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The KDM Dairy Report – January 16th, 2015

What's Bullish:

Futures Month	Class III 01/16	Class III 01/09	Change	Dry Whey 01/16	Dry Whey 01/09	Change	Cheese 01/16	Cheese 01/09	Change
Jan-15	$16.01	$15.97	$0.04	56.000¢	56.000¢	0.00¢	$1.578	$1.581	($0.003)
Feb-15	$14.43	$14.84	($0.41)	44.925¢	45.750¢	(0.83¢)	$1.488	$1.521	($0.033)
Mar-15	$14.02	$14.66	($0.64)	36.925¢	40.250¢	(3.33¢)	$1.492	$1.539	($0.047)
Apr-15	$13.90	$14.41	($0.51)	33.600¢	35.250¢	(1.65¢)	$1.496	$1.540	($0.044)
May-15	$14.18	$14.52	($0.34)	33.000¢	34.150¢	(1.15¢)	$1.536	$1.561	($0.025)
Jun-15	$14.80	$15.00	($0.20)	33.500¢	34.000¢	(0.50¢)	$1.591	$1.608	($0.017)
Jul-15	$15.51	$15.76	($0.25)	35.075¢	34.500¢	0.58¢	$1.656	$1.683	($0.027)
Aug-15	$15.84	$16.09	($0.25)	35.000¢	35.500¢	(0.50¢)	$1.693	$1.715	($0.022)
Sep-15	$16.06	$16.34	($0.28)	34.000¢	35.000¢	(1.00¢)	$1.712	$1.737	($0.025)
Oct-15	$16.20	$16.35	($0.15)	35.600¢	35.000¢	0.60¢	$1.722	$1.740	($0.018)
Nov-15	$16.10	$16.36	($0.26)	36.575¢	36.100¢	0.48¢	$1.710	$1.736	($0.026)
Dec-15	$16.01	$16.20	($0.19)	36.250¢	36.000¢	0.25¢	$1.700	$1.718	($0.018)
12 Mo Avg	**$15.26**	**$15.54**	**($0.29)**	**37.538¢**	**38.125¢**	**(0.59¢)**	**$1.615**	**$1.640**	**($0.025)**

- Fluid Milk East: Manufacturing milk volumes are more manageable than in recent weeks in the Northeast region, but continue to keep balancing plants very busy. The situation has eased somewhat in the Mid-Atlantic region where strong Class I demand from the Southeast and Florida is lowering manufacturing milk volumes. Manufacturing milk supplies in the Southeast region have been greatly reduced due to the huge Class I demand. A significant number of loads have been pulled from manufacturing plants to cover the demand coming from bottlers. Florida milk production has leveled off over the past couple of weeks as weather has been lowering cow comfort levels with variable temperatures and plenty of rain. Class I demand is very strong, prompting 150 loads to be imported into the state this week.
- Fluid Milk Central: Recent colder weather led to a few reduced milk intake levels as cows expended additional feed energy for body warmth in place of milk production. Some cheese plants expressed additional interest for spot milk this week. Milk handlers noted milk volumes are closer to balance as spot loads are ranging from $4 under Class to Class. Bottling sales are improving with stores and schools restocking supplies. Class II demand is beginning to pick up as the Super Bowl related orders start. Butter churn operators continue to pull heavy on cream supplies.
- Cheese Northeast: Milk flows going into cheese plants continue to be strong, but demand from retail outlets has increased as store managers restock ahead of the NFL playoffs and the Super Bowl. Food service orders are sluggish as restaurant business is down following the holidays, but demand for mozzarella is expected to increase in the near term as pizza sales will increase as colleges and universities start their spring terms. Cheese supplies are building, but are not seen as burdensome.
- CWT has accepted 28 requests for export assistance to sell 2.993 million pounds of Cheddar and Monterey Jack cheese and 11.678 million pounds of 82% butter to customers in Asia, Europe, the Middle East and North Africa. The product will be delivered in January through July 2015.

What's Bearish:

- Spot Market: Block finished the week down 12¢ to settle at $1.47/lb and barrels gave up 9½¢ to close at $1.45. Sellers had the upper hand, with 6 loads of blocks and 13 loads of barrels exchanging hands. Grade A NDM declined 3¾¢ to 95¢/lb on just 2 trades, while butter managed a 1¢ gain to close at $1.55/lb on one trade.
- Butter stocks at USDA-selected storage centers were up 37% vs. a year ago for the period 01/01 through 01/12. Cheese stocks were up 1% over the same period.
- Dairy cow slaughter in 2015 is starting out slower than 2014. For the week ended 01/03, 48,200 head were culled, down 3,000 head (5.8%) vs. the same period last year.
- Fluid Milk West: CA milk production is mainly steady though some handlers are seeing slight increases. Milk is available for all usages. AZ milk output is trending higher and January supplies are building. Additional cow numbers, more feeding, and a slight push for cash flow are noted reasons.
- Fluid Milk Pacific Northwest: Milk production in the region is increasing along seasonally expected volumes. Moderate winter temperatures are helping to increase production in the region. UT and ID milk production continues to improve. Lower milk prices are encouraging dairies to increase herd size.
- Butter: Production continues to be strong as cream supplies are readily available at profitable margins for churning. Export orders are improving, but domestic sales are mostly steady, keeping butter stocks on the rise.
- Dry Whey Northeast: Prices are steady but the market has a weak undertone. Heavy milk volumes going into cheese are keeping whey production steady and inventories are building at current production levels. Efforts to control inventories led some manufacturers to offer spot sales at discounted prices.
- Dry Whey Central: Buyers are indicating offerings are increasing. Many end users are sitting on the sidelines with adequate supplies on hand and in anticipation of lower pricing ahead. Domestic interest is light to moderate, while export demand is limited as U.S. prices are uncompetitive against international markets.
- NDM East: Current production schedules are very active in the Northeast but lessening in the Mid-Atlantic region where good Class I demand has pulled milk away from dryers. Spot sales of low heat NDM by some manufacturers to clear inventories created sales volume at the lower end of the price range. Buying demand has been generally good, but increased inventories built up over holiday weeks have been a significant factor pushing prices lower.
- NDM Central: The undertone is softening with supplies readily available at discounted rates. Production is mostly steady with some manufacturers producing at capacity. Domestic demand is light as buyers have many options available.
- NDM West: Prices are sharply lower. Spot pricing is being traded at lower prices and additional offerings are being made at lower prices to stimulate buying interest. The market tone continues to trend weaker. Demand is uneven. Production is active as milk supplies build in the region. Stocks are indicated to be building.

- Cheese Midwest: Cheese manufacturing is hunkered down, moving milk through the plants. Some plants have lower sales than recent weeks, which resulted in inventory levels increasing. Other plants are balancing extra milk into cheese manufacturing.
- Cheese West: Cheese production is mostly steady to higher as milk supplies in the West slowly increase. Cheese stocks are building. Export demand is low but starting to pick up.
- During November, 4.2 billion pounds of packaged fluid milk products is estimated to have been sold in the United States. This was 6.0% lower than November 2013. Estimated sales of total conventional fluid milk products decreased 6.5%.
- More than half of the nation's dairy producers signed up for the new Margin Protection Program. With milk prices headed on a steep descent, payouts will likely keep weaker operations afloat (and producing milk), with little incentive to cut production, all at the taxpayer's expense.
- International: A year ago, China was tight on milk, with some estimates saying they were down a massive 20% from the prior year. This year, a drop in consumer demand in China and cheap milk imports from other countries has put them in an oversupply situation. Several news outlets this week reported instances of Chinese dairies dumping milk on the ground because of the milk glut.

Recommendation:

After a brief move higher, spot cheese prices came under pressure again this week. With the exception of Jan futures, which are basically priced, Class III finished solidly in the red. Worst hit were Feb-Apr, down an average 52¢. Internationally, lower dairy prices are already starting to hit producers hard. Operations in China are dumping milk and culling cows. Dairies in Ireland may see a 50% pay cut while UK farmers are up-in-arms over low prices. EU dairies aren't faring much better. As a result, we may see production cuts in these areas sooner than in the U.S. Finally, dry weather in New Zealand could see their current milk season end sooner as farmers dry off cows early. But it will be too little too late for Q1 and Q2. U.S. dairies have yet to feel much financial pain and continue to increase the herd size. In addition, more than 50% of the nation's producers signed up for the Margin Protection Program. While we don't blame them for taking advantage of available programs, government meddling in markets causes unintended consequences. With this many operations covered, normal supply and demand signals become distorted. It's obvious we've entered into a combination of weaker demand and stronger supply. A completely free market would see prices drop dramatically (which they have), which would normally constrict supply and possibly stimulate demand. But many producers in the MPP program will have no such incentive to reduce their supply with the government payouts (using taxpayer money) artificially supporting their milk price. Eventually supply and demand will once again find a balance, but it will take longer than it would have in a completely open market free of subsidies. End of rant. Producers who have hedged at higher prices should be looking to cover those sales with call options. Many of you sold in the $16-17 range. Consider buying the following: Mar 16.00 at 7¢. Apr 16.00 at 8¢, May 17.00 at 9¢, Jun 17.50 at 14¢, July 18.00 at 20¢ and Aug-Oct 18.50 at 24¢ avg. Getting these call options purchased protects your sold milk from upside risk, should prices rally later this year. Price may head even lower if futures plunge to new lows, but these prices are already fairly inexpensive insurance to complete your hedge. Start getting something done. We may see a small relief rally in the near term as buyers appear to want to own cheese in the low $1.40's. In addition, solid Class I demand has limited the amount of manufacturing milk in some parts of the country. Super Bowl (biggest pizza delivery day of the year) and March Madness will produce some short term demand, while cheese inventories are not yet burdensome. Have a plan! Get something done!

Note: Our offices will be closed on Monday in observance of MLK day. Markets will be closed as well.