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The KDM Dairy Report – August 24th, 2012

What's Bullish:

Futures Month	Class III 08/31	Class III 08/24	Change	Dry Whey 08/31	Dry Whey 08/24	Change	Cheese 08/31	Cheese 08/24	Change
Sep-12	$18.89	$19.10	($0.21)	56.75¢	58.00¢	(1.25¢)	$1.865	$1.887	($0.022)
Oct-12	$19.76	$20.01	($0.25)	60.50¢	60.00¢	0.50¢	$1.925	$1.955	($0.030)
Nov-12	$19.90	$19.98	($0.08)	61.00¢	60.25¢	0.75¢	$1.944	$1.947	($0.003)
Dec-12	$19.88	$19.95	($0.07)	62.73¢	62.00¢	0.73¢	$1.937	$1.950	($0.013)
Jan-13	$19.77	$19.63	$0.14	60.00¢	58.95¢	1.05¢	$1.943	$1.934	$0.009
Feb-13	$19.37	$19.23	$0.14	58.50¢	58.50¢	0.00¢	$1.918	$1.900	$0.018
Mar-13	$19.20	$19.00	$0.20	57.00¢	57.00¢	0.00¢	$1.917	$1.870	$0.047
Apr-13	$19.12	$19.16	($0.04)	57.45¢	56.50¢	0.95¢	$1.903	$1.867	$0.036
May-13	$18.87	$18.80	$0.07	58.00¢	55.48¢	2.53¢	$1.875	$1.855	$0.020
Jun-13	$18.65	$18.65	$0.00	58.00¢	55.00¢	3.00¢	$1.849	$1.855	($0.006)
Jul-13	$18.80	$18.81	($0.01)	57.00¢	55.00¢	2.00¢	$1.859	$1.859	$0.000
Aug-13	$18.55	$18.49	$0.06	55.00¢	53.50¢	1.50¢	$1.855	$1.855	$0.000
12 Mo Avg	**$19.23**	**$19.23**	**($0.00)**	**58.49¢**	**57.51¢**	**0.98¢**	**$1.899**	**$1.895**	**$0.005**

- Spot Market: Butter gained 4¢ on six trades to settle at $1.84/lb while NDF jumped 3½¢ with no trades to close at $1.70/lb.
- Ag Prices Report: The Aug milk-feed ratio was reported virtually unchanged from July's record low, at 1.35.
- Class III components were higher for the second consecutive week in the NDP Sales Report. 40-lb blocks increased 5.8¢ to average $1.81/lb, while 500-lb barrels increased 4.2¢ to $1.76/lb. Butter was 4.2¢ higher to average $1.76/lb, dry whey inched up 0.8¢ to 54.8¢/lb and nonfat dry milk tacked on 3.8¢ to average $1.30/lb.
- Weekly cold storage numbers indicate there was quite a large drawdown in August. Butter stocks at USDA selected storage centers fell 6% over the period 08/01 through 08/27, while cheese stocks fell 4% over the same period.
- Dairy cow slaughter for the week ended 08/18 totaled a solid 61,000 head, up 12.5% from a year ago.
- While recognizing the sad human side to this story, several large, established dairies in CA went to auction this week, with more slated for early September, according to an article this week in Wisconsin State Farmer. The article also mentions that Wells Fargo, the largest Ag lender in the country, is getting out of the dairy business in CA, leaving only two other primary lenders. Credit is tight, with one major bank having 24 dairies in "special asset" group status, meaning they either pay or declare bankruptcy.
- Fluid Milk East: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions have declined with the increase in Class I demand, as most schools are back in session. The limited manufacturing milk supplies are offering plant managers the opportunity to complete maintenance projects. The Southeast region imported 5 spot loads this week to ensure Class I needs were met. These are the first imports into the region since April. Florida imported 78 loads this week, up from 72 last week. Strong fluid pulls from yogurt manufacturers are also contributing to the limited availability of condensed skim supplies. Some balancing plant managers continue to be concerned about future milk supplies and their ability to meet their nonfat dry milk commitments.
- Fluid Milk West: CA milk production is leveling off after several weeks of very hot weather. Processors are only seeing slight upticks in milk intakes. Expected increases in milk output are thought to be tempered by current feed practices and additional cow culling in the state. Demand for hay has slowed. Processing plants are running well at reduced levels. Several comments are noted that current milk levels are running around 3-5% or more below a year ago. AZ milk supplies remain seasonally low and below current needs. Conditions are more favorable but milk intakes not changing very much.
- Butter: Sales are being called very good with some sellers noting a certain percentage of buyers ordering ahead. Producers are seeing an increase in demand from buyers in other regions. Retail orders remain good to very good. Stocks of butter on July 31, 2012, totaled 232.0 million pounds, down 11.2 million pounds from the end of June 2012. An average decline during the month of July has been about 4 million pounds. Therefore, the drawdown has been heavier and earlier than normal.
- Dry Whey East: Prices were higher this week while demand is good as baking manufacturers are increasing their production schedules as fall approaches. Buyers looking for additional loads have to look out of region and or for resale opportunities. Resale prices have increased significantly and are well above the contract levels. The market undertone remains firm.
- Dry Whey Central: Dry whey prices in the Central region shifted higher this week. Sellers indicate current purchasers are looking for hedges against expected dry whey shortfalls in Q4. Spot load availability from some manufacturers is tighter.
- Dry Whey West: Prices moved higher again with demand reported as very good. Buyers are looking for additional loads of whey from any source available and are often going unsatisfied if it is not from a regular supplier. Spot sales are becoming more limited as milk receipts decline seasonally and because of recent extended high temperatures in the region. Some buyers are looking at the resale market for some additional supplies and they are only partially successful. This is a firm market and the pace seems to be increasing.
- NDM East: Nonfat dry milk prices increased for the fifth consecutive week. The combination of good Class I demand and lower seasonal milk production has reduced manufacturing milk supplies and milk volumes going to dryers. Most plants are drying only a few days a week. High heat nonfat dry milk production is very limited and supplies are very tight. Demand for nonfat dry milk is good with best interest coming from cheese makers and baking manufacturers. Current production is moving through contracts with very little available for the spot market. Existing manufacturer inventories are held in firm hands as numerous manufacturers are concerned about future milk supplies and covering nonfat dry milk contract commitments. Buyers looking for additional loads are looking out of region and or for resale opportunities.
- NDM Central: Prices firmed in both the low heat and high heat series this week. Market participants indicate somewhat slow sales activity is related to difficulties finding available NDM loads rather than flagging buyer interest. Several buyers report they were informed by their Western manufacturers/suppliers that spot load availability is light to nonexistent at this time. Manufacturers are building inventories with confidence. Resale prices are also reportedly firming as buyers seek out additional sources of NDM.
- NDM West: Prices are trending moderately to sharply higher. The market tone remains firm to strong. Buying interest remains fair to good for the current limited spot offerings. Buyers continue to find it difficult to secure additional loads. There are only limited offerings in the resale

market and those prices are at the upper side of the reported range, $1.60 to $1.80. Drying schedules remain seasonally light and at lower levels than forecast because of lower milk receipts in the Southwest. Producers' inventory levels are declining and becoming shorter than desired.

- Cheese East: Production overall has only increased marginally with steady cheddar production, while mozzarella cheese makers are attempting to increase production in the face of limited manufacturing milk supplies. Demand for cheese has increased with strong orders for mozzarella and improved sales for low fat and regular cheddar cheeses. Swiss cheese orders from food service have also improved.
- Cheese Midwest: Buyers are acquiring cheese and looking for more. Asked whether more cheese could be sold if more milk were available, one plant manager said "that's a big yes!" Stronger interest in buying cheese from manufacturers spanned last week and this week - buying interest beyond the 26 loads of blocks and 26 loads of barrels sold during CME trading last week and through Wednesday this week. Manufacturers continue to receive inquiries from prospective cheese buyers seeking to buy either more loads than already contracted, or from buyers not already contracted, spot cheese purchases. Many manufacturers are not able to fill this added interest with present milk supplies, but are not willing to pay class premiums to secure additional milk. With about a week until some cheese plant managers expect milk supplies to tighten further when many upper Midwest schools open for the semester, this situation is being monitored. Some cheese manufacturers have already experienced losing dairy producers who had been providing milk for cheesemaking, when those farmers sold out under pressure from increased crop prices. Additional herd sales are anticipated in coming months. Manufacturers of large volumes of cheese curds have been experiencing increased orders for curds during recent weeks. This is attributed in part to consumers who become introduced to cheese curds, increasingly featured at state fairs, who then continue to purchase curds in the grocery store.
- CWT has accepted 14 requests for export assistance to sell 4.581 million pounds of Cheddar and Gouda cheese to customers in Asia, the Middle East, North Africa and the South Pacific. The product will be delivered September 2012 through February 2013.
- Commercial disappearance of dairy products during the first six months of 2012 totals 100.2 billion pounds, 2.4% above the same period in 2011. Comparing disappearance levels with year earlier levels: butter is +4.1%; American cheese, +0.8%; other cheese, +1.2%; NDM, +45.6%; and fluid milk products, -2.2%.
- International: Rabobank's most recent quarterly dairy outlook states that over the next decade, milk production growth in New Zealand will slow to a trickle. The development of new dairy farms and processing facilities fuelled a nearly 50% increase in milk production over the past decade, but over the next decade, growth will no longer be driven by increasing the number of dairy cows, but by productivity improvements. This will also have ramifications across the global dairy market as importers will likely be forced to broaden the number of countries they buy product from, while competing exporters may see opportunities if New Zealand exports are unable to keep pace with growing demand.

What's Bearish:

- Spot Market: Blocks finished the week down 3¼¢ to $1.82/lb and barrels lost 2½¢ to close at $1.77¾/lb. Trading was heavy as 13 loads of blocks and 24 loads of barrels exchanged hands.
- Fluid Milk Central: Milk supply and demand are reportedly in balance in the Central region. Refilling the school pipeline occurred easily this year, according to some milk handlers. Cream supplies are steady to somewhat more available as a few ice cream plants reduce production seasonally. Milk production is generally stabilizing in the Central region as cow comfort improves with the arrival of cool weather.
- Fluid Milk Northwest: Milk supplies into the Pacific Northwest have rebounded from the recent bout with high temperatures. Contacts believe that producers in the Northwest may be better positioned to handle the financial stress caused by the increasing feed and hay prices not balanced off by high enough milk prices than other portions of the West.
- International: Milk production across Western Europe is uneven, but tracking along seasonal levels in the major producing countries. Milk supplies are sufficient for current needs and processors are able to run all the product lines that they desire.
- International: Australia is off to a strong start in the first month of their new milking season. Output in July was up 3.5% vs. a year ago. The New Zealand milk production season is off to a fast start with processors/handlers reporting milk intakes higher than year ago levels during the early weeks of the season.

Recommendation:

The spot market disappointed this as prices were down by week's end. Bidders put up a valiant effort, but the major commercial seller had an answer for every bid, and then some. Today's session finished with 5 unfilled block offers and 1 unfilled barrel offer. While the seller appears to have the upper hand in the short term, the consensus seems to be that milk will get tighter over the coming weeks. Butter/powder continues to rock higher, putting Class IV at over a $2 premium to Class III. That can't last indefinitely. The last two week's we've warned about a possible correction in the Q4 months, and that occurred with the weak spot market for cheese. Sep is down 50¢ from its high of the week. Technically we could see further correction in the Q4 contracts next week, especially if cheese continues to be offered at the CME. In addition, Dec corn has had a difficult time putting in new highs and is vulnerable to profit taking prior to the next crop report. The bottom line is milk could still go down from here. Producers should still look to get PUT options coverage for Q4. Call us for a specific recommendation for your operation.

Note: We will be closed on Monday in observance of Labor Day. We wish all of you a safe and wonderful weekend!