

The KDM Dairy Report – December 13th, 2013

What's Bullish:

- Spot Market: Blocks gained 4¼¢ for the week to settle at \$1.92½/lb on 7 trades, while barrels gave up ¼¢ to close at \$1.83 on just 2 trades. Grade A NDM pushed 2¼¢ higher to \$2.08/lb on 2 trades, but butter lost 7½¢ to close at \$1.57/lb on 7 trades.
- Fluid Milk Northeast: The yearend holiday dairy product production push is on in the Northeast and Mid-Atlantic regions and has significantly reduced milk volumes at balancing plants. The Mid-Atlantic region has also seen retail runs on dairy products and increases in Class I demand, prompted by snow storms that closed schools and federal government DC operations. Milk production is showing some increases as it moves along the usual seasonal trend, but component levels in some areas are below year ago levels.

Futures Month	Class III 12/13	Class III 12/06	Change	Dry Whey 12/13	Dry Whey 12/06	Change	Cheese 12/13	Cheese 12/06	Change
Dec-13	\$19.02	\$19.08	(\$0.06)	58.75c	59.50c	(0.75c)	\$1.873	\$1.873	\$0.000
Jan-14	\$18.52	\$18.55	(\$0.03)	58.75c	60.50c	(1.75c)	\$1.825	\$1.822	\$0.003
Feb-14	\$17.96	\$18.00	(\$0.04)	59.98c	63.00c	(3.03c)	\$1.756	\$1.752	\$0.004
Mar-14	\$17.75	\$17.68	\$0.07	60.25c	61.00c	(0.75c)	\$1.738	\$1.723	\$0.015
Apr-14	\$17.61	\$17.42	\$0.19	59.75c	60.00c	(0.25c)	\$1.719	\$1.711	\$0.008
May-14	\$17.48	\$17.27	\$0.21	59.15c	59.00c	0.15c	\$1.708	\$1.703	\$0.005
Jun-14	\$17.47	\$17.23	\$0.24	59.25c	58.00c	1.25c	\$1.699	\$1.699	\$0.000
Jul-14	\$17.35	\$17.32	\$0.03	58.25c	57.50c	0.75c	\$1.706	\$1.719	(\$0.013)
Aug-14	\$17.39	\$17.36	\$0.03	57.00c	56.00c	1.00c	\$1.715	\$1.722	(\$0.007)
Sep-14	\$17.42	\$17.41	\$0.01	57.00c	56.50c	0.50c	\$1.717	\$1.727	(\$0.010)
Oct-14	\$17.38	\$17.34	\$0.04	55.75c	54.50c	1.25c	\$1.717	\$1.730	(\$0.013)
Nov-14	\$17.42	\$17.27	\$0.15	56.50c	54.50c	2.00c	\$1.730	\$1.733	(\$0.003)
12 Mo Avg	\$17.73	\$17.66	\$0.07	58.36c	58.33c	0.03c	\$1.742	\$1.743	(\$0.001)

- Fluid Milk Southeast: Class I demand is very strong in Florida as early cold spells in other regions of the country appear to have increased tourism and seasonal residents to the state and increased consumer demand for dairy products. Milk production has fallen flat, due to the warm humid weather reducing cow comfort levels. The situation of increased demand and lackluster milk production has tightened milk supplies and expanded import spot loads to 95 this week, up from 79 last week. Bottling plant demand is very strong as storms have increased consumer demand for dairy products. Manufacturing supplies are limited and near their contract minimums. Cream demand is stronger this week than last as cream based dairy product manufacturers are in their final production push to get products on retail shelves prior to the holidays. Most manufacturers have expanded their contracted cream volumes to their maximum levels. Available spot sales are very limited and manufacturing supplies going to Class IV production are significantly reduced.
- Fluid Milk Central: Milk production and components are trending up, but with the recent cold spurt in the Upper Midwest some producers are worried cows may start to utilize more feed energy for body warmth resulting in reduced milk production rates. Milk supplies tightened this week for the last minute push for year-end holiday orders; premiums were generally \$2.00 over Class. Milk processors have received many Q1 inquiries for spot loads of milk. Bottling sales are peaking with heavy retail promotions going on for milk, eggnog, and other holiday dairy products. Class II demand has been above seasonal trends, leading to additional tightness in milk supply availability. Cream supplies tightened this week and continue to show stronger than seasonal demand, but is expected to loosen over the year-end holidays. Cheese manufacturers are actively looking for additional milk supplies.
- Fluid Milk Southwest: Manufacturing processing capacity remains available throughout the region for handling current farm milk supplies. A recent cold snap in CA brought minor declines in production due to cow comfort in some areas, but on the whole, milk production in California is making modest gains compared to a few weeks ago. Various handlers report the feed cost situation is one of the items still hampering strong growth in farm milk production. NM farm milk production is uneven because dairy producers have had some challenges in maintaining cow comfort as weather conditions remain changeable between seasons. Fluid demand is mostly steady, but a few bottlers are pulling more strongly to make up for loads missed over the weekend due to poor transportation conditions. Milk sales into Class II are active, with some manufacturers making a last push to deliver holiday related products to grocery outlets. Dairy processors in AZ report milk intakes are uneven as weather has been changeable. Below normal temperatures were recorded in several areas across the state during the last 7-10 days. Fluid demand is very active as retail outlets run specials on several package sizes/varieties of milk as well as holiday related fluid products. Cream demand throughout the Southwest is active. Manufacturers of aerated cream, dips, sour cream, cream cheese and butter have active production schedules planned for the balance of this week and through the weekend. Some cream sellers indicate they are regularly fielding calls from in-State and out-of-State buyers/end users, but can only fill a small portion of those requests for spot cream loads due to contract commitments.
- Fluid Milk Pacific Northwest: An early cold spell enveloped the region at the beginning of this week. Milk production levels are at seasonally expected low points, but the freezing temperatures added to stress on dairies as cows spent more energy on staying warm. Class II demand is still very good as time to ship product for the holidays is shortening. UT and ID milk production continues to lag behind year ago levels due to lower cow numbers in the region. Production levels are at seasonal lows and early cold weather only added to the lower numbers. Manufacturing capacity in the region exceeds current milk supplies. Tighter lending practices are said to be making expansion plans for dairies more difficult.
- Butter Northeast: Production has fallen off in the region as strong cream demand has reduced churn volumes. Stocks are tight, causing some plants to work inventories lower to fill committed sales. Domestic demand is very good as retail stores, bakeries, and food processors make products available for the upcoming holiday. Export interests are comparatively good, with some butter makers choosing to fill existing export orders.
- Butter Central: Central butter prices strengthened as the market tone remains firm. Some butter churn operators had some difficulty finding cream supplies but expect the availability to loosen over the next few weeks. International interest has pushed some additional manufacturers to begin 82% butter production. Domestic demand for butter remains good. Butter inventories are decreasing.
- Butter West: The market tone is mostly steady as good retail demand for the upcoming holiday keeps moving product. Print orders are good, but time is running out for getting the product to end users. Cold weather across the West has tightened the milk supply and reduced churning.
- Dry Whey Northeast: Prices firmed again this week. Production is active as most cheese plants in the region are on 6-7 day production schedules, yet supplies have tightened. Domestic sales have improved, while export sales have remained steady. Some manufacturers have

indicated their supplies are committed through the remainder of 2013. Demand for whey has improved as various buyers are looking to purchase protein and finding dry whey as a lower priced, per unit of protein, alternative.

- Dry Whey Central: Prices were slightly higher this week and the market tone is steady to slightly strengthening as export interest has improved. Contracting for 2014 has been mixed. Some buyers and sellers want to work strictly in the spot market while others are electing to secure additional contract loads. Additional inquiries were seen for dry whey product this week as end users look for product.
- Dry Whey West: The market tone is mostly steady with a firm undertone reinforcing light spot trading. Contract sales continue to clear inventories as manufacturers look to lower stored stocks for end of year audits. Whey production is steady to lower as milk for cheese plants is seasonally tight. Demand for whey is steady with negotiations ongoing for 2014 supplies.
- NDM East: Prices moved higher this week in a firm market. Production has declined as increased Class I and II demand has pulled milk volumes away from dryer operations. Supplies are tight with some manufacturers sold out through 2013. Demand is good as numerous dairy product manufacturers are in the final production push to get products on retail shelves prior to the holidays. Some buyers are sourcing product out of region and/or via resale opportunities.
- NDM Central: The market tone remains firm with little product availability to supply continued strong domestic and export demand. Prices continued to edge higher this week.
- NDM West: Prices are higher on a firm market. Domestic and international demand for NDM/SMP is insatiable according to some sellers. Manufacturers and resellers indicate they are trying to fill as many requests as possible on a weekly basis, but have to hold onto enough stocks to fill nearby contracts. NDM contracting activity is increasing for the first few months of 2014 as buyers now realize there is little chance of prices decreasing in the near term.
- Cheese Northeast: Production is active with most plants in the region operating on 6-7 day production schedules, yet demand is such that supplies are being worked lower as end of year holiday orders are being filled. Export demand and trade interest also remains active.
- Cheese West: The market for block cheese remains strong with retailers looking to stock store shelves for the holiday. Barrel demand is lighter, although contracted sales continue to move. Cheese production is limited due to seasonally light milk supplies. Cold weather across much of the West has also added to tight milk supplies.
- CWT has accepted 33 requests for export assistance to sell 5.064 million pounds of Cheddar, Gouda and Monterey Jack cheese and 1.863 million pounds of butter to customers in Asia, Central America, Europe, the Middle East and North Africa. The product will be delivered in December 2013 through May 2014.
- Exports: The U.S. Foreign Ag Service reported exports of cheese and curd for October 2013 totaled 59.7 million pounds and were 42% higher than a year ago. January-October 2013 exports totaled 566.7 million pounds, up 17% from the same period a year ago, and accounted for 6.1% of U.S. cheese production for the year. Butter exports were even more impressive, with October totaling 23.2 million pounds, up 153% from last year. The January-October export total was 160.4 million pounds, up 72% compared to last year. Exports of dry whey for January-October 2013 totaled 438.4 million pounds, up 8% same period a year ago and equated to 56.3% of the total dry whey production in the U.S. On a total solids basis, total October dairy exports were equivalent to 16.3% of U.S. milk production. Wow!

What's Bearish:

- Dairy cow slaughter for the week ended 11/30 totaled 48,500 head, down 25%, or 16,600 head from the same period a year ago.
- Cheese Midwest: The markets are unsettled, with no clear sustained trend up or down. Milk production is reported by a number of cheese plants to be increasing. A large Wisconsin source of milk generating in the range of eight tankers of milk a day, is no longer having its milk purchased by a large cheesemaking operation. Interest in barrels is reported as weaker than blocks by a number of cheese plants. This has led to decreasing barrel production in favor of blocks in some plants. Cheese inventories vary. Some plants report inventories as tight, causing order fulfillment to be delayed. In other plants, inventories are reported to be stable.
- Grains: Corn and wheat put in new lows this week while beans were under pressure, as USDA increased their estimate on feed grain supplies. A bill has been introduced that would end ethanol mandates, while China has rejected several corn shipments due to GMO concerns.
- International: Another article this week confirming a dramatic drop in China's dairy cow numbers. Following drought, high feed costs and strong beef prices, it's estimated China's milk production has declined 20% this year. The emerging shortage in China could maintain relatively strong world dairy markets into 2014.

Recommendation:

In a sign that the markets are getting more volatile, barrel cheese fell 5¢ on Monday, then spent the rest of the week trying to keep up with blocks which kept moving higher. There's no question we're getting into lofty price levels, with Dec Class III above \$19. And current cheese prices appear to be hurting export interest a bit at these levels. Combine that with an order drop-off post holidays and we could be in for a bit of a correction. We say "bit" though because we think it will be mild. International demand for powder continues to make headlines, and with demand apparently "insatiable", Grade A notched its highest price of the year at \$2.08/lb. That puts Class IV at around \$22.60/cwt, which should support Class III to some extent into Q1. This is an amazing opportunity for hedgers to get some protection. The first half of the year averages \$17.80 as of today's close. We would look to lightly sell above \$18.00. That's just a great price. In light of feed costs coming down, there will be plenty of incentive to expand.

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