

The KDM Dairy Report – May 12th, 2017

What's Bullish:

- Spot Market: Blocks gained 3½¢ for the week to settle at \$1.63½/lb on 12 trades, while barrels jumped 8¢ to close at \$1.53/lb on 26 trades. NDM increased 1¼¢ to settle at \$0.86¼/lb on 10 trades, and butter shot up 15½¢ to close at \$2.26¼/lb on 24 trades.

Futures Month	Class III 05/12	Class III 05/05	Change	Dry Whey 05/12	Dry Whey 05/05	Change	Cheese 05/12	Cheese 05/05	Change
May-17	\$15.58	\$15.58	\$0.00	51.000¢	50.750¢	0.25¢	\$1.539	\$1.541	(\$0.002)
Jun-17	\$16.21	\$15.87	\$0.34	48.250¢	47.300¢	0.95¢	\$1.618	\$1.594	\$0.024
Jul-17	\$16.68	\$16.33	\$0.35	46.525¢	44.025¢	2.50¢	\$1.679	\$1.655	\$0.024
Aug-17	\$17.10	\$16.76	\$0.34	45.225¢	42.975¢	2.25¢	\$1.728	\$1.711	\$0.017
Sep-17	\$17.28	\$17.01	\$0.27	45.250¢	43.325¢	1.93¢	\$1.746	\$1.735	\$0.011
Oct-17	\$17.14	\$16.96	\$0.18	43.750¢	42.150¢	1.60¢	\$1.740	\$1.735	\$0.005
Nov-17	\$16.95	\$16.78	\$0.17	42.250¢	41.000¢	1.25¢	\$1.730	\$1.729	\$0.001
Dec-17	\$16.73	\$16.60	\$0.13	41.050¢	40.000¢	1.05¢	\$1.712	\$1.715	(\$0.003)
Jan-18	\$16.54	\$16.36	\$0.18	39.400¢	38.375¢	1.03¢	\$1.704	\$1.708	(\$0.004)
Feb-18	\$16.50	\$16.40	\$0.10	38.775¢	38.500¢	0.27¢	\$1.706	\$1.704	\$0.002
Mar-18	\$16.50	\$16.40	\$0.10	38.175¢	38.000¢	0.17¢	\$1.707	\$1.707	\$0.000
Apr-18	\$16.43	\$16.32	\$0.11	37.175¢	36.500¢	0.67¢	\$1.709	\$1.710	(\$0.001)
12 Mo Avg	\$16.64	\$16.45	\$0.19	43.069¢	41.908¢	1.16¢	\$1.693	\$1.687	\$0.006

- Fluid Milk Southwest: Milk production in California is lower as warmer temperatures settles into the state. Sales into bottling are stable while milk intakes for ice cream and frozen dessert manufacturing are climbing to match the needs of some production lines. In Arizona, higher daytime temperatures are affecting milk output in many areas of the state. Milk production continues to slow down. In New Mexico, farm milk volumes into manufacturing facilities are stable to somewhat decreasing this week. Only 27% of pasture and range are currently in good to excellent condition.
- Fluid Milk Pacific Northwest: Milk production is still increasing after a cold, wet winter, but some manufacturers say milk intakes are tighter than usual for this time of year. While manufacturers are running facilities at or near full capacity, some do not anticipate a large spring flush this year. They suggest the harsh winter and flooding earlier in the year will have created enough stress to curtail cow lactations in parts of the region.
- Butter Northeast: Current bulk butter prices for domestic sales are reported 5-7 cents over the market of the CME Group, with various time frames and averages used. Retail interest is steady to strong, for both salted and unsalted butter.
- Butter West: Some manufacturers are predicting a slight increase in export opportunities over the next few months, and are hopeful for additional business. Butter stocks are heavy and still growing, but a few processors are selling off cream in lieu of churning. Bulk butter prices have firmed and discounted loads are less prevalent.
- Dry Whey Northeast: Cheese output in the region is high, thus whey streams are also elevated. However, dry whey supplies vary around spot market needs, as reports suggest limited availability, due to active contractual customer requirements.
- NDM East: Production is operating at high levels, as dryers run strong every day. With heavy output, low/medium heat NDM inventories are building and are adequate for near term contracts. However, some market participants communicate there is a lot of interest, and they are regularly receiving requests. A few buyers are looking for Q3 and Q4 contracts for low/medium heat NDM.
- NDM Central: Production of low/medium heat NDM is steady. Some Midwestern end users continue to wait out lower prices. However, other Central contacts report that export interest is up, and Southeast Asian buyers are finding current prices favorable in relation to other global competitors. Inventory reports of low/medium heat NDM vary from completely committed in the near term to readily available.
- NDM West: Some manufacturers think the market is firming and are holding some stocks, anticipating higher prices in the near future. This is decreasing the spot availability of NDM in some areas of the region. Meanwhile, some buyers/end users remain baffled about current NDM price trends.
- Cheese Midwest: Milk remains available for cheesemakers in the region, and spot milk prices ranged from \$4.00 to \$6.00 under Class III. However, some contacts reported that milk offers were starting to slow down, and expectations of milk intakes at current prices are nearing their end. Some plants remain on 6-7-day work schedules, but demand, both in retail and food service is generally strong. Both pizza cheese and traditional cheesemakers report that orders are increasing week over week. The cheese market tone has improved.
- Cheese West: Cheese makers are running facilities at or near full capacity to handle the milk. Industry contacts say there are large stocks of barrels, but cheese block inventories are in better balance. Cheese is generally moving well through existing contracts and some cheese makers report orders are up. A few industry contacts say retail demand is steady and export opportunities are improving. Domestic demand for American cheese varieties has been a little slow to develop, but grilling season is stimulating interest.
- Foreign Cheese: In the European Union (EU), cheese production is lower due to a weakening of their milk supplies in recent weeks. The stocks of sliced cheese continue to shrink further as demand increases. Cheese requests from retailers, large consumers and other EU countries are good. In addition, export opportunities have been consistently good. Since the beginning of May, prices have been firm, with a stronger tendency. For June, contracts are negotiated at higher prices.
- Dairy analysts at Rabobank forecast dairy prices to rise for Oceania's next milking season, according to an article in DairyNews. The recovery in prices is being attributed to low milk prices in other dairy exporting countries, resulting in a cut in production and cow numbers. In addition, China has increased purchasing and is expected to continue through the year.
- CWT has accepted seven requests for export assistance to sell 1 million pounds of Cheddar and Monterey Jack cheeses, and 440,525 pounds of butter to customers in Asia and the Middle East. The product has been contracted for delivery in the period from May through August 2017.
- International: German dairy processors report lower milk deliveries in April compared with April last year. Similar observations were made in France. Contributing factors were cooler than normal recent weather resulting in slowing pasture development. Butter prices are stronger, now at the highest level of 2017. Price advances were noted in Germany, France, Netherlands and Italy. Butter stocks in Western Europe are tight. Cream prices have been increasing, which is attributed to the lower than expected milk supply in Europe. Buyers are wary of locking in high prices, but still somewhat nervous about the potential for prices to continue upward. Recent increased demand for block butter in the short term is

particularly demanding on limited stocks. EU production of butter January-February 2017, declined 3.7% from the same period of 2016 according to Eurostat. European whey prices are stronger and set a new high for 2017. Demand has been strong and continuing price strength is expected. Concerns are voiced about potential supply tightness.

- International: Milk production in Australia continues to be limited by generally lower herd sizes, as well as dairy producer caution in making capital investments in farms after recent tough times and claw backs by some processors. While there is increasingly a sense that production recovery is underway, milk production remains lower than recent times. According to Dairy Australia, March 2017 milk production in Australia was 5.1% below March 2016.
- International: Milk production in Argentina is increasing, but slowly. The percentage of fat in the milk is at high seasonal levels. Nevertheless, the current milk/cream supply is below sufficient to cover all manufacturing needs. For some butter makers, it is difficult to find extra loads of cream as supplies are highly committed through contracts. In Uruguay, favorable climate is increasing the comfort of dairy herds. In general, farm milk intakes are adequate to meet most processing needs. Butter exports to Russia and Brazil are very active, while most whey powder is exported to China. March 2017, Uruguay farm milk volumes sent to processors were 126.1 million liters, 0.9% lower than a year ago. In Brazil, milk production has slightly improved, but the cream market continues firming due to the low availability of milk fat throughout the country. The low supply of raw material has also boosted imports of butter.

What's Bearish:

- Fluid Milk Northeast: Milk output continues to inch upward. Rainfall has been consistent but cows have been put out on grass as fields green up. In the Middle Atlantic area, milk output rises along typical patterns. Surplus milk volumes are still quite heavy, but manageable for some.
- Fluid Milk Southeast: Milk production remains active. Plants continue to ship milk to other outlets, on prearranged agreements. Manufacturing schedules have changed little from the previous week. Florida's weather continues to be very hot and dry with no rain in the forecast. Milk sales are flat, with the outlook for increasing unfavorable, as schools are set to close in a few weeks. Export milk shipments are trending higher with spot shipments totaling 170 loads this week. The cream market undertone continues on the weaker side. Supplies are abundant. Spot movement is sluggish to fair as loads clear within the East and across regions.
- Fluid Milk Central: Milk production continues at flush levels. Some contacts are reporting that spot milk offers are starting to taper a bit and that spring flush may be nearing its apex. Even so, Class III spot milk prices were reported at \$4.00 to \$6.00 under Class. Some cheese producers continue to forego fortifying cheese with nonfat dry milk, as spot milk remains plentiful. Class I demand has slowed a bit, and bottlers are concerned about summer breaks at educational institutions. Cream, which saw some firmness last week, has reportedly returned to the availability levels of previous weeks. Some contacts report that ice cream interests have not been substantial yet.
- Butter Central: Butter contacts report that ice cream producers have yet to pull down the overall cream supply, as weather has been cool and wet in the Central U.S. Butter retail sales were reportedly slower, after recent weeks have been steady. Butter production reports vary, but some producers are continuing production at steady rates in order to store bulk supplies for later in the year, taking advantage of the current cream availability. The butter market tone is fair, and butter stores continue to build.
- Dry Whey Central: Prices decreased on the bottom of the range and saw a slight decrease on the top of the mostly price series. Some end users report that spot market offers are increasing. Dry whey production is high, in line with ongoing cheese production and surplus milk supplies. Cheesemakers report that dry whey export interests are trending downward.
- Dry Whey West: Demand has been relatively good and steady. However, it has not been able to keep pace with the growth of inventories at some manufacturers' facilities. Contacts say offers from processors are increasing. In addition, market participants report there is much more price competition in some markets.
- Cheese Northeast: Milk supplies at most cheese locations challenge plant capacity. As cheese production nears annual peak levels, impending school closings are expected to add to the burden. Cheese stocks are fully adequate to ample and building, in some instances. Process interest is active as the grilling season begins. As well, sources feel that Swiss demand should pick up with the outdoor activity.
- International: While New Zealand flooding in April continues to be widely discussed as potentially having an adverse impact on milk production, data for March shows gains in milk solids. March 2017 New Zealand milk production was 1.9 million MT, up from 1.7 million MT a year ago. March milk solids, 178.5 million kg, are up from 162.4 million kg a year ago. Some observers are encouraged by a growing consensus that dairy herd rebuilding is increasing cow numbers on the North Island more than cow numbers declined on the South Island. If this continues it is expected to benefit milk production moving forward. Oceania cheddar prices firmed at each end of the price range. The continuing tightness of dairy fat supplies in Oceania is helping price strength. Consumer demand for cheese is also cited as a factor in price strength.

Recommendation:

Last week we traded 54 loads of barrels; this week just 26, even as bidders took the price up 8¢. We talked last week about the sustainability of the pace barrels were trading, and while the country is still long barrels, signs of new demand are emerging as grilling season finally settles in. We need to remember we are now in a global dairy market. So while the U.S. is awash with milk and dumping it at a record pace in parts of the Midwest, much of the rest of the world is short of dairy fats. Butter had the most impressive run, with spot up 15½¢ by week's end and butter futures trading expanded limits. Both cheese and butter are tight in Western Europe. The U.S. most definitely will need a strong pickup in export opportunities in order to support current milk production, but it appears the cards are falling in to place and we are ideally situated to meet that demand. This is why we argued last week that global demand is playing a supportive role in our pricing. Apparently, the market thought so too as we broke out of a sideways to lower trend, with some explosive moves to the upside. We gave some of that back on Friday, and we would expect more sharp moves, both up and down, going forward. We still think, however, that the larger and longer move is to the upside from here. Producers who took our advice and bought call options did nicely. We would switch to more of a PUT-buying mode if prices continue to rise next week.

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