

**The KDM Dairy Report – March 3<sup>rd</sup>, 2017**

**What's Bullish:**

- Dairy cow slaughter for the week ending 02/18 totaled 62,600 head, up 6.8% vs. the same period a year ago. YTD the dairy cull is up about 10,000 head from 2016.
- CWT has accepted 19 requests for export assistance to sell 2.588 million pounds of Cheddar and Monterey Jack cheeses, and 52,360 pounds of butter to customers in Asia, Central America, the Middle East and Oceania. The product has been contracted for delivery in the period from February through May 2017.
- Fluid Milk Pacific Northwest: Milk production in the mountain states of Idaho, Utah and Colorado is below

Futures Month	Class III 03/03	Class III 02/24	Change	Dry Whey 03/03	Dry Whey 02/24	Change	Cheese 03/03	Cheese 02/24	Change
Mar-17	\$15.94	\$16.27	(\$0.33)	49.400c	48.500c	0.90c	\$1.591	\$1.629	(\$0.038)
Apr-17	\$15.92	\$16.32	(\$0.40)	47.950c	45.000c	2.95c	\$1.597	\$1.659	(\$0.062)
May-17	\$16.04	\$16.48	(\$0.44)	46.975c	44.575c	2.40c	\$1.617	\$1.677	(\$0.060)
Jun-17	\$16.33	\$16.74	(\$0.41)	44.000c	43.975c	0.02c	\$1.660	\$1.700	(\$0.040)
Jul-17	\$16.62	\$16.96	(\$0.34)	41.750c	43.475c	(1.73c)	\$1.705	\$1.727	(\$0.022)
Aug-17	\$16.91	\$17.09	(\$0.18)	40.500c	42.975c	(2.48c)	\$1.740	\$1.745	(\$0.005)
Sep-17	\$16.91	\$17.10	(\$0.19)	40.375c	42.925c	(2.55c)	\$1.749	\$1.750	(\$0.001)
Oct-17	\$16.88	\$17.09	(\$0.21)	39.975c	43.225c	(3.25c)	\$1.746	\$1.749	(\$0.003)
Nov-17	\$16.80	\$17.05	(\$0.25)	40.000c	42.625c	(2.63c)	\$1.733	\$1.741	(\$0.008)
Dec-17	\$16.58	\$16.81	(\$0.23)	39.750c	41.800c	(2.05c)	\$1.719	\$1.725	(\$0.006)
Jan-18	\$16.55	\$16.71	(\$0.16)	39.000c	42.000c	(3.00c)	\$1.722	\$1.709	\$0.013
Feb-18	\$16.56	\$16.71	(\$0.15)	39.875c	42.000c	(2.13c)	\$1.720	\$1.700	\$0.020
<b>12 Mo Avg</b>	<b>\$16.50</b>	<b>\$16.78</b>	<b>(\$0.27)</b>	<b>42.463c</b>	<b>43.590c</b>	<b>(1.13c)</b>	<b>\$1.692</b>	<b>\$1.709</b>	<b>(\$0.018)</b>

- Although cow comfort conditions are improving, parts of Idaho are still dealing with flooding and mud. In addition, another snow storm blanketed parts of the region. There is concern that flooding damaged existing feedstocks and may have drowned out some alfalfa fields. It may be some time before the full impact of the flooding is known.
- Dry Whey Northeast: Prices are steady to higher. Contracts continue to clear a large percentage of current production. Producers' stocks, in some venues, appear balanced at this time. Other marketers suggest that dry whey demand outpaces production. Dry whey exports are seeing fair movement, while the market undertone is moderately strong.
- Dry Whey West: Buyers say whey producers are not offering any discounted loads and inventories are fairly tight. Manufacturers are seeing relatively good demand, especially from end users that require dry whey in their recipes.
- International: Whey prices in Western Europe increased slightly. The market is considered firm. Food whey demand for both exports and European consumption is strong.
- Cheese Midwest: Milk continues to be abundant for Midwest region cheese producers, which makes it a challenge to maintain cheese production, yet manage increasing inventory levels. However, this week cheese contacts report demand is generally improving. The seasonal lull has begun to fade and orders are slowly trending upward. Pizza cheese producers are also seeing a demand turnaround, with orders edging up compared to the past two to three weeks.
- International: Financial losses continue to register for one of the largest dairy processors in Australia. Milk supplies have decreased over 20% in the last half year due to producers ending sales to the company and going to other processors, or quitting dairy production.
- International: Butter prices in Oceania firmed this week, reaching the highest level of 2017. This was expected as a consequence of the current deemed shortness of dairy fats in the region. Most sellers in Australia, deal with a pecking order of sorts, with preference in sales going to larger and longer term customers. Buyers who do not fit that description struggle to secure deliveries.
- International: Domestic cheddar sales in Australia have continued to grow. Cheese manufacturers cite steady growth in cheese sales throughout 2016, both volumes and revenues. This week, cheddar cheese averaged a U.S.-equivalent \$1.74/lb.
- International: In Argentina, weather conditions have improved in the recently flooded dairy states of Ccrdoba and Santa Fe. However, milk production continues decreasing as many cows died due to the recent floods. In addition, the current high summer temperatures are boosting heat stress on milking cows. With most educational institution reopening, milk requests from bottlers are increasing. As a result, there is less than adequate milk supply to cover some manufacturing needs. In Uruguay, farm milk yields have plateaued in many dairy operations due to steady weather conditions. Fat and protein levels in the milk remain low. Butter production rates are lower, driven by shorter cream supplies. In Brazil, farm milk output is steady to slightly lower, prompted by higher daytime temperatures, around 95 degrees, in some key dairy states. The shortage of milk is helping to sustain higher farm gate prices. Fluid milk orders from educational institutions are strong. With an increasing consumption of milk fat and lower seasonal supply, the cream market is strengthening. Cream demands from butter churners and manufacturers of other cream based products are strong.

**What's Bearish:**

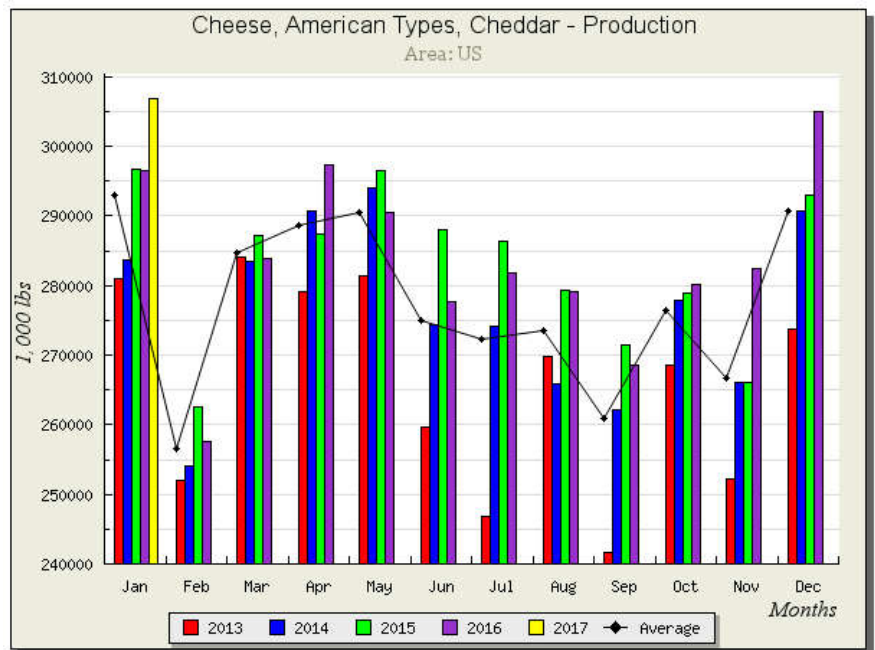
- Spot Market: Block cheese finished the week down 9¼c to settle at \$1.48/lb on 8 trades, while barrels gave up 8c to close at \$1.43¾/lb on 21 trades. NDM shed 1¼c to close at \$0.80½/lb on 8 trades, but butter gained 3¼c to settle at \$2.16¼/lb on 23 trades.
- Dairy Products Report: Cheddar cheese output in January is off to a strong start at 3.5% higher than last year. Total cheese output increased 3.7% vs. Jan '16, while butter output was up 1.2%.
- Butter stocks at USDA-selected storage centers are up 33% over the period 02/01 through 02/27. Cheese stocks are up 4% over the same period.
- Fluid Milk East: Milk production is strong. Each week, production continues to grow, filling manufacturing plants full with abundant volumes of milk. This week, in parts of the East, Class I sales were flat to weaker. Florida has been seeing near to record high temperatures for this time of year, but milk shipments out of the state were the same as the previous week. The Eastern cream supplies are readily available.
- Fluid Milk Central: Milk production continues to build across the region. With good supplies of feedstocks and comfortable weather, North and South Central contacts report milk components are particularly strong on fat and protein content. Demand from bottlers is steady to lower throughout the region as some school districts are beginning to cut back on orders ahead of spring break. Spot loads are available at \$1.50 to \$2.00 under Class. Cream, like milk, is plentiful. Some North Central region contacts were offered cream from as far away as the Pacific coast.
- Fluid Milk West: In the past weeks, dramatic storms in California have caused farm milk production to be flat at a time where it is usually increasing. However, this week, mild temperatures and drier weather are slowly replacing the showery weather, increasing cow comfort and supporting farm

milk output and quality. In Arizona, milk yield is higher this week. Current milk volumes are higher than that produced last year around the same time. Some cheese plants are working at full capacity. Harvesting of good quality alfalfa hay is active. Farm milk production is still trending higher in New Mexico this week. Some manufacturers are clearing their milk intakes into extra condensed milk. Milk volumes are more than sufficient to meet manufacturing needs. Interests for Class I are down due to school pipelines being full. Class II sales are also down.

- Butter: Although cream demand from Class II processors is improving, there are more than adequate cream volumes for butter churning. Thus, butter production is ongoing across the nation. Most processors are focusing on print butter output in order to meet improved spring holiday demand. In addition, bulk production is also active in some plants. Print/bulk butter inventories are steady to building into cold storage.
- Dry Whey Central: Production levels are corresponding to the surplus milk supplies and the active cheese production in the Midwest. Some reports suggest Southeast Asian interest may slow down due to increasing prices and comfortable inventory levels in China, while domestic demand is steady. Some contacts suggest whey is nearing or at its peak price.
- NDM Northeast: Prices moved lower in response to regional f.o.b. spot transactions. International market uncertainty is adding to the downward pressure. Production remains strong. Low/medium heat NDM offerings appear in excess of current demand. In general, buyers/sellers are currently more price sensitive. As noted by one market observer, a buyers' market appears to be developing. The NDM undertone suggests a weak market.
- NDM Central: Prices dropped on both the range and mostly price series this week. Production of low/medium heat NDM continues to be active, corresponding to milk supplies. Domestic demand is relatively steady, but not on par with building inventories.
- Cheese Northeast: Cheese production is generally heavy. Output exceeds year ago volumes due to milk receipts and the decline of interest from Class I usage. In light of the current milk supplies, cheese operations are adding to their inventory volumes.
- Cheese West: Cheese is moving well through existing contracts, and manufacturers are hopeful that softening cheese prices may provide more opportunities for export sales. However, industry contacts say current inventories are long for both barrel and block cheese. Cheese makers are busy with plenty of milk moving into cheese vats.
- International: Expectations for milk production again trending upward in the EU is closer to reality with reports this week of early year milk production in parts of Germany and France being slightly ahead of one year ago. A causal factor is prices for dairy products such as butter, whey, skim milk powder and whole milk powder, being ahead of one year ago. This is encouraging to producers and is expected to continue driving milk production to trend upward in coming months. Poland, a significant Eastern European milk producing nation, had 2.4% higher 2016 milk production than 2015, as well as 1.0% higher December 2016 production than December 2015. Preliminary estimates for January 2017 are that milk production in Poland is higher than one year earlier. Some processors note intakes over 3% higher.
- International: Skim milk powder prices in Western Europe are lower this week at each end of the price range. Weaker prices occurred in a number of major SMP producing countries including Germany, France and Netherlands. Demand has lessened, both within the EU and in export markets. Buyers in domestic and export markets seem confident in strong SMP supplies going forward, leaving buyers more languid in closing deals.

**Recommendation:**

At \$1.49/lb, the spot block/barrel average price is at its lowest since last June. The USA also now has the cheapest cheese in the world. There are hopes that this will spur new export business, but it has been slow to develop so far. Meanwhile, milk production continues to surge around the nation. Domestic orders are starting to improve as we head in to a new holiday season (Easter) and from there, grilling season is around the corner. Also, March Madness brings increased pizza demand. The July-Dec Class III average peaked near \$17.80/cwt in early Feb, and has since dropped about \$1 to a \$16.78/cwt close today. For producers who made forward sales on their milk, this may be a good opportunity to purchase upside protection in the form of CALL options. While milk output may be to improve again in the EU, the situation in South America and Oceania are far different, where milk production is still short of demand. That will become a stabilizing force as the EU and USA look to benefit from increased export opportunities. Pressure in the spot market also seems to have eased somewhat. With cheese in the \$1.40's, how much further can it fall? There is now probably more upside risk than downside for spot cheese. It may not happen next week, or the week after, but buyers currently see a bargain at today's prices. Once we get past peak production in the U.S. and the weather warms, we think prices will rebound. At this point, we would not aggressively sell anything. Producers who are more risk tolerant may even want to consider lifting hedges in the front months, or exercising PUT options and taking profits early. Have a great weekend!



**Note:** There will be no KDM Dairy Report next week, due to travel commitments.

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