to buy the 15.00 PUT and sell the 19.00 CALL July-Dec at net premium of zero. If that gets done, you can try a 16.00 x 19.00 or 16.00 x 20.00 to additional coverage.