

The KDM Dairy Report – April 11th, 2014

What's Bullish:

- Dairy Products Report: Butter output in Feb was down 4.6% vs. 2013 and down 9.1% vs. Jan. Cheddar cheese output declined 0.8% and 10% over the same periods. Total cheese output in Feb was down 0.6% vs. a year ago, and down 10.7% from Jan levels.

Futures Month	Class III 4/11	Class III 04/05	Change	Dry Whey 4/11	Dry Whey 04/05	Change	Cheese 4/11	Cheese 04/05	Change
Apr-14	\$24.02	\$23.94	\$0.08	67.850c	67.000c	0.85c	\$2.321	\$2.323	(\$0.002)
May-14	\$21.50	\$21.96	(\$0.46)	64.750c	65.350c	(0.60c)	\$2.091	\$2.129	(\$0.038)
Jun-14	\$20.05	\$20.56	(\$0.51)	61.450c	63.225c	(1.78c)	\$1.955	\$2.002	(\$0.047)
Jul-14	\$19.55	\$20.28	(\$0.73)	58.750c	59.975c	(1.23c)	\$1.924	\$1.993	(\$0.069)
Aug-14	\$19.45	\$20.02	(\$0.57)	57.000c	58.025c	(1.03c)	\$1.926	\$1.972	(\$0.046)
Sep-14	\$19.41	\$19.78	(\$0.37)	56.025c	57.525c	(1.50c)	\$1.919	\$1.951	(\$0.032)
Oct-14	\$19.04	\$19.35	(\$0.31)	56.875c	57.975c	(1.10c)	\$1.882	\$1.908	(\$0.026)
Nov-14	\$18.71	\$18.92	(\$0.21)	55.775c	57.375c	(1.60c)	\$1.853	\$1.865	(\$0.012)
Dec-14	\$18.35	\$18.53	(\$0.18)	56.700c	57.350c	(0.65c)	\$1.820	\$1.828	(\$0.008)
Jan-15	\$18.17	\$18.25	(\$0.08)	56.050c	56.050c	0.00c	\$1.820	\$1.935	(\$0.115)
Feb-15	\$18.07	\$18.13	(\$0.06)	54.000c	54.000c	0.00c	\$1.827	\$1.830	(\$0.003)
Mar-15	\$17.95	\$17.88	\$0.07	53.250c	53.250c	0.00c	\$1.798	\$1.795	\$0.003
12 Mo Avg	\$19.52	\$19.80	(\$0.28)	58.206c	58.925c	(0.72c)	\$1.928	\$1.961	(\$0.033)

- Fluid Milk Southwest: CA milk processors report farm milk intakes are stepping lower seasonally at some plants. Intakes are uneven from plant to plant. Loads of condensed skim are clearing out-of-state to fill supply gaps in other areas of the Western region. Farm milk production in NM continues to increase on a week to week basis, but over 60% of the state's topsoil moisture is rated short to very short. Water availability for irrigation is limited according to some contacts. Daytime temperatures are reaching the mid-90s in parts of AZ, and nighttime temperatures are slow to reach the mid-60s. Cow comfort aids are being used, but milk production in Arizona is dropping. Cream demand is steadily increasing from ice cream and frozen dessert manufacturers. A few butter producers are also purchasing cream loads to fill churn runs.
- CWT has accepted 17 requests for export assistance to sell 4.556 million lbs of Cheddar, Gouda and Monterey Jack cheeses and 2.480 million lbs of 82% butter to customers in Asia, Central America, and the Middle East. The product will be delivered April through August 2014.
- Dry Whey Northeast: Prices moved higher this week and the undertone remains firm. Domestic demand for dry whey is solid with contract sales driving production volumes in some channels. Tight supplies are limiting spot sales. The Foreign Agricultural Service (FAS), reports that February 2014 U.S. dry whey exports totaled 42.3 million pounds, a 17% increase from last year.
- Dry Whey Central: Prices increased marginally as a result of higher spot trades and various indices. The market tone is firm due to supply shortages in the spot market. Domestic demand is steady. Exports orders are steady to lower with some competing international market prices lower. Stocks of dry whey are limited.
- Dry Whey West: Domestic prices continued to move higher this week, though export prices are mostly steady and meeting increased resistance. Domestic prices are firming due to tight stocks. Whey production is down as more of the whey protein products are utilized in concentrated whey protein products.
- Cheese Midwest: Some Wisconsin cheese cutters and packagers are challenged in finding Colby jack and Swiss this week. The market for cheese curd is very strong, up from last year and described as fantastic. This curd market strength has led to some manufacturers shorting barrel production. Food service demand is said to lead the buying interest but retail is also up. Process cheese demand is building for summer needs and buyers are looking to increase purchases at the lower price points. As baseball parks open across the country, there are increased orders for cheese curd and various other cheese products for sports fans. Some large cheese manufacturers report that production is mostly steady to slightly lower from the last two weeks. Some inquiries for surplus milk are being made, offering up to \$1.60 above class, but sellors are hard to find. Especially in central to northern regions of Wisconsin, there are still occasional patches of snow lingering in many fields. With hay still considered high priced and feed quality lagging, milk production is not yet as robust as might be expected.
- Despite record-high milk prices and lower feed costs, dairymen in the western U.S. aren't making any moves to expand production beyond slowing cull rates, according to an article in the Capital Press. Their focus is to rebuild equity after devastating losses they incurred during 2009.
- Exports: The numbers are in for February, and they show exports running to new record highs. Export volumes in Feb were the highest in six months (on a per-day basis), up 19% from last year. Cheese exports were up 44% vs. Feb '13. WMP was up 191% and butterfat up 102%. U.S. exports were equivalent to 15.5% of U.S. milk solids production in February.
- International: Australian milk production is trending lower, approaching seasonally low levels, typically seen from April through June. The autumn rains have yet to arrive, restricting forage growth in non-irrigated fields. Producer margins remain positive, but are narrowing as feed costs are inching higher.
- International: A Rabobank report says the cost of labor in Australia's dairy industry is now double that of the United States, and the cost of producing grain is higher than any other competitor. In addition, they predict New Zealand's milk production growth is likely to be constrained over the next five years as the ability to change land use will become more difficult and expensive.

What's Bearish:

- Spot Market: Blocks lost 18¢ for the week to settle at \$2.17/lb. Barrels shed 14½¢ to close at \$2.08/lb. Sales were light with just 9 loads of blocks and 3 loads of barrels exchanging hands. Grade A NDM fell 9¢ to \$1.90¢/lb on just 2 trades, while butter was unchanged at \$1.97 with no activity all week.
- Dairy cow slaughter numbers continue to lag year ago levels as producers hang on to cows longer. For the week ended 03/29, 57,700 head were culled, compared to 63,000 during the same week last year. YTD the cull is down 69,400 head (7.9%).
- Fluid Milk East: Some areas of Florida experienced heavy rainfall over the weekend into the first of the week. Milk production benefited from the downpours, which brought cooler conditions to offset warmer temperatures that tend to reduce cow comfort level. Production at the farm level is holding strong. Exports of Grade A milk increased to 140 compared to 120 a week ago. Milk supplies are showing moderate to strong increases in the Northeast and Mid-Atlantic regions. Production is moving upward in the Southeast region. Contacts are reporting that fluid milk volumes are increasing faster than sales. Bottling plants are reported to have reached capacity and are unable to handle full delivery.
- Fluid Milk Central: The cows in the Upper Midwest are welcoming the warmer weather and beginning to show noticeable increases in milk production. Producers are seeking replacement heifers in high demand to keep the barns full. Bottling demand is steady. Condensed skim prices

are trending lower as increased supplies are becoming available. Class II demand is steady to slightly lower as holiday orders finished up in the early part of the week.

- Fluid Milk Pacific Northwest: Milk production in the region continues to build along seasonally expected lines. Favorable milk prices and good cull cow prices are encouraging dairies to look into increasing herd size. UT and ID milk production levels are also increasing, albeit at a slower rate than hoped. Processing demand is good with some milk being imported from outside the region to fill needs. Some late season storms in the upper elevations, mixed with rains in the valleys, have buoyed confidence in adequate irrigation supplies for the upcoming crop season.
- Butter: Many international prices are trending lower, slowing export orders. Domestic demand is steady, but print sales have trailed off since the completion of holiday commitments.
- NDM East: Prices for Eastern nonfat dry milk are lower. The market tone is weakening. Manufacturers are running 7-day production schedules at some facilities.
- NDM Central: The market tone is weak as inventories are growing and more discounts on spot loads are available. Milk processors are generally drying at strong production rates of low/medium heat NDM, however, a few are focusing on drying higher return products such as milk protein concentrate. Domestic demand is light to moderate as buyers are in a "wait and see" approach as to how far NDM could fall. Export orders are slowing as price competition increases in global markets.
- NDM West: Prices are lower on a weaker market. Market participants termed the current NDM pricing structure as spongy, with room for additional price adjustments in the weeks ahead. Market participants indicate recent decreases in prices have yet to bring in megabuyers. Those buyers who regularly use millions of pounds of low/medium heat NDM have yet to show interest in taking a mid to long-term position on NDM at current pricing.
- Cheese Northeast: Production is steady to higher as some cheese makers look to replenish inventories and cheese vat volumes increase with additional milk supplies. Domestic demand is moderate. The market tone is steady to weak. Interest from export markets remains active.
- Cheese West: The market tone is weak with buyers waiting to see where the cheese market will level out. Lower spot prices at the CME Group are encouraging buyers to hold off on additional orders above immediate needs. Easter/Passover orders are mostly completed and in place. Cheese production is increasing slowly as more milk becomes available to the manufacturing plants. Stocks of barrels and blocks are adequate for current demand.
- Packaged Milk Sales: During February, 4.0 billion lbs of packaged fluid milk products is estimated to have been sold in the United States. This was 2.1% lower than February 2013.
- International: Milk production in Western Europe continues to show robust increases compared to year ago levels. The new quota year has started with good weather and good producer margins, prompting increased milk volumes from the EU. Manufacturers of milk powders continue to dry at maximum capacity. Excess milk supplies are flowing into cheese vats and are causing increased cheese production. Concerns over the effects of cheese production expansion on farm milk prices are growing. Cheese prices in the EU are said to be under continued downward pressure, even after recent declines. The declines in EU cheese prices have sparked some additional export interest. Producers acknowledge that peak milk prices are behind them and anticipate lower prices in the coming months. Dairy product prices have declined as global demand has diminished in the face of growing supplies in the northern hemisphere.
- International: New Zealand milk production trends are mixed between the North and South Islands, but overall milk production remains very positive with March production estimates near 7% above year ago levels. The prolonged milk production season on the South Island has allowed dairy product manufacturers to build adequate supplies to cover contract needs for the upcoming carryover period. Large investments are being made to increase whole milk powder manufacturing in New Zealand for the next season. Producers are also looking to expand herds and increase milk production. Dairy Product prices have weakened, due to global milk production increases and a decline in sales to China following their significant milk powder purchases during January and February.

Recommendation:

"Be more aggressive in getting the front months done!" That was our parting thought two weeks ago in our last report. Since putting in highs on April 4th, May Class III is down \$1.22/cwt, June is down \$1.12/cwt and July is off \$1.05/cwt. Considering that average block/barrel price in the spot market has given up 30¢, which really isn't too bad, as the futures contracts were predicting this sharp drop before it happened. At one point we had spot pricing Class III at over \$24/cwt while May futures sat in the \$22's; a big spread. Spot is now pricing Class III at about \$22.05, so while May futures are still pricing a discount, it's fallen to about 50¢. Bidders in Friday's spot session lent some support to the market as the freefall over the past week and a half was abated and prices were even bid a bit higher. During our last trip down to these spot prices in mid Feb, a \$2.08/lb average cheese price was established as support, and we then climbed to a new record. We are now at a \$2.12/lb average and we expect that support line may be tested again. There is still much to be positive about in the market. Exports in Feb hit a home run, expansions are slow and production increases in the Midwest are lagging. However, it does appear that demand from China may be backing off some and there is pressure on dairy product prices in the EU. Should we break through that \$2.00-2.08 level, the next support comes in around \$1.85/lb. To top it all, the stock market took quite a hit this week and may be putting in a medium-term top. Should we suffer a 10-15% correction in this market, it will hurt consumer confidence and perhaps spending habits. And that could slow domestic demand. For those of you still looking to get hedges on, you can get a May \$20.75 PUT for 23¢ and a Jun \$18.25 PUT for 23¢. The July-Dec average is off its high of \$19.68, but is still \$19.05. Consider selling up to 25% of your production there. We don't know where prices are headed from here, only that it's bound to stay volatile for a while. Have a great weekend.

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