

The KDM Dairy Report – February 20th, 2015

What's Bullish:

- This week's GDT auction saw the dairy price index rise 10.1%, the fifth consecutive increase. Cheddar cheese had the largest gain, up 16.8% to a U.S.-equivalent \$1.39/lb. WMP was next with a 13.7% jump.
- Cheese stocks at USDA-selected storage centers are down 2.7 million lbs (3%) over the period 02/01 through 02/16. However, butter stocks increased 9% over the same period.
- Livestock Slaughter Report: 275,400 dairy cows were removed from the herd in Jan, up 5,200 head (1.9%) vs. Jan '14. It was the second month in a row that slaughter

Futures Month	Class III 02/20	Class III 02/13	Change	Dry Whey 02/20	Dry Whey 02/13	Change	Cheese 02/20	Cheese 02/13	Change
Feb-15	\$15.54	\$15.73	(\$0.19)	53.000c	54.650c	(1.65c)	\$1.546	\$1.554	(\$0.008)
Mar-15	\$15.53	\$15.52	\$0.01	48.500c	49.000c	(0.50c)	\$1.567	\$1.565	\$0.002
Apr-15	\$15.32	\$15.20	\$0.12	45.500c	45.400c	0.10c	\$1.565	\$1.555	\$0.010
May-15	\$15.66	\$15.44	\$0.22	43.400c	44.225c	(0.83c)	\$1.607	\$1.592	\$0.015
Jun-15	\$16.28	\$15.97	\$0.31	42.500c	41.500c	1.00c	\$1.673	\$1.659	\$0.014
Jul-15	\$16.74	\$16.67	\$0.07	42.625c	42.250c	0.38c	\$1.727	\$1.725	\$0.002
Aug-15	\$17.15	\$17.16	(\$0.01)	42.525c	42.750c	(0.23c)	\$1.772	\$1.775	(\$0.003)
Sep-15	\$17.22	\$17.22	\$0.00	41.725c	42.125c	(0.40c)	\$1.785	\$1.775	\$0.010
Oct-15	\$17.34	\$17.31	\$0.03	42.000c	41.500c	0.50c	\$1.801	\$1.793	\$0.008
Nov-15	\$17.25	\$17.16	\$0.09	41.000c	41.250c	(0.25c)	\$1.785	\$1.775	\$0.010
Dec-15	\$16.98	\$16.82	\$0.16	41.500c	41.500c	0.00c	\$1.748	\$1.745	\$0.003
Jan-16	\$16.55	\$16.61	(\$0.06)	42.000c	41.700c	0.30c	\$1.730	\$1.730	\$0.000
12 Mo Avg	\$16.46	\$16.40	\$0.06	43.856c	43.988c	(0.13c)	\$1.692	\$1.687	\$0.005

- numbers have exceeded prior year levels, after 14 consecutive months of lower levels.
- For the third week in a row, weekly dairy cow slaughter numbers have exceeded last year. 62,800 head were culled during the week ending 02/07, up 2,900 head (4.8%) vs. the same period a year ago.
- CWT has accepted 7 requests for export assistance to sell 2.943 million pounds of 82% butter to customers in Asia, Europe and the Middle East. The product will be delivered in March through August 2015.
- Fluid Milk Southeast: Winter storm Octavia, which consists of both snow and ice, has crippled multiple milk distribution routes in the Southeast. Handlers are reporting a number of cases where roads are impossible to travel, therefore delays are occurring. Milk shipments to manufacturing are light, as bottlers request additional loads. Class I sales are up, with advancing consumer purchases. Milk from Florida's farms has increased slightly. Export shipments for the week totaled 24 loads, down from 60 last week. Class I sales have increased, with added loads clearing to bottling.
- NDM Northeast: Prices are trending higher throughout all pricing series. Low/medium nonfat dry milk production schedules are very active at most plants. Despite relatively weak end-user demand, the market, while unsettled, is firming.
- NDM Central: Prices are up and the market tone is strengthening. Supplies are strong and stocks are building, but some end users did not buy when the market was lower, with the result being demand is increasing.
- Cheese Midwest: Many commercial cheese buyers continue to have an active interest in building inventory levels for aging programs at current cheese prices. Cheese manufacturing is at very heavy levels in most plants, but sales are strong for large volume commercial buyers for retail sale and aging programs, cheddar in particular.
- Cheese West: Production schedules are running full, manufacturers of cheese have all of the milk they want, and exports are not a significant factor in sales. However, cheese sales are good for both name brands and store brands. In addition, at current prices, there is noticeable interest among buyers in building inventory levels for retail sale as well as for cheddar and provolone aging programs. A number of manufacturers do not expect any significant divergence from current price levels in coming weeks.
- International: Seasonal increases in milk production are weaker in some of the major milk producing regions of Western Europe. The likelihood of levee payments for exceeding quota levels is the cause for the weaker trend. This change in milk production has resulted in the expectation of tighter supplies for butter, SMP, and WMP. Price increases for most dairy commodities in Oceania lend support to the firm market undertones in most European dairy markets. Eastern European milk production is increasing, but at a slower rate in some countries. Current production increases are weakening in Poland, Estonia and Latvia as producers in those countries near quota levels and the possibility of levee payments. Lower milk prices paid to producers have also contributed to the weaker production trend in those countries.
- International: Australian milk production is near the seasonal low point. Some estimates of current milk production volumes have Australia just above year ago levels. A small but increasing number of Australian dairy companies are seizing the opportunity to export fresh pasteurized milk to China. The expectation of reduced dairy commodity supplies out of New Zealand is the predominate force supporting higher prices in the dairy markets this reporting period. The New Zealand government has officially declared the South Island as being in a state of drought. Conditions on the North Island are not as dry, but milk production continues to decline. Dairy commodity supplies are adequate to cover current commitments, but manufacturers are keeping a close eye on production levels and stocks to prevent being over committed.
- International: In Oceania, demand for butter has increased as buyers are anxious to purchase ahead of possible future price increases. Available export supplies are primarily out of New Zealand. Australian supplies are tight with some manufacturers having committed stocks through Q2 and a few marginally oversold. Fairly tight cheddar cheese supplies in Australia are limiting volumes available for export with domestic prices above export levels. Prices averaged a U.S.-equivalent \$1.68/lb this week.
- International: Cheese exports from the U.S. to European destinations have seen increased activity in recent weeks. European contacts report supplies of hard cheese varieties are tight and aging programs are being rebuilt.

What's Bearish:

- Spot Market: Blocks finished the week up 1½¢ to \$1.54½/lb on just 3 trades, while barrels were unchanged at \$1.48½/lb on only 4 trades. Sellers pushed NDM 4¢ lower to \$1.11/lb, dumping 24 loads in the process. Butter managed a ¼¢ gain to settle at \$1.72¼/lb with 12 loads exchanging hands.
- Milk Production Report: Milk output in January was 2.1% higher than a year ago, while cow numbers increased 9,000 head month-to-month. The 9.308 million cows in the milking herd is the most since Jan, 2009.

- Cold Storage Report: Butter stocks at the end of Jan were up 3% vs. last year and 41% higher than Dec. American cheese stocks were flat vs. last Jan and up 1% from Dec, while total cheese stocks increased 3% and 2% respectively.
- Fluid Milk Northeast: Winter storms continue to wallop parts of region, but contacts are reporting that no major disruptions are occurring at manufacturing plants outside of areas heavily hit by the storm. Manufacturing milk supplies are readily available at most operations. Class I demand is good. Milk production in the Mid-Atlantic is steady. Manufacturers note that milk supplies remain heavy.
- Fluid Milk Central: Milk production is remaining steady at above year ago levels. With the drop in milk price, some farmers have supplemented cash flow by buying more cows, adding to production levels. Milk loads are selling for Class and heading to cheese plants. Cream demand is up. There are ample supplies and favorable pricing. Class I demand is lower as bottling demand has weakened.
- Fluid Milk Southwest: In CA, milk intakes continue to increase steadily. A warming trend in daytime temperatures is adding to cow comfort. Fluid milk sales are unchanged. Milk production in AZ continues to trend higher from week to week, and is also higher compared to one year ago. Processors indicate plants are running close to full as some cheese operations take needed downtime for maintenance. NM milk production is sustaining seasonal growth, although the rate of increase is tapering off.
- Fluid Milk Pacific Northwest: The milk supply in WA and OR is described as decent and sufficient for production needs, but is not trending as high as had been expected. Very nice weather could boost production soon. Milk production in UT and ID continues to be strong and increasing, helped by nice early Spring weather. Producers have ample feed available at decent prices.
- Butter: Market participants take a wait-and-see approach, hoping for lower pricing. Inventories are building for print butter. Bulk butter buyers report having sufficient supplies on hand. Retail demand has started to pick up as the spring holidays near. Due to higher milk volumes, churns have been running at or near capacity.
- Dry Whey Northeast: Prices are steady to lower as the market continues to soften. Heavy milk supplies are clearing to cheese vats and providing the wherewithal to maintain high dry whey output levels in the region. Stocks are moderate.
- Dry Whey Central: Buyers and sellers believe that pricing will go lower. Manufacturers are filling supply contracts, but spot demand is lower this week. End users are getting offers but most are either only purchasing for current needs or are using inventories on hand. Some manufacturers are reporting that the port slowdowns in the West are affecting international demand.
- Dry Whey West: The undertone for Western whey markets is weak and uncertain. Spot sales and resale transactions are occurring at prices lower than some contract pricing. Many whey manufacturers had previously targeted export markets for substantial volumes of output, but the impact of slowdowns at Western ports has intensified even for manufacturers who had been able to maintain some export volumes. There is a backlog of ships waiting to unload or load. This is leading to cancellation of pending export contracts by some foreign customers, leaving increasing volumes of whey characterized as being "landlocked", with an uncertain future. Some whey manufacturers have learned that some of their traditional foreign customers are now looking to sources outside the U.S. for whey. That casts additional uncertainty onto the whey awaiting export. Containers for moving or holding whey are in short supply as is warehouse space. With cheese production in the region continuing at a high rate, there is increasing uncertainty as to whey markets looking forward, especially if the export terminals remain closed. The situation with Western ports has escalated from a matter of interest to a matter of genuine concern.
- Cheese Northeast: Cheese operations are maintaining active production schedules. In general, stocks are on the rise, as seasonal milk increases and limited export interest spawns inventory growth. Cheddar is clearing into aging programs at a moderate rate, but demand is light.

Recommendation:

Milk and cheese supplies will most likely overrun demand this spring, but don't look for a price collapse yet in the next 3-4 weeks. Steady spot prices have encouraged buyers to continue to load up on cheese to rebuild aging programs. This strong domestic demand has kept inventory at comfortable levels in most regions of the country. In addition, cheddar is tight in Australia and export interest from the EU for hard cheese is on the rise. Dairy markets appear to be firming globally, as indicated in this week's GDT auction. While these are all positive signs, we still believe prices will see a correction lower. Cow numbers are at 6-year highs and feed is inexpensive for many. Milk output in the Midwest, where we make the most cheese, is keeping those plants running hard. The rebuilding of aging programs is holding inventories from growing for now, but when that demand is satisfied, there will be surplus product available. The puts Apr-Jun as the most vulnerable months in our opinion. Per our recommendation the past two weeks, we would continue to look at selling these months on rallies. All our sell targets from last week would have filled this week (Mar \$15.85, April and May \$15.65, June at \$16.20). These contracts all appear to be forming double or triple tops before failing to lower levels. We could continue to target sell orders near those established resistance levels.

