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The KDM Dairy Report – February 8th, 2013

What's Bullish:

Futures Month	Class III 02/08	Class III 02/01	Change	Dry Whey 02/08	Dry Whey 02/01	Change	Cheese 02/08	Cheese 02/01	Change
Feb-13	$17.24	$17.18	$0.06	63.00¢	62.50¢	0.50¢	$1.662	$1.669	($0.007)
Mar-13	$17.42	$17.26	$0.16	57.75¢	57.48¢	0.27¢	$1.710	$1.700	$0.010
Apr-13	$17.64	$17.41	$0.23	55.38¢	54.43¢	0.95¢	$1.750	$1.730	$0.020
May-13	$18.02	$17.89	$0.13	54.55¢	54.25¢	0.30¢	$1.800	$1.780	$0.020
Jun-13	$18.46	$18.27	$0.19	54.50¢	54.50¢	0.00¢	$1.846	$1.810	$0.036
Jul-13	$18.52	$18.40	$0.12	55.90¢	54.50¢	1.40¢	$1.845	$1.826	$0.019
Aug-13	$18.56	$18.50	$0.06	55.50¢	54.50¢	1.00¢	$1.856	$1.833	$0.023
Sep-13	$18.57	$18.57	$0.00	55.00¢	54.25¢	0.75¢	$1.855	$1.841	$0.014
Oct-13	$18.44	$18.38	$0.06	54.75¢	54.25¢	0.50¢	$1.830	$1.826	$0.004
Nov-13	$18.22	$18.17	$0.05	54.53¢	54.50¢	0.02¢	$1.814	$1.807	$0.007
Dec-13	$18.14	$18.05	$0.09	54.25¢	54.05¢	0.20¢	$1.803	$1.803	$0.000
Jan-14	$17.95	$17.95	$0.00	48.80¢	48.80¢	0.00¢	$1.805	$1.805	$0.000
12 Mo Avg	**$18.21**	**$18.00**	**$0.21**	**55.33¢**	**54.83¢**	**0.49¢**	**$1.798**	**$1.786**	**$0.012**

- Spot Market: Both blocks and barrels ended the week higher, for the first time in several weeks. Blocks picked up ½¢ to settle at $1.65/lb on 3 trades while barrels gained 1¾¢ to close at $1.56/lb on 10 trades. Butter finished unchanged at $1.55½ on just 4 trades.
- Cattle Report: The bi-annual Cattle Report released last week indicates the number of milk cows at 9.2 million head was unchanged from a year ago, but the number of milk replacement heifers fell 2% to 4.6 million head.
- Dairy cow slaughter continues at a good clip in 2013. For the week ended 01/26, 64,700 head were removed from the milking herd, up 9.3%, or 5,500 head.
- Fluid Milk West: CA milk production is mostly steady compared with recent weeks and continues to trend slightly lower than year ago levels. The dairy economic impacts at the farm level remain in play, with dispersals continuing and other producers right sizing the milking herd to balance off the lower producing cows. The high beef prices for cull animals are welcomed and positive to help with cash flow for replacement animals. The January 4b price (cheese) is $15.84, $0.46 lower than December, and $2.30/cwt lower than the Federal Order Class III price for January at $18.14.
- Butter: In the East, cream supplies continue to be readily available in the region with churns operating at increased schedules, but good domestic print and bulk orders for this time of year are helping balance supplies. Export demand continues to be fairly good prompting increased production of 82% unsalted butter. Current bulk butter prices remain strong and range from 4-14¢ over the market. Western retail accounts continue to purchase butter with some interest in additional volumes. Stocks of butter are increasing, but manufacturers are content to inventory butter for use later in the year.
- CWT has accepted requests for export assistance to sell 4.696 million lbs of Cheddar, Gouda and Monterey Jack cheese to customers in Asia, the Middle East, North Africa and South America. The product will be delivered February through July 2013. YTD, CWT has assisted member cooperatives in exporting 19.312 million pounds of cheese.

What's Bearish:

- Dairy Products Report: American cheese output in Dec was up 2.6% vs. 2011 and up 4.2% from Nov. Total cheese output increased 2% and 3.8% respectively. Butter production increased 4.4% from Dec '11 and up a massive 20.9% from Nov.
- Cheese prices were down sharply in this week's Dairy Product Sales Report. 40-lb blocks fell 3.5¢ from the previous week to average $1.70/lb and 500-lb barrels lost 5.2¢ to $1.66/lb. Butter increased 1.4¢ to average $1.51/lb, but dry whey declined 0.6¢ to 64.8¢/lb and nonfat dry milk decreased 1.1¢ to $1.54/lb.
- Fluid Milk East: Manufacturing milk supplies are increasing slightly in the Mid-Atlantic and Northeast regions as Class I demand has leveled off. Milk production remains strong in both regions with good component levels. Milk production in Florida continued to increase this week as moderating temperatures improved cow comfort levels. A weakening of Class I demand prompted 20 spot loads of milk to be exported. Milk production increases are expanding throughout the Southeast region. Supplies are marginally above demand needs and with some loads being shipped to auxiliary manufacturing facilities. Cream supplies are at levels that quickly overwhelm demand, which necessitates numerous loads be shipped out of region in order to find a home.
- Fluid Milk Central: Milk haulers and processors report the story on farm milk in the Central region is unchanged: strong production, weak demand for spot loads. At least one plant is trying to place multiple February milk loads, but there are few takers. Some plants indicate there is no room for outside milk as the operations are completely involved with processing milk from their regular suppliers. Spot milk prices remain in the same narrow channel of previous weeks, $1 to $3 under Class. Spot cream loads are also readily available.
- Fluid Milk Southwest: AZ milk output is flat, but processors indicate that the seasonal peak has not yet occurred. Cream markets remain on the weak side of normal and are characterized by moderate to heavy supplies, light demand from buyers who do not want to pay much, and heavy butter production. Demand from higher class items has slipped after recent buildups around the Super Bowl.
- Fluid Milk Pacific Northwest: Temperatures were moderate this week with no problems reported in handling of milk supplies. Milk volumes are mostly steady to up slightly in the region. Dairy farmers continue to face high feed costs, which do not

encourage herd expansion, but they are maintaining herd numbers with most content to continue the status quo at current milk prices. Increased milk demand in the region has yet to significantly influence farm milk prices.

- Dry Whey East: Dry whey production remains strong as most cheese makers are operating on 6-7 day production schedules. Demand remains sluggish with most end users purchasing for immediate needs only, unwilling to take a market position in a supply heavy market. Resale activity continues to provide another indication of the markets weak undertone with limited sales in the mid to upper $0.50's.
- Dry Whey Central: Manufacturers' dry whey stocks on hand started out high in the beginning of the year. December 2012 dry whey stocks were the highest end of the year holdings since December 2008. Since the beginning of 2013, the overall market tone has been weak, based on heavy production, building inventories, and light demand. Dry whey production is active throughout the region as farm milk intakes continue at volumes higher than last year.
- Dry Whey West: Increased whey production over the past two months is increasing manufacturers' stocks along with stocks held by brokers. The higher stocks and lower whey futures have combined to encourage holders of whey to market more aggressively.
- NDM East: Prices moved lower this week, while milk production increases are adding to condensed skim milk volumes heading to the dryers, increasing nonfat dry milk production. Demand remains lackluster and sluggish as end users are resisting purchases in what they feel is a downward trending market.
- NDM Central: Prices held steady, but the market tone is weak. Manufacturers indicate they do receive inquiries for blocks of loads, but price remains the stumbling block for buyers to take positions on NDM. Many users are shopping in the resale market, where NDM prices are reportedly lower than through direct purchases from manufacturers. Milk production in the Central region has not faltered during this winter ramp up to the flush and NDM manufacturers indicate they continue to fill out dryer schedules to match farm milk intakes and condensed skim volumes.
- NDM West: Western low/medium heat NDM prices are lower and the market undertone is weaker. The impact of heavier production and stocks is not being offset with corresponding demand. Buyers are reluctant to make purchases and are being offered lower prices in the resale market. Drying remains active in the region to process available milk and skim intakes. Export interest is slow to fair to emerge for new business.
- Cheese East: Cheese production remains on 6-7 day production schedules with production adding to inventories. Demand has weakened with cheese makers hoping promotions will prompt increased sales ahead of Easter. Aging programs continue to build as cheddar supplies are ample.
- Cheese Midwest: The spread between blocks and barrels is nine cents, and the universal view is that this is unsustainable. The volume of cheese manufactured is causing some push back from cutters and wrappers, who are increasingly struggling to keep current with volume and schedules. Another factor in some Midwest plants is Mozzarella sales backing up more than other varieties, causing unexpected Mozzarella price weakness, particularly related to Cheddar which at least can be aged longer when sales slow below production.
- Cheese West: Buyers are purchasing only for immediate needs with many trying to determine if the market has found a plateau. Production schedules are trying to match demand with slightly larger supplies. The lower prices have increased interest for export.
- Grains. Falling, falling, falling.

Recommendation:

Dairy supply fundamentals continue to paint an ugly picture, but spot cheese prices settled the week higher, supporting a rally in futures as Class III, cheese and dry whey all finished in the green. To be honest, we're scratching our heads here a little. As we wrote last week, from a technical standpoint, a bounce was due. We just don't see a lot of upside from here. Cheese production is exceeding demand. Butter output is exceeding demand. Milk production and components are strong. The bottom line is, we think you should sell this rally, especially the front months. March settled at $17.42, but it starts pricing in a week and spot prices only get it to about $16.47. Some sparks are going to fly here real soon. Unless the spot market continues to rally amidst bearish fundamentals (and it could), Mar futures will fall to close the nearly $1.00 premium futures are carrying. We're also watching grain prices. After a rally which began in early January, further increases have come against resistance, confirming the downtrend which started after the highs in August remains intact. Today's crop report yielded sharply lower beans and further losses in corn. New crop in particular looks vulnerable to further price erosion. With milk production as strong as it is, we can only think of one thing to do if feed prices move substantially lower….. SELL. If you milk cows in a region where you receive a healthy premium, consider these prices: Q2 settled at $18.04. Q3 settled at $18.51. Q4 settled at $18.23. Some of you can make very good money here (pushing $20+ with component pay). Sell up to 75% of your production in March above $17.50. Get 50-75% covered in Q2. Get 25-50% covered in Q3,Q4.