

The KDM Dairy Report – June 14th, 2013

What's Bullish:

- Spot: Blocks declined 2½¢ to settle at \$1.72¼/lb, but buyers picked up 13 loads along the way. Barrels are tighter and gained 1¼¢ for the week to close at \$1.77¼/lb on just 2 trades. NDM increased 1¢ to \$1.70¼/lb on just bids, while butter fell 1¢ to \$1.53/lb on 3 trades.

Futures Month	Class III 06/14	Class III 06/07	Change	Dry Whey 06/14	Dry Whey 06/07	Change	Cheese 06/14	Cheese 06/07	Change
Jun-13	\$17.99	\$18.09	(\$0.10)	57.10¢	58.28¢	(1.18¢)	\$1.772	\$1.774	(\$0.002)
Jul-13	\$18.03	\$18.58	(\$0.55)	57.25¢	59.00¢	(1.75¢)	\$1.779	\$1.831	(\$0.052)
Aug-13	\$18.52	\$19.05	(\$0.53)	58.48¢	59.50¢	(1.03¢)	\$1.827	\$1.867	(\$0.040)
Sep-13	\$18.81	\$19.08	(\$0.27)	58.50¢	59.50¢	(1.00¢)	\$1.856	\$1.874	(\$0.018)
Oct-13	\$18.79	\$18.87	(\$0.08)	59.50¢	59.98¢	(0.48¢)	\$1.845	\$1.852	(\$0.007)
Nov-13	\$18.55	\$18.54	\$0.01	59.00¢	59.00¢	0.00¢	\$1.830	\$1.820	\$0.010
Dec-13	\$18.16	\$18.13	\$0.03	59.00¢	59.00¢	0.00¢	\$1.790	\$1.780	\$0.010
Jan-14	\$17.60	\$17.65	(\$0.05)	54.35¢	54.35¢	0.00¢	\$1.759	\$1.745	\$0.014
Feb-14	\$17.25	\$17.30	(\$0.05)	50.00¢	50.00¢	0.00¢	\$1.735	\$1.726	\$0.009
Mar-14	\$17.17	\$17.15	\$0.02	49.00¢	49.00¢	0.00¢	\$1.740	\$1.730	\$0.010
Apr-14	\$17.15	\$17.13	\$0.02	48.00¢	48.00¢	0.00¢	\$1.737	\$1.727	\$0.010
May-14	\$17.16	\$17.13	\$0.03	48.00¢	48.00¢	0.00¢	\$1.730	\$1.720	\$0.010
12 Mo Avg	\$17.93	\$18.06	(\$0.13)	54.85¢	55.30¢	(0.45¢)	\$1.783	\$1.787	(\$0.004)

- Fluid Milk East: The convergence of a cold front and Tropical Storm Andrea dumped 3-6 inches of rain over much of the Northeast and Mid-Atlantic regions over the weekend and into the early portion of the week. Manufacturing milk supplies continue to be heavy in both regions, but are being better handled this week compared to previous weeks. The heavy rains restricted field activities and may have hindered crop conditions. Florida weather in the wake of Tropical Storm Andrea has turned very hot and humid, lowering cow comfort levels and could translate into significant reductions in milk production. Milk production declines are being noted in the Southeast as heat and humidity are blanketing the region. Class I demand showed some improvement this week. Demand for cream continues to increase and is marginally reducing churning schedules. Increased pulls for cream are coming from ice cream and cream cheese manufacturers with strong demand also coming from cream bottlers.
- Fluid Milk Central: Milk supplies in the region are rated as steady from one month ago, but lower than one year ago. Milk handlers and processors shared anecdotal reports on feed availability issues hindering farm milk production. Demand for additional milk from some Class II and Class III processors is higher for the week, but availability of spot loads of milk is tight within the region. Some plants augmented Central milk supplies with condensed skim spot loads from the West and Southwest to meet active Class II production schedules. Orders for soft serve mix from some fast food chains are higher as they offer reduced price frozen dessert menu items for a short time. Farmers in some North Central states report first cutting alfalfa has yet to be taken in some areas. Extended periods of moist, overcast weather conditions limited effective drying and some farmers opted to leave alfalfa until conditions improved. Now, though, some stands are lodging and forage nutritive values are on a downward trend for first crop alfalfa still in the field. Heavy thunderstorms moved through North Central states again this week, halting replanting efforts on corn as well as the field work on soybean fields waiting to be planted.
- Fluid Milk West: Handling milk in CA has not been a problem this spring even with schools letting out for various vacation periods. Conditions were warm over the weekend in AZ and will continue this week in the same vein. Temperatures are nudging past the 110 mark. The real problem is that it is now only getting down to the low 80s at night. That does not give the cows much time to recover. Readings in the Southwest are running 7-13 degrees above normal for daytime highs. Milk receipt tests are declining seasonally and plants are able to handle the milk flow efficiently.
- Butter East: Cream demand has improved to the point where it has marginally reduced butter production. The current demand for butter continues to be sluggish and below seasonal expectations, but most butter makers remain comfortable with their current inventories. Current bulk butter prices for this week are 4-8¢ over the market.
- Dry Whey East: Dry whey prices again moved marginally higher this week. Manufacturing milk supplies going to cheese plants continues to be heavy keeping dry whey production at elevated levels, but demand has improved as ice cream manufacturers are expanding production schedules. Export sales are steady and continue to be a means of managing inventories for some manufacturers. Overall, most manufacturers do not view their inventories as burdensome.
- Dry Whey West: Whey production continues at a steady pace with many cheese plants operating at near capacity. However, demand remains good for dry whey as ice cream plants accelerate production. Export sales are increasing with prices close to domestic pricing.
- NDM East: Prices for nonfat dry milk moved higher this week as sales moved into the upper end of the price range. Production continues to be at increased levels as manufacturing milk supplies continue to be heavy, but export interest has increased significantly with almost daily queries to suppliers. Most manufacturers are very comfortable with their inventories. The increased export interest and current inventory levels are giving the market a firm undertone.
- NDM Central: Prices are unchanged to higher on a modestly firmer market. Some market participants report buyers now realize the chance for further price reduction is probably gone. While buyers could have purchased NDM in recent weeks at a bit of a bargain, more interest is popping up as prices firm.

- NDM West: Prices moved generally higher this week. Export sales are driving the market harder than domestic sales at this time. Inventories are available, but they are not heavy at all. Sellers are not very aggressive in trying to move extra loads now.
- Cheese Midwest: Speculation among cheese manufacturers during recent weeks that many buyers were delaying purchases while awaiting evidence that markets were near bottom, seemed validated when 50 loads of blocks were sold during CME trading last week. This surge of CME purchasing coupled with other factors, has led to a more widespread feeling of general cheese price bullishness expected to continue. With Midwest weather finally showing signs of warming as the calendar moves toward the Summer Solstice, milk supplies are expected to seasonally decrease. Hay prices also remain a concern. For example, a coop cheese plant manager commented about the number of its relatively smaller dairy farmers who recently stopped dairy farming often for reasons related to the cost and availability of feed. Most converted to growing alfalfa and other feed. This trend could affect milk supplies available for making cheese. For these reasons among others, there is widespread concurrence with the perception that spot cheese market looks comfortable and well supported near recent price levels.
- Cheese West: Barrels are thought to be in tighter supply as processors look to acquire additional inventories. Barrels are currently selling at a premium to blocks. Cheese production continues strong with good export sales helping to move some additional product.

What's Bearish:

- World Ag Supply & Demand Report: USDA lowered their Class III price expectations for the remainder of 2013. Stocks of both butter and cheese are high, leading to weaker-than-expected prices. In addition, fat basis exports for 2013 were lowered, based on slow butter exports through April.
- Most Class III components were lower in this week's USDA price survey. 40-lb cheddar blocks decreased 3.4¢ to average \$1.78/lb while 500-lb barrels were down 1.3¢ to \$1.76/lb. Butter fell 6.8¢ to average \$1.55/lb and dry whey lost 1.3¢ to 56.8¢/lb, but NDM bucked the trend, increasing 1.5¢ to average \$1.68/lb.
- Dairy cow slaughter for the week ended 06/01 was the lowest total since the first week of the year. Just 47,800 head were culled, down 4.2% vs. the same period in 2012.
- Fluid Milk Pacific Northwest: Favorable temperatures are helping to keep milk production levels steady. Class I usage is lower as schools finish their year and increased supplies are moving into manufacturing plants.
- Butter Central: There is more than plenty of butter in inventory, according to a coop representative. Nevertheless, some churns are reporting strong production this week. Bulk butter prices are mostly reported as flat.
- Butter West: The market is restrained by larger inventories and good production levels. Increased ice cream demand has allowed some butter manufacturers to sell cream rather than moving it to the churns, but discounts to move bulk butter are resulting in limited success. The increased inventories in cold storage continue to weigh on the market.
- Dry Whey Central: Prices edged lower this week and the market tone is unsettled. Several manufacturers indicate inventories are in balance, but some contract customers delayed picking up loads as originally scheduled. A few manufacturers are opting to clear spot loads at minor market discounts to balance stocks on hand.
- Cheese East: Cheese production remains very active as milk volumes going to cheese plants remain heavy. Most plants are on 6-7 day production schedules. Heavier cheese production schedules and expanding inventories have prompted an increase in cheese features with fairly significant price discounts in an effort to boost sagging cheese sales. Export interest has diminished considerably in recent weeks.

Recommendation:

After already showing up in the West and South, warmth has finally arrived in the Midwest, giving a firmer tone to the butter/powder market. The pull for cream is increasing just as the amount of standardized cream is reduced with the letting out of schools across the country. While that increases the amount of manufacturing milk available, international demand for dry whey and NDM appears to be picking up. Compared to last week's massive trade volume in cheese, the spot market was far quieter this week. That said, buyers still picked up 13 loads of blocks compared to just 2 loads of barrels. Part of the reason for this is an attempt to keep the block/barrel spread from getting too far out of whack. Barrels, which were in abundance earlier this year, suddenly find themselves in a tighter supply situation than blocks and currently are priced at a 5¢ premium to blocks. With the butter/powder market beginning to firm, we once again may be seeing the start of a Class IV rally, which has led Class III the past few years. Current spot prices for butter and NDM work out to about \$19.25 Class IV, while Class III works out to just \$17.90. Should butter/powder begin a run higher, milk will be directed away from the vat and into the churn and drying operations. All to say, despite the weaker block price and losses in upfront Class III futures this week, we see limited downside in both, from here. Further supporting this view, we're hearing more evidence of dairies either shuttering their operations or under financial stress due to the cost of/lack of feed. The lost alfalfa acres and slow start to new forage growth is having an impact over a wide area of the Midwest and Northeast. Peak milk production is probably now at or past the highs in all regions of the country. If you have milk sold up front, we would purchase upside risk protection. Consider buying the July 18.50 CALL at 15¢ or less and the Aug 19.75 CALL at 25¢ or less. While we have an upside bias, we could be wrong. The July-Dec average is \$18.48. If you have no protection and a good margin here, you should consider selling up to 20% of your production.