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

The KDM Dairy Report – February 15th, 2013

What's Bullish:

Futures Month	Class III 02/15	Class III 02/08	Change	Dry Whey 02/15	Dry Whey 02/08	Change	Cheese 02/15	Cheese 02/08	Change
Feb-13	$17.23	$17.24	($0.01)	63.98¢	63.00¢	0.98¢	$1.663	$1.662	$0.001
Mar-13	$17.30	$17.42	($0.12)	58.25¢	57.75¢	0.50¢	$1.690	$1.710	($0.020)
Apr-13	$17.36	$17.64	($0.28)	54.75¢	55.38¢	(0.63¢)	$1.722	$1.750	($0.028)
May-13	$17.61	$18.02	($0.41)	54.00¢	54.55¢	(0.55¢)	$1.750	$1.800	($0.050)
Jun-13	$18.02	$18.46	($0.44)	55.00¢	54.50¢	0.50¢	$1.789	$1.846	($0.057)
Jul-13	$18.47	$18.52	($0.05)	55.00¢	55.90¢	(0.90¢)	$1.829	$1.845	($0.016)
Aug-13	$18.54	$18.56	($0.02)	55.50¢	55.50¢	0.00¢	$1.844	$1.856	($0.012)
Sep-13	$18.53	$18.57	($0.04)	54.00¢	55.00¢	(1.00¢)	$1.851	$1.855	($0.004)
Oct-13	$18.40	$18.44	($0.04)	54.75¢	54.75¢	0.00¢	$1.835	$1.830	$0.005
Nov-13	$18.22	$18.22	$0.00	54.50¢	54.53¢	(0.02¢)	$1.814	$1.814	$0.000
Dec-13	$18.15	$18.14	$0.01	54.30¢	54.25¢	0.05¢	$1.808	$1.803	$0.005
Jan-14	$17.95	$17.95	$0.00	48.80¢	48.80¢	0.00¢	$1.805	$1.805	$0.000
12 Mo Avg	**$17.98**	**$18.10**	**($0.12)**	**55.24¢**	**55.33¢**	**(0.09¢)**	**$1.783**	**$1.798**	**($0.015)**

- Spot Market: Blocks gained 2½¢ to settle at $1.67½/lb and barrels picked up 7¢ to close at $1.63/lb. Trading was light with just 4 loads of blocks and 3 loads of barrels exchanging hands. Butter picked up a nickel to settle at $1.60½/lb on 9 trades.
- Dairy cow slaughter for the week ended 02/02 totaled 63,200 head, the 4th consecutive week slaughter numbers have been above 60k.
- Global dairy prices are forecast to keep rising due to weather extremes in major milk producing countries, according to Rabobank analysts. Key import nations are working off inventory, which may keep a lid on Q1 prices, but they will need to eventually re-enter the market. That increased demand, combined with a predicted fall in milk production, could send prices higher.
- Fluid Milk Southeast: Milk production in Florida continues to increase, but remains below year ago levels. Some producers are indicating they are not inclined to change feed ratios to optimize the flush, due to feed supply constraints. Hay has increased in price and rainfall totals are insufficient to prompt a steady regrowth of hay. Milk supplies are nearly in balance with demand in the Southeast region with only a few loads being shipped to auxiliary manufacturing facilities.
- Cheese East: Cheese production continues to be active with most operations on 6-7 day production schedules; however, mozzarella plants have had good orders, which reduced inventories. Domestic demand has improved as the general downward trend in cheese prices over the last few weeks has prompted some end users, that have worked inventories lower and held off purchases for lower prices, to make purchases to replenish supplies. Export demand remains fairly good supported by incentive programs.
- CWT has accepted requests for export assistance to sell 524,700 lbs of butter and 2.344 million lbs of Cheddar and Monterey Jack cheese. The product will be delivered February through July 2013.
- International: Relatively high feed costs in Western Europe remain a concern for dairy producers attempting to grow output through supplemental feeding. Milk is showing incremental, seasonal growth, but overall volumes are projected to be below year ago levels in January and the trends are also reported to continue into February. Processors are finding adequate milk supplies to make products of first choice, but some milk declines resulting from early season conditions are now not allowing all product spectrums to be manufactured. The Euro weakened during the past weeks, but has begun to strengthen against other currencies. The effects are having some impacts on restricting exports. There remains good internal demand for fresh dairy products. Butter offerings have been readily absorbed into the market.
- International: New Zealand milk output trends continue to show milk volumes dropping and current trends pulling season to date total volumes lower. Milk is beginning to move below year ago marks. Expectations are that this will continue throughout the remainder of the season. Recent dry conditions in the North Island milk producing areas are impacting the milk flow there with some farmers drying off cows early. Australian milk production is also trending lower with the latest stats for December being down 1.3% versus a year earlier. The current milk flows are noted to be running at below year ago levels at this time with the total seasonal growth rate versus a year ago shrinking. The weather conditions of rains and flooding in the Northern Queensland region are severely impacting the dairy industry in that area. Elsewhere, hotter and dryer weather conditions in the major milk producing regions of Victoria and New South Wales are impacting milk yields and output to a limited extent. Dairy product pricing trends are steady to slightly firm. With declining milk supplies at or below seasonal trends, processing schedules are being aligned to make products of greatest needs. Cheddar cheese is still averaging about $1.81/lb.

What's Bearish:

- Fluid Milk Northeast: A major winter storm hit the Northeast region, dumping more than 30 inches of snow on over 40 cities and towns in New England. Class I demand is strong as many dairy shelves were depleted prior to the storm, but New York and Pennsylvania did not get the brunt of the storm and dairy operations were only marginally affected. As a result, manufacturing milk supplies actually increased in the Mid-Atlantic region as milk was diverted from the Northeast. Dairy plant operations quickly returned to normal following the weekend. Cream supplies remain heavy due to volumes from Class I plants and yogurt manufacturers. The combination of the two cream streams quickly surpasses demand, necessitating loads be moved out of region in order to find a home. Demand for cream has improved somewhat, but not enough to dent the oversupply situation.

- Fluid Milk Central: Throughout the Central region, weather has been conducive to cow comfort this winter. Drought conditions are easing somewhat due to snowfall and rain received in the last two weeks. Some plant operators indicate their intake volumes started a slow decline during the last 1-2 weeks, but other processors note their intakes continue growing on a weekly basis. Milk haulers are reporting more milk per load is arriving at processing plants than in January. Spot milk loads in the Central region are readily available from several sources this week, but interest for loads is light and price driven. Spot load prices are stuck below Class.
- Fluid Milk West: Weather conditions for milk production in CA have been near ideal for a number of weeks. There are now numerous reports of output pulling ahead of year ago numbers for the first time in many months. This has caught some contacts by surprise because of the ongoing negative financials at the farm level. Milk output in AZ and NM is being called steady. Cream markets remain on the weak side. Milk production in the Pacific Northwest remains on a mostly steady keel. The weather has been conducive to increased cow comfort with warmer days and cool nights.
- Butter: Butter production is strong across all regions. Ample cream is reported in the West and Central regions, with increased cream available in the Northeast following winter storm Nemo. Most manufacturers in all regions are building inventories.
- Dry Whey Northeast: Prices moved this week. Dry whey production remains very active with a majority of cheese makers on 6-7 day production schedules. Inventories are expanding for most manufacturers. Some buyers are holding off delivery of contract loads, feeling prices will adjust soon to the heavier supplies being carried by manufacturers. Demand has also been affected by a decline in exports, due to the beginning of the Chinese New Year and the typical seasonal decline in shipments. Most end users are purchasing for immediate needs only, unwilling to take a market position in a market showing bearish tendencies.
- Dry Whey Central: Prices retreated on a weak market. Some Central manufacturers report dwindling inquiries for spot market dry whey loads on a week to week basis. Many manufacturers continue clearing dry whey at prices below their normal market position, to help manage dry whey inventories. Dry whey production is active at many Central locations. Some manufacturers indicate that although cheese sales are sluggish, milk intakes continue clearing through cheese production because spot milk interest is weak and some producers do not have alternative end products. With price pressure also building on the whey protein and whey isolate markets, some market participants anticipate greater volumes of whey solids will clear through commodity dry whey markets.
- Dry Whey West: Domestic and export prices continue to vary significantly with increasing activity to lower the contracted domestic price. The overall tone of the market is lower as buyers of whey are looking to reduce price levels to align with other international competitors. Sales to China are reported to be slow while they celebrate their New Year.
- Nonfat Dry Milk: Inventory buildup within the Central region and throughout the country is pushing prices lower, thus, buyers are in no hurry to establish positions on NDM. Nonfat dry milk production is steady to higher, with a few operations shuttling increasing farm milk volumes away from cheese production and toward butter/powder production. In the Northeast, winter storm Nemo caused numerous loads of milk to be redirected to powder plants, which added to the already heavy manufacturing supplies and drying schedules. The increase in production added to manufacturer's inventories. Demand remains weak as numerous end users are waiting for prices to adjust to the, more than ample, supply situation. In the West, market activity continues to be slower than anticipated. Buyers see no reason to make additional purchases as prices continue to decline. Production of powder is often heavier than planned and more areas are noting that milk receipts are now moving ahead of last year for the first time in many months.

Recommendation:

The CME daily spot market is usually the driver of Class III futures, but that was not the case this week. Spot cheese and butter prices finished higher, with little resistance from sellers, but every Class III rally after spot was thoroughly sold. Class III finished the week in the red in every month through October, with the biggest losses in Q2. This should tell you something. Fundamentals are still largely bearish, and the news that CA output is now above year-ago levels is downright scary, since milk is still more than ample in the Midwest and Northeast. The international picture is brightening and heat will eventually come to the U.S., but that is still months away. As we said last week, if you can cash flow at these prices, you should SELL. From what we're hearing, cheese sales are still slow, which likely means more product will be headed to the CME spot market. If buyers aren't willing to step up, prices will go lower. The Q2 average fell 40¢ from last week and now sits at $17.66. The Q3 average is unchanged at $18.51 while Q4 actually gained 3¢ to average $18.26. This tells you what the market thinks is going to happen. A sell-off in Q2, followed by firmer prices in the second half of 2013. If you're still waiting around to get some coverage, we wouldn't advise it. Sell any Q2 rallies next week.

Note: Markets will be closed on Monday in observance of President's Day. Our offices will reopen on Tuesday.