April 4, 2017

New Zealand Dairy News

Synlait profits creep ahead:

Synlait reported a half year net profit of NZ$10.6m for the six months ending January 31, 2017, up 4% from the first half of FY2016. According to chairman Graeme Milne, Synlait's strategy is progressing as planned with strong sales of canned infant formula driving improved earnings as Synlait's gross margin was NZ$43.7m, up NZ$2m compared to the first half of 2016. The increased earnings was offset by increase in overhead costs of NZ$4.7m which included investment in people and business development as well as a one-off cost of dual listing on the ASX.

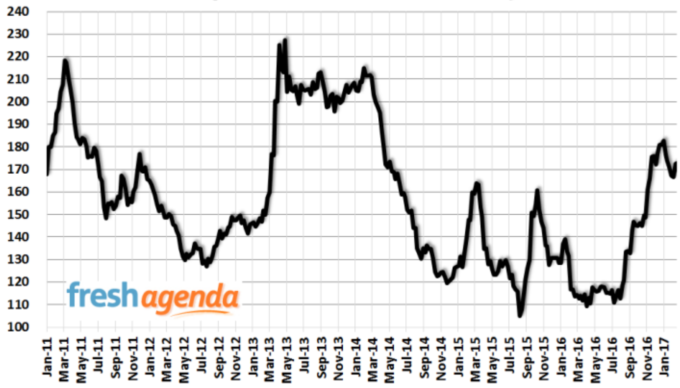
Synlait's gross profit was not as high as it could have been due to carry-over stock from FY2016, but according to managing director and chief executive John Penno, Synlait remains confident and will continue growing its infant formula business, with a planned doubling of infant formula base powder capacity once a second wet mix facility is completed at Dunsandel in November.

New Chinese import regulations taking effect 1 January 2018 are pushing the company's plans to build a new standalone site for blending and packaging, expected to be announced in the next couple of months. Managing director John Penno said while a new site involved higher cost it would be greatly outweighed by the reduced business risk of a second site and the value of working with a larger group of customers.

NZ Dairy Export Index

Index edges higher – Stable commodity prices and a slightly weaker NZ$, saw the index climb just 0.27% this week. Spot quotes from Australasian remained at last week's levels with WMP at US$2,890/t and SMP at US$1,985/t. Cheddar sat at US$3,550/t, while butter maintained its highest recorded index price of US$5,000/t. The NZ dollar fell marginally to **US$0.7009**, lifting the index by **0.44 points** to **161.29.**

NZ export index since January 2011



Take note: The index is an indicator of spot trends in gross export returns to the industry based on quoted NZ export prices, movements in currency and the total milk usage in exports by the NZ industry. It was set at 100 on 1 January 2000.

Using derivatives to improve prices:

OMF director Nigel Brunel has been reported illustrating the use of put and call options in a creative set of transactions to improve milk prices beyond those available through milk price futures, and locking in a price for a substantial part of next year's milk production. Brunel provided the example of a farmer that used these derivatives in a deal he referred to as a "zero cost ratio option", to lock in a milk price of NZ$6.10/kg MS for 60,000kg MS, giving away more price upside, at the time when September 2018 milk price futures were priced at NZ$5.80/kg MS.

Brunel cautioned that farmers who sell call options are subject to margin calls should milk prices lift above the strike price (here NZ$6.10/kg MS), and there are other factors which should be considered before executing these types of trades.

USDA: NZ dairy herd in rebuild mode:

In its semi-annual New Zealand cattle report, the USDA said total cattle slaughter rates slowed last year and were expected to reduce even further this year as culling rates from dairy farmers were particularly high in 2015, slowing 9% in

2016. According to the USDA, it was likely dairy farmers killed a higher-than-usual number of empty cows not in calf in 2016 to reduce costs in a low-payout environment and increase cashflow from higher beef prices. USDA expects dairy farmers to retain more young stock to bolster numbers and allow for sufficient culling without next year without depleting cow numbers.

Australian Dairy News

Processors focus on cheese:

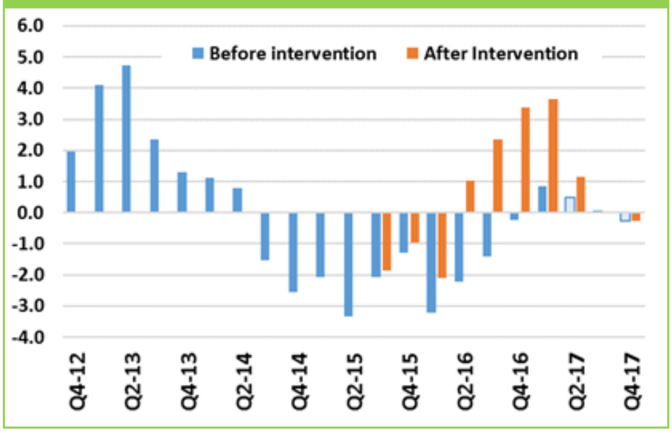
Australian dairy manufacturers continued to prioritise cheese production with falling milk collections in the first seven months of the 2016/17 season. Despite a 9.3% fall in southern milk supply over this period, cheese output was flat Cheddar output was 3.3% ahead on the prior season however, while production of non-cheddar cheese varieties dropped 3.9%. In the July to January period, cheddar accounted for 55.7% of total cheese output, up from 53.8% over 2015/16.

There was in a 26% drop in WMP output compared to the same period in the 2015/16 season. SMP output fell 11% for the period, with butter production declining 15%.

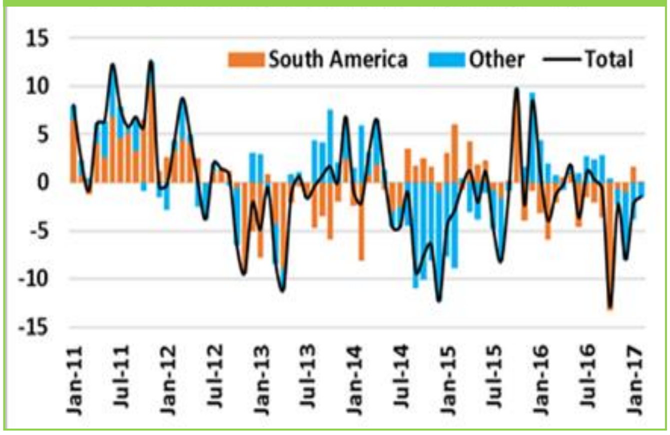
Butter is shortening:

A combination of a drop in overall milk production forcing a shift in product mix, increasing demand and changing consumer taste means small to medium food manufacturers are facing a chronic butter shortage. According to Dairy Australia senior analyst John Droppert a 9% increase in full cream milk sales over the past 12 months has taken a lot of fat out of the supply chain and along with an overall drop in Australia's milk supply, distributors of butter and smaller manufacturers of butter food products are finding it very difficult to source supplies. Food and dairy product manufacturers who small volumes are finding it much harder than bigger companies due to a lack of long term arrangements with suppliers.

12-mth rolling global import demand less export availability (bn litres ME)



YOY growth, Argentina WMP exports ('000t)



Global and Corporate Dairy News

Flat global outlook at best:

Freshagenda's latest Global Dairy Directions outlook is for a more balanced outlook after two years of excess supply, with low prices, and the need to replenish supplies expected to spur demand. Milk powder prices are projected to remain relatively flat, with the pace of milk supply recovery in EU and New Zealand, and in the case of SMP, the status of intervention stocks key influencers.

Intervention dynamics are challenging to project, however the dairy consultants view is that no sales will be made from intervention in 2017, based on the EU Commission's target price, while over 100,000t will be added to the stockpile. In contrast, the Commission's latest short-term outlook envisages no new intervention purchases and sales of just 22,000t for the year. SMP dynamics will continue to constrain butter output, which has already pushed butter prices to historic highs.

US farm margins weaker in February:

The 2014 Farm Bill income-over-feed costs (IOFC) measure was at its lowest point during the last three months in February, USc23.3/kg, with a weaker all-milk price at USc40.8/kg and higher feed costs per the USDA's latest Agricultural Prices report.

As a result, subscribers to the Margin Protection Program (MPP) will not receive an indemnity payment as the milk margin calculated for February is greater than the highest insurance level of USc17.6/kg. Margins are still projected to improve over the coming months and will remain above the mean profitability levels needed to ensure additional growth in national milk supply.

EU butter stocks at historically low levels:

The latest Milk Market Observatory (MMO) Economic Board meeting report estimated EU butter stocks at historically low levels through the end of January 2017. As a result, butter prices are expected to remain firm. In addition, cheese inventories are also estimated to be low. With strong growth in exports and persistent domestic demand, cheese prices can also be expected to remain firm after the spring flush. The report project an annual milk production growth of 0.5% in the EU for 2017 with deliveries recovering in the second quarter.

With expectations of a seasonal increase in output, offers of SMP to the public intervention scheme are expected in the coming weeks. Latest data reported by the Commission shows no sales through to 26 March.

Argentina's WMP exports down a third:

Argentina's export availability plummeted at the end of 2016 where local milk output was affected by floods and supply was not able to keep up with domestic cheese and fresh product demand. As a result, WMP exports fell 34% in the quarter to February. This was despite a 76% growth in shipments to the priority market of Brazil, while shipments to the Venezuela (in economic and political chaos) and all other destinations were down by 21% and 58% respectively on the same period in the prior year.

Beef and Lamb News

Imported beef prices higher still:

Last week, the 90 CL imported cow beef indicator edged higher, still due to limited supplies, closing at US$2.145/lb, up 0.5% on the week prior and tracking 15.3% ahead of the same week last year. Price dynamics in the US imported beef market are still driven by tight supplies out of Australia and New Zealand, respectively tracking 39% and 10% behind on the comparable. In the US, a growing cull cow and bull slaughter tracking above the previous two years, but below 2013-levels, is seeing import prices approaching domestic benchmarks.

New Zealand red meat sector readies for Brexit:

Last week, when the UK invoked article 50 to formally begin the process of exiting the EU, the New Zealand red meat sector was swift to respond with a target to maintain the quality and quantity of access. A joint statement from Beef + Lamb New Zealand and Meat Industry Association said the existing arrangement couldn't be "eroded under WTO rules." However, it would require considerable effort to maintain the current flexibility which allows NZ to decide whether it wants to export to the UK or EU depending on market conditions. Last year EU28 took nearly 50% of NZ's total global sheep meat exports of which half went to the UK.

Cargill profits jump:

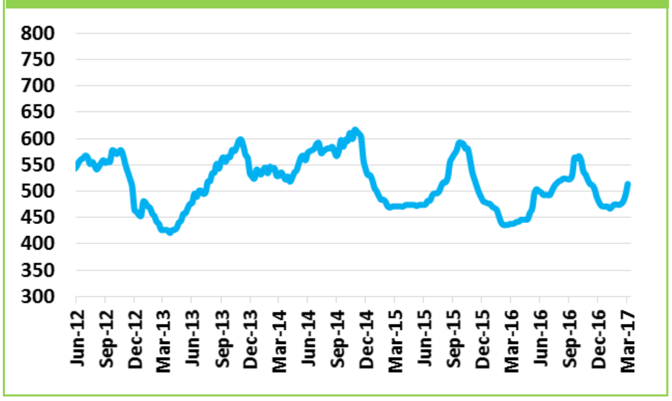
Commodity giant Cargill has recorded booming profits in the three months to February with adjusted operating earnings rising 50% to US$715m and revenue up 8% YOY to US$27.3bn in the same period. Earnings from its livestock and feed business grew significantly thanks to rising meat prices. In a statement, Cargill said its North American protein business continued to benefit from renewed consumer demand for beef, despite being below the earnings pace set in the first half.

USDA: NZ beef herd to grow 1.6%:

In its latest semi-annual slaughter New Zealand cattle and beef report, USDA says total cattle slaughter rates are expected to slow further this year after slowing through last year on the back of heavy culling in 2015 with beef producers reducing older cow numbers in response to very dry conditions in some regions. According to USDA, a reduction in calf slaughter during 2016 was an indicator that more young cattle were kept for both dairy and beef herd expansion in 2017 with total beef numbers expected to be 1.6% higher.

US cow 90CL (USc/lb)

NZ lamb 17.5kg cwt (NZc/kg)



Feed/Arable News

IGC: total global grains forecast up:

The International Grains Council (IGC) have raised its forecast for total grains production in 2016/17 by 4mt to 2,106mt, up 5% YOY and the largest production ever recorded by IGC. Consumption forecasts were boosted and opening stocks were upgraded. Upgrades to the South American crops lift the 2016/17 world soybean production forecast by 5mt to a peak of 341mt, up 8% YOY. The IGC's first full set of projections for total grains in 2017/18 point to an overall fall in production of 3%, led by wheat and maize, while another record soybean outturn is expected due to area gains in key producers.

NAB: El Niño outlook concerning:

National Bank Australia's (NAB) March Agribusiness view points to a worryingly dry weather outlook in Australia which could hit the 2017/18 wheat crop. Based on the Bureau of Meteorology's three-month outlook which points to a very high chance of drier than average conditions across Australia, the bank says the outlook for the wheat harvest in 2017/18 is "considerably more circumspect", as it means lower yields. Although the bank says an El Nino event is in no way certain at this time of year, seldom those conditions seldom deliver above average crops in Australia.