BATORY FOODS

Dairy Newsletter

Dairy Commodities Summary

March/April 2016

Milk Production

There is a lot of milk out there.

The European Union is still producing milk. Despite falling farmgate prices and stocks moving into intervention, dairy farmers are still putting up huge numbers. EU output on a January-to-January basis grew over 5%. One publication compared that to a US growth of almost 7% and a whopping 35% or more in New Zealand. This is a lot of milk. There is talk about allowing voluntary supply controls by countries. This would be a return, to some degree, of a form of quotas that the European Union just jettisoned.

US production grew tepidly at 1%, led again by the Midwest at 4.3%. California and the Southwest remain in the negatives. The Northeast showed strong output at 2.5%.

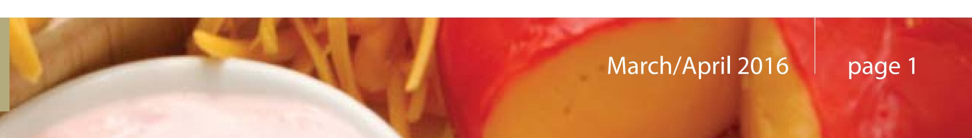
New Zealand's output continues to be hampered in part by poor commodity prices and poor returns at the farm level. Farmers are expected to dry off cows early rather than limp along with the feed, labor and energy expenses associated with milking. If there isn't a turnaround in pricing soon, they could also see an increase in culling.

We have entered into an extended period of very low pricing in the powder markets. Both nonfat and whey continue to hover at lows not seen in years or, in the case of nonfat, ever. Producers note some signs of a potential price increase:

- You've heard the old saying, "the cure for high prices is high prices"? Some say the corollary is true. Low prices should eventually spur buying and move prices higher.
- Is it going to be hot this summer? Strong evidence indicates the likelihood of higher temperatures across the country this summer. The El Nino which has been in place for most of the winter is rapidly deteriorating, moving toward La Nina. Will this make a difference? A hot summer may mean increased demand for ice cream, but it may not be hot enough to effect milk production.
- The dollar is not as strong as it once was, making our exports more attractive to the world market.

In our view, all of this is more optimistic contemplation (wishful thinking) than anything else. The bearish fundamentals, at least for the near term, are strong:

- A lot of milk is coming down the road. In the US, we are entering the flush and processors will need to push a lot of fluid milk through the doors. That means growing stocks of cheese, nonfat, butter and whey.
- With huge stocks, there is no real sense of urgency for end users to go out and buy. Certainly, those that need assured volume will continue to forward contract. Those who can comfortably operate through spot buys will do so with little concern.
- Demand from the key international markets—Asia, Africa, Russia—is still sluggish. Increased demand from those regions will be needed to really clear the inventories and get prices on the rise.



Two ingredients that seem to defy this trend are butter and nonfat dry milk high heat. The spot butter market, while cycling up and down, remains strong; the futures are elevated as buyers desire coverage going into the year and, specifically, the fall. We have had and continue to have strong production and good inventories. Yet prices stay elevated.

The other item that will likely see price firmness and rise is high heat nonfat. As plants receive large quantities of milk, they will not take the time to dry high heat. There might be isolated tightness with prices reflecting this.

Dry Whey

Dry whey continues to hold steady. Since January, the National Dairy Products Sales Report (NDPSR), West AMS and Central AMS have hovered between \$0.23/lb and \$0.25/lb, with the NDPSR breaking above \$0.25 for a couple of weeks in February. Futures have continued to reflect this with 3rd and 4th quarters reflecting declines. While the most recent production report showed a March decline over 2015, it was up 14% over February 2016. This does not help the cause. The other major source of whey, the EU, is reporting similar inactivity and stagnant prices.

From our perspective, strong inventories of whey, more competitive pricing out of the EU due to our stronger dollar position and the prospects of increased production as we enter the period of heavy milk production do not portend higher whey prices. They are likely to remain at or near current levels at least into June.

Nonfat Dry Milk

After hitting lows below \$0.70/lb, the nonfat market has moved steadily higher over the past several reporting periods. That's not to say prices are recovering. They still remain at lows not seen in years. Futures have moved up and down with no real commitment one way or the other. On average, 3rd and 4th quarter futures are trading at a 10 to 15 cent premium to the spot market.

Noncontract spot offers are likely to remain at or near current futures numbers (mid to upper 80's). Realistically, unless global demand increases, the excess inventory and growing supply do not provide any upside price risk. With US milk production hitting seasonal highs, it is highly unlikely we will see any significant upward movement in the CME spot price.

Butter

Butterfat, scorned a couple of decades ago, is more popular than ever. Demand is strong in the US and prices remain elevated. Butter consumption has returned as more and more shun margarine. Whole milk is seeing a revival as well, removing butterfat from the normal butter production chain.

Most interesting, cheese production is booming. In 2015, it consumed more than 45% of all butterfat produced in the US. Butter consumption is up from both a retail and industrial perspective and cheese consumption is flourishing. Coupled with steady growth in both butter production and stocks, it is no wonder that we still see elevated prices. As mentioned before, two straight years of butter topping \$3.00 a pound is not insignificant when you consider the number of end users putting on forward contracts. No one wants to guess wrong again this year.

In view of this popularity, and despite reports of imports coming into the country, we feel that there is simply enough demand to keep prices elevated. As we enter the summer months and cream inevitably gets diverted from the churn to ice cream production, we see no mechanism out there to soften prices.

Add to this the fact that the first half of the year comes to a close soon. With it, the primary season for butter production before the baking season kicks in. This is a recipe for higher spot prices and a continued firm forward contract price.