

The KDM Dairy Report – October 18th, 2013

What's Bullish:

- International: China's demand for dairy imports is set to grow for at least the next two years, as its local milk production struggles under structural change in the supply chain, according to a special report released by Rabobank. China is expected to remain a key driver of global dairy consumption, despite the fast development of their own dairy farms. Milk production has struggled to grow as small farmers exit the business and large-scale farms are not yet online. At the same time, the country's reliance on dairy imports has grown by 20-30% over the last two years. China is now expected to import almost 20% of its milk products to satisfy current domestic demand, and this aggressive buying has squeezed out many other buyers and held dairy prices at high levels.

| Futures Month | Class III 10/18 | Class III 10/11 | Change | Dry Whey 10/18 | Dry Whey 10/11 | Change | Cheese 10/18 | Cheese 10/11 | Change |
|------------------|-----------------|-----------------|---------------|----------------|----------------|--------------|----------------|----------------|----------------|
| Oct-13 | \$18.25 | \$18.22 | \$0.03 | 58.25c | 58.35c | (0.10c) | \$1.803 | \$1.799 | \$0.004 |
| Nov-13 | \$18.32 | \$18.20 | \$0.12 | 58.75c | 58.75c | 0.00c | \$1.810 | \$1.800 | \$0.010 |
| Dec-13 | \$17.72 | \$17.65 | \$0.07 | 59.50c | 59.35c | 0.15c | \$1.747 | \$1.735 | \$0.012 |
| Jan-14 | \$17.07 | \$17.05 | \$0.02 | 58.00c | 57.33c | 0.67c | \$1.690 | \$1.694 | (\$0.004) |
| Feb-14 | \$16.77 | \$16.76 | \$0.01 | 57.00c | 55.53c | 1.48c | \$1.659 | \$1.665 | (\$0.006) |
| Mar-14 | \$16.65 | \$16.66 | (\$0.01) | 56.25c | 54.28c | 1.98c | \$1.655 | \$1.660 | (\$0.005) |
| Apr-14 | \$16.57 | \$16.55 | \$0.02 | 55.50c | 53.60c | 1.90c | \$1.655 | \$1.645 | \$0.010 |
| May-14 | \$16.65 | \$16.58 | \$0.07 | 54.25c | 53.75c | 0.50c | \$1.660 | \$1.659 | \$0.001 |
| Jun-14 | \$16.92 | \$16.78 | \$0.14 | 53.25c | 53.25c | 0.00c | \$1.687 | \$1.679 | \$0.008 |
| Jul-14 | \$17.12 | \$17.01 | \$0.11 | 52.00c | 52.00c | 0.00c | \$1.722 | \$1.717 | \$0.005 |
| Aug-14 | \$17.13 | \$17.06 | \$0.07 | 51.00c | 51.00c | 0.00c | \$1.725 | \$1.725 | \$0.000 |
| Sep-14 | \$17.12 | \$17.11 | \$0.01 | 49.00c | 49.25c | (0.25c) | \$1.740 | \$1.740 | \$0.000 |
| 12 Mo Avg | \$17.19 | \$17.14 | \$0.05 | 55.23c | 54.70c | 0.53c | \$1.713 | \$1.710 | \$0.003 |

- International: Chinese companies are approaching UK farmers direct asking for millions of liters of milk, according to an article this week in The Telegraph. Euromonitor predicts that the Chinese market for infant formula will double over the next four years. During the first five months of this year, Germany also exported 38,190 tons of dairy products to China, an increase of 138% compared to the same period a year earlier. China is already Germany's largest customer outside Europe for milk products. Retailers in the UK also rationed sales of powdered baby milk earlier this year because of a surge in demand in China.
- International: Milk prices in India are set to soar, according to an article this week in the Business Standard. Increases in input costs, including cattle feed prices, fodder prices, diesel and other inputs has prompted the price hike. An extended monsoon has led to the scarcity of dry fodder and therefore fodder prices have increased by about 30%. In addition, cattle feed has seen a 15% increase since September 2012.

What's Bearish:

- Most dairy products were lower in this week's Global Dairy Trade auction. The average price for all products declined 1.9% from the last auction two weeks ago. Butter Milk Powder and Butter were the largest decliners, falling 5.2% and 3.5% respectively. Skim milk powder inched 0.7% higher, but cheddar cheese fell 1.7% to a U.S. equivalent \$1.96/lb.

Recommendation:

This week we attended the American Dairy Products Institute – Dairy Risk Management Seminar in Chicago. In lieu of our normal commentary, we thought we'd highlight some of the presenters' comments:

- Weather in New Zealand is THE single greatest factor influencing dairy markets worldwide. Watch it!
- Lots of new milk production coming online around the world. EU milk production should improve in 2014. Farmers getting high prices for milk have the incentive to increase output. Expect lots of milk in Spring, especially 2nd and 3rd quarters. U.S. should have more milk too. Many producers are very profitable and will respond.
- Class IV at nosebleed prices - how long can those be sustained? It's ALL about powder now and the story keeps evolving. Demand from China still insatiable, but... when will enough be enough?
- Large cheese inventories!
- Yogurt demand gaining traction. Greek-style will account for 50% of sales by year end
- Restaurant sales positive but slow growth.
- Fluid milk sales horrible. Retail breakfast cereal sales down 7% from 2009 to 2012.
- Bottom line, int'l demand propping things up for now, but the bear is out there.

We also visited the dairy floor at the Chicago Board of Trade. Not a lot of bullishness there from the dairy floor traders. On the flipside, we're hearing some chatter about cheese moving pretty well for the short-term from our cheese plants. With the gov't re-opened, we should start getting some better info next week with the resumption of weekly dairy reports. Until then, we think Nov/Dec will be steady to slightly higher, but producers should start getting more aggressive obtaining coverage for 2014. Our July-Dec 16.25 x 18.25 fence rec filled last week. Consider putting that on as protection against that wall of milk production some are predicting. Look at selling Q1 at 17.00 avg or better. Have a great weekend!

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