

The KDM Dairy Report – November 2nd, 2012

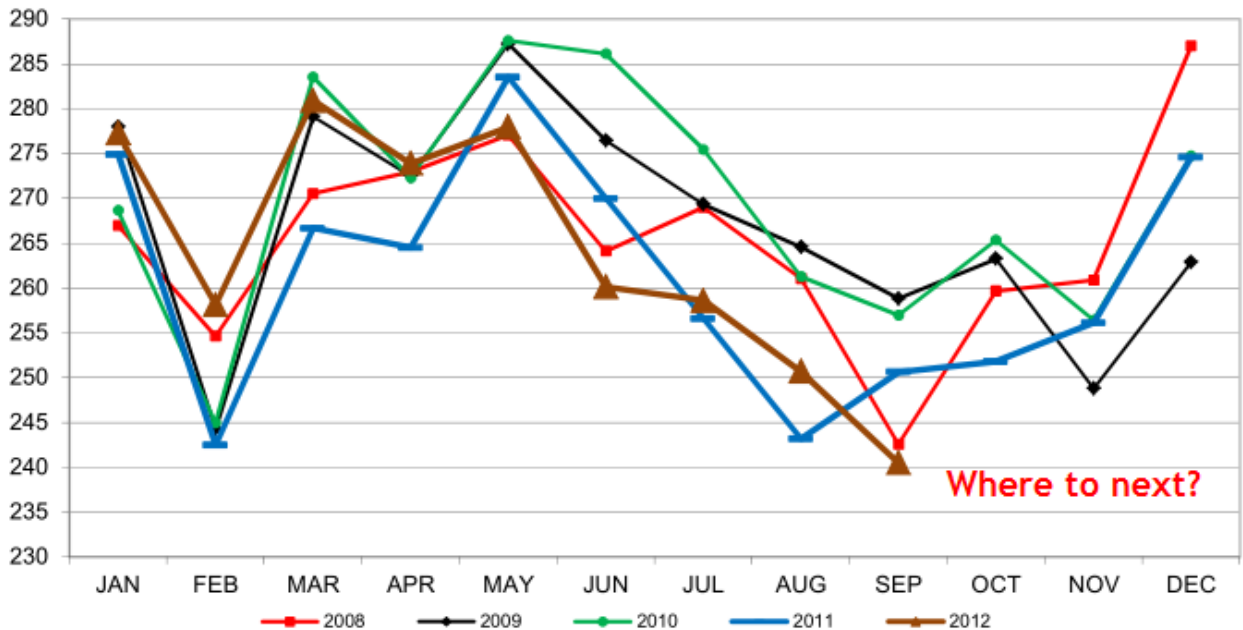
What's Bullish:

- Spot Market: Blocks lost a penny for the week, settling at \$2.11/lb on just 2 trades. Barrels closed unch at \$2.08/lb, but shot up 8¢ on Friday to close the block/barrel spread. Just 4 loads traded all week. Butter closed down ¼¢ to \$1.88/lb, but Grade A NDM increased a penny to \$1.57/lb.
- Dairy Products Report: Despite most milk production losses concentrated in the West (butter/powder country) and remaining robust in the Midwest, cheddar cheese output in September was down 2.7% vs. Sep '11, and down 4.1% from Aug. The Sep total for cheddar was the lowest in the last 4 years (see chart). Total cheese output was up just 0.3% from a year ago and down 1.9% from the prior month. Butter output in Sep declined 1.1% vs. last year, but was up 5.3% from Aug.

Futures Month	Class III 11/02	Class III 10/26	Change	Dry Whey 11/02	Dry Whey 10/26	Change	Cheese 11/02	Cheese 10/26	Change
Nov-12	\$21.20	\$21.13	\$0.07	62.95¢	62.60¢	0.35¢	\$2.064	\$2.059	\$0.005
Dec-12	\$20.40	\$20.28	\$0.12	63.78¢	63.45¢	0.32¢	\$1.985	\$1.986	(\$0.001)
Jan-13	\$19.46	\$19.50	(\$0.04)	59.95¢	60.00¢	(0.05¢)	\$1.915	\$1.912	\$0.003
Feb-13	\$19.10	\$19.26	(\$0.16)	59.00¢	59.00¢	0.00¢	\$1.884	\$1.880	\$0.004
Mar-13	\$18.97	\$18.99	(\$0.02)	58.73¢	60.00¢	(1.28¢)	\$1.871	\$1.860	\$0.011
Apr-13	\$18.95	\$18.85	\$0.10	57.98¢	60.00¢	(2.03¢)	\$1.872	\$1.855	\$0.017
May-13	\$18.78	\$18.66	\$0.12	58.23¢	59.75¢	(1.53¢)	\$1.833	\$1.830	\$0.003
Jun-13	\$18.65	\$18.60	\$0.05	57.88¢	59.25¢	(1.38¢)	\$1.840	\$1.840	\$0.000
Jul-13	\$18.55	\$18.57	(\$0.02)	56.75¢	57.00¢	(0.25¢)	\$1.830	\$1.830	\$0.000
Aug-13	\$18.46	\$18.50	(\$0.04)	56.00¢	56.00¢	0.00¢	\$1.831	\$1.831	\$0.000
Sep-13	\$18.43	\$18.50	(\$0.07)	54.50¢	54.50¢	0.00¢	\$1.825	\$1.825	\$0.000
Oct-13	\$18.24	\$18.35	(\$0.11)	53.00¢	53.00¢	0.00¢	\$1.805	\$1.805	\$0.000
12 Mo Avg	\$19.10	\$19.10	\$0.00	58.23¢	58.71¢	(0.49¢)	\$1.880	\$1.876	\$0.004

- Weekly cold storage numbers indicate cheese stocks were down 3% (3.066 million lbs) over the period 10/01 through 10/29. Butter stocks were up 15%, however.
- Dairy cow slaughter continues to run at elevated levels. 62,600 head were culled during the week ended 10/20, up 10.4% from 2011. YTD the cull is 146,000 head higher than a year ago.

MILLION POUNDS U.S. CHEDDAR CHEESE PRODUCTION



- Fluid Milk East: Hurricane Sandy caused significant interruptions in dairy manufacturing in the Mid-Atlantic region and in the southern portions of the Northeast. Numerous plant closures, for a day or two, occurred in New Jersey, Maryland and Pennsylvania. Some plants in other areas had periodic shut downs due to power outages with one major bottling plant remaining closed through Tuesday. Class I demand is very strong as plants attempt to resupply retailers, who saw their inventories depleted prior to the storm. Dairy product deliveries may be delayed due to trucking and transportation logistic problems caused by the storm. Milk production continues to increase in the Southeast region. Supplies are, for the most part, in balance with bottling demand. Manufacturing milk supplies continue to be held to their contract minimums. Due to the recent increase in rejected loads due to aflatoxin, bottling plants have increased testing to ensure product quality.
- Fluid Milk West: Milk production in CA continues to trend mostly steady across the state. Some local areas are seeing slight gains, but the overall tone has been flat for several weeks. Weather trends have been seasonally favorable and would normally be a slightly positive influence on milk output for this time of year, but the strong counter is the impact of feed costs and other inputs for those producers buying feed but balancing rations to mitigate expenses. September 2012 pool receipts of milk totaled 3.08 billion pounds, 3.0% lower than last year, according to CDFA. The September blend price, at a fat test of 3.71%, is \$17.64. The September quota price is \$18.42 and the over quota price is \$16.72. AZ milk production is moving higher, but farm level factors are constraining additional growth. Class I demand is fair to good and current retail featuring is creating additional pulls. Increases in cream demand are noted for cultured dairy products in Class II channels in advance of holiday needs. Demand for whips, cream cheese, sour cream, egg nog, and similar products is noted to be building as buyers secure needs. Rain and mild conditions prevail over most of the Pacific Northwest. Milk is off a bit in the region so operations are deciding where to put supplies for best returns and to fill existing contracts.
- Dry Whey East: Some cheese plant managers reduced production this week, because of not wanting to add to inventories while CME Group cheese prices are at their current levels. The resulting decline in dry whey production has some manufacturers delaying contract deliveries.

Damage to the Eastern transportation grid by Hurricane Sandy may also affect future product deliveries. Spot sales are very light with current production moving through contracts. Export demand remains good. Whey supplies are tight in the region, providing for a firm undertone.

- Dry Whey West: Prices were steady to fractionally higher this week. Producer stocks of whey are generally in balance with needs to tight. Some buyers indicate that they have to make additional calls to cover current needs. Whey production this past summer was above trend lines as plants shifted whey solids around, but output this fall is again below trend.
- International: Cheddar cheese output in Australia was down 3.5% vs. a year ago, but is still up 16.8% in the new season. Total cheese output was down 10.2% vs. Sep '11.

What's Bearish:

- Ag Prices Report: While still historically low, the milk-feed ratio for October came in at 1.68, the third month in a row the index has increased.
- Most Class III components were lower in this week's price survey. Butter decreased 3.6¢ to average \$1.89/lb. 40-lb cheddar blocks lost 1.7¢ to average \$2.07/lb while 500-lb barrels gave up 3.7¢ to \$2.03/lb. Dry whey made a new high for the year, up 0.5¢ to average 63¢/lb, and nonfat dry milk increased 1.4¢ to average \$1.49/lb.
- Fluid Milk Florida: Florida milk production appears to have turned the corner and is increasing as cooler weather has significantly improved cow comfort levels. Class I demand remains good, but has leveled off. Class I demand is expected to increase next week as Egg Nog production will increase as the holidays near. The increase in milk production has limited spot imports to 39 loads this week, down 78 loads from last week.
- Fluid Milk Central: Weekly customary milk shipments into manufacturers seem to satisfy most needs, according milk handlers. Interest in either selling or buying extra milk loads for manufacturing is low. Several handlers and manufacturers shared their expectation that milk loads may stairstep from East to the Central as the East region works through storm damage and power availability. However, most plant operators indicate there was little to no demand on Central region facilities to accommodate Eastern milk.
- Butter: Churning schedules across the country remain active, and in many instances, butter producers are not aggressively seeking additional cream volumes. Some extra cream was looking for a home in the Eastern part of the country this week as Hurricane Sandy impacted butter churns and Class II manufacturing facilities in the storm track. Butter stocks and projected fresh production are in fairly good balance for the upcoming holiday period. Orders continue to develop, but for the most part, Thanksgiving orders are in the books and shipments are on schedule.
- Dry Whey Central: Prices inched higher this week, but market participants describe the dry whey market as boring. Dry whey spot loads are readily available from several Central manufacturers and the trade. Spot offers from some manufacturers and most resellers yield some price discounts to the market.
- Cheese East: Hurricane Sandy had little effect on cheese plants in the Northeast as most plants received near normal intake milk volumes with only minor, periodic power outages. Cheese production was mixed with some plants at steady production levels, while others are lowering production, unwilling to expand inventories at the current price levels on the CME Group. Some cheese makers continue to increase cheese going into aging programs, because of lower input costs compared to previous years. Cheese production declines have been partially attributed to slower incoming orders and reduced governmental purchases of cheese for school lunch and institutional needs.
- Cheese Midwest: Orders are being met and inventories are "comfortable". However, some manufacturers in the Midwest note that they expect cheese manufacturing volume to increase in coming weeks as more milk becomes available seasonally beginning after Thanksgiving. Plants expect to make more cheese as a result. This leaves the current manufacturing/sales situation as mostly stable in the present, but expected to generate more cheese in the near future. From a manufacturing perspective the overall cheese supply/demand situation is probably fairly well in balance, but there is concern that continuation of CME price swings will cause retailers to be more tentative in ordering, which could adversely affect sales in the longer run.
- Cheese West: Price gyrations in the CME spot market are causing some buyers to change ordering plans and for manufacturing plants to modify production schedules. None of this uncertainty is helping to sell extra cheese. Production at most operations is lighter than anticipated.

Recommendation:

Class III futures were mainly steady this week with some contracts up and others down. With block cheese holding above \$2/lb for more than 30 days and wild weekly swings in the barrel price, buyers are on edge. Cheese makers don't want to make any extra cheese either, and be forced to put it in inventory at these prices. On the other hand, holiday buying is not done so there is still some pent up demand. Current spot prices work out to about \$21.70 Class III. With just two weeks to go before the December contract begins pricing, if cheese prices hold or go higher next week, the front months, which have been reluctant to move lately, will be forced to meet spot. That could mean more than \$1 move higher for Dec, which settled today at \$20.40. With dairy culling continuing to remain robust, it's unlikely we'll see major gains in milk production in the near future. On the other hand, if demand weakens, we may not need the milk and could see a sizeable correction in the market. International prices continue to exert downward influence on prices as well. We continue to recommend a conservative hedging strategy. Consider the Jan-Jun the 17.50 x 21.00 fence. Consider selling up to 25% of your production July-Dec at \$18.35 avg or better.

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