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The KDM Dairy Report – July 26th, 2013

What's Bullish:

Futures Month	Class III 07/26	Class III 07/19	Change	Dry Whey 07/26	Dry Whey 07/19	Change	Cheese 07/26	Cheese 07/19	Change
Jul-13	$17.35	$17.38	($0.03)	57.95¢	57.73¢	0.23¢	$1.711	$1.713	($0.002)
Aug-13	$17.88	$18.26	($0.38)	58.50¢	58.78¢	(0.27¢)	$1.758	$1.792	($0.034)
Sep-13	$18.38	$19.04	($0.66)	58.75¢	62.00¢	(3.25¢)	$1.805	$1.862	($0.057)
Oct-13	$18.40	$19.00	($0.60)	58.75¢	61.98¢	(3.23¢)	$1.803	$1.854	($0.051)
Nov-13	$17.94	$18.45	($0.51)	58.60¢	60.50¢	(1.90¢)	$1.764	$1.805	($0.041)
Dec-13	$17.33	$17.86	($0.53)	58.00¢	59.98¢	(1.98¢)	$1.705	$1.760	($0.055)
Jan-14	$16.74	$17.30	($0.56)	54.50¢	55.28¢	(0.77¢)	$1.670	$1.721	($0.051)
Feb-14	$16.64	$17.12	($0.48)	54.00¢	52.50¢	1.50¢	$1.672	$1.720	($0.048)
Mar-14	$16.78	$17.09	($0.31)	53.25¢	51.75¢	1.50¢	$1.686	$1.730	($0.044)
Apr-14	$16.78	$17.10	($0.32)	52.00¢	51.00¢	1.00¢	$1.715	$1.735	($0.020)
May-14	$16.90	$17.19	($0.29)	50.75¢	50.00¢	0.75¢	$1.721	$1.750	($0.029)
Jun-14	$17.13	$17.22	($0.09)	49.50¢	48.00¢	1.50¢	$1.740	$1.760	($0.020)
12 Mo Avg	**$17.35**	**$17.75**	**($0.40)**	**55.38¢**	**55.79¢**	**(0.41¢)**	**$1.729**	**$1.767**	**($0.038)**

- Spot Market:
- Cheese stocks at USDA selected storage centers are down 10%, or 11.9 million lbs, over the period 07/01 through 07/22, according to the Weekly Cold Storage Holdings report.
- Dairy Cow Slaughter for the week ended 07/13 totaled 56,600 head. That's down 400 head from a year ago, but is the largest weekly cull in 7 weeks. YTD, slaughter numbers are up 46,000 head vs. a year ago.
- Fluid Milk East: The heat and humidity that has hung over the Eastern region has ended, but not without taking a toll on milk production. Milk production has declined 10% in some areas. Balancing plant supplies are down substantially as decreased production and improved Class II demand are combining to limit the remaining manufacturing supply. Florida milk production has declined to a level where exports fell to zero, down from 42 loads last week. This is the first time milk has not been exported out of the state since late January. Milk production declines are expected to continue as producers are "drying off" cows. Imports of spot loads of milk are anticipated to occur soon, possibly next week. Class I demand has marginally increased this week. Milk production in the Southeast region continues to decline, causing some logistic problems as suppliers scramble to cover their contracted volumes. Class I demand is expected to increase in the coming weeks as schools in Georgia and Alabama commence their fall terms in early August. Cream supplies have become tight, primarily due to the impact of the recent heat wave on milk production and butterfat levels. Some contracted supplies are being shorted or at best delayed for later delivery. Cream supplies going to Class IV production are limited. Condensed skim demand has improved as the recent heat wave has prompted increased ice cream and frozen dairy dessert production. Some condensed skim supplies have been shipped outside the region for Class III production as other regions are also experiencing declines in milk production. Class IV production has been reduced again this week with some manufacturers drying for only a few days.
- Fluid Milk Central: Milk handlers and processors in the Central region report the recent heat wave knocked down milk intakes by 8-10% in many locations. Some improvement in milk intakes started this week with the arrival of cooler daytime temperatures. Milk component values are faltering seasonally. Field representatives from various cooperatives report that some of the new forages are below the usually sought after nutrient values of "dairy quality". Spot milk loads within the Central region are difficult to find. Various milk handlers report demand is well above supply. Prices range up to $2 over Class for completed sales. Some unsolicited bids at +$3 over Class were turned down as plant operators are trying to keep their own plants operating efficiently. Spot cream load availability tightened this week. Eastern and Western cream loads filled some of the Central demand, clearing mostly into ice cream/frozen dessert facilities. Class II demand is active and various manufacturers indicate orders for soft serve mix extend through August.
- Fluid Milk West: CA milk production is uneven. Some areas in the far south are hot and humid, and seeing milk decline. Conditions are hot during the day, yet cooler at night in the Central Valley. Processing plants are running on light to moderate schedules. June 2013 pool receipts of milk in CA totaled 3.35 billion lbs, 2.2% lower than last year, according to CDFA. AZ milk output is trending lower. The "monsoon season" is present, resulting in higher humidity level and sporadic heavy rains. Class I demand is steady. Schools will begin in early August, so bottlers will be prepping the pipeline to handle those needs. Cream markets are firming. Demand is trending higher across several product categories. Cream supplies are lower as milk production and milkfat contents are down in the region. Ice cream demand is higher. Cream is moving eastward as buyers there look for product. Pasture and Range conditions in the West continue to be a problem for the region. Arizona has 79% of the pasture and range in the very poor and poor categories, California is 95%, Colorado 64%, Nevada 70%, and New Mexico 79%.
- Fluid Milk Pacific Northwest: Milk production in the region is under stress again as temperatures are running 6-19 degrees above normal. Many areas will hit triple digits at midweek. The stress will not be nearly as bad as in early July, but eventually it does become cumulative and little rebound is expected at that time.
- Butter: Recent hot weather reduced cow comfort and pushed butterfat components seasonally lower in most areas of the country. With the recent downturn in butterfat components, some balancing plant operators indicated they have few cream loads available for clearing to the spot market. Based on cream availability, cream sales into ice cream and soft serve mix operations are active. Butter production is declining as summer advances. Some butter producers note an uptick in retail interest this week.
- Dry Whey East: Whey production has declined as decreases in milk production, butterfat and protein levels have lowered milk flows to vats and cheese yields. Most dry whey manufacturers are comfortable with their current inventories. Domestic demand remains lackluster, but export interest continues to be fairly good and accounts for a majority of the spot sale activity.
- NDM East: Prices increased this week as spot sales substantially increased the upper end of the range. Significant declines in milk production, caused by the recent heat wave, have limited milk volumes going to dryers and production of low heat nonfat dry milk. Lower milk volumes are allowing manufacturers to focus and increase production of high heat nonfat dry milk, which is in fairly tight supply. Domestic demand is steady to increasing as some buyers are purchasing spot loads as a hedge against anticipated future price increases. Export interest continues to be good.

- NDM Central: Prices are unchanged to higher on a firmer market. Buyers are more active in the spot market compared to the beginning of July, but purchases continue with one to two load orders dominating sales activity, according to market participants. Central producers note their manufacturing milk intakes are seasonally lighter, as well as faltering during the recent heat wave.
- NDM West: The market tone is firm. Buying interest have been fair to good for the current limited producer offerings. Demand is better into international channels both through direct sales and through brokers. Production is trending lower, reflective of the decline in milk output across Western states and the decline in milk solids. Stock levels are light to moderate and held with confidence. Resale offerings are light and at or above producer prices.
- Cheese East: Cheese production continues to be mixed with some declines, due to the downturn in milk production. Most cheese production declines are seen at those plants making mozzarella and provolone. Some plants making cheese for aging programs are maintaining active production schedules and adding to inventories. Most cheese makers in the region are comfortable with their current inventories.
- Cheese Midwest: The recent heat wave in the Midwest has taken its toll on milk production and cheese plants are seeing less milk at lower component levels. Some cheese makers have purchased condensed skim loads from the Eastern region to augment their supplies, while others are fortifying with nonfat dry milk. Domestic demand has improved as some cheese makers have taken on new business, while some buyers were prompted to purchase cheese ahead of the expected declines in production. Export demand has seen some increased activity with support from export assistance programs.
- Cheese West: The heat stress in the West has now moved from primarily in the Southwest into the Northwest and Mountain States also. Therefore, milk production is being adversely affected across the entire region. Also, component levels are being hit very hard which reduces cheese yields. Some buyers, noting the additional stress on the milking herds in the region, are beginning to make some new calls looking into the supply and stock situation for fall needs. Most contacts in the region are comfortable with their working inventories.
- CWT has accepted requests for export assistance to sell 3.417 million lbs of butter and 2.3178 million lbs of Cheddar cheese. The product will be delivered July through January 2014.
- International: June milk output in Australia was down 6.8% vs. 2012, according to Dairy Australia. YTD, the '12/'13 production year fell 3%.
- International: Dairy consumption is skyrocketing in the Asia-Pacific region, according to Rabobank dairy analysts. Indonesia, Malaysia, Thailand, Singapore, Vietnam and the Philippines have high birthrates and rising income levels, along with modernizing retail systems, which has driven the demand. Dairy consumption in these six countries will grow by 2.4% every year, until 2020. That's seven years of rapid growth — and it means the region needs an extra three billion liters of milk during those seven years. The region is already struggling to meet existing demand, which presents a very good opportunity for U.S. exports.

What's Bearish:

- Spot Market: Cheese prices finished off their highs and butter took a hit. Blocks closed the week at \$1.76¼/lb, up 2¼¢ but had been as high as \$1.78¼ on Thursday. Just 5 loads exchanged hands. Barrels settled 2¢ higher to \$1.76/lb on 11 trades. Butter lost 5¾¢ to close at \$1.43¼/lb on just 2 trades, while Grade A NDM managed to gain ½¢ to settle at \$1.78/lb on 3 trades.
- Grains: Feedstock prices plunged this week as the weather outlook improved over the remaining areas of the grain belt states and demand remains lackluster. Dec corn settled just above \$4.75/bu, a multi-year low not seen since 2010.
- Cold Storage Report: Butter stocks at the end of June were 33% higher than a year ago, according to USDA. American cheese stocks were 6% higher than last year, but down 1% from May. Total cheese stocks were up 5% vs. June '12 but unchanged from May.
- Livestock Slaughter Report: Dairies are hanging on to more cows. Commercial dairy cow slaughter in June totaled 220,300 head, down 8,900 head or 3.9% vs. a year ago.
- Dry Whey Central: Buyer interest in F.O.B. and resale market loads remains lethargic according to some sellers. Buyers remain confident about their ability to quickly obtain needed loads outside of contract arrangements.
- Dry Whey West: Domestic demand is fair and export sales are facing some increased pricing pressure. The market lacks any clear direction. This is also the case in other whey markets in other world trading centers.

Recommendation:

The plunge in the grain market was the big story this week. As prices for corn, beans and meal plummeted, milk prices, which had risen earlier in the week, began to aggressively sell off. Notable was a substantial drop in the 2014 contracts as producers, still seeing profitable margins with falling input costs, sold aggressively. With cooler weather now hovering over much of the Midwest and Northeast, milk production is rebounding. However, we're still hearing from sources that feed quality is an issue and components are still struggling in some areas. In addition, it's heating up again in the West, while Florida is likely to become a milk deficit state soon. We think this means the supply of 30-day cheddar is getting tighter, and while the spot cheese market finished lower on Friday, it has limited downside from here. Powder (Class IV) continues to be tight and dry whey prices are rising. Fluid milk updates this week indicate manufacturing milk is less available and cream is tightening. However, butter stocks continue to weigh on the market. We think some of the selloff in Class III, at least in the front months, could be overdone and would not be surprised to see a rebound next week. And while we've been recommending for several weeks to get some coverage on the first half of 2014, the 34¢ decline to an avg now of \$16.83 has us less enthusiastic about putting on further hedges at these levels. Sure, feed prices are falling, but even with corn in the \$4 range, many Western operations will struggle at these prices, especially if they drop further. So, what do we do with this? If you are comfortable with the risk and have sold milk Aug-Oct at substantially higher levels, we would lift your hedges and take the profit now. Or, consider buying CALL options to protect the upside in milk you have sold. Beyond that, we would wait. If we get the rebound we're expecting in the next week or two, have orders ready to sell into them. While we expect an upside reaction to this week's decline, with grain prices looking set to be substantially lower for quite some time, we don't expect this rally to stick around too long. It's really a short-term reaction to the heat we had over much of the country, and once production levels are re-established, we're likely to stay range-bound in the \$17's and \$18's like we have for most of the year so far.