

The KDM Dairy Report – March 8th, 2013

What's Bullish:

- Spot Market: Blocks closed the week up 2½¢ to \$1.60/lb while barrels gained 2¢ to \$1.58/lb. Trading was active with 12 loads of blocks and 6 loads of barrels exchanging hands. Butter increased 5½¢ to settle at \$1.63/lb on just 1 trade.
- Most Class III components were higher in this week's Dairy Products Sales Report, despite a weak spot market. Butter increased 1.4¢ from last week to average \$1.59/lb and dry whey was up 0.5¢ to 63.5¢/lb. 40-lb cheddar blocks declined a modest 0.1¢ to average \$1.66/lb, but 500-lb barrels popped 2.1¢ higher to \$1.65/lb. Lastly, nonfat dry milk decreased 2.3¢ to average \$1.55/lb, but it has no impact on the Class III calculation.

Futures Month	Class III 03/08	Class III 03/01	Change	Dry Whey 03/08	Dry Whey 03/01	Change	Cheese 03/08	Cheese 03/01	Change
Mar-13	\$17.03	\$16.79	\$0.24	61.95¢	60.00¢	1.95¢	\$1.646	\$1.634	\$0.012
Apr-13	\$17.20	\$17.13	\$0.07	58.25¢	56.03¢	2.23¢	\$1.684	\$1.692	(\$0.008)
May-13	\$17.80	\$17.43	\$0.37	55.25¢	54.75¢	0.50¢	\$1.774	\$1.731	\$0.043
Jun-13	\$18.20	\$17.72	\$0.48	55.25¢	54.75¢	0.50¢	\$1.800	\$1.762	\$0.038
Jul-13	\$18.51	\$18.12	\$0.39	55.25¢	54.40¢	0.85¢	\$1.830	\$1.795	\$0.035
Aug-13	\$18.77	\$18.33	\$0.44	55.98¢	54.50¢	1.48¢	\$1.856	\$1.829	\$0.027
Sep-13	\$18.80	\$18.42	\$0.38	55.00¢	54.50¢	0.50¢	\$1.860	\$1.830	\$0.030
Oct-13	\$18.58	\$18.26	\$0.32	54.75¢	54.50¢	0.25¢	\$1.838	\$1.820	\$0.018
Nov-13	\$18.32	\$18.06	\$0.26	54.25¢	54.50¢	(0.25¢)	\$1.813	\$1.793	\$0.020
Dec-13	\$18.06	\$17.87	\$0.19	53.25¢	54.00¢	(0.75¢)	\$1.795	\$1.782	\$0.013
Jan-14	\$17.80	\$17.80	\$0.00	48.80¢	48.80¢	0.00¢	\$1.805	\$1.805	\$0.000
Feb-14	\$17.62	\$17.58	\$0.04	42.00¢	42.00¢	0.00¢	\$1.810	\$1.810	\$0.000
12 Mo Avg	\$18.06	\$17.79	\$0.27	54.16¢	53.56¢	0.60¢	\$1.793	\$1.774	\$0.019

- Dairy cow slaughter for the week ended 02/23 totaled 64,400 head, up 5.4% from last year. YTD, 560,400 head have been culled, the highest in more than six years.
- Fluid Milk East: Milk production is increasing seasonally, however the next winter storm is arriving, thus some Mid-Atlantic and Northeast region fluid milk bottling plants this week used somewhat more fluid milk for bottling in advance of the latest winter snow storm, due to expected strong retail purchasing. In the Southeast, milk production is up enough to cause some seasonal manufacturing plants to be in operation, but in Florida, the flush has leveled off during the past two weeks. Weather extremes, alternating between cool days and nights, then high 80's by day and 60's by night has the cows confused. Export spot loads moving out of state this week totaled 70 loads, down from 78 loads last week.
- CWT announced the acceptance of export assistance bids for 8.8 million lbs of butter and 6.4 million lbs of cheese slated for international delivery.
- Cheese West: Cheese production remains mostly steady as milk volumes are within expected ranges. Retail demand continued mostly steady with light featuring for the Easter/Passover periods. Mozzarella sales are improved with increased domestic pizza promotions. Export demand is improving as U.S. prices are more competitive with World prices. Cheese stocks are reported to be in balance with most needs.
- International: At the March 5th Global Dairy Trade auction, average prices for all products were higher to sharply higher. Prices for all products in the index increased 10.4% vs. the last auction two weeks ago. Butter jumped 9.6%; cheddar cheese up 8.3%; skim milk powder +4.6%; and whole milk powder, +18.0%.

What's Bearish:

- Dairy Products Report: Cheddar cheese output in January was up 2.9% vs. 2012 while total cheese output increased 2.4% over the same period. Butter output was 2.6% higher than last January, and the largest volume for this month on record.
- Fluid Milk Central: Farm milk production is inching higher in some Central areas as the early stages of the flush emerge. Manufacturing milk remains plentiful in the region because of strong farm milk production as well as flat fluid demand. Spot milk load prices are generally struggling to reach flat Class; prices reportedly range from \$0.50 to \$3 under Class.
- Fluid Milk West: CA milk production levels are mostly steady with recent weeks. Rains and wet conditions have not impacted the milk flow and processing plants are receiving steady milk volumes. AZ milk production is steady to slightly higher. Gains have been modest, but the peak of the milk season is expected to be forthcoming in the next month. Processing plants are running on active schedules to handle the available milk supplies. NM milk output is indicated to be flat, with milk volumes and offerings adequate for buyers' needs, but surplus milk continues to move to balancing plants and the cream market remains weak. Supplies are heavy and being offered within the region and to outside buyers. Ice cream demand for cream remains light and unaggressive. Butter churning is active to process the cream supplies.
- Butter: Butter production continues to be strong throughout the country as cream supplies are ample to fill both awakening interest from dips, aerated cream, and ice cream producers and still leave volumes for churning.
- Dry Whey East: The market remains weak. Factors leading to this include heavy cheese production, with many regional plants operating 6 or 7 days a week. This in turn increased whey production, resulting in higher inventory levels. A number of parties holding the increasing inventories have been motivated to offer spot sale discounts to move some inventory out. Improving export demand has not been able to compensate for recently "lackluster" domestic demand.

- Dry Whey Central: Prices are unchanged to lower as this market seeks a price floor. One or two manufacturers reduced sale prices within reseller/distributor-type relationships to encourage sales into international markets. Dry whey production continues to be active as farm milk intakes into Class III plants are steady.
- Dry Whey West: Prices continue in a steady to weak direction. Dry whey production continued at mostly steady levels. Cheese plants are operating mostly full production schedules and whey stream products are available. Inventories are said to be building. The increased availability of whey has dampened demand at the higher end of the price range. Export prices are at the low end of current prices.
- NDM: Northeast nonfat dry milk was described by various participants this week as plentiful and discounted. A number of plants with drying capability are running full. Heavy milk supplies are expected to continue into the immediate future, maintaining the impetus for drying. In the Central region, production is steady to higher at several facilities as farm milk production holds firm and interest in spot loads of condensed skim decreases. Some plant operators indicate offers of condensed skim spot loads at flat market did not garner any buyer's attention this week. In the West the overall trend is being pressured lower. Production is active and heavy. Stocks are available from producers and resellers alike. Western NDM is finding competitive pricing when compared with other regions. Export interest is light to fair for U.S. powders.
- Cheese East: Production over the last few weeks has been strong, and continues strong, driven by available milk supplies. Retail demand has been sluggish and export interest is modest. There are reports of milking herd expansion, so the magnitude of seasonal milk supply increases is somewhat unknown at this point.
- Cheese Midwest: Continuing abundant milk supplies are keeping cheese manufacturers busy - even if enthusiasm among manufacturers for prevailing production levels varies. Some manufacturers refer to retail demand as dismal, with sales described as underwhelming. Looking forward toward spring, higher milk supplies are what many manufacturers expect. Cheese export shipments are not at volumes that manufacturers would like.

Recommendation:

Despite fundamentals that indicate we'll have plenty of milk output in the coming weeks, both cheese and butter prices increased in the spot market and Class III rallied, with double-digit gains in most contracts. Tuesday's GDT auction, the drought in Oceania and the fact that cheese prices were in the \$1.50's (a significant discount to the rest of the world) all worked together to support the market. As one person in the industry summed it up, \$1.50 cheese is too low (there's an incentive to buy and store here) while \$1.70 cheese is too high (demand falls and prices are too close to world prices). So, for the time being, it looks like we'll sit in the \$1.60's. If bidders come back to the spot market like they did this week, expect sellers to get more aggressive. While one eye is watching the potential for tighter milk supplies later this year, the other is watching for the spring flush which has yet to hit much of the heartland. This should keep a cap on prices in the near term, but July on out should remain well supported. We would continue to recommend selling strong rallies in Q2 while selling up to half your production in the second half, assuming you are paid a healthy premium and this works for you from a cash-flow standpoint. We also like buying cheap disaster insurance for any of these months in the 16.50 to 17.00 strike range for PUT options. Today's crop report caused corn to rally and beans to minimize their losses. The bottom line though is that there is the potential for much lower feed costs this year should weather not be a factor. The 2nd half of 2013 could go either way in our opinion, and because of this unknown, it's a good idea to get a risk management plan in place! Don't wait until it's too late.

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