

A newsletter from Freshagenda of major events in international dairy markets

Highlights

- Trade a mixed story
- US milk grows 1.6% in June
- Processors remain focused on cheese
- EU butter prices still surging
- Flooding across NZ's Sth Island

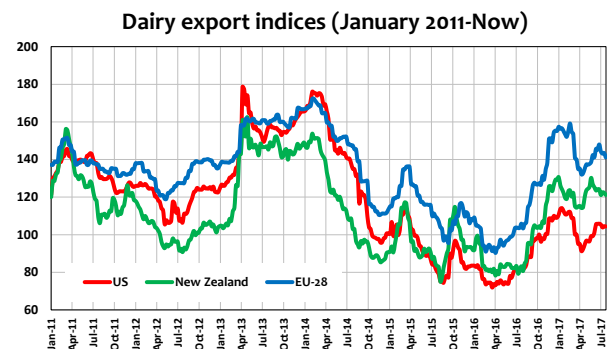
What we are seeing this week

Our latest Global Dairy Directions Trade Trends report highlights that the recent improvement in trade is largely a return to trend – with intervention no longer in play – rather than a significant improvement in demand. Latest NZ exports add a bit more positive news.

In New Zealand it's wet as, bro! At least in the South Island where floods created a "state of emergency" in a number of regions. There's been little news at the time of writing about likely impacts on milk production. It seems that water has mostly run-off pastures and disruption has been minimal. You can bet if there is a likely impact, we will hear about it – will the market react this time?

International dairy export indices

Our international dairy export indices all trended down despite the US\$ weakening. The NZ index shed 1.2 points to 121 on a stronger NZ\$ and the EU-28 dropped 2.4 points to 141, accounting for the biggest fall. The US index managed to only shed 0.2 of a point to 104.



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

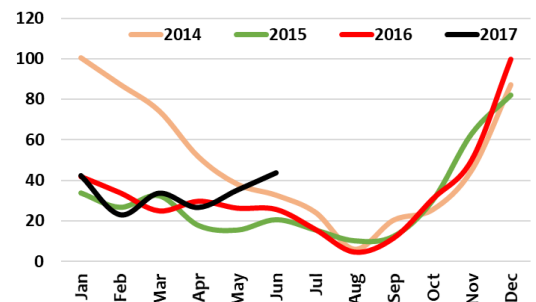
NZ WMP exports surge – Total WMP exports rose for the 2nd consecutive month in June, up 19.1% YOY, bringing the 1H-17 total 1.4% ahead of the same period in 2016. WMP shipments to China & HK increased 71% YOY in June, shipments likely booked when prices were weaker March and April. This brought the 1H-17 total of shipments to the region 12.2% ahead of the 2016 comparable. During the first 6 months of the year, WMP exports to ASEAN were up 4.3%, while shipments to Africa, GCC and South America were each weaker.

China was the strongest market across commodities in June. Monthly SMP exports to China have been patchy in the past three quarters, but were 52.7% higher YOY in June, which helped lift total NZ exports above the same month last year, but YTD SMP trade in total was down 13.2% over the half year. Cheese exports were down 2% in H1-2017, but cheese exports to China & HK rose 28%.

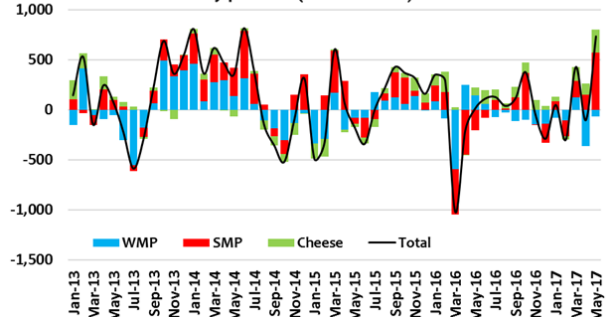
Overall trade trends mixed – Our latest Global Dairy Directions Trade Trends report indicates for the year to May; global trade rose by 1.25bn litres ME (or 2.2%) on the prior 12-month period. The early 2016 comparative does include a period of large SMP sales into EU intervention, but ongoing strength in cheese trade has contributed to the rise. Trade volumes over the latest 6 months of total data were similar to the same period in 2015 and 2014. Global WMP trade is tracking lower, despite a revival in New Zealand exports – offset by lower EU and Argentinean availability. Fat trade remained weak, due to chronic shortages in the EU and lower NZ supply.

In **SE Asian trade** for the 12 months to May up 3%. WMP shipments to the region rose 19% in the May quarter, with higher shipments to Thailand, Malaysia and Singapore, making up for

NZ WMP exports to China & HK ('000t)



YOY growth, total dairy exports by product (mn litres ME)



weaker trade late last year. SMP demand appears to have grown at low prices, up 8% over the past year but also 3% higher than the 12 months ending May 2015. Among ASEAN-6 countries, reduced SMP trade with the Philippines and Indonesia were more than offset by increased shipments to all other destinations led by Vietnam. Thailand and Vietnam were the weakest markets over the past year.

WMP shipments to the **Middle East** were down 19% in the year to May compared to the previous 12-month period. SMP trade was down 8%, although average shipped prices rose 14% in the year to May compared to the year to May 2016. WMP and SMP exports to the Middle East fell 25% and 18% over the most recent quarter respectively. **North Africa** was a brighter market, as Algerian tender activity increased WMP shipments by 20% compared to the 12 months ending May 2016, and 11% up on the same period to May 2015. SMP was 6% higher in the year to May, but trailed shipments in the year to May 2015.

GDT rule change? – The Global Dairy Trade (GDT) platforms wants to expand its reach and relevance with more sellers and more products. Multi-seller pools are being considered, with the governing body proposing three rule changes and opening a period of public consultation. Should the multi-seller pools be implemented, the first new users would be a group of United State lactose processors, who would be identified and required to offer a minimum quantity of the standard lactose specifications each year.

However, each company could pick and choose its GDT events and the actual tonnages offered, while prices achieved by each company wouldn't be disclosed. Buyers would bid on US lactose pools and tonnages, knowing which companies were registered sellers, and that their premises and products were independently certified. According to the GDT Events oversight board, a number of US dairies want better price discovery mechanisms. The pool structure would provide confidentiality and account for significant differences in freight costs. According to AgriHQ dairy analyst Susan Kilsby, the multi-seller pool proposal would be driven primarily by sellers' needs, rather than buyers.

EU dairy market and policy

Processors remain focused on cheese – According to Eurostat, EU-28 cheese production rose 1% during the first 5 months of 2017 with significantly more favourable returns earlier in the year and firm demand from domestic and export markets. This was despite a 1.1% fall in raw milk supply – as drinking milk output declined 1.6% over the same period. We estimate that milk available for manufacturing dropped by less than 1% over the prior year.

Between January and May, SMP and butter output fell by 12% and 6.5% respectively, but latest trends reflect a slight shift towards this stream, particularly as butter wholesale prices have continued to surge due to chronically low inventories. Butter manufacturing has been further constrained by strong output of cream for direct consumption – production expanded 2% YTD. WMP output fell 0.5% YTD – while exports rose 2% in the same period. This export trend may be short-lived, as Oceania suppliers are far more competitive based on latest quotes.

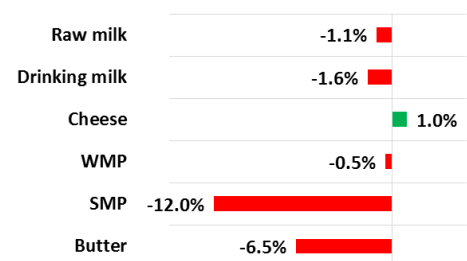
EC projects modest recovery in milk output – The European Commission's latest "Short-term outlook for EU agricultural markets in 2017 and 2018" projects EU-28 deliveries to dairies to increase 0.7% in 2017 and a further 0.9% next year. All of the growth in milk supply is expected to be due to increases in average yield/cow as dairy cow numbers are projected to fall in the three consecutive years to 2018 to 22.6m head.

Most of the increase in supply during 2017 and 2018 is expected to flow into cheese as demand from export and domestic markets remains healthy, with output increasing 2.2% this year and a further 2% next year.

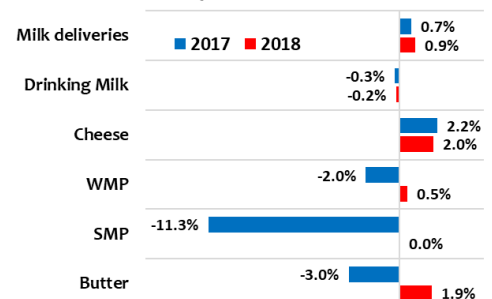
With heavy local inventories, SMP production is expected to remain weak - down 11.3% this year to its lowest point since 2014 and remaining flat in 2018. With exports expected to grow 24% to 724,000t in 2017, total SMP stocks are projected to decline by 72,000t this year including a 22,000t drop in intervention stocks.

Butter stocks are expected to remain chronically low at 65,000t by the end of Dec-17. This assumes a fall of 3% in production this year and despite exports falling 20%. Next year's ending butter stocks are also pegged at 65,000t, driven by higher domestic use and despite a 1.9% increase in output.

2017 EU-28 dairy product output (5 months to May 2017, YOY changes)



Projected YOY growth in EU-28 production



Source: European Commission

Butter prices still surging – According to Milk Market Observatory (MMO) data for the week ending 16 July, butter prices gained another €106/t to €5,747/t. Local traders indicate butter prices are currently stable as negotiations with Germany’s largest retailer have started during the summer holiday break, but are far ahead of EC-reported figures in the €6,100-6,200/t range.

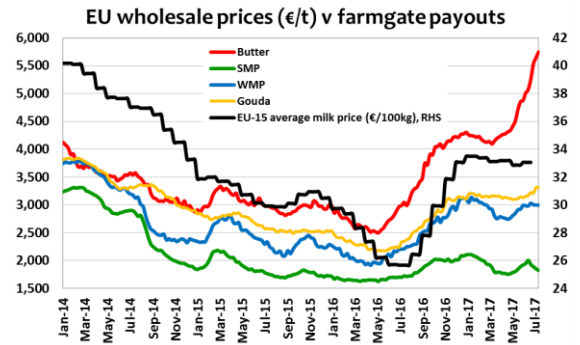
SMP prices fell for the 4th consecutive week, down €29/t to €1,824/t – with relatively strong farmgate prices, policy makers have an environment in which intervention volumes could be released to the market – yet there is no evidence that demand will be sufficient to absorb old stocks as well as expected increased production in the coming 6 months. EU-28 SMP exports surged in latest data through May, making it unlikely that further volumes would flow into intervention - even if the scheme is extended to the end of the calendar year. Meanwhile, SMP EEX futures contracts for delivery through to the end of 2017 are trading below the €1,800/t benchmark.

Cheese prices have trended higher, but gouda was unchanged in the latest week at €3,311/t. Our milk valorization analysis suggests that given latest wholesale prices, the butter/SMP stream (€46.01c) is ahead of gouda and cheddar (€45.66c and €45.45c respectively) while WMP ranks last at €41.75c per kg of milk.

France opens food review – France has kicked off a string of debates focusing on a farm-to-fork review of its food sector, a review that was promised by president Emmanuel Macron during his election campaign. The review aims to implement a more sustainable, equitable and safer food production chain which allows farmers and growers to make a decent living from their work, fosters healthy consumption and is more respectful of the environment; reconciling international competitiveness in agri-food production with social issues.

New trading platform opens – Along with its partner Cream Ltd, Trigona Dairy Trade has developed a new online platform, DAO.EU for trading SMP, SWP, cream and other dairy products for both animal and human consumption. The new platform was launched last week in the Netherlands and offers a facility to trade around the clock. With the promise of anonymity, DAO.EU promises greater immediate access to more products and customers, as well as direct price and market information. Dairy producers, processors, traders and farmers can register on the platform. While DAO.EU is a wholly-owned subsidiary of Trigona, it runs independently from the company and will have its own oversight board.

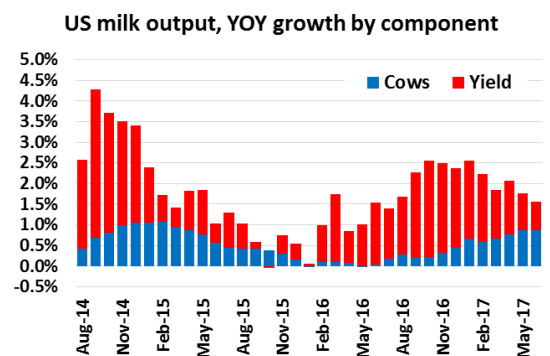
Price rises announced – Arla Foods has announced a 1c/l increase for its 12,700 suppliers across Europe. In the UK this translates to an increase of 0.81ppl to 29.98ppl. “The current market situation is characterised by strong demand and low stocks of fat and this is driving up prices for products containing fat,” said Johnnie Russell, director of Arla Foods amba in the UK. “Meanwhile, the protein market remains stable, however at a low level.” Muller will also increase prices by 1.5ppl in August. Lactalis has announced a series of monthly price increases for its French milk suppliers – taking the price from 35c/l in July to 36c/l in September (for 4.1% fat and 3.3% protein composition).



US dairy market and policy

Milk output grew 1.6% in June – USDA’s NASS reports milk output rose 1.6% YOY in June, and 2% ahead year to date. Average yield per cow was up 0.7% YOY in June, the lowest increase in the past 17 months. Cow numbers rose 0.9% YOY – that brought the number of milk cows on farms in June to 9.404m head, 78,000 head more than in June 2016, and 4,000 head more than the prior month.

Our analysis shows that June was the first month since October 2015 in which the majority of the growth was due to expansion in the dairy herd rather than per cow yield, with heat affecting average yield/cow in the West. In addition, lower rBST use has also started to have an impact. Across major producers, California’s June output fell 2.1% YOY with cow numbers falling by 3,000. Wisconsin’s production was up only 0.2% YOY while output in South-Western Texas and New Mexico rose 15% and 9.8% respectively. Among North-eastern states (including Pennsylvania, New York and Vermont), output was affected by milk check “market adjustment” deductions and supply management schemes implemented by local co-ops in recent months.

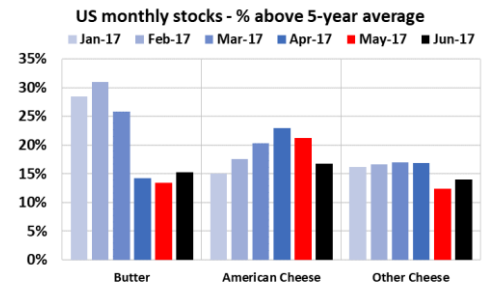


American cheese stocks decline in June – According to the latest USDA’s Cold Storage report, American cheese stocks fell 26,000t between May and June 2017. June American cheese stocks reported at 810,275t were still 16.7% above the 5-year average, but the apparent domestic disappearance picked-up significantly over the last 2 months when

accounting for revisions to historical data. This, along with stronger exports and expectations of weaker milk supply has been reflected in higher CME cheese prices since the start of the month.

Other-than-American cheese stocks increased 13,265t between May and June – this was 2.7% higher in YOY terms and 14% above the 5-year average. Butter stocks were lower in YOY terms for the 3rd consecutive month in June at 140,665t – this was 15.2% above the 5-year average.

No rBST for Hilmar Cheese – Hilmar Cheese notified its producers that they will transition to use rBST-free by June 2018 if they want to keep supplying milk to the company. In a statement, the company says that while scientific research, US government agencies and global health organisations have stated the safety of rBST, Hilmar Cheese can no longer accept milk from producers using rBST due to consumer confusion created by “absence-based” marketing. Hilmar’s words go further to speak of the long support they have given the technology (as a farmer-owned company), but have been forced to respond to a situation that has gone past a tipping point where they cannot be differentiated against for the greater good of promoting the benefits of healthy dairy milk. We understand Agropur subsidiary Davisco has also called time on the use of rBST on supplier farms.



Oceania dairy markets

Flooding across NZ’s Sth Island – A severe storm has battered New Zealand’s South Island with two days of wild weather delivering a month’s worth of rain, resulting in widespread flooding with rivers breaching banks. States of emergency were declared in Christchurch, Timaru District, Otago and Dunedin. While the weather cleared Sunday, the state of emergency has remained in place in several areas. The heaviest recorded fall was 266mm just north of Dunedin over a 48-hour period, some areas received triple the monthly average rainfall in two days. The heavy rain caused problems for emergency services with water on roads, slips and debris still around. According to Dunedin Civil Defence it will take months to clear all the landslips.

Fonterra NZ invests in cream cheese – Fonterra has pushed the go button on a NZ\$150m project to build two new cream cheese plants at Darfield to meet rising Asian. The first plant will be completed in 2018 with the second to follow in either 2019 or 2020. According to Fonterra’s global food service director Grant Watson, Chinese consumers have few preconceived notions around how dairy should be eaten, making room for some of the most innovative product developments, such as tea with cream cheese. The new technology which is to be introduced at the plants will give Fonterra the flexibility to quickly change products as needed. When completed the first plant will have a capacity of producing up to 24,000t of cream cheese each year for export, the second plant will have the same output.

AgriHQ: Stronger 2017/18 milk price – The AgriHQ farmgate milk price forecast for the 2017/18 season moved to NZ\$6.68kgMS last week, NZ\$0.18kgMS above Fonterra’s forecast. The AgriHQ spot price, which measures what the milk price would be if current commodity prices were achieved for the full season, has gained 5c to NZ\$6.61kgMS. The September 2018 milk price futures contract settled at \$6.50kg MS last week, in line with Fonterra’s 2017/18 forecast. The AgriHQ forecast for the 2016/17 season remains at NZ\$6.23kgMS, NZ\$0.08kgMS above Fonterra’s forecast.

MG confirms 200m litre intake drop – In a business update to the Australian Securities Exchange, Murray Goulburn (MG) has confirmed its milk intake for the 2017/18 season will be 2.3bn litres, 200m litres less than it previously forecast, and down from an estimated intake of 2.7bn litres in the 2016/17 season. The reduction in milk intake will not affect the opening average available Southern Milk Region farmgate milk price of \$5.20kgMS, however, MG stressed that should the Australian dollar continue to strengthen, it would jeopardise the upper end of its forecast 2017/18 farmgate milk price of \$5.50kgMS.

In the update, MG also announced the sale of its Kiewa Country brand and associated assets to a local business, which is expected to recommence local production, and the appointment of Deutsche Bank as its financial adviser during its comprehensive strategic review.

Organic boost in Australia – Wattle Health Australia (WHA) has entered into a non-binding heads of agreement with Organic Dairy Farmers of Australia Pty Ltd (ODF), Mason Ventures Ltd and Pack Niche Dairy Pty Ltd to undertake due diligence for the establishment of a joint venture to produce organic powdered milk. If the parties agree on the commercial due diligence, the JV will construct a \$25m-\$30m powdered milk spray drying plant, adjacent to ODF’s current Geelong-based organic milk processing centre. The JV will process Australian certified organic milk and conventional milks supplied exclusively to ODF. WHA will contribute a maximum of \$1.5m for 2.5% of the JV, ODF will have a 50% share.

Other news



Great Lakes building new cheese plant – Great Lakes Cheese (GLC) is building a new US\$55m cheese packaging plant in Wausau, Wisconsin with a US\$5.9m tax incentive scheme gifted by the city of Wausau to help offset the cost of building the new facility. In return, the city will have use of the property where GLC's current plant is located. The cheese company anticipates it will be adding at least 125 new jobs within three years of completing the new factory. It already employs 200 people at its current factory.

Unilever books first half improvement – Unilever has reported higher first-half profits, helped by ahead-of-markets sales growth, and efforts to control costs. The company has also lifted its forecast for 2017 underlying operating margin, expected to rise at least 100 basis points, up from an earlier estimate of 80 basis points. In the first half of 2017, Unilever posted a 22.4% rise in net profit to €3.32bn and a 27.9% lift in operating profit to €4.84bn with turnover up 5.5% to €27.73bn. Compared to the first half of 2016, the company's underlying sales slowed with a 3% increase, made up by a 3% rise in prices while volumes remained flat.

Unilever's food arms reported a 2.1% lift in first half turnover, while underlying sales growth, stripping out mergers, acquisitions and exchange rates was slower at 0.6%. Underlying volumes fell 1.7% as sales was hampered by declines of some of its non-core brands in Europe. Its spreads business which the company plans to sell or de-merge, slowed 3.7%. Its refreshment division which includes ice cream and drinks, reported a 3.9% increase in first-half turnover, helped by a 6.1% rise in underlying sales with volumes providing 1.2 percentage points of the growth. Shares in Unilever were up 1.11% on the first half results announcement.

Abbott sees small rise in nutrition sales – US pharma group Abbott Laboratories has reported a rise in second quarter sales from its paediatric nutrition division, although the increase wasn't enough to stem a fall in the first half of the year. The company booked a 1.4% rise in sales to US\$987m, helped by continued solid growth in the US and a slower rate of sales decline internationally.

In the first half of the year, sales were down 1.3% to US\$1.91bn, due to a 4.1% drop in sales YOY in first quarter. On a comparable basis, excluding exchange rates, first-half sales of paediatric nutrition dipped 0.4% YOY. Abbott said its US sales growth in the second quarter was above the rate of growth in the market, and was driven by recently launched infant formula products and by its PediaSure toddler brand. International sales declined 3.7% and international paediatric sales fell 12.2% YOY.



Grupo Lala book higher sales – Mexican dairy company Grupo Lala reported higher second-quarter sales and earnings due to expansion in the US and organic growth in Mexico and Central America. Revenue rose 16% YOY to US\$843.3m. The company's value-add portfolio grew with sales of "other dairy products" lifting 27.5%, driven by innovations, greater capacity and acquisitions. Operating income increased 5.9% to US\$92.2m and net earnings lifted 4.3% to US\$65m.

Yakult to build new Chinese plant – Rising Chinese demand means Japanese Yakult will start building its third plant in China this month with production of the Yakult probiotic drink to begin in March 2019. The plant will be the company's sixth in China and have a capacity of 1.2m bottles of Yakult and Yakult light fermented milk drinks per day. In a statement, the company said growing health awareness meant sales were expected to expand to suburban cities and not only in the central cities of the Guangdong province where the plant is being built.

Arlon Group buys Brazil's Betania dairy – New York-based food and agriculture investment firm Arlon Group has acquired a stake in CBL Alimentos SA (Betania) in Ceara, Brazil. As part of the agreement, Arlon Group's South American representative Bruno Martins Silva will join the board of directors, while Betania's CEO and majority stakeholder will remain at the helm. Betania produces fluid milk, dairy drinks, yoghurt and other dairy products and is the largest dairy company in the northeast region of Brazil. According to Silva, Betania is well positioned in the milk industry with a value-add portfolio, good brand recognition and a strong supply chain. Arlon has US\$1.5bn in assets under management in Latin America.

Fonterra looking at SanCor? – According to media reports from Buenos Aires, Fonterra has been in talks with Argentine dairy group SanCor, however, the New Zealand cooperative has declined to comment on the rumour. Argentina's two biggest newspapers report that a teleconference between Fonterra and SanCor executives were scheduled last week and that Fonterra had visited Argentina in the last two weeks to discuss a deal. According to one of the papers La Nacion, SanCor had been valued by an international consultant at US\$1bn, but that it had debt representing 40% that amount.

Furthermore, LA Nacion wrote that in the case SanCor and Fonterra were unable to find common ground, SanCor would reactivate its contact with Lactalis, who has also been rumoured to be interested in the beleaguered coop.

