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The KDM Dairy Report – August 23rd, 2013

Futures Month	Class III 08/23	Class III 08/16	Change	Dry Whey 08/23	Dry Whey 08/16	Change	Cheese 08/23	Cheese 08/16	Change
Aug-13	$17.90	$18.05	($0.15)	57.53¢	58.00¢	(0.48¢)	$1.771	$1.779	($0.008)
Sep-13	$17.28	$18.23	($0.95)	57.00¢	58.05¢	(1.05¢)	$1.710	$1.797	($0.087)
Oct-13	$17.73	$18.23	($0.50)	55.50¢	58.00¢	(2.50¢)	$1.774	$1.800	($0.026)
Nov-13	$17.44	$17.60	($0.16)	55.75¢	58.25¢	(2.50¢)	$1.735	$1.732	$0.003
Dec-13	$16.99	$16.95	$0.04	56.55¢	58.00¢	(1.45¢)	$1.686	$1.673	$0.013
Jan-14	$16.50	$16.41	$0.09	53.50¢	54.50¢	(1.00¢)	$1.662	$1.636	$0.026
Feb-14	$16.23	$16.21	$0.02	52.70¢	53.38¢	(0.67¢)	$1.635	$1.635	$0.000
Mar-14	$16.24	$16.19	$0.05	52.03¢	52.28¢	(0.25¢)	$1.635	$1.627	$0.008
Apr-14	$16.17	$16.11	$0.06	51.25¢	52.00¢	(0.75¢)	$1.637	$1.625	$0.012
May-14	$16.25	$16.26	($0.01)	51.25¢	52.00¢	(0.75¢)	$1.644	$1.640	$0.004
Jun-14	$16.59	$16.44	$0.15	52.00¢	52.00¢	0.00¢	$1.672	$1.655	$0.017
Jul-14	$16.89	$16.79	$0.10	49.50¢	49.00¢	0.50¢	$1.718	$1.710	$0.008
12 Mo Avg	**$16.85**	**$16.96**	**($0.10)**	**53.71¢**	**54.62¢**	**(0.91¢)**	**$1.690**	**$1.692**	**($0.002)**

What's Bullish:

- Milk Production Report: July milk production in the U.S. increased a less-than-expected 1.1% vs. a year ago, and was down 100 million lbs from June. The largest percentage gains were from smaller dairy states, led by KS up 10.8%, IA up 8.6% and IN up 7.6%. Notably, CA output fell 3.5% while WI was up 2.9%.
- Livestock Slaughter Report: 250,700 dairy cows were removed from the milking herd in July. That's up 11,700 head from a year ago, or 4.9%. YTD the dairy cow cull stands at 1.8 million head, up 55,400 head from 2012.
- Cold Storage Report: American cheese stocks at the end of July were 5% higher than a year ago, but down 1% from June. Butter stocks were 26% higher than a year ago, but were down a sharp 7% from June.
- Weekly cold storage numbers continue to reflect a strong seasonal drawdown. Butter stocks over the period 08/01 through 08/19 have declined 12%, or 2.1 million lbs, while cheese stocks have fallen 3%, or 3.3 million lbs.
- Dairy cow slaughter for the week ended 08/10 totaled 58,800 head, up 2.6% vs. a year ago.
- Most Class III components were higher again in this week's price survey. 40-lb block cheddar increased 3.2¢ to average $1.76/lb and 500-lb barrels were up 3.1¢ to $1.80/lb. Dry whey inched 0.2¢ higher to average 57.6¢/lb and NDM increased 0.6¢ to $1.77/lb, but butter fell 1.6¢ to average $1.44/lb.
- Fluid Milk East: Milk production remains above seasonal levels and adding to manufacturing milk supplies in the Northeast region. However, manufacturing milk supplies in the Mid-Atlantic region are being reduced as increased Class I demand in the Southeast is pulling supplies out of the region. Milk production in Florida continues to decline with the typical seasonal low point still a few weeks out. Nearly all schools are back in session and Class I demand is very strong. Retail fluid milk promotions are also contributing to the increase in fluid demand. Florida imported 212 spot loads of milk this week, up from just 73 last week and the highest number of import loads since August of 2006. Class I demand is also strong in the Southeast region with nearly all supplies going to fill fluid needs. Manufacturing milk supplies, for all practical purposes, have been reduced to contract minimums.
- Fluid Milk Central: The number of milk loads leaving the Central region heading to the Southeast to fill Class I demand is increasing from week to week. Handlers expect weekly milk load increases will continue until all schools are back in session and the pipeline is completely filled. Manufacturing milk spot loads are scarce within the Central region as a result of increasing Class I demand and seasonally decreasing farm milk intakes. Several cheese manufacturers indicated they are running below optimal efficiency due to the strong draw on their milk supplies from bottlers. Some plants are reducing cheese making schedules by whole or partial days as manufacturing milk availability drops. Spot milk load pricing is running between $1.75 - $2.50 over Class. In areas of the North Central, dry weather is a cause for concern for owners of corn and soybean fields, as moisture is critical at certain stages of cob and pod filling.
- Fluid Milk West: CA milk production is trending lower, resulting from a spell of hot weather. Some processors saw a quick 2-4% drop in receipts from a week earlier. AZ milk production is lower. Hot weather advisories were being issued for man and beast. The conditions are stressing the milking herds and heat abatement measures are not able to mitigate all the problems. Processing plants are running on reduced schedules because of lower receipts and a stronger call for Class I milk needs. Some retail interest is improving as consumer buying picks up to accommodate changes in home eating patterns.
- Fluid Milk Pacific Northwest: Milk production in the region continues to decline along expected seasonal lines. Some increases in production above year ago levels have been noted in Washington as dairies expanded to take advantage of higher milk prices, but hot weather in the Eastern areas of the region is weighing on dairy cows and lowering production levels. More milk is being sent to bottlers as schools gear up for the new season. With less milk available, some plants are scheduling routine maintenance projects. UT and ID milk supplies are being restricted by continued hot weather, with the result that few plants are able to operate at capacity.
- European butter prices remain considerably above the US price, prompting continued export interest. CWT has accepted requests for export assistance to sell 1 million lbs of butter. The product will be delivered August through January 2014. CWT also accepted requests for export assistance to sell 2.189 million lbs of Cheddar, Gouda and Monterey Jack cheese.
- Butter: Demand for print butter into retail and club store accounts is reported to be very good.
- NDM East: Prices moved higher this week. Production is mixed in the East with drying schedules fairly active in the Northeast, but less active elsewhere in the region as increased Class I demand is lowering manufacturing milk supplies. Domestic demand has improved as buyers view the market as on an upward trend and are making purchases ahead of possible future price increases. Manufacturers' inventories are being worked lower with the outlook of continued declines in the near term. Reductions in manufacturing milk supplies, due to increased Class I demand with the start of the school year, are giving the market a firm undertone.
- NDM Central: Prices stepped higher on the strength of both index based prices and F.O.B. spot prices. The market tone is firm. Resellers indicate getting one or two spot loads is usually doable, but blocks are generally unavailable. Anecdotal reports indicate larger end users are actively in the market for Q4 needs despite the futures showing lower pricings in the months to come. Some market participants interpret the early shopping to mean some end users have concerns about sufficient Q4 NDM supplies. Current nonfat dry milk production is below plant capacities at many locations. This lower NDM production relates to the seasonal downturn of farm milk intakes as well as the increasing draw

from bottlers to fill Class I demand. Cheese plants are also actively seeking out milk spot loads, taking additional milk loads of out of NDM manufacture. Nonfat dry milk inventories are comfortable at some locations, but other producers indicate they are sold out for the balance of the year.

- NDM West: Prices continue to trend higher, with a firm undertone. The market continues to be helped by good demand for skim milk powder. Domestic interest in NDM is light and unaggressive, but export demand is fair to good. Production of NDM is tending to be steady to lower. Production of skim milk powder remains active in the region to service the aggressive export market.
- Cheese East: More than adequate milk supplies are keeping most cheese makers on 6-7 day production schedules. However, demand for cheese has increased as food service and pizza makers gear up for the commencing of classes at schools and universities. Quality concerns have spread from New Zealand dry products to New Zealand cheeses, which have prompted some countries to explore the possibility of increased cheese imports from the US.
- Cheese Midwest: As this week opened, cheese manufacturing was active using the regular milk supplies available. Some plants would increase production if more milk were available. There is minimal acquisition of spot milk by cheese plants to supplement committed milk supplies, reflecting seasonal declining production and Class I milk demands in the Southeast being supplemented with Midwest milk. Mozzarella sales demand has been strong, which is typical for this time of year. Retail cheese sales in general are reported to be "stagnant", but the steep declines in spot cheese prices this week at the CME have some manufacturers perplexed and challenged to explain the movement based on production, inventory and sales.
- Cheese West: Cheese production is down slightly due to lower available milk supplies. Continued hot weather and typical seasonal declines have reduced the amount of milk for manufacturing. The return of Class I fluid demand for schools has further tightened supplies. Demand for cheese at the retail level is described as good.
- In the most recent GDT auction on Tuesday, the dairy price index increased 2.3%, led by anhydrous milk fat which was up 7.1%. Butter was up 3.3% while whole milk powder increased 2.7%. Cheddar cheese was up 0.9% to a U.S. equivalent $1.98/lb.
- Grains: Continued dry weather in several key soybean states has resulted in declining crop conditions. Extended hot weather and the forecast for little chance of precipitation in these areas caused beans and meal to rally hard today. Dec meal broke out to new contract highs, settling up $19.20/ton to $419.50/ton.

What's Bearish:

- Spot Market: Steep losses in cheese prices this week as blocks fell 10¾¢ to $1.67/lb, with barrels down 12¼¢ to $1.64¼/lb. Trading was light until Friday, with a total of 18 loads of blocks and 8 loads of barrels exchanging hands. Grade A NDM increased ½¢ to $1.80/lb on no trades, while butter gained 2½¢ to $1.39½/lb on 10 trades.
- Cream markets continue to be relatively weak. More cream is becoming available from milk standardization, as milk needs increase for schools and colleges. Demand is light to fair for higher-class items. Ice cream season is winding down so there is limited spot interest. Excess cream supplies are clearing to the butter churns, putting more pressure on the butter pricing structure.
- Butter: Reports are that more cream is becoming available to butter manufacturers, due to reduced ice cream demand as well as standardization of fluid milk as bottling plants begin the process of filling the school milk pipeline. This is expected to send more cream to butter churns at a time when butter stocks are viewed by one manufacturer as "plentiful". If more cream does get churned in coming weeks, one observation is that it will make a currently tough situation even more difficult.
- Dry Whey East: Dry whey prices declined this week. Milk production remains above year ago levels and is keeping most cheese makers in the East on 6-7 day production schedules. Dry whey production is active and adding to most manufacturers' inventories. Domestic end user demand is flat with export demand at levels below manufacturers' expectations. Some manufacturers are offering price discounts for multiple load spot sales, as a way to better manage their inventories. The combination of active production schedules, more than adequate supplies and lackluster demand are giving the market a weak undertone.
- Dry Whey Central: Sale prices based on various indices moved lower this week. Blocks of loads and single Eastern spot loads are also filling demand in the Central region, adding supply competition into a lackluster regional market.
- Dry Whey West: Prices are lower across the full range with a weak undertone being noted. Whey production schedules are reduced as milk volumes available for cheese plants are declining, but current supplies are described as adequate to fill immediate demand needs from both manufacturers and brokers. Demand is moderate as buyers look for lower prices for additional product.

Recommendation:

Perplexing has been a good way to describe the milk market as of late. We've often pondered how for most of the summer our cheese prices could maintain such a significant discount to the rest of the world. Yes, we get the fact that we have a lot of cheese in storage and that there is an additional 15-25¢ in freight costs, but we've steadily maintained a 30-40¢ discount to global prices, which seems too wide to us. We also thought the strength in global butter and powder prices would help keep us above $1.70 cheese, but that one hasn't worked out either. Despite a Class IV price of about $19.50, derived from current spot prices, Class III only works out to about $16.95. Our sources remain positive in the short-term, saying cheese sales are good and milk receipts are declining. Maybe that's why on Friday, cheese buyers came out of the woodwork during the spot session and aggressively bid for product. It remains to be seen if we'll see any follow-through buying next week, but at a minimum, we think the lows in cheese are in. With Florida importing the most milk since 2006 and strong fluid demand from the opening of schools around the country, manufacturing milk supplies are taking a hit. Much of the Midwest will be under some sustained heat next week, which may only have minimal effect on milk output, but may cause more deterioration to crop yields. Throw in the fact that most milk futures contracts were heavily "oversold" from a technical standpoint, and we could be in for one wild week ahead of us. Hedgers should look for opportunities to sell Q4 on a substantial rally. We would hold off on any more 2014 sales unless they are closer to the $17 area. More needs to be known about potential feed costs as this year's crop gets closer to harvest. It could make the difference between being profitable, or not. Have a great weekend!