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The KDM Dairy Report – April 20th, 2018

SPOT MARKET	4/13	4/20	Change	Trades
Cheddar Blocks	$1.6050	$1.6025	($0.0025)	5
Cheddar Barrels	$1.4600	$1.5000	$0.0400	55
Butter	$2.2875	$2.3150	$0.0275	39
Grade A NDM	$0.7325	$0.8050	$0.0725	57
Dry Whey	$0.3050	$0.3150	$0.0100	2

Futures Month	Class III 04/13	Class III 04/20	Change	Dry Whey	Dry Whey 04/20	Change	Cheese 04/13	Cheese 04/20	Change
Apr-18	$14.41	$14.52	$0.11	26.000¢	26.250¢	0.25¢	$1.564	$1.577	$0.013
May-18	$14.70	$14.90	$0.20	27.775¢	28.250¢	0.48¢	$1.579	$1.601	$0.022
Jun-18	$15.10	$15.30	$0.20	29.225¢	30.850¢	1.63¢	$1.618	$1.626	$0.008
Jul-18	$15.70	$15.76	$0.06	30.175¢	32.000¢	1.83¢	$1.673	$1.666	($0.007)
Aug-18	$15.96	$16.12	$0.16	30.975¢	32.750¢	1.78¢	$1.698	$1.695	($0.003)
Sep-18	$16.21	$16.35	$0.14	31.550¢	33.525¢	1.98¢	$1.715	$1.711	($0.004)
Oct-18	$16.19	$16.35	$0.16	30.875¢	33.650¢	2.78¢	$1.713	$1.711	($0.002)
Nov-18	$16.10	$16.24	$0.14	33.000¢	34.250¢	1.25¢	$1.700	$1.698	($0.002)
Dec-18	$16.04	$16.17	$0.13	33.175¢	34.775¢	1.60¢	$1.694	$1.694	$0.000
Jan-19	$15.71	$15.81	$0.10	34.100¢	34.475¢	0.38¢	$1.664	$1.661	($0.003)
Feb-19	$15.66	$15.76	$0.10	32.350¢	33.475¢	1.13¢	$1.665	$1.656	($0.009)
Mar-19	$15.63	$15.75	$0.12	32.800¢	33.300¢	0.50¢	$1.664	$1.653	($0.011)
12 Mo Avg	**$15.62**	**$15.75**	**$0.13**	**31.000¢**	**32.296¢**	**1.30¢**	**$1.662**	**$1.662**	**$0.000**

What's Bullish:

- Milk Production Report: U.S. milk output in March was up 1.3% vs. a year ago, the smallest monthly increase YTD, and slightly below most expectations. In addition, cow number declined 2,000 head from March.
- Livestock Slaughter Report: 286,900 dairy cows were removed from the herd in March, up 5.8% (15,800 head) vs. Mar '17, and the highest recorded total for March ever.
- Dairy cow slaughter for the week ending 04/07 totaled 61,000 head, up 6.1% vs. the same period a year ago. YTD, the cull rate is up a solid 4.8% vs. last year.
- Fluid Milk Northeast: Milk production is steadily picking up on the farms, however many market participants communicate milk volumes aren't as heavy as they were last year at this time.
- Fluid Milk Southeast: In some areas, production is flat and in other areas, production is decreasing. Some market participants report fluctuating weather conditions could be the reason. Class I sales have increased, and bottling orders are taking many milk loads, taking some pressure off balancing operations.
- Fluid Milk Central: Milk intakes are more than adequate to cover most processing needs. However, some regional dairy farmers with small operations are opting to close their operations, auctioning off their herds. Meanwhile, shipments to bottling are higher.
- Fluid Milk Southwest: Balancing pressure is slowly declining in response to slight drops in California milk output. Due to aphids and erratic weather conditions, the yields were low on the first two cuttings of alfalfa hay in southern California and in Arizona. The acres used to grow alfalfa hay are down 2%, and supplies are tight. Some market participants believe this will negatively impact 2018 alfalfa hay production. Milk production is slowly dropping in Arizona as the state's climate is warming up and cows are starting to feel the heat.
- Butter Northeast: Salted and unsalted butter production is mixed as some industry contacts report decreased production. Cream is available, however, some contacts note that they are selling off cream stocks. Butter demand continues to meet expectations. Butter orders into the food service sector are strong as schools have reopened after spring break.
- Butter Central: In the Midwest, a few butter processors report limited milk/cream supplies due to some hauling delays prompted by the last weekend blizzard. This week, the volumes of post-holiday sales for both print and bulk butter are improving as requests from retailers and food service are steadily inching up while butter inventories are sufficient. The current prices of butter in the U.S. are still below the international butter values; this could represent a possible export opportunity for some domestic processors/traders.
- Butter West: Manufacturers report orders for print butter have eased since the passing of spring holiday demand. However, butter prices on the commodity markets are supported, and domestic buyers are seeking coverage. Some international buyers are looking at the favorable U.S. butter price points compared to European and Oceania butter prices.
- Dry Whey Northeast: Production is ongoing as cheese production is steady and strong. However, inventories are being kept in balance due to regular contract shipments.
- Dry Whey West: Supplies are tightening up in the spot market because of solid demand from buyers. Exports to China and Southeast Asia are snowballing.
- NDM Northeast: Prices are steady to higher as many manufacturers offered loads at increased prices. Many market participants are wondering why the sudden uptick in current pricing occurred, but traders and end users who purchase regular spot loads were willing to purchase higher priced loads this week. Inventories are around, however there are reports of some limited fresh supply in the East.
- NDM Central: Spot offer prices moved higher throughout the region as pricing indices increased. Many buyers and end users are somewhat uncertain why prices shot up as NDM supplies are available.
- NDM West: The market is steadily firming based on high demand from the domestic and international food processing industry. Exports to Mexico are strong, while domestic interest from cheese makers, confectioneries, and bakers is fair/good. Some processors are reserving some NDM/SMP volumes from recent production in order to sell it in the near future at a higher price. This is producing an apparent tightness in the spot market.
- Cheese Northeast: Production is close to full capacity as more available milk loads are being cleared into intakes. However, inventories are being kept in balance, as manufacturers report mozzarella and provolone retail orders are good. Domestic cheddar cheese spot prices are fairly steady, and some export cheddar trading prices have increased.
- Cheese Midwest: Demand has been solid. It may not be something to write home about, but better than a few months ago when winter storms in the Northeast froze out some cheese demand. Food service and retail buyers are now making consistent purchases and that is helping to keep the cheese moving.
- Cheese West: Most plants are running at full capacity, but some reports state that a number of processors are switching their output from cheddar to parmesan. Cheese supplies are heavy, but manageable. Blocks and barrels are selling well. Cheese trades in the retail sector are uneventful to slightly up. U.S cheese prices are competitive with international prices. As so, export interest remains active.

- Foreign Cheese: Inventories in the EU remain lower due to robust demand both in the domestic and export markets. Semi-hard cheese, cheddar cheese, as well as other cheese types are selling strong in Germany, making non-contractual cheese orders challenging to fulfill. In general, prices for EU cheese have remained higher.
- This week's GDT auction saw the price index reverse four consecutive losses and jump 2.7%. Gains were led by lactose, up 14.8%, AMF up 5.3% and Cheddar cheese, up 4.6%, to a U.S. equivalent $1.75/lb.

What's Bearish:

- Over the first 9 days of April, butter stocks at USDA-selected storage centers have increased 14% (3.3 million lbs).
- Fluid Milk Pacific Northwest: Milk production is generally well-balanced with processing needs, though output in the mountain states of Idaho, Utah and Colorado remains strong. Industry contacts are anticipating an early flush. Massive volumes of condensed skim continue to clear into nonfat dry milk.
- Dry Whey Central: Some buyers report receiving multiple dry whey offers, but declined due to already full inventories. Manufacturer inventories are mixed, ranging from firm to tight. Domestic demand is stagnant.

Recommendation:

What a wild week. A spring snowstorm through central Wisconsin caused several barn roofs to collapse; one of our contacts estimated more than 60 in his area alone. Spot NDM jumped 7¼¢ for the week, causing record trade volume in NDM futures contracts on Thursday. Buyers picked up 55 loads of barrels, pushing the price up 4¢ to help close the spread, while blocks somewhat unexpectedly fell 3¼¢ in Friday's spot session. Overall, this week's news and reports seemed to be interpreted as more friendly to milk prices, with Class IIIs finishing double-digits higher at week's end. Both weekly numbers, as well as this week's Livestock Slaughter report indicate the dairy cull is on the upswing. As more reports emerge of some dairies exiting the business, at least some of those cows are retired. The Milk Production Report showed a month-to-month decrease for the first time this year. Is it the start of a longer trend lower? Cow numbers have been stuck right around 9.4 million head for 6-8 months now, so perhaps a near-term top has been made. Butter demand continues to show strength, while dry whey prices are on the rise. Class IV prices have made up quite a bit of ground on Class III, with spot calculations working out to $14.43 and $14.77 respectively. Recall, the last couple rallies we've seen in Class III, were led by Class IV. Going forward, it will be interesting to see if Class IV can continue to show upside momentum. With very competitive prices on the global market, one would think that record exports we saw in February would continue to remain strong in March. Cheese remains tight in the EU. We don't want to give the impression that milk prices are ready to take off; we still have some big inventories to chew through. But the potential for U.S. milk production to start to flatten or decline, in addition to strong exports and improving domestic demand, have the potential dramatically reduce the current oversupply of dairy end products. With that in mind, we recommend producers be cautious on any new milk sales, and get more aggressive on opening up milk already marketed with call options, July-Dec.

Spot prices all came off intra-week highs, with offers in the cheese markets particularly making their presence known. As a result, nearby Class III futures finished nearly flat with a week ago. The bullish export data of a week ago quickly lost its influence as loads of actual product made its way to the CME. However, both weather and demand are supporting the market, especially the deferred futures contracts. A freakishly cold April has the upper Midwest still in the grips of winter, with 8-12 inches of snow predicted this weekend in a band across much of ND, SD, MN and WI. Parts of the Southwest, meanwhile, are in drought conditions. New Zealand has contended with very storm/wild weather, while the EU is also experiencing a very cold, slow start to spring. More farms in the Midwest are calling it quits. On the demand side, cheese is tight in the EU, and solid domestic demand in the U.S. is helping keep inventories mostly manageable. Strong milk output across the U.S. will keep cheese production high, but if demand can remain robust, warmer weather should help improve cheese prices. Butter demand continues to soar, with EU prices nearly reaching $3/lb. U.S. butter prices are very competitive and should attract strong international buying interest. Domestic butter demand is strong as well. We see only limited downside to butter prices going forward. It appears then, that we may remain somewhat rangebound as supply and demand battle it out up front. Current spot prices work out to about $14.50 Class III. Adding NASS survey premiums gets us close to $15.00. With the May contract at $14.70 and beginning its calculation next week, it is not carrying much premium and will rise or fall depending on what happens to spot cheese prices next week. We continue to recommend using cheap PUT options up front to protect against lower prices, and to purchase CALL options July-Dec to open up existing sales to potential higher prices. The July-Dec 17.00 call options averaged about 34¢ each. This might be a level you want to look at, depending on where you sold. With the weakness in the market we saw today, we may see some follow through selling next week. But all things considered, we believe there is more upside risk at current price levels than downside risk. Have a great weekend.