

The KDM Dairy Report – Oct 9th, 2009

What's Bullish:

- Cash Market: Cheddar blocks and nonfat dry milk both made big moves to the upside this week. Barrels and butter just watched. Blocks jumped 6¾¢ to close at \$1.50¼/lb with just 2 trades for the week. Barrels gained just a penny from last Friday to settle at \$1.43/lb today. Just two trades for barrels as well. Butter nipped up ¼¢ to \$1.23¾/lb on 8 trades, but Grade A nonfat dry milk jumped 10¢ on just bids to reach \$1.28/lb.
- World Ag Supply & Demand Report: USDA predicts stronger world dairy prices and a weak U.S. dollar will increase export demand in 2010. As a result, they increased their Class III price forecast from last month's report, expecting an average of \$14.30/cwt.
- NASS surveyed Class III components were mostly higher this week. 40-lb blocks were down just 0.3¢ to average \$1.31/lb, but 500-lb barrels were up 3.8¢ to \$1.34/lb. Butter lost 0.1¢ to average \$1.21/lb and dry whey gave up
- Class I demand has reduced milk supplies in much of the Eastern region of the country, with the Mid Atlantic seeing the tightest supply all year, according to Fluid Milk & Cream Review. Manufacturers are able to cover little more than contract minimums. Milk production is declining in the Southeast while Class I demand has increased. Late season heat hit Florida, with high's in the 90's, which has lowered milk production. Some winter residents are returning, increasing Class I needs. Class II and III demand is good as manufacturers get ready for increased production to cover seasonal orders.
- Fluid Milk & Cream Review reports milk supplies in the Central region have tightened appreciably in recent weeks, with the real squeeze likely in a few weeks when bottlers and others gear up to produce holiday specialties. Handlers are concerned that perhaps too many cows and producers could leave the business from CWT removals or foreclosures.
- Milk production in California continues to run 4-7% below year ago levels, according to Fluid Milk & Cream Review. Processing plants are still running on reduced schedules with some plants being taken offline to perform seasonal maintenance. Arizona milk output continues to trend 7-8% lower than year ago levels, the effects of fewer cows being milked from herd selloffs and buyouts. Poorer feed rations are also resulting in reduced milk and milk solids. Processors in Utah and Idaho are actively looking for additional supplies as milk intakes remain below year ago levels. Production schedules continue to be adjusted for available supplies.
- Central dry whey prices were higher again this week, according to Dairy Market News. Despite many plants operating 24x7, buying interest is strong for both immediate and future needs.
- Dairy Market News reports demand is good for available Western dry whey supplies. Contract needs are being met, but any additional product being offered is at a premium.
- Spot offerings of Western nonfat dry milk are tight, according to Dairy Market News. The market tone is strong, with prices sharply higher. Most current production is moving towards contracts and demand is good for current offerings. Some buyers are not finding the product they need and they have to secure supplies in resale channels at higher prices. Drying schedules are below expectations as milk intakes and solids are on the light side.
- Dairy Market News reports the Central nonfat dry milk market is firm with prices higher. Drying schedules are lighter due to tighter milk supplies and solid demand for other dairy products. Many producers are just trying to meet commitments, and resellers are able to command premiums above the range.
- Demand for dry whole milk is exceeding the domestic supply, according to Dairy Market News. This is leading to a very firm market, with imported dry whole milk powder filling the gap.
- International: Milk production in Australia for the first two months of the new milking season is off 1.6% compared to a year ago, according to Dairy Australia statistics. In addition, cheese output is down 3.3%, butter output is down 10.4% and whey powder is down 13% over the same period. Within cheese output, cheddar production fell 22.9%, a drop of 5,503 metric tons, which is 12.1 million lbs.

Futures Month	Class III 10/09 Close	Class III 10/02 Close	Change	Dry Whey 10/09 Close	Dry Whey 10/02 Close	Change
Oct-09	\$12.75	\$12.80	(\$0.05)	32.00¢	35.00¢	(3.00¢)
Nov-09	\$14.50	\$13.96	\$0.54	35.50¢	36.00¢	(0.50¢)
Dec-09	\$14.70	\$14.44	\$0.26	37.50¢	36.03¢	1.48¢
Jan-10	\$14.75	\$14.44	\$0.31	37.75¢	37.00¢	0.75¢
Feb-10	\$14.62	\$14.46	\$0.16	37.50¢	36.00¢	1.50¢
Mar-10	\$14.87	\$14.60	\$0.27	36.50¢	36.00¢	0.50¢
Apr-10	\$14.77	\$14.52	\$0.25	37.50¢	36.00¢	1.50¢
May-10	\$14.81	\$14.68	\$0.13	37.50¢	35.50¢	2.00¢
Jun-10	\$14.90	\$14.74	\$0.16	36.00¢	35.50¢	0.50¢
Jul-10	\$15.05	\$14.94	\$0.11	35.00¢	37.00¢	(2.00¢)
Aug-10	\$15.30	\$15.26	\$0.04	36.00¢	36.00¢	0.00¢
Sep-10	\$15.43	\$15.44	(\$0.01)	35.50¢	36.00¢	(0.50¢)
Oct-10	\$15.48	\$15.50	(\$0.02)	34.75¢	32.50¢	2.25¢
Nov-10	\$15.52	\$15.60	(\$0.08)	33.00¢	32.00¢	1.00¢
Dec-10	\$15.66	\$15.63	\$0.03	32.75¢	31.00¢	1.75¢
Q4	\$13.98	\$13.73	\$0.25	35.00¢	35.68¢	(0.68¢)
2010	\$15.10	\$14.98	\$0.11	35.81¢	35.04¢	0.77¢

What's Bearish:

- Nothing to write home about, dairy cow slaughter for the week ending 09/26 was 49,900 head, about even with a year ago when 49,800 head were culled.
- Just 2.2 million lbs of butter were pulled from CME-approved warehouses during the week ending 10/03. Last year at this time 4.6 million lbs were removed.
- Fluid Milk & Cream Review reports plant receipts in the Pacific Northwest remain at steady levels with fall weather increasing cow comfort. Higher milk prices and favorable feed costs have buoyed the spirits of producers and their bankers.
- Churning activity in the Central region is seasonally active, according to Dairy Market News. While cream supplies are starting to be absorbed into Class II holiday products, food service orders are fair at best. Slower sales continue to be reported, reflecting the general trend of consumers eating out less.
- Dairy Market News reports that even though milk supplies have tightened this week, some Northeast cheese makers have or will be increasing production schedules to build inventory for the upcoming holiday season.
- The Midwest cheese market is firm, according to Dairy Market News, but some traders feel that the current supply/demand situation may not be tight enough yet to maintain current or higher prices. A big concern for many is the sizeable volume of cheese in storage with much still in need of a buyer. Reports indicate aged cheddar movement remains light, and some natural American producers are trying to limit current production to keep from accumulating additional supplies.

Recommendation:

Front-month milk futures made yet another run higher this week, powered by gains in cheese and a powder market that is on fire. We've gone up so quickly that producers may be tempted to believe happier days are surely on the horizon. That may eventually happen, but we would warn against complacency. Complacency burned most of the industry this year when \$20 milk was available for all of 2009 but was ignored by most. The market has made a substantial move higher, so protective action should be taken on at least some of your production. Several weeks ago we recommended buying call options for first quarter 2010. This strategy has worked out well for producers who did it. For example, on 9/17 we bought Jan 15.00 calls for 30¢, and then placed orders to sell Jan milk at 14.75. The sell orders filled this week, completing the hedge. Those 15.00 calls are now worth 59¢, protecting the sale of our milk at 14.75. Should prices continue to rise, the loss on our futures position at 14.75 will be offset by additional gains by the calls we purchased back in Sept. We also bought Feb 15.75 calls and Mar 16.00 calls for 30¢ back in Sept. and have orders to sell in those months that have not been hit yet, but are getting closer; just a real life example to demonstrate how the strategy works. Our bias is still for continued price recovery, so we don't recommend selling outright yet, but we would consider the following:

If you have 2009 milk that is not hedged, buy Nov 14.00 PUT options for 20¢ and Dec 14.00 PUT options for 25¢.
 For Jan-Mar buy 13.50 PUT options and sell 16.50 CALL options for a net cost of 5¢/mo. That's a cap at \$1.70+ cheese.
 For Apr-Dec buy 14.00 PUT options and sell 18.00 CALL options for a net cost of 30¢/mo. That a cap at \$1.90+ cheese.

Do this on up to 50% of your production.

Have a great weekend!

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