

The KDM Dairy Report – March 14th, 2014

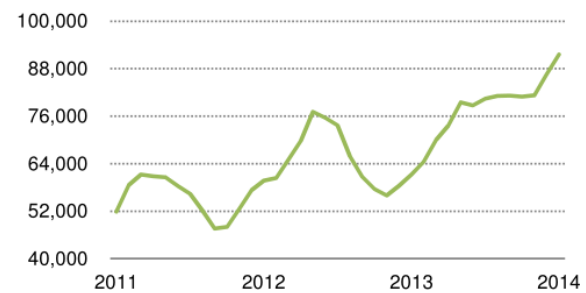
What's Bullish:

- Spot Market: Blocks gained 7¢ for the week to settle at a new record \$2.36¼/lb while barrels were up 1¼¢ to \$2.26¼/lb. There were no block trades and just 2 loads of barrels exchanged hands. Both butter and NDM were unchanged on the week at \$1.88/lb and \$2.04/lb respectively. Trading was light with 8 trades in butter and 2 in NDM.
- World Ag Supply & Demand Report: USDA increased their 2014 Class III price forecast from a month ago, due to predicted strong demand for cheese, butter, NDM and whey. They now expect Class III to average \$19.25/cwt for the year, up 55¢ from last month's forecast.

Futures Month	Class III 03/14	Class III 03/07	Change	Dry Whey 03/14	Dry Whey 03/07	Change	Cheese 03/14	Cheese 03/07	Change
Mar-14	\$23.29	\$22.65	\$0.64	65.00¢	64.00¢	1.00¢	\$2.265	\$2.213	\$0.052
Apr-14	\$22.37	\$21.25	\$1.12	64.25¢	63.50¢	0.75¢	\$2.174	\$2.067	\$0.107
May-14	\$20.76	\$20.25	\$0.51	62.85¢	62.25¢	0.60¢	\$2.023	\$1.973	\$0.050
Jun-14	\$20.26	\$20.01	\$0.25	62.98¢	62.25¢	0.73¢	\$1.968	\$1.950	\$0.018
Jul-14	\$20.05	\$19.80	\$0.25	60.18¢	60.50¢	(0.33¢)	\$1.951	\$1.942	\$0.009
Aug-14	\$19.83	\$19.59	\$0.24	60.00¢	60.25¢	(0.25¢)	\$1.940	\$1.927	\$0.013
Sep-14	\$19.50	\$19.34	\$0.16	58.43¢	59.00¢	(0.58¢)	\$1.910	\$1.898	\$0.012
Oct-14	\$19.19	\$19.15	\$0.04	57.65¢	57.50¢	0.15¢	\$1.886	\$1.880	\$0.006
Nov-14	\$18.87	\$18.77	\$0.10	57.28¢	57.20¢	0.07¢	\$1.858	\$1.850	\$0.008
Dec-14	\$18.52	\$18.50	\$0.02	57.18¢	56.80¢	0.38¢	\$1.829	\$1.827	\$0.002
Jan-15	\$18.15	\$18.05	\$0.10	54.75¢	54.75¢	0.00¢	\$1.772	\$1.770	\$0.002
Feb-15	\$17.81	\$17.68	\$0.13	50.03¢	50.03¢	0.00¢	\$1.772	\$1.770	\$0.002
12 Mo Avg	\$19.88	\$19.59	\$0.30	59.21¢	59.00¢	0.21¢	\$1.946	\$1.922	\$0.023

- Weekly cold storage numbers indicate an anti-seasonal drawdown on cheese stocks, which typically build from Nov/Dec through May. Holdings at USDA-selected storage centers declined 2%, or 1.5 million lbs over the period 03/01 through 03/10.
- Dairy exports were up 19% in Jan vs. last year, according to the U.S. Dairy Export Council. Cheese exports were above 32,000 tons, a new record for the third straight month (see graph).
- Cream East: Supplies are not as available this week, with some manufacturers reporting that loads are hard to find. Interest from ice cream manufacturers continues to develop. Increases in cream cheese and holiday kosher production are causing tightness in cream supplies. Yogurt production continues to be active.
- Cream Central: Supplies firm up as cream cheese manufacturers stepped up cream order volumes while many butter churn operators maintained or increased churn rates. Ice cream makers are slowly increasing production rates. Demand for ice cream is marginally improving as the temperatures increase. Class III interest is steady to higher with Easter orders coming in.
- Fluid Milk West: Farm milk production in CA is mostly steady. One or two facility managers noted milk intakes wavered slightly this week, compared to one week ago. Demand for stick/cone/cup novelties is heading up as theme and sports parks extend hours and offer spring events. Ice cream and frozen dessert manufacturers are taking in a few more loads of milk and cream on a weekly basis to accommodate increased orders.
- Butter: Manufacturers are busy fulfilling good export orders, especially in the West, along with increased domestic retail demand for the upcoming Passover and Easter holidays. The market tone is firm as several butter makers are unable to grow inventories due to better than seasonal demand. Stocks of butter are light to moderate.
- Dry Whey Northeast: Prices continued to move higher this week. Dry whey is seeing marginal increases in production, but inventories are tight. Nearly all new production is through contracts and spot offerings are very limited. The market undertone is firm with good domestic and export demand.
- Dry Whey Central: The market tone is firm as dry whey manufacturers have little excess supplies to offer in the spot market. Production rates for dry whey are steady to slightly higher as cheese orders continue to pick up. Demand domestically is good, but buyers are having some difficulty finding supplies.
- Dry Whey West: Prices are higher and the market is firm with tighter supplies being reported. Whey production levels are mostly steady, but are well below year ago levels. Much of the difference is increased production of whey protein concentrate products. Cheese production is increasing seasonally, but much of the whey stream is being directed towards the concentrated whey markets. Domestic demand for whey is steady, while export interest for whey is good. Higher whey prices are being noted as hindering some negotiations, but end users are not pushing back yet on contract deliveries. Availability of spot loads for domestic use is tightening.
- Cheese Northeast: Export activity remains strong while domestic demand is good leading up to the Easter holiday. Cheese production is steady, with some volumes continue to be channeled into cheddar aging programs. As cheese makers look to fulfill near term export commitments, some plants are maintaining 7 day production schedules to keep up with demand.
- Cheese Midwest: Demand for cheese remains strong, both domestic and export. Production is steady to increasing in light of higher orders. Information about block and barrel availability varies. Some people have commented on blocks being somewhat tighter than barrels, while other sources feel barrels are harder to find. A few people commented about whether prices will sustain these levels, but the totality of current demand leaves overall ordering strong.
- Cheese West: Cheese plants are seeing increased milk supplies as milk production builds seasonally, but this is welcomed as stocks are tight. Good export demand continues to keep inventories tight with some plants reporting being close to sold out for current sales. Domestic retail demand is good as retailers look to secure supplies for upcoming Easter/Passover demand. Spot loads of barrels and blocks are increasingly hard to find.

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- Dairy Market News reports improved profits from dairies are increasing demand, and prices, for replacement heifers. Dairies hoping to build herd numbers facing competition from both slaughter buyers, due to high beef prices, and other dairies. Recent replacement heifer auctions are reporting significantly higher prices. Replacement heifer quotes are \$100-\$200 higher per head than as recent as a month ago.
- International: Asian demand for milk is pushing U.S. prices higher, according to a WSJ article this week. Exports to China, Indonesia and Vietnam have surged in the last year, while drought kept production in New Zealand and Australia in check. U.S. dairy exports grew by 19% by volume last year as American companies shipped record amounts of dairy products overseas. The export demand has resulted in tighter U.S. milk supplies.
- International: Australia cheese output in Jan was down 9.5% vs. a year ago, according to Dairy Australia. SMP was up 84.1%, indicating milk flowed to higher valued end-products.
- International: Australian milk production is generally stable with recent weeks. Weather conditions are tracking at drier than normal patterns across much of the dairy regions. Supplemental watering and irrigation are being utilized to compensate for rainfall shortages and to keep pastures and crops in decent shape. January 2014 milk production in Australia was 3.1% above January 2013, but season-to-date it is down 2.2%.
- International: High milk prices for New Zealand dairies are a result of sustained high commodity pricing and good demand for milk powders from global accounts, most notably from China. Areas of Waikato and other parts of the North Island are indicated to be in drought like conditions, even though there is no official drought declaration. News reports are that some dairy farmers dried off herds due to dry conditions of pastures.

What's Bearish:

- Dairy cow slaughter numbers continue to lag 2013. For the week ended 03/01, 61,200 head were culled, down 3.16% vs. the same period a year ago.
- Fluid Milk East: Class I demand is leveling off in most of the Southeast and Mid-Atlantic regions. With additional loads being channeled to balancing plants, manufacturing milk supplies are reported as balanced to increasing. Northeast milk volumes have eased from last week and Florida's farm production has leveled off. But Class I demand is expected to decrease as spring breaks start over the next four weeks.
- Fluid Milk Central: Warmer temperatures in the region contributed to improved milk production rates as the cows were able to convert more feed energy towards milk production, which had previously been used for body warmth. Additional milk supplies are becoming available with most milk spot load prices ranging from Class to \$2.00 over Class. Bottling orders are mixed as some educational institutions are on spring break resulting in sluggish orders.
- Fluid Milk Southwest: Milk producers in NM continue to add loads to the daily totals. Milk handlers are finding processing capacity within the state for this milk, along with handling milk loads from other states. Bottler orders are trending lower.
- Fluid Milk Pacific Northwest: Milk production in the region is increasing along seasonally expected amounts. Some of the additional supplies are being credited to dairies keeping cows in the milking line longer to take advantage of current farm milk prices. Mild weather across much of the region is another positive to increasing milk supplies.
- International: Milk production patterns continue to show increased milk supplies at levels averaging around 4% higher than a year ago for Western Europe. Weather conditions remain very conducive to milk growth. Higher milk prices and milk premiums continue to provide incentives to increase milk output, even when weighed against any quota penalties. The higher milk supplies are stretching plant capacities, making it harder to find processing room as the milk intakes move towards the seasonal peak levels. Dairy product prices are trending steady to lower and reflect additional offerings and some softening of demand. Milk production in Eastern Europe is trending higher for many countries. Dairy product manufacturing is increasing and offerings are being made available to local buyers and into the export channels. Demand is uneven as buyers assess needs against pricing.
- International: New Zealand milk production trends remain well above year ago marks and are indicated to be tracking nearly 5% higher for the season through February. February output is forecast at 10.6% higher than during the same month in 2013. Production is being tempered by dry conditions on the North Island, but higher pay prices for milk are providing an incentive for farmers to keep cows in the string longer, while feed, hay, and silage supplies are in greater supply than a year ago.

Recommendation:

Block cheese set a new all-time record high as strong international and domestic demand continue to support prices. Milk production is increasing across the country and will continue to do so, but for now, cheese stocks are tight and look to remain so in the short term. As the realization of this hit the market, the March, April and May Class III contracts rallied sharply higher. Futures had been predicting an imminent drop in cheese prices which now doesn't look to happen. Additionally, dry whey is on the tighter side and could add to Class III pricing, as each penny increase causes a 6¢ jump. With April beginning its pricing period next week and carrying more than a \$2 discount to spot prices at the beginning of the week, the gap was closed some with a \$1.12 rally for the week. However, current spot prices work out to about \$23.80 Class III, so should spot hold for the next week or two, April could be in for more sharp gains and quite easily hit \$23+. No one can predict when domestic output will catch up with demand, but so far, demand is winning. This could bode well for May as well, which saw a 51¢ move higher for the week. The drought in CA shows no signs yet of abating and could cause a significant impact to that state's milk output, but no one knows that yet. El Nino patterns are still not certain. Likewise, there is more info coming out regarding weakness in the Chinese economy. These are yellow flags. Producers should continue to protect their income, and we still like the May-Oct fence strategy, buying the 18.50 PUT and selling the 22.00 CALL. Get a current quote from us next week and get something in place. Several of our producers already have orders in and working, waiting to hit. Have a great weekend!

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