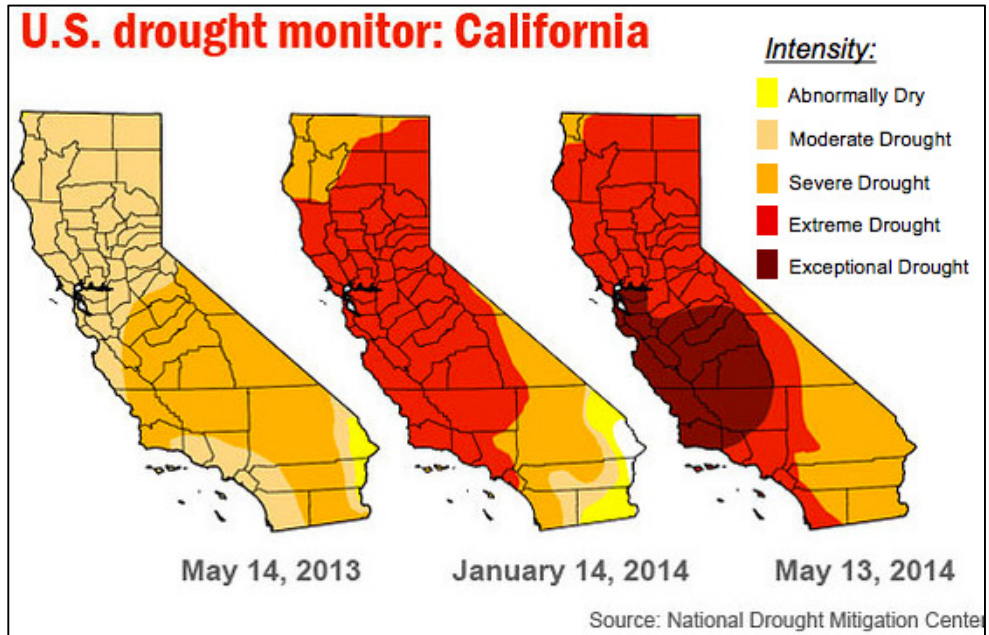


**The KDM Dairy Report – May 16<sup>th</sup>, 2014**

**What's Bullish:**

- Weekly cold storage numbers indicate that for the first 12 days of May, butter stocks at USDA-selected storage centers declined 1%, while cheese stocks were flat. Cheese stocks had been building in prior weeks.
- Fluid Milk Southeast: Milk production shows signs of leveling, as wet-hot-humid weather invades the area. Some manufacturing operations are seeing significant reductions in their milk intakes this week. Florida milk production continues to decline as hot weather and rainstorms, which look to remain for the next few days, take a toll on volumes produced. Pasture quality in southwest Florida has declined due to the hot, dry, breezy conditions of the last week. Class I demand bounced back from last week, although some colleges and universities are in the process of closing or are already closed. There were 120 spot loads of milk transferred out this week, down 20 loads from last week. Cream supplies remain sufficient, but demand is strong, limiting volumes going to the churns. Ice cream production is strengthening with the warmer temperatures in the Southeast and Mid-Atlantic regions.
- Fluid Milk Central: Milk production is steady to slightly higher, but rates are mostly below projections. Cheese makers are seeking additional loads of milk to meet current orders and to rebuild inventories at current prices. Bottling orders are soft as some educational institutions are closing for the school year, but Class II demand is mostly steady with reports of soft serve sales picking up. Ice cream makers are actively building inventories for seasonal demand and are taking additional volumes of cream and condensed supplies.

Futures Month	Class III 05/16	Class III 05/09	Change	Dry Whey 05/16	Dry Whey 05/09	Change	Cheese 05/16	Cheese 05/09	Change
May-14	\$22.58	\$22.71	(\$0.13)	66.850¢	66.750¢	0.10¢	\$2.172	\$2.185	(\$0.013)
Jun-14	\$20.49	\$21.23	(\$0.74)	65.450¢	66.250¢	(0.80¢)	\$1.966	\$2.039	(\$0.073)
Jul-14	\$20.01	\$20.27	(\$0.26)	62.000¢	63.025¢	(1.03¢)	\$1.942	\$1.965	(\$0.023)
Aug-14	\$19.93	\$19.94	(\$0.01)	61.500¢	61.950¢	(0.45¢)	\$1.942	\$1.940	\$0.002
Sep-14	\$19.84	\$19.90	(\$0.06)	59.500¢	60.500¢	(1.00¢)	\$1.941	\$1.941	\$0.000
Oct-14	\$19.67	\$19.53	\$0.14	59.000¢	59.550¢	(0.55¢)	\$1.932	\$1.920	\$0.012
Nov-14	\$19.19	\$19.08	\$0.11	58.750¢	58.750¢	0.00¢	\$1.884	\$1.871	\$0.013
Dec-14	\$18.71	\$18.61	\$0.10	57.250¢	57.250¢	0.00¢	\$1.846	\$1.826	\$0.020
Jan-15	\$18.24	\$18.29	(\$0.05)	55.000¢	55.000¢	0.00¢	\$1.815	\$1.812	\$0.003
Feb-15	\$18.07	\$18.13	(\$0.06)	53.500¢	53.975¢	(0.48¢)	\$1.814	\$1.810	\$0.004
Mar-15	\$18.05	\$18.05	\$0.00	52.500¢	53.000¢	(0.50¢)	\$1.814	\$1.810	\$0.004
Apr-15	\$18.00	\$18.05	(\$0.05)	52.000¢	52.500¢	(0.50¢)	\$1.814	\$1.800	\$0.014
<b>12 Mo Avg</b>	<b>\$19.40</b>	<b>\$19.48</b>	<b>(\$0.08)</b>	<b>58.608¢</b>	<b>59.042¢</b>	<b>(0.43¢)</b>	<b>\$1.907</b>	<b>\$1.910</b>	<b>(\$0.003)</b>



- Fluid Milk West: Milk handlers in CA indicate on-farm pickup volumes are trending lower. Bottler demand is steady to lower as school districts throughout the state advance toward the close of the spring semester, but some school districts offer year-round instruction and continue to place food service orders on a steady basis. Farm milk production in NM is beyond the peak. Sales into Class II are steady to higher. Cheese manufacturers' orders are variable from plant to plant, depending on current orders. AZ farm milk production is heading lower as the season advances. Class I draws are declining as several school districts will close before the Memorial Day holiday, but ice cream and frozen dessert manufacturers are increasing cream orders on a weekly basis to supply longer production schedules for bulk and individual novelty items. Ice cream/frozen dessert manufacturers are using cream actively in the West region as that season advances.
- 100% of California is now in "severe to exceptional" drought, according to the National Drought Mitigation Center (see graphic). The worst conditions stretch into the Central Valley, which accounts for 8% of U.S. agricultural output.
- Butter West: Increased ice cream demand is pulling more cream supplies away from churns. Some manufacturers with increasing milk supplies are able to keep up production levels, but are having a difficult time building inventories. Export demand is weaker as U.S. prices are no longer as competitive, but domestic demand for retail is steady and bulk sales are good as end users look to acquire additional supplies. Butter stocks are tighter than is typical for this time of year.
- Dry Whey Northeast: Production is adequate for contracted orders, but domestic offerings are light, as some buyers noted having difficulty in finding product on the spot market. Demand is good, as ice cream production is increasing throughout the region.
- Dry Whey Central: The undertone is steady as supplies remain tight. Most manufacturers are drying at steady to lower rates. Buyer interest is steady with good demand.
- Cheese Upper Midwest: Some plants in northern reaches of Wisconsin have experienced daily milk intakes dropping from levels two week ago, with little surplus milk availability. Plants in that area are scraping by to meet sales commitments and are unable to handle inquiries for additional cheese. Mozzarella demand has been strong and buyers are readily taking what is manufactured. Cheddar interest has increased, especially with prices declining. Some plants have experienced good sales, even with two weeks of lower price averages.

- CWT has accepted 11 requests for export assistance to sell 1.166 million lbs of Cheddar cheese, 551,156 lbs of 82% butter and 1.047 million lbs of whole milk powder to customers in Asia, Africa, Central America, the Middle East, and South America. The product will be delivered May through November 2014.

#### What's Bearish:

- Spot Market: Blocks finished the week down 4¼¢ on just 1 trade to settle at \$1.99¼/lb. Barrels gave up 6¢ on only 1 trade to close at \$1.96/lb. Grade A NDM gained ½¢ on heavy trading of 14 loads, while butter lost ¾¢ to close at \$2.16/lb on 9 trades.
- Dairy cow slaughter for the week ended May 3<sup>rd</sup> totaled just 48,600 head, down 12.9% from the same period a year ago, and the seventh consecutive week of declining cull numbers.
- Fluid Milk Northeast: Milk production in the region leveled off this week, but manufacturing milk supplies remain heavy. Class I demand is steady but is expected to fall off as colleges and universities close for the school term. Warm temperatures and little rainfall improved pasture conditions across the Northeast region. Yogurt production is active, adding to cream volumes.
- Fluid Milk Pacific Northwest: Milk production in the region continues to build seasonally. Additional production increases are credited to dairies keeping cows in the herd longer and increases in overall cow numbers. Processing plants in the region are busy with the increased volumes and milk is being moved to balance workloads. UT and ID milk supplies continue to build slowly. Temperatures are reaching to the 90's during the day, but are cooling nicely at night. These temperatures are conducive to increased cow comfort levels and subsequent increased production. First crop alfalfa harvest is nearing and could help to push production further.
- Butter Northeast: Churning is active around 82% unsalted butter for export, but domestic purchases are fair with most orders placed for immediate needs, as buyers speculate an easing of prices in the near future. Inventories are tight, but adequate for near term contractual commitments.
- Butter Central: The U.S. butter price disadvantage to most global markets has caused a few international buyers to back off orders. The undertone is mixed. Slower domestic print sales have caused some churn operators to shift production from consumer to bulk supplies.
- Dry Whey West: Production in the region is steady to building in areas with increasing milk supplies and shifting of whey solids. Recently, whey offerings are increasing as some manufacturers in the West are building supplies due to production increases and some new production coming online. Some manufacturers with higher inventories are looking to clear stocks in the spot market.
- NDM East: Prices moved sharply lower this week as nonfat dry milk production is active with sufficient volumes of condensed skim going to the dryers. Inventory volumes are growing with increased production and sluggish sales. One processor expects sizable increases in plant drying capacity after supplementing dry product operations with an additional dryer. As the market continues to settle, with lower prices available for product, most buyers remain comfortable in waiting to make purchases beyond their urgent needs. International demand is moderate. The market tone continues to weaken.
- NDM Central: Prices continue to move lower on heavy spot trading activity. The market tone is weak with supplies readily available. Manufacturers are drying at mostly higher rates with additional milk coming into the processing plants.
- NDM West: Prices were pressured lower this week on a weaker market. Domestic spot demand continues to follow hand to mouth patterns as buyers wait for the NDM price to stabilize. Contract loads are clearing on time and export sales are steady to increasing, but greater volumes of condensed skim are clearing into NDM at Western manufacturing facilities.
- Cheese Northeast: Plants in the region are seeing substantial milk intakes, which are prompting extended production schedules in some cases, with additional cheese volumes clearing to inventories. Declines in domestic cheese demand are prevailing as spring courses at many educational institutions prepare to end. With the easing in purchases, manufacturers look to manage inventory levels. Interest from export markets remains active, but the market undertone is softening.
- Cheese Midwest: In much of the Midwest, milk supplies are long and milk is readily available for cheese making. Plants looking for extra milk can generally find it, ranging from \$3.00 under Class to \$1.00 over, depending on location and timing. Expectations are for strong milk availability in coming weeks, comforting both to plant officials and customers. The first cutting of hay may commence soon in some of Southern Wisconsin, which is also taken as a good sign for milk production in the near future.
- Cheese West: Some manufacturers are running at or near full capacity, while others are balancing milk intakes to current orders. Wholesale prices are lower again this week and buyers are showing increasing interest in building stocks. Export interest has slowed as international prices are becoming more competitive. Cheese stocks are said to be in balance with demand.

#### Recommendation:

All in all it was a fairly quiet week. Just one load of blocks and one load of barrels exchanged hands during the daily spot sessions, while offers were able to walk the price lower. Aware of increasing milk production in the U.S. and outside pressure on international prices, buyers don't need to be aggressive. Cash blocks and barrels are at their lowest prices of the year, which will potentially keep buyers on the sidelines next week as they wait for a bottom. Dairy operations continue to hang on to cows as seen in the weak cull numbers that have been reported that last couple months. However, as Class III prices decline from their peak, we expect culling to pick up. While demand has slowed with school closings and more product availability/competition from the EU, we are still tight on butter stocks worldwide and cheese stocks are not burdensome. Now is the time for again programs to sock some product away in the coolers, which should play a supporting role on prices. Hot, humid temps are making their way north in the Eastern part of the country, while the upper-Midwest is still cooler than usual. The California drought continues to worsen, and while it may not have much effect on prices in the near term, it could be a big factor later this fall. Our rec remains the same from last week. Many of you have milk sold or capped in the \$16-19 range for the last half of the year. We would look for opportunities to "open up" those contracts by purchasing CALL options, say Aug-Oct. They are still too expensive today, but further weakness in Class III in the coming weeks could make them more affordable eventually.

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