

The KDM Dairy Report – February 24th, 2017

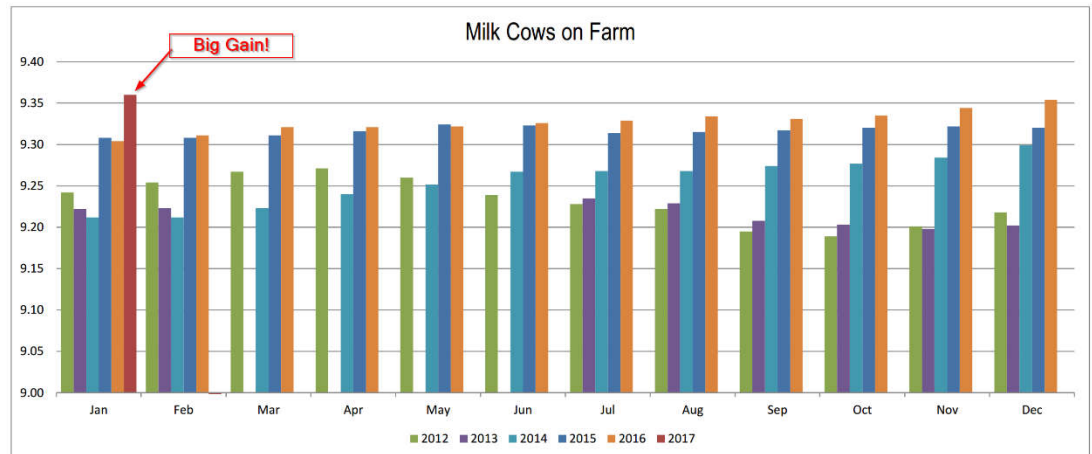
What's Bullish:

- Fluid Milk West: Recent heavy storms in California are causing multiples road closures and delays in farm milk deliveries. Milk output is flat this week. Cows are also uncomfortable with current weather conditions, leading to farm milk components being low. According to the California Department of Water Resources, the water content of the Sierra Nevada snowpack is 188% above normal for this time of the year. Producers anticipate more flooding in Northern California and are taking contingents measures in case there is a need to move cows along the San Joaquin River.
- Fluid Milk Pacific Northwest: Milk production conditions are gradually improving in the mountain states of Idaho, Utah and Colorado. However, parts of Idaho are still facing considerable challenges brought on by flooding. Lots of water from rapid snow melt, following cold temperatures, had no way to soak into the frozen ground. Streams and canals overflowed and water quickly backed up into low areas. Dairy farms close to the canal systems were hardest hit. A number of dairy farms were forced to either temporarily relocate, or deal with the flooded and muddy paddocks as best they could. Industry contacts say cull rates are rising and many hospital barns are full. In addition, hay stacks and silage piles that were flooded are significantly degraded and may not be useable. Milk production has decreased within the state.
- Dry Whey Northeast: Most dry whey is moving well through existing contracts. Industry contacts suggest the market tone is still strong, but some market participants sense a slowing market demand. Dry whey inventories are comfortable to tight.
- Dry Whey Central: Prices moved higher on both ends of the mostly price series and at the bottom of the price range. Production is steadily increasing to match surplus milk intakes, but export demand is trending upward. Inventories are adequate, but reportedly tightening.
- Dry Whey West: Industry contacts say whey stocks are generally tight. Restraints on production capacity has limited the number of dry whey spot offers.
- Foreign Cheese: Demand for cheese manufactured in Europe is steady. Supplies have been available to meet current demand although, only by dipping into manufacturer inventories. The weaker Euro is helping to boost export opportunities. For the coming weeks leading to Easter, internal European demand for cheese is expected to increase.

Futures Month	Class III 02/17	Class III 02/17	Change	Dry Whey 02/17	Dry Whey 02/17	Change	Cheese 02/17	Cheese 02/17	Change
Feb-17	\$16.86	\$16.88	(\$0.02)	48.250c	48.500c	(0.25c)	\$1.685	\$1.688	(\$0.003)
Mar-17	\$16.27	\$16.87	(\$0.60)	48.500c	49.500c	(1.00c)	\$1.629	\$1.684	(\$0.055)
Apr-17	\$16.32	\$16.90	(\$0.58)	45.000c	49.250c	(4.25c)	\$1.659	\$1.690	(\$0.031)
May-17	\$16.48	\$17.00	(\$0.52)	44.575c	49.250c	(4.68c)	\$1.677	\$1.700	(\$0.023)
Jun-17	\$16.74	\$17.25	(\$0.51)	43.975c	49.000c	(5.03c)	\$1.700	\$1.723	(\$0.023)
Jul-17	\$16.96	\$17.46	(\$0.50)	43.475c	48.925c	(5.45c)	\$1.727	\$1.747	(\$0.020)
Aug-17	\$17.09	\$17.59	(\$0.50)	42.975c	48.775c	(5.80c)	\$1.745	\$1.765	(\$0.020)
Sep-17	\$17.10	\$17.61	(\$0.51)	42.925c	48.550c	(5.63c)	\$1.750	\$1.767	(\$0.017)
Oct-17	\$17.09	\$17.63	(\$0.54)	43.225c	48.025c	(4.80c)	\$1.749	\$1.765	(\$0.016)
Nov-17	\$17.05	\$17.56	(\$0.51)	42.625c	47.525c	(4.90c)	\$1.741	\$1.758	(\$0.017)
Dec-17	\$16.81	\$17.21	(\$0.40)	41.800c	48.000c	(6.20c)	\$1.725	\$1.737	(\$0.012)
Jan-18	\$16.71	\$17.00	(\$0.29)	42.000c	49.625c	(7.63c)	\$1.709	\$1.714	(\$0.005)
12 Mo Avg	\$16.79	\$17.25	(\$0.46)	44.110c	48.744c	(4.63c)	\$1.708	\$1.728	(\$0.020)

What's Bearish:

- Spot Market: Blocks finished the week down just ½¢ to settle at \$1.57½/lb on 10 trades, but barrels plunged 10¼¢ to close at \$1.51¼ on 35 trades. Grade A NDM lost 4¼¢ to settle at \$0.82¼/lb on 10 trades, while butter gave up 2¼¢ to close at \$2.13/lb on just 2 trades.
- Milk Production Report: U.S. milk output in January was up 2.5% vs. last Jan, according to USDA. Meanwhile, cow numbers increased 6,000 head from Dec. Milk per cow also jumped 35 lbs to 1,937 lbs. At 9.36 million head, the milking herd is the largest it's been since modern record-keeping began in 1998.
- Cold Storage Report: Butter stocks at the end of January were 16% higher than a year ago and 34% higher than in Dec. American cheese stocks finished the month up 6% vs. Jan '16, while total cheese stocks were up 5%.
- Livestock Slaughter Report: 269,000 dairy cows were removed from the milking herd in Jan, but that was just 1.3% higher than a year ago, and trails percentage gains in herd size.
- Weekly cold storage numbers indicate butter stocks at USDA-selected storage centers have jumped 25% (4.04 million lbs) over the period 02/01 through 02/20. Cheese stocks over the same period are up 5% (4.26 million lbs).
- This week's GDT auction saw the dairy price index decline 3.2% vs. the last auction. Losses were led by butter milk powder, down 12.9%. Cheddar cheese lost 5.3% to a U.S. equivalent \$1.63/lb.
- Fluid Milk East: Throughout the Eastern region of the United States, milk production is gradually climbing, making production close to peak. Showery weather appears in the East this week, but does not expect to dampen production. With Southeastern milk production slightly scaling, the ample volumes of milk are moving to manufacturing plants. This week in parts of the East, bottling orders are down. Class I sales in the



Southeast dropped off a tad, and do not expect to rise soon. Florida's milk shipments will export around 140 this week, up from 125 last week and 100 a year ago. Eastern cream is readily available.

- Fluid Milk Central: Milk production is building across the region. Some parts of the South Central area received beneficial precipitation that will help winter grains and early season pastures. Record warm temperatures are prompting some industry contacts to suggest the North Central region may have an early and strong spring flush. Feedstocks are in good supply, and an early spring would help assure adequate forages are available through the expected first hay harvest of 2017. There is plenty of milk available for Class III producers. Some processors are trying to slow down production a little as a way to control the buildup of cheese inventories.
- Fluid Milk Southwest: In Arizona, milk output is plentiful, rapidly getting close to the seasonal flush level. The region is oversupplied with milk, and balancing plants have their dryers full to capacity, turning their milk into Class IV. Some of the milk is sent out-of-state to be processed. Milk production is higher in New Mexico this week following seasonal trends. Weather conditions are still favorable, allowing higher farm milk production and good quality output. Manufacturers do not have enough capacity to process all their milk intakes. Therefore, they continue clearing some of their stocks to Colorado and Texas to meet processing needs. Sales into Class I are slightly down.
- Butter: National butter processing is very active as cream supplies are abundant. Although cream demands from some cream cheese, sour cream, and ice cream processors are slightly increasing, most cream volumes are clearing into butter churns. Butter production is primarily focused on bulk. In general, most bulk inventories are building into cold storage throughout the country. International demand for U.S. butter is light as the dollar continues strong, while domestic butter prices are above international values.
- NDM East: Prices for eastern low/medium heat nonfat dry milk shifted down in the range as well as in the mostly pricing series. The market undertone is unsettled. Some buyers/end users remain quiet, studying the market. Meanwhile, other NDM customers continue putting pressure on the spot market in order to get lower prices. There are plenty of offers from manufacturers. Condensed skim volumes, prompted by robust regional farm production, are more than adequate for NDM processing. As a result, NDM inventories are steady to building.
- NDM Central: Prices are lower on the range and the mostly series. NDM spot offers are available, but some end users report being content with current supplies. With available milk, production of NDM continues at active levels. Demand is not matching increased inventories, and questions remain about export and trade deals.
- NDM West: Many buyers are taking a wait and see attitude, trying to understand what is happening in the market. Meanwhile, some consumers continue to put pressure on NDM sellers in order to get lower prices. Mexican buyers are also cautious over trade policies and currency. NDM demand from Mexico is sluggish. Back to the U.S., some processors are trying to clear NDM inventories ahead of the upcoming spring flush. Thus, there are sufficient spot offers from manufacturers to traders/buyers at competitive prices. With large condensed skim intakes clearing into dryers, low/medium heat NDM production is ongoing. As a result, inventories are building.
- Cheese Northeast: Cheese output is steady as seasonal milk volumes clear to Class III processing plants. Buyers in general remain hesitant to place orders now, with expectations of continued declines. Hence, stocks overall are growing. Block and barrel interests range from relaxed to moderate. Meanwhile, mozzarella sales are irregular and often lighter.
- Cheese Midwest: Milk is abundant for cheesemakers in the Midwest this week. Cheese production is active. Cheese producers are trying to balance their inventories while maintaining production levels that coincide with the surplus milk receipts. Some producers report a general slowdown in demand, characteristic of this time of year. Inventories of blocks and barrels are long.
- Cheese West: Although poor weather conditions in parts of the West have suppressed milk intakes, manufacturers are able to acquire loads of milk or condensed skim from inside and outside the region to keep production schedules full. Demand is seasonally lower at this time of year, but many processors are seeing a steady pull of cheese stocks from regular customers. New inquiries for cheese are a little slow to develop. Cheese stocks are rising and most industry contacts suggest both barrel and block inventories are heavy.

Recommendation:

Dairy futures of all types lost significant ground this week as near-term fundamentals turned further bearish. In spite of poor weather in some dairy-producing parts of the country, milk output in general continues to climb, to the extent that processors are struggling to handle the surplus while keeping a handle on growing inventories. Sales continue to slow. Barrels have been long for some time, but blocks had maintained a more balanced position. But the situation is changing to one of having heavy inventories of both. The current chill in relations with Mexico, our biggest dairy export market, has slowed sales to that country. Meanwhile, the U.S. continues to push towards peak milk production, which is still some weeks away. The surge in selling this week was combined with an increase in open interest, meaning, new sellers have entered the market in a big way. To top it off, we had to swallow bearish Milk Production and Cold Storage reports. The significant gain in herd size is concerning. Producers who followed last week's recommendation and bought PUT options are now glad to have the protection. As much as the market has dropped, it still feels heavy in the near term. We would still look at getting downside price protection in place through June, due to our conviction that fundamentals are going to continue to get worse before they get better.

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