

The KDM Dairy Report – February 10th, 2017

What's Bullish:

- Fluid Milk Pacific Northwest: Steady bottling demand and active manufacturing are keeping any extra milk volumes from building beyond area plant capacities. Milk intakes are generally in pretty good balance with processing needs, but some industry contacts report getting inquiries from cheese makers within the region who are looking for extra milk. Unfavorable winter weather is creating some milk production headaches in the mountain states of Idaho, Colorado and Utah. The region received heavy snows and cold temperatures followed by some thawing, localized flooding, and mud. Industry

Futures Month	Class III 02/10	Class III 02/03	Change	Dry Whey 02/10	Dry Whey 02/03	Change	Cheese 02/10	Cheese 02/03	Change
Feb-17	\$16.86	\$16.87	(\$0.01)	48.250c	47.275c	0.98c	\$1.692	\$1.693	(\$0.001)
Mar-17	\$16.91	\$17.19	(\$0.28)	49.975c	47.500c	2.48c	\$1.689	\$1.724	(\$0.035)
Apr-17	\$17.02	\$17.26	(\$0.24)	50.000c	48.250c	1.75c	\$1.700	\$1.732	(\$0.032)
May-17	\$17.13	\$17.31	(\$0.18)	50.025c	48.250c	1.78c	\$1.714	\$1.738	(\$0.024)
Jun-17	\$17.39	\$17.54	(\$0.15)	50.200c	47.475c	2.73c	\$1.740	\$1.758	(\$0.018)
Jul-17	\$17.67	\$17.75	(\$0.08)	49.900c	47.575c	2.33c	\$1.768	\$1.783	(\$0.015)
Aug-17	\$17.91	\$17.90	\$0.01	50.000c	48.000c	2.00c	\$1.785	\$1.802	(\$0.017)
Sep-17	\$17.87	\$17.92	(\$0.05)	50.000c	48.250c	1.75c	\$1.788	\$1.800	(\$0.012)
Oct-17	\$17.77	\$17.82	(\$0.05)	50.000c	48.250c	1.75c	\$1.780	\$1.782	(\$0.002)
Nov-17	\$17.66	\$17.67	(\$0.01)	49.750c	48.250c	1.50c	\$1.770	\$1.771	(\$0.001)
Dec-17	\$17.48	\$17.48	\$0.00	50.000c	48.500c	1.50c	\$1.750	\$1.752	(\$0.002)
Jan-18	\$17.03	\$17.00	\$0.03	50.000c	48.750c	1.25c	\$1.716	\$1.712	\$0.004
12 Mo Avg	\$17.39	\$17.48	(\$0.08)	49.842c	48.027c	1.81c	\$1.741	\$1.754	(\$0.013)

- contacts report some farmers are dealing with cow health issues and lameness. Contacts further state milk intakes are noticeably lower. Milk supplies are adequate for many processors, but some processors are looking for extra loads of milk.
- Dry Whey Central: Prices shifted higher in both the range and mostly price series for the second consecutive week. Some contacts suggest dry whey production levels are lighter, as producers maintain focus on higher protein concentrations. Domestic demand remains strong, but questions remain as to whether Asian markets will pick up following the Chinese New Year, or whether U.S. price points are going to deter Asian exports. End users report a scarcity in spot offers of dry whey, and some buyers suggest a tightening supply.
- Dry Whey West: Prices are mostly higher, but edged back slightly at the top of the range. Whey industry contacts suggest the market tone is fairly strong and stable. Demand is mixed. Contacts say Asian buyers are just coming back to the market after the Chinese New Year, Mexican customers are cautious over concerns about currency and trade policies, and domestic shoppers are pulling good volumes of whey. A number of whey market participants look to the year over year decrease in whey production and a shift to whey protein isolate production as a cause of supply side tightness in the marketplace.
- Foreign Cheese: Cheese demand in Western Europe is expected to increase in March. Within the EU, orders from southern countries have strengthened after a weaker early year experience. Stocks are adequate to satisfy current demand. Contract discussions for the second quarter are slow to finalize. Increased uncertainty about available milk supplies is a risk factor affecting future seller and buyer pricing expectations. Last week, the Dutch farm minister stated that a reduction of up to 100,000 cows in the Netherlands may be necessary to meet EU phosphate production limits.
- CWT has accepted 6 requests for export assistance on contracts to sell 557,770 pounds of Cheddar and Monterey Jack cheeses to customers in Asia. The product has been contracted for delivery in the period from February through April 2017.
- Data released from the U.S. Dairy Export Council this week shows that December dairy export volume was up 15% vs. a year ago. Record sales of whey to China pushed exports of that product up 43% vs. Dec '15. U.S. exports of dairy products in December were equivalent to 14.5% of U.S. milk production that month. On an annual basis, U.S. dairy exports totaled 14.2% of milk production, vs. 14.0% in 2015. Exports to China in 2016 were up 57% vs. 2015, with exports to South Korea up 53% YOY.
- International: Global milk supplies are expected to remain below previous year levels in most of the key exporting nations in the first half of 2017, according to an article on The Cattle Site. Supplies coming out of Oceania will be limited for the first half of the year, as the current milking season ends in a few months. EU production remains below previous year levels. Demand for cheese and butter is expected to remain robust through 2017, with per capita consumption within the EU rising. Current stocks of cheese and butter are relatively tight. Butter production is expected to grow in the EU, although with stocks believed to be relatively low, most of the additional production is likely to be used to satisfy domestic demand. This will leave less available for export, keeping markets firm. Globally, there are likely to be lower exports of SMP from NZ, as milk is diverted to WMP and added-value products. Counterbalancing this was the view that the US may increase its SMP exports, as milk production continues to grow. Demand for SMP is still growing on a global level, helping to support the market.

What's Bearish:

- Spot Market: Cheddar blocks lost 13c this week to settle at \$1.61/lb on 25 trades. Barrels gave up 5¼c to close at \$1.65/lb on 25 trades. Grade A NDM shed 2c to settle at \$0.92/lb on 19 trades, while butter decreased 5½c to close at \$2.10/lb on 12 trades.
- Fluid Milk East: In the Northeast and Mid-Atlantic, milk production is steady and ample, clearing to balancing plants. Class I sales are flat to up. Balancing plants are clearing milk volumes to Classes III and IV. The fluid cream supplies are readily available. Milk production in the Southeast is stable, and in some areas, climbing, with anticipation of a peak in the upcoming weeks. In areas of Florida, bottled milk sales have increased marginally and the trend is expected to continue with approaching tourism in the spring months. Cooler temperatures still linger in Florida, keeping farm milk production active. With the state's milk supply exceeding local demand, Florida's export milk shipments totaled 135 loads this week, up from 110 last week and just 30 a year ago. With the ample amounts of condensed skim available, sellers in the East are clearing loads to long distance buyers at low prices.
- Fluid Milk Central: Seasonally mild weather continues to support higher milk production trends in the North and South Central areas. Milk supplies in some areas exceed local processing capacities. Bottlers report demand is generally quiet. Class II demand is lower for the week as yogurt production backs away from the demands related to New Year's resolution fulfillment. Cream demand is steady, with spot loads readily available throughout the region. Price competition between West and Central cream spot loads is keeping a lid on Central multiples, especially in locales bordering the West region. Interest from cheese manufacturers is steady to lower as they reassess cheese inventories post-Super Bowl. With

several weeks looming before the next holiday, some cheese makers are reluctant to get too far ahead on uncommitted inventories, especially in an uncertain market.

- Fluid Milk West: In California, milk production at the farm level has plateaued. However, milk intakes are more than suitable for manufacturing purposes. Consequently, balancing plants are running at full capacity, clearing large intakes of milk. After the Super Bowl weekend, Class 1 requests from retailers and food service have dipped slightly. Overall, dairy feed supplies are plentiful for late winter and early spring needs. Farm milk yields in Arizona continue to inch up as weather conditions remain ideal for cows' comfort. The requests for Class I milk are steady to higher which is alleviating some processing pressure on plants. Some handlers pulled additional milk loads to cover weekly sales, but plant managers indicate plants within the state are running close to capacity. Farm milk production in New Mexico continues to be seasonally higher as weather is favorable for dairy herds. Some balancing plants are unable to process all their daily farm milk intakes. As a result, system-wide holdovers remain high. Milk handlers are working with haulers to manage milk volumes being stored overnight and meet processing timelines. To avoid additional holdovers, farm milk is being cleared inside and outside the state to other manufacturers. Manufacturing milk intakes into Class I and Class III are higher this week as many processors are cooperating in clearing milk volumes.
- Butter Northeast: Production rates across the region are strong in a fairly unsettled market. Readily available cream supplies and uneven demand prompt active churning at most plants. Buyers are showing restraint with butter purchases, as interest continues to center around short term or immediate needs. International interest is limited, while prices continue above the global marketplace. Butter inventories are increasing, with uneasiness from manufacturers who are concerned with building inventory in the current market.
- Butter Central: Cream remains readily available for butter producers. Butter makers continue to turn spot market cream away, as internal and contract supplies are more than sufficient. Reports on demand vary. Some butter producers report stronger sales continuing from last week, while others report steady to slower sales. The market undertone is unsettled.
- Butter West: High volumes of cream are forcing Western butter makers to try to find a home for available loads of cream. Butter inventories are building. Manufacturers would like to slow their churns and control the growth of butter stocks more closely. However, summer cream specialty manufacturers have yet to ramp up production. As a result, much of the cream is finding its way into butter churns.
- Dry Whey Northeast: A few industry contacts note mixed demand and a pullback on the top end prices. Manufacturers report domestic buyers are still showing a good amount of interest, but export markets are mixed. Inventories are comfortable to tight and in pretty good balance with current demand. A few manufacturers have some whey available for immediate shipments. The market tone remains steady, but some industry contacts expressed a little unease over the direction the market may take in the next few months.
- NDM Northeast: Prices shifted lower on the range and mostly series, following downward trends on various indices. Spot sales activity has been light throughout the week. Low/medium heat NDM production is active as large condensed skim intakes are clearing into dryers in many balancing plants across the region. Inventories are steady to building.
- NDM Central: Prices moved lower in both the range and mostly price series this week. NDM demand is reportedly tepid, as end users are working through contracts and are able to be selective with spot market options. Production of NDM remains active as condensed skim supplies are abundant. NDM inventories are adequate and building.
- NDM West: Prices are lower on the mostly series, in line with downward movements on various indices. Several buyers are pushing strong in the spot market in order to get lower values. As a result, some manufacturers have been forced to drop prices to cover immediate needs from buyers. Demand for low/medium NDM from Mexico is waning as some Mexican buyers/end users are looking to buy NDM/SMP from other countries aside from the United States. In addition, Mexican SMP production has been stronger compared to a couple of weeks ago. Back into the U.S. markets, low/medium heat NDM production is active throughout the western region as milk intakes step seasonally higher. Therefore, more farm milk is clearing through balancing plants into NDM. Low/medium heat NDM inventories are steady to building.
- Cheese Northeast: Cheese production rates are moderate to seasonally heavy in the region. Surplus milk supplies facilitate the manufacturing of cheese. Meanwhile, cheddar-aging programs continue to absorb good volumes. Cheese stocks are more than adequate to meet current demand. Orders dipped, in part, with the completion of Super Bowl weekend events. Retail orders are fair, while food service orders appear steady. Export trade is moderate.
- Cheese Central: Fluid milk is readily available for cheese producers. Some cheese makers report backing away from buying extra milk as they are using supplies on hand, while others are considering selling extra milk as opposed to increasing cheese inventories. Some are continuing to run at fully active production levels, matching the abundant milk supply. Other producers, however, are cutting back on production in order to manage growing cheese stocks. Contacts report demand for pizza cheese is seasonally slow. Food service and retail orders are down as well. Some contacts expect light demand until March, when spring holiday and summer orders begin. Inventories of blocks and barrels remain long.
- Cheese West: Production is active and there is plenty of milk available to processors. Some industry contacts suggest demand is caught in a post-Super Bowl lull. Although cheese demand from food service and cut and wrap buyers has eased back a little, manufacturers say domestic cheese block demand is good. There is some interest from export markets. However, because U.S. cheese prices are still slightly higher than cheese prices in other parts of the world, exports have yet to fully develop for many U.S. cheese manufacturers. Western cheese inventories are steady to growing for blocks, but long for barrels.

Recommendation:

Markets continued to show uncertainty this week as the spot market was mainly weak. Blocks are now 24¢ below their spike high last week, shaving \$1.30/cwt off of Class III. Both butter and NDM finished the week lower as well, as the build to the flush, combined with post Super Bowl lull have slowed orders. In uncertain times, it may be best to stick with PUT options for risk management, which establishes a floor, yet leaves the upside open. Dry whey is still strong, while milk output in the EU and Oceania should limit their ability to export. While prices are on the decline now, demand is increasing globally, and the U.S. is ideally situated to meet that demand. Powder could find a bid at any moment from China, how that they are past the New Year. Consider the Mar 1675 PUT at 15¢. The April-Sep 16.25 PUT settled at an average 19.5¢/mo. Get them. That's protection for the next seven months, giving you some peace of mind, yet buying you time as this market determines which direction it's ultimately headed. We still have some bearish concerns in the near term, but remain bullish longer term.

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