

The KDM Dairy Report – March 15th, 2013

What's Bullish:

- Spot Market: Blocks and barrels both gained a penny for the week to settle at \$1.61/lb and \$1.59/lb respectively. Trading was active with 14 loads of blocks and 4 loads of barrels exchanging hands. Butter finished the week 2½¢ higher to \$1.65½/lb on just 3 trades.
- It's still early, but weekly cold storage numbers indicate cheese stocks are dropping over the first 11 days of the month. Holding at USDA selected storage centers fell 935,000 lbs, or 1% during this period, while butter stocks declined 17,000 lbs.
- Dairy cow slaughter for the week ended 03/02 totaled a robust 63,200 head, up 2,000 head vs. a year ago. Through the first 10 weeks of the year, 21,000 more cows have been removed from the herd than in 2012.

Futures Month	Class III 03/15	Class III 03/08	Change	Dry Whey 03/15	Dry Whey 03/08	Change	Cheese 03/15	Cheese 03/08	Change
Mar-13	\$16.95	\$17.03	(\$0.08)	61.00¢	61.95¢	(0.95¢)	\$1.642	\$1.646	(\$0.004)
Apr-13	\$17.15	\$17.20	(\$0.05)	57.88¢	58.25¢	(0.38¢)	\$1.676	\$1.684	(\$0.008)
May-13	\$17.65	\$17.80	(\$0.15)	54.50¢	55.25¢	(0.75¢)	\$1.751	\$1.774	(\$0.023)
Jun-13	\$18.15	\$18.20	(\$0.05)	54.25¢	55.25¢	(1.00¢)	\$1.798	\$1.800	(\$0.002)
Jul-13	\$18.54	\$18.51	\$0.03	54.13¢	55.25¢	(1.13¢)	\$1.844	\$1.830	\$0.014
Aug-13	\$18.75	\$18.77	(\$0.02)	54.03¢	55.98¢	(1.95¢)	\$1.863	\$1.856	\$0.007
Sep-13	\$18.75	\$18.80	(\$0.05)	54.00¢	55.00¢	(1.00¢)	\$1.870	\$1.860	\$0.010
Oct-13	\$18.53	\$18.58	(\$0.05)	53.75¢	54.75¢	(1.00¢)	\$1.850	\$1.838	\$0.012
Nov-13	\$18.30	\$18.32	(\$0.02)	53.75¢	54.25¢	(0.50¢)	\$1.825	\$1.813	\$0.012
Dec-13	\$18.03	\$18.06	(\$0.03)	52.33¢	53.25¢	(0.92¢)	\$1.805	\$1.795	\$0.010
Jan-14	\$17.80	\$17.80	\$0.00	48.80¢	48.80¢	0.00¢	\$1.805	\$1.805	\$0.000
Feb-14	\$17.60	\$17.62	(\$0.02)	42.00¢	42.00¢	0.00¢	\$1.810	\$1.810	\$0.000
12 Mo Avg	\$18.02	\$18.06	(\$0.04)	53.37¢	54.16¢	(0.80¢)	\$1.795	\$1.793	\$0.002

- Global dairy analysts Rabobank released their quarterly report this week and predict supply contraction and Chinese buying will tighten the market and cause dairy prices to rise in Q2 and Q3. GDT auction prices in March saw their 9th consecutive monthly increase and are gaining momentum. Adverse weather in NZ, Australia, Uruguay and Argentina is putting a dent in these exporting nations' ability to supply the world market. While domestic demand in the U.S. is weak, a surge in Chinese buying is helping support world powder prices. In addition, wholesale U.S. prices, currently a discount to world prices, will work to clear U.S. stocks.
- Fluid Milk Southeast: Florida's milk production has shown only incremental increases during this year's flush as compared to the significant upswings of previous years. High grain prices, causing a change in feed rations, and continuing drought are the major factors contributing to the limited flush this year. The increase of wildfires and sinkholes in the state are further evidence of the worsening drought. Class I demand increased this week, limiting milk exports to 63 spot loads vs. 70 last week. Milk production in the Southeast is increasing along the seasonal trend, but milk supplies are nearly in balance with Class I demand with only limited loads being shipped to manufacturing plants. Demand for cream has increased significantly ahead of the Easter/Passover holidays, so much so, that for the first time in several weeks no loads of cream are being shipped out of region.
- Fluid Milk West: Weather conditions are warming quickly this week in CA, with temperatures into the 80 degree range. The rainfall last weekend was very spotty and not terribly significant. Water rationing is occurring again this year. Milk is increasing seasonally in the state, but most contacts report output is trailing year ago numbers, and plants are able to handle milk efficiently. Conditions are also warming rapidly this week in AZ and NM. Temperatures should be into the 90's in Arizona and into the 70's in New Mexico. Milk output is increasing, but plants are not having problems with any milk intakes at this time. Cream markets are beginning to show some spring life. Supplies of cream remain heavy, but demand is picking up seasonally. The Pacific Northwest experienced mild temperatures with rain along the coastal areas. Milk production in the region is reported to be following expected volumes, while manufacturing plant capacity is sufficient to handle the current supply with ease.
- Dry Whey Central: Resellers and end users are now more willing to take positions on dry whey, as they are more confident of having short and mid-term value with minimal downside risk. Dry whey inventories are uneven as some recent sales helped rebalance stocks on hand and near term needs.
- Dry Whey West: Prices are mixed with a mostly steady undertone. Whey production continues to run behind year ago levels, but manufacturers and brokers have sufficient inventories for spot trades. Export demand is increasing, and sellers are offering prices at the lower end of pricing series for larger quantity purchases.
- NDM East: Milk production and manufacturing milk supplies continue to increase and as a result milk volumes going to dryers are also increasing. However, inventory expansion has been limited by some fairly active spot sale activity and good export interest. Demand has improved marginally as some buyers consider the market is near its low point.
- NDM Central: Some buyers are returning to the market, purchasing multiple loads as long as pricing incentives are available. Some of these buyers indicate they anticipate there is limited downside risk at current prices.
- NDM West: A number of contacts indicate that they are feeling much better about the overall market than 2-3 weeks ago. Buyer interest is increasing and stocks are falling for some operations. Some are indicating that a partial cause may be the drought in New Zealand and the subsequent strength in the most recent GDT auction. One Western contact did indicate that he is turning down bids this week that he would have accepted last week.
- Cheese Northeast: Milk volumes going to cheese vats are keeping cheese makers on 6-7 day production schedules. But cheese inventories have seen limited expansion as demand for cheese has increased with the approach of the Easter/Passover holidays and the upcoming NCAA basketball tournament. Export demand continues to be fairly good.
- Cheese Midwest: Cheddar manufacturing remains strong in the region, with some Wisconsin manufacturers buying surplus milk at \$3 to \$5 under Class III so they can increase cheddar cheese production. However, in some cases, all projected production through this month has already been sold and sales into May have been committed. With uncertainty remaining concerning milk supplies during the next month or so, this run of price strength surprised some manufacturers. Other manufacturers more engaged in the export market, mentioned increasing concern with growing drought in New Zealand as well as firmer global dairy prices following the GDT auction last week Tuesday, as factors moving markets up.

- Cheese West: Cheese production in the region continued to be near full production schedules. Inventories of cheese are up slightly, but are not considered to be heavy. Retail sales are described as moderate with some increases due to upcoming holidays. Mozzarella sales are good with some pizza chains offering specials for "March Madness". Export sales are higher than year ago levels and are being aided by CWT assistance.
- According to the Foreign Ag Service, exports of cheese and curd for January 2013 totaled 48.4 million pounds, up 13% from the previous January. The exports account for 5.2% of total cheese production in the U.S.
- International: Milk production for Western European continues below year ago levels. In January 2013, EU milk deliveries were 2.1% lower than during January 2012. Germany production was stable, Ireland was down 11.8%, the UK was down 5.3%, and France was down 4.2%. Supplies, quality, and prices of feed, are all having an impact on milk output. Dairy product prices are steady to higher across reported categories, gaining momentum from events in other areas of the world. Dry conditions in Oceania have curtailed milk output and have been a contributing factor to higher dairy product prices.
- International: The New Zealand milk production is being pulled downwards because of dry conditions. A drought designation was declared for many regions of the North Island. Pasture conditions have deteriorated and the resulting lack of feed is causing a sharp decline in milk production. Supplemental feeding is being done on some farms to keep cows in milk. Some producers have moved to once per day milking or a longer than normal spacing of the milking times to cope. Other farmers are drying off cows earlier than planned. Additionally, cow slaughter rates are increasing for those who do not have the feed or resources to keep fully stocked. Processing plants are running on reduced schedules. Australian milk production is also being affected by hot and dry conditions in major output areas. Many locations are seeing record March consecutive days with temperatures above 86 degrees F. Cows are not fond of the hot conditions and pasture growth is being impacted. Current milk output is trailing year ago numbers. Dairy product prices for butter, SMP, WMP, and cheese are all sharply higher when compared to recent weeks. The impact of the drought conditions and the decline in milk receipts has created tighter supply conditions across product categories. Demand interest is fair to good with some buyers seeking to secure additional coverage. Many are not finding all the offerings that they desire. Cheddar cheese pricing is slightly higher, averaging \$1.86/lb. The market is tighter with seasonal declines noted in offerings. In addition, the decline in milk production is also seeing less milk being placed into cheese plants.

What's Bearish:

- All Class III components were lower in this week's Dairy Products survey. 40-lb cheddar blocks fell 1.6¢ to average \$1.64/lb, while 500-lb barrels lost 2.6¢ to \$1.62/lb. Butter decreased 1.7¢ to average \$1.58/lb, dry whey lost 2.7¢ to average 60.8¢/lb and nonfat dry milk gave up 2.1¢ to \$1.53/lb.
- Fluid Milk Northeast: Milk production continues to expand along the seasonal trend, adding to the already ample manufacturing milk supplies in the Northeast and Mid-Atlantic regions. Class I demand has leveled off and in some areas declined where schools are beginning their spring breaks. Some milk shipments have been rerouted away from bottling to manufacturing plants, due to inspection issues.
- Fluid Milk Central: Sales into bottling facilities are flat. Prices of spot loads of milk trended lower for some transactions, with volumes playing a part in pricing considerations. Prices ranging down to \$5 under Class were agreed to, to help clear milk from bottling and cheese plants into other cheese plants. Market participants indicate sales of Italian-type cheeses are slow, and some manufactures want to lighten cheese inventories on hand rather than continue building reserves.
- Dry Whey East: Production remains very active as milk production increases are keeping cheese makers on 6-7 day production schedules. Current production is adding to inventories. Dry whey manufacturers are pricing multiple spot loads significantly under contract pricing in order to better manage inventories. Domestic demand for dry whey remains sluggish as numerous buyers are hesitant to purchase volumes beyond current needs, believing prices will be pressured lower in the near term. Export demand is fairly good with pricing for block sales at the low end of the range. The market undertone remains weak.

Recommendation:

Milk and cheese output continue to be strong in the U.S., but the drought in Oceania and limited increases in the EU have left the market with a bullish undertone. The big question over the next 30 days is will improved demand be enough to balance "yet-to-come" flush-level production in the Midwest and Northeast? It just might. Milk production and cheese inventories appear to be relatively in balance from the South (starting in Florida), all the way West (CA) and up through the Pacific Northwest (WA). Plants have so far been easily able to cope with the milk supply. Cream demand is improving and Class IV prices are rising. As primarily a powder exporter, the drought in Oceania could provide more upward momentum for Class IV if world buyers start looking to the U.S. for product. Current spot prices work out to \$18.00/cwt Class IV and \$16.50/cwt Class III. Further upward momentum in Class IV will have a supportive effect on Class III as the spread widens. Even in the Midwest, which has yet to reach peak production, cheese output is strong, but so are sales. Some plants are sold out through April and are working on May commitments. This week's spot market saw only a penny gain in blocks and barrels, but buyers were definitely the aggressor. There just doesn't seem to be much downside from current spot prices, which work out to about \$16.50 Class III. The next 30 days will be critical in determining whether supply or demand win the short-term battle. The market could get quite choppy and volatile. Longer term though, we believe there is growing support. Producers should look to aggressively purchase upside protection in Q2 months on milk they have previously sold. Consider the April 17.50 CALL at 7¢, the May 18.50 CALL at 15¢ and the June 19.00 CALL for 26¢. July-Dec, consider the 17.00 x 22.00 fence at 10¢ cost per month or less.

NOTE: There will be no KDM Dairy Report next Friday.

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