

The KDM Dairy Report – May 17th, 2013

What's Bullish:

- Spot Market: Blocks lost 7½¢ to settle at \$1.77/lb, but barrels gained 3¼¢ to close at \$1.76/lb. Buyers saw value here as they picked up 23 loads of blocks and 27 loads of barrels. Butter increased ½¢ to settle at \$1.61½/lb on just one trade, but NDM gave up 2¢ to close at \$1.68/lb on 7 trades.
- Crop Production Report: A hay shortage is looming. Winter kill has hit the alfalfa crop hard, with record low May 1st hay stocks established in Connecticut, Illinois, Michigan, Minnesota, New York, Ohio, Vermont, and Wisconsin. WI hay stocks are down 55.7% vs. 2012 and MN is down 45.6%. In many areas, the limited availability of native feedstuffs has forced producers to feed their herds earlier than normal. Additionally, a cold, wet spring has limited pasture growth, causing prolonged dependence on supplemental roughage and feedstuffs in portions of the Midwest.

Futures Month	Class III 05/17	Class III 05/10	Change	Dry Whey 05/17	Dry Whey 05/10	Change	Cheese 05/17	Cheese 05/10	Change
May-13	\$18.52	\$18.55	(\$0.03)	57.98¢	58.00¢	(0.02¢)	\$1.826	\$1.826	\$0.000
Jun-13	\$18.36	\$18.08	\$0.28	57.25¢	57.25¢	0.00¢	\$1.804	\$1.778	\$0.026
Jul-13	\$18.73	\$18.74	(\$0.01)	57.25¢	57.50¢	(0.25¢)	\$1.852	\$1.843	\$0.009
Aug-13	\$19.01	\$18.95	\$0.06	57.75¢	58.00¢	(0.25¢)	\$1.869	\$1.865	\$0.004
Sep-13	\$19.12	\$19.06	\$0.06	57.00¢	58.50¢	(1.50¢)	\$1.900	\$1.878	\$0.022
Oct-13	\$18.84	\$18.81	\$0.03	56.00¢	57.00¢	(1.00¢)	\$1.878	\$1.861	\$0.017
Nov-13	\$18.43	\$18.40	\$0.03	56.00¢	57.50¢	(1.50¢)	\$1.821	\$1.825	(\$0.004)
Dec-13	\$17.98	\$17.99	(\$0.01)	55.50¢	56.00¢	(0.50¢)	\$1.780	\$1.784	(\$0.004)
Jan-14	\$17.55	\$17.59	(\$0.04)	54.35¢	54.35¢	0.00¢	\$1.760	\$1.770	(\$0.010)
Feb-14	\$17.35	\$17.34	\$0.01	50.00¢	50.00¢	0.00¢	\$1.752	\$1.760	(\$0.008)
Mar-14	\$17.17	\$17.23	(\$0.06)	49.00¢	49.00¢	0.00¢	\$1.750	\$1.750	\$0.000
Apr-14	\$17.16	\$17.25	(\$0.09)	48.00¢	48.00¢	0.00¢	\$1.752	\$1.794	(\$0.042)
12 Mo Avg	\$18.19	\$18.17	\$0.02	54.67¢	55.09¢	(0.42¢)	\$1.812	\$1.811	\$0.001

- Fluid Milk Southeast: Class I demand in Florida improved marginally this week. Producers continue to be faced with high hay and grain prices. The downward trend in milk production, combined with the modest increase in Class I demand lowered the number of spot load export shipments to 90, which was down 40 loads from last week. Milk supplies in the Southeast region continue to be nearly in balance with demand with only a few loads over and above contract minimums going to manufacturing plants.
- Fluid Milk Southwest: CA milk production is holding mostly steady with recent weeks. There is some wonderment whether the peak has already been placed for the year. The lingering effects of the general dairy economy are thought to be the biggest reason for milk being stuck at current levels. Processing plants are easily able to handle the available milk intakes. NM milk supplies are adequate for processor needs. Creams supplies are moderate to heavy in the region, but supplies are moving to the churn and ice cream interest is slowly developing.
- Butter: Some grocery and convenience stores are running ads to help push print butter into consumers' hands. Sale prices on 1 pound packages range from \$1.79 to \$3.91 throughout the country. Orders from food service firms catering to education institution accounts are transitioning toward lighter summer ordering patterns. Butter production is seasonally active, but competition for cream is emerging strongly from frozen dessert/ice cream manufacturers.
- Dry Whey Central: Some manufacturers' stocks are clearing at discounts to the market. These sales will reportedly dwindle as inventories decrease. Dry whey production is steady to lower as a few multiple end product operations indicate farm milk intakes are trending lower in some areas more quickly than anticipated.
- Dry Whey West: Cheese plants are operating at increased levels and subsequent whey stream supplies are up. However, production of dry sweet whey is in balance with current needs. Manufacturers and brokers are reporting inventories are in balance in most cases. An increase in demand for export product was noted.
- Cheese Midwest: Demand for cheese has been stymied by the continuing cool wet spring, delaying the grilling season, but this situation may be coming to a quick end as a significant warm front in the Midwest has pushed day time highs into the 90's.
- Cheese West: Cheese production in the West is geared to maximizing plant efficiencies and many plants are running full schedules as milk is available. Block prices have moderated and export interest is increasing. Retail demand continues to be in balance with the increased production.
- International: China's demand for dairy products, particularly infant formula, continues to surge. Mistrust in domestic brands, along with a growing middle class, has led to rising demand for Western baby milk formula. Black markets for the product have thrived in New Zealand, Australia and Hong Kong, and are now being seen as far away as Switzerland, Germany and Britain. Reports are rife of Chinese baby milk tourists emptying supermarket shelves in Western countries to meet a perceived shortfall of safe formula in China. Supermarkets in some countries started to ration the amount of formula customers could buy, fearing local shortages as tins of formula were mass purchased and shipped to China. The volume of imported milk formulas in China quadrupled between 2008 and 2012.

What's Bearish:

- Stocks of both butter and cheese are on the rise so far this month. Through 05/13, holdings of butter at USDA selected storage centers are up 1.5 million lbs, or 9%. Cheese holdings are up 5.3 million lbs, or 5%.
- Just 55,800 head of dairy cows were culled during the week ended 05/04, the third lowest total weekly cull this year.
- Fluid Milk Northeast: Milk production is just beyond its seasonal peak in the Mid-Atlantic region and is showing some marginal declines. Northeast milk production is quickly building to its peak volume. Class I demand is showing some declines as numerous

Universities have completed their spring terms. Weather conditions have been optimal for field work activities in the Northeast with corn plantings ahead of the 5 year trend in all states. Pastures are open with conditions rated as mostly good to excellent throughout the region.

- Fluid Milk Pacific Northwest: Milk production in the region is slowly building towards the spring flush. Temperatures have been favorable with warm days and cool nights adding to comfort levels for dairy cows. The increased milk production is being utilized by manufacturers within the region with cheese and powder plants as the preferred destination. Class I needs are mostly steady. Milk supplies in UT and ID are increasing slowly with comfortable temperatures. Increased manufacturing capacity in the region continues to accommodate any increases in milk volumes.
- Dry Whey Northeast: Production of dry whey remains very active as seasonal milk production increases are adding to milk volumes going to cheese plants. Most manufacturers' inventories are expanding. Domestic demand for dry whey remains weak with some sellers struggling to clear supplies. Export interest is slowing as a number of buyers have recently made purchases and expanded their inventories.
- NDM Northeast: Production of nonfat dry milk is active, as the combination of seasonal milk production increases and lackluster demand for condensed skim by ice cream manufacturers, are maintaining heavy manufacturing milk volumes going to dryers. Export demand has weakened as SMP pricing on the g/DT auction has declined. Many buyers have a wait and see attitude, wanting a clearer picture of the market prior to making additional purchases. The various contradicting market factors have given the market a weak undertone.
- Cheese East: Manufacturing milk supplies going to cheese plants continue to be at increased volumes as milk production off the farm increases towards its seasonal peak. Current cheese production is adding to already expanded inventories. Domestic demand has declined as the cool spring, in many areas, has delayed the grilling season and softened retail sales. Export interest has also turned weak as numerous buyers have recently expanded supplies and are now waiting for the cheese market to settle out from its current downward trend.

Recommendation:

Spot action was the big story early this week, as it appeared sellers were intent on fixing the block/barrel spread by forcing blocks lower. In fact, that's what happened. Futures sold off swiftly. But by Wednesday, with both blocks and barrels in the \$1.70s, buyers became the aggressors, picking up a total of 50 loads of cheese in heavy trading. With international cheese prices still pushing well past \$2/lb, buyers saw value in owning product at those levels. So, it appears we are putting in a bottom in the cheese market. It's most likely we'll continue to see two-sided trade in the spot market over the coming 2-3 weeks as milk production remains for the most part at elevated levels and cheese production is strong. However, as grilling season finally gets under way and temps warm throughout the country, we could be in a completely different situation 60 days from now. In fact, we're already hearing some talk of milk output falling in WI and MN due to feed issues. The hay shortage in these and other states is a big deal, while the extremely late spring will mean first cuttings will be a month or more late, with the prospect of not getting in a 3rd or 4th cutting by the end of the growing season. Producers we talked to this week were scrambling for feed and finding little available. We'll be watching this issue closely. If you have milk already sold, we would use the drop in prices this week to try to procure some upside coverage. Consider the following target orders: July 1900 call @ 35 and the Aug 1950 call at 45. If you need to get a floor under your milk, consider buying the July-Oct 17.50 put at an average of 22¢/month. If successful, you will have an effective floor with a base price of 17.38. Adding your component pay on top of that should yield a final mailbox price at cash flow or better for many producers. And if prices stay strong, you have no cap on your milk. This is really not a bad way to go!

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