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The KDM Dairy Report – August 9th, 2013

What's Bullish:

Futures Month	Class III 08/09	Class III 08/02	Change	Dry Whey 08/09	Dry Whey 08/02	Change	Cheese 08/09	Cheese 08/02	Change
Aug-13	$18.09	$17.89	$0.20	58.03¢	58.25¢	(0.23¢)	$1.784	$1.760	$0.024
Sep-13	$18.05	$18.42	($0.37)	58.50¢	58.60¢	(0.10¢)	$1.780	$1.817	($0.037)
Oct-13	$17.96	$18.41	($0.45)	58.00¢	58.25¢	(0.25¢)	$1.773	$1.817	($0.044)
Nov-13	$17.55	$17.75	($0.20)	58.50¢	58.50¢	0.00¢	$1.729	$1.750	($0.021)
Dec-13	$16.91	$17.20	($0.29)	57.50¢	57.75¢	(0.25¢)	$1.681	$1.689	($0.008)
Jan-14	$16.41	$16.49	($0.08)	54.85¢	54.50¢	0.35¢	$1.642	$1.649	($0.007)
Feb-14	$16.35	$16.39	($0.04)	54.10¢	54.00¢	0.10¢	$1.641	$1.640	$0.001
Mar-14	$16.44	$16.41	$0.03	53.00¢	53.50¢	(0.50¢)	$1.655	$1.642	$0.013
Apr-14	$16.43	$16.42	$0.01	52.98¢	52.00¢	0.98¢	$1.655	$1.656	($0.001)
May-14	$16.52	$16.58	($0.06)	53.00¢	51.00¢	2.00¢	$1.664	$1.682	($0.018)
Jun-14	$16.65	$16.80	($0.15)	53.00¢	49.75¢	3.25¢	$1.696	$1.705	($0.009)
Jul-14	$16.96	$16.96	$0.00	50.00¢	49.98¢	0.02¢	$1.725	$1.740	($0.015)
12 Mo Avg	**$17.03**	**$17.14**	**($0.12)**	**55.12¢**	**54.67¢**	**0.45¢**	**$1.702**	**$1.712**	**($0.010)**

- Dairy cow slaughter for the week ended 07/27 totaled 57,200 head, up 1,300 head from a year ago. YTD the cull is up 42,000 head from 2012.
- Most Class III components were higher in this week's national dairy price survey. 40-lb blocks averaged $1.72/lb, up 2.4¢ from last week. 500-lb barrels gained 2.9¢ to $1.74/lb. Dry whey increased 0.4¢ to average 58.4¢/lb and nonfat dry milk increased 1.2¢ to $1.76/lb, though butter decreased 1.3¢ to average $1.44/lb.
- Fluid Milk East: Continued cooler temperatures have increased cow comfort levels and milk production in the Northeast and Mid-Atlantic regions. Manufacturing milk supplies have marginally increased with the bounce back in milk production, but overall supplies remain limited. Frequent showers and highs in the 90's have lowered cow comfort levels in Florida and reduced milk production. A few schools began their fall terms this week, increasing Class I demand. Nearly all Florida schools will be back in session by August 19. Florida imported 28 spot loads of milk this week. These were the first imports into the state since late January. Milk supplies in the Southeast region are nearly in balance with demand with only the occasional load, above contract minimums, going to manufacturing plants. A few schools have started their fall terms this week. Class I plants are preparing for increases in demand as the bulk of schools will start over the next couple of weeks. Condensed skim supplies remain fairly tight, even with the bounce backs in milk production. Most supplies are moving through contracts with what remains held in firm hands as most balancing plants see price advantages in making nonfat dry milk rather than sell condensed skim.
- Fluid Milk Central: As schools reopen in the Central and Southeast regions, milk processors report they are sending an increasing number of milk loads to local bottlers to meet current Class I demand. This is cutting into cheese and NDM production on a weekly basis and is expected to continue until the school pipeline is full. Availability of spot loads of milk is generally light. Those spot loads cleared to good interest with prices quoted at $2.25 over Class. Cream demand from sour cream and dip producers is gradually moving higher.
- Fluid Milk Pacific Northwest: Conditions have warmed up again this week. East of the coastal range temperatures are running into the mid-90s. The stress on the milking herd is not immediate, but it is taking output down along seasonal patterns. Pastures and alfalfa fields are showing signs of the heat. The heat in UT and ID is more intense. The stress on the cows is more immediate and direct. Incoming loads of milk are lighter and tests are lower. Some areas are being given notice that their water will be shut off soon which will impact the end of the season for some crops and hay. Western Idaho is working on the third cutting of hay now. The yield has been down some this year and prices in the field are higher than last year.
- NDM East: Milk volumes going to nonfat dry milk manufacturers remain low, but there were some marginal increases as cooler weather prompted some bounce back in milk production. Domestic demand is about steady with last week, but there are indications of increased buyer interest as the fall baking season approaches. Export interest remains fairly good. The limited production schedules continue to provide the market with a firm undertone.
- NDM Central: North American demand into the Central region is traditionally slower during July, but manufacturers anticipate fresh interest as summer draws to a close. Additional interest from cheese plants for NDM and/or condensed skim was noted by a few balancing plants. Farm milk intakes continue to show seasonal declines, although a part of the volume decreases in milk intakes during the recent heat wave have been recovered. Several manufacturers note orders from bottlers increased this week. Milk loads are moving within the region and to milk deficit regions to fill fluid needs. Nonfat dry milk production is slowing, based on milk intakes and those sales to Class I processors. Manufacturers' NDM inventories are termed comfortable to short of what is needed for August - December contract fulfillment.
- NDM West: Western nonfat dry milk pricing continues to move higher. The market tone is firm. Demand is fair to good into export channels; light to fair for domestic usage. Production runs are often lower than projected. Some areas are seeing more impacts from recent hot weather. Class I needs are also higher where schools are starting. Economics also favor the production of SMP. The skim milk powder market also continues to firm with production active to service export orders. The U.S. export sales remain robust.
- CWT has accepted requests for export assistance to sell 992,080 lbs of butter and 1.4 million lbs of cheese. The product will be delivered August through October 2013.
- Exports: The Foreign Ag Service this week reported cheese exports for June were up 9% from a year ago. Total exports for the first six months of the year have reached 327.9 million pounds, up 6% from the same period in 2012. Exports of NDM/SMP in June totaled 106.2 million pounds, up 23% from a year ago. On a total-solids basis, dairy exports in June were equivalent to 16.5% of U.S. milk production, just below the record hit in May. Jan-Jun, total-solids exports were equivalent to a record 14.7% of U.S. milk production, up from 13.5% over the same period a year ago.

What's Bearish:

- Spot Market: Blocks managed to gain 2¼¢ for the week on 10 trades, to settle at $1.79¾/lb. Barrels, however, lost ¾¢ to close at $1.76½/lb on 5 trades. Grade A NDM picked up a penny to close at $1.79¼/lb on 3 trades, but butter was down 4¼¢ to $1.39¾/lb on 5 trades.
- In this week's GDT auction, dairy prices fell an average of 2.4%. Cheddar cheese was down 4.4% to a U.S. equivalent $1.97/lb.

- Fluid Milk West: CA milk production is uneven, but moderate weather conditions are providing relief and reducing stress on the milk cows in the major producing areas. Feed conditions are generally good and some locations are seeing a positive impact from new crop feeds. Processing plants are running on seasonal schedules. AZ milk production is steady to higher, with gains noted due to cooler nighttime temperatures and because of increased feeding levels. Cream pricing is often trending lower, reflecting the declining basing points from the CME Group pricing closes and averages.
- Butter: Bulk butter demand has hit the summer doldrums. This is evidenced by declining pricing at auction sites and Cold Storage holdings at the end of June were 33% higher than year ago quantities. Most buyers are content to wait on further purchases.
- Dry Whey East: Prices declined this week as both spot sales and sales based on various price indices lowered prices. Some manufacturers sold multiple loads at discounts in order to better manage inventories. End user demand remains flat as buyers are only purchasing for immediate needs. Export interest is about steady with the activity of recent weeks. Production of dry whey marginally increased within the region as milk production bounces backs and expanded milk volumes are going to cheese plants. The supply situation is becoming more in balance with the recent spot sales activity giving the market a weak undertone.
- Dry Whey Central: Prices were largely unchanged this week, but some market participants note condensed whey is readily available. For some, this translates into ample manufacturers' inventories. Interest in spot loads of whey is stagnant and currently facing competition from resellers on price.
- Dry Whey West: Prices took a step backwards this week as manufacturers attempt to keep stock levels in line with the plan for this time of the season. Sales took place at lower prices to stimulate interest and to get the deal done. Some of the lower sales prices are tied to the export market. Export sales in June were up 9% versus a year earlier at 45.9 million pounds. Domestic buyers are taking contracted volumes, but are in no hurry to pick up additional supplies at this time.
- Cheese East: A persistent cool weather pattern over the region has increased cow comfort levels and provided for some additional bounce backs in milk production. Some cheese makers have expanded production schedules in response to the additional milk supply.
- Cheese Midwest: Cooler weather patterns, now covering the region, are allowing for some milk production bounce backs from the recent bout of hot humid weather. The continued heavy national inventories of cheese in combination with bounce backs in milk production have numerous market analysts believing the typical August increase in the cheese market, up 10% last year, will be limited in 2013.
- Cheese West: Sales are being called fair in the West with stocks in a reasonably comfortable position for August. Weather stress so far with this current warm spell in the region has not done too much to reduce milk supplies, but components continue to decline.
- Grains: New crop grains had another disappointing week, with Dec corn putting in a new multi-year low.

Recommendation:

What a crazy, wild week. Over the weekend, news that China had stopped all imports of New Zealand milk powders due to contamination had Sunday evening milk futures trading up 30+ cents. By Monday, however, more facts surfaced which revealed only a particular WPC product was affected and that China was still importing the majority of Fonterra’s products, causing futures to lose their gains. On Tuesday, with no real action in the spot market, Sep futures plunged near limit down, with heavy losses across the board. But on Wed and Thur, those losses were almost entirely erased, only to see Friday sharply lower again. After reaching a high of $18.72 in the morning, Sep futures hit a low of $17.81, before settling just above $18.00. Open interest has increased through this whip-lash, including on the down days, which is bearish, as it indicates new short positions are being established. We can’t help but have a somewhat negative bent going forward as well. It’s true that components are falling and Florida is now a milk deficit state, but these are all seasonal and to be expected. School starts every fall, pulling milk away from manufacturing and into Class I. However, continued high inventories of cheese and a pathetic butter situation is putting a damper on the market’s ability to rally. We’ve seen that this week, with every futures rally getting beaten down. Now dry whey fundamentals are tilting to the negative side. In addition, the spot market hasn’t shown any real ability to break out to the upside. Sure, we’re gradually moving higher overall, but any attempt to push prices significantly higher has been met with aggressive sellers hitting those bids. About the only positives are the outlook for NDM and the wide spread between U.S. and world prices. Exports are great, at a record level. But what happens if international demand falters? The grain factor is another negative. Next week’s Crop Production report could result in more sharply lower prices. As we said last week, we think for the moment we are range-bound between $17-19. The close we get to $19, the more compelling it is to sell. In light of the grain situation and our more negative bias, we’re lowering our target for sales in 2014. If you can profit at $16.50 base price, we would consider selling a small percentage of Jan-Jun ’14 (currently $16.47). Consider further sales at $16.70 and $16.90. We’re just not confident, short of dramatic change in fundamentals, that prices can rally much further. And if inputs keep dropping, Class III futures will too.