

The KDM Dairy Report – August 1st, 2014

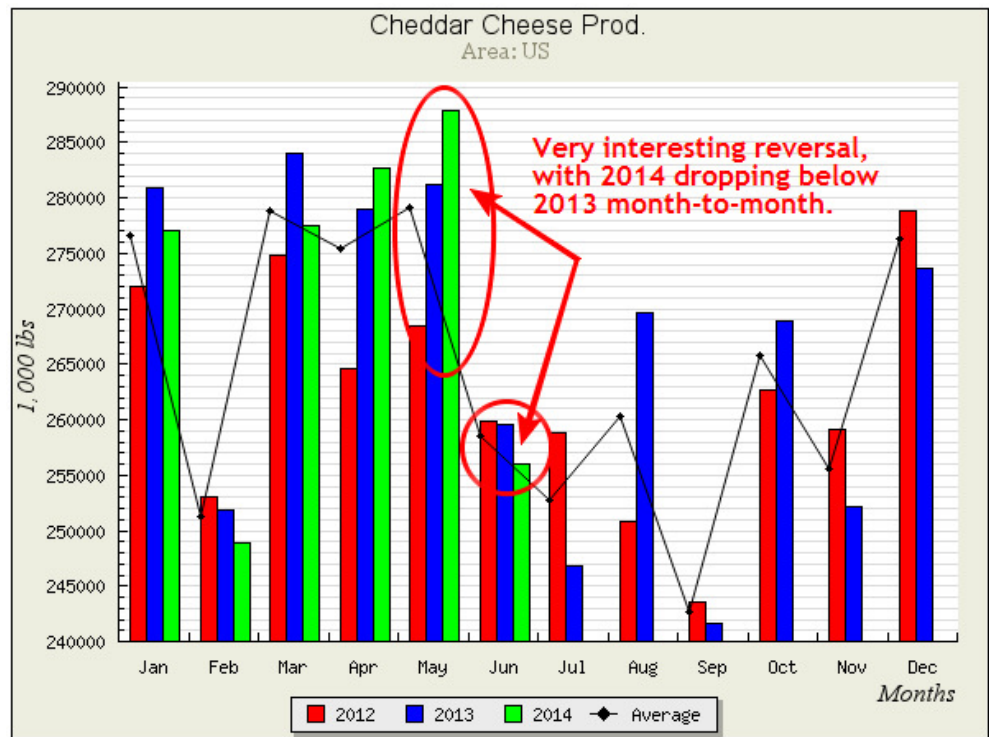
What's Bullish:

- Spot Market: Blocks gained 3¢ for the week on 10 trades to settle at \$2.00/lb. Barrels picked up 4¼¢ on 6 trades, also closing at \$2.00/lb.
- Dairy Products Report: American cheese output in June was down 3.8% vs. a year ago, according to USDA, and down a surprising 10.8% from May. Total cheese output in June was up 0.5% vs. 2013 but down 5.2% from last month. If these numbers are correct, it's bullish to the market.
- Weekly cold storage numbers continue to paint a picture of strong domestic demand.

Cheese holdings at USDA-selected storage centers have declined 3.4 million pounds (4%) over the period 07/01 through 07/28.

- Fluid Milk Southeast: Milk production is showing signs of falling off with decreases in cow comfort. Bottling sales are slightly down but are expected to move higher as schools re-open. Retail promotions are enhancing Class I sales. Manufacturing milk intakes have declined compared to a week ago. Florida continues to experience decreases in farm-level milk output as cow comfort declines due to consistent hot, wet weather conditions. Class I demand is seasonally adequate but expected to increase with the re-opening of a few area schools next week. There were no exports of spot milk this week, which is down 35 loads from last week.
- Fluid Milk Central: Milk production and components in the region are mostly on the decline, following seasonal trends. Spot loads of milk tightened as prices ranged from Class to \$2.00 over Class. Bottlers are beginning to plan for filling school pipelines in the coming weeks. Ice cream and yogurt accounts are actively taking condensed skim supplies.
- Fluid Milk Southwest: Milk production varies in CA, with milk haulers reporting steady to lower volumes. Recent daytime temperatures in the Central Valley are regularly topping 105 degrees Fahrenheit, though some dairies have been able to maintain production. All of California is currently suffering from severe to exceptional drought. Some dairy farmers are pumping ground water to make up for surface water shortages. Transportation costs of milk from farms to processing locations, and from processing locations to other locations as a finished ingredient or bottled milk are becoming more expensive. Due to clean air requirements, some trucking operators are raising hauling rates to cover the cost of modifying or replacing transportation equipment. Milk production in NM turned lower this week despite a drop in daytime temperatures. Some dairy operators anticipate there will not be a recovery from these production drops until fall. Heat has taken a toll on milk production in AZ. Milk intakes are lower at balancing plants. Cream demand is steady, but volumes are lower as butterfat solids decline within milk intakes. Improved interest for cream was noted, but some brokers/traders report a shortage of tankers is holding up some sales finalizations.
- Fluid Milk Pacific Northwest: Hot weather returned to the region and milk production has suffered. Recent hot spells hurt production, but the cumulative effect of a new heat wave is being blamed for lower milk volumes in the region. Most milk is now being processed within local production areas with fewer loads moving out of state. UT and ID milk production has slowed with the return of hot weather. Some processors are reducing production schedules. Farmers have responded to higher milk prices and favorable feed costs by increasing dairy cow numbers, but this has caused heifer prices in the region to rise significantly higher than year ago levels.
- Butter: The market tone remains firm. Several manufacturers noted the last few weeks of historical high prices have not affected demand enough to catch up on Q4 stock building. Production rates are mostly steady. Orders into food service/restaurant accounts are strong and above last year's numbers following reports of increased dining and price movements relative to other foods. Industrial demand is solid as spot load offers are restricted. Butter manufacturers are managing tight inventories closely.

Futures Month	Class III 08/01	Class III 07/25	Change	Dry Whey 08/01	Dry Whey 07/25	Change	Cheese 08/01	Cheese 07/25	Change
Aug-14	\$21.47	\$21.45	\$0.02	68.750¢	67.500¢	1.25¢	\$2.038	\$2.034	\$0.004
Sep-14	\$21.57	\$20.72	\$0.85	67.000¢	64.000¢	3.00¢	\$2.050	\$1.990	\$0.060
Oct-14	\$20.82	\$19.90	\$0.92	63.575¢	59.500¢	4.08¢	\$2.000	\$1.945	\$0.055
Nov-14	\$19.92	\$19.35	\$0.57	61.500¢	56.850¢	4.65¢	\$1.925	\$1.910	\$0.015
Dec-14	\$19.48	\$19.10	\$0.38	60.050¢	56.500¢	3.55¢	\$1.899	\$1.896	\$0.003
Jan-15	\$18.70	\$18.40	\$0.30	57.000¢	53.500¢	3.50¢	\$1.847	\$1.842	\$0.005
Feb-15	\$18.35	\$18.04	\$0.31	54.375¢	52.250¢	2.13¢	\$1.824	\$1.814	\$0.010
Mar-15	\$18.20	\$18.00	\$0.20	53.500¢	51.275¢	2.23¢	\$1.821	\$1.814	\$0.007
Apr-15	\$18.10	\$17.91	\$0.19	53.000¢	51.750¢	1.25¢	\$1.816	\$1.812	\$0.004
May-15	\$18.13	\$17.93	\$0.20	52.725¢	51.225¢	1.50¢	\$1.813	\$1.810	\$0.003
Jun-15	\$18.12	\$17.94	\$0.18	52.250¢	51.000¢	1.25¢	\$1.820	\$1.812	\$0.008
Jul-15	\$18.10	\$18.06	\$0.04	51.950¢	50.975¢	0.98¢	\$1.821	\$1.839	(\$0.018)
12 Mo Avg	\$19.25	\$18.90	\$0.35	57.973¢	55.527¢	2.45¢	\$1.890	\$1.877	\$0.013



- Cheese Northeast: Available milk supplies continue to spur 7-day production schedules for cheddar makers, but good cheese demand from travel resorts are benefitting food service transactions. Inventories are satisfactory, though with little opportunity for growth at this time, as strong interest clears current production volumes.
- Cheese Midwest: Many cheese makers have already booked orders through August. Inventories are tight in many plants. Plants with committed buyers are sensitive to preserving inventory levels sufficient to meet already booked future commitments, factoring anticipated production capabilities. Seasonally declining milk production is limiting cheese manufacturing schedules. Most manufacturers are operating with production schedules ranging from 5 to 6 days a week. Manufacturers of mozzarella cheese are increasing production, manufacturing to fill building demand from school lunch buyers ordering pizza, college students returning to the pizza nutrition program, and football viewers adding to the mix. With barrels being at nearly the lowest closing prices of July during recent days, manufacturers who use process cheese have been active in seeking some extra loads.
- Cheese West: Production is steady to lower as milk receipts continue to drop, mainly due to hot weather. Retail demand is good and process cheese interest is picking up as summer grilling is ongoing. Some increased demand from foodservice accounts for fall orders is also noted. Export demand has slowed, but manufacturers are being kept busy filling contract and spot orders for domestic needs.
- CWT has accepted 8 requests for export assistance to sell 1.645 million pounds of Cheddar cheese, and 2.222 million pounds of whole milk powder to customers in North Africa, Central and South America. The product will be delivered July 2014 through January 2015.

What's Bearish:

- Spot Market: While cheese was higher, butter plunged 19¢ to settle at \$2.40/lb on heavy volume of 26 trades. Grade A NDM lost 2½¢ to close at \$1.65/lb with no trades.
- Dairy cow slaughter for the week ended 07/19 totaled 53,100 head, down 4.5% (2,500 head) vs. the same period last year.
- Fluid Milk Northeast: Milk production in the Northeast and Mid-Atlantic region is steady as somewhat cooler temperatures secure farm-level output. Manufacturing milk supplies are heavy but manageable for most balancing plants.
- International: Western European milk production has shown only marginal declines over the previous two weeks. Weather conditions are good, timely rains have prompted good forage growth on pastures, and margins remain positive for dairy producers. Dairy markets are in general experiencing decreased demand as numerous buyers covered their near term needs ahead of the European holiday. A majority of the manufacturing milk volumes are being channeled to skim milk powder and butter production. There is a lack of actual storage data, but it is generally acknowledged that stocks are building for both commodities. Eastern European milk production continues to be strong with weather conditions favorable for dairy operations. Manufacturing schedules remain active for butter, skim milk powder, and whey. Some manufacturers are offering loads of various commodities at discounts in order to clear excess available supplies.
- Dry Whey Northeast: Prices were lower this week due to declines in various price indices. Inventories are increasing marginally and the market tone is weakening.
- Dry Whey Central: The undertone is softening as buyers/end users note being offered additional spot loads at steady to lower pricing. Domestic interest is slowing as many buyers/end users are heavy on warehouse supplies.
- Dry Whey West: Competing protein sources are being pressured lower and some buyers are looking for price breaks to follow that trend, though lower cheese production and increased production of concentrated whey proteins are keeping supplies of whey tight. Export sales are slow as international prices are often lower than domestic pricing.
- NDM East: Prices fell significantly this week as spot loads traded lower. Most purchasing is done hand-to-mouth, aside from contractual procurements. As a result, brokers looking to clear low/medium heat nonfat dry milk are experiencing limited success in locating buyers, even with discounts applied. Producers are adding to their nonfat dry milk inventories as the levels of condensed milk supplies necessitate heavy dryer schedules at most balancing plants. The market undertone is weak.
- NDM Central: Prices shifted lower behind weak spot trading and various indexes. The undertone is weak, with manufacturers generally offering larger volumes in the spot market. However, many buyers are purchasing strictly for immediate needs and taking smaller quantities. Domestic demand is weak as purchasers are leery of taking a position in a potential falling market. Export orders are limited. Supplies of low/medium heat NDM are readily available.
- NDM West: The market tone is weak as many buyers wait for a clear signal to reenter the market. Several brokers defined their customers' interest in any NDM offers as dead on arrival. Brokers who contracted heavily for adequate supplies throughout the year indicate internal supplies are building steadily.

Recommendation:

Spot cheese prices bounced off of well-established support in the mid \$1.90's as buyers, as they have done before, got more aggressive with any discount below \$2. By the end of the week, both blocks and barrels sat at \$2.00/lb. Perhaps the realization that the tight cheese situation will not be solved until well into Q3 or possibly Q4, along with the desire to build inventory now, spurred them on. Holiday demand is not all that far away. Or perhaps commercial buyers anticipated today's Dairy Products Report, which showed a surprising drop in both American and Cheddar cheese output. Either way, Class III futures received quite a boost, with Sep-Nov seeing the biggest weekly gains. On the flip side, spot butter took a big hit this week and NDM was weaker. As a result, the premium of Class IV over Class III, which very recently was close to \$3, is now only about \$1. With cheese likely to be bid again next week, we could see Class III overtake Class IV for the first time this year. Producers should be mindful about the possibility of receiving a negative PPD in their future milk checks if that were to happen. With the bulls back in charge of the market (for now!), we continue to recommend buying PUT option protection for the balance of this year. We're not clever enough to call the top! Give us a call next week for quotes on what might work for your operation.

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