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The KDM Dairy Report – November 9th, 2012

What's Bullish:

Futures Month	Class III 11/09	Class III 11/02	Change	Dry Whey 11/09	Dry Whey 11/02	Change	Cheese 11/09	Cheese 11/02	Change
Nov-12	$20.78	$21.20	($0.42)	63.98¢	62.95¢	1.03¢	$2.016	$2.064	($0.048)
Dec-12	$19.49	$20.40	($0.91)	63.38¢	63.78¢	(0.40¢)	$1.890	$1.985	($0.095)
Jan-13	$18.93	$19.46	($0.53)	59.50¢	59.95¢	(0.45¢)	$1.851	$1.915	($0.064)
Feb-13	$18.76	$19.10	($0.34)	57.25¢	59.00¢	(1.75¢)	$1.850	$1.884	($0.034)
Mar-13	$18.85	$18.97	($0.12)	56.75¢	58.73¢	(1.98¢)	$1.855	$1.871	($0.016)
Apr-13	$18.82	$18.95	($0.13)	55.98¢	57.98¢	(2.00¢)	$1.850	$1.872	($0.022)
May-13	$18.76	$18.78	($0.02)	56.00¢	58.23¢	(2.23¢)	$1.836	$1.833	$0.003
Jun-13	$18.65	$18.65	$0.00	56.00¢	57.88¢	(1.88¢)	$1.835	$1.840	($0.005)
Jul-13	$18.55	$18.55	$0.00	56.75¢	56.75¢	0.00¢	$1.840	$1.830	$0.010
Aug-13	$18.47	$18.46	$0.01	56.00¢	56.00¢	0.00¢	$1.835	$1.831	$0.004
Sep-13	$18.41	$18.43	($0.02)	54.00¢	54.50¢	(0.50¢)	$1.830	$1.825	$0.005
Oct-13	$18.33	$18.24	$0.09	52.50¢	53.00¢	(0.50¢)	$1.811	$1.805	$0.006
12 Mo Avg	**$18.90**	**$19.10**	**($0.20)**	**57.34¢**	**58.23¢**	**(0.89¢)**	**$1.858**	**$1.880**	**($0.021)**

- World Ag Supply & Demand Report: USDA revised their 2013 Class III forecast higher based on higher whey and nonfat dry milk prices. Class III is now expected to average $18.30/cwt, up 10¢/cwt from last month's forecast.
- Most Class III prices were up in this week's sales report. Butter increased 0.7¢ to average $1.90/lb, dry whey bumped 0.9¢ higher to 63.9¢/lb and nonfat dry milk increased 0.6¢ to $1.49/lb. 40-lb block cheddar decreased 0.7¢ to average $2.06/lb, but 500-lb barrels were up 1.8¢ to $2.04/lb.
- Dairy cow slaughter continues at a strong pace. 62,900 head were removed from the milking herd for the week ended 10/27, up 5.2% vs. a year ago.
- Fluid Milk East: Class I demand is very strong in the wake of Hurricane Sandy and has tightened manufacturing milk supplies in the Northeast and Mid- Atlantic regions. Some milk producers in New Jersey were forced to dump milk due to power outages and/or transportation problems. Numerous warehouses lost dairy products, both dry and refrigerated, due to flooding and/or power outages. The extent of inventory losses at the retail or wholesale level has yet to be fully determined. Milk production in Florida has significantly increased as mild weather continues, improving cow comfort levels. Some co-ops have encouraged their producers to increase herd size with limited success. High feed and replacement heifer costs are factoring into producers' decisions not to expand their herds at this time. Milk production in the Southeast region has also picked up significantly this past week, but supplies are basically in balance with demand with most auxiliary manufacturers being held to their contract minimums. Loads rejected due to high aflatoxin remain a problem, resulting in loads being dumped.
- Fluid Milk Central: Farm milk production and intakes are variable in the Central region. Some marketers note that as dairy producers introduce 2012 silage into rations, milk production is decreasing somewhat. Also, auctions continue to cull more animals and redistribute animals interregionally. Spot milk marketing is light within the region. Most plants are working with intakes from regular suppliers and not seeking outside milk.
- Butter West: Although buyers are looking for the market to weaken, they continue to purchase on an as needed basis for holiday orders. Butter manufacturers report steady sales demand for immediate delivery. Churns are operating to fill demand while being careful to keep inventories down.
- Dry Whey Northeast: Prices for dry whey increased again this week. The market has seen price increases for 18 consecutive weeks. Production has been limited in recent weeks as many cheese makers were not inclined to increase inventories when CME Group cheese prices were over $2.00. Dry whey in the region is moving through contracts with virtually no spot or resale activity. Supplies are tight with some manufacturers lagging behind their contract deliveries. Domestic and export demand are good and the market undertone remains firm.
- Dry Whey Central: This week, market participants learned a Central dry whey plant will cease operations within the next few months. This development raised questions in the marketplace regarding 2013 Central dry whey supplies. Many dry whey buyers indicate trying to become a new customer at another facility is difficult as projected dry whey production is contracted close to 90 - 95% at some of the remaining facilities, leaving a minimal buffer zone to accommodate new customers.
- Dry Whey West: Spot activity is light as the bulk of current production is tied to contract deliveries, leaving little excess available.
- NDM East: Prices for nonfat dry milk increased this week. Another storm hit the Northeast region Wednesday, further complicating recovery/relief efforts, slowing transportation and disrupting dairy manufacturing schedules. Class I demand is strong and is limiting manufacturing milk supplies and thus production of nonfat dry milk has declined. Demand has increased from baking manufacturers, ahead of the upcoming holiday. Most supplies are moving through contracts. Inventories are fairly tight as production has been limited for a number of weeks. The market undertone is firm.
- NDM Central: Prices are mostly higher on a moderately firming market. Various brokers and traders remarked that spot loads were tougher to find from Central manufacturers this week, and competition for loads was increasing. NDM production in the Central region is steady, well below capacity, and pinned to manufacturing milk availability.
- Cheese East: Strong Class I demand has tightened milk supplies going to cheese plants with cheese production slightly below week ago levels. Most cheese makers are attempting to match production with orders, not wanting to expand inventories at the current cheese price levels on the CME Group.
- Cheese Midwest: Milk supplies going into cheese plants are mostly in balance with their production schedules. Overall cheese production for the region is steady with some plants slightly increasing and others slightly decreasing production. A co-op announced the closing of one its cheese plants by year's end and will adjust the excess milk supply to its other plants. Inventories are steady with the exception of mozzarella which is viewed as tight. Most cheese makers in the region are hesitant to build inventories. Demand for cheese is mixed with lagging export sales, but domestic demand remains fairly strong.
- Cheese West: Western cheese prices were firmer this week. Buyers and sellers are cautious about prices remaining at current levels, but Western milk supplies are below previously expected levels. Cheese plants are watching inventories and are reluctant to build supplies with any purchased milk above contracted needs. Demand at the retail level has been good.

- International: Milk production in Western Europe continues to decline. Milk handlers are stating that supplies are snug and dairy product manufacturers are gearing their production schedules to the limited supply of milk. In most instances, liquid milk is the most active product at this time with minimal drying occurring. Drinking milk is absorbing a significant portion of available milk supplies with the balance clearing to other needs in a liquid or condensed form. Cream volumes are tight and actively being sought for fresh product needs. Much of this need is for upcoming holiday cream based products. Overall supplies of manufactured dairy products in Europe are tightening. Traders and handlers are indicating that often firm prices are limiting international sales activity, with most sales centered around an internal or domestic market. Since mid-August, nearly half of PSA butter has been removed from the program.
- International: Cheddar cheese exports from Australia were down 11.1% Jul-Sep vs. a year ago, according to Dairy Australia. Total dairy exports were up 3.1%, with the biggest jump coming from butter (up68.5%) and SMP (up 34.8%).

What's Bearish:

- Spot Market: Blocks plunged 19¢ on 8 trades (all Friday) to settle at $1.92/lb. Barrels lost even more, down 24½¢ on 16 trades to close at $1.83½/lb. Butter gained ¼¢ on 11 trades to settle at $1.89/lb and Grade A NDF was up ½¢ on 2 trades to settle at $1.57½/lb.
- Fluid Milk Central: The expected tightening in the cream market has yet to materialize, according to a few cream buyers. Some Central churn operators reported cream from the East is still clearing into Central butter/powder operations at multiples that are unchanged from last week. They relate the cream availability to decreased ice cream making and increased yogurt making in that region. Also, there is a need to find processing capacity outside the East, sending cream loads into the Central region.
- Fluid Milk West: CA milk production is steady to trending slightly higher in the major milk producing areas of the state. Weather conditions are typically good to ideal for milk cows. Plant intakes are along expectations. Recent milk prices have moved higher as a result of higher dairy product prices, and this is helping to offset recent months of loses, though cost of production remains high. AZ milk output is moving higher on a weekly upwards trend, helped along by very good conditions for making milk. Processing schedules are building at the plant level. Class I demand is fair to good, with good retail features noted. The cream market is seeing uneven demand across market segments. Supplies and offerings are on the moderate side and generally are in excess of buyers' needs at this point. Excess cream is still moving to the butter churns and printers are actively making print butter. Cool, seasonal weather in the Pacific Northwest is helping to maintain milk production levels. The weather is favorable for dairy cows and milk production. Milk levels are at expected amounts and supplies are being moved within the region to maximize returns.
- Butter Central: Producers and handlers feel that a weak pricing trend will continue for the foreseeable future as yearend butter orders continue and are finalized. Churning schedules are seasonally active with many butter producers churning regular sourced cream volumes and not seeking additional volumes. Some butter producers are indicating that they are being offered cream volumes and are often not taking advantage of the offerings unless attractively priced.
- Butter East: Standardized cream volumes are significant as Class I demand is very strong in the wake of last week's storm. Cream stored in tankers and silos at various facilities during the storm is also adding to cream supplies. Demand for butter remains good as holiday orders continue to be strong with most inventories being worked lower. Export loads may be delayed out of New York as port operations recover from the disaster.
- Hurricane Sandy: The effects of Hurricane Sandy on consumer demand for cheese and other dairy products are still being felt. Some areas have yet to see a return of electrical power and in those areas demand for refrigerated dairy products has all but been eliminated. The area severely damaged by the storm is geographically small, but the area is densely populated. Cheese being exported may be delayed as the port of New York is still recovering from the storm and is allowing only limited departures.
- International: New Zealand milk producers and handlers are indicating that the peak was probably two weeks ago, but generally maintaining a high level. Many milk handlers are speculating that the peak was slightly higher than last year. Milk handlers remain very optimistic about the upcoming season and continue to anticipate a 3-4% growth pattern over 2 years ago which would be a few percentage points lower than the very positive season last year. In Australia, the milk production season is basically at peak levels with some Victoria regions recording very positive growth. Overall, milk volumes are running 2% stronger than last year at this time. Manufacturing facilities in both New Zealand and Australia are at or very near capacity levels. Stocks of manufactured dairy products are readily available for contractual needs and some uncommitted volumes at this peak time of the season are being reported.

Recommendation:

Call it an election reaction or hurricane Sandy fallout, but either way (or both), despite indications that manufacturing milk remains largely tight around the country, market makers are more worried about a potential drop in demand. Bidders stepped aside in the spot market, allow prices to be offered substantially lower. We did see some aggressive buying today, however, so it's possible we're getting close to putting in a bottom. More than $2/cwt was shaved off the Class III calculation this week; current spot prices work out to about $19.57/cwt. Another possible explanation for this week's drop is the need to clear out some inventory nearing the 30-day age mark. After 30 days, it can't be sold on the spot market. We're not going to call a bottom, but are pretty strong in our belief that prices will once again come back up, and sooner rather than later. We are not at a level that is not profitable for much of the West, and 3-4 months of it would most likely hurt milk production substantially as more dairies went under and more cows were liquidated. As far as hedging, this is just another lesson to get something done before an unanticipated fall. It's awfully hard to sell or buy PUT options in a down market. The Dec 19.00 PUT settled at 26¢. If you need some piece of mind and need protection in this month, it might not be a bad idea to buy these. We can't see selling 2013 at this point, but if 18.58 average for the year is profitable for you, consider marketing a small percentage of your production.