

The KDM Dairy Report – January 22nd, 2016

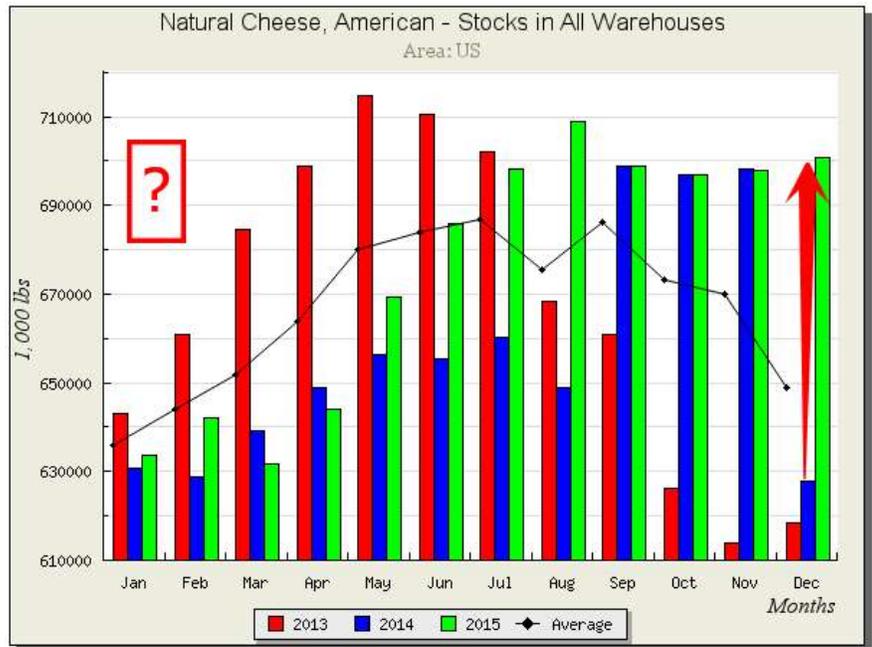
What's Bullish:

- CWT has accepted 9 requests for export assistance to sell 766,547 pounds of Cheddar, Gouda and Monterey Jack cheese, 1.543 million pounds of butter, and 110,231 pounds of whole milk powder to customers in Asia and the Middle East. The product has been contracted for delivery in the period from January through July 2016.
- Fluid Milk Northeast: The snow storm expected to move up the coast and add to the region's current wintry conditions will likely force a solid run on milk at retail outlets. The region, in general, is seeing robust demand from bottling facilities, as retail sales are strong. Northeast and Mid-Atlantic milk production is steady to increasing. Production has eased significantly at some balancing plants as milk supplies detour to Class I production. Manufacturers expect further disruptions, due to milk delays, as wintry conditions progress.
- Dry Whey Northeast: Prices for dry whey are steady to higher. Some contacts report a slight firmness in the market. Inventories are generally in close balance.
- Dry Whey West: Prices were unchanged for the week. Some contacts report production is up a little from the previous year, but processors say their inventories are slightly tight.
- International: November milk production in Australia was down 3.4% vs. a year ago. This is a dramatic turn from the start of their milking season in July, when a gain of 5.5% was notched.

| Futures Month | Class III 01/22 | Class III 01/15 | Change | Dry Whey 01/22 | Dry Whey 01/15 | Change | Cheese 01/22 | Cheese 01/15 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Jan-16 | \$13.72 | \$13.78 | (\$0.06) | 23.650¢ | 23.975¢ | (0.33¢) | \$1.517 | \$1.520 | (\$0.003) |
| Feb-16 | \$13.78 | \$14.18 | (\$0.40) | 23.475¢ | 22.950¢ | 0.53¢ | \$1.517 | \$1.554 | (\$0.037) |
| Mar-16 | \$13.75 | \$14.16 | (\$0.41) | 23.325¢ | 23.025¢ | 0.30¢ | \$1.512 | \$1.549 | (\$0.037) |
| Apr-16 | \$13.93 | \$14.23 | (\$0.30) | 23.925¢ | 23.250¢ | 0.68¢ | \$1.528 | \$1.556 | (\$0.028) |
| May-16 | \$14.27 | \$14.69 | (\$0.42) | 23.575¢ | 23.400¢ | 0.18¢ | \$1.561 | \$1.607 | (\$0.046) |
| Jun-16 | \$14.65 | \$15.07 | (\$0.42) | 24.275¢ | 24.025¢ | 0.25¢ | \$1.597 | \$1.637 | (\$0.040) |
| Jul-16 | \$15.07 | \$15.40 | (\$0.33) | 24.250¢ | 24.625¢ | (0.38¢) | \$1.640 | \$1.666 | (\$0.026) |
| Aug-16 | \$15.55 | \$15.75 | (\$0.20) | 24.750¢ | 24.950¢ | (0.20¢) | \$1.686 | \$1.706 | (\$0.020) |
| Sep-16 | \$15.85 | \$16.00 | (\$0.15) | 25.050¢ | 26.025¢ | (0.97¢) | \$1.714 | \$1.730 | (\$0.016) |
| Oct-16 | \$15.95 | \$16.14 | (\$0.19) | 26.475¢ | 26.025¢ | 0.45¢ | \$1.728 | \$1.729 | (\$0.001) |
| Nov-16 | \$15.92 | \$16.05 | (\$0.13) | 26.500¢ | 27.250¢ | (0.75¢) | \$1.719 | \$1.724 | (\$0.005) |
| Dec-16 | \$15.90 | \$15.89 | \$0.01 | 27.000¢ | 28.000¢ | (1.00¢) | \$1.715 | \$1.719 | (\$0.004) |
| 12 Mo Avg | \$14.86 | \$15.11 | (\$0.25) | 24.688¢ | 24.792¢ | (0.10¢) | \$1.620 | \$1.641 | (\$0.022) |

What's Bearish:

- Spot Market: Blocks lost 3½¢ for the week to settle at \$1.46/lb, while barrels notched a 9½¢ loss to close at \$1.43/lb. Just 3 loads of blocks and 8 loads of barrels exchanged hands. NDM declined 4¢ to settle at \$0.71/lb on 23 trades, and butter finished the week 8¢ lower to \$2.17/lb on 8 trades.
- Milk Production Report: Despite a late December storm that caused the deaths of thousands of cows in TX and NM, milk output in the nation climbed 0.7% over Dec '14. Even more surprising, cow numbers increased 1,000 head from Nov, though we may see more of the cattle loss in the Jan report. Milk per cow increased 8 lbs vs. a year ago. We finished the year with a milking herd of 9.322 million cows, up 23,000 head from last year. On an annual basis, 2015 milk production increased 1.2% over 2014. Dec gains were led by SD up 13%, with MI and WI both up 4.8%.
- Cold Storage Report: American cheese stocks in warehouses at the end of December were 12% higher than in 2014, while total cheese stocks were up 13% over the same period. Butter stocks were up a stunning 46% vs. Dec '14 and up 15% from Nov.
- Livestock Slaughter Report: 254,800 cows were removed from the milking herd in Dec, but that was down 2,000 head vs. a year ago. For 2015, just 98,700 more dairy cows were culled than in 2014; about two-week's worth of our average weekly slaughter.
- Butter stocks at USDA-selected storage centers jumped 61% (4.7 million lbs) over just the first 18 days of the month!
- Fluid Milk Southeast: Milk production in the region is increasing, albeit supplies are circumventing manufacturing with strong pulls from Class I processors. Handlers expect aggressive growth in Florida's milk production over the next few weeks, as current daytime temperatures settle in the 50s. Milk exports totaled 25 loads market this week, up from no loads last week. Condensed skim supplies remain fairly heavy. Class II demand is showing some weakness as most manufacturers match production with contracted supplies. Heavy condensed skim volumes continue to clear to Class IV production. Cream is moderate to plentiful as current market conditions determine available levels. Along with increasing milk supplies, contributing to overall availability is heavy volumes of standardized cream from bottling.
- Fluid Milk Central: Milk production throughout the region is steady with last week. Sales into bottling accounts shifted lower as production of some specialty products comes to an end. Interest in manufacturing milk varies. Some cheese plant operators report they are only handling milk from their patrons. This is a result of demand for some cheese varieties trending lower. Prices for spot milk loads range from \$1.00 under Class to \$0.75 over, with additional spot loads being offered over the weekend.



- Fluid Milk Southwest: California farm level milk output is up. Most balancing plants are running at full capacity. Milk production is still rising in Arizona. The weather has been advantageous for milking cows. Class I sales are steady to lower. Condensed skim processing is steady and supplies are sufficient.
- Fluid Milk Pacific Northwest: Steady rains over the last week have led to muddy dairy paddocks and have suppressed milk production slightly. However, milk components are increasing. Milk intakes have rebounded as temperatures climbed from the previous cold streak several weeks ago. Industry contacts say parts of the region have received precipitation in excess of water needs for the coming growing season. Processors say there is plenty of milk for manufactured products.
- Butter: Output is active in the country. Heavy cream volumes continue to clear into butter churns in all regions. Production is mostly focused on bulk butter. Some print butter is being made to meet immediate needs, however, a major part of the current production is moving into cold storage.
- Dry Whey Central: Prices shifted lower this week. Several manufacturers are pushing through some sales to export, which necessitated lower prices to compensate for transportation. Production in the region is active. A few plant operators report their daily farm milk intakes are higher, prompting production of additional cheese vats and dry whey.
- Cheese Northeast: Inventories are building under fair domestic demand. Interest for mozzarella is fair to good for this time of year. Pizza promotions are noted, prompted by the NFL playoffs. Cheese yields remain solid, with fat and protein at typical seasonal levels.
- Cheese Midwest: Cheese makers indicate a slowdown in commercial cheese sales following the winter holidays. Although demand is lighter, domestic consumer requests for retail cheese packages, deli and food service, are still relatively strong. Milk supplies are readily available and cheese production is active. Some processors are selling extra loads of milk where they can, often at prices near Class. Other manufacturers are running full production schedules to use as much of the dairy solids as possible. Cheese inventories are building.
- Cheese West: Readily available milk is pushing western cheese production. Cheese making is active as processors work to use the available milk. Cheese supplies are exceeding demand and adding to already long inventories.
- At this week's GDT auction, the dairy price index fell 1.9%. Butter was down 5.9% to a U.S. equivalent \$1.43/lb, while cheddar cheese declined 3.4% to a U.S. equivalent \$1.30/lb.
- International: Northern European milk production is said to significantly exceed levels one year ago. November milk production was an estimated 4.9% above November one year ago, exceeding 4.2% in October, the previous high. During the period January-November, 2015, the top increases in milk production over the same period of the prior year for EU countries are: Spain, 13.69%; Ireland, 12.87%; Luxembourg, 8.05%; and Belgium, 6.38%. Overall higher levels of milk production than one year ago are expected to continue through the first months of 2016. Processors are facing the challenge of what to do with increased volumes of milk in a global situation of more milk from various sources seeking customers.
- International: Hay has benefitted from rain which has mitigated the dry conditions in Northern Australia. This has resulted in increased paddock feed. The demand for purchased feed has lessened as a result. Baling is difficult in coastal areas as a result of continuing storms. Less hay is being shipped as a consequence of the rain's impact on growth. Prices for cheddar cheese are lower in Oceania, down to a \$1.34/lb-U.S. This week's GDT event, combined with concerns over growing global milk supplies, were factors cited for the drop.

Recommendation:

First half Class III contracts were sharply lower this week as continued turmoil in the financial markets and a series of bearish USDA reports were released this week. USDA reported December milk production increased 0.7% and revised cow numbers higher for several of the preceding months. And cow numbers increased from Nov to Dec, in the face of falling milk prices. The Cold Storage report threw more bearish news on the pile, with both cheese and butter stocks sharply higher. During a season when cheese inventories typically build, imagine what next month's cold storage number might show for Jan (reference the boxed "?" in the graph), based on the Dec level. Ouch. Milk production is strong in the EU to begin the year; we will be competing with the EU to find a home for our exports. Price is king, so expect downward competition. We would continue to recommend producers sell any rallies Mar-Jun as we believe it will take that long before any substantial rally can happen. On the flipside, with international cheese prices hanging in the \$1.30's, support for U.S. cheese prices in the \$1.40's should remain for now. However, with the amount of product available on a global basis, both the international and U.S. prices could head lower going forward. Current spot prices work out to about \$13.20 Class III. With the current premium still being seen in the weekly NDPSR, parity with futures is probably closer to \$13.60 or so, which is about where Q1 Class III contracts finished the week. However, should spot cheese prices slide in the weeks ahead, Class III will follow.

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