

The KDM Dairy Report – May 10th, 2013

What's Bullish:

- Dairy cow slaughter for the week ended 04/27 totaled 59,900 head, up a strong 13.7% vs. the same period last year.
- Fluid Milk West: The milk flow in CA is being called steady and being handled with no problems by manufacturing plants. The entire state slipped further into drought last week, even with some late week shower activity. The California Water Resources report indicates the snow pack is only 17% of normal. Aphids in the southern part of the state are becoming much more of a problem with hay yields down 30-80%. Very little, if any, cream has to leave California. Most of the cream continues to clear to churns.

| Futures Month | Class III 05/10 | Class III 05/03 | Change | Dry Whey 05/10 | Dry Whey 05/03 | Change | Cheese 05/10 | Cheese 05/03 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| May-13 | \$18.55 | \$18.70 | (\$0.15) | 58.00¢ | 57.75¢ | 0.25¢ | \$1.826 | \$1.840 | (\$0.014) |
| Jun-13 | \$18.08 | \$18.91 | (\$0.83) | 57.25¢ | 57.25¢ | 0.00¢ | \$1.778 | \$1.864 | (\$0.086) |
| Jul-13 | \$18.74 | \$19.14 | (\$0.40) | 57.50¢ | 58.28¢ | (0.77¢) | \$1.843 | \$1.884 | (\$0.041) |
| Aug-13 | \$18.95 | \$19.20 | (\$0.25) | 58.00¢ | 58.05¢ | (0.05¢) | \$1.865 | \$1.885 | (\$0.020) |
| Sep-13 | \$19.06 | \$19.23 | (\$0.17) | 58.50¢ | 58.50¢ | 0.00¢ | \$1.878 | \$1.888 | (\$0.010) |
| Oct-13 | \$18.81 | \$18.88 | (\$0.07) | 57.00¢ | 58.30¢ | (1.30¢) | \$1.861 | \$1.847 | \$0.014 |
| Nov-13 | \$18.40 | \$18.52 | (\$0.12) | 57.50¢ | 58.50¢ | (1.00¢) | \$1.825 | \$1.820 | \$0.005 |
| Dec-13 | \$17.99 | \$18.17 | (\$0.18) | 56.00¢ | 58.00¢ | (2.00¢) | \$1.784 | \$1.787 | (\$0.003) |
| Jan-14 | \$17.59 | \$17.80 | (\$0.21) | 54.35¢ | 54.35¢ | 0.00¢ | \$1.770 | \$1.780 | (\$0.010) |
| Feb-14 | \$17.34 | \$17.55 | (\$0.21) | 50.00¢ | 50.00¢ | 0.00¢ | \$1.760 | \$1.780 | (\$0.020) |
| Mar-14 | \$17.23 | \$17.49 | (\$0.26) | 49.00¢ | 49.00¢ | 0.00¢ | \$1.750 | \$1.800 | (\$0.050) |
| Apr-14 | \$17.25 | \$17.33 | (\$0.08) | 48.00¢ | 48.00¢ | 0.00¢ | \$1.794 | \$1.794 | \$0.000 |
| 12 Mo Avg | \$18.17 | \$18.41 | (\$0.24) | 55.09¢ | 55.50¢ | (0.41¢) | \$1.811 | \$1.831 | (\$0.020) |

Weather fronts have cooled off conditions in AZ. Temperatures have been just in the 80s and low 90s and conditions have been very windy. Milk output continues to decline from the seasonal peak. Temperatures in NM were way below normal late last week. Fat tests on incoming milk in the region are declining along normal patterns.

- Dry Whey West: Prices firmed this week as export sales were reported higher. Export prices had been trading at a discount to domestic sales and that gap has narrowed. Good export interest, combined with domestic demand, has spurred the higher prices. Whey production and stocks are behind year ago levels.
- CWT has accepted requests for export assistance to sell 1.896 million lbs of Cheddar, Gouda and Monterey Jack cheese to customers in Asia, North Africa and the Middle East. The product will be delivered May through November 2013.
- Exports: According to the Foreign Agricultural Service, exports of butter and milkfat for January-March 2013 total 33.6 million pounds, up 20% or 5.6 million pounds from the same period a year ago. The butter and milkfat exports account for 6.2% of butter production in the U.S. Exports of cheese and curd over the same period total 154.4 million pounds, up 8% from the same period a year ago. The exports account for 5.6% of total cheese production in the U.S.
- International: Chinese demand for New Zealand dairy products is currently more than the country can supply, according to a news article this week. Demand has sharply increased, causing a 50% rise in prices in the past two months. Part of the spike was driven by the drought in New Zealand, but powder has been tight world-wide regardless.
- International: Cheese production in Australia during March was down 2.5% vs. a year ago. After being ahead of last season most of the year, YTD output is now 0.7% below year-ago levels.
- International: New Zealand milk production continues to trend lower and total volumes are tracking below year ago levels. The milk season is winding down and coming to a harder close than normal year projections. The effects of the lower milk output this season and impacts on finished dairy products have mostly been absorbed by the market. The implications of the recent rainfalls are limited on current milk output. Currently, processing plants are running on reduced schedules and processors are closing down plants in incremental ordering to facilitate the decline in milk receipts. Australian milk production is trending lower and tracking at levels below year ago marks. While conditions have stabilized in April and brought more normalcy to the milk production curve, there are concerns about getting the herds and pastures in shape for next season. Farmers are feeding supplemental feedstuffs to augment the feed shortages. The impact of weather, feed costs, and time of season, are all playing a role in the declining milk receipts.

What's Bearish:

- Cash Market: Sellers across all products were active this week. Blocks traded 16 times and lost 6½¢ to settle at \$1.84¼/lb, while barrels traded 7 times and was down just ¼¢ to \$1.72½/lb. Butter decreased 4¢ on 19 trades and Grade A NDM was down 4¼¢ to \$1.70/lb on 5 trades.
- World Ag Supply & Demand Report: USDA revised their 2014 Class III price lower (\$17.50/cwt) due to a forecasted increase in milk production and lower feed costs. 2013 prices were forecast lower as well, due to falling whey prices offsetting a rise in cheese prices. USDA now expects 2013 Class III to average \$18.05/cwt.
- Fluid Milk East: Milk production is at or just past the seasonal peak in the Mid-Atlantic region and is increasing rapidly in the Northeast region. Milk volumes going to balancing plants are heavy, but not burdensome. Weather has been great in both regions this past week. Pastures are greening up and opening up for grazing with a majority of pasture conditions in both regions being rated as either fair or good. Milk production in Florida increased this week as mild weather improved cow comfort levels. Class I demand continues to decline as Universities are completing their spring terms. Milk supplies are nearly in balance with demand in the Southeast region and manufacturing milk supplies are approaching contract minimums, but cream supplies are very heavy as butterfat levels remain high, adding to cream volumes coming from Class I plants and the seemingly ever increasing yogurt production. Demand for cream has fallen flat as ice cream production is yet to be in full swing and demand from cream cheese remains steady at best. Current supplies quickly exceed demand with many loads having trouble finding a home, requiring out of region discount sales.
- Fluid Milk Central: Milk production is variable. Processors in the East Central area report milk pickups and intakes moved slightly higher as warm weather settled across the area. Other states report milk intakes are holding steady. Some commodity cheese plants reportedly sold milk loads to temper further build up in cheese inventories during an unstable market. Those milk loads generally moved into specialty cheese operations.

Bottlers also released a few loads into the spot market as fluid milk sales decline seasonally. Some Class IV plants also cleared milk to nearby drying operations as intakes approach capacity.

- Fluid Milk Pacific Northwest: Warm days and cool nights are helping to build milk production. The favorable weather is adding to cow comfort levels and resulting in increased production. Dairies in central Washington are building herd numbers as feed costs become more favorable. The added production in the region has some milk shipments out of the area being reported. UT and ID milk supplies are still increasing marginally as they build towards spring flush. First cutting of forages will begin soon and should help to raise production.
- Butter: Prices have shown weakness this week. Northeast butterfat levels remain good and cream supplies continue to increase, adding to cream volumes going to churns. Butter production continues to expand with increased bulk butter production adding to inventories. Central churns are active throughout the region, benefitting from slow cream demand from Class II operations. Various manufacturers indicate butter inventories are steady to building. The market tone for bulk butter is weak due to increased inventories reported in storage. Manufacturers appear content with current inventories and continue to operate churns at higher than expected rates. NASS's Dairy Products report showed national March butter production totaled 183.6 million pounds, the highest production weight for any March, based on available NASS records covering 1919 - 2013!
- Dry Whey East: Dry whey prices experienced a downturn this week. Seasonal increases in milk production are maintaining strong volumes of milk going to cheese plants and keeping dry whey production steady. Domestic demand for dry whey has softened as numerous buyers have recently purchased additional supplies. Export interest remains good, but is showing signs of slowing following a period of increased market activity. The market undertone has weakened compared to previous weeks' activity.
- Dry Whey Central: Prices moved lower on both ends of the range. The market is mixed. Various manufacturers indicate they are clearing some dry whey loads to avoid sending inventories to outside warehouses. Sales into ice cream and ice cream mix are somewhat below seasonal norms, according to market participants.
- NDM: The trade indicates that the market continues to have a firm undertone, but it is not as aggressive. Indications continue that the U.S. remains the primary source for those in the world searching for good quality dairy proteins at this time. Production is seasonally heavy in the West, but plants are operating on normal, planned schedules. In the Central region production is very active in the region, with some plants now processing at daily capacity volumes. Manufacturers' inventories are building steadily. In the East, most buyers have increased supplies over the recent weeks and are now taking a wait and see attitude on additional purchases. Export interest remains fairly good, but sales have also moderated. Production of nonfat dry milk remains very active as seasonal milk production increases are maintaining heavy manufacturing milk volumes going to dryers.
- Cheese East: Cheese production continues to be strong as seasonal milk production increases are channeling more milk to cheese plants. Cheese inventories are building, which is typical for this time of year. Domestic demand for cheese remains fairly good with good pulls from retail chains and pizza makers. Most cheese makers in the region are very comfortable with their expanding inventories and look to build more to cover their needs for later in the year when milk supplies and cheese production schedules may be limited. Export interest for cheese remains fairly good, but volumes going for export have declined over the past few weeks.
- Cheese Midwest: Many cheese manufacturers have cheese stock volume they describe as increasing. While there do not seem to be any sign of alarm, the reality of the situation has led to some plants incrementally notching production back. This has also led to some milk being offered for sale for as much as \$2.75 under class. Cheese retail sales are not good in the view of at least one large manufacturer. That, coupled with the uncertainty in market prices still adjusting from a near record block-barrel price spread, leaves many retail customers hesitant about committing to new purchases.
- Cheese West: Barrel cheese supplies are still felt to be long. Block cheese inventories are more manageable with supplies felt to be in balance for needs. Block cheese volume is being aided by export sales.
- Grains: This week's World Ag Supply & Demand report put ending corn, bean and wheat stocks above estimates. Demand was revised lower, while production is projected higher. USDA estimates corn will average \$4.70/bu. Futures plunged on the news.
- International: Milk output is beginning to develop at incrementally higher levels across most countries in Western European. Temperatures are warmer and drier periods have materialized. The change is allowing for pasture growth and more intense grazing. As milk output builds, processing plants are increasing production schedules. Dairy product prices are steady to lower, reflecting softness in international markets. The changes follow sharply higher prices in recent months. Buyers are more comfortable with short-term positions and are less aggressive.
- International: Dairy product prices in Oceania are retreating from recent seasonal high levels. Demand became more uneven as the pricing levels reached higher points. Buyers are less aggressive in pushing prices and the drop in demand was expected as near-term coverage became more common and buyers were reluctant to be in the market at the high prices.

Recommendation:

With GDT auction prices for powder down two sessions in a row, it appears global butter/powder prices were a victim of up to far and two fast. International demand has faded slightly, while domestic demand is fair. This, right when milk output in the Northeast to the Pacific Northwest continues to surge. Domestically, block cheese hit \$1.91½ in the spot market, which also appears to have dried up orders. The unsustainable block/barrel spread began to close, with blocks making the larger move. Class III responded sharply lower with the June contract losing 83¢ for the week. Further out, losses were more muted. With international cheese prices still over \$2.10/lb, buyers in the spot market should begin to get more aggressive as and if prices continue to fall next week. The spring peak in the northern regions of the country won't last forever and when summer warmth and grilling season begins in earnest, much of the current surplus could dry up. As we stated last week, we think the near term is still bearish, but continue to see this market supported further out. We'll all need to watch the grains as a perfect summer could put continued pressure on feed prices, which would encourage expansion and lower milk prices. Our recommendation for this week is simply to stay on the sidelines.

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