

The KDM Dairy Report – July 15th, 2016

What's Bullish:

- Spot Market: Block cheese gained 3¢ this week to settle at \$1.66/lb, while barrels were up 2½¢ to close at \$1.74½/lb. There was just one block trade, but 15 barrels trades during the week. Grade A NDM lost 1½¢ on 16 trades to settle at \$0.87½/lb, but butter increased 3¼¢ on 5 trades to close at \$2.32/lb.
- Fluid Milk Northeast: Hot, humid and dry conditions in most areas of the East are prompting declines in farm-level milk production. Handlers note heat and humidity levels are depressing cow comfort and milk production, as volumes are marginally lower. In some areas, drought conditions are beginning to strengthen with the onset of a hot, dry weather patterns. Mid-Atlantic milk output is declining as well.

Futures Month	Class III 07/15	Class III 07/08	Change	Dry Whey 07/15	Dry Whey 07/08	Change	Cheese 07/15	Cheese 07/08	Change
Jul-16	\$15.33	\$15.20	\$0.13	27.900¢	27.375¢	0.52¢	\$1.649	\$1.638	\$0.011
Aug-16	\$16.46	\$15.96	\$0.50	29.500¢	29.600¢	(0.10¢)	\$1.750	\$1.697	\$0.053
Sep-16	\$16.49	\$16.06	\$0.43	31.500¢	31.500¢	0.00¢	\$1.742	\$1.696	\$0.046
Oct-16	\$16.52	\$16.15	\$0.37	32.275¢	32.150¢	0.13¢	\$1.740	\$1.700	\$0.040
Nov-16	\$16.40	\$16.10	\$0.30	33.000¢	33.000¢	0.00¢	\$1.726	\$1.692	\$0.034
Dec-16	\$16.18	\$15.90	\$0.28	33.725¢	34.000¢	(0.27¢)	\$1.706	\$1.675	\$0.031
Jan-17	\$16.04	\$15.82	\$0.22	34.400¢	34.400¢	0.00¢	\$1.688	\$1.668	\$0.020
Feb-17	\$16.10	\$15.90	\$0.20	35.350¢	35.350¢	0.00¢	\$1.671	\$1.660	\$0.011
Mar-17	\$16.15	\$15.91	\$0.24	35.500¢	35.500¢	0.00¢	\$1.679	\$1.669	\$0.010
Apr-17	\$16.23	\$16.05	\$0.18	35.550¢	35.550¢	0.00¢	\$1.703	\$1.678	\$0.025
May-17	\$16.31	\$16.16	\$0.15	35.475¢	35.475¢	0.00¢	\$1.705	\$1.691	\$0.014
Jun-17	\$16.47	\$16.32	\$0.15	36.000¢	36.000¢	0.00¢	\$1.718	\$1.707	\$0.011
12 Mo Avg	\$16.22	\$15.96	\$0.26	33.348¢	33.325¢	0.02¢	\$1.706	\$1.681	\$0.026

- Fluid Milk Southeast: Milk production in the region has declined significantly due to the extended bouts of hot and humid weather. Bottling plants are adding loads, due to lighter load weights. The frequency of load rejections and temperature issues have increased. Florida milk production continues to rapidly decline. This week, cream demand increased but supplies waned. Spot sales of cream are above contract prices in some instances, an indication that overall cream demand is good. Ice cream, ice cream mix and cream cheese processors are staying busy while pulling the bulk of the cream supply.
- Fluid Milk Central: Milk production is dropping in the region. Milk processors are making adjustments as the components in milk decrease as well. Spot loads of milk are available, but some contacts feel they are harder to come by. Many market participants report a tightening cream supply reflected by higher multiples. However, a few market participants shopped around and report purchasing spot loads of cream at lower multiples. Overall, industry contacts feel that at the end of this week, flowing into next week, cream will continue to tighten and multiples will climb. Ice cream manufacturers are running full schedules, pulling large amounts of cream into production.
- Fluid Milk Southwest: Milk butterfat in California continues at the lowest level of the year. Bottled milk sales to retailers are higher as many grocery stores are restocking shelves. Meanwhile, orders from restaurants are steady. Condensed skim demand from NDM processors is strong. Interest for flavored milk, as chocolate milk, is active. Ice cream sales are seasonally inching up. Dairy farmers' demand for premium/supreme alfalfa hay is picking up, but supplies are tight in California. Farm milk production in Arizona has plateaued, as daytime temperatures are slightly lower this week. Bottled milk requests from the retail sector are lower, but demands for Class II dairy products as ice cream and frozen desserts are seasonally strong. Milk output is trending lower in New Mexico. The warmer climate is rising heat stress in dairy cattle. Class I sales to supermarkets and restaurants are higher this week. Condensed skim demand from NDM producers is active. Manufacturing milk volumes moving to Class III processing plants are steady to slightly lower.
- Cream West: Availability is tight and demand from ice cream manufacturers is strong. Cream volumes moving into butter churning are steady. However, a few processors are selling cream in lieu of churning. The western cream market undertone is firm.
- Butter: Nationwide, butter output is steady to lower. Substantial volumes of cream are moving into ice cream manufacturing. Consequently, less cream is available for butter churning. In addition, some processors are compelled to satisfy contracted cream commitments ahead of churning. In the East, interest for print butter from retailers and food service is mostly steady. In the Central region, a few manufacturers are microfixing bulk butter to meet upcoming customers' needs. The market undertone is firm. In the West, domestic demand is steady. A few processors are opting to sell cream instead of churning as multiples are firming.
- Dry Whey Central: Cheese vats remain full keeping the whey stream flowing and dryers full with whey. However, several manufacturers report increased calls from potential buyers. Some market participants are confident in raising prices while maintaining current interest levels from buyers. Some industry contacts feel a large amount of domestic sales is contract driven. International buyers are reportedly active on the dry whey spot market. Central region whey inventories are mixed. Active production is resulting in building inventories for some market participants, while strong sales have aided in inventory relief for other industry contacts. A few manufacturers report tight whey stocks. The market undertone is firming.
- Dry Whey West: Prices moved higher again this week. Domestic demand is decent and export markets are requesting a little more. Industry contacts continue to consider the Southeast Asian pork industry's purchase of more whey and whey permeate for feed as a significant lift to whey market prices.
- NDM East: Production remains active and declines in milk production have offered limited resistance to drying rates. However, NDM is moving with improved demand from cheese manufacturers as needed for product fortification and from ice cream through contracts. The market expectations of a noteworthy price drop, at this point, is viewed as doubtful by some in the market
- NDM West: Offers from manufacturers to brokers have declined this week. Some processors indicate that NDM stocks are trending lower in line with the regional farm milk production. At this point, the market undertone is firm. International demand, especially from Mexico, is strong. Domestic demands from bakers and dry mix manufacturers are active. Low/medium heat NDM manufacturing is steady, but at a lower rate compared to Q1 and Q2 production. Inventories are steady to lower in many processing plants.
- Cheese Midwest: Production is active across the region, but as warm weather prevails and the components in milk decrease, manufacturers are making production adjustments. Milk production is decreasing as well, but contracted milk intakes have not decreased enough to have a substantial impact on planned production for many Midwest cheese makers. However, sale volumes remain high. Some buyers continue to request

additional loads outside of contracts. A few market participants note, specifically, that interest in processed cheese is growing. Overall, many industry contacts are seeing interest in the large majority of cheese varieties increase. Inventories are mixed. Several contacts report being comfortable with inventories now that strong sales have alleviated some stock pressure.

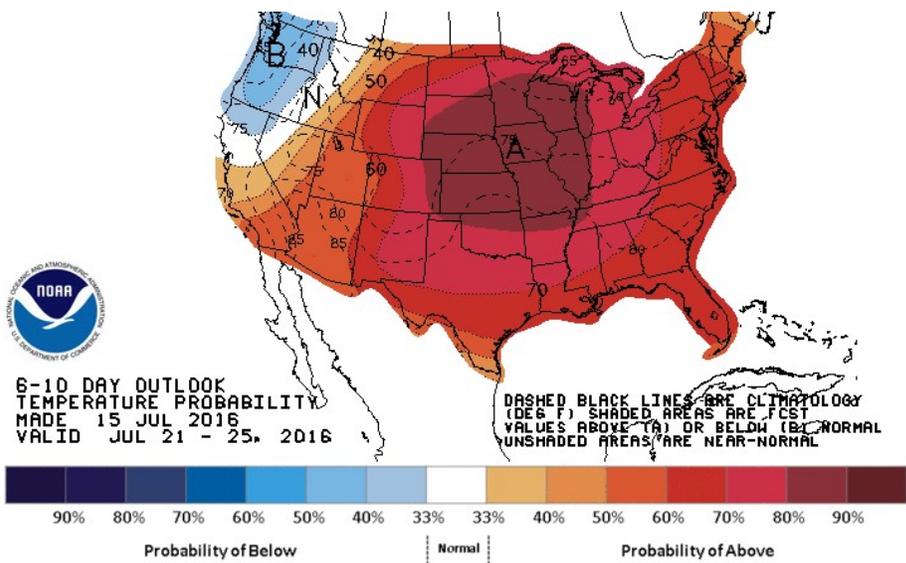
- Cheese West: Plenty of milk is finding its way into cheese vats, even in areas where milk production is seasonally down. However, domestic demand is good for most types of cheese. Retail cut and wrap cheese sales are solid. And process cheese sales are active while the nation is in the midst of grilling season. Cheese inventories continue to be long, so some manufacturers are trying to push milk into other manufactured dairy product production in lieu of producing more cheese. Others are seeking to rotate older commodity cheese out by blending with young cheese. In some cases, this is proving more difficult, as processors are finding fresh barrels a little harder to acquire.
- CWT has accepted 12 requests for export assistance to sell 1.598 million pounds of butter, 972,239 pounds of Cheddar, Gouda, and Monterey Jack cheese, and 440,925 pounds of whole milk powder to customers in Asia, Oceania and South America. The product has been contracted for delivery in the period from July through November 2016.

What's Bearish:

- Fluid Milk Pacific Northwest: Milk production is steady and industry contacts say milk intakes are in good balance with processing needs. Only the occasional load of milk needs extra transportation to find a home. Temperatures have moderated from early summer heat and cow comfort is high. Industry contacts in the mountain states of Colorado, Idaho and Utah report an abundance of milk. Milk production typically peaks in late June or early July, and this year is providing no real surprises. In Idaho, recent mild temperatures have helped move milk intakes to flush levels after a few short periods of hot weather. Most manufacturers have plenty of milk and excess milk is getting pushed into other states. A bunch of the spot loads of milk are moving into Western powder plants at \$4 to \$5 under Class IV prices. Hay is in good supply.
- Dry Whey Northeast: Sufficient whey streams are moving to production due to strong regional cheese manufacturing. Interest is increasing seasonally in the domestic market, as active trading occurs in the international markets. Inventories of dry whey are adequate in most channels.
- NDM Central: Production is active in the Central region. Manufacturers continue to make low/medium heat NDM a priority when scheduling dryer runs. Demand is mixed. Some buyers are cautious in the current market and are choosing to stay on the sidelines. Other industry contacts feel demand is picking up and report growing inquiries from buyers. Inventories in the Central region are generally long. Steady demand and active production is building inventories for several manufacturers. Heavy stocks have some industry contacts questioning the longevity of firming prices.
- Cheese Northeast: Plants are maintaining full production schedules at most area cheese operations in the Northeast. Manufacturing milk receipts remain heavy although warmer temperatures in the Northeast are leading to marginal drops in milk intake volumes. Sales to retail and food service outlets have eased following the July 4 holiday period, as typical seasonal conditions affect demand. Inventories are adequate and building.

Recommendation:

Barrel cheese put in another new high for the year, settling at \$1.74½/lb; a price not seen since June 2015. Limited barrel capacity, combined with strong domestic demand continues to be the driver. Both Class III and cheese futures finished the week solidly higher, as it feels like this spot market rally still has some legs left in it. Cheese plants continue to receive requests for product beyond contracts, the output is still at high levels with a mostly adequate milk supply. That may change, however. NOAA's 6-10 day temperature outlook is calling for above normal heat and humidity for much of the milk-producing country (see graph). Much of the impact will depend upon how cool the nights are, but even so, milk production will likely fall below levels which have been sustained close to peak, due to cool weather. The massive amount of cheese we currently have sitting in storage does give us pause, however. While spot prices are at the whim of the 30-day cheddar supply, available cheese for upcoming holiday use is plentiful, and could keep a cap on prices this fall. Should this market get "out-of-hand" to the upside (we're thinking anywhere around \$18), producers should think about establishing hedges there, or exiting previously purchased call options and taking the profit. At this point, we just don't see anything higher is possible, basis current global milk supply and demand. Longer term, there are other supportive factors, including more rumblings about the reduction in use of rBST on a national scale, improvement in Asian demand for dairy as well as continued strong domestic demand. For those reasons, we would not consider doing any hedging yet for 2017 contracts.



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