

The KDM Dairy Report – February 5th, 2016

What's Bullish:

- Spot Market: Blocks managed to pick up a penny on the week to settle at \$1.47/lb on just 2 trades. Barrels gained 3½¢ on bids only, closing at \$1.46½/lb. Grade A NDM increased 3¼¢ to \$0.75/lb, but butter finished the week down 5¢ to \$2.17/lb on heavy trading of 23 loads.
- Lower prices may finally start signaling to U.S. producers to cut back on production. January's Class III settlement at \$13.72/cwt was the lowest in five years, since a \$13.48 settlement in Jan, 2011.
- Ag Price Report: The milk-feed ratio dropped for the first time since July 2015, according to USDA. The Dec ratio came in at 2.27, down from 2.42 in Nov and the lowest number since Sep.
- Fluid Milk Southeast: Farm-level milk production in the region is fat. Bottling remains fairly strong, as limited cutbacks in orders occur. Manufacturing milk receipts are light. Heavy rain is causing flooding along some interstates, however, no delays with milk distribution are being reported. In Florida, milk output continues to climb. Sources noted that Class I sales saw some down tick this week. Milk shipped out of state totaled 35 spot loads, 5 less than the previous week.
- Dry Whey Central: Offshore interest for dry whey is increasing. Some manufacturers noted Far East buyers are more actively seeking dry whey loads. Dry whey production in the region is active and inventories are steady to building. However, some manufacturers indicate they are comfortable with current inventories as the market seems to be firming.
- Cheese: Production and demand are in balance, according to some manufacturers. Some production is shifting away from cheddars to other fresh natural varieties, like jack cheeses, to support the solid retail cheese demand. Cheese needed for Super Bowl parties has shipped and are on the shelves or in the pizza stores. Now manufacturers hope the strong domestic demand will continue, or an export market for cheese will develop to aid in the drawdown of U.S. cheese inventories.
- International: Dec milk production in Australia fell 4.5% vs. Dec '14, a sign that recent drought conditions are taking a toll on output. YTD (July-Dec), milk output went negative for the first time (-0.2%) compared to the last milking season.

What's Bearish:

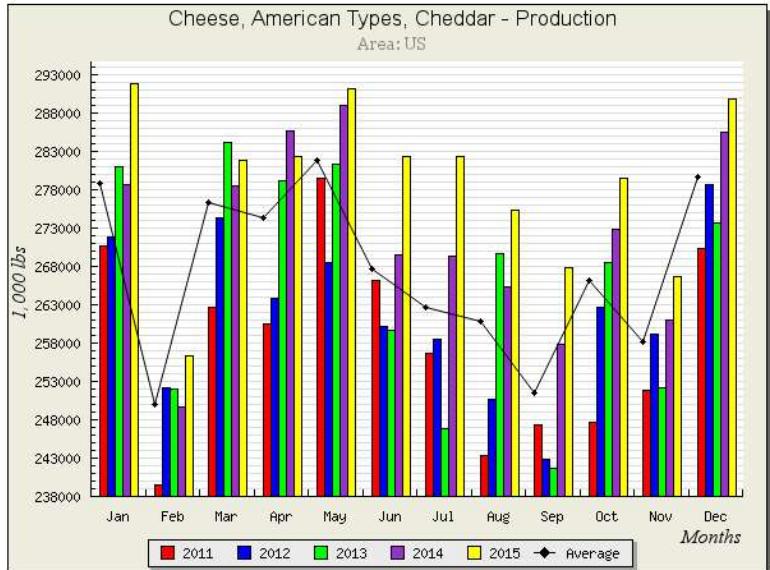
- Dairy Products Report: Cheddar cheese output in December was up 1.5% vs. a year ago and up 8.7% from Nov. Total cheese output increased 1.2% and 2.8%, respectively. Dec butter output jumped 4.3% YOY and shot up 17% vs. Nov.
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- Ag Prices Report: The milk-feed ratio dropped for the first time since July 2015, according to USDA. The Dec ratio came in at 2.27, down from 2.42 in Nov and the lowest number since Sep.
- Weekly dairy cow slaughter for the week ending 01/23 totaled 62,200 head, down 3,300 (5%) vs. the same period a year ago. YTD, the 2016 cull is down 1.3% vs. 2015.
- Fluid Milk Northeast: Milk production is steady to higher. School bottling needs vary following last week's snow storm. Manufacturing milk intakes are adequate to strong. Milk output in the Mid-Atlantic is holding steady with no significant changes being reported.
- Fluid Milk Central: South Central milk production is reportedly increasing steadily. Haulers reported the daily gains in pickup volumes from some dairy operations is surprising, due to the challenges those operations have recently faced. Milder temperatures are helping support cow comfort in that area. In the North Central region, milk production is also making incremental gains.
- Fluid Milk Southwest: Farm level milk intakes are ramping up in California. Bad weather conditions were present during the past weekend in the Central Valley. However, the milk yields were only marginally affected. In Arizona, the weather conditions are conducive to dairy cow comfort. As a result, milk production is increasing incrementally. Sales into Class I bottling plants are lower as some are closed due to repairs and maintenance projects. Milk output is flat in New Mexico. One month has been passed since the winter storm Goliath hit many dairy operations in the state. Consequently, milk volumes were very tight in some balancing plants. At this point, milk intakes moving into these processing plants are improving.
- Fluid Milk Pacific Northwest: Milk production is steady to higher in the region. Although there is still a lot of wet weather, milk intakes have increased slightly due to some warmer temperatures improving cow comfort. Schools continue to place a steady pull on milk for bottling. Utah and Idaho milk production is steady. Manufacturers say they have plenty of milk for processing.
- Butter: Butter production continues to be active throughout the country as cream availability is fairly strong. Many butter churn operations are running full. Butter processors are still interested in building inventories ahead of the summer. Industry contacts note the lack of export opportunities, heavy butter imports and large butter inventories should place a significant downward pressure on prices.
- Dry Whey Northeast: Prices for dry whey shifted slightly lower based on spot pricing and contractual adjustments. Production in the region is active, matching the region's cheese output. Interest is fair to good, but stocks are growing.
- NDM Northeast: Prices shifted lower in the mostly series this week. Active low/medium heat production continues at most NDM operations in the region. Some market participants expect sales to remain sluggish until spring, while sources note active Q2 and Q3 interest. The market undertone is weak.

Futures Month	Class III 02/05	Class III 01/29	Change	Dry Whey 02/05	Dry Whey 01/29	Change	Cheese 02/05	Cheese 01/29	Change
Feb-16	\$13.83	\$13.89	(\$0.06)	24.375¢	24.225¢	0.15¢	\$1.520	\$1.527	(\$0.007)
Mar-16	\$13.96	\$13.88	\$0.08	24.050¢	23.750¢	0.30¢	\$1.535	\$1.525	\$0.010
Apr-16	\$13.96	\$14.00	(\$0.04)	24.225¢	23.875¢	0.35¢	\$1.532	\$1.534	(\$0.002)
May-16	\$14.15	\$14.25	(\$0.10)	24.875¢	23.875¢	1.00¢	\$1.555	\$1.561	(\$0.006)
Jun-16	\$14.63	\$14.65	(\$0.02)	25.025¢	24.500¢	0.52¢	\$1.593	\$1.600	(\$0.007)
Jul-16	\$15.02	\$15.04	(\$0.02)	25.750¢	24.850¢	0.90¢	\$1.634	\$1.639	(\$0.005)
Aug-16	\$15.41	\$15.50	(\$0.09)	26.275¢	25.500¢	0.77¢	\$1.672	\$1.679	(\$0.007)
Sep-16	\$15.71	\$15.74	(\$0.03)	27.250¢	26.500¢	0.75¢	\$1.694	\$1.699	(\$0.005)
Oct-16	\$15.86	\$15.92	(\$0.06)	28.000¢	26.500¢	1.50¢	\$1.703	\$1.715	(\$0.012)
Nov-16	\$15.85	\$15.88	(\$0.03)	28.525¢	26.775¢	1.75¢	\$1.699	\$1.711	(\$0.012)
Dec-16	\$15.77	\$15.85	(\$0.08)	29.500¢	28.000¢	1.50¢	\$1.693	\$1.710	(\$0.017)
Jan-17	\$15.58	\$15.65	(\$0.07)	29.775¢	29.475¢	0.30¢	\$1.680	\$1.700	(\$0.020)
12 Mo Avg	\$14.98	\$15.02	(\$0.04)	26.469¢	25.652¢	0.82¢	\$1.626	\$1.633	(\$0.007)

- NDM Central: Prices are lower on a weak market. Buyers report they're receiving block offers from some manufacturers in which prices are trending lower. Some manufacturers indicate they are rapidly building inventories from week to week. Even as contracts are filled, the volumes entering storage are higher than volumes leaving. With the region beginning to see steady increases in milk production, there is little doubt that inventories will continue to build.
- NDM West: Prices are lower on a weaker market. Many manufacturers are offering NDM supplies at discount prices as they are trying to clear inventories. Some buyers/end users are in a wait and see attitude as they do not want to take a position at this time in the NDM market. Production of low/medium NDM is active throughout the region as manufacturing milk volumes are building. Inventories are steady to higher.
- Cheese Northeast: Manufactures of the cheddar cheese variety are running full schedules, with current orders being filled, and new product being added to aging programs. Most mozzarella cheese orders are finalized ahead of this weekend's Super Bowl event. Northeast manufacturers are optimistic cheese promotions, targeting the upcoming holiday, will prompt solid sales that provide some equilibrium for growing inventories. Wholesale cheese prices for both blocks and barrels are trending lower.
- Cheese Midwest: Cheese production remains active with a more than adequate milk supply. Although a snowstorm cut across the midsection of the country early in the week, milk intakes were only minimally disrupted. Manufacturers are comfortable with their current milk volumes and are not seeking additional loads of milk. A few Midwest cheese makers report sales into Eastern markets are still slow as a result of the massive snowstorm two weeks ago. Some cheese meant for pizza chains has backed up into Midwestern manufacturers' inventories.
- Cheese West: Plenty of milk for processing means western cheese production is still active. Domestic demand is good, especially in retail and food service venues. And industry contacts report sales from the Super Bowl effect have been decent, but are now ending for another year. Although overall cheese demand has been good, industry contacts still say supply has outpaced demand. Without many export opportunities, inventories are building slightly. The cheese trade imbalance and heavy U.S. cheese inventories are starting to weigh on the mind of a few cheese makers. There is some concern that long barrel and block cheese inventories are becoming burdensome and market factors may push cheese prices lower, especially if domestic demand cannot maintain its current pace.
- International: Milk production in the EU remains strong and is expected to remain strong this year, having bounced back from effects of winter storms the third week of January. Eurostat reports that EU milk production January-November, 2015, was up 2.2% from the same period of 2014. November production was up 5.2% from November 2014. Ireland posted the largest gain among EU countries, up 13% January-November and up 48.1% in November. EU cheese production January-November, 2015, was up 1.4% from the same period of 2014. November production was up 4.6% from November 2014. In Eastern Europe, January-November milk production was up in most countries, and yielded the following percentage changes from the prior year: Bulgaria -0.7%; Czech Republic +3.0%; Poland +2.3%; and Romania +9.1%. Cheese production for the period increased across the board: Bulgaria +3.9%; Czech Republic +2.7%; Poland +3.5%; and Romania +6.6%.
- International: This week's GDT auction saw the price index fall 7.4%, the steepest decline since a 7.9% drop in November. Losses were led by WMP down 10.4% and butter down 8.3%. Cheddar cheese fell 4.2% to a U.S.-equivalent \$1.27/lb.
- International: Welcome recent late January rain in parts of Australia helped boost milk production volumes, with about 2/3 of the season completed. Hay supplies and demand vary. In the northern region, recent widespread rains have helped pasture growth rebound. Rains have reached drought suffering inland areas and provided relief.
- International: The five-year growth streak of U.S. dairy exports is over, according to USDEC's Alan Levitt. Calling it the worst global dairy market in a decade, all dairy export products were lower in 2015, except NDM and SMP. Sales were down 26% vs. 2014 while volume decreased 8%. The volume exported was equivalent to about 14% of domestic milk production in 2015, down from 15.3% in 2014.

Recommendation:

Cheddar cheese output has been setting monthly output records for most of 2015. Can that continue? Butter manufacturers are running full tilt to meet domestic demand, but supplies are high and imports are arriving on our shores. How long can we maintain \$2+ butter? Cow numbers are not meaningfully declining; in fact the herd size has been growing for 6 months and is the largest since Jan, 2009. Our 2015 dairy exports were sharply lower, while EU milk output is strong and growing. It appears it will be some time before the global glut of milk and dairy products is more aligned with demand. We usually don't comment much on butter futures, but in light of current fundamentals and a GDT price of about \$1.32, April-June seem way over-priced. Class III futures were mostly limited to single-digit losses this week, but the market feels heavy. Not that Super Bowl orders are over, there really isn't anything to spur cheese demand until grilling season. May and June at \$14+ seem like sales to us. In addition, with the July-Dec average at \$15.60, we would get up to 50% covered there if that is a profitable number for you. This bear market appears to still be gaining traction vs. finding a bottom. Current spot prices work out to about \$13.45 for March. Despite the premium we continue to see out of the weekly NPDSR reports, weakness in the spot market going forward will bring those numbers down. Both blocks and barrels appear to be approaching "burdensome" levels in the Western region of the country especially. That means more cheese is likely to look for a home at the spot market. As we recommended last week, any rallies in the front months should probably be sold.



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