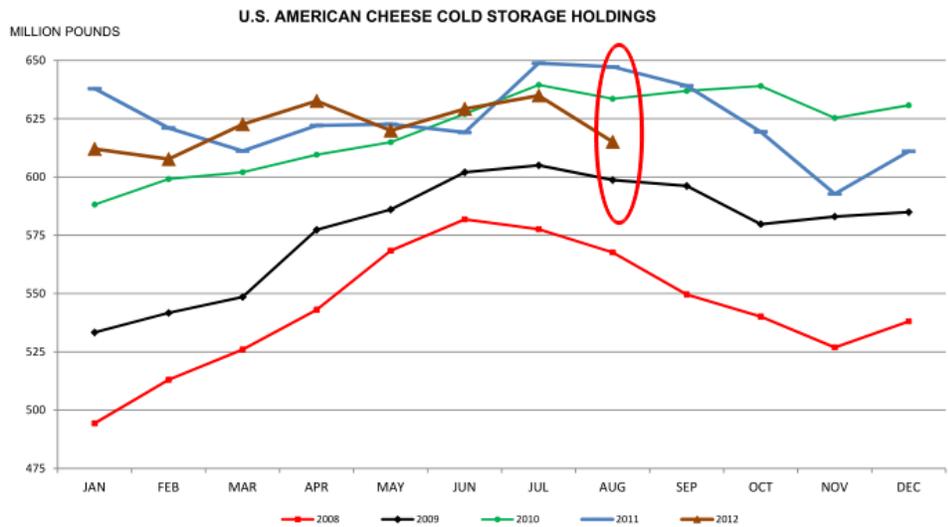


The KDM Dairy Report – September 28th, 2012

What's Bullish:

- Spot Market: Blocks picked up 7½¢ on the week to close at \$2.07½/lb, while barrels also gained 7½¢, settling at \$2.03½/lb. Buyers picked up 14 loads of blocks and just one load of barrels. Butter gained 6¢ to close at \$1.95/lb on just one trade, but Grade A NDM lost 3¢, settling at \$1.66/lb.
- Cold Storage Report: American cheese stocks in August were 5% lower than a year ago and down 3% from July (see graph). Total cheese stocks were down 6% and 4% over the same periods. Butter stocks were up 23% over last August, but fell a sharp 13% from July.
- Weekly cold storage numbers indicate both cheese and butter stocks declined in September. Cheese holdings at USDA selected storage centers fell 3%, or 3.3 million lbs, while butter stocks dropped 5%, or 582,000 lbs.
- Dairy cow slaughter for the week ended 09/15 totaled 63,400 head, up 4.3% from a year ago. YTD, 116,400 more dairy cows have been removed from the herd than last year, an increase of 5.6%.
- Fluid Milk East: Strong Class I demand in combination with seasonably low milk production continues to cause tight manufacturing milk supplies in the Northeast and Mid-Atlantic regions. Class I demand remains strong in Florida, prompting 120 spot loads to be imported this week, the same as last week. In the Southeast, Class I demand remains at increased levels and continues to be greater than available supplies can meet, prompting 65 spot loads to be imported this week. Load rejections due to aflatoxin have increased in the region. Milk shipments to auxiliary manufacturing plants are being held to their contract minimums. Condensed skim milk supplies remain very tight in the East as manufacturing milk supplies have been reduced.
- Fluid Milk Central: Farm milk continues to trend lower seasonally in the Mid to North Central areas. Recent changes in intake volumes noted at a few cooperative-owned facilities relate to gains/losses in membership rather than changes in overall milk production trends. Competition among milk handlers and/or cooperatives for milk from large dairy producers continues to affect plant intakes throughout the region. Spot milk load interest in the Central region varies widely. As production of holiday gift pack cheese varieties begins, some cheese plants are actively scouting for spot milk loads. Some handlers indicate their customers are comfortable with contract volumes, but others recorded sales topping \$1.50 - \$2.00 in premiums to the market within the region. A few rBST-Free milk loads are capturing premiums nearing \$3.00. Demand from East/Southeast bottlers pulled a few Central spot milk loads into those areas this week. Milk handlers anticipate that may continue off and on for the next few weeks.
- Fluid Milk West: CA milk production is trending slightly higher, but cost factors are high and concerns continue about the financial stress on the producer side of the dairy industry, even as dairy products and milk prices rise. Processing plants in the state are running on low to moderate pacing. Milk production in the Pacific Northwest remains mostly steady. Milk volumes are below year ago levels, but are adequate for most needs. UT and ID milk supplies are tighter than last year. Supplies are adequate for current manufacturing needs, but there are some discussions amongst processors concerning increased demand for milk as manufacturing needs are anticipated to increase with new plants coming on line in the near future. Dairy farmers have been reluctant to expand herds until they are more certain of profitable returns for their milk.
- Butter: The market tone remains firm with the CME cash butter price settling at \$1.9400 at midweek, the highest cash price in over a year. Currently, many butter producers and handlers are speculating that the cash price will soon reach the \$2.00 level. Churning schedules are seasonally active, with most butter manufacturers churning as much of their available cream as they can, to enhance butter inventories for upcoming 4th quarter needs. Bakery and confectionary orders are increasing as companies look to service upcoming holiday needs. Retail sales continue to be good with buyers looking to buy ahead of price increases. Early indications are that butter needs appear to be strong for the balance of the year.

Futures Month	Class III 09/28	Class III 09/21	Change	Dry Whey 09/28	Dry Whey 09/21	Change	Cheese 09/28	Cheese 09/21	Change
Sep-12	\$18.98	\$18.93	\$0.05	58.25¢	57.75¢	0.50¢	\$1.866	\$1.867	(\$0.001)
Oct-12	\$20.86	\$20.21	\$0.65	60.50¢	62.50¢	(2.00¢)	\$2.047	\$1.967	\$0.080
Nov-12	\$20.83	\$20.49	\$0.34	63.00¢	65.00¢	(2.00¢)	\$2.014	\$1.982	\$0.032
Dec-12	\$19.86	\$19.97	(\$0.11)	63.00¢	67.00¢	(4.00¢)	\$1.925	\$1.920	\$0.005
Jan-13	\$19.42	\$19.70	(\$0.28)	62.48¢	63.00¢	(0.52¢)	\$1.891	\$1.915	(\$0.024)
Feb-13	\$19.11	\$19.32	(\$0.21)	62.50¢	62.50¢	0.00¢	\$1.843	\$1.887	(\$0.044)
Mar-13	\$18.92	\$19.17	(\$0.25)	62.50¢	62.00¢	0.50¢	\$1.825	\$1.865	(\$0.040)
Apr-13	\$18.62	\$18.96	(\$0.34)	62.00¢	62.00¢	0.00¢	\$1.805	\$1.845	(\$0.040)
May-13	\$18.61	\$19.00	(\$0.39)	61.75¢	63.18¢	(1.43¢)	\$1.810	\$1.860	(\$0.050)
Jun-13	\$18.65	\$18.98	(\$0.33)	60.00¢	59.50¢	0.50¢	\$1.810	\$1.875	(\$0.065)
Jul-13	\$18.84	\$19.10	(\$0.26)	58.00¢	58.00¢	0.00¢	\$1.850	\$1.860	(\$0.010)
Aug-13	\$18.83	\$18.87	(\$0.04)	56.50¢	57.00¢	(0.50¢)	\$1.856	\$1.855	\$0.001
12 Mo Avg	\$19.29	\$19.39	(\$0.10)	60.87¢	61.62¢	(0.75¢)	\$1.879	\$1.892	(\$0.013)



- Dry Whey East: Manufacturing milk supplies remain tight and are limiting cheese and dry whey production. Current supplies are moving through contracts with little available for the spot market. Any available supplies are being held in firm hands as manufacturers are not inclined to sell loads on an upward trending market.
- NDM East: Strong Class I pulls in combination with seasonally declining milk production have significantly tightened the manufacturing milk supply and reduced production of nonfat dry milk. Current production is moving through contracts with little available for the spot market. The tight manufacturing milk supplies continue to concern plant managers and their ability to meet their future nonfat dry milk commitments. The market undertone remains firm.
- Grains: Corn stocks as of 9/1 were 125 million bushels below expectations, sending corn futures limit up on Friday. Corn inventories totaled 988 million bushels, the lowest level in eight years. Beans followed corn higher, despite revised higher stocks. Higher feed use implies both corn and beans will still need to be price-rationed into 2013.
- International: The global dairy market appears to be heading for a period of renewed supply scarcity in the coming 12 months, according to Rabobank. Rabobank senior dairy analyst Hayley Moynihan says the impetus for tightening emanates largely from the supply side, where low milk prices, extreme feed costs and pockets of unfavorable weather are expected to slow growth in milk production in export regions. "We fear that much of the market has been lulled into a false sense of security by the phenomenal growth seasons we saw late in 2011 and early 2012, with the next 12 months to provide a rude awakening," Ms. Moynihan says. Factoring in a modest planned increase in imports over the next 12 months from key buying regions, Rabobank expects prices to rise substantially in the international market in order to bring about the demand rationing needed to balance the market and move prices into alignment with the rallies already evident in US and EU wholesale pricing.
- International: Milk production in Europe continues to seasonally decline, with output steady to slightly lower than last year at this time. Supplies of manufactured dairy products are snug. Producers are very cautious with their commitments especially for the balance of the calendar year. Many traders are anticipating an announcement of a dairy product tender within the next few days and question what level of participation European suppliers might have with that tender. With supplies as tight as they are, participation with this tender will potentially clean up any uncommitted stocks that are available. Other international buyer interest is occurring, but tight supplies are limiting significant sales activity.
- International: Despite a strong start to the milk production season, traders and handlers in Oceania are reporting that sales activity has absorbed a significant portion of first quarter milk production and subsequent product production. Although second quarter commitments are well underway, some traders and handlers are more cautious with their commitments for this period, at least until they get a better picture on how the milk production season is developing.

What's Bearish:

- Despite recent strength in the spot market, most Class III components saw little price movement in this week's national survey. Butter actually decreased 1.3¢ from last week to average \$1.84/lb, as did 40-lb block cheddar, which was down 0.3¢ to \$1.85/lb. 500-lb barrels inched 0.8¢ higher to average \$1.83/lb, dry whey increased 0.8¢ to 59.3¢/lb and nonfat dry milk picked up 1.3¢ to \$1.39/lb.
- Dry Whey Central: According to some market contacts, the Central dry whey market is approaching, or already at a price plateau. Several resellers currently have dry whey spot loads available that compete pricewise with manufacturers' spot offerings. Some Central dry whey loads are also filling gaps in the East dry whey supply line.
- Dry Whey West: Prices are mostly steady with slight adjustments due to various contract indices. This week saw some weakness in export prices as European whey prices were reported to be softer. Whey production is adequate to fill contract needs.
- NDM Central: Central nonfat dry milk prices are mostly unchanged. Many market participants indicate that U.S. prices are idling as the market sorts through domestic and international supply/demand information. With availability of resale loads at competitive prices, some buyers indicate they are filling current needs actively through that avenue. Producers, too, indicate that buyers are hesitant to step up to higher priced spot NDM offers.
- International: August milk output in Australia was up 2.9% vs. a year ago, according to statistics released by Dairy Australia. Cheddar cheese output over the same period jumped 29.8%, with butter production up 30.4%.
- International: In New Zealand, the milk production season is well underway and early reports indicate that output is running heavier than last year at this time. Early season projections for the year are much the same as they have been for the past few weeks, 3 - 4% over output of two years ago. Milk producers indicate that herd health and conditioning in both New Zealand and Australia are the best they have been for a number of years.

Recommendation:

American cheese stocks are falling and below 2010 and 2011 levels, but \$2+ cheese on the spot market appears to be making the market nervous. The big question is, can \$2 cheese be sustained without killing demand, and for how long? Milk is still tight in the East but less tight everywhere else. As cow comfort improves with the cooler weather, increasing milk output vs. financial stress/culling may keep milk production about steady for now. But long-range forecasters predict demand will outstrip the milk supply well into 2013. That remains to be seen, but developing economies have been less affected by the economic downturn, and demand for dairy products is on the rise in those countries. The strong move higher in grains today virtually ensures feed costs are going to stay high for the foreseeable future. Cost of production will stay elevated. Dairies should look to get their corn use covered on any weakness. Our rec for milk stays the same this week. Just get a floor under it. Buy the Nov 19.75 PUT for 25¢ and target the Dec 19.25 PUT for 40¢. We'd still leave 2013 alone for now.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.