KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter, Keith Schnese & Nick Potter

The KDM Dairy Report – June 13th, 2014

What's Bullish:

Futures Month	Class III 06/13	Class III 06/06	Change	Dry Whey 06/13	Dry Whey 06/06	Change	Cheese 06/13	Cheese 06/06	Change
Jun-14	$21.30	$21.24	$0.06	66.500¢	67.575¢	(1.08¢)	$2.035	$2.026	$0.009
Jul-14	$20.93	$20.38	$0.55	64.125¢	64.750¢	(0.63¢)	$2.016	$1.965	$0.051
Aug-14	$20.70	$20.33	$0.37	61.000¢	61.900¢	(0.90¢)	$2.010	$1.987	$0.023
Sep-14	$20.63	$20.32	$0.31	58.250¢	58.500¢	(0.25¢)	$2.025	$2.000	$0.025
Oct-14	$20.16	$20.05	$0.11	57.000¢	58.975¢	(1.98¢)	$1.993	$1.977	$0.016
Nov-14	$19.64	$19.53	$0.11	56.250¢	57.525¢	(1.28¢)	$1.945	$1.932	$0.013
Dec-14	$19.17	$19.05	$0.12	55.250¢	56.100¢	(0.85¢)	$1.902	$1.894	$0.008
Jan-15	$18.59	$18.49	$0.10	54.000¢	54.950¢	(0.95¢)	$1.861	$1.840	$0.021
Feb-15	$18.32	$18.26	$0.06	52.000¢	54.000¢	(2.00¢)	$1.840	$1.837	$0.003
Mar-15	$18.26	$18.27	($0.01)	52.000¢	52.500¢	(0.50¢)	$1.847	$1.840	$0.007
Apr-15	$18.28	$18.28	$0.00	51.750¢	52.000¢	(0.25¢)	$1.841	$1.840	$0.001
May-15	$18.32	$18.24	$0.08	52.000¢	52.000¢	0.00¢	$1.850	$1.840	$0.010
12 Mo Avg	**$19.53**	**$19.37**	**$0.15**	**56.677¢**	**57.565¢**	**(0.89¢)**	**$1.930**	**$1.915**	**$0.016**

- Fluid Milk Southeast: Milk production has declined, a result of heat and humidity affecting cow comfort. Bottling sales are up slightly. Florida's production on the farm is on a steady decline as temperatures in the upper 90s during the day and mid-70s at night decrease cow comfort level. Rain has also factored in milk production rates with some areas suffering thunderstorms constantly over a ten-day period. Class I demand has bounced back with loads getting lighter and independent farm production dropping off. Export spot loads fell dramatically to 120, down from 240 last week. Cream demand is unyielding as butterfat levels decline. Standardized cream volumes are being reduced due to the impact of school closings. Churning schedules are seeing reductions with several dairy products competing for available supplies. Ice cream manufacturing is steady to increasing and pulling heavy on cream supplies.
- Fluid Milk Southwest: Many processors in CA report milk intakes have edged downward. A stretch of hot days, with limited nighttime relief, has impacted dairy cow comfort. Expectations are that milk volumes will continue to trend lower through the balance of June to mid-September. Sales of condensed skim into frozen dessert accounts are active. Farm milk production in NM continues to step lower. Class I orders are taking decreasing volumes from the system, but sales into some Class II facilities notched higher. Class III use is uneven as manufacturers of fresh-type cheese note sales of some varieties are slower. In AZ, dairy processors report milk intakes are declining steadily. Daytime temperatures continue to surpass 100 degrees in some locations. Dairy producers report that at some point, misting and fans are losing the battle against prolonged spells of heat. Cream demand is active into butter, ice cream, and frozen confection operations. Within the Southwest, where temperatures are regularly climbing over 100 degrees, one or two processors report they are limiting cream sales to nearby destinations to better control the temperature at delivery.
- Butter: Cream multiples firmed this week as supplies tighten from increased demand from ice cream producers. Some butter manufacturers were able to take advantage of the situation by selling cream for better returns than putting it into manufacturing. However, this, along with new churn upgrades and operators producing ice cream instead, lead to additional butter churn operations going offline, reducing production levels. A few butter manufacturers microfixed bulk supplies to meet print needs. Domestic sales are mostly steady while continuing to exceed seasonal expectations. Export orders have slowed. Inventories are light with little headway made on rebuilding stocks.
- NDM: Prices for low/medium heat nonfat dry milk were higher this week. Inventories are adequate for fulfilling contractual commitments, with substantial volumes clearing to international customers. However, buyers and sellers are concerned about future inventory levels being inadequate, and the resulting impact on price. Some traders are paying premiums for low/medium heat nonfat dry milk to cover immediate needs. Domestic interests from ice cream manufacturers are good. The market undertone is firm.
- Cheese Midwest: Regional milk production is still increasing and milk is readily available to cheesemakers. Most cheese manufacturers are operating at full schedules. Some manufacturers are also enhancing vats with condensed skim, which is attractive at current prices. Despite this, increased sales of barrels at prices above CME Group pricing are noted, as buyers work to prepare and ship finished products to be available for 4th of July holiday consumption. In addition, block availability is also occasionally tight, in part because more buyers are seeking to re-build their inventories.
- CWT has accepted 12 requests for export assistance to sell 2.138 million pounds of Cheddar, Gouda and Monterey Jack cheese, 440,925 pounds of butter (82% butterfat) and 1.250 million pounds of whole milk powder to customers in Asia, South America and North Africa. The product will be delivered June through November 2014.
- International: Alfalfa exports to China have grown nearly eightfold since 2009, according to an article this week in the LA Times. China has pushed past Japan as Asia's biggest buyer, and is now second only to the United Arab Emirates as the world's top importer. Meanwhile, CA produced 6 million tons of alfalfa last year, down from 8 million in 2002. As a result of the jump in demand and diminished supply, alfalfa prices have doubled in the last three years to over $300/ton. The higher prices are carving into the profit margins of dairy farmers. Even so, Chinese demand for alfalfa may continue to grow exponentially as the country scours the globe for food.

What's Bearish:

- Spot Market: Blocks lost 2¢ for the week to close at $2.03/lb and barrels were unch at $1.96¾/lb. Trading was fairly light with just 11 block trades and 5 barrels exchanging hands. Grade A NDM lost 3¼¢ for the week, all on Friday, with just one trade. In contrast, butter sellers dumped 37 loads of product this week, with butter settling down 3¾¢ to $2.18½/lb.
- Dairy cow slaughter for the week ended 05/31 totaled just 42,900 head, down 10.3 vs. the same period last year, and the lowest weekly total since mid-2011.
- Fluid Milk Northeast: Milk production volumes in the Northeast and Mid-Atlantic are just south of peak as contacts report temperatures that encourage cow comfort. Milk supplies continue to be heavy in both regions, as milk intakes have many/most dairy manufacturers filled to capacity. With extra milk on hand, spot loads are being traded under Class in some channels. Class I demand in the Mid-Atlantic is steady to decreasing, as school continues to close.

- Fluid Milk Central: Farmers are wrapping up first crop alfalfa and note the quality and quantity is greater than the last few years. The milk producers are eagerly pushing cows with additional feed and supplements to get the most out of them with current milk prices. Milk handlers are seeing upticks in milk intakes while a few note components trending lower with the higher temperatures. Milk processors are handling the heavy milk supplies in a combination of selling condensed skim, drying powders, and/or producing cheese at near capacity levels. Many ice cream makers are fully converted to using condensed skim with reduced prices available. Some cheese makers are using additional condensed skim supplies too. Demand for bottling is soft.
- Fluid Milk Pacific Northwest: Milk production in the region is reaching a plateau as increases have slowed. Milk handlers reported an earlier than expected peak of production. Some of this is credited to dairies keeping cows in the herd longer to take advantage of favorable milk prices. Current milk supplies are pushing production facilities to full capacity. Increased manufacturing milk is available as most schools are ending their semesters. UT and ID milk supplies are at or near peak production. Favorable weather and some early forage production are contributing to pushing milk cows to full production. Excess milk supplies from out of the region continue to be offered to processors with some discounts to complete sales. Processors are running near full production schedules.
- Dry Whey: The undertone is softening as some end users report adequate supplies on hand and purchasing in a hand-to-mouth fashion. Manufacturers are drying at mostly higher levels with additional whey streams available as many cheese makers are running at full production rates. Domestic buyer interest is curtailed. New export orders are limited as U.S. prices are currently not competitive with the world markets.
- Cheese Northeast: Favorable milk supply volumes are permitting most cheese plants to operate at/near capacity levels. Declining protein levels in milk intakes are reducing cheese yields, but supplies are available for current demand. Lowfat cheddar production is down as sales decline. Some facilities are primarily making cheddar cheese to go through a 6-12 months aging process. Inventory levels vary as orders are filled. Export demand is steady, with some additional forward sales receiving support.
- Cheese West: Cheese production in the West is in full swing as milk supplies near peak levels. Additional milk is also becoming available for manufacturing as schools close for summer break. Some cheese plants are trying to control production to meet orders rather than building stocks. Export demand continues to be slow as U.S. prices are above international offers. New demand into the third quarter from export buyers is often tied to price assistance from an export assistance program.

Recommendation:

We're now past peak production in most areas of the country, but while warmer weather is starting to affect milk output in the southern tier, it has yet to make any impact in the northern tier. In addition, most schools are now closed, so there is still plenty of manufacturing milk available and cheese plants are running hard. With all the cheese being produced, dry whey output is higher and prices are under pressure. Despite spot cheese seeing some active sellers, prices held pretty well. Class III put in a decent week but still remains range bound as the market is desperate for some fundamental news to give it direction. We've been a little negative in our bias in the short run, but that is starting to change. There are several paradoxes which make us think we may have put in a bottom. While cheese output is running full tilt, it appears buyers are actively looking for product to put in aging programs since they got such a late start in procurement. Butter prices are the highest in the world and came under pressure this week, yet inventories are described as "light". We are past peak production in much of the country and the northern tier will get warmer. Cream is getting tight. Geopolitical events (Iraq, Ukraine, etc.) have the potential to spread instability to large areas. Crude oil is firming. So in summary, we're going to back off our 2015 sell recommendation and get back to just supporting the front months with PUT options. July 20.25 PUTs settled at 18¢ and August 19.50 PUTs closed at 28¢. Enter some target orders just below these premium levels for some peace of mind to carry you, until more is known about this market.