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The KDM Dairy Report – November 1st, 2013

What's Bullish:

Futures Month	Class III 11/01	Class III 10/25	Change	Dry Whey 11/01	Dry Whey 10/25	Change	Cheese 11/01	Cheese 10/25	Change
Nov-13	$18.84	$18.73	$0.11	57.00¢	58.00¢	(1.00¢)	$1.876	$1.858	$0.018
Dec-13	$18.27	$17.94	$0.33	57.90¢	58.75¢	(0.85¢)	$1.814	$1.777	$0.037
Jan-14	$17.31	$17.09	$0.22	57.50¢	57.83¢	(0.33¢)	$1.722	$1.692	$0.030
Feb-14	$16.90	$16.80	$0.10	57.00¢	57.35¢	(0.35¢)	$1.681	$1.662	$0.019
Mar-14	$16.75	$16.70	$0.05	56.00¢	56.85¢	(0.85¢)	$1.666	$1.655	$0.011
Apr-14	$16.68	$16.68	$0.00	55.50¢	55.83¢	(0.33¢)	$1.663	$1.655	$0.008
May-14	$16.69	$16.62	$0.07	54.40¢	54.55¢	(0.15¢)	$1.665	$1.660	$0.005
Jun-14	$16.85	$16.88	($0.03)	53.90¢	54.03¢	(0.13¢)	$1.685	$1.680	$0.005
Jul-14	$17.08	$17.06	$0.02	53.00¢	53.00¢	0.00¢	$1.715	$1.723	($0.008)
Aug-14	$17.08	$17.10	($0.02)	52.50¢	52.50¢	0.00¢	$1.726	$1.726	$0.000
Sep-14	$17.14	$17.17	($0.03)	51.00¢	50.00¢	1.00¢	$1.735	$1.740	($0.005)
Oct-14	$17.08	$17.11	($0.03)	51.50¢	50.00¢	1.50¢	$1.730	$1.730	$0.000
12 Mo Avg	**$17.22**	**$17.16**	**$0.07**	**54.77¢**	**54.89¢**	**(0.12¢)**	**$1.723**	**$1.713**	**$0.010**

- Spot Market: Blocks gained 1¾¢ to settle at $1.89¼/lb while barrels picked up 5¢ to close at $1.87/lb. There were just 9 block and 3 barrel trades for the week. Butter was up 3½¢ to settle at $1.53¼/lb on 9 trades and Grade A NDM increased a penny to $1.91/lb on 2 trades.
- Milk Production Report: Output in September was up just 1% from a year ago, which was well below most analyst expectations for a 2-3% increase. In addition, since resumption of USDA tallying cow numbers, we now see the herd has contracted two consecutive months. From July to August there were 10,000 fewer head, and from Aug to Sep there was a drop of 25,000 head, leaving us at 9.207 million head in the herd. This number is also well below analyst expectations. The current herd size is the lowest since Nov '12.
- Fluid Milk East: Milk delivery load weights are increasing in the Mid-Atlantic and Northeast regions, but strong fluid contract needs are leaving only marginal supplies available for spot sales or manufacturing. A number of hard frosts have brought about a conclusion to the growing season in both regions, and there is concern in areas of New England that supplies of quality forages will run short prior to the end of winter. A period of cooler weather this past week has prompted milk production increases in Florida, but Class I demand continues to be strong. The increase in milk production lowered the total number of import spot loads to 120 this week from 178 last week, but that is still well higher than a year ago when just 39 loads came in. Milk supplies in the Southeast are in balance with demand. Manufacturing supplies are being held to their contract minimums. Milk production is increasing along the seasonal trend and Class I demand continues to be fairly strong. Cream demand remains very good and supplies are tight. Those buyers looking for additional loads may have problems securing desired supplies within the region. Strong pulls are coming from cream cheese, sour cream, cream based dips, butter manufacturers with even some eggnog beginning to be produced.
- Fluid Milk Central: Milk manufacturers in the Central region are receiving a premium for spot loads ranging from $2.50 to $4.00 per CWT due to tight milk supplies. Production remained flat to a slight increase and components are increasing, but fluid orders have been steady with high seasonal demand from cheese manufacturers. Milk processors are seeing an increase in competition as farmers are reviewing their marketing options. Class I demand is decreasing due to seasonally, but cream demand remains steady due to good Class II demand for the holiday season and increased butter production. Due to 2012 feed shortages, some farmers were forced to feed 2013 corn silage before it was properly fermented, which led to lower dry matter intake and decreased milk production, as well as causing digestive problems for the cows. Another common trend in this year's corn crop was its energy levels are less than prior years. Those factors resulted in lower component numbers for the past couple weeks.
- Fluid Milk West: CA farm milk production is unchanged on volumes while components maintain their gradual upward trend. Milk processors indicate farm milk intakes are well below processing capacity. September 2013 milk receipts totaled 3.08 billion pounds, unchanged from September last year, according to CDFA, but YTD receipts are 3.1% lower from the comparable months in 2012. Milk production is on the rise in AZ, with cooler weather patterns benefiting cow comfort. Various milk marketers indicate, though, the demand from recently opened Class II plants continues to draw strongly on current farm milk volumes. A few plant managers report they are operating below capacity on most milk products due to the low volumes remaining in house for processing. Sales of cream into cream cheese, aerated cream, sour cream and dips is steady to higher.
- Fluid Milk Pacific Northwest: Milk production in the region continues to decline slightly, although component levels are improving. Class I demand remains mostly steady with manufacturing plants moving milk to plants with best returns. Processing plants are running below capacities and are using down time for maintenance operations.
- Butter East: Facilities are busy filling both bulk and print orders with production about equal with last week. The good demand for butter is made up in part by strong pulls from bakeries, food processors and private label orders. Supplies are being worked lower as some plants have to microfix inventories to fill existing orders. Production of 82% has declined in recent weeks as most butter makers are focusing on their domestic customers, but export interest remains good.
- Butter Central: Supplies are moving at a steady rate from manufacturers into retail. Retail demand has driven up sales as much as 20% for some manufacturers. Much of the butter demand is for 82%, meeting the needs of the increased international demand.
- Butter West: The market tone is firm with retail orders for upcoming holidays keeping print lines busy. Churns are actively making butter to fill orders in time for holiday featuring. Export sales continue to pull excess supplies.
- Dry Whey East: Inventories in the region are not as burdensome as they have been in previous weeks. Domestic buyers are purchasing only for immediate needs, but export demand, which has been below manufacturer's expectations, is improving.
- Dry Whey Central: Supplies are said to be ample, but some manufacturers are slowing down production. In addition, manufacturers report moving product readily and some are even experiencing extra sales. Domestic demand has been steady, while export demand has been increasing.

- NDM East: Production of nonfat dry milk in the region is at reduced levels as manufacturing milk supplies remain tight. Domestic demand for product is good, but buyers are purchasing only for immediate needs, unwilling to expand inventories at the current price levels. Export demand is also good, but there too, buyers are becoming resistant to the higher price levels. Supplies of nonfat dry milk are tight within the region. The market undertone is steady to firm.
- NDM Central: Supplies have been hard to come by as manufacturers are trying to keep up with international and domestic demand. Product is being found but is coming with a high price tag. Demand is good, with some manufacturers in a sold-out position. Many manufacturers are selling product as soon as they finish producing it.
- NDM West: Prices are mostly higher on a firm market. Production for the export market continues as a focus for many NDM/SMP operations in the West. A few manufacturers are shifting production away from cheese plants and into butter/powder plants to keep on top of active NDM/SMP international demand. NDM producers indicate light to moderate stocks limit offers to the spot market at this time.
- Cheese East: Orders remain strong, keeping cheese production very active in the region. Increased component levels of milk coming into cheese plants are increasing yields, but cheese inventories are being worked lower as orders are being filled ahead of the holidays. Most all varieties of cheese are experiencing seasonally strong sales. Export interest remains active with sales above year ago levels.
- Cheese Midwest: Some regional cheese plants report that milk supply declines have begun to reverse, but other plants still mention less milk availability for cheese manufacturing than is desirable. Orders remain generally strong ahead of the holiday season.
- Cheese West: Prices were steady to higher this week and the market continues to exhibit a firm undertone. Cheese production is limited somewhat by competition for milk into Class IV production. Seasonally lower milk volumes also continue to limit cheese production. Retail demand is good with strong block sales. Barrel demand is steady. Block supplies are tightening with the good spot demand.
- Kraft Foods pulled about 750,000 cases of string cheese products due to premature spoiling, according to a UPI story this week. Those products will need to be restocked for retailers.
- International: Milk output in parts of India has fallen 20% recently due to excessive rains. The continuous rain and cold weather has also impacted the availability of quality feed, according to The Times of India.

What's Bearish:

- Cold Storage Report: Butter stocks at the end of September were 39% higher than a year ago, while American and Total cheese stocks were up 3% from Sep '12. Butter stocks did decline 12% from Aug to Sep, however; a big monthly drawdown.
- Dry Whey West: Prices are mixed for the week. Whey production is higher as cheese manufacturers are busy with holiday orders. Domestic demand is seasonally good, but export sales are mostly steady to weak.

Recommendation:

Hang on folks. Sunday night's open and Monday's trade could get a little wild. Usually the Milk Production Report doesn't cause much stir in the markets, but the realization that cow numbers have declined 35,000 head the past few months when we all thought there were increasing, should be interpreted as bullish. In addition, milk output was up just 1%, far less than expected. Those holiday cheese buyers that haven't procured product yet will be biting their nails all weekend, as it appears demand is still in full swing. The spot market saw nice gains this week, although we wouldn't call it panic buying, yet…. But when you plug in the numbers, Class III calculates to about $19.20/cwt. With Nov futures at $18.84 and half priced already, it should benefit from possible spot cheese increases next week, but the Dec contract at $18.27 could be the real beneficiary here. It begins pricing in two weeks with bullish fundamentals that predict no letup in that timeframe. Q1 contracts should also go along for the ride but to a lesser extent. This is all great news for producers who may get opportunities to hedge at prices higher than we expected just a week ago. But before we all buy in to the hype, let's get some perspective:

1. Cheddar blocks settled at $1.90¼ today. The spread between international prices and U.S. prices is GONE, and the value of the USD is rising, making the cost of our goods more expensive internationally. We are awfully close to $2 cheese and past experience tells us what that does to demand. Internationally we're starting to see some pushback on powder prices.
2. Feed prices continue to drop, increasing margins for dairy producers, and along with it, incentive to expand. The wall of milk IS coming, though we may not see the full effect of it until Q2 and beyond.
3. Just two bearish bullet points….. Hmmm, when everyone thinks prices can do nothing but go up…..the opposite usually happens.

Don't get us wrong, in the short term, we're bullish; but hedger beware! Have a plan in place to protect your 2014 production. At this point, we would leave Q1 open to higher prices and focus on getting coverage Q2-Q4. Consider the Apr-Dec 16.25 x 18.25 fence at an average cost of 10¢/month. This is great protection for a lot of dairies. Be ready to sell Q1 outright as holiday buying WILL END at some point. It's hard to predict what Q1 might do, but a $17.50 average looks to be within the realm of possibility. Why not sell some there and scale in more selling at higher levels if it happens? Have a great weekend!