KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter, Keith Schnese & Nick Potter

The KDM Dairy Report – August 17th, 2012

What's Bullish:

Futures Month	Class III 08/17	Class III 08/10	Change	Dry Whey 08/17	Dry Whey 08/10	Change	Cheese 08/17	Cheese 08/10	Change
Aug-12	$17.66	$17.64	**$0.02**	53.50¢	53.50¢	**0.00¢**	$1.760	$1.763	**($0.003)**
Sep-12	$19.57	$19.17	**$0.40**	57.75¢	57.50¢	**0.25¢**	$1.940	$1.898	**$0.042**
Oct-12	$20.25	$19.74	**$0.51**	61.48¢	60.75¢	**0.73¢**	$1.984	$1.929	**$0.055**
Nov-12	$20.10	$19.61	**$0.49**	62.75¢	63.50¢	**(0.75¢)**	$1.960	$1.900	**$0.060**
Dec-12	$20.08	$19.54	**$0.54**	63.45¢	62.95¢	**0.50¢**	$1.947	$1.900	**$0.047**
Jan-13	$19.73	$19.17	**$0.56**	59.10¢	60.00¢	**(0.90¢)**	$1.934	$1.885	**$0.049**
Feb-13	$19.30	$18.83	**$0.47**	58.50¢	59.00¢	**(0.50¢)**	$1.855	$1.850	**$0.005**
Mar-13	$19.15	$18.75	**$0.40**	57.00¢	58.75¢	**(1.75¢)**	$1.865	$1.849	**$0.016**
Apr-13	$19.13	$18.63	**$0.50**	55.50¢	57.00¢	**(1.50¢)**	$1.850	$1.856	**($0.006)**
May-13	$18.86	$18.70	**$0.16**	55.48¢	56.50¢	**(1.03¢)**	$1.855	$1.830	**$0.025**
Jun-13	$18.70	$18.68	**$0.02**	55.00¢	56.00¢	**(1.00¢)**	$1.850	$1.841	**$0.009**
Jul-13	$18.77	$18.79	**($0.02)**	55.00¢	55.00¢	**0.00¢**	$1.859	$1.840	**$0.019**
12 Mo Avg	**$19.28**	**$18.94**	**$0.34**	**57.88¢**	**58.37¢**	**(0.50¢)**	**$1.888**	**$1.862**	**$0.027**

- Spot Market: Grade A nonfat dry milk roared to life, jumping 15¢ for the week to settle at $1.65/lb. Butter gained 4¼¢ to close at $1.79¼/lb. There was just one nonfat trade and no butter trades.
- Global Dairy Trade: Prices of dairy products posted their third-biggest gain in about two years in the latest GDT auction held on Tuesday. The GDT Price Index rose 7.8% compared to the last sale just two weeks ago. The price for cheddar cheese increased 8.8% to a U.S. equivalent $1.54/lb.
- Livestock, Dairy and Poultry Outlook Report: USDA acknowledges that the severe drought will impact milk production both for the remainder of this year, and next year as well. Weekly dairy cow slaughter turned sharply higher in July, leading USDA to reduce their herd size estimate, and now expects the herd to contract in 2013. USDA revised their 2013 Class III price forecast upwards by 45¢/cwt from last month, and now expect an average of $17.20/cwt. 2013 futures average $18.67/cwt.
- The Weekly Cold Storage Report indicates that over the first 13 days of August, cheese stocks at USDA selected storage centers declined 2.333 million lbs, or 2%. Butter inventories fell 725,000 lbs, a sharper 6% decline.
- Dairy cow slaughter for the week ended 08/04 was up 10.9% compared to a year ago. A solid 59,000 head were culled vs. 53,200 last year. YTD the cull is up 81,600 head vs. 2011.
- Fluid Milk East: Florida became a milk-deficit state for the first time this season, with 44 loads being imported, which is up from 35 loads imported last year. Demand has increased due to schools starting. Florida produced milk has been declining in volume with cow comfort being "terrible" at this time of year. Temperatures are in the 90's days and 80's nights. Class I milk is in a tight supply situation in the Mid-Atlantic region as the school pipeline is beginning to be filled. This has left some plants to stop all drying and churning, to maximize milk available for Class I use.
- Fluid Milk West: California milk output is being severely impacted by hot and humid weather conditions that remain over wide areas of the state. Milk intakes are lower and the solids levels are lower. Processors with milk supply contracts are finding themselves in tighter milk positions to run their own plants after all their commitments are filled to others. In addition, schools and colleges are creating a stronger pull and the Class I processers are pulling heavier. The heat is the story, yet the underlying financial stress on input costs is playing out in farm and cow sales. In addition, cows on adjusted rations are further impacted by the heat stress. Processing plants are running on reduced schedules and able to handle the milk supply in the state despite several plants remaining down for scheduled maintenance. There are processors who would like to have more milk in the short term. This is a sharp contrast to the early months in 2012 when producers were being asked to limit milk marketings. Arizona milk production is steady to lower at seasonal low levels. The excessive heat warnings remain in effect and the conditions are impacting milk receipts. Feeding and reproduction concerns are on farm issues that will have longer-term impacts. At the plant level, lower milk supplies are creating issues as processors adjust schedules in attempts to satisfy customer needs for milk and products. Cream markets are firm and supplies are tighter with milk production declining across much of the Southwestern states. Some butter producers in other regions are bidding for cream to augment their holdings. Milk supplies in the Pacific Northwest are being affected by another session of high temperatures. Coastal regions of Oregon and Washington are also seeing the unusually high temperatures with humidity. Grain prices and availability will be major factors in planning for the fourth quarter of 2012 and into 2013. Utah and Idaho milk production is also suffering from hot temperatures. Processors report lower volumes and less solids in the milk that is delivered.
- Butter: In most instances, current churning schedules are not keeping pace with demand and inventoried stock is being used to fulfill butter demand. Retail orders are often being enhanced by scheduled feature activities. Food service buyers are indicating that summer traffic flow through their operations has been positive and often stronger than anticipated. Butter export activity continues to occur with the assistance of the CWT program. Within the past week, CWT export assistance was awarded for 661,387 pounds (300 MT) of butter for export now through January 2013.
- Dry Whey: There is price strength in Northeast whey, with re-sale activity occurring in the face of apparent limited spot market availability from manufacturers. Demand for dry whey remains good. Central dry whey prices are higher. Some manufacturers report they could use extra milk for cheese and whey production, but spot milk loads are tight to unavailable. In some of those locations, dry whey manufacturers are getting inquiries for additional loads of dry whey, but they have none to offer. Western dry whey prices continue to show strength. The market remains strong as supplies are mostly adequate for contracted needs. Spot availability is described as tight for additional product needs. Extremely hot weather across most of the West has reduced milk supplies into cheese plants and whey stream products are seeing reduced volumes.
- Nonfat Dry Milk: Nonfat dry milk prices are moving moderately to sharply higher across trading categories. The market tone remains firm. Some domestic buyers who were not inclined to contract in 2012, are now concerned about getting needs in a more tightly held NDM market and are searching for those needs. Production schedules are reduced as hot weather in parts of the country reduce intakes at the plant level. In addition, solids in the milk are trending lower. Further, with schools and colleges starting, there is a stronger pull for Class I milk. The overriding comment is that there is less milk available for powder plants and powder output is lower.

- Cheese Northeast: Production remains steady and inventories are adequate, though sales are pushing up in response to orders related to school openings. Cheese retail advertising volume reported in the National Dairy Retail Report is up, following three periods of declining volume. Current cheese ad numbers are 20.2% above volume two weeks ago. CWT has accepted requests for export assistance to sell 3.1 million pounds of Cheddar and Monterey Jack cheese. The product will be delivered August 2012 through January 2013.
- Cheese Midwest: The significant price increases last week have impacted cheese orders received by plants. Orders seeking immediate delivery increased, from buyers acting quickly to attempt to "get ahead of the averages". In contrast, standing orders from some regular customers notched down somewhat in the future, as those buyers looking ahead, became more nervous about what prices "might be" in the weeks ahead. Manufacturers who received a sudden increase in ordering, took cheese from inventory to fill the orders. Some of those manufacturers would now be happy to increase cheese production to replenish inventory if more milk became available to them, but that generally is not the case.
- Cheese West: Very hot temperatures across much of the West are reducing farm milk production and affecting milk solids yields. Cheese production is steady to slower. Prices at the CME were the highest since mid-November of 2011. The recent increase has fueled interest in securing inventory before anticipated further price increases. Demand for Labor Day retail specials and filling the pipeline for school openings have added to immediate interest.
- International: Consumers in China are developing a more vigorous taste for more dairy products than the country can supply, and cows there are craving more alfalfa than the country's farmers can grow, according to an op-ed this week in a California paper. One of the reasons hay prices are so high in the U.S., is that we have become a hay exporter to China, with domestic dairymen competing for limited supply.
- International – Western Europe: Although the milk production season has been fairly strong thus far, stocks of manufactured dairy products are often not as plentiful as in years past. European whey powder markets and prices are firm. Stocks of whey powder are not excessive, with traders and handlers indicating that procuring volumes for customer needs is often challenging. Traders and handlers are reporting that domestic and international sales have been occurring during the past 6 weeks or so when sales are typically lighter during the summer holiday period. This year, buyer presence in the marketplace has remained throughout the holiday period and continues. Much of this buyer presence is being attributed to the uncertainty of available stocks for the upcoming winter season. Also, a concern to international buyers is the impact high temperatures and drought conditions in the U.S. will have on their dairy industry. Uncertainty of U.S. participation in international dairy markets is potentially causing some international buyers to procure upcoming needs earlier than usual from sources that currently have product available.

What's Bearish:

- Spot Market: Blocks up 1½¢ for the week to close at $1.87/lb, but were down 3¢ on Friday. Likewise, barrels are 1½¢ higher than last week at $1.83½/lb, but fell 2¢ on Friday. There were 2 block and 16 barrel trades for the week.
- Milk Production Report: July milk output totaled 16.6 billion lbs, up 0.7% vs. a year ago. Most analysts had expected at least a small decline year-over-year in what was a very hot month. Cow numbers, however, did decline by 12,000 head. CA output was down 1%, but WI was 4.4% higher even with the heat. Other strong states were CO up 5.8% and UT up 5.6%.
- Fluid Milk Central: Ice cream manufacturing operators describe near term orders for ice cream are returning to traditional fall patterns, with less emphasis on frozen novelty items. Cream use in dips, whipping cream and sour cream is steady. Various milk handlers indicate their milk supplies and demand are in balance, with no sales or purchases of outside milk loads required to meet weekly needs.
- The weekly National Dairy Products Sales Report seems to be "out-of-whack" with the spot market, even when allowing for a 2-week lag. Grade A nonfat dry milk shot up to $1.65/lb in today's spot session, but increased just 3.2¢ in the report to $1.25/lb. Can it make up the 40¢ spread in 2 weeks? Butter increased 2.9¢ to average $1.66/lb, while 40-lb blocks were just 0.6¢ higher at $1.72/lb and 500-lb barrels gained only 0.6¢ to $1.71/lb. Dry whey crawled 0.9¢ higher to average 52.9¢/lb.

Recommendation:

The market began the week with much excitement but ends in much confusion and mixed signals. Starting out with the spot market, we saw new 2012 highs in blocks and barrels, only to see a weak decline on Friday as bidders disappeared. Much was made about the heat in July…only to get a Milk Production report showing an annual increase, against all expectations! We may see an initial negative reaction to the report when trading begins Sunday evening, but we still think the bulls have the edge. While the Milk Production report was positive, it was the smallest increase yet this year, and cow numbers declined for the 4th consecutive month. Weekly culls have remained strong too. Milk seems to be in balance in the Northeast and almost plentiful in the Midwest, but now the West is under the heat gun and output is declining rapidly. Florida is importing milk and schools will start en masse very soon. Feed remains expensive. Spot nonfat and butter remained strong, hanging on to their gains. As we discussed last week, Class IV prices leap-frogged over Class III this week. Class IV works out to about $19.86/cwt while Class III is at about $18.97. With close to a dollar premium over Class III, we should see more milk diverted away from cheese and into butter/powder as processors seek the most profitable ways to utilize their milk. Sep-Feb milk futures made all new contract highs this week, blowing through resistance. This is bullish and portends further gains, assuming the spot market is supported next week. Now that we have $20 milk again, expect the markets to be more volatile and whippy. However, we still expect the overall trend to be up in the long run. Use PUT options to put a floor under your milk. The Oct-Dec 18.50 PUT closed today at an average 29¢/mo. Bid 25¢ on these. If you get them, you'll have a great floor, yet still be able to sell or contract your milk outright should prices go crazy to the upside.