

The KDM Dairy Report – June 21st, 2013

What's Bullish:

- Fluid Milk South: Severe drought conditions in Florida have been eliminated in the wake of Tropical Storm Andrea. But the weather following the storm has turned hot and humid, causing considerable declines in milk production. Class I demand did show some increase compared to the previous week. The combination of reduced milk production and marginally increased fluid demand limited exports to 92 spot loads this week, down 96 loads from last week. Milk production in the Southeast is holding about steady with last week. Milk supplies continue to exceed demand, but load rejections, due to temperature issues, continue to be a

Futures Month	Class III 06/21	Class III 06/14	Change	Dry Whey 06/21	Dry Whey 06/14	Change	Cheese 06/21	Cheese 06/14	Change
Jun-13	\$18.03	\$17.99	\$0.04	57.25c	57.10c	0.15c	\$1.777	\$1.772	\$0.005
Jul-13	\$17.79	\$18.03	(\$0.24)	57.45c	57.25c	0.20c	\$1.755	\$1.779	(\$0.024)
Aug-13	\$18.33	\$18.52	(\$0.19)	58.00c	58.48c	(0.48c)	\$1.806	\$1.827	(\$0.021)
Sep-13	\$18.64	\$18.81	(\$0.17)	58.00c	58.50c	(0.50c)	\$1.840	\$1.856	(\$0.016)
Oct-13	\$18.64	\$18.79	(\$0.15)	58.75c	59.50c	(0.75c)	\$1.845	\$1.845	\$0.000
Nov-13	\$18.50	\$18.55	(\$0.05)	58.00c	59.00c	(1.00c)	\$1.823	\$1.830	(\$0.007)
Dec-13	\$18.11	\$18.16	(\$0.05)	59.00c	59.00c	0.00c	\$1.786	\$1.790	(\$0.004)
Jan-14	\$17.60	\$17.60	\$0.00	54.35c	54.35c	0.00c	\$1.760	\$1.759	\$0.001
Feb-14	\$17.26	\$17.25	\$0.01	50.00c	50.00c	0.00c	\$1.737	\$1.735	\$0.002
Mar-14	\$17.15	\$17.17	(\$0.02)	49.00c	49.00c	0.00c	\$1.740	\$1.740	\$0.000
Apr-14	\$17.16	\$17.15	\$0.01	48.00c	48.00c	0.00c	\$1.737	\$1.737	\$0.000
May-14	\$17.17	\$17.16	\$0.01	48.00c	48.00c	0.00c	\$1.730	\$1.730	\$0.000
12 Mo Avg	\$17.87	\$17.93	(\$0.07)	54.65c	54.85c	(0.20c)	\$1.778	\$1.783	(\$0.005)

- problem with transports out of the most southern areas of the region. Demand for cream is increasing and reducing the flow of cream to churns. Increased pulls for cream are coming from ice cream, cream cheese, whipping cream manufacturers and cream bottlers.
- Fluid Milk Central: Availability of spot loads of milk is uneven. Some cheese manufacturers indicate their internal milk supplies are declining seasonally and access to additional milk supplies would be helpful to meet near term cheese orders. A few manufacturers with nonfat dry milk and cheese production capabilities are opting toward sending additional loads of farm milk intakes into NDM operations as that market appears to be gaining near term strength. Some Class III operations are also favoring American style production to keep pace with the uptick in process cheese sales during the traditional grilling season. Cream sales into ice cream and mix facilities are active and reach into the Northeast. Various Class II processors indicate their cone, cup, stick and tub operations are nearing full production and will remain at that peak through the balance of the month and possibly into July, depending on sales. Orders for ice cream/soft serve mix for various restaurant brands increased this week to meet demand for summer menu items. Progress on field planting for corn moved toward completion in many states during the last week, but remains below 100% in most areas. First cutting for alfalfa is approaching completion, but 3 - 4 weeks behind historical average dates in many North Central areas. Dairy farmers currently are employing various options for managing feed and maintaining milk output, including reformulating rations to match available feed inputs. Milk haulers report feed supplies are a top concern for North Central dairy operators. Up to this point, dairy operators have been stretching out stored feed from 2012 along with whatever forages could be purchased.
- Dry Whey Central: Domestic interest is steady, while interest from off shore buyers is reportedly increasing. Central dry whey producers indicate the price difference between Central and West dry whey represents an opportunity to compete in the international market. Dry whey production is steady to somewhat lower as internal milk supplies step seasonally lower.
- Dry Whey West: Export demand is said to be good with increased interest for Q3 and Q4 of this year. Much of the Western whey is moved offshore and firmer export prices are welcomed. Whey production continues at a steady pace as cheese production schedules are heavy.
- NDM Central: Prices increased on both the range and mostly series this week. Interest from buyers is more pronounced, but pricing remains part of the conversation. Nonfat dry milk production is variable, driven by factors unique to each operation. Some plant operators report condensed skim sales are active into Class II and shunting milk away from dryers. Nonfat dry milk inventories are steady.
- NDM West: There is a firm undertone mostly driven by export sales and interest. Producers are in no hurry to sell additional powder. Most believe that the market looks good for them moving forward. More manufacturers are also very happy to make as much SMP for export as they are able to. Prices are good for that product and it tightens up the supply of NDM for domestic use.
- Cheese Northeast: Cheese production remains steady with previous weeks' levels as milk volumes going to cheese plants remain strong. However, inventory expansion has slowed as cheese sales have improved with increased retail promotions. Export demand has also seen some increased interest.
- Cheese Midwest: Some manufacturers report having had extra milk available late last week, but more manufacturers offered comments such as "no spot milk was available" or "we could use more milk". Some of those manufacturers report using nonfat dry milk to fortify cheese recently manufactured. A manufacturer commented that there was "big processor demand" for Barrels. Mozzarella sales continue to be "in the tank" according to a Midwest cheese manufacturer. Nevertheless, sales to food service end users remain good.
- Cheese West: Western wholesale cheese prices were stronger this week. Domestic demand is steady, but export interest is up as U.S. prices are favorable to international markets. Cheese stocks are heavier than usual, but are not felt to be problematic.
- CWT accepted requests for export assistance that totaled 1.923 million lbs of Cheddar, Gouda and Monterey Jack cheese. The product will be delivered June through October 2013.
- Prices for dairy products in this week's GDT auction averaged 1.1% higher than two weeks ago. Butter was up 4.7% to a U.S. equivalent \$1.78/lb and skim milk powder increased 3.2% to a U.S. \$1.94/lb. Cheddar cheese was down 6.5% on just two contracts traded, but still averaged a U.S. \$2.08/lb.
- International: Milk production trends in Western Europe are steady to lower for most milk producing countries. Volumes are declining from the seasonal peak. For the EU, April milk production was 3.1% lower than April 2012. Though current conditions have been generally favorable, many countries were noting the milk volumes were lower than a year ago in May. Milk prices in most countries are rising.
- International: New Zealand milk production is trending lower at or near seasonal lows. Processing plants continue to be stepped down for end of season maintenance and to maximize efficiencies. Milk output levels are down sharply when compared to year ago levels, unofficial counts

are often more than 30% lower in May. This is a continuation of the poor results seen in March and April. According to DCANZ, April milk production was 34.5% lower than April 2012. Farmers began to cull heavier and earlier to compensate for the drought conditions. Australian milk production trends are expected to continue at the light side of normal with projections being eased lower. Processors and coops are announcing higher milk prices for the upcoming season, at levels up 20% or more than for last season's start. Cheese prices eased slightly, but still average a U.S. equivalent \$1.99/lb.

What's Bearish:

- Spot Market: Blocks finished the week $\frac{1}{4}$ ¢ higher to \$1.72 $\frac{1}{4}$ /lb on just 1 trade, but barrels fell 5 $\frac{1}{2}$ ¢ to \$1.71 $\frac{1}{4}$ /lb on no trades. Butter declined 3 $\frac{1}{2}$ ¢ to \$1.50/lb on 2 trades, but NDM increased 2 $\frac{1}{4}$ ¢ to \$1.73/lb on 6 trades.
- Cold Storage Report: American cheese stocks in cold storage at the end of May were 10% higher than a year ago and 3% higher than in April, according to USDA. Total cheese stocks were up 8% and 3% over the same period. Butter stocks jumped 24% over May 2012 and 4% higher than the prior month.
- Milk Production Report: May milk production in the U.S. was up 0.8% vs. a year ago, according to USDA. Gains were led by KS up 8.1%, IN up 5.2% and VT up 3.6%. CA output declined 0.5% while WI was 1.2% higher.
- Livestock Slaughter Report: Dairy cow slaughter during the month of May totaled 247,700 head, down 1.4% vs. a year ago. While the YTD is still higher by about 50,000 head, monthly numbers have been lower 3 out of the first 5 months of 2013.
- The Weekly Cold Storage Holdings report indicates both cheese and butter stocks are rising in June. For the period 06/01 through 06/17, cheese stocks are up 3%, or 3.5 million lbs, at USDA selected storage centers. Butter stocks are also up 3%, or 529,000 lbs over the same period.
- Fluid Milk Northeast: Weather conditions favorable of cow comfort levels in the Northeast and Mid-Atlantic regions have supported a strong and prolonged seasonal milk flush. Manufacturing milk supplies continue to be heavy and above year ago levels. Class I demand is near its seasonal low point as nearly all schools have closed for summer break.
- Fluid Milk Southwest: Weather in CA is not stressing the milking herd at all. Temperatures in the Central Valley are running in the low 90s daytime and low 60s to high 50s night time. The peak in milk production is past, but output is not dropping off very much or very fast. California hay prices in the north are running \$210-249/ton FOB. Warm conditions continue to persist in AZ and the outlook for the entire week is about 108 for the high and 81 the low. The milking herd is under some stress, but the heat abatement measures continue to work well. Milk intake managers continue to be surprised that output is holding up as well as it is. Milk receipts in NM continue to hold up reasonably well. Days are warm in the dairy areas, but drop into the mid-60s at night. Milk is being handled efficiently by processing plants.
- Fluid Milk Pacific Northwest: Weather conditions are ideal for comfortable cows. This is helping to hold milk production levels near the seasonal peak. Coastal areas are well supplied with rains for pasture. Milk supplies for processing showed some increases this week as Class I usage drops with schools letting out. UT and ID milk supplies are mostly steady. High temperatures during the day are balanced with cooler nights and cows are not stressed to any extent currently. Manufacturing capacity is still above milk production in most parts of the region. First crop harvest of forages is ongoing and adding to feed supplies in the area.
- Butter: Western butter prices are steady to weak as increased butter in cold storage weighs on the market. Buyers are looking for discounts as an incentive to purchase more than immediate needs. Domestic demand for print butter into Western retail and club stores continues to be strong. Central bulk butter production is active. Northeast cream demand continued to improve this week, but domestic demand for Northeast butter remains lackluster and below year ago levels and producers are building inventory. According to the Foreign Ag Service, quota imports of butter for January-May 2013 total 4.0 million pounds, 50.3% more than the same period in 2012.
- Dry Whey East: Prices declined after two weeks of increases. The continuing strong prolonged seasonal milk flush in the region is keeping cheese production and dry whey production at increased levels. Current production is adding to overall inventories. Domestic demand is fairly light as mild weather has limited the expansion of ice cream sales, production and dry whey purchases. Export sales remain steady and continue to be the primary means for some manufacturers to manage their inventories. Spot and resale prices are under contract pricing and give the market a weak undertone.
- NDM East: The strong and prolonged spring flush continues to channel heavy milk volumes to dryers, keeping nonfat dry milk production at elevated levels. Some manufacturers in the East have and continue to operate at near capacity levels. Current production is adding to most manufacturers' inventories.

Recommendation:

It's a strange week when spot NDM has higher trade volume (6) than spot cheese (1), and it has us scratching our head. Trade volume was low overall in Class III as well, as it seemed the main goal for the week was simply to fix the inverted block/barrel spread, which it did. We keep being optimistic and calling a bottom, but front month futures keep sagging as spot cheese prices are stuck in a rut. We like to be right as much as anyone, but obviously our timing is lacking on this one. Today's bearish Cold Storage Report may be one of the reasons for the inability of cheese prices to move higher. We keep hearing about decent demand, but obviously some of this stuff is getting put away as inventories are climbing. The bottom line though is that nationally we are now past the peak and getting warmer. Feed issues are a big deal in many parts of the country, and we keep hearing anecdotal stories about operations under financial stress. At some point, this has to turn in to higher milk prices. Or does it? With the surprise upside in cheese inventories and higher milk production, it could be that demand just isn't as great as we thought. We have one week of the July futures contract in at about \$17.60 average. With July settling at \$17.79, if the spot market doesn't wake up next week, more premium will be taken out. August was lower for the week but settled near the high, with big trade volume seen at \$18.30 (132 of 219 total trades). This was most likely short-covering, so perhaps we are finally starting to carve out a bottom. Cold storage aside, there appear to be too many positives in the market to keep prices lower much longer in our opinion, but who knows? We wouldn't advise hedgers to sell here, but to continue buying CALL options Aug and beyond to later sell in to. The rubber band continues to be stretched and we feel it will snap back at some point in violent fashion!

This material has been prepared by a sales or trading employee or agent of KDM Trading, Inc. and is, or is in the nature of, a solicitation. By accepting this communication, you agree that you are an experienced user of the futures markets, capable of making independent trading decisions, and agree that you are not, and will not, rely solely on this communication in making trading decisions. DISTRIBUTION IN SOME JURISDICTIONS MAY BE PROHIBITED OR RESTRICTED BY LAW. PERSONS IN POSSESSION OF THIS COMMUNICATION INDIRECTLY SHOULD INFORM THEMSELVES ABOUT AND OBSERVE ANY SUCH PROHIBITION OR RESTRICTIONS. TO THE EXTENT THAT YOU HAVE RECEIVED THIS COMMUNICATION INDIRECTLY AND SOLICITATIONS ARE PROHIBITED IN YOUR JURISDICTION WITHOUT REGISTRATION, THE MARKET COMMENTARY IN THIS COMMUNICATION SHOULD NOT BE CONSIDERED A SOLICITATION. The risk of loss in trading futures and/or options is substantial and each investor and/or trader must consider whether this is a suitable investment. Past performance, whether actual or indicated by simulated historical tests of strategies, is not indicative of future results. Trading advice is based on information taken from trades and statistical services and other sources that KDM Trading, Inc. believes are reliable. We do not guarantee that such information is accurate or complete and it should not be relied upon as such. Trading advice reflects our good faith judgment at a specific time and is subject to change without notice. There is no guarantee that the advice we give will result in profitable trades. © Copyright 2013 - KDM Trading, Inc. All Rights Reserved - www.kdmtrading.com