

The KDM Dairy Report – April 26th, 2013

What's Bullish:

- Cheese prices were sharply higher in this week's National Dairy Products survey. 50-lb cheddar blocks jumped 6.8¢ to average \$1.76/lb and 500-lb barrels were up 5.3¢ to \$1.72/lb. Butter increased 3.3¢ to average \$1.69/lb, dry whey inched 0.6¢ higher to 57.7¢/lb and nonfat dry milk averaged \$1.55/lb, up 3.7¢.

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
Apr-13	\$17.62	\$17.62	\$0.00	58.20¢	58.25¢	(0.05¢)	\$1.726	\$1.735	(\$0.009)
May-13	\$18.70	\$19.11	(\$0.41)	56.50¢	56.10¢	0.40¢	\$1.844	\$1.886	(\$0.042)
Jun-13	\$19.26	\$19.47	(\$0.21)	59.25¢	59.25¢	0.00¢	\$1.883	\$1.909	(\$0.026)
Jul-13	\$19.45	\$19.40	\$0.05	60.00¢	60.03¢	(0.02¢)	\$1.904	\$1.890	\$0.014
Aug-13	\$19.39	\$19.29	\$0.10	60.25¢	60.68¢	(0.42¢)	\$1.887	\$1.879	\$0.008
Sep-13	\$19.30	\$19.17	\$0.13	60.25¢	60.63¢	(0.38¢)	\$1.888	\$1.874	\$0.014
Oct-13	\$18.92	\$18.97	(\$0.05)	59.50¢	60.75¢	(1.25¢)	\$1.845	\$1.853	(\$0.008)
Nov-13	\$18.53	\$18.70	(\$0.17)	59.00¢	60.50¢	(1.50¢)	\$1.817	\$1.830	(\$0.013)
Dec-13	\$18.13	\$18.30	(\$0.17)	58.75¢	58.08¢	0.67¢	\$1.784	\$1.802	(\$0.018)
Jan-14	\$17.75	\$17.96	(\$0.21)	54.35¢	54.35¢	0.00¢	\$1.784	\$1.787	(\$0.003)
Feb-14	\$17.52	\$17.61	(\$0.09)	50.00¢	50.00¢	0.00¢	\$1.784	\$1.792	(\$0.008)
Mar-14	\$17.41	\$17.51	(\$0.10)	49.00¢	49.00¢	0.00¢	\$1.800	\$1.800	\$0.000
12 Mo Avg	\$18.50	\$18.59	(\$0.09)	57.09¢	57.30¢	(0.21¢)	\$1.829	\$1.836	(\$0.008)

- Dairy cow slaughter for the week ended 04/13 totaled 63,900 head, up 7.9% vs. a year ago. YTD the cull is 32,100 head higher than 2012.

- Fluid Milk Southeast: Cow comfort levels and milk production continue to decline in Florida as the weather continues to heat up. The decline in milk production lowered export loads to 70 this week, down from 89 last week and 200 a year ago. Milk production is past its peak in the Southeast region with some areas noting marginal declines. Milk supplies are nearly in balance with demand with only a few loads being shipped to manufacturing facilities. Class I demand showed some strength this week as a few plants added some loads. Cream supplies have increased in the East with the oncoming seasonal flush of milk, but improved cream demand has limited exports to other regions. The cream supply continues to receive good pulls from ice cream, cream cheese, and whipping cream.

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- Fluid Milk North Central: Dairy operators in the northern tier of states report last summer's heat hindered breeding. They anticipate some cows in the northern herds will be freshening through May, June, and July because of delayed settling in 2012. Feed shortages are reported within the Central region, especially in the North. Farmers are actively pursuing leads for alfalfa and/or grass/alfalfa mix hay to round out rations. Pastures in much of the Central region are still off limits to grazing due to the land being too wet. Far North fields remain snow covered and inaccessible.

- Fluid Milk West: CA remains abnormally dry with moderate to severe drought recorded over most of the state. Above average temperatures and strong, dry north winds are raising concern about forage development. Hay prices in the Central Valley are ranging from \$250 for supreme and \$235 for premium FOB the farm. March 2013 milk receipts were 4.7% lower than last year, according to CDFR. YTD milk receipts are 5.3% lower than in 2012. Demand from other users besides butter plants is beginning to increase seasonally. AZ milk output continues to hold near peak levels, but temperatures this weekend are expected to approach the high 90s. The weather in NM is cooler than normal for this time of the spring. The hay crop is coming along, but the first cutting looks to be on the later side of average. Milk supplies are normal.

- Dry Whey Northeast: Dry whey production remains very active with more milk being channeled to cheese vats as the spring flush is adding to the overall milk supply. Domestic demand for dry whey has marginally improved as buyers of dairy proteins view whey as a competitively priced alternative and more readily available. Export interest is very good with buyers from China actively seeking product, but actual sales have yet to be confirmed. The market undertone, despite this week's dip in prices, is steady to firm.

- Dry Whey West: Western dry whey prices were mostly steady this week, but the overall tone of the market is firm, as competing dairy proteins continue to show strength. The demand side of the market is reported to be good with product available from manufacturers. In trading this week spot loads of whey from resellers are often trading above market averages.

- NDM East: Prices for nonfat dry milk moved higher this week. Manufacturing milk supplies are increasing in the East as the spring flush has begun, but the general lack of high heat production has acutely limited the availability of product with inventories held in firm hands. Domestic demand has declined ahead of the industry conference to be held in Chicago next week, but export interest remains very active.

- NDM West: Prices for Western low/medium heat powder continue to move higher, and some sellers are holding for firming prices. Offerings of powder remain on the short side of average. Some buyers still need coverage and continue to bid up spot prices. High heat powder prices are sharply higher as there is not much available and the limited offers are finding strong demand.

- Cheese East: Despite milk production remaining strong in the region, cheese demand and sales have been good as buyers try to stay ahead of anticipated price increases. Export interest for cheese also remains good.

- Cheese Midwest: Cheese production in the Midwest is mostly steady with some manufacturers even ahead in production from where they had expected to be, due to milk supplies. But orders are also stronger. Prices that were increasing through much of last week are reported to have motivated some buyers to order more heavily than usual to get ahead of anticipated price increases.

- Cheese West: Stocks are heavier than last year, but not at burdensome levels for current demand. Blocks continue to see good demand for most varieties. Mozzarella sales are slower than expected for domestic needs, but export demand is still good in light of lower world cheese inventories. Barrel demand is weak domestically compared to block sales. Cheese production is continuing at a heavy pace as increased milk supplies become available.

- International: Western European milk production trends remain lower than a year ago due to the lingering effects that wet and cold weather conditions are having on milk cows and the start of pasture and crop growth. A concern among producers is that the slow start to the milk season may not be able to be captured during the rest of the season. Eastern European milk production levels are generally trending lower. The lingering winter-like conditions are tempering any growth potential. High feed costs are limiting supplemental feeding at current milk prices. Dairy product output is also lower. European butter markets continue to firm with prices moving higher. This week butter averaged \$2.36/lb.

Buying interest remains good within the EU and to regular trading partners. Skim milk powder pricing levels continue to move higher, with prices average a U.S. equivalent \$1.93/lb. The market tone is firm with decent clearances of SMP to internal and export customers.

- International: Despite recent rains in New Zealand, the influence of the drought is established. Current milk production is trending lower. Processing plants are reducing schedules and adjusting to the changes in milk intakes. Australian milk production is showing steady to slight gains in mid-April, yet output is not expected to gain enough traction to reverse the seasonal output into positive territory. The market forces of weather, grain prices, and milk prices have been working against the dairy farmer. Butter prices are slightly higher, at a U.S. equivalent \$2.11/lb. Supplies are on the light side of normal. With milk supplies lower than projections and the fat levels tailing off, the available milkfat supplies are lower. SMP production trends continue to move lower, reflecting a seasonally declining milk flow. Holdings are at light to moderate levels with availability to service orders on the books. Prices were mixed this week, average a U.S. equivalent \$2.37/lb. Cheddar cheese prices are steady, at a U.S. equivalent \$2.08/lb. Production levels are seasonally light with producer offerings being on the lower side of expectations. Contracted shipments are indicated to be moving on timely basis. Demand is good for local accounts and into export channels. Sales on the books are clearing.

What's Bearish:

- Spot Market: Blocks gave up 2¢ for the week to settle at \$1.86/lb on 10 trades and barrels lost 8¢ to close at \$1.68½/lb on 15 trades. Butter shed 9¼¢ to close at \$1.69/lb while Grade A NDM was down 1½¢ to \$1.76/lb on 2 trades.
- Livestock Slaughter Report: Dairy cow slaughter in March totaled 274,200 head, down 3,800 head from a year ago.
- Cold Storage Report: Butter stocks at the end of March were 22% higher than a year ago (levels not seen since 1993.), and 7% higher than Feb. American cheese stocks were 4% higher than last year and up 1% from last month. Total cheese stocks were 5% and 3% higher over the same periods.
- Cheese U.S.: After three weeks of higher prices, spot trading at the CME Group this week was sharply lower for barrels and prices for blocks were also lower. Increased milk production in the Midwest translated into increased cheese inventories. Cheese production across the rest of the country was also active with manufacturers sending milk to cheese plants in light of good sales. Block cheese supplies are not felt to be burdensome currently, but some heavier supplies of barrels are weighing on the market. With the spring milk flush approaching, buyers now appear willing to wait to see where the market settles.
- Fluid Milk Northeast: Milk production has noticeably increased in the Mid-Atlantic region as the spring flush has begun and weather conditions are markedly improving cow comfort levels. The Northeastern region has also noted significant increase in milk volumes. Some manufacturers in both regions are operating at levels approaching their facilities' capacities. Class I demand has declined in the Northeast as some schools were not in session.
- Fluid Milk South Central: South Central region dairy producers and milk handlers report milk intakes are trending higher as the flush arrives in traditional fashion in that area. Class I sales are slow. Bottlers are getting ample volumes from their contract sources and are only intermittently bringing in milk loads from their secondary suppliers. Some cheese manufacturers indicate their year to date cheese production is 10-15% higher because of very low Class I sales volumes.
- Fluid Milk Pacific Northwest: Milk production in the region is building slowly towards the annual flush. Feed supplies in the region are reported adequate as dairies await the arrival of new crop forages. UT and ID milk supplies are at mostly steady levels. Daytime temperatures have improved and fresh forages are greening up. Manufacturing capacity remains above current supplies in the region. Irrigation supplies for the upcoming growing season are reported adequate with no expected shortfalls. Lower feed costs would be a large incentive for dairies to consider expansion of milk herds.
- Butter: Cream supplies are more plentiful as milk production is increasing with the oncoming spring flush. Butter production has increased as manufacturers deal with the expanding volumes of cream. Domestic demand for butter has turned very sluggish, causing most manufacturers to expand inventories. Export interest continues to be strong.
- NDM Central: Buyers pushed back on F.O.B. spot load offers priced between \$1.75 - \$1.80, knowing current production is active and NDM inventories are growing at both producer and broker facilities. Various end users reported that by midweek, some resellers had decreased prices on NDM loads they were offering to help manage near term inventories.
- International: New Zealand drought conditions have eased as widespread and substantial rainfalls were received across the North Island. The rains are a positive sign for the upcoming milk production season. The rains will help pasture regrowth and reseeded projects.

Recommendation:

Sellers in the spot market made their presence felt this week as they pushed barrels and butter the most aggressively. Our Cold Storage Report indicates cheese stocks are high, but part of that could have been end-users buying heavily in advance of price increases. The market is honestly quite confusing at the moment. On the one hand, there appears to be plenty of cheese and other dairy product output, but on the other, demand seems to be taking about everything that can be produced. We heard reports this week of cheese orders getting pushed back into June and producers beginning to run out of quality feed in the Midwest. With Jun-Sep futures well over \$19/cwt, the market appears convinced that these prices are destined to rise. The selling we observed in the spot market this week was primarily from one large commercial producer and almost felt like they were trying to keep the market in check vs. exploding. The block/barrel spread now sits at an unsustainable 17½¢. Barrels appear to be more plentiful for the moment, but the consensus out there is that the spread will be corrected with barrels moving higher, as blocks are in a tighter situation. Current spot prices work out to about \$18.10 Class III, so that will need to start happening soon. Even correcting for the spread only gets Class III to about \$18.80, so blocks will need to get to \$1.90+. But, with the bullish momentum seemingly behind the market, we would switch to a PUT option only hedge for now. Consider the Jun 18.50 at 18¢, July 18.00 at 16¢, Aug 18.00 at 20¢ and Sep 18.00 at 30¢. Q4 futures finished lower for the week, indicating we might be headed for a blow-off top in Q2Q3, followed by lower prices in Q4. Certainly \$20+ milk all summer would make that a possibility! At this point, however, the Q4 contracts could rally in sympathy with Q2Q3, so hold off on any marketing of these months for now.

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