

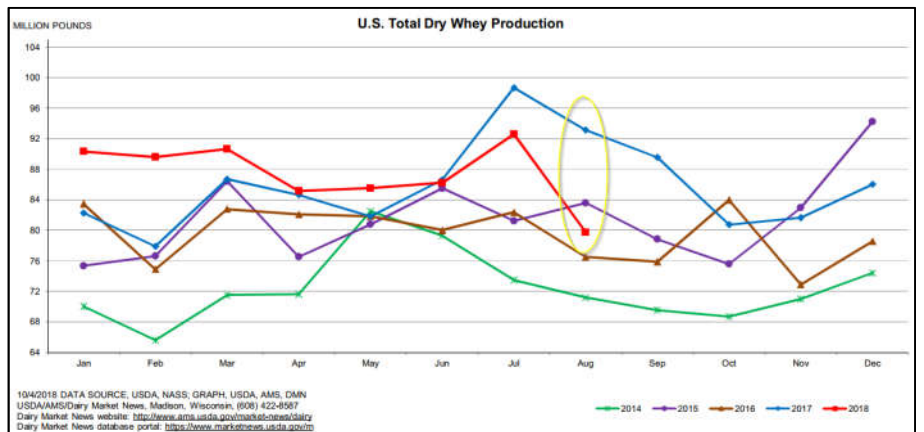
The KDM Dairy Report – October 5th, 2018

SPOT MARKET	9/28	10/5	Change	Trades
Cheddar Blocks	\$1.6900	\$1.6500	(\$0.0400)	21
Cheddar Barrels	\$1.3825	\$1.3675	(\$0.0150)	36
Butter	\$2.3200	\$2.2900	(\$0.0300)	50
Grade A NDM	\$0.8750	\$0.8600	(\$0.0150)	6
Dry Whey	\$0.5500	\$0.5625	\$0.0125	1

Futures Month	Class III 09/28	Class III 10/05	Change	Dry Whey	Dry Whey 10/05	Change	Cheese 09/28	Cheese 10/05	Change
Oct-18	\$15.80	\$15.81	\$0.01	43.750¢	43.050¢	(0.70¢)	\$1.599	\$1.603	\$0.004
Nov-18	\$16.31	\$16.05	(\$0.26)	45.375¢	45.350¢	(0.02¢)	\$1.639	\$1.613	(\$0.026)
Dec-18	\$16.13	\$15.97	(\$0.16)	45.750¢	46.625¢	0.88¢	\$1.623	\$1.602	(\$0.021)
Jan-19	\$15.99	\$15.85	(\$0.14)	44.000¢	44.525¢	0.52¢	\$1.620	\$1.604	(\$0.016)
Feb-19	\$15.87	\$15.77	(\$0.10)	42.075¢	41.800¢	(0.28¢)	\$1.621	\$1.613	(\$0.008)
Mar-19	\$15.89	\$15.79	(\$0.10)	40.600¢	40.000¢	(0.60¢)	\$1.633	\$1.628	(\$0.005)
Apr-19	\$16.01	\$15.95	(\$0.06)	40.150¢	39.325¢	(0.82¢)	\$1.648	\$1.646	(\$0.002)
May-19	\$16.04	\$15.97	(\$0.07)	39.550¢	37.500¢	(2.05¢)	\$1.654	\$1.656	\$0.002
Jun-19	\$16.07	\$16.07	\$0.00	38.550¢	37.300¢	(1.25¢)	\$1.669	\$1.671	\$0.002
Jul-19	\$16.28	\$16.21	(\$0.07)	38.000¢	37.375¢	(0.63¢)	\$1.690	\$1.697	\$0.007
Aug-19	\$16.46	\$16.42	(\$0.04)	38.250¢	37.300¢	(0.95¢)	\$1.705	\$1.715	\$0.010
Sep-19	\$16.53	\$16.55	\$0.02	38.000¢	37.550¢	(0.45¢)	\$1.712	\$1.720	\$0.008
12 Mo Avg	\$16.12	\$16.03	(\$0.08)	41.171¢	40.642¢	(0.53¢)	\$1.651	\$1.647	(\$0.004)

What's Bullish:

- Sunday evening, Canada agreed to a new trade deal, called USMCA, to replace NAFTA. With it, Canada will eliminate Class 6 and 7 milk, which shut down U.S. exports, as well as gradually open up more of their country to dairy imports. It also means Mexico will drop it's 25% import tariff on U.S. cheese.
- Dairy Products Report: Dry Whey output in August fell 15% vs. a year ago (see chart), while manufacturer's stocks for human consumption at the end of the month was 28% lower than in 2017. American cheese output increased 2.7% while total cheese output rose 2.8%, but both were in line with expectations.
- Driven by stronger same-store sales and customer traffic levels, the Restaurant Performance Index (RPI) registered a healthy gain in August, according to the National Restaurant Association. The RPI stood at 102.0 in August, up 1% from a level of 101.1 in July. The Current Situation Index stood at 102.3 in August - up 1.6% from July and the highest level since December. August represented the seventh consecutive month in which the Current Situation Index stood above the 100 level in expansion territory.
- August dairy exports were strong, working out to 16.8% of total U.S. milk output for the month. The improvement was led by a 26% YoY increase in powder sales to Mexico, which reached a 22-month high, according to USDEC. Total dairy export volume was up 12% vs. a year ago.
- Dairy cow slaughter for the week ending 09/22 totaled 60,700 head, up 0.8% vs. the same period a year ago.
- Fluid Milk Southeast: Milk production is flat to slightly down. Milk is being moved into the region from the West to meet bottling demand. The expected uptick in milk production has been slow to develop, especially in Missouri and Arkansas. It is noted at balancing plants that more milk was being received from those states in early October last year than is the case this year. No milk is going from balancing plants into dairy manufacturing plants. Florida milk production has been bottomed out for a while. Weather is still hot, with slight cooling at night. Dairy producers and cows would welcome a break from the unrelenting heat, typically reaching the 90s most days since May. Continuing heat has taken a toll. Higher production is not expected until weather cools more. Bottled milk sales are slightly up. Sales will start some uptick as the pace of winter residents heading to Florida picks up.
- Cream East: Cream is more difficult to obtain than many buyers had thought would be the case. Spot market competition for cream has been noted to include more interest from whole milk powder manufacturers than has recently been typical. Competition from cream cheese and sour cream manufacturing contributes to cream supply tightness. Cream from Indiana, Ohio and even Michigan is flowing into the East. Activity to secure cream for making butter from late October to early December is increasing. Even when cream is available for purchase, transportation in more and more a challenge. There have been instances where booked trucks simply do not show up, leaving plants scrambling. Condensed skim availability is tight. Most deliveries are to fill contracts. There is little activity for spot market transactions.
- Fluid Milk Central: Component level reports indicate a downtrend in the Upper Midwest. Contacts suggest milkfat coming from the farm has remained at lower, summer-like levels, along with overall volumes. Additionally, as milk loads continue to head to bottling plants, cheese, butter and other processing facilities are taking in less milk. Cheesemakers continue to report Class III prices to \$1.50 premiums, but there are some that suggest offers have ebbed, and higher premiums are expected near term. Cream continues to be steady to tight, depending on the area. Market participants relay cream availability is tighter than expected at this point in the season. Upticks in cream intakes by cream cheese producers have played a role.
- Butter Northeast: Cream supplies are somewhat elusive, keeping butter production rates fixed. A few retailers sought to lock in a butter price for holiday promotions. Customers' butter orders, under the private label brand, are upbeat. Inventories are moderate to light.
- Butter Central: Producers are still going lighter on the churns, as cream availability is tighter than some had expected this time of year. Milkfat is reportedly slight, along with other components. Bulk butter is being sought after and prices have increased. Some contacts suggest there is a possibility of butter prices reaching 2018 highs this fall.



- Butter West: Food service orders have remained strong and retail orders are building. Some processors expect retailers to start actively promoting print butter to attract shoppers into their stores in the next few weeks. As expected, inventories are getting pulled down with the heavy orders. Various specialty food processors are ramping up their calls for bulk butter ahead of the fall harvest and baking seasons.
- Dry Whey Northeast: Many market players are keeping their purchase steady and are not looking to buy additional loads of dry whey due to prices being too high for them. Some of the players are adopting the wait and see approach while others are looking for alternative products in the whey protein complex market. However, dry whey output is slow and milk availability is limited. Supplies of dry whey are sufficient to meet contractual requirements but are restricted for short-term spot needs.
- Dry Whey Central: Prices shifted up on the top of the range. A majority of offers are now trending toward and above the \$.50 mark, but hesitant buyers are wary of adding to their inventories. Supplies are tight, and some producers report loads are headed directly to contractual obligations.
- Dry Whey West: Prices inched up at the bottom of the mostly price series. International demand hasn't changed much from a week ago. Inventories continue to be tight.
- NDM Northeast: Prices edged up, with most current offers/trades trending toward the \$.90 mark. Contacts suggest most NDM drying is contract bound. Milk supplies have been limited and condensed skim demand is trending upward. Producers suggest that one more factor in the low/medium heat NDM supply reduction is that if supplies are available, high heat NDM drying is picking up to meet those demand needs. The NDM market tone is steady to bullish.
- NDM Central: A growing number of sales are falling into a tight price bubble just below, at, or just above \$.90. Overall spot activity was busier. Producers suggest tight to balanced inventories and solid demand, and a few have nothing to offer on the spot market. The market tone is mostly positive. With alternative powders garnering more dryer time and already somewhat tight inventories, higher offer prices could begin to catch more buyers' eyes.
- NDM West: New contractual agreements for Q4 are beginning to take place between processors and customers. Meanwhile, in the political environment, new trade agreements are being established between the United States, Mexico and Canada, which for several contacts is positive for the welfare of the nation's dairy industry. The market undertone is stable as demands from the bakery and confectionary sectors are improving ahead of the year-end holidays. In the same way, several regional cheese processors continue pulling strong on NDM for cheese fortification.
- Cheese Northeast: Repair and maintenance workloads at certain eastern cheese processing facilities prevented those plants from operating at full capacity this week. Furthermore, Class III milk intakes are steady to somewhat lower. As the result, cheese output in the Northeast has remained stable to decreasing. Swiss cheese is not as much manufactured this week due to limited milk availability. Mozzarella and provolone sales have picked up with the pizza season and the resuming of school terms. Retailers and restaurant managers are also taking in more cheese.
- Cheese Midwest: American style cheesemakers have relayed production days are or have already increased, as heavier Q4 orders are beginning to come in. Those inventories are reportedly tight. Additionally, some pizza cheesemakers continue to see steady demand and production activity. Milk handlers are relaying they are swamped with calls from cheesemakers. Milk handlers are expecting longer term contracts, throughout Q4 and into Q1 2019. They suggest, however, cheesemakers are generally not interested in mid/long term milk contracts. Spot milk prices ranged from Class III to \$1.50 over.
- Cheese West: Demand has remained strong like it was last week. Intakes from retail stores and restaurants have increased and contributed to higher block cheese prices. Mozzarella demand by pizza manufacturers is very active. As the result, stocks are starting to tighten up. Some industry players state that their inventories are fully committed for the rest of 2018.
- Foreign Cheese: In Germany, sliced cheese sales are good this week. Domestic retail and wholesale orders are solid. Cheese production is unchanged from last week. Due to declining milk output, cheese processors are unable to adjust higher current cheese production volumes to match the needs of the industry. As so, cheese inventories are still lower and insufficient to meet short-term requests. Next month, milk production is expected to decrease while cheese demand will most likely increase. As a result, the cheese supply is unlikely to improve soon.
- CWT accepted three offers of export assistance from CWT that helped them capture contracts to sell 612,885 lbs of Cheddar cheese. The product has been contracted for delivery in Asia, North Africa and Central America for the period from October 2018 through January 2019.

What's Bearish:

- Fluid Milk Northeast: Milk production is in the early stages of being slightly up seasonally in some areas, reversing the recent trend lower. Intakes are increasing in some New York plants. Balancing plants in Massachusetts report steady milk intakes. Some mid-Atlantic plants are receiving milk from other areas such as New York, where intakes have increased. Some regional balancing plants being already well stocked with butter are not churning now.
- Fluid Milk Southwest: In California, milk production is generally flat. Some plant managers say that they are receiving more milk than expected, but they have enough capacity to handle all the milk volumes. However, in the southern part of California, there have been some reports of milk deficit. As so, milk prices are higher in that area. In Arizona, slightly favorable weather conditions are helping milk production to remain steady. Milk intakes into both Class I and II customers are firm. Supplies and demand of milk are in good balance. New Mexico milk production is stable and in line with the needs of the industry. Component levels are improving week by week.
- Fluid Milk Pacific Northwest: Manufacturers report getting plenty of milk needed for processing. Milk production in the mountain states of Idaho, Utah and Colorado is heavy, but generally in good balance with processing needs. Condensed skim is plentiful, and some plant managers are looking for alternative ways to clear it.
- This week's GDT auction saw the dairy price index decline 1.9%. There has not been an increase since the May 15th auction. Cheddar cheese fell 1.2% to \$1.57/lb.

Recommendation:

A strong economy is providing strong domestic demand, and that is starting to eat in to supply. And while the new USMCA trade agreement will take time to implement, it does provide certainty to both international buyers and sellers, which should encourage deals to be made. Despite the improving conditions, barrels gave up 1.5¢ on the week, putting the block/barrel spread back near record levels. Class III finished the week lower as a result. One has to wonder the connection between spot and reality, but that is another discussion. It does appear to be broken, as far as a price discovery tool is concerned. We still think upside price risk is greater than downside at current levels, so wouldn't be aggressive sellers in Q4 or 2019 at this point.