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The KDM Dairy Report – September 9th, 2016

Futures Month	Class III 09/09	Class III 09/02	Change	Dry Whey 09/09	Dry Whey 09/02	Change	Cheese 09/09	Cheese 09/02	Change
Sep-16	$16.51	$16.87	($0.36)	30.250¢	30.900¢	(0.65¢)	$1.768	$1.799	($0.031)
Oct-16	$16.70	$16.98	($0.28)	35.000¢	35.500¢	(0.50¢)	$1.756	$1.777	($0.021)
Nov-16	$16.59	$16.70	($0.11)	36.075¢	36.300¢	(0.22¢)	$1.741	$1.745	($0.004)
Dec-16	$16.20	$16.28	($0.08)	37.000¢	37.250¢	(0.25¢)	$1.697	$1.697	$0.000
Jan-17	$15.96	$15.96	$0.00	38.475¢	38.000¢	0.48¢	$1.670	$1.657	$0.013
Feb-17	$16.01	$15.96	$0.05	39.475¢	38.250¢	1.23¢	$1.670	$1.665	$0.005
Mar-17	$16.04	$16.04	$0.00	39.000¢	38.950¢	0.05¢	$1.675	$1.667	$0.008
Apr-17	$16.12	$16.13	($0.01)	39.325¢	38.750¢	0.58¢	$1.678	$1.685	($0.007)
May-17	$16.26	$16.30	($0.04)	39.000¢	39.000¢	0.00¢	$1.698	$1.697	$0.001
Jun-17	$16.43	$16.46	($0.03)	39.500¢	39.475¢	0.02¢	$1.716	$1.715	$0.001
Jul-17	$16.66	$16.65	$0.01	39.000¢	39.000¢	0.00¢	$1.737	$1.741	($0.004)
Aug-17	$16.81	$16.74	$0.07	39.250¢	39.250¢	0.00¢	$1.740	$1.740	$0.000
12 Mo Avg	**$16.36**	**$16.42**	**($0.07)**	**37.613¢**	**37.552¢**	**0.06¢**	**$1.712**	**$1.715**	**($0.003)**

What's Bullish:

- Fluid Milk Northeast: Manufacturing operations can expect the strong effect of Class I demand to limit supply intakes, as pipelines fill, particularly in the Northeast. Milk production in the Northeast and Mid-Atlantic is continuing along their seasonal declines, with sharper falloffs noted in some areas due to recent periods of heat and humidity. Mid-Atlantic milk re-distributions are supporting bottled milk sales in the Central region.
- Fluid Milk Southeast: Milk output is experiencing rapid declines in some areas. Manufacturing plant operators who typically facilitate milk distribution report very limited to no deliveries made this week as strong demand from Class I and decreases in milk production persist. Declines in Florida's farm milk output remain steady. 100 loads were imported into the state this week. As increased volumes of standardized cream come from Class I plants, ice cream processors have eased production schedules as the height of the season concludes. However, with active pulls from cream cheese and butter makers, demand remains good.
- Fluid Milk Central: Milk production in the southern area of the Central region is rebuilding incrementally as summer heat dissipates. However, milk quality issues are mounting as heavy rainstorms hit dry lot-housed dairy herds across the southern band of states. North Central area operations are benefiting from comfortable weather and abundant feed. However, milk loads clearing from the Central region into the Southeast continue to ease the supply deficits there, but limit availability of spot loads in the Central. Cheese makers are still looking for spot loads of milk on a weekly basis, but some have resorted to using NDM for fortification due to the shortfalls in milk supply and disadvantageous pricing on spot milk. Prices for spot loads range from $.75 to $3.00 over class.
- Fluid Milk Southwest: The remnants of tropical storm Newton are causing heavy rains throughout Arizona. As a result, milk yields are lower due to the wet conditions. Class I demand from retailers, food service and educational institutions is higher. Sales into Class II are seasonally decreasing. Alfalfa hay harvesting has been delayed due to the weather conditions. New Mexico milk output is steady to slightly lower. The wet conditions are reducing cows' comfort.
- Butter: Output is increasing in the East, as cream is more available, but in the Central region, churning is mixed. Cream supplies are very tight in a few processing plants as cream continues clearing into Class II and Class III. Some processors are actively microfixing bulk butter to meet the current high demand for print butter from restaurants and retailers. In the West, domestic retail demand is firm and butter is moving well through contracts. Manufacturers are using available cream to focus on filling current print orders.
- Dry Whey Northeast: Market firmness persists as participants note a growing number of transactions done at premiums. Some producers are undergoing seasonal challenges in supplying regional cash markets. Production is steady, but inventories are tight.
- Dry Whey Central: Prices are higher and industry contacts describe the market tone as firming a little. Some manufacturers report tight or comfortable inventories. A few industry contacts note some buyers are open to taking in a few extra loads to insulate themselves from potential price increases.
- Dry Whey West: Prices are higher, even though dry whey is generally available. Some industry contacts, however, say specific brands are tight or committed. A few processors suggest the commitments to higher protein concentrations is reducing the amount of dry whey they are able to make. Domestic demand is stable and export demand is solid.
- NDM: The market undertone is firmer for many industry participants, but unsettled for others. According to some processors, the recent upward GDT price movement is boosting domestic prices. Consequently, some manufacturers are holding stocks instead of selling, anticipating higher prices in the next few weeks. Low/medium heat NDM demands from bakers and cheese makers are active.
- Cheese Northeast: Some areas are experiencing fairly tight milk supplies, due to strong Class I pulls. With schools and universities back in session, pizza consumption prompts strong mozzarella orders. Retailers are attempting to stay ahead of prices they expect to trend upward as the year progresses.
- Cheese Midwest: Cheese production has slowed somewhat with the seasonal downturn in milk intakes. Manufacturers report discounted spot loads of milk are not as readily available. A few cheese makers note an increase in orders from food service over the last week. Retail orders for specialty cheese varieties are also strong. Industry contacts suggest inventories are still a little long, but not to the point of being a concern. Some cheese cutters say they have noticed a little more tightness for cheese blocks.
- Cheese West: Domestic retail and food service demand has been good. Customers are taking regular shipments and helping keep cheese stocks under control. Industry contacts say commodity cheese inventories are long, but sellers are not in a rush to clear stocks. A few cheese makers indicate their inventories of 40-pound block cheese has been drawn down to more comfortable levels leading into the fall holidays.
- Foreign Cheese: European cheese supplies available for immediate sale from manufacturers are tight to scarce. Demand remains active from consumers and food service. Northern European cheese manufacturers also have strong demand from buyers in Southern European countries. Milk supplies are not sufficient to meet cheese manufacturer interest, which is restricting desired production levels.
- This week's GDT auction saw the dairy price index rise 7.7%, reaching its highest level since early 2015. All product categories were higher, led by AMF up 15.4% and butter up 14.9%. Cheddar cheese put in a strong showing, gaining 9.0% to a U.S. equivalent $1.56/lb.

- Exports: July dairy exports were up 7% by volume over year ago levels, according to data released by the U.S. Dairy Export Council. The biggest gains were seen in NDM/SMP up 31% and whey up 12%. Shipments of powder to Southeast Asia rose 80%, with most of the whey gains heading to China. U.S. exports as a percentage of production increased to 14.4%, compared to 13.8% a year ago.

What's Bearish:

- Spot Market: Blocks finished the week up 3¢ to $1.71/lb on 9 trades, but barrels fell 3½¢ to $1.60½/lb on 24 trades. Grade A NDM gained 3½¢ to close at $0.90½/lb on 12 trades, but butter lost 1¾¢ to settle at $2.03¼/lb on 5 trades.
- Fluid Milk West: Farm milk output is slowly improving in California. Daytime temperatures below 95 degrees are supporting cows' comfort. Manufacturing milk supplies are adequate for post-holiday orders. Class 1 sales are steady to lower as the schools' pipelines are at comfortable levels. Sales into Class 3 are lower as interest for ice cream and frozen desserts is steadily decreasing.
- Fluid Milk Pacific Northwest: Although milk production is steady to lower, bottling demand has plateaued as school milk pipelines are filled. Manufacturers have adequate milk supplies for most processing needs. Milk intakes are steady to lower in the mountain states of Colorado, Idaho and Utah too. But current weather patterns are favorable for cow comfort and milk production. The good growing season has yielded a lot of high quality hay and other crops. Contacts expect feed costs to remain favorable for dairy production into the coming year.
- Grains: Feed is cheap, of excellent quality and widely available.

Recommendation:

Limited processing capacity and strong process demand resulted in the short barrel cheese supply situation that powered both cheese and Class III prides higher this summer. But with 24 loads of barrels changing hands this week and 32 loads last week, that is obviously not the case anymore. The grilling season is over and demand has now shifted over to mozzarella with pizza demand on the rise. Futures did not react kindly to the drop in spot prices, with Sep and Oct Class IIIs taking the brunt of the losses. With current spot prices working out to about $15.85/cwt, even with our weekly survey premium, cheese prices are going to need to rebound in order for the front months to start heading up. But, there are still plenty of positive fundamentals for the long term; contracting milk supply in Europe and Oceania, tight cheese supplies in the EU, improved exports and strong domestic demand, to name a few. But clearly in the near term, we need to work through some of this inventory. Milk production in the U.S. is mostly likely close to bottoming out and will now begin a slow rise heading in to the New Year. As noted earlier in this report, encouraging signs of a rebound in dairy exports will need to hold and even increase, in order to support dairy prices. We think that will happen, as it will take some time for Oceania and the EU to reverse their current production trajectory, but cheap and available feed could limit gains. Producers we spoke with this week weren't very enthusiastic about hedging at current prices. We're not either. We would repeat our recommendation from last week to target Q4 '16 at $16.90 or higher. Those that are frustrated about missing out on recent higher prices that were seen in the 2017 contracts, hang in there. Do you really believe the highs for 2017 are done and gone? A lot can happen in 4-5 months, so be patient and wait for the next opportunity. The current 2017 average is $16.50/cwt. While there is certainly potential downside from there, we believe the greater risk is to the upside. Have a great weekend.