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

The KDM Dairy Report – January 25th, 2013

What's Bullish:

Futures Month	Class III 01/25	Class III 01/18	Change	Dry Whey 01/25	Dry Whey 01/18	Change	Cheese 01/25	Cheese 01/18	Change
Jan-13	$18.12	$18.11	$0.01	64.25¢	64.25¢	0.00¢	$1.754	$1.755	($0.001)
Feb-13	$17.02	$17.28	($0.26)	59.00¢	58.95¢	0.05¢	$1.668	$1.700	($0.032)
Mar-13	$16.95	$17.12	($0.17)	55.58¢	54.48¢	1.10¢	$1.680	$1.707	($0.027)
Apr-13	$17.30	$17.60	($0.30)	53.70¢	54.10¢	(0.40¢)	$1.742	$1.769	($0.027)
May-13	$17.85	$18.13	($0.28)	54.50¢	53.75¢	0.75¢	$1.790	$1.812	($0.022)
Jun-13	$18.37	$18.47	($0.10)	55.25¢	55.50¢	(0.25¢)	$1.817	$1.840	($0.023)
Jul-13	$18.54	$18.61	($0.07)	56.05¢	55.25¢	0.80¢	$1.835	$1.846	($0.011)
Aug-13	$18.56	$18.70	($0.14)	56.05¢	54.50¢	1.55¢	$1.835	$1.860	($0.025)
Sep-13	$18.49	$18.58	($0.09)	55.75¢	54.03¢	1.73¢	$1.835	$1.847	($0.012)
Oct-13	$18.32	$18.39	($0.07)	54.03¢	54.03¢	0.00¢	$1.815	$1.830	($0.015)
Nov-13	$18.18	$18.26	($0.08)	54.50¢	54.50¢	0.00¢	$1.807	$1.817	($0.010)
Dec-13	$18.10	$18.13	($0.03)	54.05¢	54.03¢	0.02¢	$1.799	$1.800	($0.001)
12 Mo Avg	**$18.21**	**$18.12**	**$0.10**	**56.06¢**	**55.61¢**	**0.45¢**	**$1.781**	**$1.799**	**($0.017)**

- Dairy cow slaughter for the week ended 01/12 totaled a strong 72,500 head, the highest weekly total in more than 5 years and a 15.8% jump over the same period a year ago.
- Fluid Milk East: Manufacturing milk supplies are steady in the Northeast and Mid-Atlantic regions as milk production has leveled off. Bitterly cold temperatures and wind chills in the upper Northeast may provide a surge in fluid sales as the public stocks up ahead of the adverse weather. The combination of increased Class I demand and flat milk production, below year ago levels, has brought about the need to import spot loads of milk into Florida. This is the earliest imports have occurred since 2006. Milk production increases have been stymied by lower producer margins, limited feed and forage availability and warm summer like weather lowering cow comfort levels. Producers have to continue with supplemental hay feeding as pastures have been slow to regrow due to dry conditions. The US Drought Monitor currently has 60% of the state listed as abnormally dry. Spot milk shipments imported into the state this week totaled 84 vs. a year ago when 70 loads were exported. Only marginal supplies of milk are being diverted to auxiliary manufacturing facilities.
- Fluid Milk West: Weather conditions in CA have been dry for a number of weeks and contacts indicate that the state needs rain. Most all plants indicate that they are getting less milk than last year. Also, they do not expect much chance of a rebound with milk prices moving lower and feed/hay prices remaining firm. AZ contacts indicate that milk production is flattening out in the region. The feed/milk price stress is increasing and producers don't believe that will end any time soon.
- CWT has accepted requests for export assistance to sell 3.814 million lbs of Cheddar and Monterey Jack cheese. The product will be delivered January through June 2013.

What's Bearish:

- Spot Market: Blocks shed another 4½¢ for the week to settle at $1.64½/lb while barrels lost 5½¢ to close at $1.57¼/lb. Trading was light with just 4 loads of blocks and 10 loads of barrels exchanging hands. Butter was unchanged at $1.50½/lb with 4 trades.
- Milk Production Report: Milk output in Dec was up 1.6% vs. a year ago, and cow numbers increased for the second consecutive month. The dairy herd finished just 10,000 head shy of last year's levels. With the herd getting younger, milk per cow jumped 31 lbs over last year, to 1,826. Gains were led by KS up 10%, CO up 6.3%, and WI and MI both up 5.5%.
- Cold Storage Report: Butter stocks in Dec were 43% higher than a year ago and increased 20% from Nov. American cheese stocks were down 1% vs. last Dec, but up 4% from Nov. Total cheese stocks were unchanged from a year ago but jumped 5% from Nov.
- Livestock Slaughter Report: Dairy cow slaughter in Dec totaled 258,800 head, down 1.2% vs. a year ago, the first time in 2012 that numbers fell below 2011 levels. For the year, 3.1 million dairy cows were culled, the highest total in more than 7 years and an increase of 6.4% over 2011.
- Most Class III components were lower in this week's price survey. 40-lb cheddar blocks fell a penny to average $1.74/lb and 500-lb barrels declined 1.1¢ to $1.73/lb. Butter decreased 4.4¢ to average $1.48/lb and dry whey lost 1.2¢ to 64.5¢/lb, but nonfat dry milk managed to pick up 2.3¢ to average $1.57/lb.
- Cold storage numbers so far in Jan paint an ugly picture. For the period 01/01 through 01/21, butter stocks have increased 75%, or 4.1 million lbs at USDA selected storage centers. Cheese stocks are up 2%, or 2.1 million lbs over the same period.
- Fluid Milk Central: Milk handlers and processors indicate farm milk pickups and intakes continue to surpass expectations and show steady increases from week to week. Milk marketers report spot milk loads are readily available in the Central region and pricing has not gained any traction compared to last week. Prices on spot milk loads continue to range from flat Class to $3 under Class. Class I demand is light and various cheese plant operators indicate they are not receiving any calls for loads of milk to accommodate bottled demand.
- Fluid Milk Pacific Northwest: Milk supplies are reported to be increasing slowly. Higher farm milk prices over recent months have helped to maintain and in some instances build herds in the region. Milk component levels are reported higher and helping to build processing yields. Class I usage is following along expected levels. UT and ID milk production is also building slowly. Locally grown feed supplies are reported to be available for current needs. Increased demand in the region for milk has helped to maintain herd size and keep farm milk prices competitive.

- Butter: Manufacturers indicate cream is still ample and multiples are still lower than what is needed to sell spot cream above flat market. Internally generated cream as well as cream coming from Class II operations is moving through the churns and into bulk butter inventories. Central region churning operations are especially active as spot loads from the East and the West are also clearing through the Midwest. Retail demand is light, and retailers trimmed butter advertisements by almost 17% compared to two weeks ago.
- Dry Whey East: Domestic demand remains sluggish with many potential buyers taking a wait and see attitude, anticipating prices to fall in the near term. The weak demand has prompted some significant discounts in resale activity with prices reported in the mid $0.50's. Export interests are able to secure discounts for multiple load purchases. The market undertone remains weak.
- Dry Whey Central: Spot load availability of dry whey from several Central manufacturers is steady to higher. Several manufacturers note current farm milk intakes exceed projected volumes, which is sending higher milk volumes into cheese and increasing end product availability downstream from cheese manufacturing. Resellers, too, are increasing their offers of dry whey loads outside of their own contract agreements to manage their inventories.
- Dry Whey West: Increased whey production in the region, tied to higher cheese production, has inventories above expected levels. Export sales are active at the lower end of both pricing series. Manufacturers continue to fill export orders to keep inventories at manageable levels. The increased supplies and lower export prices are pressuring domestic prices to follow suit. Brokers with stored inventory are becoming more willing sellers as supplies build.
- NDM: With mostly light demand from much of the higher Class milk uses, nonfat dry milk production is very active. Many manufacturers and resellers indicate few buyers feel the need to stock up on NDM right now. Market participants expect the current active production trend will keep NDM prices from rising dramatically in the near future. Central manufacturers' NDM inventories are building steadily.
- Cheese East: Increased milk production continues to keep Northeast cheese operations on 6-7 day production schedules. Cheese demand has improved following increased retail promotions ahead of the upcoming Super Bowl and current cheese pricing is conducive for increased volumes of cheddar to be moved into aging programs. Exporters are becoming increasing concerned about the unresolved labor contract with Longshoremen as the strike deadline date of February 6 approaches.
- Cheese Midwest: There continues to be regionally heavier than expected milk production. Thus, coupled with what some manufacturers characterize as recent declines in fluid milk consumption, regionally the result is "there still appears to be plenty of cheese around". Some plant managers believe some price weakness remains, based solely on expectations for milk supplies. The Midwest stores more cheese than any other region and generally has lower average advertised prices than the national average.
- Cheese West: Production continues at a heavier than typical pace as milk supplies are increasing. Buyers are hesitant to purchase above contracted quantities in the softer market. Export interest is increasing.

Recommendation:

$19-20 milk in Sep-Nov was enough motivation to add cows it appears. Dec milk production was up and cow numbers increased for the second consecutive month. At the same time, an end-of-year fall in demand has resulted in big cheese and butter inventory increases. Milk output in the Midwest continues to exceed expectations, while output in the Northeast and Pacific Northwest is more than ample to meet needs. As a result, cheese plants are continuing to run on heavy schedules throughout much of the upper-tier of the country. The bottom line? It continues to look like prices have little upside potential in the near term. On the positive side, U.S. prices for cheese are now very competitive on the global market and export interest is on the rise. Grain prices have declined but are still historically high, keeping feed expensive. The bearish reports and falling spot market this week pushed Class III into the red again, and we saw our first $16 price in a long time in the Mar contract. Current spot prices work out to about $16.30 Class III. If spot prices continue to head lower, expect Feb – Jun to take the brunt of losses. We would look for small rallies to sell into, if you are looking for more coverage. Mar hit a high of $17.23 this week on a weird rally that lost its legs. Consider selling Feb above $17.25 and Mar above $17.45 if we see something like that again next week. Otherwise, the Feb 17.00 PUT can be bought for 15¢ and consider the Mar 16.75 PUT at 30¢. Consider also selling Apr-Jun at an average of $17.85, but be prepared to buy it back early on any sign the market is recovering. If Q1 prices head into the $16's, there will be a lot of hurt out there, especially in the West. An equally strong upward reaction should eventually follow.