

From the Trading Floor

KEY MARKET DRIVERS

- gDT stable / Chinese demand continues post CNY
- E.U. Intervention bids rejected for a 2nd time
- US export sales rebound
- Dairy world looks toward beginning of the Northern Hemisphere Spring

- Last nights gDT saw a fairly stable result considering many pundits had predicted continued falls (especially for WMP). The reason given for the predicted fall was Chinese demand waning for shipments arriving after the Chinese New Year period. Conversely to this view it seems that Chinese demand was actually reasonably strong at last night's event considering there is a lot of product already due to arrive this month and demand does typically fall after the big CNY celebrations.
- For the second time in a row there were no sales of SMP out of the E.U. Intervention stocks earlier this month. Of the total 20,000MT offered the commission received bids for approx. 13,000MT but none of the bids were high enough to meet the sales guidelines (e.g. Product can not be sold at a loss / commission will not release stock at a price that will upset the market). The big concern from buyers in committing to intervention stock remains that the current pricing of fresh production EU SMP is not super high and therefore the necessary discount needed to take aged product puts the bid prices back at close to the original intervention levels.
- Recent export numbers from the USA saw a big rebound in export activity for NFD (SMP) & Cheese. Mexico remained strong as the number 1 export destination for US product but renewed demand from Asia has spurred the outward bound trade activity as prices for Oceania and European product bounced hard (in some cases quickly past US Pricing levels)
- Now that we are half way through a Southern Summer / Northern Winter we now know what the story is from a New Zealand / Australian / South American perspective. The focus will soon turn to Northern Hemisphere as Spring fast approaches. Of most interest is European and Chinese milk production (US appears to be steadily tracking at 1 – 2% annual growth). Will Euro milk recover in response to recent milk price hikes and will Chinese milk production also recover from 2016 falls? From last years experience the season is beginning earlier than history would suggest with ramp up beginning mid-February (as opposed to mid-March onward). The other factor effecting Euro milk will be the Phosphate issues in Netherlands and the effect on milk production there as the industry tries to comply with the new guidelines.

Matt Cooper, Director, Ausfine Foods

FUTURES

Extremely flat forward curves continue to be a theme for NZX/GDT WMP and SMP markets, with Q3/4 in both trading at basically zero premium to spot markets – similar things are being seen in CME butter, while EU/EEU butter is actually trading in backwardation (forward prices below spot markets). Flat / backwardated curves are normally seen as signs of tight(ish) spot markets which are expected to soon be relieved by increasing production – the market is telling participants they are better off selling now at \$3300-3400 (WMP) rather than storing and selling later – the flat curve is not paying costs like storage, financing etc. Might make sense for SMP/fat, where the tight EU butter balance will be relieved by increased milk production in Q2; whether it is the right curve for WMP remains to be seen, with NZ weather risk still an issue and a very heavy forward sold order book out of NZ also at play – Q2/3 WMP markets could become tight.

Scott Briggs, Derivatives Trading Manager, Ausfine Foods

DAIRY EXPORT INDEX

Index falls – The Australasian dairy export index dived another 3% last week, due to a stronger A\$. Spot quotes for commodities were mixed; WMP remained at US\$3,350/t, while SMP rose US\$50/t to US\$2,800/t. Butter gained US\$400/t to average US\$4,700/t and cheddar lost US\$50/t to sit at US\$3,900/t. The A\$ continues to gain, this week rising over 2c to **US\$0.7500**, causing the index to shed **2.9 points to 213.4**.

Australasian dairy export index (Jan 2012-now)



AUSTRALIAN INDUSTRY NEWS

Bellamy's axes CEO, reworks supply deal

After a five week voluntary ASX trading halt as a 'business update' was prepared infant formula manufacturer Bellamy's announced the departure of CEO Laura McBain. Andrew Cohen – formerly COO – will take over as acting CEO as Bellamy's downgraded its forecast FY2017 EBIT by \$22m-\$26m. Increased inventories due to stalling Chinese demand, forced Bellamy's to renegotiate its key manufacturing contract length with Fonterra, extending the period from 5 to 8 years to deliver the same volume. However, should any shareholder group control more than 30% of Bellamy's capital, Fonterra has the right to terminate the supply deal under. Since August 2016, the company's market value has fallen from \$1.4bn to \$517.3m.

Blue Lake opens

Chinese-owned Blue Lake Dairy Group has opened its newly built processing plant in South Australia, supplying up to 20,000t of infant and adult formula to Asia, using powdered milk ingredients. The project's Stage 2 will see a new milk drying facility built worth \$50m and is expected to commence in coming months.

Weather highlights

- Australia, rain across VIC & NSW by the weekend, followed by warm and dry conditions.
- In New Zealand, heavy rains on both North & South Islands, cold southwesterlies spreading across the South.
- In the US, storms and rain across the west coast, wet weather in the midwest and eastern states.
- Possible thunderstorms in northern Argentina, warm across the central plains. Thunderstorms and showers in central Brazil.
- Southern France below zero temperatures and snow. Central and southern also Germany below zero.

Fonterra milk down 4.8% in Dec

Fonterra's December milk collection was down 4.8% compared to the same month in 2015. On the North Island, milk collection was down 6% YOY, while milk collection on the South Island fell 2.9% for the month.

While consistent rain and a lack of any intense summer temperatures have kept grass green and growing in most parts of the North Island, pastures in the South Island are much greener, as a mild summer has created excellent conditions for grass growth.

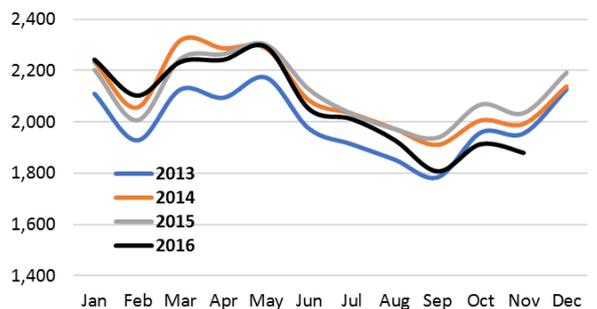
Argentina floods again

Santa Fe local government in Santa Fe has evaluated flood losses, estimating 869 dairy farms in the area will not be able to operate for a month with an estimated loss of 1.5m litres of milk per day, bringing the economic loss to AR\$256m for 30 days, not counting damage to infrastructure and roads. The local government will raise a proposal on a bailout plan for the dairy farmers.

France hits 7-year low in Nov

France recorded its lowest November milk output in 7 years at just under 1.9mt, almost 8% down on the same month in 2015. French milk collections for the six months to November were 11.6mt, 5% down on the same period in 2015, and 2% down for the calendar year to date.

France milk collection (000t)



Source: Eurostat

Brazil's WMP imports still strong

In 2016, Brazilian WMP imports rose 115% on the prior year as falling local milk supplies opened the gate for foreign product to balance the domestic market. Depending on local

milk supply and relative price competitiveness, Brazil shifts between being a net importer and net exporter of WMP. On a rolling 12-month basis, Brazil has been a net importer of WMP since March 2015, with total net imports of 111,240t in the 2016 calendar year.

US foodservice sales slow

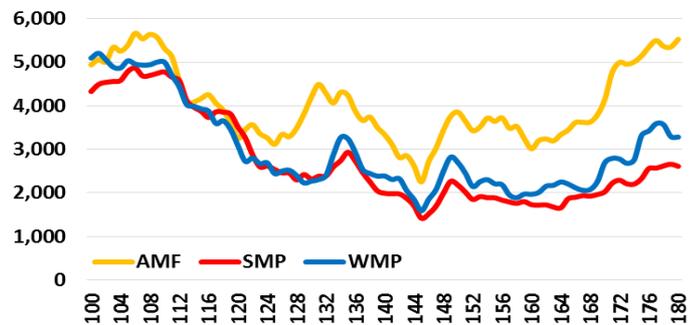
US foodservice sales remain strong but continue to ease, according to Census Bureau retail sales data. In the three months to November, sales in full service restaurants rose 5.2% relative to the same period in 2015. Limited-service eating outlets saw a 5.8% growth in sales for the period, while grocery stores recorded a 3.2% rise.

GDT index stabilises

The GDT price index lifted 0.6% this week, on a smaller offering of 22,030t.

The WMP weighted average price slid 0.3% to US\$3,283 with February and March contracts lifting, while contracts for later delivery were down. SMP weighted average price dropped 1.8% to US\$2,612/t, with the steepest decline in the April contract, down 2.3%. Butter prices lifted 1.7% to US\$4,382/t, while AMF rose 3.3% to US\$5,528/t, February and July contracts rose 9.8% and 8.8%, respectively. Cheddar prices averaged US\$3,940/t, up 1.2% from the previous event.

GDT weighted average auction prices by event, US\$/t



DAIRY FUTURES

Powders, fats down – NZX SMP and WMP lost ground as well as AMF. CME butter lost, while cheese remained flat.

	18-Jan	SMP	NDM	WMP	Cheese	AMF	Butter
Exchange		NZX	CME	NZX	CME	NZX	CME
Feb-17	2,600	2,337	3,350	3,788	5,180	4,982	
Mar-17	2,600	2,379	3,330	3,867	5,180	4,977	
Apr-17	2,700	2,422	3,375	3,887	5,180	5,028	
May-17	2,700	2,469	3,375	3,900	5,200	5,027	
Jun-17	2,700	2,513	3,375	3,942	5,220	5,032	
Jul-17	2,700	2,566	3,400	3,962	5,190	5,027	
Change	-1%	-2%	-1%	0%	-2%	-1%	
Op interest	6,691	3,445	25,346	12,798	411	2,898	

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