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

The KDM Dairy Report – May 3rd, 2013

What's Bullish:

Futures Month	Class III 04/26	Class III 04/19	Change	Dry Whey 04/26	Dry Whey 04/19	Change	Cheese 04/26	Cheese 04/19	Change
May-13	$18.70	$19.11	($0.41)	57.75¢	56.10¢	1.65¢	$1.840	$1.886	($0.046)
Jun-13	$18.91	$19.47	($0.56)	57.25¢	59.25¢	(2.00¢)	$1.864	$1.909	($0.045)
Jul-13	$19.14	$19.40	($0.26)	58.28¢	60.03¢	(1.75¢)	$1.884	$1.890	($0.006)
Aug-13	$19.20	$19.29	($0.09)	58.05¢	60.68¢	(2.63¢)	$1.885	$1.879	$0.006
Sep-13	$19.23	$19.17	$0.06	58.50¢	60.63¢	(2.13¢)	$1.888	$1.874	$0.014
Oct-13	$18.88	$18.97	($0.09)	58.30¢	60.75¢	(2.45¢)	$1.847	$1.853	($0.006)
Nov-13	$18.52	$18.70	($0.18)	58.50¢	60.50¢	(2.00¢)	$1.820	$1.830	($0.010)
Dec-13	$18.17	$18.30	($0.13)	58.00¢	58.08¢	(0.08¢)	$1.787	$1.802	($0.015)
Jan-14	$17.80	$17.96	($0.16)	54.35¢	54.35¢	0.00¢	$1.780	$1.787	($0.007)
Feb-14	$17.55	$17.61	($0.06)	50.00¢	50.00¢	0.00¢	$1.780	$1.792	($0.012)
Mar-14	$17.49	$17.51	($0.02)	49.00¢	49.00¢	0.00¢	$1.800	$1.800	$0.000
Apr-14	$17.33	$17.35	($0.02)	48.00¢	48.00¢	0.00¢	$1.794	$1.794	$0.000
12 Mo Avg	**$18.41**	**$18.57**	**($0.16)**	**55.50¢**	**56.45¢**	**(0.95¢)**	**$1.831**	**$1.841**	**($0.011)**

- Dairy Products Report: Total cheese output in March was 0.2% below year-ago levels, while American cheese output was 1.4% higher. Both numbers were below most analyst expectations. Butter production was up 4.2%, but dry whey output fell 4.2% and NDM output was down 22.8%.
- Spot Market: Cheddar blocks gained 5¢ for the week to settle at $1.91/lb while barrels picked up 4½¢ to close at $1.73/lb. Buyers were aggressive as they purchased 8 loads of blocks and 26 loads of barrels. Butter declined 4¢ to settle at $1.65/lb on 14 trades, while Grade A NDM lost 1¼¢ to close at $1.74¾/lb on just one trade.
- Class III component prices were mostly higher in this week's USDA price survey. 40-lb cheddar blocks averaged $1.82/lb, up 5.4¢ from a week ago, while 500-lb barrels gained 5.5¢ to $1.78/lb. Butter increased 2.8¢ to average $1.72/lb and NDM jumped 5.4¢ to $1.60/lb, but dry whey decreased 1.2¢ to average 56.5¢/lb.
- Dairy cow slaughter for the week ended 04/20 totaled 62,300 head, up 9.3% vs. 2012.
- Fluid Milk Central: Some plant managers indicate intakes are unchanged, but a few cooperative managers in the North Central indicate milk intakes declined this week compared to the prior week. Feed availability in the Central region is becoming more challenging for some operations. Variable rations are pointed to as one possible cause for plateauing farm milk. However, some sale barn operators report herd dispersal sales are taking place for operations that have exhausted feed supplies, with a net result of decreasing milk flowing to some balancing or manufacturing facilities.
- Fluid Milk West: Some contacts in CA are beginning to think that peak milk production has been reached, at a level a bit lower than last year. Temperatures are getting warmer, at times much warmer, than average. At midweek, high temperatures are as much as 15 degrees above normal for early May. Also, on Tuesday, temperatures approached 103 degrees in the border areas of Arizona and California. Very little, if any, cream has to leave California at this time and demand from ice cream plants is gaining some momentum. Conditions for milk production in AZ are becoming much warmer. The dairy areas were over 100 for 3 consecutive days. The peak has probably been reached and warmer temperatures will start to push output lower. Temperatures are also warming in NM. Midweek temperatures are moving into the low 90s. Cow comfort is still OK, but windy conditions, with gusts noted in the 40-50 range, are causing some cow stress.
- Butter Central: Butter inventory levels remain over 2012 levels, but greater export interest this year is keeping a number of churns operating at a good pace, in the expectation that demand will keep prices up and possibly higher later in the year.
- CWT has accepted requests for export assistance to sell 1.102 million pounds of butter and 925,942 pounds of Cheddar cheese. The product will be delivered May through October 2013.
- Dry Whey East: Production of dry whey continues to be heavy as the spring milk flush adds to milk volumes channeled to cheese vats. But domestic demand for dry whey is improving as buyers of dairy proteins view whey as a competitively priced alternative and more readily available. Export interest, with China being the major player, continues to be good. Export sales have reduced whey inventory levels for some manufacturers. The market undertone is steady to firm.
- Dry Whey Central: Manufacturers in the Central region indicate sales into export markets are steady, but they anticipate Decree 152 of the Chinese government may slow the pace of exports in the near term. A few manufacturers indicate farm milk intakes declined slightly this week. Field reps indicate some dairy farmers are struggling to stretch feed through to the point when pastures and/or green chop are available.
- Dry Whey West: Whey production continues to be robust as cheese plants are running full schedules in many cases, but international demand is helping to firm prices.
- NDM East: Prices moved higher this week. Domestic spot sales were light this week, but export interest remains very good with numerous multiple load sales of low heat. Some traders feel demand for product may increase in the short term as buyers attempt to get ahead of expected contract price increases, driven by export sales.
- NDM Central: Manufacturers are not hesitant about building NDM inventories. Other participants are also finding reasons to hold on to the nonfat dry milk in their stocks. Those who have NDM are holding with confidence. Production is active through the region, but a few processors note overall weekly intakes for their operations are lower. Processors speculate nutritional changes from varying rations may be at the heart of the atypically lower milk intake volumes.
- NDM West: Prices continue to move sharply higher. Sellers are in no hurry to move additional loads of powder at this time. They believe the fundamentals are strong enough in their favor that time is on their side. The Oceania situation has eased, but the U.S. still seems to be the only pool of quality, available powder in the world. Offerings of high heat powder are limited. Many plants are not able to make much powder at this time, as they are more concerned with throughput.

What's Bearish:

- This week's GDT auction in New Zealand resulted in a 7.3% drop for the dairy price index vs. the last auction two weeks ago. WMP fell 10.2% followed by SMP with a decline of 9.5%. Butter was down 6.7%, but cheddar cheese managed to increase 3.4%.

- Butter stocks at USDA selected storage centers jumped 30%, or 3.7million lbs, in March. Cheese stocks were down 1%, or 1.5 million lbs over the same period.
- Cheese Northeast: Domestic demand for cheese is relatively good, but production and supplies quickly outpace demand and, as a result, inventories continue to increase. Export interest for cheese remains good, which assists in the movement of blocks more so than barrels and partially explains the wide discrepancy, in price, between barrels and blocks.
- Cheese Midwest: The velocity of block price strength has been fueled by export interest. When last week's trading closed with the price spread between blocks and barrels reaching an "almost-never-seen premium". The magnitude of this price spread was not generally expected in part because there remains quite a lot of cheese in storage. With the spread increasing this week, various explanations are offered but all boil down to speculation, especially weighed against current ample cheese stocks. The impact of current prices has left domestic retail cheese sales lagging, with some buyers expressing reluctance to build inventory at recently elevated price levels.
- Cheese West: Cheese production remains heavy as milk supplies are steady to building in the region. Block cheese plants are comfortable with the busy schedules, while barrels are thought to be in a surplus position. Domestic demand is adequate for much of the block inventory with excess supplies seeking sales in the international markets.
- Fluid Milk East: Milk production continues to increase in the Northeast and Mid-Atlantic regions, adding to the already heavy manufacturing milk supply. Both regions have had good weather for fieldwork activities. A majority of pastures are rated as fair to good in both regions. Class I demand has declined considerably in Florida as the tourist season has slowed and seasonal residents have all but left the state. Milk production continues to trend downward as cow comfort levels are declining, but the decline in fluid milk demand increased spot export loads to 130 this week, up from 70 last week. Milk supplies in the Southeast region are in balance with needs, but Class I demand is flat. Cream supplies are heavy and continue to increase, following the increases in milk production. Condensed skim demand has seen some improved demand coming from ice cream manufacturers, but supplies quickly exceed demand, and as a result, a majority of volumes continue to be channeled to Class IV production
- Fluid Milk Pacific Northwest: Milk production continues to build slowly as spring weather aids cow comfort levels. Warm temperatures and rain along the coastal areas are allowing grazers to take advantage of fresh forages. Milk production is slowly building in the region. UT and ID weather is favorable for most spring activities. Dairies are busy with increasing milk supplies and preparing for new crop forages. Hay and other feedstuff prices are lower than last year. Increased processing capacity in the region and higher milk prices have dairies taking a serious look at expansion plans.
- Butter East: Cream supplies continue to increase as milk production is increasing with the oncoming flush. The increases in the cream supplies are channeling more volumes to churns and butter production is expanding. Domestic demand for butter remains flat, causing butter manufacturers to produce more bulk butter and expand inventories.
- Butter West: Production remains at a high level as cream is readily available. Inventories of butter continue to build in many cases. Domestic demand for print butter is moderate into club stores and moderate to weak into grocery accounts.

Recommendation:

Front month futures were pummeled at the end of the week, despite both blocks and barrels moving higher in this week's spot market. With the block/barrel spread hitting 23¢ this week and the block supply being tight due to strong international demand, the thought was that the spread would be corrected with barrels moving higher. However, now that blocks are inching towards $2.00, a level that has hurt demand in the past, domestic buyers, at least, appear to be holding off on purchases. It now looks more likely that the spread will be corrected with a combination of barrels rising and blocks falling. It's anyone's guess as to where this middle ground will be found, but with international prices for cheddar still over $2.00, somewhere in the $1.80's is reasonable. That would put Class III in the $18.50 neighborhood. It appears traders had a similar conclusion as June futures settled down 41 to $18.91 today, and hit as low as $18.76. Be prepared for more volatility next week. If you are a hedger and have sold your June milk at higher prices, we would consider lifting your hedges early for a profit if June futures slip below $18.50. July on out may fall in sympathy in the short term, but we believe they are ultimately headed higher. The slow start to planting has allowed grains to rebound somewhat, and the recent thaw, followed by rain/snow, followed by hard freeze has caused significant alfalfa damage in much of WI. In eastern WI counties, it's reported that at least 50% of the alfalfa has received moderate to severe damage. Hay will be in short supply in America's Dairyland, while the delayed spring means first cuttings are at least 3-4 weeks out, if not further. We are getting feedback from some of our commercial clients that milk receipts are starting to take a small hit, in part due to ration changes as producers try to stretch their feed supply. The heat last summer also affected breeding, so there are an unusually large number of dry cows for this time of the year that won't freshen until June. We would hold off on any aggressive selling for now, even though we look to be headed for a short-term correction. If you are desperate to get something done, consider buying cheap disaster insurance. The July-Oct 17.00 PUT averages just 13¢/month.