

The KDM Dairy Report – February 28th, 2014

What's Bullish:

- Spot Market: Blocks finished the week up 6¢ to settle at \$2.22¼/lb and barrels gained 4¼¢ to \$2.20/lb. All bids went unfilled as there were no trades. After declining early in the week, butter made it all back and then some on Friday, with a 10¢ move higher. Butter finished the week up 8¢ to \$1.88/lb on heavy volume of 36 loads exchanging hands. Grade A NDM settled at \$2.04/lb, down ½¢ on 12 trades.
- CWT has accepted 23 requests for export assistance to sell 4.791 million lbs of Cheddar, Gouda and Monterey Jack cheese, and 1.032 million lbs of 82% butter to customers in Asia, the Middle East, North Africa and South Pacific. The product will be delivered in February through June 2014.

Futures Month	Class III 02/28	Class III 02/21	Change	Dry Whey 02/28	Dry Whey 02/21	Change	Cheese 02/28	Cheese 02/21	Change
Feb-14	\$23.18	\$23.19	(\$0.01)	62.88¢	62.88¢	0.00¢	\$2.272	\$2.271	\$0.001
Mar-14	\$22.15	\$21.79	\$0.36	64.18¢	63.50¢	0.67¢	\$2.163	\$2.118	\$0.045
Apr-14	\$20.85	\$20.90	(\$0.05)	63.00¢	63.08¢	(0.08¢)	\$2.033	\$2.039	(\$0.006)
May-14	\$20.07	\$20.01	\$0.06	61.50¢	62.98¢	(1.48¢)	\$1.965	\$1.953	\$0.012
Jun-14	\$19.94	\$19.72	\$0.22	60.50¢	62.50¢	(2.00¢)	\$1.958	\$1.926	\$0.032
Jul-14	\$19.73	\$19.38	\$0.35	58.75¢	59.23¢	(0.48¢)	\$1.940	\$1.906	\$0.034
Aug-14	\$19.43	\$19.12	\$0.31	58.25¢	57.75¢	0.50¢	\$1.910	\$1.889	\$0.021
Sep-14	\$19.10	\$18.86	\$0.24	57.75¢	56.75¢	1.00¢	\$1.885	\$1.865	\$0.020
Oct-14	\$18.89	\$18.60	\$0.29	57.28¢	56.75¢	0.52¢	\$1.872	\$1.849	\$0.023
Nov-14	\$18.55	\$18.34	\$0.21	57.20¢	56.98¢	0.23¢	\$1.835	\$1.808	\$0.027
Dec-14	\$18.26	\$18.00	\$0.26	56.80¢	55.50¢	1.30¢	\$1.811	\$1.778	\$0.033
Jan-15	\$17.85	\$17.60	\$0.25	54.75¢	55.00¢	(0.25¢)	\$1.760	\$1.760	\$0.000
12 Mo Avg	\$19.83	\$19.63	\$0.21	59.40¢	59.41¢	(0.00¢)	\$1.950	\$1.930	\$0.020

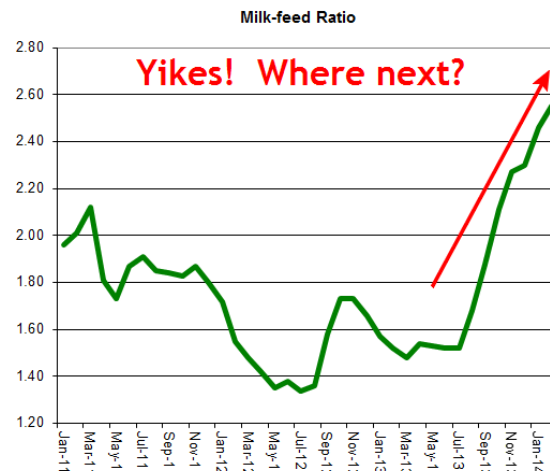
- Dry Whey Northeast: Dry whey production is improving in the region, with upticks in milk supplies going to cheese manufacturers. However, inventories are tight, with supplies primarily moving through contracts. Demand is good.
- Dry Whey Central: Prices increased this week and the market tone is firm. Many dry whey manufacturers are focusing solely on contract commitments. Resellers were able to move product readily with increased buyer interest. Domestic demand is good and international interest is active. Dry whey supplies are limited.
- Dry Whey West: Prices are higher this week, with both buyers and sellers expressing concern about prices moving above current levels. Nevertheless, contract sales are ongoing with some spot sales being reported. Whey prices are competitive with other whey stream products when comparing protein price levels. Strong export prices with good demand from both domestic and export markets are helping to bolster prices.
- NDM Northeast: Prices strengthened this week. Tight inventories are reported in the region, with some manufacturers' drying schedules geared to cover only contracted volumes, with limited spot drying. Domestic demand is good. Export demand is active.
- NDM West: The market tone is firm. Manufacturers in the Western region are dividing production time among several products, including low heat nonfat dry milk, skim milk powder, and concentrated milk products. Because of the diverse ways producers are handling intakes, nonfat dry milk inventories are only able to build slowly.
- Butter: The current high prices have market participants unsure about the price direction with some buyers showing resistance. However, export contracts are active and retail orders are picking up, improving domestic demand.
- Cheese Midwest: Manufacturers report that retail and food service cheese orders are strong, even with CME cheese prices having increased over the last week and a half or so. When prices began increasing more aggressively mid to late last week, there was little reduction in ordering, unlike patterns earlier this year. An observation is that buyers were gun shy for so long as prices increased, they had no choice but to pull the trigger when prices declined. The need to build store and food service inventories now generally overrides the influence on buying patterns as prices increase. Food service cheese orders picked up quicker than retail, but both are now up. Bulk cheese orders are also increasing with some buyers reported to be replenishing stocks. The increasingly widespread perception that order strength is real and will be sustained, is leading to cheese manufacturers becoming more comfortable with increasing production. Icy, snow conditions causing transportation delays resulted in some milk delays to cheese plants last week, reducing vat numbers.
- Cheese West: Prices are mixed with a firm undertone. Cheese production is slowly increasing as farm milk supplies are building, but some plants are restricting production so as not to build inventories. Export demand is good and is absorbing much of the production increases.
- Cheese stocks are declining anti-seasonally so far in February. Holdings at USDA-selected storage centers are down 2%, or 1.7 million lbs through 02/24.
- Cheese: After reaching record high spot prices the first week of February, the market moved sharply lower. Those lower prices cleared inventories and the market has returned to a firming undertone. Demand remains good with buyers looking to purchase on signs of price weakness. Buyers who have held off on purchases and are now looking to increase inventories, are having a harder time sourcing spot cheese. Export demand is good.
- International: Worsening smog in China is blocking natural light and could spell disaster for agriculture, according to an article this week in the South China Morning Post. Smog blankets up to 25% of the mainland at times, slowing the photosynthesis process. If the smog persists or intensifies, the country's food supply could face devastating consequences.
- International: U.S. dairy product exporters have been paying increasing attention to the needs of the global market, according to an article in AgWeb this week. U.S. dairy companies and coops have dramatically increased their investments in new plants and equipment to meet the needs of the international market. Sales and marketing offices are being opened in customers' home countries. As a result of this progress, it looks more likely that dairy exports will continue to experience healthy growth.
- International: Queensland reports they have a 100 million liter a year milk shortage as a result of a supermarket price war, drought and rising costs.
- International: Export demand for milk powders in Western Europe is very active as EU prices are internationally competitive and gaining more interest. Near term available supplies are very limited. Bulk butter prices, after declining for a number of weeks, are now drawing increased export interest.
- International: Milk production in Eastern Europe is behind the Western European pace, but increasing along the seasonal trend. Butter and cheese exports to Russia remain active.
- International: Australian milk production has suffered from recent heat waves and limited bounce backs in production. Dairy Australia is forecasting milk production for the 2013/14 season to be flat to 2% lower, compared to last season. A majority of dairy product supplies are committed for Q1 and Q2 and global demand remains active with most markets seen as stable.
- International: New Zealand milk production in December was reported by DCANZ at 2.72 million tons, up 4.7% from December 2012 and 11.8% higher than two years ago. However, some production areas on both the North and South Islands are currently dry and needing rain to promote pasture growth. Strong global demand and good margins are continuing to prompt producers to provide supplemental forage feeding to extend the milk

production season. Manufacturers are building supplies to fill future commitments over the carry over period. Butteroil demand has improved following recent price declines.

- International: Oceania butter pricing was steady to firm, currently average a US-equivalent \$2.14/lb. The supply situation is tight with some manufacturers having no allotments available, while others have only limited uncommitted volumes. Demand remains fairly good, even though numerous international buyers are shifting their focus to supplies in the northern hemisphere. A majority of current production is filling domestic demand needs. Cheese prices remained mostly stable, averaging a US-equivalent \$2.36/lb. The firm SMP and WMP markets are supporting the cheese market, as cheese makers need a good return on cheese in order to make it. Without good returns for cheese, manufacturers are inclined to make milk powders.
- International: New Zealand whole milk powder (WMP) exports to China totaled 124,938 tons in Jan 2014, up 62% from a year ago.

What's Bearish:

- Ag Prices Report: The preliminary Feb milk-feed ratio came out to 2.55, the highest number since Jan 2008.
- Dairy cow slaughter for the week ended 02/15 totaled 57,800 head, down 7,800 head (-11.9%) vs. the same period a year ago.
- Fluid Milk Northeast: Milk production is reported higher in the Mid-Atlantic and Northeast regions. Manufacturers are seeing an uptick in milk supplies. Some manufacturers report heavier volumes coming into their plants. The improved weather conditions, have led to sluggish Class I demand.
- Fluid Milk Southeast: Florida's farm milk production is higher but not at the expected rate. Class I demand fell off as extended consumer dairy purchases from last week flattened dairy retail purchases this week. Weather conditions are good for production, as Florida is experiencing record setting rain levels during typically dry periods. The decrease in Class I demand saw 70 loads exported this week, up from 39 last week. Class I demand has eased in the Southeast, as bottling plants limit their orders. Manufacturing milk supplies are strong. Cream supplies are heavy with expanded volumes going into butter production.
- Fluid Milk Central: Milk production rates were marginally higher this week. Milk spot loads are becoming available and some buyers found discounts on supplies. Several balancing plants were running heavy this week. Class I demand is light to moderate as sales are slow. Some processing plants are offering out additional loads of condensed skim to the spot market. Class II interest is light to moderate with indications of ice cream production picking up. Despite cream sellers having good sales, supplies are outpacing demand. Some cheese makers are bumping up production levels with increased sales over the past week.
- Fluid Milk West: CA milk production is steady to higher. Processors continue to send loads of raw milk and/or condensed skim to buyers beyond state borders to assure timely milk manufacturing. January 2014 Pool Receipts of milk in CA totaled 3.54 billion lbs, 6.4% higher compared to January last year. NM weather is optimal for milk production, and milk processors report plants are working at full capacity. Bottlers' in-state demand decreased from the previous week, following seasonal ordering patterns. Fluid orders from Southeastern bottlers also shifted lower. In addition, some milk loads from outside the state cleared into NM to find processing room. On farm milk production in AZ is steady to higher, while fluid milk orders are steady to lower. Processors are taking in some over-capacity milk loads from neighboring states on an occasional basis, as day to day processing room allows.
- Fluid Milk Pacific Northwest: Milk production in the region is continuing its upward trend. Typical seasonal increases are being aided by favorable weather across much of the Northwest. Favorable prices for farm milk have contributed to some increases in cow numbers, especially in Washington. UT and ID milk production is also increasing, though still short of manufacturing demand. Recent increases in milk prices to dairies are hoped to help with herd expansion plans and grow the milk supply in the region.
- NDM Central: Buyers are reluctant to be long on inventories at current prices. Export interest is good, but domestic demand is moderate. Inventories are steady to increasing.
- Cheese Northeast: Production is active, with increased volumes of milk supplies being reported by cheese makers. Some manufacturers are considering the likelihood and significance of farm milk prices relaxing. Stocks are improving, as a few cheese makers build their inventories around a 7-day production schedule. Demand for domestic cheese is mixed, but exports are strong.
- International: Western Europe milk production continues to increase. Weather conditions are phenomenal in the region with some areas reporting conditions 4-6 weeks ahead of the typical spring trend. Heavy milk production and good prices for milk powders have dryers operating at capacity levels.



Recommendation:

Milk production continues to improve in many parts of the country and the futures curve is aware of that. Prices in the front months remain over \$20/cwt, but decline from there. With cheese prices having been over \$2/lb now since Dec, buyers have been purchasing more or less hand-to-mouth, waiting for the typical break. But it hasn't happened. We continue to hear about very good export demand and even some improving domestic demand for fresh product. In the near term then, it feels like we may be able to maintain these higher spot prices for now. Indeed, there were no cheese transactions at all in this week's spot market. With March about half calculated and current spot prices working out to about \$22.80/cwt, short of a quick move lower next week, March futures look well supported and could climb higher. April is now in the crosshairs. Will milk production increase enough in the next few weeks to generate more cheese and lower prices? With the Midwest, the main cheese producing region, in the midst of another Polar Vortex, it may not. April Class III is pricing about \$2.02/lb cheese, and that realistically may be on the lower end of the range. Of course, we could be wrong! Cull numbers continue to decline and the milk-feed ratio hit a 5-year high. There is currently a lot of incentive to make as much milk as possible! Beyond April, then, we would recommend producers get their downside coverage in place. Once the writing is on the wall, it will be too late. The May-Oct average is \$19.53. Consider selling some milk there if you haven't already. That's six months of very good prices. Or, try to put on a May-Oct fence, buying the 18.50 PUT option (current avg 25c) and selling the 22.00 CALL option (current avg 25.3c) at a net premium of zero. That is very cheap insurance and it gives you \$3.50 of upside before you are capped.

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 2014 - KDM Trading, Inc. All Rights Reserved - www.kdmtrading.com