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The KDM Dairy Report – October 5th, 2012

What's Bullish:

Futures Month	Class III 10/05	Class III 09/28	Change	Dry Whey 10/05	Dry Whey 09/28	Change	Cheese 10/05	Cheese 09/28	Change
Oct-12	$20.90	$20.86	$0.04	62.00¢	60.50¢	1.50¢	$2.045	$2.047	($0.002)
Nov-12	$20.99	$20.83	$0.16	63.50¢	63.00¢	0.50¢	$2.055	$2.014	$0.041
Dec-12	$20.32	$19.86	$0.46	63.00¢	63.00¢	0.00¢	$1.972	$1.925	$0.047
Jan-13	$19.57	$19.42	$0.15	60.50¢	62.48¢	(1.98¢)	$1.904	$1.891	$0.013
Feb-13	$19.11	$19.11	$0.00	59.00¢	62.50¢	(3.50¢)	$1.866	$1.843	$0.023
Mar-13	$18.83	$18.92	($0.09)	59.00¢	62.50¢	(3.50¢)	$1.825	$1.825	$0.000
Apr-13	$18.57	$18.62	($0.05)	58.65¢	62.00¢	(3.35¢)	$1.813	$1.805	$0.008
May-13	$18.43	$18.61	($0.18)	58.50¢	61.75¢	(3.25¢)	$1.813	$1.810	$0.003
Jun-13	$18.37	$18.65	($0.28)	59.00¢	60.00¢	(1.00¢)	$1.815	$1.810	$0.005
Jul-13	$18.60	$18.84	($0.24)	58.00¢	58.00¢	0.00¢	$1.829	$1.850	($0.021)
Aug-13	$18.55	$18.83	($0.28)	56.50¢	56.50¢	0.00¢	$1.839	$1.856	($0.017)
Sep-13	$18.45	$18.78	($0.33)	54.00¢	54.00¢	0.00¢	$1.822	$1.822	$0.000
12 Mo Avg	**$19.22**	**$19.28**	**($0.05)**	**59.30¢**	**60.52¢**	**(1.21¢)**	**$1.883**	**$1.875**	**$0.008**

- Spot Market: Blocks gained 2½¢ for the week to push settlement to $2.10/lb. Barrels also increased 2½¢ to $2.06/lb. Buyers picked up 17 loads of blocks and just 2 loads of barrels.
- All Class III components were strongly higher in this week's survey. 40-lb cheddar blocks increased 4.2¢ to average $1.89/lb while 500-lb barrels jumped 7.7¢ to $1.91/lb. Butter gained 3.6¢ to average $1.88/lb, dry whey increased 1.3¢ to 60.6¢/lb and nonfat dry milk picked up 4.5¢ to average $1.44/lb.
- Dairy cow slaughter for the week ended 09/22 totaled a robust 63,000 head, up 7.3% vs. a year ago. Culling in the SW states was 31% higher than last year. YTD, 120,700 more head have exited the milking herd than in 2011.
- Fluid Milk East: Milk production is beginning to increase in the Northeast and Mid-Atlantic regions. However, Class I demand remains strong and continues to limit manufacturing milk supplies. Pasture regrowth has slowed in the Northeast and supplemental feeding has begun. Numerous producers remain concerned about possible hay shortages and/or additional dairy herd culling. Milk production in Florida is beginning to show some marginal increases, but remains below last year's levels. Class I demand remains strong, prompting 98 spot loads to be imported this week. Pasture conditions are beginning to decline in some areas due to shorter days and cooler nights. Producers have changed their feed ration formulas to account for the higher feed costs. Some contacts have indicated they feel this year's flush will be lower, due to hot weather; market prices and feeding changes have or are affecting milk production. Milk production continues to increase in the Southeast region, but manufacturing milk supplies are still being kept at their contract minimums. Cream supplies have tightened in some areas as demand for cream from sour cream, cream cheese and butter manufacturers has increased.
- Fluid Milk West: CA milk output is mostly steady, though there are reports of slight intake declines in areas of hot weather over the past week. Feed prices remain high with alfalfa prices steady and corn prices lower from recent highs. Higher milk prices are welcomed, yet the underlying sentiment is unsettled because of high production costs. Processing plants are running on lighter than projected schedules. With milk supplies lagging year ago levels, challenges remain for processors filling milk supply contracts to others. Finding the appropriate balance is creating tightness in some segments and few avenues to find additional milk supplies in the state. In AZ, milk production trends are building higher, but there is a stronger demand for Class I milk from bottlers. Retail ads are featuring more dips, sour cream, cream cheese, and similar, that are creating more demand and utilizing more cream. Milk production in the Pacific Northwest is mainly steady. Increased milk prices have brightened the profitability picture, but higher feed costs are still the 500 lb. gorilla in the room and are the main reason for dairies to remain hesitant about expanding herds.
- Butter East: Cream supplies have tightened in some areas as demand for cream has improved. Butter production has increased as most major butter makers are now receiving orders for the upcoming holiday season.
- Butter Central: Active churning schedules are absorbing good volumes of cream and end product is clearing to current orders and enhancing inventories for future needs. Butter producers are indicating that orders for the balance of the calendar year are developing well. Although 7 weeks away, retail buyers are preparing for the upcoming Thanksgiving holiday. Buyers are placing good orders in anticipation of potential strong butter sales. Food service buyers are also placing good butter orders. Reports indicate that traffic flow through food service and restaurants is positive.
- Butter West: Demand continues to be strong as buyers look to build their inventories ahead of price jumps. Retail sales are good into warehouse retailers and supermarkets. Food service accounts are also showing some improvement. Butter production is steady to weak as less cream is available to be channeled to the churns. Manufacturers continue to pull additional supplies from stored inventory to fill orders and manage supplies.
- Dry Whey East: Cheese and dry whey production continues at levels below most manufacturers' desired levels, because of the tight manufacturing milk supply, brought about by the combination of good Class I demand and lower seasonal milk production. Current production is moving through contracts with little being added to inventories. Spot market and resale activity in the Eastern region is negligible. Buyers looking for additional loads have to look outside the region. Dry whey demand is good and is shifting as ice cream production slows and baking product manufacturing increases. Export interest has improved compared to recent weeks. The market undertone remains firm.
- Dry Whey West: The market tone is firm on good demand and tighter supplies. Dry whey production in the West is reduced from previous months due to increased production of concentrated whey protein products. Tight milk supplies in the West are also reducing available milk to cheese plants. The bulk of whey production is tied to contract needs.
- Cheese East: Production remains steady, but most cheese makers would like to expand output. Most production is filling current orders with limited production for aging programs, due to the tight milk supplies. Domestic demand for mozzarella remains active with good orders from pizza makers and restaurants. Most makers of cheddar cheese are comfortable with their current inventories. Export interest continues to prompt sales.

- Cheese Midwest: Milk supplies in the Midwest are tight enough to lead many cheese plants to a situation of paying a class premium for milk. This is true even with some plants with intakes up from what had been expected. Domestic cheese sales find Mozzarella moving well but cheddar sales being more "spotty". Cheese retail advertising volume reported in the National Dairy Retail Report has increased 57.8% from two weeks ago, following a 23.0% increase during the last cycle from four weeks ago.
- Cheese West: Demand is outlasting offered supplies. Cheese production in the West is lagging behind year ago levels due to tighter milk supplies. Buyers are looking to increase orders to fill their expected holiday needs. Retail and food service demand is good with processors finding tighter barrel supplies.
- International: Changes to Indian laws may allow multi-national investment in the nation, according to an article this week in Agri-View. Dairy consumption demand is outpacing milk output increases as a growing middle class adds more dairy to their diet. India, with a population of 1.21 billion people, adds 25 million newborns per year (about the population of Texas), compared to 16 million in China.

What's Bearish:

- Spot Market: Butter hit a high of $1.95¼ on Thursday, but fell 9¢ in Friday's spot session, settling at $1.86/lb. A total of 14 loads traded for the week.
- Dairy Products Report: Cheddar cheese output in August was up 3.1% vs. a year ago and total cheese output increased 2.6%. Butter output declined 3.5% over the same period.
- Fluid Milk Central: Milk haulers and handlers report the volumes of farm milk pickups are mixed. A few haulers report declines as the milk production season advances, while haulers in other locations report farm milk volumes are on the rise. Depending on location, a few manufacturing facilities report they are currently running at full capacity. Other operators indicate that lighter demand from the fluid sector allowed them to retain more of their intake volumes and increase Class III production.
- Dry Whey Central: Domestic interest in Central dry whey is steady to lower. A few resale market representatives indicate pushback by their buyers for dry whey loads began recently and continues this week. Sellers indicate buyers are less willing to unquestioningly support the strong price trend since dry whey seems to be available from multiple sources on an as needed basis.
- NDM Central: Prices are both higher and lower on a mixed market. Some market participants indicate buyers/end users are pushing back on higher priced NDM spot loads. Some end users and buyers who have purchased spot load NDM steadily through the last several weeks are opting to decrease spot load purchases because they expect NDM prices will decrease in early to mid-November. These circumstances point toward adequate to ample supplies of NDM in the hands of buyers and the ability to obtain NDM from multiple sources.

Recommendation:

Demand for cheese at $2+ appears to be sustainable, for now. Manufacturing milk remains tight in the East and is getting tighter in the West as cow numbers continue to decline. Cheese makers in the Midwest would like to make more cheese but aren't willing to pay the premium for extra milk. Holiday demand has kicked in as buyers have decided prices aren't going much lower. September Class III was announced at $19.00, but California 4b came in at $17.50. Mailbox checks in the West continue to lag other parts of the country (which needs to be fixed) and will continue to put financial stress on operators there. Front-month contracts finished the week higher, but the deferred months were lower. It could be some spread trading (buy the front, sell the back) is involved, or just the idea that if prices are strong through Q1 2013, it will be time enough for the market to respond to the call to increase output. Next week will be critical in determining grain prices (and thus feed prices) going into 2013. Beans appear to have put in a bottom, but Thursday's crop report may revise yields upward. However, there are just as many analysts that bullish as bearish on this one, so we'll have to wait and see. But meal prices have dropped over $50/ton from their Sep highs. It would make sense to us to take advantage of this price retracement and look to cover at least some of your 2013 needs. Beans could do limit up on Thursday if there's a surprise in the report. Best to do something while you can. We continue to favor defending milk with PUT options. Look at the Nov 20.25 PUT which settled at 28¢. Enter orders to buy at 25¢. The Dec 19.25 PUT settled at 37¢. Enter orders to buy it at 30¢. The Jan 18.25 PUT settled at 35¢. Try to get it for 30¢.