

The KDM Dairy Report – February 26th, 2016

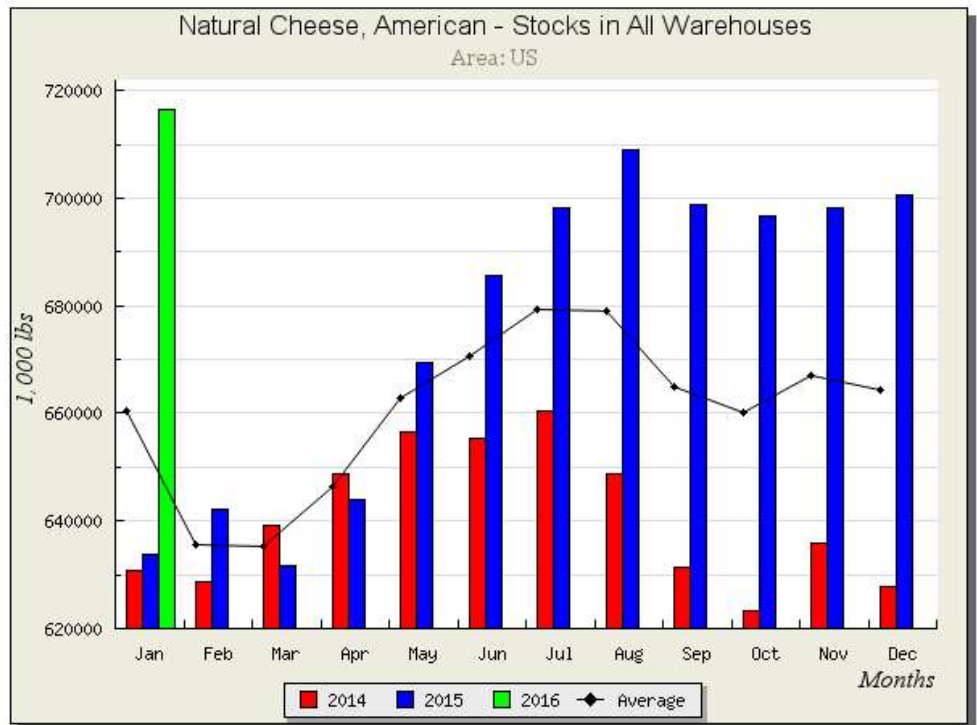
What's Bullish:

- Fluid Milk Pacific Northwest: Milk production is building seasonally. Bottling demand is steady and manufacturers say milk supplies are adequate for processing needs. Although milk is generally adequate for processing needs, several manufacturers note an increase in demand for loads of milk and some tightness of supplies.
- Butter: Churning is active throughout the country as cream volumes generated from standardizing are trending higher. In the Northwest, demand from food service and retailers are steady to increasing. In the Central region, interest from Class II operations is moderate. Butter sales into retail outlets are active. In the West, domestic butter sales continue to be strong in advance of the Q1 spring holidays.
- Dry Whey Northeast: Prices are steady to higher at the top of the range, resulting from adjustments to pricing indices. Some buyers note trouble finding all the Northeast whey they want in a timely fashion. Dry whey interest from ice cream is improving seasonally. The market has a firming undertone.
- NDM West: Sales in the domestic spot market are steady. However, exports to Mexico has been very active throughout the week. Some industry participants anticipate a growth in demand as the spring holiday baking season approaches. Production of low/medium heat NDM is slightly lower as moderate condensed skim volumes are moving into ice cream manufacturing plants. Inventories are steady to slightly lower.
- Cheese West: Cheese output is active, yet some manufacturers are finding milk intakes to be a little short of their needs to run at full production. They are reaching out for a few extra loads of milk to fill up cheese production schedules. Domestic cheese demand is still strong, especially for retail and cheese for pizza. Although the Super Bowl has passed, demand for pizza continues to be good through food service and schools.

| Futures Month | Class III 02/26 | Class III 02/19 | Change | Dry Whey 02/26 | Dry Whey 02/19 | Change | Cheese 02/26 | Cheese 02/19 | Change |
|------------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Feb-16 | \$13.80 | \$13.82 | (\$0.02) | 24.500c | 24.500c | 0.00c | \$1.518 | \$1.520 | (\$0.002) |
| Mar-16 | \$13.66 | \$13.85 | (\$0.19) | 24.250c | 24.750c | (0.50c) | \$1.510 | \$1.527 | (\$0.017) |
| Apr-16 | \$13.50 | \$13.81 | (\$0.31) | 24.000c | 25.000c | (1.00c) | \$1.490 | \$1.523 | (\$0.033) |
| May-16 | \$13.53 | \$13.93 | (\$0.40) | 24.000c | 25.000c | (1.00c) | \$1.498 | \$1.531 | (\$0.033) |
| Jun-16 | \$13.84 | \$14.34 | (\$0.50) | 25.175c | 25.750c | (0.57c) | \$1.529 | \$1.571 | (\$0.042) |
| Jul-16 | \$14.21 | \$14.75 | (\$0.54) | 25.475c | 25.650c | (0.17c) | \$1.552 | \$1.613 | (\$0.061) |
| Aug-16 | \$14.60 | \$15.12 | (\$0.52) | 25.000c | 26.000c | (1.00c) | \$1.596 | \$1.653 | (\$0.057) |
| Sep-16 | \$14.94 | \$15.50 | (\$0.56) | 26.250c | 27.000c | (0.75c) | \$1.622 | \$1.684 | (\$0.062) |
| Oct-16 | \$15.20 | \$15.79 | (\$0.59) | 26.275c | 28.000c | (1.73c) | \$1.648 | \$1.700 | (\$0.052) |
| Nov-16 | \$15.20 | \$15.84 | (\$0.64) | 26.775c | 28.625c | (1.85c) | \$1.653 | \$1.700 | (\$0.047) |
| Dec-16 | \$15.19 | \$15.82 | (\$0.63) | 27.500c | 29.500c | (2.00c) | \$1.647 | \$1.699 | (\$0.052) |
| Jan-17 | \$15.25 | \$15.70 | (\$0.45) | 29.600c | 29.775c | (0.17c) | \$1.658 | \$1.684 | (\$0.026) |
| 12 Mo Avg | \$14.41 | \$14.86 | (\$0.45) | 25.733c | 26.629c | (0.90c) | \$1.577 | \$1.617 | (\$0.040) |

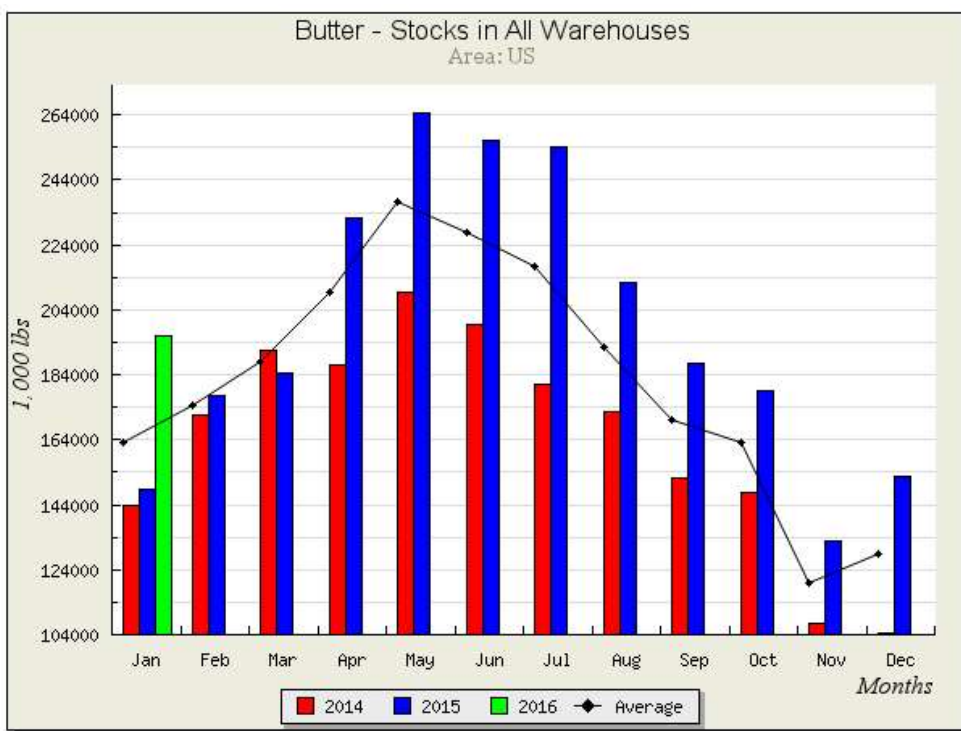
What's Bearish:

- Spot Market: Blocks finished the week down ¼¢ to \$1.48/lb on 11 trades, while barrels lost 5¢ to close at \$1.43/lb on 6 trades. Butter gave up 7¼¢ to close at \$1.97¼/lb on 10 trades, but NDM managed to gain 2¢ to \$0.76/lb on 12 trades.
- Cold Storage Report: Butter stocks at the end of January were 32% higher than a year ago and 26% higher than Dec, according to USDA. American cheese stocks jumped 13% YOY, while total cheese stocks increased 12%. The 716 million lbs of American cheese in storage is the highest since amount since 1986.
- Livestock Slaughter Report: 265,500 head were removed from the milking herd in Jan, down 3.6% (10,100 head) vs. a year ago.
- Butter stocks at USDA-selected warehouses increased 35% (5.1 million lbs) over the period 02/01 through 02/22.
- Fluid Milk Northeast: The viewpoint of some market participants is that Eastern manufactures are better handling heavy milk intakes. With reported growth in milk output and inflows of heavy supplies into manufacturing this week, processors in some instances were noted operating at/near full. However, with most areas of milk production in the region merely at the opening stage of the spring flush, to others the real test of preparedness is still weeks away. Regionally, Northeast and Mid-Atlantic farm-level milk producers report seasonal increases in milk volumes. Manufacturing milk supplies are adequate for meeting production needs. Area school closings in the Northeast contribute to surplus milk flows into manufacturing. Class I demand is lighter.
- Fluid Milk Southeast: Milk output is moving up. Sources are surprised by the quantity of cuts in bottling orders. As a result, Class III facilities are seeing notable increases in milk receipts. Florida's milk production continues to have fairly significant rises. Class I sales are flat, with little expectation of increasing beyond current levels in the short-term. Approximately 100 f.o.b. export milk shipments moved out of state this week.



Condensed skim supplies are heavy, with light to moderate interest aside from filling customer contractual needs. Condensed skim supplies for Class IV production remain strong. Eastern level of cream availability is surprising to some. Loads are being turned away, in slow trading.

- Fluid Milk Central: Farm milk intakes are steady to higher within the region. Weather has not slowed milk production, and on-farm feed availability is ample on many operations. Several Central Italian cheese producers report the Eastern snow storms curtailed demand from that sector for several weeks as pizza shop owners work through supplies on hand. Prices for spot loads of milk range from \$3.00 under to flat Class. Cream supplies are readily available within the Central region, and end users are also receiving cream loads from western sellers. Cream cheese production is stepping seasonally higher as the spring holidays approach.
- Fluid Milk West: Farm level milk output in California is flat to higher. Manufacturing milk volumes are heavy throughout the state. Fair/good quality alfalfa hay is near to the first cut of the year. Milk production in Arizona continues on the raise. A low humidity weather pattern is aiding to cows comfort. Manufacturing milk volumes are heavy. Harvesting of good/excellent quality alfalfa hay is active throughout the state. In New Mexico, a warmer climate pattern is aiding dairy herd comfort. As a result, farm level milk production is higher. Cream supplies are readily available in the West. Sales of cream loads in the spot market are more active this week. Heavy cream volumes continue to clear into butter churns.
- Dry Whey Central: Prices are steady to fractionally lower as some variable contract prices adjusted to fluctuations in indices. Production is steady to higher at many facilities in the Central region as manufacturing milk supplies continue to step higher. As a result, some growth in inventories held by brokers and traders, in addition to producers' inventories is occurring.
- Dry Whey West: The market tone is stable, however processors still face some headwinds as they reach for stronger market prices. Some manufacturers say inventories are a little heavy and building somewhat across the industry. A few other manufacturers report stocks are committed and a little low. Production continues to be active.
- NDM Northeast: Prices are steady to lower, while production is seasonally heavy. Dryers are running full schedules at some plants. Low/medium nonfat dry milk inventories are steady to building. The market undertone remains weak.
- NDM Central: Prices are unchanged to lower on a weak market. Production of low/medium heat NDM is very active throughout the region as milk intake volumes trend seasonally higher. Some cheese plants are modifying supply contracts, as permitted, to curtail further cheese production during a slump in cheese demand. This is leaving additional milk loads to clear through butter/powder plants. Low/medium heat NDM inventories are steady to building.
- Cheese Northeast: Cheese is being manufactured at a high rate in the East, as milk intake volumes drive 7-day production schedules. Good pre-holiday orders are relieving the inventory concerns of some manufacturers. However, there is some uneasiness about supply/demand levels in a post-holiday cheese market.
- Cheese Midwest: Relatively mild winter weather is keeping the milk flowing to Midwest cheese plants. Cheese production is steady. Inventories are building, even with good demand from food service and retail customers. Following experience of the past year with production increases which had not generally been anticipated early in the year, followed by higher sales, the current market undertone is awareness of creeping inventories but hopefulness that demand will continue to show strength.



Recommendation:

After last week's bearish Milk Production Report, more bearish fundamentals rolled in this week. Producers are still not financially incentivized to reduce their herd sizes as this week's Livestock Slaughter report indicates culling is at lower levels than a year ago. Cheap feed is keeping more cows in the herd as producers try to make more milk to make up for lower Class III prices. But the Cold Storage Report had even worse news, with American cheese stocks at levels not seen since 1986, and butter stocks sharply higher as well (see graphs). Domestic demand may indeed still be strong, but it's going to have to get even stronger if we expect prices to be supported here. With the EU also overproducing, the global milk glut looks set to continue. Spot prices were pressured on the news, but made a small recovery Friday. For the week though, Class III finished in the red, with 2nd half futures taking the biggest hit. No doubt producers were scrambling to get coverage with milk still starting with a \$15 disappearing. The trend still looks down in the medium term. We would sell rallies up front.

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