

The KDM Dairy Report – April 6th, 2018

SPOT MARKET	3/29	4/6	Change	Trades
Cheddar Blocks	\$1.5300	\$1.6025	\$0.0725	6
Cheddar Barrels	\$1.4400	\$1.4500	\$0.0100	32
Butter	\$2.2150	\$2.2875	\$0.0725	51
Grade A NDM	\$0.6900	\$0.7275	\$0.0375	11
Dry Whey	\$0.2850	\$0.3200	\$0.0350	2

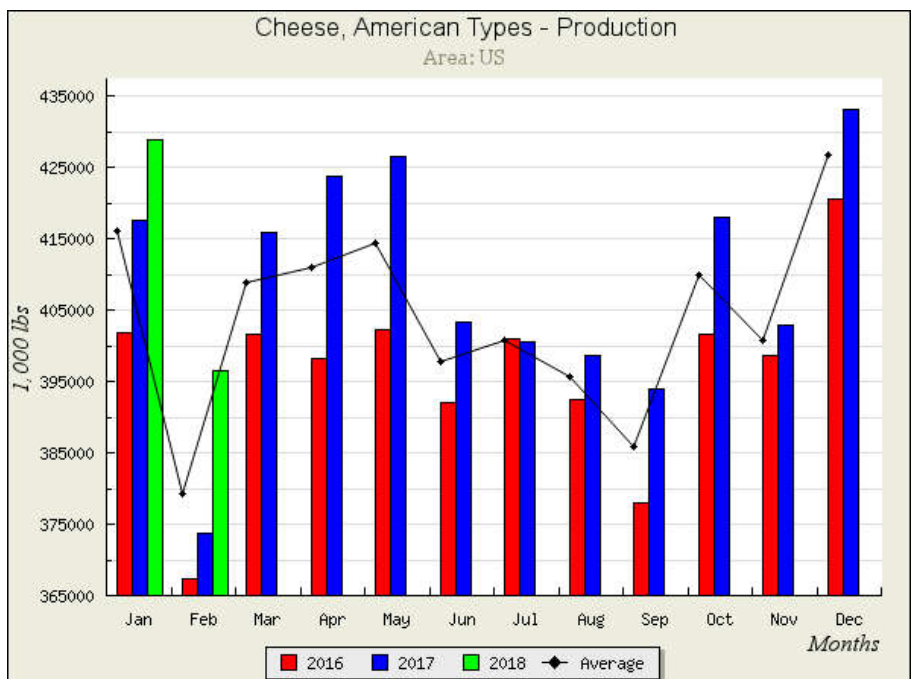
Futures Month	Class III 03/29	Class III 04/06	Change	Dry Whey	Dry Whey 04/06	Change	Cheese 03/29	Cheese 04/06	Change
Apr-18	\$14.27	\$14.41	\$0.14	26.400¢	27.000¢	0.60¢	\$1.553	\$1.563	\$0.010
May-18	\$14.27	\$14.70	\$0.43	27.500¢	28.250¢	0.75¢	\$1.541	\$1.581	\$0.040
Jun-18	\$14.66	\$15.05	\$0.39	28.250¢	28.550¢	0.30¢	\$1.580	\$1.612	\$0.032
Jul-18	\$15.23	\$15.57	\$0.34	28.525¢	29.000¢	0.48¢	\$1.637	\$1.664	\$0.027
Aug-18	\$15.61	\$15.84	\$0.23	28.750¢	29.025¢	0.27¢	\$1.669	\$1.693	\$0.024
Sep-18	\$15.90	\$16.09	\$0.19	29.250¢	29.650¢	0.40¢	\$1.693	\$1.715	\$0.022
Oct-18	\$15.90	\$16.09	\$0.19	30.000¢	29.550¢	(0.45¢)	\$1.698	\$1.717	\$0.019
Nov-18	\$15.83	\$16.00	\$0.17	30.250¢	29.675¢	(0.57¢)	\$1.687	\$1.708	\$0.021
Dec-18	\$15.78	\$15.96	\$0.18	30.750¢	30.050¢	(0.70¢)	\$1.680	\$1.697	\$0.017
Jan-19	\$15.64	\$15.65	\$0.01	31.600¢	31.600¢	0.00¢	\$1.668	\$1.668	\$0.000
Feb-19	\$15.65	\$15.66	\$0.01	31.750¢	31.750¢	0.00¢	\$1.668	\$1.667	(\$0.001)
Mar-19	\$15.61	\$15.64	\$0.03	32.250¢	32.250¢	0.00¢	\$1.661	\$1.663	\$0.002
12 Mo Avg	\$15.36	\$15.56	\$0.19	29.606¢	29.696¢	0.09¢	\$1.645	\$1.662	\$0.018

What's Bullish:

- Dairy cow slaughter for the week ending 03/24 totaled **62,700 head, up 4.9%** vs. the same period a year ago. YTD the dairy cull is **up a solid 4.8%** (40,500 head).
- Butter Northeast: Churns remain active as manufacturers have shifted production to **meet near term needs**. While some contacts report growing inventories, others relay that **current inventories meet demand**. Sales of bulk butter in domestic markets are 4 to 8 cents **over** the market of the CME Group. The market tone is stable to **firming** as butter prices on many pricing indices have **increased**.
- Butter Central: Cream levels headed for the churns are **not** where some **butter producers were expecting** following the holiday. Reported cream multiples **increased** to a tighter grouping. Butter **demand is not slowing down**. 82% butterfat loads are **sought after on the world market**, whereas 80% butterfat loads have been **moving fairly regularly** in the domestic arena. Contacts continue to relay the increased cold storage data have **not affected overall market positivity**. Where other dairy market contacts are experiencing more and more consternation recently, **butter contacts remain bullish**.
- Dry Whey Northeast: Prices ticked **higher** on the top of the range, as many pricing indices moved up. Moreover, supplies in the East are fairly stable for regular contract needs, however, spot offers are **somewhat tight** as a few manufacturers are **low on inventories**. Interest is generally stable in the region as many industry individuals are **willing to purchase dry whey at high prices**.
- Dry Whey Central: Inventory reports are mixed, with some contacts reporting **supplies are becoming more difficult to find**. Some producers are saying loads are **moving towards Asian markets**.
- Dry Whey West: Spot trades are active as market participants report an **increased purchase interest** from buyers. **Sales to the international market are up** due to higher dry whey prices in the European Union.
- NDM West: Prices for low/medium heat NDM are slightly **up** on the range. According to several industry participants, the NDM market conditions are **slightly improving** in the region with **fair/good demand** from cheese makers, bakers and the confectionary sector. Meanwhile, exports to Mexico are **active**.
- Foreign Cheese: In the European Union (EU), cheese demand has been consistently **higher** and **absorbed most of the available inventories**. During the holiday weekend, additional demand for cheese **could not be fulfilled** due to **limited availability**.
- CWT has accepted 11 requests for export assistance from cooperatives that captured contracts to **sell 2.017 million lbs of Cheddar and Gouda cheese** to customers in Asia, Central America and the Middle East. The product has been contracted for delivery in the period from March through June 2018.
- International: The **severe drought** in the Southern Cone of South America continues to affect the quality of soybean/corn crops and pasture on many farms. Feed inputs (corn/soybean) are one of the most **expensive operating costs for dairy farmers** in the region. Therefore, this represents a **major concern** for the regional dairy industry.
- Exports: February dairy export volume reached a **record high** for the month, according to USDEC, reaching **17.2%** of all milk solids produced in the U.S. That's the **highest percentage since October 2016**. Leading the surge were sales to Southeast Asia, which were **up 71%** YTD vs. a year ago. Lactose shipments to China were **double** what they were last Feb. Cheese exports were the **highest in 8 months**, while total whey exports were the **best in almost 4 years**. Finally, Mexico imported the **most NDM/SMP in 9 months**. The total volume of dairy exports in Feb were **up 19% YOY and up 14% YTD**.
- Rabobank's quarterly look at the global dairy market had some encouraging views. They expect demand from China to **remain strong through 2018**, with a **double-digit increase** in imports. As well, production issues in South America and New Zealand, as well as poor weather in the EU (cold), could help **lessen the seasonal peak** in the Northern Hemisphere.

What's Bearish:

- Dairy Products Report: Production of most dairy products was **way up** in February; a sign of increased milk production. Butter output **jumped 4.7%** above last February, while American cheese output **climbed 6.1%**. Total cheese production **increased 4.2%** vs. Feb '17.



- Over the first 19 days of March, butter stocks at USDA-selected storage centers have increased 7% (1.5 million lbs) while cheese stocks have increased 2% (1.4 million lbs).
- Fluid Milk East: Northeast milk production is slightly increasing. Milk loads are more available for manufacturing needs as bottling orders are down. Mid-Atlantic milk production is steady to flat in some parts. Many dairy producers are adding enhancements to feed for higher quality. Manufacturing operations are close to capacity as milk volumes are accessible. Southeast milk production is still on the rise. Class I sales are lower due to schools still out for break. Southeastern excess milk loads are being transported to other areas. Cream multiples are lower as current demand is somewhat decreased.
- Fluid Milk Central: Dairy farmers in and out of the region are contacting Midwestern cooperatives attempting to locate destinations for their milk supplies. As milk is already roiling throughout the region, the attempts are often fruitless thus far. Bottling is flat, and supplies are headed into cheese. This week, more cheesemakers reported opting in on spot milk supplies, as discounts remained as low as \$5 under Class.
- Fluid Milk Southwest: In California, milk processors report that milk output has reached the peak of the spring flush. Processing plants continue to process at full capacity. Some loads of milk are moving from California to Nevada to find processing homes. In Arizona, although temperatures are warming up little by little, milk output is strong following seasonal trends. Industry contacts report that Arizona is at the peak of the spring flush. Some manufacturers are sending milk loads to California to help out with balancing. New Mexico milk production slightly increased this week. Plants are running at or near full capacity.
- Fluid Milk Pacific Northwest: Milk production is trending higher, following seasonal trends. Some industry contacts say this is the beginning of the spring flush that will continue to climb through early May. Manufacturers report no shortage of milk or cream. Bottlers and processors are busy handling the early swells of milk within the region. Milk production in the mountain states of Idaho, Utah and Colorado is steady to higher. Manufacturers report there is plenty of milk for most processing needs.
- Butter West: Butter makers report spring holiday retail sales were good. However, after career through the holidays, butter orders have slowed somewhat this week. Currently, cream is readily available, butter production is vigorous and butter inventories are generally heavy and growing.
- NDM Northeast: Prices are steady to higher this week, but production is increasing, and offerings are adequate for all needs. In general, stocks are moderate to heavy for most sources.
- NDM Central: Spot market activity remained slow following the holiday weekend. Inventories and production are heavy. Condensed skim only seems to be increasingly abundant, and NDM drying is following suit.
- Cheese Northeast: With bottling orders still down, available milk loads are clearing into more manufacturing intakes. Cheese processing is steady and contract orders are fairly firm. Pricing indices are mixed, yet cheese spot sales are quite moderate this week. The wholesale price for cheddar and Muenster decreased, while the process cheese price shifted lower.
- Cheese Midwest: Cheese demand is a mixed bag this week. Reversing a trend from previous weeks, Italian style cheesemakers are reporting steady to increased sales. While on the other hand, traditional style cheesemakers, who have recently provided generally positive demand reports, are relaying decreasing sales in some cases. More cheesemakers are taking on discounted spot milk loads. This week, reported Class III spot milk prices ranged from \$2.50 to \$5 under. Milk offers are prevalent, and cheesemakers who have not opted for spot milk for a majority of 2018 are becoming more enticed with seemingly ubiquitous, discounted spot milk offers. Cheese production, falling in line with the milk multitudes, is also increasing and/or remaining fully active.
- Cheese West: Cheese production is active as milk continues to be readily available in the dairy market. Manufacturers expect production to remain solid in the coming weeks as they reach the upsurge of the spring flush. With current abundant cheese inventories, prices are fairly steady. Some industry contacts report that the prices are not reflecting the current condition of the market. Cheese inventories/production are more than demand; therefore, according to contacts, prices are supposed to be lower than they are. Post-holiday cheese sales are lower to steady. Mozzarella demand is lackluster.
- This week's GDT auction saw the dairy price index decline for the 4th consecutive event. The index lost 0.6%, led by a 7% drop in AMF. Cheddar cheese increased 2.2% to a U.S. equivalent \$1.69/lb.

Recommendation:

Despite bearish supply fundamentals as we head in to peak production in the U.S., both the spot market and most dairy futures contracts finished the week higher. By all accounts, the cheese situation is still oversupplied. February American cheese output set a new record for the month while most processors in the U.S. are running near or at full capacity. Domestic demand is good, but not stellar. So why the rally? Export numbers released today may have a lot to do with it. February exports were yuuuuuge! For domestic end-users of dairy products, this report may be reason enough to motivate long-hedging in the second half of the year. In addition, poor weather in other parts of the world, as well as rising grain/feed costs are supporting the market. Rabobank's quarterly update predicts that the Northern Hemisphere's wall of milk (recall EU production was up more than 4% last month) may not have as big an impact due to the decline in other parts of the world. So, despite the fact that the U.S. has still not seen a meaningful reduction in the size of its milking herd, that may be ok. Recent weekly cull numbers have been strong, so it will be interesting to see what next month's herd numbers reveal. That said, there are so many variables in play that it's safe to say we're not out of the woods yet. Q2 could still act as a bear with peak output coming yet in the Northeast and Midwest. A lot of cheese is going to be made. Spot loads of milk are going for as low as \$5 under class, that that cheese can be made cheaply! New tariffs against China were announced this week, with China's earlier counter tariffs playing havoc with the bean market. Will they announce still more tariffs against the U.S.? Dairy operations with fixed contracts in the second half of the year may want to think about getting more aggressive with upside coverage in the form of call options. Look at the 17.00 calls July-Dec. Up front, current spot prices work out to about \$14.55 Class III. With one week until May Class III becomes the front month, further strength in the spot market would cause it to rally. And with a 15¢ spread, blocks premium to barrels, how and when will it be narrowed? We've shown we can go extended periods with a wide spread, but strength in blocks may eventually lead to support in barrels. Should that happen, the front months will really take off. But we honestly don't know what will happen up front, given current demand/supply. Hedgers looking to avoid a price drop from this rally should consider cheap put options May-Jun, assuming spot prices keep rising next week. Hang on. It looks like we may see some volatility ahead!

