KDM Trading, Inc.
877.695.8538 www.kdmtrading.com
Dan Schindler, Mark Potter, Keith Schnese & Nick Potter

The KDM Dairy Report – March 11th, 2016

What's Bullish:

Futures Month	Class III 03/11	Class III 03/04	Change	Dry Whey 03/11	Dry Whey 03/04	Change	Cheese 03/11	Cheese 03/04	Change
Mar-16	$13.79	$13.78	$0.01	25.200¢	25.500¢	(0.30¢)	$1.518	$1.517	$0.001
Apr-16	$13.66	$13.53	$0.13	24.875¢	25.575¢	(0.70¢)	$1.504	$1.489	$0.015
May-16	$13.50	$13.53	($0.03)	25.250¢	25.700¢	(0.45¢)	$1.493	$1.491	$0.002
Jun-16	$13.63	$13.63	$0.00	25.125¢	25.625¢	(0.50¢)	$1.500	$1.494	$0.006
Jul-16	$14.03	$14.04	($0.01)	25.400¢	26.025¢	(0.63¢)	$1.537	$1.534	$0.003
Aug-16	$14.45	$14.50	($0.05)	25.325¢	26.250¢	(0.93¢)	$1.580	$1.580	$0.000
Sep-16	$14.74	$14.77	($0.03)	26.000¢	26.100¢	(0.10¢)	$1.609	$1.607	$0.002
Oct-16	$14.79	$15.00	($0.21)	27.000¢	27.000¢	0.00¢	$1.611	$1.623	($0.012)
Nov-16	$14.79	$15.00	($0.21)	27.400¢	27.700¢	(0.30¢)	$1.610	$1.624	($0.014)
Dec-16	$14.80	$15.00	($0.20)	27.500¢	27.700¢	(0.20¢)	$1.608	$1.626	($0.018)
Jan-17	$14.79	$15.02	($0.23)	29.600¢	29.600¢	0.00¢	$1.600	$1.629	($0.029)
Feb-17	$14.78	$15.05	($0.27)	30.500¢	30.500¢	0.00¢	$1.580	$1.641	($0.061)
12 Mo Avg	**$14.31**	**$14.40**	**($0.09)**	**26.598¢**	**26.940¢**	**(0.34¢)**	**$1.563**	**$1.571**	**($0.009)**

- Fluid Milk West: Milk production is flat to slightly higher in California, but the butterfat component level of the milk is starting to decrease slowly. Demands for condensed skim from ice cream and soft serve mix manufacturers are picking up. According to the last snow survey, the snowpack in Sierra Nevada is below average at 83% of normal for this date.
- NDM West: According to some industry contacts, supplies are somewhat tight as supply is mostly committed to contracts. Some processors are transitioning from NDM to MPC production. High heat nonfat dry milk prices are steady to slightly higher. Demand from the bakery sector is moderate, yet inventories are slightly tight.

What's Bearish:

- WASDE Report: USDA lowered their forecast Class III price for 2016 as they foresee falling cheese prices. Despite a slight reduction in milk output and slower growth in milk per cow, dairy exports are expected to decline due to strong international competition and a strengthening U.S. dollar. USDA now expects Class III to average just $13.90/cwt, down 50¢ from last month's prediction.
- Spot Market: Blocks finished the week down 2¢ to $1.50/lb on no trades, but barrels were up 1¢ to $1.47/lb on just 2 trades. NDM gained 3¢ on heavy volume of 25 loads, but butter lost 5¼¢ to $1.98¾/lb on 11 trades.
- Fluid Milk Northeast: Farm milk levels are steady to increasing in the Northeast and Mid-Atlantic regions. Distribution concerns were eased as some plants that were down for maintenance are back on normal schedules. Milk volumes to manufacturing are sufficient. Some manufacturers are working to improve holiday inventory volumes.
- Fluid Milk Southeast: Milk output is increasing seasonally. A few bottling orders were added this week, but fluid sales are below expectations. Manufacturing is full. Florida milk production continues to climb. Class I milk sales took a downturn this week. Export milk shipments totaled 90 spot loads, up from 75 last week. Condensed skim is plentiful in the region, with discounted trading taking place as supplies clear to Class II and III. Cream supplies are readily available for most dairy manufacturing needs. Cream is supporting active Class II and III production to domestic and export markets.
- Fluid Milk Central: South and mid-Central milk production rates are trending higher as warm weather settles into those areas. In the North Central, milk haulers note there is a steady uptick in milk pickup volumes. Throughout the region, K-12 milk orders are in flux due to the spring break calendaring. Spot milk prices are $3.50 under to flat Class.
- Fluid Milk Southwest: Arizona milk output is increasing along seasonal trends. Manufacturing milk volumes are heavy. Orders from bottlers are steady to lower, as most K-12 schools will start the spring break during next week. Demand for condensed skim is steady this week. Milk output in New Mexico is ramping up as warmer temperatures are aiding dairy herd comfort. Bottled milk sales to retailers and food service are lower.
- Fluid Milk Pacific Northwest: Manufacturers in the region report milk intakes are climbing, and the spring flush is underway. Some processors have less available capacity for toll processing. They are turning away extra loads of milk, and are unable to take in milk from other handlers.
- Butter: Production is active throughout the country as heavy cream volumes continue clearing into butter manufacturing. However, many churners are less interested in pursuing additional cream loads as the spring holiday butter orders are getting filled. In the West, some processors are backing off butter production and shifting cream to other manufactured product lines, like cream cheese and ice cream. Butter inventories are building across the nation. Butter demand from retailers is good in the East and Central regions as the spring holidays approach, but in the West, butter demand has eased somewhat.
- Dry Whey: In the Northeast, surplus Southeast milk distributed to a key cheese plant is supporting dry whey output, and increasing dry whey available for cash trading. Demand is balanced with supply in the Central region, but in the West, demand is currently a little lighter and inventories are building back somewhat. Some end users are choosing to burn through inventories and waiting on any new purchases.
- NDM Northeast: Prices are steady to lower. Production of low/medium heat nonfat dry milk is increasing as milk production levels rise. End users, in general, are only buying supplies they need; otherwise, buyers are holding to previously contracted loads. International interest is active. Stocks of low/medium NDM are moderate to growing.
- NDM Central: As buyers witness the recent price changes on various indices, they are less willing to enter the market. The repeating cycle of higher and lower prices, in fairly rapid succession, has buyers wary of overpaying for NDM in a market seeking firm backing. Low/medium heat NDM production is steady to higher as milk intakes trend upward. Milk is moving around within the region to find processing room.
- Cheese Northeast: This week, milk intakes continue to prompt production output that is beyond normal interest and holiday demand. Cheese procurements from contracted customers remain good, while spot exchanges are sluggish. Non-competitive prices discourage global sales. The influence of cheese imports on domestic market transactions increase sale challenges for some cheese types.
- Cheese Midwest: Manufacturers are voicing concern about increasing cheese inventories. Most cheese plants have contracted milk arriving every day, so cheese continues to be made. Sales are stable and sales volume is still pretty good. The challenge in the overall mix is the strong volumes of milk produced during a relatively mild winter and into early spring. The near term looks like the present, with hopes that domestic customers will continue buying cheese. However, there will be a point that cheese storage is essentially full unless one of three eventualities, or some combination, occurs: milk flows decline so less cheese is made; domestic consumption increases further; or export sales increase.

- Cheese West: Cheese makers are seeing <u>increases</u> in milk intakes, and as a result, steady to <u>higher</u> cheese production. A few processors report <u>sales have slowed</u> somewhat as <u>buyers pause</u> to see what direction cheese market prices will take, and whether U.S. consumers continue to eat cheese at high rates like last year. End users are <u>fielding a lot of offers</u> from cheese makers, but have a desire to work through their own inventories and draw those stocks down to more comfortable levels. Most processors note <u>inventories continue to be long</u>.
- Foreign Cheese: EU markets for semi hard cheese are <u>weaker</u>, with slowly <u>weakening</u> prices in the EU. The continuing <u>higher</u> volumes of cheese production are <u>ahead of demand</u> and this is driving price trends.

Recommendation:

Most Class III contracts finished in the red this week, especially Q4 2016 and even into 2017 contracts. Right or wrong, there is a growing belief that it will take that long to correct the supply side of the equation. The fact is, we have not yet seen any significant herd reduction month to month, and even in the mid-$13’s Class III, component pay for producers in much of the country puts their mailbox check at a level that is close it, if not quite cash flow. In other words, there hasn’t been any significant pain yet, and thus no signal to slow production. Fortunately, domestic demand appears to be holding up. But there are some warning signs. Is it real consumer demand, or just commercial buying going in to storage? Recent reports indicate record, or near record holdings of cheese. While cheese plants we mentioned last week are still seeing strong demand, there is growing concern that once the warehouses are filled, demand will take a sudden dip. We are entering the highest milk production months of the year, so unless demand picks up further, there doesn’t appear to be much hope for a price rally. That said, commodities in general did catch a bit of a bid this week. Crude oil prices increased and grain prices appeared to follow. The U.S. dollar was sharply lower, helping our exports compete on the global market. Should this trend continue, higher feed prices would eventually help support higher milk prices. Producers should be looking to lock in their feed prices through their local provider, or through futures and options contracts. Grains may not have much downside from here, and certainly have some upside risk. There is currently very little weather premium built in to new crop contracts, so using futures may be an ideal way to lock in some of your input costs well in to 2017. Call us if you would like some help putting together a plan. On the milk side, we wouldn’t sell anything starting with a $13, and we’re still holding out for some kind of event to give us a rally in the second half of 2016. Operations that have already hedged should look to protect those with cheap call options.