

The KDM Dairy Report – May 9th, 2014

What's Bullish:

- Exports: According to the U.S. Dairy Export Council, the value of U.S. dairy exports in March topped \$700 million for the first time. Exports of cheese, whey proteins, lactose and milk protein concentrate all reached new highs, while butterfat exports were the most in more than 20 years and nonfat dry milk/skim milk powder (NDM/SMP) rebounded from the level of the previous four months. U.S. suppliers shipped 201,380 tons of milk powders, cheese, butterfat, whey and lactose in March, up 33% from last year. Total value of all exports was \$717.0 million, up 46%. Exports to China nearly tripled in March, to \$91 million, while shipments to Mexico were up 60%, Southeast Asia up 43% and Middle East/North Africa up 33%. These four customers accounted for nearly two-thirds of U.S. exports during the month. Cheese exports in the first quarter were up 42% and butterfat exports more than doubled compared with a year earlier, accounting for nearly 14% of US butter production. U.S. exports (on a total milk solids basis) were equivalent to 17.7% of U.S. milk solids production in March – the most ever (see data table at right).

| Futures Month | Class III 05/09 | Class III 05/02 | Change | Dry Whey 05/09 | Dry Whey 05/02 | Change | Cheese 05/09 | Cheese 05/02 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| May-14 | \$22.71 | \$22.75 | (\$0.04) | 66.750c | 68.025c | (1.28c) | \$2.185 | \$2.187 | (\$0.002) |
| Jun-14 | \$21.23 | \$21.55 | (\$0.32) | 66.250c | 67.000c | (0.75c) | \$2.039 | \$2.065 | (\$0.026) |
| Jul-14 | \$20.27 | \$20.55 | (\$0.28) | 63.025c | 65.000c | (1.98c) | \$1.965 | \$1.979 | (\$0.014) |
| Aug-14 | \$19.94 | \$19.94 | \$0.00 | 61.950c | 63.500c | (1.55c) | \$1.940 | \$1.930 | \$0.010 |
| Sep-14 | \$19.90 | \$19.87 | \$0.03 | 60.500c | 62.000c | (1.50c) | \$1.941 | \$1.933 | \$0.008 |
| Oct-14 | \$19.53 | \$19.51 | \$0.02 | 59.550c | 59.550c | 0.00c | \$1.920 | \$1.910 | \$0.010 |
| Nov-14 | \$19.08 | \$19.05 | \$0.03 | 58.750c | 58.750c | 0.00c | \$1.871 | \$1.857 | \$0.014 |
| Dec-14 | \$18.61 | \$18.62 | (\$0.01) | 57.250c | 57.500c | (0.25c) | \$1.826 | \$1.830 | (\$0.004) |
| Jan-15 | \$18.29 | \$18.25 | \$0.04 | 55.000c | 54.750c | 0.25c | \$1.812 | \$1.812 | \$0.000 |
| Feb-15 | \$18.13 | \$18.15 | (\$0.02) | 53.975c | 53.975c | 0.00c | \$1.810 | \$1.810 | \$0.000 |
| Mar-15 | \$18.05 | \$18.05 | \$0.00 | 53.000c | 53.000c | 0.00c | \$1.810 | \$1.810 | \$0.000 |
| Apr-15 | \$18.05 | \$17.98 | \$0.07 | 52.500c | 52.500c | 0.00c | \$1.800 | \$1.800 | \$0.000 |
| 12 Mo Avg | \$19.48 | \$19.52 | (\$0.04) | 59.042c | 59.629c | (0.59c) | \$1.910 | \$1.910 | (\$0.000) |

- Fluid Milk Florida: Florida milk production is showing declines for the third consecutive week because of varying weather conditions. The state experienced heavy rains toward the end of last week through the weekend that left standing water on the farms. This week, Florida is seeing high temperatures and humidity, all of which influence cow comfort levels.
- Dairy Market News reports some mid-size to smaller sized producers in the Midwest, along with older producers are selling their herds at current high cattle prices.
- Fluid Milk West: Milk production in CA, while beyond the peak, is active and holding steady. However, many plant managers who scheduled projects for the weeks following the flush are finding limited opportunities to fit in additional milk for Class 4a production. Interest from the Class 3 market sector is climbing as frozen dairy dessert and ice cream manufacturers increase volumes. NM milk handlers report the daily number of milk loads being transported to processors is steady. This may indicate milk production has reached the peak of the flush. Demand from bottlers is dropping, but Class II manufacturers upped milk load orders throughout the week, as frozen yogurt and ice cream production heads seasonally higher. In AZ, farm milk production is flat to declining on a week to week basis. Handlers report the recent bout of daytime temperatures in the high 90s dealt a blow to cow comfort and precipitated the downturn in milk intakes. Active cream demand showed up again this week in the West as several butter manufacturers focus on building inventories ahead of near term contract needs. Production of 80% and 82% butter is active. Ice cream and frozen dessert producers are steadily increasing draws on contract cream loads. For some balancing plant operators, concern about butterfat shortages during summer months is rising and may affect the volumes of cream offered to buyers in coming weeks.
- Butter: Prices increased on a firm market with solid print demand and ongoing exports orders keeping stocks tight. Butter churns are operating at mixed levels. Increased milk supplies have improved production for some manufacturers, while others reduced churn rates because Class II buyers purchased additional cream supplies at higher prices. Inventories are being monitored closely to meet current and long-term needs. Spot load availability of bulk butter is light.
- Dry Whey Northeast: Prices moved higher this week on solid sales. Production is steady and inventories are sufficient. Demand is good from ice cream manufacturers and bakeries. The market is firming. March U.S. month ending stocks of human food dry whey totaled 58.7 million lbs, 20.5% less than March 2013. Cumulative U.S. 2014 dry whey production totals 197.9 million lbs, 23.5% lower than 2013 production during the same period.
- Dry Whey Central: Prices increased as a result of higher spot trading. The market tone is steady to firmer. Some cheese makers indicated reduced cheese sales and backed off cheese production, resulting in less whey being dried at some plants. Domestic demand is good with active buyer interest. International demand is slowing due to more favorable global market prices. However, manufacturers report increased inquiries from international buyers pricing around. Manufacturers note stocks are in better positions than weeks' prior, but are still tight.
- Dry Whey West: Production continues to lag significantly below year ago levels though, as increasing amounts of whey stream products are being directed to whey protein concentrate production. Whey stocks are tight with production often being tied to contract fulfillment. Spot sales of whey are limited. Dry whey prices are higher as various pricing indices and spot prices adjust higher. Demand is reported to be good in both domestic and export markets.

| | YEAR-TO-DATE | | | % CHG |
|---------------------------------|-------------------|-------------------|-------------------|------------|
| | 2012 | 2013 | 2014 | |
| NDM/SMP | 118,253 | 106,111 | 126,549 | +19 |
| WMP | 4,638 | 4,231 | 14,212 | +236 |
| Cheese | 65,007 | 70,024 | 99,546 | +42 |
| Butterfat | 12,382 | 14,591 | 31,416 | +115 |
| Total Whey | 106,950 | 112,194 | 125,211 | +12 |
| -Dry whey | 57,621 | 52,839 | 61,129 | +16 |
| -WPC | 44,492 | 54,858 | 58,091 | +6 |
| -WPI | 4,837 | 4,497 | 5,991 | +33 |
| Lactose | 79,465 | 84,982 | 91,970 | +8 |
| MPC | 8,907 | 10,664 | 16,531 | +55 |
| Food preps (blends) | 19,390 | 20,074 | 18,218 | -9 |
| Aggregate volume* | 414,991 | 422,870 | 523,653 | +24 |
| Fluid milk/cream (000 liters) | 14,332 | 21,630 | 23,676 | +9 |
| Total Value (millions) * | \$ 1,324.2 | \$ 1,352.2 | \$ 1,885.9 | +39 |

JANUARY-MARCH (VOLUME, MT)

- Cheese Northeast: Manufacturers have expanded production schedules at some cheese facilities, in response to consistent increases in spring flush milk supplies. However, some are having difficulty replenishing tight inventories, due in part to volumes required to fulfill short-term commitments. Domestic sales are uneven. Export demand is steady.
- Cheese West: Good demand from both domestic and export buyers is helping to clear stocks on a timely basis. Lower prices over the past week and into this week have some buyers more comfortable with increasing order volumes. Other buyers are still waiting to commit to larger orders. Cheese stocks are adequate for most current demand.
- International: Milk production in New Zealand is transitioning from maintaining or maximizing current production levels, to winding down current production operations and preparing for next season. The recent storms that caused flooding on the North Island and battered the West Coast on the South Island have prompted some producers to dry off cows at increasing rates.
- Spot Market: Butter gained 9¼¢ to settle at \$2.16¼/lb on just 4 trades, while Grade A NDM managed a small ¼¢ increase to \$1.78/lb on 3 trades.

What's Bearish:

- Spot Market: Blocks fell 2½¢ for the week to settle at \$2.04¼/lb on 15 trades, while barrels gave up 6½¢ to close at \$2.02/lb on 7 trades.
- World Ag Supply & Demand Report: Milk production for 2015 is forecast higher as lower feed costs and strong milk prices are expected to support both herd expansion and gains in milk per cow. With higher milk production, cheese, butter, NDM, and whey prices are forecast lower. Class III in 2015 is projected to average \$17.40/cwt, in USDA's first estimate attempt.
- Dairy cow slaughter for the week ended 04/26 totaled just 48,900 head, the sixth consecutive week of lower numbers and the smallest weekly cull since the first week in Jan. This week's number was down 18% vs. a year ago, while YTD, 107,000 fewer cows have been removed from the milking herd.
- Fluid Milk East: Farm level production is seeing steady increases in the Northeast and Mid-Atlantic regions. Manufacturing milk supplies are heavy. Southeast milk production is steady and manufacturing milk supplies are heavy. Cream supplies are adequate for contractual commitments throughout the region. Condensed skim supplies are abundant. Manufacturers are filling contracts and channeling as much as possible to Class IV production. Manufacturers in the Midwest are purchasing East region's surplus supplies at significant discounts.
- Fluid Milk Midwest: Producers are indicating the region is into the flush as the cows are producing at an increasing rate. Milk supplies are climbing and spot loads of milk are readily available, ranging from \$3.00 under to \$1.75 over Class. Many plants are skimming additional volumes of milk. Bottlers are reporting backups with lackluster demand and fewer sales.
- Fluid Milk Pacific Northwest: Milk production in the region is steady to increasing this week. Processors are reporting increased milk supplies compared to last year that are on track with earlier forecasts. Dairy processing plants are on busy schedules to meet the increased volumes. Favorable temperatures and intermittent rains across the region are helping to move spring planting forward. Clover and alfalfa fields are growing and dairies are looking forward to fresh forage. UT and ID milk supplies are building, while some milk from outside the region continues to arrive. Dairies looking to expand herds are finding very good cull cow pricing, but heifer replacement costs have moved sharply higher at recent auctions. Prices at local auctions are \$100-\$200 dollars per head higher in the last two months, with heifers ranging from \$2100-\$2300 for the better quality replacements.
- Cheese Midwest: Prices were mostly lower this week. The market tone is unsettled. Cheese manufacturers are producing at steady rates for the most part, while a few reduced levels following weaker sales. Buyer interest varies as some are in a "wait and see" approach, while others are increasing orders. Inventories of cheese are mixed.
- International: Milk production has reached the seasonal peak in Western Europe. Weather conditions are optimal for milk production, pastures are in good condition, feed costs are comparatively low and farm gate prices are relatively high. Together, these factors are prompting producers to maximize milk production. Processing plants are having difficulty processing available milk supplies. Some condensed skim loads are being sold at significant discounts in order to find a home. Drying facilities are working at capacity with some whey drying facilities being utilized for skim milk powder production. Buyers are only covering immediate needs, anticipating heavy production schedules will result in lower prices. Milk production in Eastern Europe is quickly building towards the seasonal peak. Good weather and producer margins are supporting producers' milk production efforts. Drying facilities with available capacity are able to secure loads of skim concentrate at significant discounts. Skim milk powder is more readily available compared to Western Europe.
- International: Australian milk production has benefitted from some timely and targeted rains which brought about an autumn bump to milk volumes. The rains have improved pasture and crop conditions. The good margins are also incentivizing producers to take advantage of the situation and extend the milking season.
- International: This week's GDT auction saw the dairy price index decline 1.1%, the sixth straight auction resulting in lower prices. Cheddar cheese fell 1.8% to a US-equivalent \$1.90/lb.

Recommendation:

Q1 exports were crazy good, setting records and helping explain why prices have been able to be sustained at high levels longer than anyone predicted. The thing about export data though, is its age. We're in May and much has changed since the end of March. Demand from China, while still good, is down from its peak. Producers are hanging on to cows as long as they can, with the result being increasing levels of milk production. The Eastern part of the country is still awash with milk, though heat and humidity will not be far off. Prices were lower in this week's GDT auction, as well as for spot cheese here in the U.S., though for both, the rate of decline has decreased. Buyers are starting to jump in at these levels with 15 blocks exchanging hands this week. World butter stocks remain tight and strong international demand is supporting prices. There are legitimate concerns about supplies later on this year. Aging programs still need to be stocked and China will be back. In summary, we feel the market may not be at its low yet, but it appears to be carving out a bottom. Current spot prices work out to about \$21.35, with June Class III futures settling just below at \$21.23. We would still look at getting PUT option protection Jun/July in the event weakness continues. Look at buying CALL options Aug-Dec on milk you may already have sold. CALLs may not get a whole lot cheaper.

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