

The KDM Dairy Report – September 30th, 2016

What's Bullish:

- Butter stocks are down 12% (3.3 million lbs) and cheese stocks fell 3% (2.6 million lbs) at USDA-selected storage centers over the period 09/01 through 09/26.
- Fluid Milk Northeast: Milk production is steady, but good bulk milk sales are limiting volumes moving into manufacturing, Mid-Atlantic milk production is steady to lower. Bottled milk demand is steady.
- Fluid Milk Southeast: Milk output is unchanged to lower at seasonal levels. Manufacturing intakes remain restrained. Florida milk is nearing seasonal lows. Some producers have initiated cow

Futures Month	Class III 09/30	Class III 09/23	Change	Dry Whey 09/30	Dry Whey 09/23	Change	Cheese 09/30	Cheese 09/23	Change
Sep-16	\$16.39	\$16.38	\$0.01	30.700c	30.700c	0.00c	\$1.751	\$1.751	\$0.000
Oct-16	\$15.21	\$15.56	(\$0.35)	33.275c	33.850c	(0.58c)	\$1.616	\$1.648	(\$0.032)
Nov-16	\$15.63	\$15.78	(\$0.15)	34.500c	34.900c	(0.40c)	\$1.650	\$1.663	(\$0.013)
Dec-16	\$15.50	\$15.73	(\$0.23)	34.825c	35.750c	(0.92c)	\$1.635	\$1.656	(\$0.021)
Jan-17	\$15.38	\$15.62	(\$0.24)	35.000c	35.850c	(0.85c)	\$1.628	\$1.642	(\$0.014)
Feb-17	\$15.50	\$15.73	(\$0.23)	35.000c	36.500c	(1.50c)	\$1.632	\$1.650	(\$0.018)
Mar-17	\$15.64	\$15.79	(\$0.15)	35.250c	37.000c	(1.75c)	\$1.650	\$1.661	(\$0.011)
Apr-17	\$15.70	\$15.86	(\$0.16)	35.250c	37.250c	(2.00c)	\$1.654	\$1.666	(\$0.012)
May-17	\$15.88	\$16.05	(\$0.17)	35.250c	37.500c	(2.25c)	\$1.677	\$1.682	(\$0.005)
Jun-17	\$16.14	\$16.25	(\$0.11)	36.000c	38.000c	(2.00c)	\$1.694	\$1.700	(\$0.006)
Jul-17	\$16.36	\$16.49	(\$0.13)	36.000c	38.025c	(2.03c)	\$1.716	\$1.724	(\$0.008)
Aug-17	\$16.55	\$16.63	(\$0.08)	36.525c	39.000c	(2.48c)	\$1.735	\$1.735	\$0.000
12 Mo Avg	\$15.82	\$15.99	(\$0.17)	34.798c	36.194c	(1.40c)	\$1.670	\$1.682	(\$0.012)

- freshening. Class I utilization in Florida, was 84.14 percent in August. This is an increase of 0.81 percent compared to last month and is an increase of 1.13 percent compared with August 2015. Imported milk shipments totaled 90 loads this week, up from 70 last week.
- Dry Whey Northeast: The regions' rate of output for dry whey is improving with active cheese processing, but whey streams are clearing to higher protein manufacturing in some instances. Limited supplies in manufacturing channels constrain spot purchases, as contract customer needs take preference. Consequently, resale markets are actively facilitating traders' dry whey requests. The dry whey market undertone is steady to firm.
- Dry Whey Central: Prices moved higher at the bottom of both the range and mostly prices series. Dry whey production is steady, however a number of industry contacts suggest there may be greater interest by manufacturers to make higher protein concentrations instead of dry whey. Contracted customers are taking most of the dry whey produced and processors report limited or no spot market whey availability.
- Dry Whey West: Demand is reasonably good. Some good volumes of dry whey continue to move into Mexico and Southeast Asia. Most whey is moving consistently through contracts, but spot market activity is a little light. Inventories are mixed. A few manufacturers report being committed through the end of the year.
- NDM Northeast: Prices continue to display strength. Production is slightly limited as some manufacturing plants' dryer operations remain down. F.O.B. spot trading has been very light. The market undertone is firm.
- NDM Central: Prices increased slightly this week. Overall, production is mixed. Extra loads of condensed skim were available, as supplies offered out of the East cleared into Central region NDM plants. But inventories are in good position and manufacturers are comfortable as NDM stocks appear to be in balance.
- NDM West: Prices are higher on light to moderate trading. The market undertone continues to be firm. Some manufacturers prefer to hold stocks at this point, anticipating higher prices in the near future. NDM demands from bakers, cheese makers and dry mix manufacturers are active. International interest, especially from Mexico, is strong. Inventories are steady to slightly tight in many plants.
- Cheese Northeast: Cheese production is steady. Some manufacturers would make additional cheese if more milk were available. It is noted that strong milk sales are pulling on manufacturing milk supplies. Production is clearing to near-term customers' accounts. Cream cheese activity continues to grow, while foodservice orders increase in the wake of typical seasonal trends.
- Cheese Midwest: Cheese production is steady. Milk intakes are relatively balanced and many manufacturers are running near full production schedules. A few processors are looking for additional loads of milk to round out production, but spot loads are a little less available for discounted prices. Retail and food service cheese orders are strong and have been building a little into the end of the year. All varieties of natural cheese have good demand.
- Cheese West: Cheese makers say they are not having any problems getting enough milk for the vats. Cheese production is active and often running near full capacity. Retail and food service demand is firm. Industry contacts still report long inventories, but processors are turning the stocks and a good pull of bulk cheese is moving into cut and wrap facilities.
- Foreign Cheese: Cheese stocks remain tight in Western Europe, with production limited by milk availability.
- International: EU 28 milk production January-July 2016 is 1.3% below the same period of 2015. This was the second consecutive month in 2016 behind 2015 levels. Of the top 6 milk producing nations, 4 had lower milk production in July 2016 than July last year. The UK had the biggest fall-off in production in July, -8.3%. Milk production in Poland for July has fallen back to near the level of July, 2014. Overall EU milk production is expected by many processors, to be weaker through the rest of 2016.
- International: Western European butter prices firmed at each end of the price range. Demand for packaged butter is good. Price increases are anticipated in coming weeks.
- International: August milk solids were 113.13 million kg, down from 116.68 million kg in Aug 2015. Observers commented that a factor contributing to lower production and solids may be bad weather at the end of this August. Nevertheless, the August 2016 results have left some anxiety about milk supply volumes that will be available for manufacturing in coming months. Cheddar cheese prices firmed slightly to a U.S. equivalent \$1.65/lb. Production in New Zealand continues to be lower than desired due to the volumes of early season milk availability.
- International: Over 52,000 farmers from 27 member states in the EU have signed up for the Milk Production Reduction Scheme. The plan aims to trim milk production in Q4 2016 by 1.06 million tons, which represents a 2.9% reduction vs. the prior year.
- International: Leading ag analysts at Rabobank now expect milk prices to rise to nearly \$6.00 per kg next year, a substantial increase from its previous forecast in the high \$4's. A rapid tightening of market fundamentals including a global decrease in milk production, combined with strong

demand in Europe and the US. Asia has returned to strong import growth in the last month, and in China and Latin America growth has continued, albeit at a slower pace.

What's Bearish:

- Spot Market: Butter plunged 13¢ to settle at \$1.89/lb on just 8 trades. Block cheese lost 2¼¢ on 24 trades while barrels managed to finish unchanged at \$1.51/lb on 40 trades. Grade A NDM was ¼¢ lower, settling at \$0.92 on 6 trades.
- Ag Prices Report: The milk-to-feed price ratio rose to 2.42 in August, its highest level since Nov 2015 (see graph).
- Fluid Milk Central: Milk production volumes are picking up, especially in northern parts of the region. Plant problems in the East have resulted in condensed skim from the East being offered in the Midwest, but with few takers. Reports are that buyer inquiries are few, because of expectations that prices will fall in the coming weeks. Buyers who can wait are comfortable with holding back. Milk sellers report that interest from ice cream manufacturers is dropping. Cream is readily available in the region. Some sources are projecting that even more cream will be on the market next week.
- Fluid Milk Southwest: In California, farm milk output is trending up. Lower seasonal temperatures are supporting cow comfort. Protein and fat components in the milk are steadily improving. Interest for Class 3 (ice cream) continues weakening. Manufacturing milk volumes moving to Class 4b (cheese) are higher as cheese operations are running near full capacity. In Arizona, farm milk intakes are slightly higher due to cooler daytime temperatures, below 100 degrees. Demand for ice cream is seasonally waning. However, interest for other Class II products as whipped cream and sour cream is ramping up. In New Mexico, milk production had plateaued as weather conditions are getting better, compared to the previous week. Milk intakes are sufficient to keep balancing plants busy.
- Fluid Milk Pacific Northwest: Milk intakes are steady and following typical seasonal patterns. Manufacturers are getting the milk they need from sources close by. School meal programs continue to pull good volumes into bottling. Manufacturers are ramping up to meet fall and winter demand for cheese and butter. Dairy contacts in the mountain states of Colorado, Utah and Idaho report there is plenty of milk for processing needs. Most dairy farmers are entering into the fall and winter season with a good quantity and quality feed stuffs.
- Butter: Production is active across the nation as cream supplies continue to be more available for churning. Many processors are running operations near to full capacity. Some manufacturers continue converting bulk into print butter after microfixing. Nationwide, print butter production is ongoing in order to meet current buyers' needs and the anticipated high demand during Q4. Overall, inventories are still well above previous years.

Recommendation:

Another 40 loads of barrels exchanged hands, but by mid-weeks, spot bidders seemed to start getting more aggressive. We really still seem to be in a supply and demand, "tug-of-war" with no clear winner. From the supply side, we generally have plenty of milk for processing, but on the demand side, it's strong and growing as seasonal interest increases. What is growing more optimistic is the international picture. Cheese is still tight in the EU, at a time when they are intentionally reducing their milk output with a government program. So much so that Rabobank is increasing their payout projections by a significant percentage for New Zealand dairy operations. Profitability in the U.S. is ok in some areas, not so good in others. Yet somehow USDA says we added 30,000 cows from Jun-Aug. Next month's Milk Production Report will be highly anticipated to see if this rate of herd growth continues or was a one-off. As the spot market continued to lose ground this week, Class III futures responded by continuing to trim premium off the market. Most contracts ended the week with double-digit losses. Current spot prices would out to about \$15/cwt, accounting for the weekly survey premium. With October in its calculation period, it will be sensitive to moves in spot. We get the feeling that the featured barrel seller is starting to tire, while bidders snap up loads. We could see a significant short-covering rally next week if spot sellers begin to run out of bullets. In regards to 2017, the improvement in global fundamentals and revisions in outlook by a major ag lender and analyst give us little incentive to recommend selling at current prices. A lot can and will happen before 2017, and we still believe the longer term risk is to the upside. Have a great weekend.

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