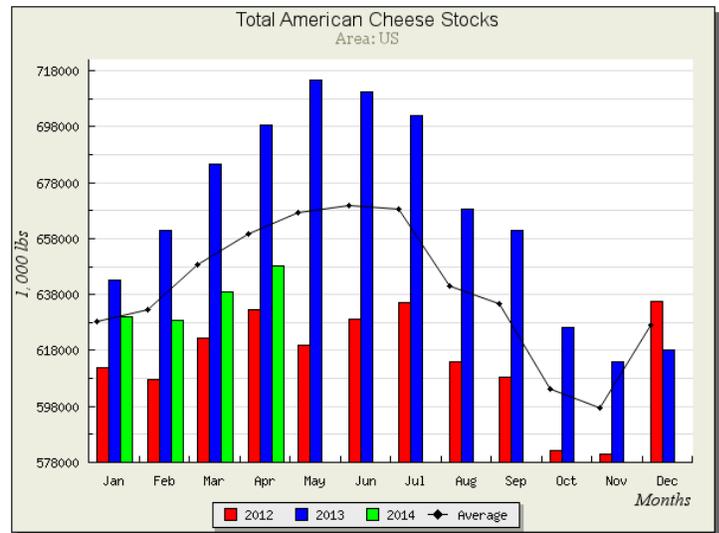
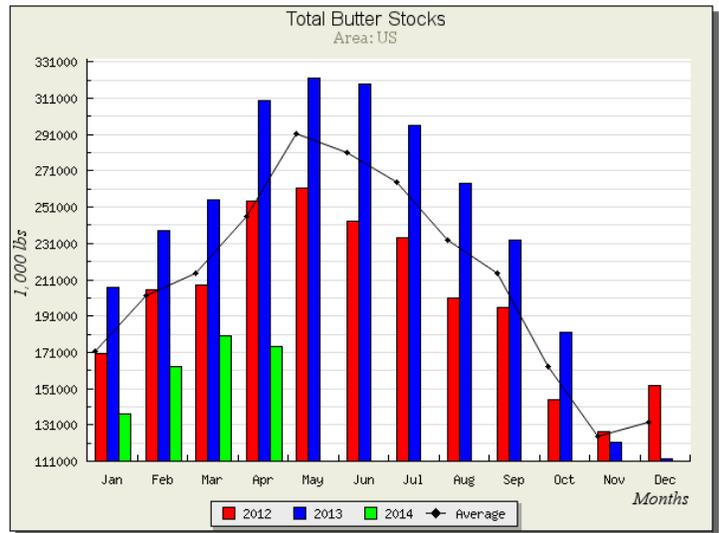


The KDM Dairy Report – May 23rd, 2014

What's Bullish:

- Spot Market: Blocks gained 2¼¢ for the week to settle at \$2.02/lb on 10 trades, while barrels picked up 6¢ to also close at \$2.02/lb on just 2 trades. NDM increased ¼¢ to \$1.79¼/lb on a single trade, while butter gained 2¢ to settle at \$2.18/lb on heavy volume of 38 trades.
- Cold Storage Report: Butter stocks at the end of April were down 44% compared to a year ago (see graph) and down 3% from March. American cheese stocks fell 7% from last April, while Total cheese stocks were off 8%.
- Fluid Milk Southeast: Most of region's farm volumes are leveling out. Some haulers are having issues with load temperatures when making deliveries, as warmer conditions necessitate equipment adjustments. Farm milk production, in Florida, is still on the decline. Cream supplies are tight. Ice cream sales are improving.
- Dry Whey Northeast: Prices moved higher across the range this week. Production is steady to increasing as cheese makers operate full schedules while processing heavy milk intakes. But buyers report that offerings remain light and some suppliers are holding onto whey. The market tone is steady to firm.
- NDM: The undertone is steady as many buyers are beginning to take larger volumes. Buyer interest is picking up domestically and internationally. Milk processors have been able to keep up with the increasing milk supplies, drying at generally higher rates. Inventory levels are maintaining.
- CWT has accepted 21 requests for export assistance to sell 1.551 million lbs of Cheddar and Gouda cheeses, 3.306 million lbs of 82% butter and 1.482 million lbs of whole milk powder to customers in Asia, Europe, the Middle East, North Africa, South America and the South Pacific. The product will be delivered May through October 2014.
- International: New Zealand milk production continues to decline and wind down seasonally with more cows being dried off and moved to winter pastures. Some manufacturing plants are shutting down operations for yearend maintenance projects. Cheese production is restricted to filling current orders. Supplies at the end of the milking season are tight as a result of this year's focus on milk powder production. The limited cheese supplies have supported prices.

Futures Month	Class III 05/23	Class III 05/16	Change	Dry Whey 05/23	Dry Whey 05/16	Change	Cheese 05/23	Cheese 05/16	Change
May-14	\$22.58	\$22.58	\$0.00	67.650¢	66.850¢	0.80¢	\$2.172	\$2.172	\$0.000
Jun-14	\$21.06	\$20.49	\$0.57	66.500¢	65.450¢	1.05¢	\$2.008	\$1.966	\$0.042
Jul-14	\$20.58	\$20.01	\$0.57	62.875¢	62.000¢	0.88¢	\$1.990	\$1.942	\$0.048
Aug-14	\$20.23	\$19.93	\$0.30	61.750¢	61.500¢	0.25¢	\$1.970	\$1.942	\$0.028
Sep-14	\$20.31	\$19.84	\$0.47	59.775¢	59.500¢	0.27¢	\$1.982	\$1.941	\$0.041
Oct-14	\$19.99	\$19.67	\$0.32	59.000¢	59.000¢	0.00¢	\$1.970	\$1.932	\$0.038
Nov-14	\$19.49	\$19.19	\$0.30	58.250¢	58.750¢	(0.50¢)	\$1.923	\$1.884	\$0.039
Dec-14	\$18.94	\$18.71	\$0.23	56.275¢	57.250¢	(0.98¢)	\$1.870	\$1.846	\$0.024
Jan-15	\$18.47	\$18.24	\$0.23	55.000¢	55.000¢	0.00¢	\$1.840	\$1.815	\$0.025
Feb-15	\$18.23	\$18.07	\$0.16	53.475¢	53.500¢	(0.02¢)	\$1.825	\$1.814	\$0.011
Mar-15	\$18.15	\$18.05	\$0.10	52.500¢	52.500¢	0.00¢	\$1.840	\$1.814	\$0.026
Apr-15	\$18.14	\$18.00	\$0.14	52.000¢	52.000¢	0.00¢	\$1.832	\$1.814	\$0.018
12 Mo Avg	\$19.68	\$19.40	\$0.28	58.754¢	58.608¢	0.15¢	\$1.935	\$1.907	\$0.028



What's Bearish:

- Milk Production Report: Milk output in April was up 1% vs. a year ago, while cow numbers increased 10,000 head from March. Gains were led by TX up 8.7% and CO up 8.5%. CA was up 1.5% and WI was down 0.3%.
- Livestock Slaughter Report: 229,800 cows were culled from the dairy herd in April, the lowest total since June and 38,600 head fewer (-14.4%) than last April.
- This week's Global Dairy Trade auction saw the price index decline another 1.8% from the previous event. Cheddar cheese fell 2.1% to a U.S. equivalent \$1.86/lb.
- Dairy cow slaughter for the week ending 05/10 totaled just 48,800 head, down 6,700 head (-12%) vs. the same period a year ago. YTD the cull is running 121,000 head behind last year.
- Fluid Milk Northeast: Milk production is steady to easing in the Northeast and Mid-Atlantic regions. Manufacturing milk supplies are heavy going into the Memorial holiday period. Balancing plants are working through the increased volumes with minimal delays. According to NASS, in New England, above average temperatures and sunny days helped to speed along fieldwork, and crop progress this past week.
- Fluid Milk Central: Milk production in the Central region is on the rise with spot loads of milk becoming increasingly available heading into the Memorial Day weekend. Most transactions are below Class. Milk handlers noted balancing supplies moving northward, going into cheese and

condensed skim production. Some milk processors expect to be skimming near capacity during the holiday weekend. Interest in bottling is lackluster with a few bottlers mentioning better sales early in the week.

- Fluid Milk West: Farm milk production in CA is steady, according to several milk handlers. Processors report all milk loads are finding processing room. Some silo storage is available in larger plants to accommodate additional milk loads over the long weekend. Class 1 interest is steady to lower as many school districts adjust orders to cover school meal program needs without overbuying as the end of the semester approaches. NM milk production is trending steady. Handlers, though, note there are increasing volumes of milk being offered on the spot market as bottlers reduce orders throughout NM and neighboring states. Milk handlers report farm milk production in AZ is steady. Dairy herds are benefiting from current daytime temperatures in the 80s, compared to the high 90s just a week ago. Nights are cool. Milk handlers report the pushback by bottlers is strong.
- Fluid Milk Pacific Northwest: Milk production in the region is building seasonally. Processing plants are running busy schedules to handle increasing milk supplies. Class I usage is steady to lower. Processors are expecting surplus volumes over the holiday weekend. First cutting of alfalfa in WA and OR has begun with reports of excellent forage growth conditions. UT and ID milk supplies continue to build. Excess milk is being moved to alleviate any spot surplus, but is typically staying in the region. Pasture and range conditions are mostly fair to good, with irrigation supplies mostly good to excellent.
- Dry Whey Central: Prices moved mostly lower this week. The market tone is unsettled. Cheese makers were generally increasing production rates as cheese prices fell and more milk was available. Manufacturers took advantage, drying additional volumes of whey. End users and buyers reported being offered a few extra spot loads from suppliers this week. Buyer interest is active. Inventories of dry whey are increasing, but still light.
- Dry Whey West: Production levels are steady to increasing. Cheese plants are operating at near full capacity depending on milk availability. This is allowing for more whey solids to reach processors. Demand for whey is fair to good as some manufacturers catch up on orders. Recent increased spot offerings are finding their way to the export market and are priced to compete with international prices. Domestic spot whey sales are light. Whey prices are steady to weak.
- Cheese Northeast: Milk supplies for cheese production are plentiful. Interest in wholesale Swiss has declined considerably. In addition, some producers indicate that current Swiss price levels are relative to March cheese prices, as a result, the market stands to lose significant margins as prices move lower. Generally, cheese inventories in the region are building as the market stabilizes.
- Cheese Midwest: Milk has been readily available to cheese makers and milk availability is expected to increase over the coming weekend. Many manufacturers have scheduled heavy cheese production over the Memorial Day weekend to take advantage of holiday milk. This is leading to expectations of plenty of cheese being available in the near future. Moreover, export sales of cheese for the third quarter have slowed. Declining prices for European cheese, relatively lower than U.S. cheese prices, are mentioned as a factor.
- Cheese West: Many plants are working at or near capacity. Wholesale cheese prices are lower again this week. Domestic demand is mostly steady with some retail and commercial buyers ordering for immediate needs. Some advance buying is occurring on price breaks as buyers look to build their inventories. Export demand is slowing as international prices are more competitive than U.S. prices.
- International: Milk production in the EU continues to be strong, but has moved beyond the seasonal peak. Favorable weather, good margins and the likelihood of lower farm gate prices in the future are prompting farmers to maximize milk production. Eurostat data reports Q1 milk deliveries compared to one year ago for selected countries are: Germany, +4.4%; France, +7.8%; Ireland, +0.3%; Netherlands, +4.5%; Denmark, +3.8%; Spain, +1.8% and the UK, +12.3%. Eurostat estimates milk production EU-28 2013/14 quota year at 2.6% above the previous year.
- International: Australian milk production has benefited from a period of unseasonably warm temperatures with highs near 70 degrees Fahrenheit. The warm weather has prompted some good pasture growth and allowed milk production to hang on and, in some areas, marginally increase. Inventories for most dairy commodities are at desired levels, prior to the end of the fiscal year, with some excess supplies being made available to the spot market. According to Dairy Australia, April 2014 milk production in Australia was 5.6% above April 2013.

Recommendation:

Spot cheese prices reversed course this week and climbed back above \$2/lb. The move higher happened on Thursday, catching most off guard in light of negative supply fundamentals, and pushed the June Class III contract limit up. July Class III wasn't far behind, up 71. For the week, both contracts finished up 57¢. Spot butter buyers went on a rampage, picking up 38 loads (at 42,000 lbs/load), pushing the price to \$2.18/lb. Despite indications that international demand is slowing down, cow numbers are growing and milk production is increasing domestically, there still appears to be a bullish undertone to the market. Locally, we've heard that the brutal winter hurt a lot of smaller dairies as they lost animals to the extreme cold, and that current feed prices are hurting profitability. And forward export sales into Q3 may not be as bad as reported, according to an insider we contacted this week. This week's Cold Storage report put further clarity on the demand situation as it shows both butter and cheese stocks well below prior year levels. In addition, red meat and poultry stocks were sharply lower, which should support cull cow prices and incentivize producers to thin the milking herd. July meal settled over \$500/ton so feeding lower producing animals will not be cheap. While the Jun/July Class III contracts saw the biggest gain this week, the July-Dec average pushed into new record high territory on Thursday and settled today at an average \$19.92. Q4 contracts also pushed into new highs at \$19.47. All we're saying here is, in spite of more short-term bearish fundamentals, the market obviously believes the bull trend is still intact and believes prices will go higher from here. We wrote a few weeks ago about the possibility of a bottom being carved out. Perhaps it already has. With the Memorial Day weekend upon us and schools coming to a close, we may see additional cheese show up in the spot market. But at this point, it appears there are buyers who need it, and want it. We would continue with a PUT option strategy. Here's an idea. For those producers that receive a solid component premium above Class III, consider the Aug-Dec 17.25 PUTs at an average price of 19¢/month. For a lot of operations, that will guarantee close to or more than \$19 mailbox for the rest of the year, with 100% upside if the market stays strong. Not bad and inexpensive for some peace of mind.

Note: We will be closed on Monday in observance of Memorial Day. Enjoy the weekend and a special thanks from all of us at KDM to any of you who have or are currently serving in the armed forces. You are our heroes.

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