

**The KDM Dairy Report – Jun 29<sup>th</sup>, 2012**

**What's Bullish:**

- Spot Market: Blocks gained 2½¢ to settle at \$1.65/lb while barrels picked up 4¢ to close at \$1.67½/lb. There was just one trade each for blocks and barrels. Butter was up ¾¢ to \$1.52¼/lb on 5 trades.
- Ag Prices Report: With high feed costs and milk prices only starting to recover, the June milk to feed ratio came in at 1.38, just 3-hundredths of a point above May, which was a new record low. Surging grain prices at the end of the month will like cause a revision lower in next month's report.

Futures Month	Class III 06/29	Class III 06/22	Change	Dry Whey 06/29	Dry Whey 06/22	Change	Cheese 06/29	Cheese 06/22	Change
Jun-12	\$15.65	\$15.67	(\$0.02)	50.50¢	50.50¢	0.00¢	\$1.577	\$1.577	\$0.000
Jul-12	\$16.87	\$16.66	\$0.21	51.25¢	51.05¢	0.20¢	\$1.702	\$1.672	\$0.030
Aug-12	\$17.62	\$17.19	\$0.43	53.00¢	53.50¢	(0.50¢)	\$1.762	\$1.720	\$0.042
Sep-12	\$17.73	\$17.15	\$0.58	53.70¢	52.50¢	1.20¢	\$1.770	\$1.720	\$0.050
Oct-12	\$17.62	\$17.10	\$0.52	53.75¢	52.50¢	1.25¢	\$1.760	\$1.720	\$0.040
Nov-12	\$17.32	\$17.05	\$0.27	54.50¢	52.75¢	1.75¢	\$1.733	\$1.708	\$0.025
Dec-12	\$17.24	\$16.90	\$0.34	53.50¢	51.80¢	1.70¢	\$1.720	\$1.700	\$0.020
Jan-13	\$17.06	\$16.70	\$0.36	46.28¢	45.00¢	1.28¢	\$1.710	\$1.686	\$0.024
Feb-13	\$16.66	\$16.51	\$0.15	42.00¢	42.00¢	0.00¢	\$1.693	\$1.671	\$0.022
Mar-13	\$16.60	\$16.25	\$0.35	41.00¢	39.50¢	1.50¢	\$1.666	\$1.665	\$0.001
Apr-13	\$16.60	\$16.25	\$0.35	38.53¢	38.50¢	0.02¢	\$1.676	\$1.675	\$0.001
May-13	\$16.60	\$16.35	\$0.25	40.25¢	40.25¢	0.00¢	\$1.713	\$1.713	\$0.000
<b>12 Mo Avg</b>	<b>\$16.96</b>	<b>\$16.65</b>	<b>\$0.32</b>	<b>48.19¢</b>	<b>47.49¢</b>	<b>0.70¢</b>	<b>\$1.707</b>	<b>\$1.686</b>	<b>\$0.021</b>

- Cheese prices continued to rise in USDA's weekly survey. 40-lb blocks averaged \$1.62/lb, up 3.6¢ for the week and 500-lb barrels gained 3.2¢ to \$1.58/lb. Butter increased 1¢ to average \$1.40/lb and nonfat dry milk inched 0.7¢ higher to \$1.11/lb, but dry whey decreased 0.9¢ to average 49.7¢/lb.
- Weekly cold storage numbers indicate cheese stocks at USDA selected storage centers declined 1% over the period 06/01 through 06/25. Cheese stocks typically increase over this period.
- Dairy cow slaughter for the week ended 06/16 totaled 53,600 head, up 2,900 head from the same period a year ago. YTD the 2012 cull is up 47,000 head vs. 2011.
- Fluid Milk Southeast: Florida and the southern areas of the Southeast region have received substantial amounts of rain from tropical storm Debby. Though the rains refilled ponds, lakes and aquifers, it was too much too quick and also caused significant flooding. Milk pickup schedules were interrupted due to flooding and road closures in numerous areas. Cow comfort levels were also degraded by the storm causing accelerated declines in milk production. The storm and increased Class I demand reduced Florida's export loads to 120, down 30 loads from last week. Areas of the Southeast region not affected by the storm are becoming increasingly hot and dry with many producers becoming increasingly concerned about hay and water shortages. Cream multiples are increasing as cream supplies tighten and demand improves. Demand for cream is very good with strong pulls from ice cream and cream cheese manufacturers.
- Fluid Milk Central: Various Central milk handlers indicate there is a push to consolidate milk volumes now that the seasonal decline in milk production is established and ongoing. In short, milk production in the Central region is below the volumes needed to meet all plant capacities. Fluid demand is steady at some locations, but orders into other suppliers moved higher this week. Another string of 90 degree plus days lingered within areas of the Central region this week. Record setting maximum daily temperatures occurred at over 500 locations nationwide.
- Fluid Milk Southwest: Conditions for milk production in most of California are ideal, but Arizona and New Mexico are beginning to experience more heat related issues. Most areas of the Southwest are noting triple digit day time temperatures in milk producing areas. Also, nighttime temperatures are not cooling off as much. Highs in New Mexico are now running about 7-8 degrees above normal and low temperatures in Arizona are 5-10 degrees above normal. Milk volumes are coming off and tests are lower. Milk per cow is up just 1.2% from last year. This rate has slowed sharply from last winter because of the financial stress noted at the farm level and because of some feed quality issues. With feed prices high and moving up this week, hay prices also higher than long term trends, milk prices steady to weaker, all mean less money to optimize rations. Demand for cream remains good with less available for churning.
- Butter: Tightening cream supplies and good demand for cream from ice cream and cream cheese manufacturers are giving butter makers the option to sell excess supplies on the spot market. Current butter inventories are significantly above year ago levels, and as a result, current production is filling existing orders with no additions to supplies. Demand for butter continues to be fairly good for this time of year with improved private label and food service orders.
- Dry Whey Northeast: Prices for dry whey increased this week. Cheese production remains steady at reduced levels keeping dry whey production flat. Demand for dry whey is good with strong pulls from ice cream manufacturers. Increased spot sales activity is working inventories lower as current production is moving through contracts. The market undertone is steady to firm.
- Dry Whey Central: While some manufacturers indicate inventories are somewhat above desired levels, general buyer interest is reportedly improving compared to one - two weeks ago. Other manufacturers have reestablished customary premiums to the market for their spot loads, and inventories are light to steady. Various resellers also indicate buyer interest for resale dry whey in full truck loads and LTL's is gaining strength. Dry whey production is steady to lower, based on seasonally tighter milk supplies in the Central region.

- Dry Whey West: Prices were fractionally higher this week as domestic and export sales were up slightly, and the overall market tone appears to be steady to firm. Production of whey continues to be fairly heavy as cheese plants are also working busy production schedules. But the increased whey stream supplies are finding their way into various concentrated whey products as well as sweet whey. Whey demand is good as ice cream plants and other end users are running expanded schedules.
- Cheese Northeast: Cheese production continues to hold fairly steady with some marginal declines, due to declining milk production. Cheese inventories are being worked lower as sales are better than expected for this time of year.
- Cheese Midwest: Some plants have noticed increased interest from cheese buyers in the last two weeks. This is attributed to an increasing feeling that cheese prices may be rising or at least, are not expected to decline much in the coming weeks. A number of cheese manufacturers are readily moving production out the door. A very large plant was said to "have nothing in the cooler" after filling contract commitments and selling the balance of current production as spot sales. Some participants feel that cheese is following other commodities into a "weather market", where concern over potential impacts of heat and dryness looking ahead a month or two are looming larger in expectations. Some manufacturers cite that factor as a reason driving current sales.
- Cheese West: The market continues to show a firm undertone as prices have moved higher over the past few weeks. Cheese sales are good with some production entering the export market when aided by the CWT program. Inventories of cheese are at manageable levels for current production.
- Dry Products: Most dry dairy product markets are steady to firm as milk production declines seasonally. Nonfat dry milk markets are firm and powder production varies from region to region. Many high heat producers are stating that demand is improving rapidly and often supplies are short of full needs.
- Cooperatives Working Together (CWT) announced June 19 the acceptance of requests for export assistance to sell a total of 1.709 million pounds (775 metric tons) of Cheddar, Monterey Jack and Gouda cheese to customers in Asia, South America, North Africa, the Middle East and the South Pacific. The product will be delivered June through November 2012.
- Grains: Despite the largest Mar to June gain in soy acreage since 1993, beans were strongly higher on Friday as the weather market trumped the report. Corn stocks were reported down 14% from a year ago, pushing the July corn as high as \$6.76/bu today. July beans hit the \$15 handle, trading as high as \$15.17/bu.
- International: Global demand for dairy looks positive, especially going into 2013, according to a Rabobank analyst. After being awash with milk in the first half of this year, global dairy supply is rebalancing while dairy demand has begun to accelerate. Rabobank believes there is going to be a significant shortage of milk in the Chinese market for the next three to five years, despite the Chinese trying to turn around their own industry. While their production is growing, it is not at the rate that domestic consumption is growing.
- International: Scarcely weeks after China's top-selling dairy firm pulled six months' worth of infant formula from shelves due to mercury contamination, a Chinese dairy has recalled hundreds of cartons of milk after a mechanical error tainted the batch with alkaline water. A seconds-long mechanical delay during routine maintenance at one of its Shanghai factories caused a "small amount" of alkaline cleaning solution to be flushed into 300 cartons of milk produced on Monday, the company's notice said.

#### What's Bearish:

- Fluid Milk Northeast: Milk production continues to decline in the Northeast and Mid-Atlantic regions, but milk volumes are above year ago levels. Manufacturing supplies are more than adequate to meet current demand and are augmented by declining Class I demand. A majority of the alfalfa, hay and pastures are in good to excellent condition in both regions.
- Fluid Milk Northwest: Weather conditions are ideal for milk cow comfort and production. Peak supplies for the year are thought to be past, but milk production continues to be above last year. Fresh forages are also helping to keep production numbers up.
- Dairy Market News reports the increasing price levels for cheese are beginning to impact export sales. Prospective Asian buyers have been balking at recent cheese prices quoted by Midwest manufacturers

#### Recommendation:

While spot cheese made gains early in the week, it was largely quiet by week's end. Grains and weather took the spotlight as both corn and beans made massive rallies. With heat beginning to impact milk output in more parts of the country and feed getting ever more expensive, the longer-term outlook for dairy is brightening. While we may see some corrective dips in the short-term, Q4 and beyond look well supported. We would not be inclined to make straight sales of milk but instead use a min-max strategy to protect your production. The Aug-Dec 16.00 PUTs avg 33¢/mo, while the 20.00 CALLs avg 19¢/mo. Buying the PUTs and selling the CALLs yields a net cost of 14¢/mo. Enter GTC orders for this spread at net cost of zero in anticipation of further strength. If successful, you will have established a floor at \$16/cwt and a cap at \$20/cwt. Adding in component pay should enable most producers to be above cost of production. This is very cheap insurance! If you can't stand the thought of being capped, then just buy the \$16.00 PUTs. Enter orders to buy them for an avg 25¢/mo or less. This would yield an effective floor of \$15.75/cwt yet you retain 100% upside.

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