

**The KDM Dairy Report – March 28<sup>th</sup>, 2013**

**What's Bullish:**

- Ag Prices Report: The March milk-to-feed ratio was estimated at 1.47, down from 1.52 in Feb and the lowest level since Aug 2012.
- Weekly cold storage numbers indicate both cheese and butter stocks declined during the month of March, despite heavy production. Cheese stocks at USDA selected storage centers fell 2%, or 1.9 million lbs, over the period 03/01 through 03/25. Butter stocks declined 1%, or 178,000 lbs over the same period.
- Dairy cow slaughter for the week ended 03/16 totaled 65,300 head, up 8.8% vs. the same period a year ago. YTD the cull is up 25,500 head.
- CWT has accepted requests for export assistance to sell 3.942 million lbs of butter, 44,092 lbs of anhydrous milk fat and 7.108 million lbs of Cheddar, Gouda and Monterey Jack cheese. The products will be delivered April through September 2013.
- Dry Whey West: Market participants reported that the market had a steady feel rather than the weakness that had characterized whey recently. Conditions in the whey market are mostly unchanged with supplies adequate for contract fulfillment and spot purchases. The export market exhibited some firmness as buyers were looking to acquire supplies.
- NDM: Demand from domestic and international interest is picking up. There are some indications that the U.S. as a whole will be clearing several million pounds of NDM into a recent international tender. Market participants feel this recent sale will construct a floor under NDM prices for the near term.
- Cheese Midwest: Most indicators from a number of cheese manufacturers are positive. One plant manager noted record milk supplies available to the plant, but sales are so strong that there is little concern with maintaining full out production. The manager noted sales of Italian varieties are already committed through the rest of 2013. Food service sales are stable, with weekly ordering remaining at a good level and expected to continue. Stronger exports are starting to chip away at cheese stockpiles.
- International: Milk output in Australia was down 9.2% in February vs. a year ago. While the current production year started out positive, YTD it is now down 1.1%.

Futures Month	Class III 03/28	Class III 03/22	Change	Dry Whey 03/28	Dry Whey 03/22	Change	Cheese 03/28	Cheese 03/22	Change
Mar-13	\$16.97	\$16.99	(\$0.02)	61.00c	61.00c	0.00c	\$1.645	\$1.640	\$0.005
Apr-13	\$17.26	\$17.58	(\$0.32)	58.00c	58.28c	(0.27c)	\$1.699	\$1.720	(\$0.021)
May-13	\$18.34	\$18.26	\$0.08	56.80c	57.75c	(0.95c)	\$1.805	\$1.795	\$0.010
Jun-13	\$18.95	\$18.85	\$0.10	57.50c	58.50c	(1.00c)	\$1.865	\$1.850	\$0.015
Jul-13	\$19.16	\$19.17	(\$0.01)	57.75c	58.00c	(0.25c)	\$1.889	\$1.895	(\$0.006)
Aug-13	\$19.13	\$19.24	(\$0.11)	58.50c	57.50c	1.00c	\$1.885	\$1.892	(\$0.007)
Sep-13	\$19.10	\$19.14	(\$0.04)	59.00c	57.50c	1.50c	\$1.880	\$1.894	(\$0.014)
Oct-13	\$18.90	\$18.80	\$0.10	58.00c	59.00c	(1.00c)	\$1.863	\$1.860	\$0.003
Nov-13	\$18.63	\$18.55	\$0.08	56.00c	59.00c	(3.00c)	\$1.840	\$1.846	(\$0.006)
Dec-13	\$18.26	\$18.20	\$0.06	55.50c	56.50c	(1.00c)	\$1.800	\$1.805	(\$0.005)
Jan-14	\$17.87	\$17.87	\$0.00	48.83c	48.80c	0.03c	\$1.805	\$1.805	\$0.000
Feb-14	\$17.65	\$17.59	\$0.06	42.00c	42.00c	0.00c	\$1.810	\$1.810	\$0.000
<b>12 Mo Avg</b>	<b>\$18.35</b>	<b>\$18.35</b>	<b>(\$0.00)</b>	<b>55.74c</b>	<b>56.15c</b>	<b>(0.41c)</b>	<b>\$1.816</b>	<b>\$1.818</b>	<b>(\$0.002)</b>

**What's Bearish:**

- Spot Market: Both blocks and barrels were lower this week as sellers pressured prices lower. Blocks were down ¼¢ to settle at \$1.69¼/lb on 5 trades, while barrels lost 6¼¢ to close at \$1.59¼/lb on 6 trades. Butter shed 6½¢ to settle at \$1.63/lb on just 2 trades and Grade A NDM gained 2¢ to settle at \$1.56/lb with no trades.
- Fluid Milk East: Manufacturing milk supplies have significantly increased in the Northeast and Mid-Atlantic regions this holiday week. The combination of lower Class I demand and the seasonal increase in milk production account for the expanded volumes. Class I demand in Florida has declined to its lowest level in 2013 as most schools are on spring break. Milk production has marginally increased as cooler weather has improved cow comfort levels. The decrease in Class I demand this week increased exports to 110 spot loads. Milk supplies have increased in the Southeast as Class I demand has declined and production continues to increase along the seasonal trend. Manufacturing milk supplies will increase over the holiday. Nearly all auxiliary manufacturing facilities will be utilized over the holiday period. Cream supplies are very heavy this week as demand for cream has weakened substantially ahead of the holiday. Cream supplies quickly exceed demand and are being channeled to Class IV production, keeping churning schedules at near capacity levels.
- Fluid Milk Central: Milk haulers indicate farm milk production regained some volumes lost to cold weather during the last two weeks, evidenced by topped off loads coming out of several milk pickup routes. For some cheese manufacturers, the arrival of improved farm milk volumes is either sending cheese production higher, or they are trying to clear additional loads of milk through the spot market as cheese inventories may already be above desired levels. A few intermittent cheese plant operators are buying spot loads of milk at \$3 - \$5 under Class to finish out short term contract production. Milk marketers report sales into fluid accounts are light this week as spring break decreases food service needs throughout the region.
- Fluid Milk West: CA milk production remains on a slow upward trend. Production reports from handlers have varied from below last year's level to getting closer to flush. Lower Class I usage over the Easter holiday is moving more milk into the manufacturing sector. Weather conditions have been favorable for increased milk production and new crop forages are beginning to reach dairies. AZ milk production is good with plants handling peak production levels for this year. Warm, comfortable weather with nighttime lows in the 50's is conducive to increased cow comfort levels and higher milk outputs. NM manufacturers report plenty

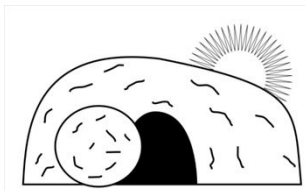
of milk available for current needs. Cooler weather has pushed milk production higher. Spring break for many schools and the Easter holiday have reduced Class I demand and that milk is finding its way to both cheese and butter/powder plants. Cream markets are weaker as the increased supplies move to butter churns in the region. Class II demand is reduced following the arrival of the Easter/Passover holidays. Cream is plentiful this week and multiples are expected to be lower over the weekend. Ice cream interest remains below expectations as warmer weather has yet to arrive in many parts of the country. Temperatures in the Pacific Northwest continue to improve with warmer days and cool nights adding to cow comfort levels. Milk production in central Washington is increasing due to some herd expansions and temperate weather.

- Butter: Cream supplies in the Northeast are very heavy this holiday week with most churns operating at/or near capacity. Domestic demand for butter is mixed. Export demand continues to be good with a number of manufacturers making 82%, unsalted butter to fill export orders. In the West, retail orders for the Easter/Passover holidays have been shipped and buyers are hesitant to buy too far ahead without clear demand signals. Retail sales to supermarkets and club stores are good, with food service sales fair. Butter churns are operating on increased schedules as cream remains plentiful. Extra cream volumes are expected over the Easter weekend as Class I sales are lower and milk supplies are sent to butter/powder manufacturers.
- Dry Whey East: Production continues to be heavy and continues to add to most manufacturers' inventories. Domestic end user demand remains sluggish, but export interest remains good with manufacturers offering price discounts for multiple load purchases. The market undertone remains weak.
- Dry Whey Central: The market tone is weak. Because of recent high Class III intakes and the need to clear milk through cheese production, some manufacturers' dry whey inventories are higher than planned for this time of year. The push now is to reset inventories at manageable levels.
- Cheese East: Milk volumes going to cheese plants continue to be strong, keeping cheese plants on 6-7 day production schedules. The very active cheese production is expanding inventories, even though demand has been fairly good. Most cheese makers indicate they are pleased with first quarter sales, as those sales are above year ago levels. Exports and mozzarella sales have been especially good, so far this year.
- Cheese West: Heavier than expected cheese production is being cited as one of the reasons for buyers backing off of purchases this week. Contracted sales are moving in an orderly fashion, but additional spot purchases are being delayed at current price levels. With the increased cheese production, buyers report there is no hurry in acquiring more inventory and are content to see what the market holds in the next few weeks.
- Grains: Prospective plantings came in as about expected, but today's Grain Stocks report was bearish for both corn and soybeans, sending corn limit down May-Sep and beans down 40+ May-Aug. The potential for sub \$5/bu corn is there, should weather cooperate this summer. Yikes!

#### Recommendation:

With domestic production continuing to be very strong, support for dairy prices is dependent on solid export sales. So far, with the drought in New Zealand and limited production gains in Europe, that formula is working. Indeed, updates this week imply butter and cheese exports are strong, with CWT helping subsidize sales. Domestic interest in both NDM and dry whey has increased, seemingly put a floor under those prices, as little downside is seen, despite heavy output. However, we still see substantial risks. The economic situation in Europe is far from good; case in point, Cyprus. And today's Grain Stocks report sent corn and beans sharply lower. More follow-through selling is expected on Sunday evening's open. Should we see a sharp decline in feed prices, we would expect it to limit milk prices over the long run. The second half of 2013 averages \$18.86 Class III. We would consider selling some milk here if this is profitable for your operation. If you want to be open to more upside, consider the May-Dec 17.00 x 22.00 fence, which we had fill last week at a cost of 12¢/month. This gives you a full \$5/cwt range between your minimum and maximum prices. Cheese has never averaged over \$1.95/lb over six months, so to consistently be capped at \$22/cwt, we'd need to be setting new records. Not a bad insurance policy for not a lot of money. With current spot prices for cheese working out to about \$16.90 Class III, we are still bearish the balance of Q2 as well. May Class III is pricing cheese at \$1.82/lb. Maybe we get there, maybe we don't. Consider some up-front protection in the form of the April 17.25 PUT at 15-20¢ and the May 17.50 PUT at 15-20¢ if you have milk open in these months.

**Note:** The dairy markets will be closed tomorrow in observance of Good Friday. We wish all of you a very Happy Easter!



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