

From the Trading Floor

KEY MARKET DRIVERS

- NZ Season 17/18 = Too Wet – Too Dry – Too Wet
- E.U. Milk is Up, Up and Up
- Use of rBST in USA being phased out by many dairy companies
- Clue to market direction – watch milk prices in US & E.U.

- The dairy world eagerly watches the vagaries of New Zealand weather patterns. The world's largest dairy exporter's extreme seasonality and farming practices means that it is very reliant on weather to maximise their milk production, particularly in Spring and concentrated in October & November. This year we have seen weather patterns that have been anything but conducive, firstly a very wet start (similar to the prior year), followed by a prolonged dry period in the middle of the Spring Flush and into December and then a return to very wet conditions in January and again last week as a result of the tail-end of a tropical Cyclone. Each impact has been loudly trumpeted by the NZ industry as they drive to keep prices moving up to meet their forecast milk payout figure.
- There are some pretty big increases in milk volumes being reported out of Europe at the moment. There are estimates that Germany, France and UK could be up 5.1%, 3.2% and 0.4% compared to same time last year. As the E.U.'s biggest milk producers these increases are significant and really represent the main game in global Dairy town. As Europe in total produces approx. 155 billion litres of milk per annum a 1% increase represents 1.55 billion litres of milk, equivalent to 7.2% for New Zealand or 17% for Australia, to put it another way a 1% increase in Europe would equate to an additional 200,000MT of Whole Milk Powder (approx.). Our thoughts are that while the price of butter fat remains relatively strong, milk cheques will remain at OK levels for farmers (above cost of production) and the milk will keep flowing.
- A conversation with a US dairyman this week turned to the phasing out of rBST in the US milk pool. While the milk hormone remains legal to use, there are definite consumer concerns on its use which are filtering through the industry and the belief (at least from that Dairyman) was that its use will be phased down (maybe not out completely) over the coming years. There is some evidence that use of rBST increases milk production by 10-12% per cow (when used correctly).
- The old adage in the dairy industry is that if a farmer is getting a good milk cheque they will milk more to maximise profit, if they're getting a poor milk cheque they'll milk more to maximise returns, either way – more milk. While that may be true in some circumstances we have certainly seen farmers in Europe and Australia turn their milk supply off when the milk price gets too low. Right now we are on milk price watch as a clue to the future direction of markets (6 months and beyond). Right now farmers in NZ and Europe are typically receiving milk prices above cost of production, supporting continued milk growth, Australia is probably neutral, but the one to watch right now is the USA where milk prices are well below cost of production. How long farmers will put up with this before taking pro-active measures such as retiring underperforming cows is yet to be seen, but watch this space. We know the US market will react quickly if there is any hint that milk growth is starting to turn negative.

Matt Cooper, Director, Ausfine Foods

DAIRY EXPORT INDEX

Index gains - The Australasian dairy export index lifted this week due to a weaker A\$ and higher commodity values. Spot quotes for major commodities all rose; butter climbed US\$10/t to US\$4,950/t and WMP lifted US\$100/t to US\$3,100/t. SMP rose US\$15/t to US\$1,850/t and cheddar was up US\$50/t to US\$3,600/t. The A\$ dropped over 1.5c to **US\$0.744** – sending the index higher by **5.9 points to 179.2**.

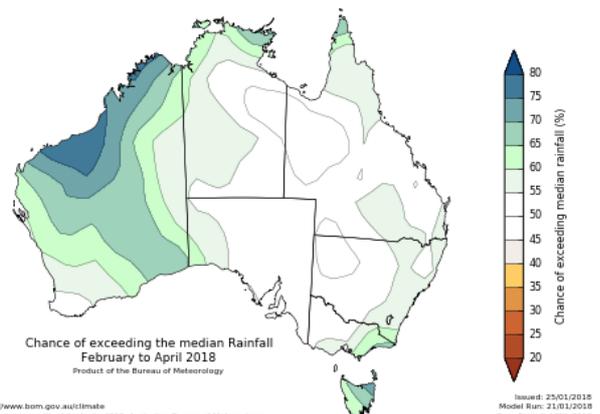


AUSTRALIAN INDUSTRY NEWS

Wetter end to summer

The Bureau of Meteorology's seasonal climate outlook for February to April indicates weak La Niña conditions will end during Autumn. February is forecast to be wetter than average for western and southern Australia, extending into southern Queensland. February to April daytime and night-time temperatures are likely to be cooler than average for parts of the western and southeastern mainland Australia, but warmer than average for Tasmania and northeast Australia.

January's heatwave across the south east led to drying soils in many parts. Water storage levels in the the Murray Darling Basin and southern Victoria are lower than same time last year, while Tasmania and Western Australia's water storage levels are higher than last January.



GLOBAL DAIRY MARKETS

Weather highlights

- For Australia, rain in Victoria during the weekend. Mixed weather in NSW.
- In NZ, weekend rain across the North Island and northern parts of the South Island.
- Cold temperatures across the Midwest with snow showers. Dry and warm conditions persist in California.
- Mixed weather in Argentina with possible thunderstorms. Showers and thunderstorms in Brazil.
- Rain in northern parts of Germany next week. Mixed weather across the Netherlands.

Japan to double SMP imports

Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) have announced its intention to import 13,000t of butter and 27,000t of SMP by March 2019 (JFY2018). While butter volumes are unchanged from the current fiscal year, initial SMP import volumes are more than double JFY2017 in response to projected increased requirements as local milk availability declines. Strong ingredient demand prompted additional SMP imports of 21,000t in 2017, and these trends are expected to continue.

MAFF expects that existing butter stocks along with stable quota imports should satisfy domestic demand for butter in JFY2018. MAFF plans to review the supply and demand status in May and September this year to determine if there is a need to revise quota.

US margins likely to weaken

USDA indicates the all-milk price was US\$0.39/litre in December. This was 5% lower than the prior month and 9% below the prior-year comparable. December was the only month of 2017 in which the all-milk price was lower in YOY terms.

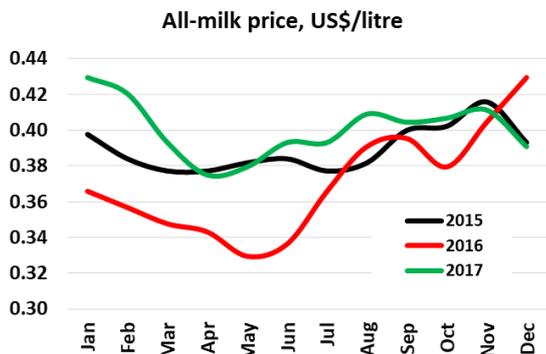
Most producers operated below cost of production in January. The outlook is even worse, with on-farm margins (expressed as income-over-feed costs) expected to weaken through to April before recovering in the period to October.

December. In January, Arla, FrieslandCampina, Royal A-ware and DMK announced price reductions of €4/100kg - €5/100kg. Both Arla and FrieslandCampina have announced further reductions in February milk price of €2 and €1.7, respectively, and it is expected there'll be another healthy drop announced by DMK. Dairy Crest announced a €2/100kg drop in payments for standard raw milk in February for its cheese plant at Davidstow.

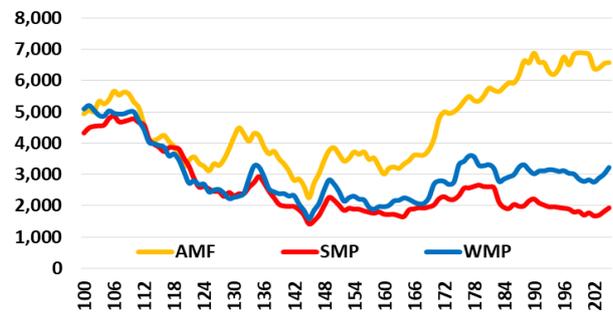
Meanwhile, according to Eurostat, EU-28 cow slaughtering fell 4% over the quarter to November relative to the same period in 2016. With the 2016 dairy herd reported at 23.55m head, for an estimated annualized decline of 1.1% for 2017. This was despite increases in the Netherlands (+4.1%), Ireland (+1.4%) and Poland (+0.7%). Among other major producing countries, the largest drops were recorded in Denmark and France – down 4.9% and 4.3% respectively.

GDT index lifts 5.9%

The GDT price index jumped 5.9% at this week's GDT auction as all commodity prices increased on a smaller offering of 22,197t. Supply concerns helped boost WMP prices 7.2% to average US\$3,226/t, with all contracts higher - the largest increases were for March and April deliveries, up 9.1% and 9.2%, respectively. SMP averaged US\$1,932/t, up 6.3% from the prior event. Butter prices rose 7.8% to average US\$5,277/t. auctions. AMF prices increased 0.5% to average US\$6,581 while cheddar rose 7.3%, averaging US\$3,739/t.



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



DAIRY FUTURES

Futures mixed – NZX powders all gained. Fats were mixed; butter lost ground, while AMF rose. CME NDM jumped. *All prices quoted in US\$/t.*

| | 6 Feb | SMP | NDM | WMP | Cheese | AMF | Butter |
|-------------|-------|-------|--------|--------|--------|-------|--------|
| Exchange | | NZX | CME | NZX | CME | NZX | CME |
| Mar-18 | 1,960 | 1,681 | 3,230 | 3,298 | 6,275 | 4,729 | |
| Apr-18 | 1,970 | 1,716 | 3,190 | 3,325 | 6,275 | 4,768 | |
| May-18 | 1,980 | 1,758 | 3,200 | 3,373 | 6,200 | 4,796 | |
| Jun-18 | 1,980 | 1,792 | 3,190 | 3,452 | 6,075 | 4,819 | |
| Jul-18 | 1,980 | 1,830 | 3,190 | 3,549 | 5,950 | 4,860 | |
| Aug-18 | 1,980 | 1,863 | 3,190 | 3,642 | 5,925 | 4,922 | |
| Change | 2% | 5% | 2% | 1% | 2% | -1% | |
| Op interest | 2,685 | 4,786 | 15,980 | 16,739 | 2,224 | 5,113 | |

EU milk prices drop

Higher production across EU is prompting major processors to reduce milk prices. Milcobel reduced its price with €2 to €33.01/100kg and Muller's decreased €1 to €37.76/100kg in

www.ausfine.com.au

Ausfine Foods International Pty Ltd ■ ABN 12 006 926 129

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T +61 3 9583 3588 ■ F +61 3 9583 4344 ■ E sales@ausfine.com.au

Suite 10, Level 4, 205 – 211 Forster Road, Mount Waverley VIC 3149 Melbourne, Australia