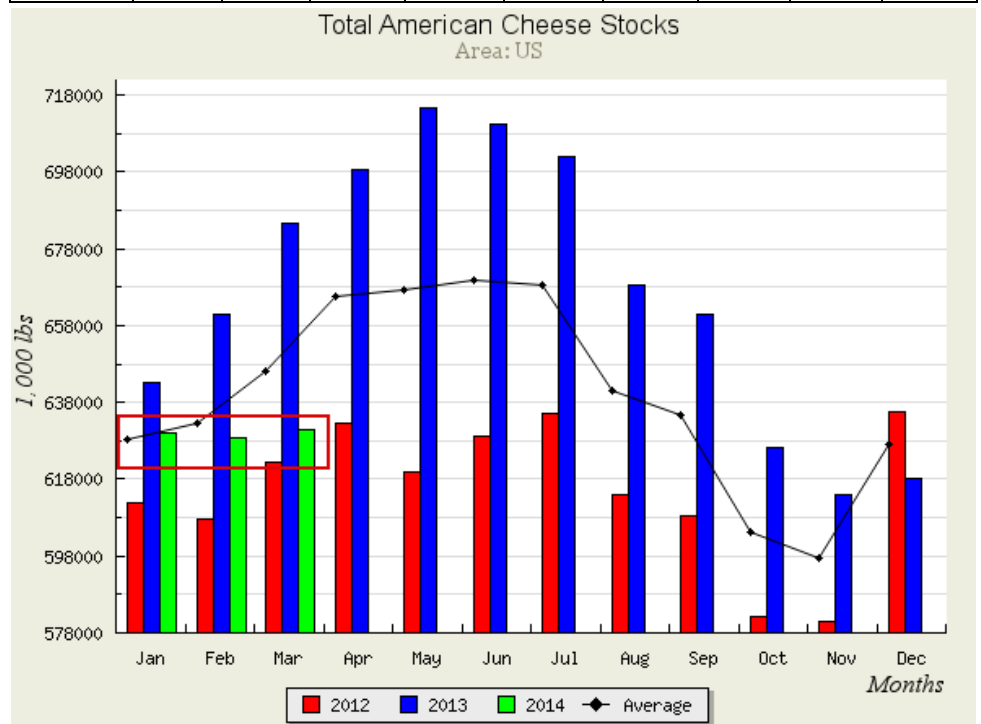


The KDM Dairy Report – April 25th, 2014

What's Bullish:

- Milk Production Report: Milk output in March was below most analysts' expectations with just a 0.9% gain over last year. In addition, cow numbers increased by just 3,000 head over February. Gains were led by CO up 6.5%, TX up 6.4% and OR up 4.2%. In the cheese-making Midwest, WI was down 1.6% and MN fell 3.8%.
- Cold Storage Report: Butter holdings at the end of March were 30% less than year-ago levels, according to USDA. Total Cheese stocks were down 9% and American cheese stocks were 8% lower (see graph).
- Fluid Milk West: CA farm milk production has plateaued according to milk handlers throughout the state. Weather remains comfortable for dairy herds. Class I demand was higher at the beginning of the week as bottlers ordered more heavily to restock consumer outlets. Demand for condensed skim and cream from Class 3 operations is ramping up steadily.
- Dry Whey Northeast: Prices were steady to higher this week. Dry whey production is improving as spring flush increases milk volumes going to cheese vats, but inventories remain tight. Domestic demand is improving, keeping the market undertone steady to firm.
- Dry Whey Central: Prices increased this week as the market tone remains firm. Dry whey manufacturers' production rates are steady to higher, but few of the Upper Midwest dry whey plants are building inventories before summertime temperatures and humidity hit the region. Domestic buyer interest is active, but they are managing inventories closely at current prices. A few exports orders were delayed or cancelled so domestic commitments could be filled.

Futures Month	Class III 4/25	Class III 4/18	Change	Dry Whey 4/25	Dry Whey 4/18	Change	Cheese 4/25	Cheese 4/18	Change
Apr-14	\$24.29	\$24.21	\$0.08	67.250¢	67.175¢	0.08¢	\$2.353	\$2.344	\$0.009
May-14	\$22.70	\$22.14	\$0.56	66.750¢	66.000¢	0.75¢	\$2.198	\$2.143	\$0.055
Jun-14	\$20.83	\$20.37	\$0.46	66.475¢	64.100¢	2.38¢	\$2.010	\$1.975	\$0.035
Jul-14	\$20.23	\$19.48	\$0.75	62.250¢	61.250¢	1.00¢	\$1.963	\$1.893	\$0.070
Aug-14	\$19.83	\$19.28	\$0.55	59.500¢	59.000¢	0.50¢	\$1.936	\$1.891	\$0.045
Sep-14	\$19.68	\$19.21	\$0.47	57.750¢	57.125¢	0.63¢	\$1.936	\$1.895	\$0.041
Oct-14	\$19.26	\$18.92	\$0.34	57.000¢	57.000¢	0.00¢	\$1.886	\$1.865	\$0.021
Nov-14	\$18.80	\$18.55	\$0.25	56.250¢	56.075¢	0.17¢	\$1.841	\$1.832	\$0.009
Dec-14	\$18.58	\$18.30	\$0.28	56.250¢	56.050¢	0.20¢	\$1.825	\$1.805	\$0.020
Jan-15	\$18.08	\$17.97	\$0.11	55.000¢	55.500¢	(0.50¢)	\$1.805	\$1.800	\$0.005
Feb-15	\$18.01	\$17.96	\$0.05	53.975¢	54.000¢	(0.02¢)	\$1.817	\$1.817	\$0.000
Mar-15	\$17.93	\$17.94	(\$0.01)	53.000¢	53.250¢	(0.25¢)	\$1.799	\$1.798	\$0.001
12 Mo Avg	\$19.85	\$19.53	\$0.32	59.288¢	58.877¢	0.41¢	\$1.947	\$1.922	\$0.026



- Dry Whey West: Prices are steady on a firm market. Manufacturers' dry whey inventories are comfortable to somewhat short of filling contract orders. Interest in spot loads is active, but few loads are available from week to week to fill current spot demand. Some resellers note they are receiving more calls from other resellers looking for dry whey loads. That is being interpreted as an affirmation of tight dry whey supplies. Export demand is steady to higher for some manufacturers and resellers, showing that U.S. dry whey prices currently are competing successfully with European dry whey prices.
- Cheese West: Demand for cheese is mixed as buyers are watching the recent price changes in cheese markets. Cheese exports are generally slower but a few Western cheese makers report contracted export sales will take the majority of their cheese through the balance of the year.

What's Bearish:

- Spot Market: Blocks gave up 7¢ for the week to settle at \$2.21/lb on 7 trades, while barrels lost 7½¢ to close at \$2.18/lb on just 2 trades. Grade A NDM declined 5½¢ to \$1.81/lb on a single trade, while butter managed to gain 2¢ to settle at \$1.91/lb on 5 trades.
- Livestock Slaughter Report: Just 245,700 dairy cows exited the herd in March, the lowest total for this month since 2009 and a 10.4% decline vs. last year.
- After showing a drawdown in cheese stocks the first half of the month, the situation has reversed. For the period 04/01 through 04/21, USDA now shows an overall 1% gain of 1.063 million lbs of cheese at selected storage centers. Butter stocks over the same period are up 7%.
- Dairy cow slaughter for the week ended 4/12 totaled just 54,000 head, down 9,900 head (15.5%) vs. the same period last year. YTD, 85,700 fewer cows have gone to slaughter than in 2013.
- Fluid Milk East: Milk production is showing increases throughout the East with greening forage, improved cow comfort, and cow and heifer calving. Production volumes in the Southeast and Mid-Atlantic are increasing. Declines in Class I demand led to reductions in most bottlers fluid milk intakes. Contacts note that milk haulers are experiencing unloading delays as surplus milk supplies look to clear at regional manufacturing plants.

Milk production continues to see increases in the Northeast region, with manufacturing volumes reported as heavy at most balancing plants. 140 spot loads of milk were exported out of Florida, compared to 100 the previous week. Cream demand is expanded, but condensed skim supplies are exceeding demand, with some contacts unable to find homes for surplus volumes. Therefore, significant volumes continue to clear through Class IV production.

- Fluid Milk Central: Milk producers are indicating the flush is beginning. Some farmers increased supplements to help make up for lower forage energy levels. Extra milk supplies in the Midwest section of the region were relocated to northern plants. Spot loads of milk are becoming readily available. Sales of bottling are steady to lower. Class II orders are steady to higher with notable increases in cultured products and whipping cream. Butter churns took greater volumes of cream over the weekend and ice cream makers are actively purchasing supplies as well. Ideal weather conditions allowed most of the southern part of the region to get corn in the ground.
- Fluid Milk Southwest: Milk production in NM continues to add farm milk loads to the state weekly totals, although handlers report the rate of increase is slowing. Fluid orders are higher as bottlers restock grocery and convenience store outlets. AZ milk handlers report farm pickup volumes are mostly steady. Daytime temperatures are warming seasonally, but nighttime temperatures are offering restorative cool down periods to dairy herds.
- Fluid Milk Pacific Northwest: Milk intakes are trending seasonally higher. For many operators, when compared to 2013, the 2014 higher milk prices and lower feed costs are improving farm finances. ID and UT farm milk production is also building steadily. Milk handlers in those states report dairy operators are keeping cows in the milking strings a little longer, which is being supported by current milk prices.
- Butter: Domestic buyer interest has backed off following the holidays, allowing a few butter manufacturers to grow inventories. The market tone is mixed. Butter makers are churning at mostly steady rates with stable to increasing focus on export orders of 82%. The market tone is steady to weak.
- NDM: Prices moved sharply lower this week. Drying operations are actively manufacturing nonfat dry milk due to increases in condensed skim supplies, as farm-level milk production picks up in the region. Inventories are growing with some plant dryers producing low heat nonfat at near-capacity levels. As the market trends downwards, domestic demand is somewhat lethargic as potential buyers delay making purchases outside of immediate needs. Export volumes are clearing through existing contracts, but the market undertone continues to weaken.
- Cheese Northeast: Production rates are up in the region, with some plants running 7-day production schedules to rebuild light inventories. Domestic demand is mixed. Export demand is steady. The market tone is steady to weak.
- Cheese Midwest: Some cheese buyers slowed orders this week, in response to the daily declines in CME cheese prices for blocks and barrels through Wednesday. These buyers hope that prices based on the weekly average will head lower. A manufacturer had a cheese export deal canceled, resulting in ongoing sales of the affected cheese blocks at below CME pricing, to move it along.
- International: Current milk production in Western Europe is nearing peak seasonal levels. The large milk volumes are prompting some discounts for fluid prices. Drying facilities are operating at near capacity levels. Export activity for most dairy products has declined in recent weeks, and as a result, prices have moved lower. A stronger Euro, a weaker Russian Ruble, the Ukrainian situation, lower demand from China, increased dairy production in the northern hemisphere, and lower priced dairy products internationally have combined to reduce European dairy exports. Milk production, as reported by Eurostat, shows EU-28 production up 4.7% from February 2013. Some excess milk and condensed supplies are making their way from Western to Eastern European countries, where drying capacities are available. Due to these increased shipments, skim milk powder production has expanded and supplies are more readily available than in Western Europe.
- International: Australian milk production has held fairly steady in the last fortnight. Mild temperatures and the arrival of autumn rains, greening up pastures, are helping maintain milk intakes above year ago levels. Increasing global milk and dairy product production, in combination with lower export demand from China, have been the major contributing factors in the recent price declines for most dairy products.
- International: New Zealand milk production in February was reported by DCANZ at 1.97 million tons, up 11.8% from February 2013 and 5.3% higher than two years ago. Favorable weather conditions and timely rains have provided for more than adequate forage growth and taken the pressure off winter grazing supplies on the South Island. Dairy herd expansion is continuing on the South Island with reports of at least 50 dairy conversions ongoing.

Recommendation:

Supportive Milk Production and Cold Storage reports supported the market this week, despite a decline in spot cheese prices. However, warmer weather has finally landed on the Midwest and Northeast and it appears manufacturing milk is plentiful. Soon schools will close their doors, increasing milk availability. But on the other hand, it appears cheese demand was so good in Q1 (exports in particular) that aging programs and inventory building have hardly started. Globally, dairy product prices are falling, and with the imminent increase in output expected in the U.S., it seems hard to fathom we'll be able to stay at the current premium. We're not hearing much at all about expansions, rather, producers are simply hanging on to their cows longer. Feed quality continues to impact some operations, but fresh alfalfa will soon be arriving. NDM is weak, but dry whey is on fire. Current spot prices of cheese/whey/butter work out to about \$22.80 Class III. Futures are factoring in further price weakness with June at \$20.83 and July at \$20.23, and they may be right. We don't see spot cheese making another run higher in the near term, considering the increasing milk supply, but on the other hand, with cheese stocks as low as they are and demand as good as it is, buyers are likely to get more aggressive if spot cheese prices approach \$2.00/lb. Class III, then, may be range bound between \$20-22/cwt for the next month or two. Weather/drought and the Chinese economy will likely then play a larger role in determining 2nd half prices. With the big gains in Class III seen this week May-Sep, we would look to buy PUT options in those months to get a floor price in place. Call us for help in putting together a plan that works for your operation.

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