

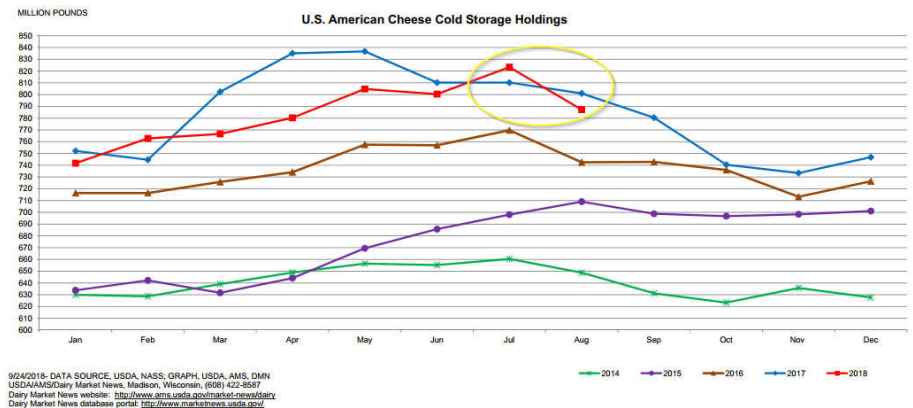
The KDM Dairy Report – September 28th, 2018

SPOT MARKET	9/21	9/28	Change	Trades
Cheddar Blocks	\$1.6350	\$1.6900	\$0.0550	0
Cheddar Barrels	\$1.3600	\$1.3825	\$0.0225	38
Butter	\$2.2350	\$2.3200	\$0.0850	26
Grade A NDM	\$0.8725	\$0.8750	\$0.0025	3
Dry Whey	\$0.5150	\$0.5500	\$0.0350	2

Futures Month	Class III 09/21	Class III 09/28	Change	Dry Whey	Dry Whey 09/28	Change	Cheese 09/21	Cheese 09/28	Change
Sep-18	\$16.14	\$16.11	(\$0.03)	41.000¢	40.500¢	(0.50¢)	\$1.655	\$1.654	(\$0.001)
Oct-18	\$16.04	\$15.80	(\$0.24)	44.000¢	43.750¢	(0.25¢)	\$1.628	\$1.599	(\$0.029)
Nov-18	\$16.37	\$16.31	(\$0.06)	45.275¢	45.375¢	0.10¢	\$1.655	\$1.639	(\$0.016)
Dec-18	\$16.24	\$16.13	(\$0.11)	45.675¢	45.750¢	0.08¢	\$1.640	\$1.623	(\$0.017)
Jan-19	\$16.02	\$15.99	(\$0.03)	43.600¢	44.000¢	0.40¢	\$1.629	\$1.620	(\$0.009)
Feb-19	\$15.88	\$15.87	(\$0.01)	42.325¢	42.075¢	(0.25¢)	\$1.628	\$1.621	(\$0.007)
Mar-19	\$15.95	\$15.89	(\$0.06)	41.000¢	40.600¢	(0.40¢)	\$1.641	\$1.633	(\$0.008)
Apr-19	\$16.08	\$16.01	(\$0.07)	39.975¢	40.150¢	0.17¢	\$1.659	\$1.648	(\$0.011)
May-19	\$16.06	\$16.04	(\$0.02)	39.600¢	39.550¢	(0.05¢)	\$1.659	\$1.654	(\$0.005)
Jun-19	\$16.10	\$16.07	(\$0.03)	38.425¢	38.550¢	0.13¢	\$1.672	\$1.669	(\$0.003)
Jul-19	\$16.32	\$16.28	(\$0.04)	39.025¢	38.000¢	(1.03¢)	\$1.690	\$1.690	\$0.000
Aug-19	\$16.46	\$16.46	\$0.00	38.250¢	38.250¢	0.00¢	\$1.705	\$1.705	\$0.000
12 Mo Avg	\$16.14	\$16.08	(\$0.06)	41.513¢	41.379¢	(0.13¢)	\$1.655	\$1.646	(\$0.009)

What's Bullish:

- Cold Storage Report: American cheese stocks declined a strong 36 million lbs from July to August (see graph), leaving inventories at the end of the month down 2% vs. a year ago. Total cheese stocks ended the month up 2% compared to August 2017, but were down 4% vs. July, due to the strongest drawdown since 2004. Butter stocks at the end of August were 4% higher than last year, but down a solid 9% from July.
- Dairy cow slaughter for the week ending 09/15 totaled 63,500 head, up 5% vs. the same period a year ago. YTD, the cull is up 100,000 head vs. 2017.
- Cheese stocks at USDA-selected storage centers declined 2% (1.4 million lbs) over the period 09/01 through 09/24. Butter stocks over the same period plunged 9% (4.5 million lbs).
- Fluid Milk Northeast: Milk production is fluctuating up slightly in the NE, but manufacturers' production schedules in the Mid-Atlantic are mixed as milk is somewhat tight. There is capacity in some balancing facilities.
- Fluid Milk Southeast: Milk production is stabilized this week, with little to no reports of milk levels rebounding. Class I sales continue to be active and some manufacturers are receiving milk from other parts of the East for processing needs. Florida's milk production is level. Class I sales are steady to lower, but some manufacturers are still sourcing for available milk from other regions. Cream availability is tight in the region. In areas that were affected by Hurricane Florence, buyers are actively purchasing cream and many haulers have dedicated themselves to transport cream where need be. Condensed skim availability continues to be tight in the East. Some manufacturers are regularly offering loads to contracts, however some do not have adequate supplies for the spot market.
- Fluid Milk Central: Some Minnesota milk handlers are suggesting lowering levels, while Wisconsin contacts suggest milk output is balanced, with supplies being pulled in a variety of directions. Bottlers are playing a prominent role in the pulldown. Cheesemakers are receiving more offers of spot milk at premiums. Reported spot milk prices ranged from Class III to \$1.50 over. Churn cream prices increased because, like fluid milk, it is being pulled into multiple varieties of end usage and into the Southeast.
- Butter Northeast: Markets continue to trend higher in meticulous fashion ahead of the baking season. The prices for bulk butter range from \$0.0500 to \$0.0800 over based on CME Group with various time frames and averages used. There are some reports of a dip in cream availability in areas. Retail store sales are good, prompted by an uptick in ads.
- Butter West: Spot loads of cream are limited for use in butter manufacturing. Butter production is currently stable. Nonetheless, not too many loads are available for spot sales. Market participants are optimistic about holiday butter sale opportunities, and buyers are starting to plan for their holiday butter needs. In general, butter sales are steady to higher depending on the seller.
- Dry Whey Northeast: Prices increased this week. Buyers' demand is stable as many market participants are trading at higher prices. Also, there are a few traders who purchased dry whey from resellers at premium prices. However, there are reports of some price resistance in the East. Dry whey production is steady to a bit lower as some operations have scheduled maintenance. Manufacturers' inventories are fairly adequate for contracts, but limited for the spot market.
- Dry Whey Central: Midwestern producers relay that whey is moving well through contracts, and a growing number of spot offers are moving into the low to mid \$.50s. That said, there is buyer hesitation at those prices.
- Dry Whey West: Prices moved higher this week. Industry contacts say there is talk within the industry of whey prices softening in Q4, but so far, they have not seen it. Market participants suggest whey availability is improving. However, buyers seeking specific brands of whey or multiple loads will likely encounter premium prices. Demand is stable. Processors are making whey in an effort to catch up on contracted obligations.
- NDM Northeast: Manufacturers are comfortable with inventory levels. With lighter milk production in some areas of the region, output volumes have dipped at some plants. While this week appeared sluggish for trading, overall, demand is good.
- NDM Central: Producers' inventories are limited to balanced, while brokers' inventories are reportedly more accessible. Production is active, but producers are reporting an increased focus on buttermilk and high heat NDM drying, which will potentially limit low/medium heat NDM drying.



- Cheese Northeast: Output is steady to lower currently, as some operations are closed for scheduled maintenance. In addition, milk availability for Class III is a bit lower for cheese processing than in recent weeks. Mozzarella and provolone processing are active, and customers' orders have increased with the reopening of educational institutions. Swiss cheese production is healthy, but with lower milk volumes, processing is not as vigorous for this time of year. Cheddar cheese production is fairly stable. Cheese inventories are adequate for immediate needs. There are reports of higher demand from retail and food service sectors, as customers are actively purchasing cheese.
- Cheese Midwest: Producers of gift/package cheddar, muenster and Colby style cheeses are taking in more milk to meet increasing demand needs. Mozzarella and provolone producers relay orders are flat to up week over week. Spot milk supplies are accessible, but most are at premiums. Reported spot milk prices ranged from Class to \$1.50 over. Some milk handlers suggest premiums could go over the \$2 mark in the near term.
- Cheese West: Contacts report strong domestic retail and food service demand are lending support to block prices. Some processors that make packaged retail goods say they are over committed through the end of the year. Furthermore, with the advent of the American football season, pizza sales are helping to clear stocks of stored mozzarella. Currently, there is an industry sentiment that suggests blocks are tight and barrels plentiful.
- Foreign Cheese: Demand for semi-hard cheese is good, especially that of the food retail sector. Supply is steady, but limited for short-term inquiries. Cheese output is consistent with seasonally lower milk production and component levels. Sales of German cheese to other global destinations are good.
- CWT accepted five offers of export assistance to sell 850,984 lbs of Cheddar cheese, and 440,925 lbs of whole milk powder. The product has been contracted for delivery in Asia and Oceania for the period from October 2018 through March 2019.
- International: While Australia had a strong start to the current milk season, that has not persisted. Unofficial expectations are that through August, milk production in Australia this season will be lower than last season. Victoria, a significant milk producing state, is expected to show declines. Near term confidence of many Australian dairy producers is believed to be lagging. Some are voicing concerns that the current season will be worse financially than the last one. Drought is a common concern and factor for diminishing confidence in seasonal outcomes. Eastern and Northern Australia are regions particularly suffering from dry conditions. Recent meteorological forecasts note an increased chance of an El Nino in coming months, leading to below average rain across northern and eastern Australia.
- International: Oceania butter prices are slightly higher at each end of the price range. At this time early in the milk production season, butter stocks are getting tight and butter production is not receiving enough milk for many butter plants to push closer to desired capacity. Complicating the situation, cream cheese manufacturing is very actively sourcing cream. Almost all current production is already committed through the year. Q1 2019 is nearly all committed as well. Prices for 82% butterfat averaged \$1.99/lb.

What's Bearish:

- Fluid Milk Southwest: Milk production in California is flat to increasing. Supplies are sufficient to meet current demand. Arizona milk output is flat this week. Evening temperatures are cooler while daytime temperatures remain in the high 90s. This is helping cows to recharge partly in the night and maintain good milk yield. Milk components have also started to improve. Milk output in New Mexico is increasing. A significant upsurge has been noticed on Class I milk intakes as well. Manufacturing facilities are running close to full capacity.
- Fluid Milk Pacific Northwest: Milk handlers report strong demand for loads of milk as manufacturers run at or near full capacity. In the mountain states of Idaho, Utah and Colorado, milk production is following typical seasonal patterns. Manufacturers are running heavily, and intakes are in relatively good balance with production runs.
- Butter Central: Butter sales have remained steady week over week, while supply reports range from balanced to longer. Domestic inquiries into salted butter continue apace, but export interest into unsalted varieties is slower.
- NDM West: Prices have declined on the range, but stayed steady on the mostly price series. Sales are softer than a week ago because buyers/end-users are making minimal purchases while waiting to see how prices evolve in the coming weeks. Export demand from Mexico is steady. Production is stable to growing in conjunction with higher milk output. Supplies are also increasing and surpass current demand.
- International: Most European dairy sources have left behind concerns about the impact of earlier summer heat and dry conditions. Milk production has normalized and processing plants have seasonally normal to normal plus milk volumes available. What are considered relatively good farmgate milk pay prices are bringing good production volumes forward. The product with the best returns for most processors in Western Europe is cheese. This is moving most extra milk to cheese vats. Cheese production in the EU January-July this year increased 2.1% from the same period last year, according to Eurostat.
- International: New Zealand continues to show good production increases. Very favorable weather has contributed to milk production increases higher than many industry participants had expected. New Zealand pastures are described as pretty green. August 2018 New Zealand milk production was up 4.5% from August 2017. August 2018 milk solids are up 4.6% vs. August 2017.

Recommendation:

Stronger domestic cheese demand is starting to help make up for declines in exports, but it still hasn't been enough to move markets. American cheese stocks saw a very strong July-Aug decline as schools reopened and pizza season began. Spot cheese prices ended the week higher. There were no block trades as supplies are a bit on the snug side. But barrels remain in surplus, with 38 loads exchanging hands this week. The spread now sits at 30¼¢, the second highest ever. With blocks less available, will the spread begin to close with barrels moving up? Who knows in this market! We may sit at a wide spread for some time, like we have in more recent history. Dry whey and NDM still appear firm, but with more buyer pushback at these levels. They may be approaching the end of their rally. Spot butter gained 8½¢ this week and looks to be making another run. International prices are lower, however, so it may be limited. Current spot prices work out to about \$15.40 Class III. Adding NASS survey premium, it's closer to \$15.80 to \$15.90. October futures settled at \$15.80 today, so price direction going forward will dependent on whether barrels move next week. Producers continue to struggle with profitability and cull numbers continue to be strong. We continue to watch for the tipping point when supply final begins to decline YoY. In the meantime, we see limited downside risk from current levels.