

The KDM Dairy Report – August 30th, 2013

What's Bullish:

- Spot Market: Blocks gained 11¼¢ on 11 trades and barrels jumped 12¼¢ on just 1 trade, settling at \$1.78¼ and \$1.77 respectively. Grade A NDM was unchanged at \$1.80/lb with no activity, but butter increased 4¼¢ to \$1.43¼ with a big 35 trades.
- Weekly cold storage numbers continue to indicate a drawdown of both cheese and butter stocks. For the period 08/01 through 08/26, cheese stocks at USDA selected storage centers declined 3.3 million lbs, or 3%. Butter stocks fell 1.8 million lbs, or 10%.
- Fluid Milk East: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions are declining, due to strong pulls from bottling

Futures Month	Class III 08/30	Class III 08/23	Change	Dry Whey 08/30	Dry Whey 08/23	Change	Cheese 08/30	Cheese 08/23	Change
Aug-13	\$17.89	\$17.90	(\$0.01)	57.60¢	57.53¢	0.08¢	\$1.769	\$1.771	(\$0.002)
Sep-13	\$17.83	\$17.28	\$0.55	58.00¢	57.00¢	1.00¢	\$1.763	\$1.710	\$0.053
Oct-13	\$18.19	\$17.73	\$0.46	57.25¢	55.50¢	1.75¢	\$1.799	\$1.774	\$0.025
Nov-13	\$17.53	\$17.44	\$0.09	57.03¢	55.75¢	1.28¢	\$1.737	\$1.735	\$0.002
Dec-13	\$16.90	\$16.99	(\$0.09)	57.05¢	56.55¢	0.50¢	\$1.665	\$1.686	(\$0.021)
Jan-14	\$16.51	\$16.50	\$0.01	54.03¢	53.50¢	0.52¢	\$1.652	\$1.662	(\$0.010)
Feb-14	\$16.41	\$16.23	\$0.18	53.00¢	52.70¢	0.30¢	\$1.649	\$1.635	\$0.014
Mar-14	\$16.40	\$16.24	\$0.16	52.50¢	52.03¢	0.48¢	\$1.651	\$1.635	\$0.016
Apr-14	\$16.35	\$16.17	\$0.18	51.50¢	51.25¢	0.25¢	\$1.642	\$1.637	\$0.005
May-14	\$16.40	\$16.25	\$0.15	51.50¢	51.25¢	0.25¢	\$1.652	\$1.644	\$0.008
Jun-14	\$16.69	\$16.59	\$0.10	51.53¢	52.00¢	(0.48¢)	\$1.677	\$1.672	\$0.005
Jul-14	\$16.99	\$16.89	\$0.10	49.50¢	49.50¢	0.00¢	\$1.718	\$1.718	\$0.000
12 Mo Avg	\$17.01	\$16.85	\$0.16	54.21¢	53.71¢	0.49¢	\$1.698	\$1.690	\$0.008

- plants. Milk production in Florida continues to follow the downward trend and is not expected to bottom out until mid-September. Class I demand remains strong, prompting 190 spot loads to be imported this week. Rainy weather patterns over the past few weeks have caused hay harvest delays and lower quality. Milk supplies are nearly in balance with need in the Southeast region with only a few extra loads, above contract minimums, going to manufacturing plants. Milk production continues to decline along the seasonal trend. Demand for cream has improved this week and tightened supplies with ice cream and cream cheese manufacturers having strong pulls and increased production schedules ahead of the holiday.
- Fluid Milk Central: Milk handlers in the Central region were tested this week as a combination of conditions had milk moving around to fill needs. One contact said it was a triple combination of increased fluid demand from retailers for Labor Day specials, Class I demand for schools returning after the holiday, and hot, humid weather reducing available milk supplies as the week progressed. Milk from the Midwest was being transported to the Southeast in increasing amounts to fill immediate demand. Manufacturing milk supplies in the Midwest for spot needs were tight and bringing a premium to secure volume. Class III plants were seeing premiums of \$2.00-2.50 over class for spot milk with some paying the freight in addition. Class IV plants were experiencing many of the same premiums. Hot, humid weather across much of the Central region was difficult on dairy cows and reductions in milk volumes and solids were common. Dry weather is becoming more of a concern as rains have been scarce for the month. Crops are showing some stress as corn and soybeans are at crucial stages for producing optimum yields. The dry weather is also limiting third crop alfalfa production in some areas.
- Fluid Milk West: CA milk production is mostly steady and the holiday weekend is not expected to create any abnormal impacts in processing milk in the state. July 2013 pool receipts were 4.8% lower than last year, according to Cdfa. Year-to-date through July 2013 receipts are 4.2% lower. AZ milk output levels are trending lower. Hot and humid weather conditions are widespread and causing stress on the milking herds. Some dust storms caused power outages and processing issues. Class I orders are good with schools being in session and for holiday needs. Handlers are pulling additional milk volumes.
- Fluid Milk Pacific Northwest: Milk production remains in a typical seasonal slowdown. Cooler temperatures at night have helped to reduce stress on dairy cows as daytime temperatures are still in the 90's. Processors are seeing some reduced volumes as more milk begins to fill the school pipeline with most schools back after the Labor Day holiday. UT and ID milk production is also in seasonal decline. Manufacturing plants are running below capacity. Temperatures in Idaho ranged from normal to nearly 10 degrees above normal for the week, continuing the hot trend. Irrigation supplies are tight and may affect late production of alfalfa.
- Butter: The butter market tone has changed as sales increased at the CME Group this week and the market began to move higher. Many buyers now appear ready to increase inventories ahead of the fall season. Cream supplies are seeing increased cream cheese demand competing with butter churns. Retail demand has substantially improved for print butter accounts with churns in the West and parts of the Northeast region operating busy schedules to fill orders. Export demand has also improved with some Eastern butter makers focusing on 82% production to fill export orders. Butter stocks remain heavy, but increased demand is helping move some product out of cold storage.
- Dry Whey West: Whey production is trending lower following seasonal milk volumes. Demand for whey is moderate with some increased interest as end users begin to prepare for fall needs. Export buyers are showing some increased interest also.
- NDM East: Prices continued to firm this week as production has declined and increases in Class I demand are pulling milk volumes away from balancing plants and dryers. Domestic demand has shown some signs of coming out of the summer doldrums as brokers have received increased inquiries from prospective buyers. Export demand is improving with increased interest coming from Asia and Mexico. Current nonfat dry milk inventories are held in firm hands. The combination of limited production and improved demand maintains the firm market undertone.
- NDM Central: The firm market undertone continued this week as manufacturing volumes are having a hard time keeping up with demand. Lower milk volumes and lower components in available milk have tightened manufactured volumes of NDM. Very good demand from international buyers for Q4 is adding to tight supplies.
- NDM West: Pricing and the market tone are firm. Interest into international channels for NDM and SMP is good and clearing substantial volumes. Producers' holdings of NDM are light to moderate and held with confidence.
- Cheese Northeast: Most cheese plants are receiving adequate milk supplies for their 6-7 day production schedules, but lower milk component levels are reducing yields. Some plants are actively seeking additional loads of condensed skim milk to improve yields and increase production.

Cheese production geared for aging programs remains strong. Demand for cheese is good coming from food service and pizza makers ahead of the upcoming school year. Export demand continues to show improved interest.

- Cheese West: Cheese production is reduced by seasonally tightening milk supplies and increased demand for Class I usage. Although cheese stocks are above year ago levels, buyers are looking to secure product for fall needs in case of supplies becoming tighter. Export demand remains good as prices are competitive in international markets.

What's Bearish:

- Dairy cow slaughter for the week ended 08/17 totaled 59,500 head, down 2.5% from the same period a year ago.
- Dry Whey East: Domestic demand continues to be lackluster, ahead of the holiday, as most end users are making do with their contracted loads or purchasing spot loads only to cover their immediate needs. Export interest is fairly active, but below expectations. Some manufacturers are reducing their inventories by offering price discounts for multiple load orders.
- Dry Whey Central: Whey is readily available from both manufacturers and brokers. Sales of whey are lackluster as buyers are bargain shopping to make any large purchases.
- Cheese Midwest: Cheese production in the Midwest is mixed as some plants continue production schedules at near capacity levels, while others have had to reduce schedules due to lower milk intakes, caused by the current hot humid weather covering the region. Increases in Class I demand have also limited milk supplies to cheese plants in some areas. Seasonal demand for cheese is increasing with buyers having no problems sourcing what they need, which is an indication that supplies are more than adequate to fill existing orders. Mozzarella sales remain strong with good demand coming from fresh and frozen pizza manufacturers. The good demand from frozen pizza makers is a bit out of the norm for the summer season. Retail cheese sales remain sluggish. Export demand has shown some improved interest.
- International: Milk production trends are mostly favorable across a wide range of countries in Western Europe. Reports are that milk production is higher than last year in Germany, the Netherlands, France and England. Current weather conditions are conductive to milk gains. Higher milk prices and lower feed costs are also contributing factors. Most countries have seen milk intakes grow and those that had been well below year ago levels, have now seen milk grow closer to the mark of a year ago. The gains have allowed processors to catch up on production of products that have been delayed and for others to better maximize returns.
- International: Australian milk production is steady to slightly higher on a week-to-week basis. There are more cows being added to the milking strings and the pasture growth situation is good for the time being. Rains and above normal temperatures are resulting in good feed values for pastures. Milk prices are trending higher as a result of better export returns, which are being helped by the relatively weak value of the Australian dollar. Dairy farmers see the potential for a more favorable year with their financials. In New Zealand, current milk production at the end of August is noted to be building with plant intakes increasing. Conditions are favorable for early season pasture growth and cows are in good condition entering the start of the season.

Recommendation:

Last week we were perplexed about the steep discount of U.S. dairy prices to the rest of the world. Apparently others were too as this week traders aggressively went after "discounted" product. Both blocks and barrels finished the week sharply higher. Even butter, saddled with large inventories, notched a weekly gain on big volume. The combination of a late heat wave in the Midwest, continued production declines in the Southeast and West, increased Class I demand due to school openings and an end-of-summer drought causing concerns over yields was enough to give the market a shake. Weekly gains in Class III front months spilled over into both dry whey and cheese futures as well. Despite the solid move higher, October Class III at a settlement of \$18.19 is still only trading at a slight premium to current spot prices, which work out to about \$18.08. In addition, with a firm NDM market out there, Class IV works out to about \$19.66 which should lend support to the other milk classes. We think Class III will probably see increased gains over the coming 2-3 weeks, but this may be the last opportunity for producers to get their Q4 hedges on. We have a hard time thinking the market will hit \$1.90 cheese for any length of time, and would recommend producers look at selling Oct milk in the upper \$18's, Nov in the upper \$17's to low \$18's and Dec in the low to mid \$17's. Don't mess around! Finally, you need to start, if you haven't already, to begin your 2014 hedge plan. Jan-Jun went from an average of about \$17.20 in July, down to \$16.17 on Aug 20th. It has since recovered to \$16.46. We would look at selling up to 25% of your production at a \$16.70 avg, which would be a 50% retracement from the low made in August. Get orders in now as you can bet every other farm is just itching to sell again if prices get back to \$17. Get ahead of the curve.

Note: Our offices will be closed on Monday in observance of Labor Day. Markets will be closed.

Have a safe weekend!

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