

The KDM Dairy Report – March 18th, 2016

What's Bullish:

- NDM West: The low/medium heat NDM market is weak. However, within some Western states, NDM inventories are tighter after significant weekly sales. A few manufacturers indicate they have limited quantities available to fulfill block needs. Demand is increasing on spot market as some end users chose to not contract ahead of time. Current holdings are adequate for contract needs, but there are occasional delays in finding spot offerings.
- International: January 2015 milk production in Australia was -0.6% below January 2014. Milk production growth early in the growing season slowed in December when hot and dry conditions prevailed. Higher grain and hay expenses curtailed producer interest in supplementing pasture grazing to maintain production. It is considered too late to recover lost milk volumes, even if end of season weather improves. Many processors expect season volumes to be lower than last season, by perhaps 1%-2%. Producers are further squeezed by grain prices. This has increased domestic price pressure, squeezing producer margins in Australia.
- International: New Zealand milk production in January was slightly below January 2015. A major dairy processor in New Zealand announced a pay price reduction. The pay price reduction will be from New Zealand \$4.15/kg of milk solids to \$3.90. As justification for the decreased pay price, processor management forecasts New Zealand milk production for the current season to be 4% lower than the last season. Less supplemental feeding due to higher feed prices, and lower herd sizes, are attributed as leading to reduced milk production.
- International: Rabobank NZ has warned of the need to put away higher provisions for bad dairy loans. The bank saw lending growth jump to \$643 million last year, with gross loans totaling \$9.5 billion. An extended period of very low milk prices has increased the risk that many farm loans will default, and lead to higher loss provisions in their dairy portfolio.
- International: Fonterra last week dropped its 2015/16 milk price payout forecast by 25¢ to \$3.90 per kg/MS. The Reserve Bank estimates the breakeven price across the dairy sector at \$5.30 per kg/MS, with farmers currently looking at three consecutive seasons of below breakeven payouts.

Futures Month	Class III 03/18	Class III 03/11	Change	Dry Whey 03/18	Dry Whey 03/11	Change	Cheese 03/18	Cheese 03/11	Change
Mar-16	\$13.83	\$13.79	\$0.04	25.500¢	25.200¢	0.30¢	\$1.521	\$1.518	\$0.003
Apr-16	\$13.93	\$13.66	\$0.27	25.575¢	24.875¢	0.70¢	\$1.530	\$1.504	\$0.026
May-16	\$13.65	\$13.50	\$0.15	25.750¢	25.250¢	0.50¢	\$1.499	\$1.493	\$0.006
Jun-16	\$13.63	\$13.63	\$0.00	26.000¢	25.125¢	0.88¢	\$1.498	\$1.500	(\$0.002)
Jul-16	\$13.96	\$14.03	(\$0.07)	26.000¢	25.400¢	0.60¢	\$1.526	\$1.537	(\$0.011)
Aug-16	\$14.23	\$14.45	(\$0.22)	26.275¢	25.325¢	0.95¢	\$1.554	\$1.580	(\$0.026)
Sep-16	\$14.53	\$14.74	(\$0.21)	26.500¢	26.000¢	0.50¢	\$1.589	\$1.609	(\$0.020)
Oct-16	\$14.65	\$14.79	(\$0.14)	26.925¢	27.000¢	(0.07¢)	\$1.600	\$1.611	(\$0.011)
Nov-16	\$14.70	\$14.79	(\$0.09)	27.250¢	27.400¢	(0.15¢)	\$1.601	\$1.610	(\$0.009)
Dec-16	\$14.70	\$14.80	(\$0.10)	27.500¢	27.500¢	0.00¢	\$1.595	\$1.608	(\$0.013)
Jan-17	\$14.65	\$14.79	(\$0.14)	29.225¢	29.600¢	(0.38¢)	\$1.588	\$1.600	(\$0.012)
Feb-17	\$14.65	\$14.78	(\$0.13)	30.225¢	30.500¢	(0.27¢)	\$1.586	\$1.580	\$0.006
12 Mo Avg	\$14.26	\$14.31	(\$0.05)	26.894¢	26.598¢	0.30¢	\$1.557	\$1.563	(\$0.005)

What's Bearish:

- Milk Production Report: U.S. output in February was up a leap-day adjusted 1% vs. a year ago and cow numbers increased 2,000 head from January. The increase was above most analyst expectations. Output per cow jumped from 1,737 to 1,815 lbs.
- Spot Market: Most Class III components were lower this week. Block cheese lost 1¢ to settle at \$1.49/lb while barrels gained 3¢ to \$1.50/lb. There was just 1 block trade and 4 barrel trades all week. NDM was down 4¢ to \$0.73/lb on 13 trades, while butter lost 3¼¢ to close at \$1.95/lb on 8 trades.
- Weekly cold storage number continue to indicate a build in both cheese and butter stocks. Over the first 14 days of March, butter stocks are up 4% and cheese stocks are up 2% at USDA-selected storage centers.
- Fluid Milk Northeast: Milk production is active throughout the region as increases occur along the seasonal pattern. Manufacturing milk supplies are heavier but manageable. March milk production levels are up in the Mid-Atlantic. Balancing plant managers are comfortable with current milk intakes, while looking ahead to imminent upsurges in milk supplies. Class I milk sales are stable. Surplus milk is moving at substantial discounts in some market channels.
- Fluid Milk Southeast: Milk production is climbing in the region. Participants in the market indicate Southeastern manufacturing plants are operating at capacity levels. Florida milk production is surging. Sources expect peak levels within the next 2 to 3 weeks. Fluid sales are sluggish, as spring break has started. With one holiday coinciding with spring break this year, surplus milk loads will likely increase during that period. This week, export milk shipments totaled 120 loads, up from 90 last week and 80 a year ago. The condensed skim market is heavy with supplies.
- Fluid Milk Central: Milk intakes are steadily increasing from week to week. Southern area milk handlers note bigger steps up in production compared to Northern milk handlers. As the flush approaches, though, there is growing concern among marketers and cooperatives regarding maintaining markets for potentially larger volumes of finished products. There has been some discussion about notifications to producers regarding changes in how milk payments will be handled for volumes above year ago marketing. Bottled milk demand is uneven from location to location as school districts cycle through week long shutdown periods. Most bottlers indicate the overall sales trend is downward. Milk spot loads and condensed skim volumes are readily available throughout the region. Confirmed spot milk sale prices range from \$3.50 under to flat Class. However a few milk marketers indicate they received bids of \$5-\$8 under Class. Milk marketers indicate cheese manufacturers have interest in spot milk loads, as long as prices are at a discount to class. Wait times for unloading are growing at some plants as intake volumes increase seasonally. Recent reports indicate that milk discards are happening.
- Fluid Milk Southwest: Farm milk production continues rising in California, the milk components are stepping lower due to an increase in temperatures. In Arizona, farm level milk intakes are higher. Most educational institutions are closed this week due to spring break. As a result, orders from bottlers are lower this week. Harvesting of good/excellent quality alfalfa hay continues around the state. A comfortable climate to dairy cows is aiding milk yields in New Mexico. Sales into Class I are lower in anticipation of spring break.
- Fluid Milk Pacific Northwest: Milk production is seasonally increasing. Some processors report the region is heading into spring flush and the processors are working hard to find homes for loads of additional milk. Regional bottling plants are pulling good volumes of milk, but demand

fluctuates somewhat depending on spring break schedules of area educational institutions. Milk production trends in Utah and Idaho are steady to higher. Manufacturers say milk is adequate for almost all processing needs. Industry contacts report forages are still ample and there will be a good carryover of feedstocks into the next few months.

- Butter Northeast: Cream volumes remain more than ample for churning. The market can reasonably expect regional churning to maintain a high rate, since most butter makers will likely churn rather than sell cream at the current multiples. As the holidays fast approach, some are storing substantial supplies of bulk butter. Demand varies, but retailers in general are placing orders in anticipation of holiday needs. The butter market undertone remains weak.
- Butter Central: Bulk and print butter production channels are active throughout the region this week. Spot cream offers are readily available, and interest is steady to light. Manufacturers indicate sales into print are ongoing, but represent previously arranged sales, for the most part, versus new sales. Butter inventories are steady to building.
- Butter West: Butter makers are seeing some of the seasonal demand ebb away. Most of the orders are now filled for the early spring holidays and inventories are building. In addition, a few industry contacts say some end users and secondary marketers have filled their warehouses to assure coverage of butter needs for later in the year. Cream supplies are readily available and butter production is still active.
- Dry Whey Northeast: Prices were fractionally lower this week at the top of the range. Active cheese production is adding to dry whey output. Manufacturers are watching stock levels, lest prices fall with heavy inventories on hand. Spot demand is deliberate as buyers delay for better prices. The market tone is steady to lower.
- Dry Whey Central: Prices are unchanged to fractionally lower on the range and mostly series. Variable contract prices showed some downward movement due to changes in indices. Buyers remain in the driver's seat on pricing as they are ready to reject offers carrying prices deemed too high for this type of market. With seasonal milk production edging higher in the North Central area, cheese plants continue to receive ample intake volumes, thus fostering steady to higher cheese/dry whey production.
- Dry Whey West: Demand for western whey is currently a little light. Overall, inventories remain mixed. Some processors report committed inventories, while others say their stocks have built back a little.
- NDM East: Plants continue to report active drying in order to clear increasing condensed skim supplies. Stocks of low/medium heat NDM, at the producer level, are building as uneven demand builds up total regional supplies. To balance growth, multi-load offerings at lower prices exist from those manufacturers hoping to reduce supply levels. Demand is weak in the spot market as buyers/users postpone purchases for better prices.
- NDM Central: Prices are unchanged to lower on a weak market. With recent declining price trends in international markets, buyers are shopping cautiously in the domestic market. With availability of low/medium heat f.o.b. spot loads from numerous producers, as well as offers from resellers, buyers are firmly in control of pricing. Low/medium heat NDM production is steady to higher. Inventories are building as on-farm milk production ramps up toward the flush.
- Cheese Northeast: Milk volumes are keeping most, if not all, cheese plants operating on heavy seasonal schedules. Overall, cheese sales are fair to good and improving, as holiday needs help boost transactions. Orders from the food service industry are steady. Manufacturers note that higher than expected milk protein levels are increasing cheese yields.
- Cheese Midwest: Midwest cheese makers are seeing plenty of milk available for their processing needs. Many manufacturers say they are near full capacity. However, they will still buy a few extra loads of milk to complete production schedules, if the milk is priced right. Some spot loads of milk are available at \$1.50 to \$3.00 under Class. Domestic retail cheese demand continues to be a good draw. Sales into food service and mozzarella for pizza have also been respectable. Barrel cheese and cheese for manufacturing lines are moving slowly with most transactions completed only on standing contracts. Manufacturers feel end users are holding off on purchases and trying to burn through their inventories, before reentering the market. Inventories continue to be long for cheese barrels, but a little lighter for blocks.
- Cheese West: Production remains steady to higher as milk intakes increase seasonally. Manufacturers say demand is still good from food service and retail accounts. However, club stores and other large retailers have slowed their cheese orders somewhat and are taking a wait and see approach to the market. Many want to see what direction the cheese price trend will take before making any large-scale purchase decisions. In addition, end users are facing a lot of offers from cheese makers, especially for cheese barrels, but are hesitant to make buys until they can work through their own inventories. Cheese stocks remain long for barrels. Some end users note a little more tightness with cheese blocks, especially fresh blocks.
- International: Strong increases in milk production during 2015 following the end of quotas has left the EU with significant volumes of milk to process and sell. This has now led to new proposals within the European Commission, announced this week, to address the increasing milk volumes and profitability squeeze for producers. Dairy herd expansions in the Czech Republic and Poland are viewed as having been particularly vigorous, leading to increased milk volumes. Eurostat reports that production for 2015 over 2014 was up 2.7% in Poland, and up 3.6% in the Czech Republic.
- International: After a small increase two weeks ago, the GDT Dairy Price Index fell 2.9% in the latest auction, held on March 15th. The index has decreased in 5 of the last 6 auctions. Cheddar cheese was down 5.6% to a U.S.-equivalent \$1.11/lb.

Recommendation:

The milk spigots are opening as we head in to the seasonal flush, except this year we also have the EU that is cranking out production at a high level. What's actually most amazing, considering the production levels, is that we still have butter close to \$2/lb and cheese near \$1.50/lb. Despite being long barrels across the country, today's spot market saw bidders come in and move the barrel price 8¢. With block cheese in a more balanced situation, one would have thought that would be the product more easily bid higher. A short-covering rally ensued after today's spot market, with most 2016 contracts finishing the day up double-digits. About the only positive news on the fundamental side is the struggle in Oceania. While the human side of the story is tough, the economic consequences should be a reduction in supply from that part of the world. One news story this week stated upwards of 25% of dairies in New Zealand were at risk of failure. As negative as fundamentals are right now, producers with hedges July-Dec or into 2017 should be protecting them with cheap call options. Many of you sold these months when prices were above \$16.00. The July-Dec \$16.50 calls settled for an average of 14¢/mo. This is very inexpensive insurance, and would give your hedge unlimited upside should the market find any reason to rebound. Get it done!

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