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

The KDM Dairy Report – September 14th, 2012

What's Bullish:

Futures Month	Class III 09/14	Class III 09/07	Change	Dry Whey 09/14	Dry Whey 09/07	Change	Cheese 09/14	Cheese 09/07	Change
Sep-12	$18.87	$18.85	$0.02	57.00¢	57.03¢	(0.02¢)	$1.865	$1.851	$0.014
Oct-12	$19.97	$19.45	$0.52	61.00¢	59.75¢	1.25¢	$1.940	$1.901	$0.039
Nov-12	$20.39	$19.71	$0.68	62.03¢	60.50¢	1.53¢	$1.964	$1.910	$0.054
Dec-12	$20.21	$19.71	$0.50	64.00¢	62.70¢	1.30¢	$1.943	$1.910	$0.033
Jan-13	$19.84	$19.61	$0.23	60.00¢	60.00¢	0.00¢	$1.920	$1.933	($0.013)
Feb-13	$19.39	$19.20	$0.19	61.00¢	58.50¢	2.50¢	$1.899	$1.898	$0.001
Mar-13	$19.14	$19.10	$0.04	57.00¢	57.00¢	0.00¢	$1.876	$1.901	($0.025)
Apr-13	$18.95	$18.98	($0.03)	58.00¢	57.45¢	0.55¢	$1.870	$1.887	($0.017)
May-13	$18.90	$18.83	$0.07	58.50¢	58.00¢	0.50¢	$1.850	$1.875	($0.025)
Jun-13	$18.74	$18.65	$0.09	58.50¢	58.00¢	0.50¢	$1.849	$1.849	$0.000
Jul-13	$18.90	$18.75	$0.15	56.75¢	57.00¢	(0.25¢)	$1.859	$1.859	$0.000
Aug-13	$18.64	$18.57	$0.07	54.75¢	55.00¢	(0.25¢)	$1.855	$1.855	$0.000
12 Mo Avg	**$19.33**	**$19.12**	**$0.21**	**59.04¢**	**58.41¢**	**0.63¢**	**$1.891**	**$1.886**	**$0.005**

- Spot Market: Blocks gained 4¼¢ for the week, settling at $1.87¼/lb, while barrels picked up 5¼¢ to close at $1.82¾/lb. Buyers were aggressive, picking up 18 loads of blocks and 12 loads of barrels. Butter lost 1½¢ to settle at $1.85/lb on just 4 trades.
- All Class III components were higher in this week's Product Sales Report. 40-lb blocks gained 0.6¢ to average $1.85/lb while 500-lb barrels nudged 0.1¢ higher to $1.83/lb. Butter picked up 3.5¢ to average $1.80/lb, dry whey increased 1.4¢ to 57.5¢/lb and nonfat dry milk jumped 3.6¢ to average $1.36/lb.
- Dairy cow slaughter remains robust. For the week ended 09/01, 62,700 head were culled, up 16.5% vs. a year ago. YTD the cull is now up over 100,000 head from 2011.
- Fluid Milk East: Strong Class I demand has significantly limited manufacturing milk supplies in the Northeast and Mid-Atlantic regions. The strong Class I pulls have accentuated the declines in milk production, primarily brought about in recent weeks by producers culling their herds to meet available feed supplies. Milk production in Florida continues to be at/or near the seasonal low point. Some contacts have indicated that current production is the lowest it has been since 2009. Class I demand remains very strong and prompted 96 spot loads of milk to be imported this week. Declining milk production combined with very good Class I demand have severely tightened milk supplies in the Southeast region as well. Bottling plants are being held to their contracted volumes, even though additional loads have been requested. Any and all efforts are being made to supply bottling plants with additional loads. Milk shipments to manufacturing facilities are being held to their contract minimums. The region has imported 47 spot loads milk this week and continue to look for additional supplies. This is the highest number of imports into the region since the fall of 2010. Pulls for cream remain strong coming from cream cheese makers and some ice cream manufacturers. Some butter makers are also purchasing spot loads as they attempt to build inventories ahead of the fall and yearend holidays. Strong Class I pulls have significantly limited condensed skim milk supplies. Most manufacturers looking for additional loads have to go out of region and pay premiums to fill their needs. The strong demand for condensed skim comes primarily from yogurt manufacturers with some additional pulls from ice cream manufacturers and cheese makers. The tight manufacturing milk supplies continue to concern balancing plant managers and their ability to meet their future nonfat dry milk commitments.
- Fluid Milk Central: Cooler weather has helped with a small rebound in production levels, with some handlers reporting better than year ago volumes. However, even with the current teacher strike, demand for milk into Class I plants is good, with plants in the Chicago area using unexpected volumes as many students are still participating in school lunch programs. Interest from Class II manufacturers is good as cream cheese plants are beginning to ramp up production schedules. Reported tight milk supplies in the East are pushing demand for Central milk supplies and components. Cheese plants in the Midwest are looking for extra milk to boost production, but premiums of up to $3.00 are slowing interest.
- Fluid Milk West: Many processors are still seeing milk intakes at lower levels than a year ago in CA. Handlers supplying milk contracts are continuing to find it difficult to satisfy all milk needs. Contacts are reporting that the farm level financial stress is not being eased, even as milk prices increase. The high input costs are creating challenges that producers have not seen in several years. AZ milk production is uneven, reflecting monsoonal conditions across the milkshed. Lower milk receipts are being received at the processor levels and there are challenges to fill product categories. Wet weather conditions were common across much of NM. Farm-level milk production was impacted and there was less milk available to the processing plants. Plants are running on reduced schedules.
- Dry Whey East: Prices increased again this week. Cheese and dry whey production declined as strong Class I demand limited manufacturing milk supplies. Current production is moving through contracts with little being added to inventories. Very few spot sales were reported this week, an indication that supplies are becoming tight. The market undertone remains firm.
- CWT has accepted requests for export assistance to sell 385,809 lbs of butter. The products will be delivered from September through February 2013. They have also accepted requests for export assistance to sell 3.337 million lbs of Cheddar and Monterey Jack cheese, with delivery over the same period.
- Butter Central: Many butter producers were surprised to see the weak trend last week and remained unsettled early this week. Some are speculating that $2.00 butter might not be out of the picture before 2013. Churning activity across the Central part of the country is seasonally active, with some butter producers still looking for additional cream volumes. Butter demand for retail remains steady at good levels.
- Butter West: Increased production over the Labor Day holiday helped to build inventories. However, butter stocks are described as adequate, but tight for future needs. Manufacturers are easing up on outside cream sales to ensure enough butter is available later this year.
- NDM East: Manufacturing milk supplies have been significantly reduced due to strong Class I demand, limiting nonfat dry milk production. Inventories are being worked lower as production is short of demand needs. The tight manufacturing milk supplies continue to concern plant managers and their ability to meet their future nonfat dry milk commitments. Demand remains good with strong pulls from yogurt and baking manufacturers, but some buyers are resisting the higher prices and looking for lower priced imported product. The market undertone remains firm.

- NDM West: Producers continue to struggle to stay timely with contracted volumes. Reports of shipment delays are more common. Drying schedules remain light in the region as milk production is lighter than projections and filling into other categories. Traders and handlers are indicating some reluctance to buy and hold NDM above the $1.70-1.75 mark. While that may be the case for now, that philosophy could be tested in a potentially, tightly supplied fall market. Stocks are light to moderate and held with confidence.
- Cheese East: Cheese production has declined due to strong Class I pulls limiting the available manufacturing milk supply. Mozzarella makers would like to increase production due to good orders coming from food service and pizza makers. Most cheddar cheese makers are comfortable with their current inventories. Export demand and activity has improved.
- According to the USDA Foreign Ag Service, exports of cheese and curd for Jan-Jul 2012 total 359.5 million lbs, up 20% from the same period a year ago. The exports account for 5.7% of total cheese production in the U.S. Mexico continued to be the largest importer of cheese with 83.0 million pounds for the year or 23.1% of U.S. cheese exports.
- International: China milk crisis #?? Reuters reported this week that shares of China's Bright Dairy & Food Co Ltd fell more than 3% on Monday after it said was recalling batches of sour milk, the latest blow to the country's scandal-tainted dairy industry which is struggling to restore consumer confidence.
- International: Milk production in Europe continues to edge seasonally lower, with some milk producers and handlers indicating that current milk volumes are lighter at this time versus last year. Manufacturers and handlers are stating that stock levels are often not at desired levels for buyer interest. Traders are indicating that it is difficult to put together volumes for potential customers as suppliers are often pushing back deliveries of previous commitments already. Demand is good, but supply availability is the challenging factor at this time. Prices are firm as the Euro strengthens. European traders and handlers continue to monitor other international markets, especially the U.S. due to the hot and dry conditions of the summer and its potential impact on supply availability for their domestic market and international buyers. U.S. dairy farmers will be challenged with feed supplies and quality during the next year as heat and drought conditions during the past summer have negatively impacted feed stocks, especially grains. The European dairy industry is also struggling with feed availability and quality, thus for many farmers, comparable conditions will prevail.
- International: Although milk production is off to a strong start in Oceania, traders and handlers are indicating that buyer interest is strong. Much of this interest is from regular and ongoing customer needs. A large percentage of early production has been committed to this need with minimal uncommitted volumes available at this time. Oceania cheese markets and prices are firm. Traders and handlers are indicating that cheese demand is picking up as the new milk production season is resuming.

What's Bearish:

- Dry Whey Central: Prices are marginally higher this week. An increase in availability of spot whey has slowed the price climb. Buyers are taking more of a wait and see approach as supplies appear adequate for immediate needs.
- Dry Whey West: Western dry whey prices were higher this week, but spot market activity this week is mixed as more product was being offered to the market. Buyers appear to have taken a wait and see attitude for product above immediate needs. Manufacturer inventories are adequate for contract and export needs, with brokers holding adequate inventories for most spot needs.
- Butter Northeast: Cream is readily available as ample supplies of standardized cream are coming onto the market. Demand for cream is not as strong as in recent weeks and as a result churning schedules have increased. Current production is filling orders and adding to inventories.
- NDM Central: Buyers in the spot market appeared to take a less determined attitude into negotiations this week. Offerings of spot loads were more evident this week as resellers were willing to bring product to the market. Manufacturers had sufficient supplies to continue to provide contracted deliveries.
- Cheese Midwest: Cheese plants are generally finding milk to be readily available. In some areas of Wisconsin, milk supplies are reported to be at levels above one year ago. There is a sense that concerns of several weeks ago that milk supplies might be tight into the fall, are gradually easing. Some plants would make more cheese if more milk was available at class prices, but few are willing to pay a class premium to obtain extra milk, which is available for a premium. There seems to be a comfort factor that adequate milk will be available through the fall, so why pay a slight premium now to accumulate more inventory?
- Cheese West: Wholesale cheese prices in the West were lower as spot prices at the CME Group were weaker last week. Both buyers and sellers report that supplies are adequate for current needs. Cheese plants are looking for additional milk in some cases, but are reluctant to pay premiums that may not be recouped in the product. Inventories are clearing into retail stores and processors are taking barrel deliveries to build inventories of holiday cheese spreads. Export sales are slow as international prices are lower than U.S. domestic market.
- According to USDA's Foreign Ag Service, exports of dried whey for Jan-Jul 2012 total 296.3 million lbs, down 6% from the same period a year ago. Exports of butter and milkfat total 73.2 million lbs, down 26% from the same period.

Recommendation:

Milk is very tight in the East and mostly in balance in the Midwest and West, but there are signs that milk will begin to tighten there as well. We're hearing about idled drying plants in the West and heifer growers in the Midwest that are having a hard time placing animals. With feed coming off the fields, dairies are counting the cost and numbers of animals they'll be able to support this winter. International dairy prices are rising and feed costs are starting to bite into European operations as well. Overall, global demand seems pretty good, with not a lot of excess product on hand. The announcement of QE3 by the Fed this week sent the USD in a tailspin. While in the long run the U.S. may pay for what is essentially printing more USD, in the near term it has given a boost to the stock market and caused commodities to rise. It also makes our exports more affordable on the world market. A bullish tone returned to Class III this week after two weeks of retracement following losses in the spot market. This week, multiple bidders went after product. Cheese prices, then, continue to bounce around week to week in the $1.80's. The question is, will we finally break north into $1.90-2.00 land? We think so, but that doesn't mean as a producer you should sit on the sidelines. Consider the 19.00 x 22.00 fence for Q4 at a net cost of 5¢/month. That's awfully cheap insurance to guarantee a high minimum price on your output. Do it on up to 50% of your production.