

The KDM Dairy Report – November 15th, 2013

What's Bullish:

- Spot Market: Butter shot up 9¢ for the week to settle at \$1.65/lb while Grade A NDM closed 4¼¢ higher to \$1.97½/lb. Trading was active with 18 loads of butter and 5 loads of NDM exchanging hands.
- Weekly Cold Storage numbers released Wednesday indicate a strong seasonal pull for but butter and cheese. Stocks of butter at USDA-selected warehouses declined 11%, or 1.2 million lbs over the period 11/01 through 11/11. Cheese stocks fell 3%, or 3.17 million lbs over the same period.
- Fluid Milk Southeast: Class I demand marginally increased in Florida this week and is expected to increase again next week ahead of the holiday. Milk production is increasing along the seasonal trend, but a cold front has moved into the state with gale force type winds, which is hampering transportation and lowering cow comfort levels. A major grocery store chain is now in production of Greek yogurt for their private label, which is utilizing more of the milk supply. Milk supplies in the Southeast region are nearly in balance with demand. Class I demand has significantly increased over last week. Manufacturing milk volumes are being held to their contract minimums. Milk production is increasing in the region and manufacturing supplies are expected to be especially heavy over the upcoming holiday period, but for now, demand for cream is very strong as most cream based dairy product manufacturers are at or near their seasonal production peak. Cream supplies are tight with pricing dependent on day of the week purchase and location. Spot cream sales are limited, due to the tight supply situation.

| Futures Month | Class III 11/15 | Class III 11/08 | Change | Dry Whey 11/15 | Dry Whey 11/08 | Change | Cheese 11/15 | Cheese 11/08 | Change |
|------------------|-----------------|-----------------|---------------|----------------|----------------|--------------|----------------|----------------|----------------|
| Nov-13 | \$18.82 | \$18.78 | \$0.04 | 57.50¢ | 57.23¢ | 0.27¢ | \$1.862 | \$1.862 | \$0.000 |
| Dec-13 | \$17.98 | \$17.89 | \$0.09 | 58.00¢ | 57.20¢ | 0.80¢ | \$1.773 | \$1.763 | \$0.010 |
| Jan-14 | \$17.36 | \$17.16 | \$0.20 | 57.50¢ | 57.00¢ | 0.50¢ | \$1.721 | \$1.701 | \$0.020 |
| Feb-14 | \$16.95 | \$16.94 | \$0.01 | 57.50¢ | 57.00¢ | 0.50¢ | \$1.682 | \$1.675 | \$0.007 |
| Mar-14 | \$16.78 | \$16.87 | (\$0.09) | 56.53¢ | 56.00¢ | 0.52¢ | \$1.670 | \$1.668 | \$0.002 |
| Apr-14 | \$16.73 | \$16.72 | \$0.01 | 55.80¢ | 55.00¢ | 0.80¢ | \$1.669 | \$1.667 | \$0.002 |
| May-14 | \$16.72 | \$16.69 | \$0.03 | 55.25¢ | 54.75¢ | 0.50¢ | \$1.662 | \$1.664 | (\$0.002) |
| Jun-14 | \$16.80 | \$16.81 | (\$0.01) | 54.03¢ | 53.90¢ | 0.13¢ | \$1.674 | \$1.684 | (\$0.010) |
| Jul-14 | \$17.05 | \$17.07 | (\$0.02) | 53.25¢ | 53.00¢ | 0.25¢ | \$1.715 | \$1.720 | (\$0.005) |
| Aug-14 | \$17.08 | \$17.14 | (\$0.06) | 53.25¢ | 53.00¢ | 0.25¢ | \$1.715 | \$1.726 | (\$0.011) |
| Sep-14 | \$17.16 | \$17.16 | \$0.00 | 51.75¢ | 51.00¢ | 0.75¢ | \$1.734 | \$1.735 | (\$0.001) |
| Oct-14 | \$17.18 | \$17.15 | \$0.03 | 51.00¢ | 51.00¢ | 0.00¢ | \$1.730 | \$1.730 | \$0.000 |
| 12 Mo Avg | \$17.22 | \$17.20 | \$0.02 | 55.11¢ | 54.67¢ | 0.44¢ | \$1.717 | \$1.716 | \$0.001 |

- Fluid Milk Central: Central region milk production is showing a slight to moderate improvement this week as tight milk supplies have loosened some. Milk processors are still going through a lot of milk supplies as spot loads remain at a premium of \$2.00 to \$3.00 over class. Bottling sales have picked up as some retail stores are running promotions for gallon jugs of milk. There are reports of some eggnog production starting. Class II is near peak seasonal demand and even reported above past years as demand has been great for whipping cream, sour cream, cream cheese, and other holiday dairy products. Milk processors are seeing premiums for condensed skim and for milk going to cheese manufacturers. Some processors are short on condensed skim. Interest from ice cream plants has slowed for the most part but some are still seeing steady demand. Cream supplies are tight and easily moved when available. Churn operators are paying premiums for cream to fulfill holiday butter orders. Class II cream multiple range from 1.34-1.45. Cream demand remains strong.
- Fluid Milk Pacific Northwest: Milk production in the region is reported to still be in seasonal decline. Milk handlers are moving available processing supplies to maximize production at various facilities. Increased cream demand for seasonal products is limiting butter production. Processing demand is currently above available milk supplies.
- Butter East: Demand for cream from various cream based manufacturers is very strong this week, resulting in reduced cream volumes to churns. Butter demand is seasonally strong and being met through a combination of fresh cream churning, grinding and microfixing existing supplies. Current inventories are being worked lower as orders are being filled with some plants having most of their supplies committed. Inventories are being worked lower at an accelerated pace. Export orders continue to be filled, but at reduced levels as most butter manufacturers focus on covering their domestic demand. Current bulk butter prices for domestic sales are reported 5-8¢ over the market on the CME Group. The butter market continues on a firm trend prior to the holiday, not having had a price decline in the last 16 trading sessions.
- Butter Central: Butter manufacturers are busy churning at or near full capacity with increased sales. Tight cream supplies are causing some butter makers to microfix bulk butter inventories. Demand for butter is solid to strong in the U.S., with interest also coming from resellers.
- Butter West: Prices continue to move higher with good holiday demand. Interest for additional loads is higher than expected and churns are busy trying to fill demand. Retail demand from club stores and supermarkets is strong. In addition, some bulk butter end users are looking to increase inventories. Cream demand is good from the churns and into Class II manufacturers. Butter stocks are at manageable levels with some producers short of product to meet the extra demand.
- Dry Whey East: Prices increased this week. Production of dry whey is at reduced levels at a couple cheese plants down for maintenance projects, but other cheese plants in the region are operating on 6-7 day production schedules and are showing increased production. Demand is mixed with improved export demand, but domestic demand is flat and lackluster. The increased export demand is primarily from China and Mexico, which is working some inventories lower.
- Dry Whey West: Prices moved higher this week. Whey production remains mostly unchanged although some plants are reporting lower volumes due to reduced cheese production. Demand for whey from both domestic and export channels are seasonally good.
- NDM East: Production in the region has increased as manufacturing milk supplies have expanded, especially in the upper Northeast, but increased export demand is keeping most inventories tight, with a majority of supplies committed. The improved export interest is maintaining a steady to firm market undertone.
- NDM Central: Nonfat dry milk has been hard to find in the Central region as many manufacturers are in a sold-out position and only fulfilling current commitments. Domestic demand ranges from good to strong while international demand remains steady.
- NDM West: Producers and resellers indicate pricing is too high to encourage conversations with end users regarding 2014 contracts, but on the same hand, it highlights the tight supply in the market as well as unmet Q4 end user needs. Manufacturers indicate contract fulfillment is

mostly on a just in time basis as various plants are concentrating on SMP production versus NDM. In the secondary market, a few loads reportedly topped \$2/lb on resale.

- Exports: According to the Foreign Ag Service, exports of butter and milkfat during September totaled 25 million lbs, a nearly fivefold increase from September 2012. Exports for January through September totaled 137.2 million lbs, a 63% increase over a year ago.

What's Bearish:

- Spot Market: Cheddar blocks declined ¼¢ on the week to settle at \$1.82/lb on 9 trades. Barrels fell 2½¢ to close at \$1.75¼/lb on 5 trades.
- Dairy cow slaughter for the week ended 11/02 totaled 59,000 head, down 5.6% from a year ago.
- Fluid Milk Northeast: Manufacturing milk supplies are near the seasonal low point in the Mid-Atlantic and Northeast regions, but volumes have been augmented in some areas, due to maintenance projects at a couple of cheese plants. Supplies are more than adequate to meet fluid contract needs. Milk production is picking up in both regions with improved component levels.
- Fluid Milk Southwest: Farm milk production in CA is holding steady, but manufacturers anticipate the seasonal turnaround in production should occur very soon. Dairy producers report the calving season has begun and more cows are reentering the milking string. Milk production in NM is steady to seasonally higher, but shifting temperature ranges are having some impact on cow comfort. Sales into regular bottling accounts increased for the week. Class III sales are higher and lower as improved cheese demand led to additional vats being made at some facilities. Milk production in AZ is at seasonally expected levels and component values are improving.
- Cheese Northeast: Most cheese plants are operating on seasonally heavy schedules. Demand for cheese has hit a snag after last Friday's CME Group block price declined 8 cents. Numerous potential buyers have delayed purchases, anticipating this week's average price will lower their contracted purchase price.
- Cheese Midwest: The cheese market is showing signs of price weakness. That is consistent with historic price trends for blocks and barrels during the last two months of the year in recent years. New orders have slowed for some plants due to buyers backing off to strategize pricing resulting from declining CME prices.
- Cheese West: Western cheese prices are mixed, while the overall tone of the market is weaker. Cheese plants are busy filling orders for the holiday season with good block demand. Lower price trends for barrels have increased some spot demand in that market.
- Grains: Feed is getting cheaper by the week. Beans were hit hard this week. The EPA is recommending a drop in the ethanol mandate for 2014 – bearish grains.

Recommendation:

The spot market at the CME Group this week was a tale of two tapes, as Class III components cheddar blocks and barrels realized losses, while Class IV components butter and NDM saw more pronounced gains. Tight global powder supplies continue to give Class IV the leadership position, with current spot pricing it at about \$22/cwt. With declines in this week's spot cheese prices, Class III works out to about \$18.30. Manufacturing milk is still tight in some parts of the country, but there are signs that the low is in and both milk output and components are now on the rise. Seasonal demand for cheese and a shrinking lead time for orders kept buyers active during this week's spot sessions, yet we finished the week lower, a potentially ominous sign. Holiday demand for cheese is not satisfied yet, but it may remain for only another week or two. At that time, cheese prices could fall into the \$1.60's, before stabilizing again. In light of this, we would consider selling Dec futures at \$18.00 or higher. Dec cheese futures settled at just over \$1.77/lb on Friday, implying our spot prices might see further declines. No one can predict what happens here in the short term, so if you can make a good profit here, let some of your production go. Longer term, the strength in powder/Class IV is bound to lend some support to Class III. Demand for powder is pulling milk out of the vat and into the dryer. For that reason, we don't see an imminent crash in Q1 Class III prices, though they would be affected by a sudden drop in spot cheese prices, temporarily. We do still stand by our rec from last week, however, to target some Q1 sales at 17.15 avg and more at 17.50 avg. Continue to target the Apr-Dec 16.25 x 18.25 fence at an average cost of 10-15¢/month.

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