

The KDM Dairy Report – October 11th, 2013

What's Bullish:

- Spot Market: Blocks finished the week up 4¢, settling at \$1.80/lb while barrels gained 1½¢ to close at \$1.76½/lb. Buyers were more aggressive, picking up 8 loads of blocks and 14 loads of barrels. Butter fell 7½¢ to settle at \$1.54¼/lb on 11 trades and Grade A NDM was unchanged at \$1.84½ on no trades.
- Butter and powder prices were higher in this week's National Dairy Products Sales Report. Butter jumped 4.7¢ from last week to average \$1.55/lb, while dry whey inched 0.2¢ higher to 58¢/lb and NDM increased 0.9¢ to \$1.83/lb.
- International: U.S. shipments of cheese, ice cream and dairy ingredients to Indonesia for the first six months of 2013 jumped 41% to nearly 58,000 tons compared to the first half of 2012. That performance propelled Indonesia from the No. 7 U.S. dairy export destination to No. 4.

| Futures Month | Class III 10/11 | Class III 10/04 | Change | Dry Whey 10/11 | Dry Whey 10/04 | Change | Cheese 10/11 | Cheese 10/04 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Oct-13 | \$18.22 | \$18.14 | \$0.08 | 58.35¢ | 58.50¢ | (0.15¢) | \$1.799 | \$1.787 | \$0.012 |
| Nov-13 | \$18.20 | \$17.98 | \$0.22 | 58.75¢ | 59.25¢ | (0.50¢) | \$1.800 | \$1.764 | \$0.036 |
| Dec-13 | \$17.65 | \$17.27 | \$0.38 | 59.35¢ | 59.03¢ | 0.33¢ | \$1.735 | \$1.693 | \$0.042 |
| Jan-14 | \$17.05 | \$16.85 | \$0.20 | 57.33¢ | 57.73¢ | (0.40¢) | \$1.694 | \$1.661 | \$0.033 |
| Feb-14 | \$16.76 | \$16.66 | \$0.10 | 55.53¢ | 56.50¢ | (0.98¢) | \$1.665 | \$1.649 | \$0.016 |
| Mar-14 | \$16.66 | \$16.59 | \$0.07 | 54.28¢ | 55.50¢ | (1.23¢) | \$1.660 | \$1.652 | \$0.008 |
| Apr-14 | \$16.55 | \$16.50 | \$0.05 | 53.60¢ | 53.60¢ | 0.00¢ | \$1.645 | \$1.644 | \$0.001 |
| May-14 | \$16.58 | \$16.60 | (\$0.02) | 53.75¢ | 54.00¢ | (0.25¢) | \$1.659 | \$1.657 | \$0.002 |
| Jun-14 | \$16.78 | \$16.78 | \$0.00 | 53.25¢ | 54.00¢ | (0.75¢) | \$1.679 | \$1.678 | \$0.001 |
| Jul-14 | \$17.01 | \$17.02 | (\$0.01) | 52.00¢ | 52.50¢ | (0.50¢) | \$1.717 | \$1.715 | \$0.002 |
| Aug-14 | \$17.06 | \$17.06 | \$0.00 | 51.00¢ | 52.00¢ | (1.00¢) | \$1.725 | \$1.725 | \$0.000 |
| Sep-14 | \$17.11 | \$17.13 | (\$0.02) | 49.25¢ | 49.75¢ | (0.50¢) | \$1.740 | \$1.735 | \$0.005 |
| 12 Mo Avg | \$17.14 | \$17.05 | \$0.09 | 54.70¢ | 55.20¢ | (0.49¢) | \$1.710 | \$1.697 | \$0.013 |

- International: U.S. shipments of cheese, ice cream and dairy ingredients to Indonesia for the first six months of 2013 jumped 41% to nearly 58,000 tons compared to the first half of 2012. That performance propelled Indonesia from the No. 7 U.S. dairy export destination to No. 4. Strong underlying fundamentals suggest bigger numbers await, not just within Indonesia but throughout Southeast Asia. Indonesia is the fourth most populous nation in the world, enjoying the solid economic growth that often follows political stability. Demographics are positive: a large, expanding population, around 60% of which is under age 35; a well-educated, growing middle class that has exhibited a willingness to spend; steadily rising use of dairy within the Indonesian diet; and plenty of room for per capita dairy development.
- International: Cold weather is putting the brakes on milk flow in New Zealand. The freezing front bringing snow has put a dampener on spring milk that was surging ahead of last season. After a great August with phenomenal growth, late frosts in September and in October have caused a shock to the system and the growth has slowed down. Some people who have made silage are already feeding this out.
- International: Forecast butter and milk powder shortages could limit the EU's ability to keep up with domestic and global demand, according to chocolate and confectionery trade group CAOBISCO. In an internal report shown to ConfectioneryNews, the Association of Chocolate, Biscuit and Confectionery Industries of Europe (CAOBISCO) said that providing EU milk deliveries reach 140 million tons with a modest increase of cheese manufacturing, there will be less butter and milk powders available in the 2013/14 marketing year. Increased exports of dairy products and reduced milk production volumes have meant that EU butter production levels declined significantly in the first few months of 2013. This has meant that the EU domestic market supply of butter is now experiencing a severe shortage. The internal CAOBISCO report forecasts that global exports will rise as the partial suspension of milk powder imports from Oceania due to the botulism scare is likely to mean an increased demand for powders produced in Europe in the coming months.

What's Bearish:

- While butter and powder were higher, cheese prices declined in this week's NDPSR. 40-lb cheddar blocks decreased 0.25¢ to average \$1.80/lb while 500-lb barrels lost 2.8¢ to \$1.79/lb.
- We continue to hear multiple rumblings about dairy expansions throughout the Midwest and Northeast. Output looks set to jump in 2014.
- Grains: Corn made new multi-year lows this week and beans are in a bear market. All equals cheaper feed and lower cost of production.

Recommendation:

The tightness in manufacturing milk supplies that we wrote about for 3 consecutive weeks prior to the government shutdown finally spilled into the spot market. Multiple bidders made their presence known while sellers appeared very much more on the defensive. Q4 holiday demand combined with global strength in butter/powder demand appears to be helping out. Our initial targets for Nov and Dec have hit, so we would recommend bumping further sales in these months at \$18.50 or higher for Nov and \$17.90 or higher for Dec. We don't know how long this rally will last and these are very good prices for a large number of dairies. On the international front, an interesting shift is occurring, as it relates to the U.S. domestic market. Time and again this summer we've pointed out the spread between Class III and Class IV and how it appears abnormally large. Historically this is true, but we believe we may be entering a new era where Class IV becomes the price leader. Globally, powder is what moves the most between countries from a volume standpoint, and powder is tight. Demand for powder is growing in the forms of SMP, WMP, infant formula, etc. and companies are gearing up to meet that need. It may be that the \$2+ spread between Class III and IV is here to stay for some time. The silver lining in this is that while we might not see \$20 Class III in the near future, we find it equally unlikely that we'll see \$13 Class III anytime soon either. In addition, producers are unlikely to see a negative PPD on their milk checks for some time either. The spread just can't get that large, at least for an extended time (we think!). That being the case, hedgers may want to look at fence trades for 2014, with the idea that they probably won't get hurt too badly on the upside. The July-Dec 2014 16.25 x 18.25 fence (min/max) is getting close to trading at about 10¢/month. For those producers receiving that positive PPD plus their component pay, a guaranteed minimum of \$16.15/cwt base price could be quite attractive. And if the cap is reached at \$18.15/cwt base, mailbox checks would be \$20+ in all likelihood. With the expected increases in production and cow numbers, this might not be a bad strategy to get started with on 25% of your production.

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