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

The KDM Dairy Report – January 18th, 2013

What's Bullish:

Futures Month	Class III 01/18	Class III 01/11	Change	Dry Whey 01/18	Dry Whey 01/11	Change	Cheese 01/18	Cheese 01/11	Change
Jan-13	$18.11	$18.06	$0.05	64.25¢	63.10¢	1.15¢	$1.755	$1.752	$0.003
Feb-13	$17.28	$17.61	($0.33)	58.95¢	57.28¢	1.68¢	$1.700	$1.730	($0.030)
Mar-13	$17.12	$17.70	($0.58)	54.48¢	53.60¢	0.88¢	$1.707	$1.771	($0.064)
Apr-13	$17.60	$18.00	($0.40)	54.10¢	53.75¢	0.35¢	$1.769	$1.800	($0.031)
May-13	$18.13	$18.27	($0.14)	53.75¢	53.75¢	0.00¢	$1.812	$1.822	($0.010)
Jun-13	$18.47	$18.50	($0.03)	55.50¢	54.50¢	1.00¢	$1.840	$1.842	($0.002)
Jul-13	$18.61	$18.65	($0.04)	55.25¢	54.50¢	0.75¢	$1.846	$1.857	($0.011)
Aug-13	$18.70	$18.64	$0.06	54.50¢	54.50¢	0.00¢	$1.860	$1.860	$0.000
Sep-13	$18.58	$18.46	$0.12	54.03¢	53.78¢	0.25¢	$1.847	$1.845	$0.002
Oct-13	$18.39	$18.33	$0.06	54.03¢	53.75¢	0.27¢	$1.830	$1.827	$0.003
Nov-13	$18.26	$18.25	$0.01	54.50¢	54.30¢	0.20¢	$1.817	$1.820	($0.003)
Dec-13	$18.13	$18.20	($0.07)	54.03¢	53.75¢	0.27¢	$1.800	$1.795	$0.005
12 Mo Avg	**$18.21**	**$18.22**	**($0.01)**	**55.61¢**	**55.05¢**	**0.57¢**	**$1.799**	**$1.810**	**($0.012)**

- Dairy stocks continue to increase in Jan at USDA selected storage centers. Over the period 01/01 through 01/14, butter stocks have increased 34%, or 1.8 million lbs, while cheese stocks are up 1%, or 0.94 million lbs.
- Fluid Milk West: The financial stress on dairies in CA continues with stronger grain prices noted since last Friday's crop report. Hay prices remain high and quality offerings are declining in volume from some areas. Plants are generally operating on less milk than last year.
- International: Western European milk production conditions have been generally neutral. Milk intakes have been on the lower side of expectations and processors did not see a big boost in milk intakes that some had projected. Milk prices are steady to trending higher across many countries, and feed costs are constraining supplemental feeding. EU dairy product markets are firm with prices stable to higher. The higher value of the Euro against other currencies is making European dairy product offerings more expensive into export channels. The current pricing for butter and whole milk powder are high compared to other supplying countries and thus limiting export potential.

What's Bearish:

- Livestock, Dairy & Poultry Outlook Report: USDA raised their 2013 milk production estimate slightly from last month, and lowered their cheese, butter and milk price forecasts. Prices were revised lower due to current price weakness and slower demand than expected.
- Spot Market: Blocks gave up 3¼¢ for the week to settle at $1.68¾/lb while barrels lost 3½¢ to close at $1.63¾, all new lows for 2013. 9 loads of blocks exchanged hands, and 18 loads of barrels. Butter gained a nickel to settle at $1.50½/lb on 6 trades.
- The dairy cow slaughter is getting off to a slow start in 2013. Just 51,100 head were culled for the week ended 01/05, down 7,100 head, or 12.2% vs. a year ago.
- Fluid Milk East: Milk production is increasing and above year ago levels in the Northeast, keeping manufacturing milk supplies fairly heavy. Class I demand is good, but has leveled off as pipelines are now full. Class I demand continues strong in the Southeast, but milk production is increasing. Cream volumes remain heavy as cream coming from yogurt production, standardized cream from bottling plants and high butterfat levels from increasing milk supplies, are all contributing to the overall supply. Demand is steady to weak as supplies quickly outpace demand, causing a majority of the cream to be channeled to churns. A few loads over the weekend had to move to the Midwest in order to find a home.
- Fluid Milk Central: Milk handlers continue to report farm milk pickups are on the rise, surpassing expectations of many handlers. Handlers attribute the strong uptick in volumes to the mild winter conditions prevailing across the Central region. Independent milk marketers and several cooperative representatives indicate that fluid demand is stagnant. The combination of light fluid demand and increasing farm milk intakes is resulting in plentiful spot loads of milk. Prices on milk spot loads retreated this week from flat Class, falling to $1-3 under Class. Spot milk loads are also traveling long distances to find processing room.
- Fluid Milk Southwest: Cream markets continue to show signs of weakness, with offerings much heavier than anticipated. Surplus loads are heading into Minnesota and Wisconsin. The cold weather in the West is not helping to sell high fat dairy products at this time. Milk supplies are being called heavy in AZ. Plants are scrambling in the region to handle the milk efficiently. NM contacts indicate their milk flow remains a bit above expectations in some areas and fat and protein tests remain good.
- Butter: Cream supplies are readily available this week leading to all varieties of butter, 80%, 82%, salted and unsalted, being produced in various parts of the country. In all regions, manufacturers are responding by churning more butter than current orders require. Many manufacturers are content to inventory the additional butter which exceeds current needs, rather than offering to spot markets.
- Dry Whey East: Heavy milk supplies have cheese makers in the Northeast running production schedules 7 days a week at most facilities. The resulting increases in dry whey production are moving through contracts and adding to inventories. Spot sales activity for domestic destinations is light with many buyers taking a wait and see attitude. As one buyer stated "Nobody wants to catch a falling knife", implying that the current buying sentiment sees building inventories pressuring prices lower. Some whey manufacturers are willing to discount spot sales in order to better manage their inventories. The weak demand has prompted some significant discounts in resale activity.

- Dry Whey Central: Prices are lower and the market tone is weakening. Decreased demand for fluid milk is keeping cheese plant milk intakes near capacity, and keeping dryers active clearing condensed whey into inventories. Lower western prices are providing competition to Central dry whey manufacturers, especially when cost plus transportation charges still keeps the final price below Central dry whey offers. Dry whey inventories are building steadily at several manufacturers' locations.
- Dry Whey West: Prices were lower this week and export prices have been at a discount to domestic prices for weeks, which is beginning to influence overall pricing. Increased offerings to the spot market are pressuring sellers to compete with off shore prices to move any excess supplies. Whey production is below year ago levels, but demand from international buyers is lower that of a year ago also.
- Cheese East: Milk production off the farm is increasing, keeping milk volumes going to cheese plants at increased levels. Most plants are running production 7 days a week. Current orders, for the most part, are less than desired with expanding inventories.
- Cheese Midwest: Cheese manufacturers in the upper Midwest generally agree that 2013 has opened with slow retail orders and slightly heavy milk supplies. Manufacturers lament that retail cheese purchases have not been as strong as hoped for. Recent spot market price declines have caused retail orders to slow, as professional buyers hold back to allow lower averages to factor into pricing.
- Cheese West: Western spot cheese markets were weaker. After two weeks of higher weekly average pricing, the market moved lower this week. The market tone has softened as buyers feel there is more cheese available.
- International: Oceania cheddar pricing is mostly steady and production is active with plants open to process the milk supplies. Global cheese demand is flat and traders/handlers are resuming negotiations for future orders. Domestic demand is uneven after the holidays. Cheese volumes in storage are in a balanced position to meet current and upcoming shipments.

Recommendation:

It appears more financial pain will be inflicted before the dairy market makes its comeback. Dairy sales are slow, while we have heavy milk supplies in the Northeast, Midwest and even in Arizona! Cream is moving from the Southeast and West into the Midwest, just trying to find a home. Heavy cheese output is increasing dry whey supplies, leading to weaker prices. Class III futures were whacked again this week, with the biggest loser being Mar, down 58¢ for the week and hitting a low of $17.08 today, perilously close to the $16 level. With cheese buyers remaining on the sidelines, the spot market continued to work its way lower as excess product is brought to the CME. Using current spot cheese and Mar dry whey futures prices, Class III works out to about $16.80/cwt. We don't expect any change in trend in the spot market, meaning cheese prices could head even lower. In fact, we think we'll see Class III dip below $17, possibly as early as next week. If you don't have Feb and Mar protected, you better act quick. We would buy the Feb 17.00 PUT at 11¢ or the 17.25 PUT at 20¢. Consider the Mar 17.00 PUT for 30¢, or hope for a rally above 17.50 and sell it. We still believe higher prices are coming our way, but we first need to work through the current excess milk supply. We could be setting up like 2011. Recall Jan settled at $13.48, but then roared higher to $17.00 in Feb and $19.40 in Mar. We don't think that will happen in these same months, but Q2 could get interesting. In the meantime, be prepared for further weakness before things get better.

Note: Our offices will be closed on Monday in observance of the MLK holiday. Financial markets will be closed.