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The KDM Dairy Report – August 10th, 2012

What's Bullish:

Futures Month	Class III 08/10	Class III 08/03	Change	Dry Whey 08/10	Dry Whey 08/03	Change	Cheese 08/10	Cheese 08/03	Change
Aug-12	$17.64	$17.49	$0.15	53.50¢	53.98¢	(0.48¢)	$1.763	$1.756	$0.007
Sep-12	$19.17	$18.77	$0.40	57.50¢	58.98¢	(1.48¢)	$1.898	$1.851	$0.047
Oct-12	$19.74	$19.20	$0.54	60.75¢	61.00¢	(0.25¢)	$1.929	$1.875	$0.054
Nov-12	$19.61	$19.36	$0.25	63.50¢	61.90¢	1.60¢	$1.900	$1.895	$0.005
Dec-12	$19.54	$19.20	$0.34	62.95¢	62.00¢	0.95¢	$1.900	$1.867	$0.033
Jan-13	$19.17	$18.85	$0.32	60.00¢	58.50¢	1.50¢	$1.885	$1.860	$0.025
Feb-13	$18.83	$18.50	$0.33	59.00¢	56.00¢	3.00¢	$1.850	$1.833	$0.017
Mar-13	$18.75	$18.40	$0.35	58.75¢	54.53¢	4.23¢	$1.849	$1.840	$0.009
Apr-13	$18.63	$18.37	$0.26	57.00¢	56.00¢	1.00¢	$1.856	$1.850	$0.006
May-13	$18.70	$18.35	$0.35	56.50¢	55.00¢	1.50¢	$1.830	$1.850	($0.020)
Jun-13	$18.68	$18.31	$0.37	56.00¢	55.00¢	1.00¢	$1.841	$1.860	($0.019)
Jul-13	$18.79	$18.30	$0.49	55.00¢	53.75¢	1.25¢	$1.840	$1.805	$0.035
12 Mo Avg	**$18.94**	**$18.59**	**$0.35**	**58.37¢**	**57.22¢**	**1.15¢**	**$1.862**	**$1.845**	**$0.017**

- Spot Market: Blocks jumped 14½¢ to settle at $1.85½/lb while barrels gained 13½¢ to close at $1.82/lb. Bidders were aggressive with 14 loads of blocks and 22 loads of barrels exchanging hands. Grade A nonfat dry milk was bid up 8¢ to $1.48/lb with no trades, while butter ended the week 6¢ higher to $1.75/lb.
- Culling continues to be strong. Dairy cow slaughter for the week ended 07/28 totaled 55,900 head, up 4,300 head from the same period last year.
- Ag Prices Report: the milk-feed ratio for July came in at 1.29, a new all-time record low.
- World Ag Supply & Demand Report: USDA decreased their milk production forecast for 2012 and 2013 due to higher feed costs impacting producers. As a result, they raised their Class III price forecast for 2013 by 50¢/cwt and now expect it to average $17.20 for the year.
- Fluid Milk Southeast: Manufacturing milk supplies in the Mid-Atlantic region are declining with growing concerns of having adequate supplies when Class I demand increases as schools begin to open. Cow comfort levels and milk production continue to decline in Florida with daytime temperatures in the 90's and nighttime lows in the 80's. Class I demand has increased significantly as most schools plan to open next Monday. The increase in Class I demand has brought about the end to Florida spot export loads and imports are likely in the not too distant future. Milk supplies in the Southeast are becoming tight as production continues to decline and Class I demand increases. Cream has become very tight, mostly due to very good demand. Some butter makers are concerned about future supplies and are picking up additional loads of cream when available. Some balancing plants are withholding noncontract loads of condensed from the spot market to increase volumes going to dryers as they attempt to improve their nonfat dry milk inventories.
- Fluid Milk Central: Milk processors indicate they are reluctant to send away milk loads at this time as their conversations with some dairy producers show producers are concerned regarding the feasibility of continuing some dairy operations. Some manufacturers report a few dairy operations sold out in the recent past few weeks, cutting into weekly farm milk volumes.
- Fluid Milk West: California milk production is being impacted by hot weather conditions. Milk volumes are lower, as well as fat and protein levels of the milk. The widespread high temperatures are forecast to be the hottest since 2006. Producers are adjusting rations to balance cows' needs against input costs. Culling rates are trending higher as producers adjust herd sizes. Arizona is experiencing very hot temperatures that are further impacting the milk output in the milk producing regions of the state. Excessive heat warnings have been extended into the weekend and heat abatement measures are only providing some relief to the milking herds. Processing plants are running on reduced schedules because of the lower milk receipts and increases in Class I demand. Schools are beginning sessions and suppliers are taking more milk. New Mexico milk output is trending lower and milk is being shipped to supplement Class I needs and shortages in other areas. Plants are running on lower schedules.
- Fluid Milk Northwest: Temperatures have been high enough, long enough to stress the milking herd. The stress is about normal seasonally and is bringing down milk supplies and the solids in the milk. Plants are able to efficiently handle the current milk offerings. Feed and hay cost stress is a definite factor in the region. Hay in the region is often being quoted in the $225-250 range at the production farm. Offerings are also on the light side. Conditions are also hot and dry in most of Idaho and Utah. Milk is declining at a normal seasonal rate. Offerings of various manufactured products are now off a bit as plants look at the rest of the country and are holding with more confidence any stocks they have on hand for future needs.
- Butter: Churning schedules across the country are often being challenged by tightening cream supplies. Class II demand continues to absorb a significant portion of available cream. Many butter producers feel that cream supplies will remain snug for the next few weeks, until school bottling standardizing resumes and cream supplies become more available. However, volumes of standardized cream may be lighter this year as butterfat levels on incoming milk have been lower for much of the summer. Limited churning cream supplies are often causing butter producers to reach into inventories to fulfill butter demand. Microfixing is starting to be reported at more locations. Butter demand is holding steady from coast to coast. Some butter producers are indicating that they are concerned about upcoming tight milk supplies due to drought, heat, and feed costs and supplies that will probably short milk for butter production before the impact is felt by cheese plants.
- Dry Whey Northeast: Prices moved higher for the fifth consecutive week and spot sales were noticeably absent from trading this week as most manufacturers are holding on to any excess supplies to either ensure contract coverage or to wait for possible

future price increases. Some cheese plants have seen declines in their milk supply, lowering their cheese and dry whey production. Demand continues to be very good with strong pulls from ice cream manufacturers. Buyers looking for additional loads have to look outside the region and/or for resale opportunities.

- Dry Whey Central: Prices in the Central region moved higher on both the range and mostly price series. The market tone is firming. Dry whey availability is variable.
- Dry Whey West: Prices moved sharply higher for Western whey this week. Demand is turning more aggressive as buyers attempt to increase coverage for future needs and to cover current demand. Offerings are declining as milk begins to decline more rapidly in the Western region. The first major heat is common over much of the region. Temperatures of well over 100 degrees are common over eastern areas of the Pacific Northwest and into Utah and Idaho. Any stocks that producers are holding are held with more confidence. There is a very firm undertone to the Western market.
- Nonfat Dry Milk: Prices are higher on a firm market. Spot load availability is light to tightening. Various manufacturers report that regular customers who put off arranging for Q3-Q4 coverage are now in the market on a weekly basis looking for near to mid-term NDM loads. A few manufacturers are trying to buy back previously committed NDM to help meet current contract demand. Some customers feel they missed buying opportunities in the recent past when prices were lower. The fast recovery of prices in the NDM market caught some market participants off guard in that there were general expectations of a gradual uptick in prices through Q3.
- Cheese East: Cheese production is in balance with existing orders at most plants, keeping inventories static. Cheese makers are comfortable with their current supplies. Demand is improving, especially for mozzarella as food service and pizza makers prepare for the fall school term. Export demand continues to be good. CWT announced August 6, the acceptance of requests for export assistance to sell 2 million pounds of Cheddar, Gouda and Monterey Jack cheese. The product will be delivered August through January 2013.
- Cheese Midwest: The lingering impact of summer's weather on milk production, specifically the potential for dairy producers selling-out entirely, or at least selling herds, as well as whether sales will be to other farmers or to slaughter, will impact cheese manufacturers. Variables of future milk production and future prices remain concerns. Cheese manufacturers are looking ahead toward fall. Increased demand related to schools opening is expected to materialize within weeks. A manufacturer observed that historically, demand for schools is bigger than the decrease related to summer travel.
- Cheese West: Milk supplies are beginning to tighten seasonally as heat has more of an impact on the dairy herds in the region. The solids content on milk receipts is declining at a seasonally expected rate. Contacts are concerned how the prolonged drought and the impact on feed and hay supplies will play out going into the winter on milk production. Most are assuming that supplies will be tighter than earlier predictions and are planning accordingly. Most production plants are pleased with demand at this time, and inventories are in a normal operating range.
- Grains: In this week's crop report, corn production is forecast at 10.8 billion bushels, down 13% from 2011 and the lowest production since 2006. Based on conditions as of August 1, yields are expected to average 123.4 bushels per acre, down 23.8 bushels from 2011. If realized, this will be the lowest average yield since 1995. Soybean production is forecast at 2.69 billion bushels, down 12% from last year. Based on August 1 conditions, yields are expected to average 36.1 bushels per acre, down 5.4 bushels from last year. If realized, the average yield will be the lowest since 2003.

What's Bearish:

- Fluid Milk Northeast: Milk production in the Northeast remains steady with last week. Dairy producers have fared better in New England and upstate New York than other areas in the East with timely rains and better than average forage harvests.
- Packaged fluid milk sales in June were down 0.8% from June 2011.

Recommendation:

The spot market came to life this week with blocks, barrels, butter and NDM all sharply higher. Futures have been predicting this move for weeks. We continue to hear stories of much more aggressive culling and some dairies selling out. The Midwest has cooled, but the South and West remain hot. Grains look to be well supported as USDA revised yields much lower; further rationing is ahead. With this week's gains in the spot market, we have Class III priced at about $18.80 and Class IV at about $18.20. With milk getting tighter and schools about to reopen, manufacturing milk supplies look set to get tighter still, with some potential for Class IV (butter/powder) to zoom ahead of Class III. Since moving off their lows in the $16's, Q4 futures and beyond have seen very little retracement. We appear to be in a period of consolidation now, trading in a narrow range. If spot cheese prices fall at all, expect a correction in the market. But if spot cheese takes a stab at $2.00, expect Q4 contracts to rally hard at some point and break out of their current narrow trading range. We recommend buying PUT options only at this point to get a floor price under your milk. The Oct-Dec 18.00 PUT closed today at an average 31¢/month. Enter orders to buy them at 25¢ or better. Leave 2013 alone for now. On the feed side, we would look for any retracement in bean/meal prices as an opportunity to get covered into the first half of 2013. Call us for specific feed hedge strategies.