dairyglobe

International edition

16 August 2017

A newsletter from Freshagenda of major events in international dairy markets

Highlights

- GDT: Small changes
- EU farmgate prices firmer
- USDA sees slower growth
- Rabo: Slow growth to increase competition
- McDonalds ramps up Chinese growth

What we are seeing this week

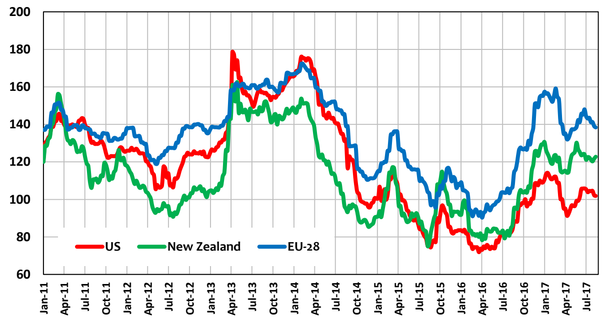
Rabobank has released a rather pessimistic analysis of the short-term NZ milk supply outlook, with a projected recovery that puts them behind 2015/16. It's difficult to reconcile with better seasonal conditions and payout prospects heading into spring. Our own current expectation is for 4.5% lift in spring peak output, with the 2017/18 season coming in 3.7% ahead of last season.

In the US, there's a slowdown in cheese demand underway as the once-buoyant foodservice sector slows. It's a concern as milk output continues to expand, albeit a little more slowly according to the USDA's latest outlook. With a weaker US$ more export activity seems likely.

International dairy export indices

Our international dairy export indices were mixed again this week with marginal changes across the board. The NZ index rose 1.1 points 123. Our EU-28 index shed 0.7 of a point to 138, while the US index shaved 0.4 of a point to 102.

Dairy export indices (January 2011-Now)

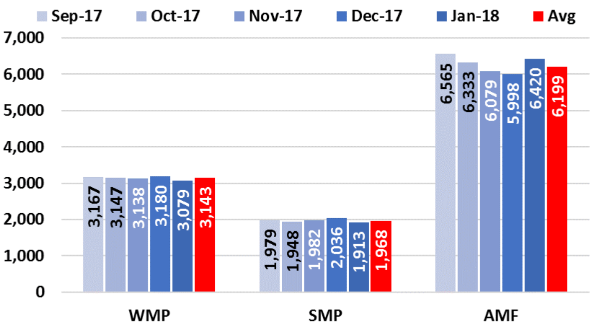


Take note: These indices track the trends in gross export returns to each of the three major exporting dairy industries, based on quoted spot prices, currency values and product mix in exports from each of the big 3. Essentially the index is of the weighted value of exports to each industry in their home currencies, set at 100 on 1 January 2007.

Global dairy markets

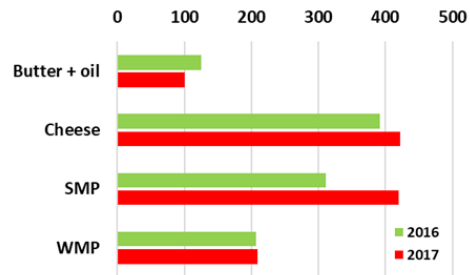
GDT: Small changes – Those trying to take their lead from NZX futures prior to this week's GDT result would have been disappointed. This week's GDT index lost just 0.4% for the index, but again was a mixed bag of small changes. WMP was 0.6% down to average US$3,143/t, with losses of almost 3% for Sept and January deliveries, with small changes in peak availability months in between – leaving a spread of just US$100/t. SMP meanwhile lifted on average 0.3% to US$1,968, losing 0.6% to US$1,979/t for immediate deliveries (which matches the tone in the EU and US), but with a slightly wider spread of US$123/t, weakest prices in January of US$1,913/t, highest in December.

GDT average winning prices 16-August-2017, US$/t



Butterfat price movements were mixed across delivery periods, after offer volumes were shifted in favour of earlier delivery periods to address shortages, and in both cases, prices for later delivery contracts lifted. Overall butter lost over 1% to average US$5,735/t, but was 4% stronger in the short term, while the January contract shot up 14% to US$5,740/t. AMF movements were subtler, losing 1.2% to US$6,199/t as the price spread tightened slightly to less than US$600/t, lowest over peak months at close to US$6,000/t. Cheddar movements were also mixed, up 1.4% on average to US$4,005.

EU-28 YTD (Jan-June) exports, '000t



EU exports: low SMP prices doing their thing – June EU SMP exports grew by more than 50% over the same month in 2016, taking shipments for the first half of the year 35% higher. Algeria, China and Indonesia have been the big movers of product this year, together accounting for just under half the additional tonnages shipped.

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Cheese was the other category to stay ahead of the prior year, up 6% for the month and by more than 7% in the half, with Japan and Korea performing best as markets. Meanwhile WMP exports slipped 3% on the prior year but stayed 1.4% higher over the first half, and the butter trade continued to slip, down 19% for the half year in butter-equivalents terms.

IMF brands approved for Chinese import – The China Food and Drug Administration (CFDA) has in the past 2 weeks approved **four batches** of infant formula registration for imports from 1 January 2018. The CFDA received 665 product registration applications, 531 from domestic sources and 134 from overseas, and in total from 75 domestic and 26 overseas companies. In the four batches of IMF registrations, 142 products have gained approval so far – manufacturers include Yili, Beingmate, Yashili, Nestle/Wyeth, FrieslandCampina, Mead-Johnson and Nutricia. Only six overseas companies have been successful in rounds to date.

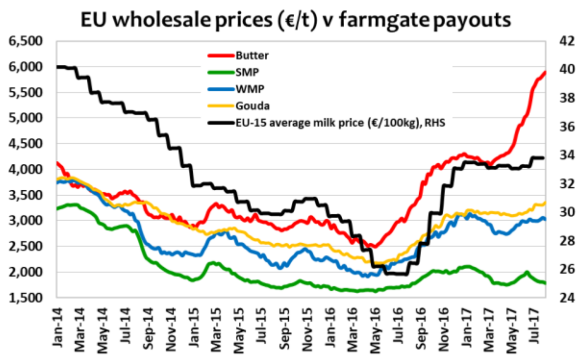
China slowing? – China's consumer inflation index slowed in July with softer non-food prices signalling economic activity may be cooling as Beijing works to reduce debt. Meanwhile, China's consumer price index rose 1.4% in July YOY, down from 1.5% in June. In July, food prices fell 1.1% YOY, while non-food items rose 2%, the lowest increase in months. China's producer price index was unchanged at 5.5% for a third consecutive month in July. The index has been positive since September last year after falling for nearly five years, but is expected to sag due to softening commodity prices and falling domestic demand.

Japan's milk output slower – Japan's June milk production was 1.9% below the same month in 2016, pulling first half output down by 1.6%. Milk output tracked below the prior year in each of the latest 10 months of available data. Milk prices remain steady, in a tight band close to ¥100/kg (close to US92c/kg) in the first half of the year which was almost 1% higher than the average a year earlier. Prices averaged ¥101.40 in June according to industry body ALIC.

Sth African imports to rise – At the South African Milk Processors' Organizations' annual general meeting its CEO Alwyn Kraamwinkel presented the outlook for the country's dairy market. South Africa's 2016 exports were down 18% on 2015, while imports fell 16.3% in 2016 on the year prior. According to estimates for 2017, exports are 6% behind, while imports are expected to rise 41% compared to 2016. Imports are spiking as South African milk production normalizes after soaring in 2015 due to ideal weather conditions, high raw milk prices and low feed costs. This is set to make South Africa a net importer of milk, cream, buttermilk and yogurt.

EU dairy market and policy

Farmgate prices firmer – The Milk Market Observatory (MMO) reports the average July EU-15 farmgate price lifted 1.7% on the month prior to €33.8/100kg. The average farmgate price in France lifted almost 7% to €34.6/100kg, while German farmgate prices were flat at €34.4/100kg. In the Netherlands, farmgate prices rose in July to average €37.3/100kg.

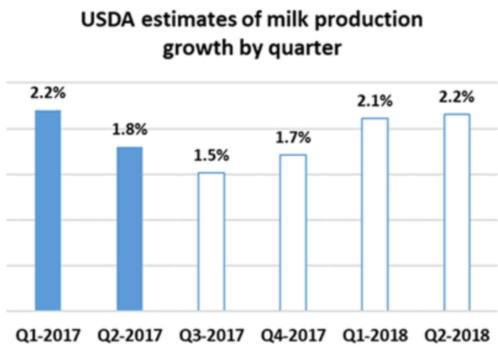


Product price trends are mixed with SMP continuing to weaken since hitting €2,000/t mid-June. In the week ending 13 August, SMP wholesale prices fell 2% from the week prior to €1,787/t, the seventh consecutive weekly drop. While no SMP has gone into intervention since May, anecdotal reports suggest that the scheme may be needed again if the current trend continues. In addition, WMP prices dipped 1% to €3,030/t, while Gouda shed 0.4% to €3,358/t.

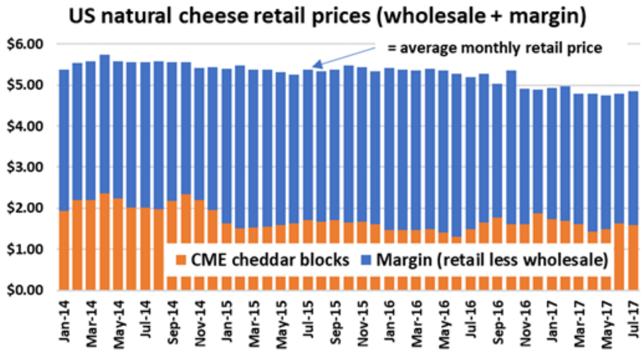
Butter wholesale prices reported by the Commission rose a further 5% to €5,892/t (with short-term EEX futures about €800/t higher), but latest spot prices vary throughout Europe with weekly quotes from Poland at €5,500/t up to Dutch butter at €6,500/t.

US dairy market and policy

USDA sees slower growth – The USDA's August outlook for 2017 milk production has been revised to an increase of 1.55%, down from the previous month's estimate of 1.84%, as lower per cow yields are more than offsetting increased cow numbers. Milk output in the third quarter is now expected to grow 1.5%, while fourth quarter growth is expected to be 1.7% up on the corresponding period in 2016. USDA 2018 milk output is expected to be up 2.1%, down on the July forecast of 2.3% growth.

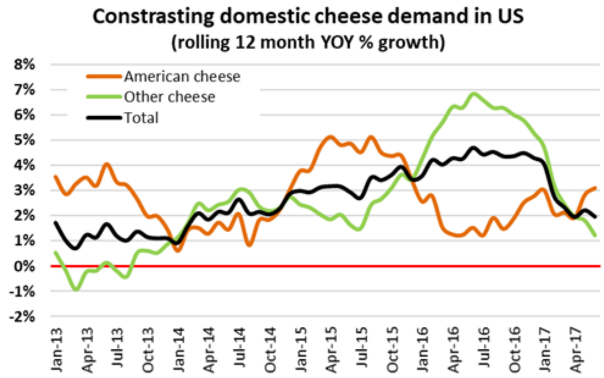


Despite slower milk growth in 2017, USDA left the expected average cheese milk (Class III) price unchanged for the 2017 year at a mid-point of US$16.00/cwt (up from US$14.87 last year), rising to US$16.80/cwt in 2018. Class IV milk price forecasts for 2017 and 2018 are raised as stronger forecast butter prices more than offset lower NDM prices. The all milk price is raised to US$17.80 to US$18.00 per cwt for 2017, but is unchanged at US$18.50 per cwt for 2018.



Retail cheese margins remain tight – The US average retail selling price for natural cheese lifted a little over the June price but remained close to its lowest in more than 6 years during July. The downward trend that has been a feature of the cheese market since early 2012.

As a consequence, the spread in gross returns achieved in the supply chain between plant and consumer continued to be tight, as the majority of sales are made on promotion, and the drift of market share towards private label slowly erodes value. The 5-year average between average retail and CME block prices is US$3.67/lb, but June's spread was just US$3.20/lb.



Cheese demand faltering – Despite the recent recovery in retail cheese demand, the weight of slowing foodservice demand, pulling down mozzarella and other cheese varieties, pegged overall US cheese demand to 2% in June. This is based on latest "disappearance" calculations taking account of production, trade and stocks data from the industry. The slowdown from the fast growth in food service channels has the overall cheese market expanding at its slowest rate since early 2014.

Butter demand remained in positive territory – growing above 1% over the comparative month in June, but lifting to 1.6% in rolling 12-month terms over the year to June.

Oceania dairy markets

Rabo: Slowing growth will increase competition – Rabobank is pointing to a more competitive farmgate milk supply landscape due to slower output growth. While the *Survive or Thrive* report points to the resilience of NZ dairy sector in recent years, and a likely recovery in 2017/18 milk output – around 2% to 3% - growth in subsequent seasons will be constrained. Rabobank expects limited new milk, as farms conversions have ground to halt and will continue to be stymied by environmental constraints and weaker land value appreciation. Expansion on existing farms will also be limited by environmental regulations and new limits on low-cost supplementary feed inputs will impact intensification efforts.

As a result, Rabobank believes processors will struggle to fill existing and planned capacity in coming years, following a ramp up in infrastructure investment between 2013 and 2015. This will affect plant utilisation, increasing overhead costs and could lead to rationalisation, and increasing competition for milk supplies. According to Rabobank this more competitive environment will require processors to carefully assess strategies, innovate to attract and retain suppliers, which present opportunities for farmers.

Synlait's FDA approval delayed – NZX-listed processor Synlait says regulatory approval from the US Food and Drug Administration (FDA) for its grass-fed infant formula is taking longer than expected – the New Infant Formula Notification process is expected to take a further 4 to 12 months. Synlait's managing director John Penno said its joint venture with Munchkin will not have a material impact on Synlait's forecast volumes for the 2018 financial year. Munchkin's Grass Fed infant Formula continues to steadily gain increased distribution in Australia and New Zealand.

Bellamy's rebound – Infant formula maker Bellamy's has seen its shares rocket to a year to date peak after the company confirmed its newly purchased Camperdown factory has its China export license reinstated after the company "diligently responded to all requests and queries on behalf of the Certification Accreditation Administration of the People's Republic of China. At the time of the announcement, shares were trading at about A$8.04 but soared to a high of A$8.84 before retreating to A$8.11 at close of trade on Tuesday. Bellamy's said it would continue the maintenance work and upgrading the quality and quantity of the facility while proceeding with the application for the China Food and Drug Administration license, required for imports to China after 1 January 2018.

Push to take milk away from non-dairy – NSW-based dairy advocacy group Dairy Connect has initiated an online petition aiming to stop makers of non-dairy substitutes using the word 'milk' to describe their products. Dairy Connect CEO Shaughn Morgan said there was a constantly evolving range of products such as 'soy milk' and 'almond milk'. The organisations believes consumers are confused by the rise in the number of dairy-imitations made from plants as some believe the plant-based alternatives have equivalent nutritional benefits to cows' milk. Dairy Connect claims a clearer distinction between the two product types would create greater consumer awareness about nutritional variations. Earlier this year, the European Union Court of Justice ruled in favour of the need to differentiate between dairy products and plant derived products.

Other news

McDonalds ramps up Chinese growth – McDonald's has announced plans to nearly double the number of restaurants in China in the next five years, which will make China its second biggest market outside the US. By 2022, McDonald's expects 4,500 of its restaurants to have opened in the country, up from 2,500, thereby growing sales in China as US consumers abandon the fast food chain. The news comes a week after McDonald's completed a deal to sell most of its operations in China. However, the Illinois-based company will retain a 20% stake.

Meanwhile, in collaboration with McDonald's, Arla UK is launching a line of co-branded organic milk products. The 250ml bottle will be available in Happy Meals in McDonald's restaurants all over the UK. According to Arla's VP of foodservice Jonathan Dixon, the roll out of the organic line gives Arla the opportunity to expand the reach of its products. Arla recently repositioned its organic milk to highlight its free-range credentials.

Kerry lowers outlook – Kerry Group has lowered its full-year earnings forecast despite reporting higher sales and earnings in the first half. Currency exchange is impacting its performance, particularly the British pound's depreciation and on-going global volatility. Kerry expects adjusted earnings per share to rise between 3% and 7%. Meanwhile, sales volume rose 4.8% on a group-wide basis and sales value increasing to €3.18bn, up from €3.04bn compared to the same period last year. Kerry's taste and nutrition unit sales increase 4.2% while consumer foods only grew 2.3%. Trading operating profit increased 5.2% to €338.4m versus €321.6m on the comparable, and net earnings increased to €225.1m vs €222.4m.

Glanbia revenue up 11.5% – Irish nutrition group Glanbia has announced a rise in total revenue for the first six months ending 1 July 2017 to €2.047bn, compared to €1.837bn in the first half of 2016. EBITA was €192.8m. Glanbia Performance Nutrition reported revenue growth of 7.6% and EBITA growth of 3.1% while Glanbia Nutritionals delivered reported growth of 12.2% and reported EBITA growth of 11.6%. Joint ventures and associates delivered revenue and EBITA growth of 23.1% and 84.8%. Glanbia's total investment in capital expenditure was €33.3m in the first half of 2017, with €19.1m deemed "strategic investment". The key project is a new innovations center in Illinois, US. Group managing director Siobhan Talbot said first half growth was driven by Glanbia Nutritionals and Joint Ventures, while Glanbia Performance Nutrition was expected to drive growth over the latter half of the year.

Dean Foods shares drop – After reporting second-quarter numbers that missed analysts' forecasts and issuing a profit warning, analysts at research firm Bernstein warned **milk price wars are here to stay** after the results. Meanwhile, the price premium of Dean Foods' Dairy Pure brand over private label widened 40% in July. Discounters such as Aldi and Lidl are using milk as a loss leader, which is further "compressing the margin of private label retail prices over the Class I milk input cost to abnormally low levels". Consumers are switching to private label, denting volumes of more profitable branded products. CEO Scozzafava said the results came in below expectations as its branded white milk volume in all channels was down 6% YOY.

Meanwhile, Walmart has announced the opening of a dairy processing plant built to supply its own store-brand. The plant will service 600 out of 4,100 Walmart stores. Dean Foods' CEO Ralph Scozzafava expects his company will lose approximately 90-95m gallons of private label fluid milk volume in 2018 and 2019. Dean Foods' stock price fell more than 20% on that news.