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The KDM Dairy Report – July 31st, 2015

What's Bullish:

Futures Month	Class III 07/31	Class III 07/24	Change	Dry Whey 07/31	Dry Whey 07/24	Change	Cheese 07/31	Cheese 07/24	Change
Jul-15	$16.28	$16.31	($0.03)	38.975¢	39.475¢	(0.50¢)	$1.697	$1.699	($0.002)
Aug-15	$16.41	$16.28	$0.13	35.675¢	37.175¢	(1.50¢)	$1.727	$1.705	$0.022
Sep-15	$16.56	$16.32	$0.24	34.500¢	35.000¢	(0.50¢)	$1.748	$1.721	$0.027
Oct-15	$16.36	$16.24	$0.12	32.950¢	33.000¢	(0.05¢)	$1.737	$1.725	$0.012
Nov-15	$16.07	$16.17	($0.10)	32.100¢	32.300¢	(0.20¢)	$1.712	$1.721	($0.009)
Dec-15	$15.90	$16.00	($0.10)	31.475¢	31.150¢	0.33¢	$1.704	$1.720	($0.016)
Jan-16	$15.58	$15.61	($0.03)	31.450¢	31.350¢	0.10¢	$1.676	$1.680	($0.004)
Feb-16	$15.46	$15.43	$0.03	31.575¢	31.550¢	0.02¢	$1.661	$1.658	$0.003
Mar-16	$15.39	$15.40	($0.01)	32.550¢	32.975¢	(0.43¢)	$1.654	$1.649	$0.005
Apr-16	$15.50	$15.47	$0.03	33.925¢	34.100¢	(0.18¢)	$1.667	$1.650	$0.017
May-16	$15.80	$15.79	$0.01	35.275¢	35.150¢	0.13¢	$1.684	$1.680	$0.004
Jun-16	$16.12	$16.17	($0.05)	36.250¢	36.100¢	0.15¢	$1.715	$1.710	$0.005
12 Mo Avg	**$15.95**	**$15.93**	$0.02	**33.892¢**	**34.110¢**	(0.22¢)	**$1.699**	**$1.693**	$0.005

- Spot Market: Blocks gained a nickel this week to settle at $1.74¾/lb and barrels managed a 3¾¢ gain to close at $1.69¾/lb. Trading was light with just 1 load of blocks and 7 loads of barrels changing hands all week. Grade A NDM gave up 1¼¢ to settle at $0.70/.lb on 7 trades, but butter pushed 3½¢ higher to close at $1.99/lb on 13 trades.
- Milk Production Report: June milk output increased just 0.7% in the U.S., well below most analyst expectations. In addition, cow numbers fell 7,000 head from May, the first monthly decline since Nov '13.
- Livestock Slaughter Report: Commercial dairy cow slaughter in June totaled 221,500 head, up a strong 11% vs. last year and the second highest June total in 5 years.
- Butter stocks at USDA selected storage centers declined 5% (949,000 lbs) over the period 07/01 through 07/27. Cheese stocks, however, increased 1%.
- Fluid Milk Southeast: Hot, humid weather has not abated in the Southeast region. Milk production is declining at an accelerated rate. Class I demand is steady to firm. Bottling demand has prompted 6 spot loads to be imported this week. Fluid demand will be increasing in the coming weeks as schools begin their fall terms. Milk loads going into manufacturing are very limited. Florida milk production continues to decline with daytime high temperatures in the 90's. This situation is likely to continue through August. Class I demand has begun to increase slightly as bottlers prepare for the opening of schools in the coming weeks. The lower milk production levels and higher fluid demand prompted 20 spot loads of milk to be imported this week. Cream markets have marginally weakened compared to last week, but overall demand remains good. Cream sales to ice cream manufacturers are good. Lower component levels in milk supplies are contributing to the generally tight supplies.
- Fluid Milk Central: Milk production is slowly decreasing, however manufacturers report having enough supplies for current needs. Bottling demand is starting to increase slightly as some educational institutions begin fall terms. Spot load availability is decreasing and most loads are selling at $1 under Class. Class II demand is still strong, with some manufacturers reporting demand for cream cheese increasing. Multiples are steady to higher, ranging from 1.47 to 1.60. Most manufacturers are reporting cream supply tightness.
- Fluid Milk West: Milk production in California is lower. Seasonal high temperatures above 105 degrees are reducing the comfort and yield of cows. The fat and protein components in the milk are slightly declining. Very few spot milk loads are traveling out of the state to be processed. June 2015 pool receipts of milk in California totaled 3.26 billion pounds, 5.2% lower compared to June last year. Milk output in Arizona is seasonally decreasing, though production is above the levels from the previous year. The warm weather and humidity are raising the stress of cows. Bottlers are requesting more milk volumes as school terms start during the next week. Therefore, the milk levels available for processing are decreasing. New Mexico milk intakes are trending lower. Fewer head of productive cows are contributing with the reduction of the milk output. Some industry contacts report a shrink in the milk herd due to the culling of low yield cows.
- Fluid Milk Pacific Northwest: Cyclical heat waves have suppressed milk production, but cooler temperatures and low humidity have allowed for a rebound. The net effect is milk production is showing a little more tightness. Manufacturers note components have dropped off. Western demand for cream from ice cream, butter, and cream cheese manufacturers continues to be strong. Cream inventories are mostly tight around the region.
- Butter: Churning rates have slowed due to the tightness of cream. When there are opportunities, some manufacturers are selling available cream for better profit margins. Demand remains strong, with some manufacturers noting an increase in sales.
- Cheese Midwest: While most cheese plants are receiving the milk volumes they want, contracted milk volumes and components are declining in most locations. Surplus milk supplies are getting tighter and less price favorable. Many Midwest cheese producers planning ahead for acquiring surplus milk are paying prices around $1.00 below Class for deliveries through July. Extra spot milk contracted beginning August 1 is tending toward 50 cents above Class and that premium price is expected to increase in the near term. Many manufacturers have taken note and the view forward is already shifting from dealing with copious milk volumes, to dealing with much tighter milk supplies. Some manufacturers are now hesitating to agree to sell additional cheese to regular contract customers through the later part of 2015 because the manufacturers are not certain they can obtain enough milk to deliver the cheese volumes in a few months. These manufacturers expect to be impacted by declines in milk production as well as the expected August increased demand for school food programs, which will leave them with insufficient milk supplies to increase contracted deliveries. Occasional cheese buyers must work harder to find available cheese from manufacturers, due to an increasing focus on satisfying regular customers as milk supplies tighten.
- Cheese West: Domestic demand for cheese has translated into decent sales volumes, especially the consumer desire for branded cheeses. Buoyed by domestic demand, cheese prices have moved higher, leading a number of contacts to ask if current prices can hold. Manufacturers suggest they are comfortable with present inventories.
- CWT has accepted 9 requests for export assistance to sell 456,357 pounds of Cheddar and Monterey Jack cheese, and 2.756 million pounds of whole milk powder to customers in Asia, Central and South America. The product has been contracted for delivery in the period from July through December 2015.
- International: Fonterra is cutting by up to 6% the volume of product offered through GlobalDairyTrade auction system in the next 12 months in response to the poor state of global dairy markets. The offering of whole milk powder will have the biggest cut with 25,450 fewer tons (-9.3%)

being put up for auction from August to October and a further reduction of 20,750 tons offered from November to January. In a statement, Fonterra said the cheese offering would be reduced by 2,100 tons from August through to July. As well as weak market conditions, Fonterra is forecasting lower milk production as farmers respond to low prices and customers alter their purchasing patterns.

What's Bearish:

- Spot
- Cold Storage Report: American cheese stocks at the end of June were 5% higher than a year ago, while total cheese stocks were up an even higher 8%. Butter stocks took the biggest leap, jumping 28% vs. June '14.
- Cattle Report: USDA's twice/year report indicates we have plenty of replacement animals available. Milk replacement heifers as of July 1st totaled 4.20 million head, up 2% vs. a year ago. The entire milking herd totaled 9.30 million head, up 1% from 2014.
- Fluid Milk Northeast: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions continue to be heavy for this time of year, due to the strong milk volumes coming off farms. Some manufacturers are commenting that milk production volumes have not declined appreciably since the peak.
- Dry whey: Prices moved lower this week. Production is steady and adding to inventories. Demand is weak with most buyers purchasing hand to mouth, unwilling to expand inventories on a downward trending market. Some manufacturers are experiencing significant price competition from whey produced in other regions or in international markets.
- NDM Northeast: Production of low/medium heat nonfat dry milk remains very active in the Eastern region as manufacturing milk supplies continue to be heavy for this time of year. Some manufacturers are unwilling to sell loads at the lower price range levels, believing prices will increase in the coming weeks as manufacturing milk supplies decline with the onset of school openings.
- NDM Central: Low/medium heat nonfat dry milk prices moved lower this week. As inventories build, some manufacturers prefer to sell condensed. Production remains active, as most manufacturers are choosing to make NDM in lieu of other dry products. Spot demand is light.
- NDM West: Prices for low/medium heat nonfat dry milk are lower in the range and the mostly price series. The spot market undertone remains weak. At this time, some manufacturers are reducing production. Therefore, the milk loads into NDM are trending lower. Many end users are buying what they really need and are waiting for lower prices. Sales based on contracts are steady but, in the spot market are lighter. However, there is a higher export activity. Inventories vary, but mostly are building.
- Cheese Northeast: Cheese production continues to be very active in the Northeast for this time of year, due to the strong milk production volumes being experienced. Most cheese plants are operating on 6-7 day production schedules. Hot, humid weather in the region has caused milk components to decline, resulting in lower yields. Demand for cheese is about steady with levels experienced in recent weeks.

Recommendation:

Time for a rally? Maybe. While many fundamentals still paint a bearish picture (China's economy, general "out of favor" attitude toward commodities, weak powder market), we could be finally carving out a bottom. Maybe we'll even climb past the narrow, $1.26 range Class III has settled in since the first of the year. On the international side, poor milk prices have begun to hurt Oceania operations. Fonterra just announced a reduction in product that would be offered in their twice monthly GDT auctions. Here in the U.S., typical summer heat has finally started reducing the milk supply, with Florida and the Southeast becoming milk-deficit regions for the first time this year. Cream is tight. Spot butter briefly traded above $2/lb on Friday before settling at $1.99/lb. We expect it to push north of $2 next week. While spot prices put Class III at a $4/cwt premium over Class IV, sustained strength in the butter market over the coming months should begin to support NDM. Indeed, in this week's Dairy Market News updates, some NDM manufacturers are hanging on to product rather than sell at current low prices, with the idea that prices will begin to rise soon. On the cheese side, yields are falling, and while there is some question on the demand side, manufacturers are a whole lot less confident about being able to supply adequate cheese volumes to meet demand in just a couple months. Schools are opening soon and football season is upon us. The spike in fluid consumption and mozzarella cheese (which has a short shelf life) will pull milk out of over manufacturing channels. We're not saying $20 milk is on the horizon, just that we see the upside risk as greater than significant downside risk over the balance of the 2015 contracts. If you have milk sold through you plant or in your hedge account, this is a GOLDEN opportunity to purchase upside protection using call options. Or for the more aggressive, consider even lifting your hedges early and taking the profit. Call us for quotes/ideas/strategies that we can help you implement for your operation.