

**The KDM Dairy Report – March 7<sup>th</sup>, 2014**

**What's Bullish:**

- Spot Market: Blocks gained 7¢ for the week on no trades to settle at \$2.29¢/lb while barrels picked up 5¢ on just 3 trades to close at \$2.25/lb. Grade A NDM closed unchanged for the week at \$2.04/lb on 6 trades, while butter was flat at \$1.88/lb on 15 trades.
- Dairy Products Report: Cheddar cheese output in January was down 1% vs. a year ago while increased demand for Gouda and Italian varieties put Total Cheese output up 1.6%. Butter production declined 3% from Jan '13 and dry whey output fell 22.8% as other protein categories used available milk supplies.

Futures Month	Class III 03/07	Class III 02/28	Change	Dry Whey 03/07	Dry Whey 02/28	Change	Cheese 03/07	Cheese 02/28	Change
Mar-14	\$22.65	\$22.15	\$0.50	64.00¢	63.50¢	0.50¢	\$2.213	\$2.163	\$0.050
Apr-14	\$21.25	\$20.85	\$0.40	63.50¢	63.08¢	0.42¢	\$2.067	\$2.033	\$0.034
May-14	\$20.25	\$20.07	\$0.18	62.25¢	62.98¢	(0.73¢)	\$1.973	\$1.965	\$0.008
Jun-14	\$20.01	\$19.94	\$0.07	62.25¢	62.50¢	(0.25¢)	\$1.950	\$1.958	(\$0.008)
Jul-14	\$19.80	\$19.73	\$0.07	60.50¢	59.23¢	1.28¢	\$1.942	\$1.940	\$0.002
Aug-14	\$19.59	\$19.43	\$0.16	60.25¢	57.75¢	2.50¢	\$1.927	\$1.910	\$0.017
Sep-14	\$19.34	\$19.10	\$0.24	59.00¢	56.75¢	2.25¢	\$1.898	\$1.885	\$0.013
Oct-14	\$19.15	\$18.89	\$0.26	57.50¢	56.75¢	0.75¢	\$1.880	\$1.872	\$0.008
Nov-14	\$18.77	\$18.55	\$0.22	57.20¢	56.98¢	0.23¢	\$1.850	\$1.835	\$0.015
Dec-14	\$18.50	\$18.26	\$0.24	56.80¢	55.50¢	1.30¢	\$1.827	\$1.811	\$0.016
Jan-15	\$18.05	\$17.85	\$0.20	54.75¢	55.00¢	(0.25¢)	\$1.770	\$1.760	\$0.010
Feb-15	\$17.68	\$17.45	\$0.23	50.03¢	50.03¢	0.00¢	\$1.770	\$1.760	\$0.010
<b>12 Mo Avg</b>	<b>\$19.59</b>	<b>\$19.36</b>	<b>\$0.23</b>	<b>59.00¢</b>	<b>58.34¢</b>	<b>0.67¢</b>	<b>\$1.922</b>	<b>\$1.908</b>	<b>\$0.015</b>

- Cream Southeast: Supplies are reported as tightening. Demand for cream has increased as numerous manufacturers increase production of Class II and Class III ahead of Easter and Passover. Yogurt production is active along with some increases in ice cream manufacturing. Condensed spot sales are limited with most activity resulting from contract transaction.
- Fluid Milk Central: Milk production rates are improving, but milk supply availability is mixed as some buyers are seeing extra loads available, while loads are tight in other areas. The milk spot load prices reflect the availability with some marginal premiums around \$1.50 over Class. Class II demand is improving with St.Patrick's Day promotions increasing soft serve sales. Condensed skim interest is increasing with supplies moving readily. Class II manufacturers are beginning to ramp up production for Easter demand.
- Fluid Milk CA: Milk processors report overall CA farm milk production is steady. There were pockets of decreased milk production in areas inundated by the recent rains, while other locations maintained the established week over week increase. Frozen dessert and ice accounts took more cream loads this week. Various ice cream manufacturers report they are starting their seasonal ramp up on production. Last week's rain brought some short term relief in terms of row crop water needs, but the drought remains in place throughout much of the state. The latest U.S. Drought Monitor map from the National Drought Mitigation Center shows all parts of California experiencing drought.
- Butter: U.S. butter prices remain competitive with international prices fostering good export sales. Additional cream supplies available in Q1 have allowed many butter churn operators to fulfill domestic and international needs, therefore using less bulk inventories. Butter stocks are building slowly, but are often described as tighter than usual in some parts of the country.
- Dry Whey Northeast: Prices moved higher during the week. Production is from steady to slightly increasing, but dry whey inventories are limited. Domestic demand is increasing as baking manufactures gear up for Easter holiday season. Export demand remains steady.
- Dry Whey Central: Prices moved higher on a firm market as buyers are having difficulty securing product with current tight supplies. Some dry whey production rates have been reduced due to shifting to higher profit, whey products such as whey protein concentrate and whey protein isolates. Domestic demand is strong as sellers in the F.O.B. and resell markets are readily moving supplies on hand. International interest is steady with good export sales. Inventories of dry whey are limited.
- Dry Whey West: The firm market undertone is being reinforced by tighter inventories. Production saw significant declines in January. Although cheese production in the West for January was up 4.5% compared to last year, dry whey production was down 35.3% from a year ago. Whey stream products were directed towards WPC production versus dry whey manufacturing. Demand for whey for both export and domestic use is reported to be good.
- Cheese Northeast: Production continues at a steady to higher rate with available milk supplies, but the levels of increases in inventory are marginal at some plants due to holiday cheese orders. Demand for domestic cheese is mixed, but export interests are active with support being provided.
- Cheese Midwest: Some Wisconsin cheese plants are now running at capacity to meet demand and report being sold out. Producers opting to maintain steady production are generally drawing down inventory levels to meet demand. Orders have remained strong, even after markets saw prices strengthen. Orders received in the Midwest include those from regular customers, as well as orders to meet cheddar demand not being met by some Western cheese producers facing reduced milk availability. Among regular buyers, there has been a noticeable increase in demand for hard Italian cheeses. Plants manufacturing mozzarella and provolone report stronger interest in mozzarella.

- Cheese West: Retail demand is good with buyers looking to fill contracted needs and often waiting for price breaks to make additional purchases. Export demand is mixed as the higher prices are close to international pricing. Cheese stocks are tight to adequate to fill contract needs, but are tighter for spot sales.
- CWT accepted requests for assistance with sales of 3.1 million lbs of butter and 783,000 lbs of cheese this week for delivery in March through June 2014.
- The lingering effects of drought in California, the Great Plains and Texas have led to the smallest U.S. beef herd size in the past 60 years. That has pushed fresh beef prices to a record high \$5.04/lb in January. It will also keep cull cow prices strong and may provide incentive for dairy farms to continue actively culling.

#### What's Bearish:

- Dairy cow slaughter continues to lag year-ago levels. 58,400 head were culled for the week ended 02/22, down 6,000 head (9.3%) vs. the same period a year ago. YTD the cull is off 45,000 head.
- Fluid Milk Northeast: Milk production continues to increase in the Northeast and Mid-Atlantic regions. As bottling sales decline, loads are increasingly going to manufacturers in the region. Some manufactures have increased Class III and Class IV production while expanding inventories as a result of the increased milk supplies.
- Fluid Milk Southeast: Manufacturing milk supplies in the region are heavy, resulting from increased production and sluggish Class I demand. Florida milk production is higher as warm weather and mild rain induces good cow comfort levels. Some producers are adding cows to their herds. Strong surplus milk supplies saw 140 loads exported from Florida this week, up from 70 last week.
- Fluid Milk Southwest: NM farm milk production is steady to higher with comfortable daytime temperatures and low humidity aiding cow comfort. Milk handlers report orders from bottling facilities are mostly lower for the week, but Class II picked up some of those loads. A few plants continue to take in surplus milk loads from out-of-state to ease manufacturing loads in those areas. AZ milk production continues to trend higher. Milk haulers report drivers' schedules are tight and there is some concern about meeting required maximum on-farm milk holding times. Fluid demand is seasonally light. Churns are operating close to capacity in some locations.
- Fluid Milk Pacific Northwest: Milk production in the region is increasing. Warm weather is credited with some of the production increases. Rains along coastal areas and inland are welcomed for the upcoming growing season while increased snowpack in the upper elevations will aid irrigation supplies. Favorable milk prices and lower feed costs are helping to keep cows in the milking herd longer to aid in the production increases. UT and ID milk supplies are improving slowly with mild temperatures, but remain near year ago levels. Production is being hampered by lower dairy cow numbers in Idaho. Recent increases in pay price to dairies in the region is hoped to help in rebuilding cow numbers.
- NDM: Prices in the East are higher across the range, but brokers and traders are receiving a lot of offers in the region and finding it harder to move loads. In the Central region, resellers are managing inventories, but sometimes taking a loss as most reseller loads are falling around the bottom of the price range. The market tone is mixed as many buyers continue to purchase in a "hand-to-mouth" manner until they get a better feel for the market. Additional milk supplies are hitting the dryers making production rates steady to higher for many manufacturers. Domestic demand is steady, though international interest is improving. In the West, buyer demand is active for immediate needs, but interest in contracting for upcoming quarterly needs is light. Participants in the nonfat dry milk market expect some type of price adjustment in the near term, but producers have yet to signal a willingness to offer contract prices with market adjusters or discounts to the market. Nonfat dry milk production is nearing capacity at several locations in the West. Low/medium heat nonfat dry milk inventories are building. A portion of Western manufacturers note in-house storage is at capacity.
- The GDT price index fell 4% vs. the prior auction two weeks ago. Declines were led by BMP (-5.8%), WMP (-5.7%) and SMP (-3.9%). Cheddar cheese, however, increased 0.7% to a US-equivalent \$2.19/lb.

#### Recommendation:

Milk production is really picking up where the weather is warmer, primarily in the Southeast and Southwest. But for now, fresh cheese still appears to be on the tighter side. The recent drop in spot cheese prices prompted a flood of orders as buyers have been waiting and looking for any kind of discount to pull the trigger. That has left several cheese plants "sold out", according to USDA's weekly updates. After some weakness in barrels in the beginning of the week, the bluff was called and barrels shot up 11½¢ pm during Wednesday's spot session. Both blocks and barrels ended the week in positive territory with bidders for blocks coming up empty and barrel buyers obtaining only 3 loads for the week. With current spot prices working out to about \$23.35 Class III and only one week left to price, March futures look steady to higher from here. If spot prices hold beyond that, April futures should see some wild upward movement as it attempts to close the gap with spot. It's a tough call though. With milk production increasing now in much of the country, supply may begin to get the upper hand. We would aggressively get after some cheap PUT options for April to protect against any volatility that might come in the next few weeks. Consider buying the April 20.50 PUT for 25¢ (filled at that price today). We continue to like the May-Oct fence strategy, buying the 18.50 PUT and selling the 22.00 CALL at a net premium of zero. Brace for more volatility in the weeks ahead!