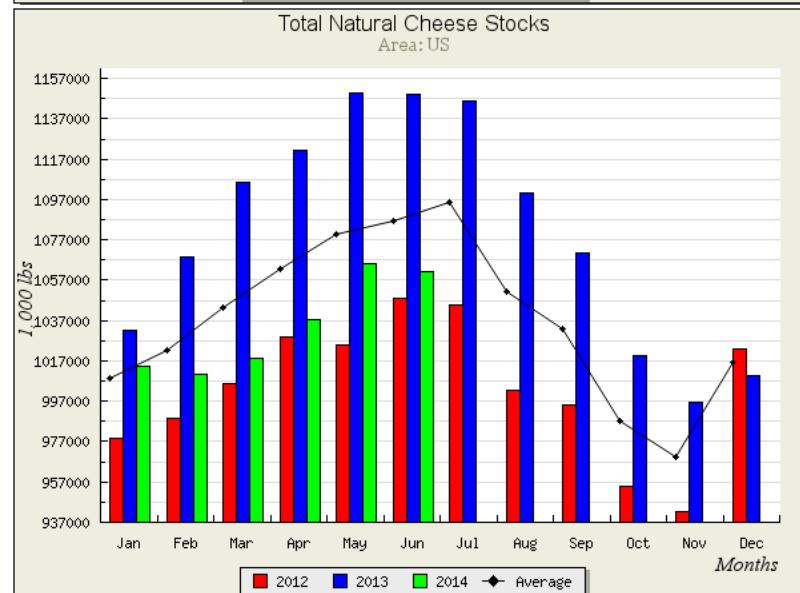
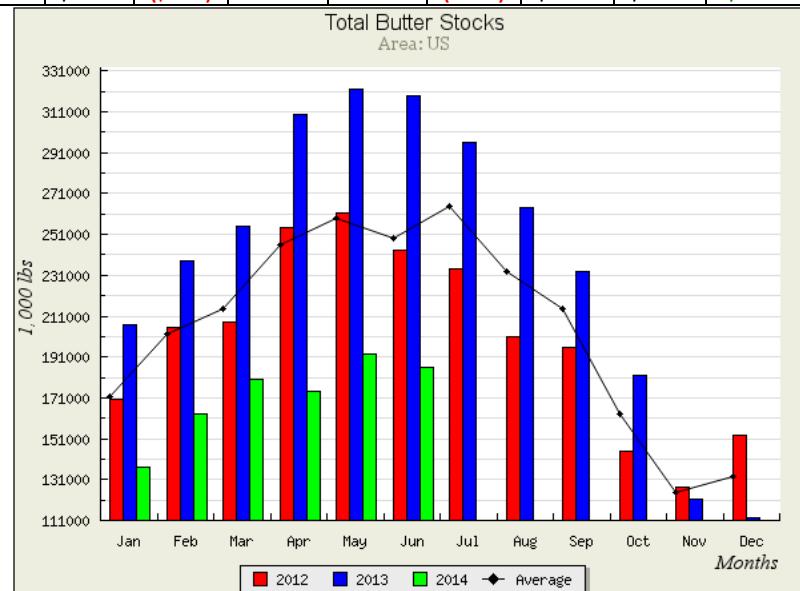


The KDM Dairy Report – July 25th, 2014

What's Bullish:

- Cold Storage Report: Butter stocks at the end of June were down 42% vs. a year ago and down 3% from May. American cheese stocks were 7% lower than last year, while total natural cheese stocks fell 8% (see graphs below).
- Cattle Report: While milk cows, at 1.3 million head are up 1% from July 2012, milk replacement heifers totaled 3.9 million head, down 5% respectively. The total of all calves and cattle in the U.S. as of July 1st was 95 million head, the lowest number since tracking began in 1973.
- Cheese stocks at USDA-selected storage centers have declined 2% (2 million lbs) over the period 07/01 through 07/21.
- Fluid Milk Central: Milk production and components in the region are mostly on the decline, following seasonal trends. Spot loads of milk are tighter as prices ranged from Class to \$2.00 over Class. Milk handlers note slow bottling sales with a few exceptions in tourist areas seeing upticks in orders. Bottlers are beginning to plan for filling school pipelines in the coming weeks. Ice cream and yogurt accounts are actively taking condensed skim supplies.
- Fluid Milk Southwest: CA milk production is variable from area to area, and generally trending steady to seasonally lower. Evening rainstorms are providing some relief to dairy cows after hot daytime temperatures, but milk production in NM is heading seasonally lower. Fluid sales are light.
- Fluid Milk Pacific Northwest: Milk production in the region continues to slowly taper off seasonally. Hot weather reduced volumes above expected levels, but milk has rebounded some with cooler nighttime temperatures. More milk is being processed locally as plants are operating at less than capacity in some cases. UT and ID milk levels are being negatively affected by hot weather in the region. Processors are expressing satisfaction with current milk trends related to demand.
- Butter: Butter production is generally declining as milk production and components are seasonally lower. Cream supplies are mostly priced above profitable production margins causing many churn operators to sell cream spot loads for better returns. Several butter manufacturers are microfixing sought-after bulk butter to fill print orders. Butter sales into retail and food service are mostly steady. High butter prices and production input costs are restricting stock building for Q4 needs.
- Dry Whey Central: The market tone is mixed as there is a growing divergence between purchasers that are flexible, bargain shopping or those in need. Availability is also mixed, as production rates have dropped with lower seasonal milk intakes have reduced cheese output. Export orders are ongoing.
- Dry Whey West: The market tone is mixed as downward pressure from other milk protein sources weigh on the market. However, whey production is lower as milk supplies into cheese plants contract. Whey stocks are tight with some brokers mentioning forward commitments for available supplies reducing spot availability. Spot buyers are finding loads harder to source.
- Cheese Northeast: Cheese production is very active as milk flows to cheese plants remain strong. However, demand for cheese is steady to increasing as retail sales are fairly good and USDA purchased mozzarella have increased in preparation to the start of the school year. Butterfat and protein levels of milk intakes are down, compared to year ago levels, with some cheese operations fortifying with nonfat dry milk.

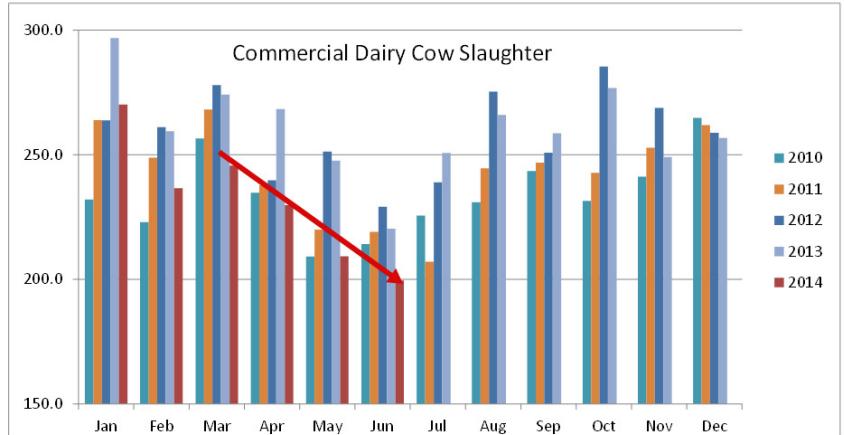
Futures Month	Class III 07/25	Class III 07/18	Change	Dry Whey 07/25	Dry Whey 07/18	Change	Cheese 07/25	Cheese 07/18	Change
Jul-14	\$21.53	\$21.51	\$0.02	68.175¢	67.950¢	0.22¢	\$2.042	\$2.041	\$0.001
Aug-14	\$21.45	\$21.33	\$0.12	67.500¢	67.500¢	0.00¢	\$2.034	\$2.025	\$0.009
Sep-14	\$20.72	\$20.33	\$0.39	64.000¢	63.150¢	0.85¢	\$1.990	\$1.954	\$0.036
Oct-14	\$19.90	\$19.83	\$0.07	59.500¢	60.500¢	(1.00¢)	\$1.945	\$1.930	\$0.015
Nov-14	\$19.35	\$19.42	(\$0.07)	56.850¢	58.500¢	(1.65¢)	\$1.910	\$1.905	\$0.005
Dec-14	\$19.10	\$19.18	(\$0.08)	56.500¢	58.750¢	(2.25¢)	\$1.896	\$1.888	\$0.008
Jan-15	\$18.40	\$18.50	(\$0.10)	53.500¢	55.250¢	(1.75¢)	\$1.842	\$1.847	(\$0.005)
Feb-15	\$18.04	\$18.19	(\$0.15)	52.250¢	53.250¢	(1.00¢)	\$1.814	\$1.822	(\$0.008)
Mar-15	\$18.00	\$18.09	(\$0.09)	51.275¢	52.750¢	(1.48¢)	\$1.814	\$1.815	(\$0.001)
Apr-15	\$17.91	\$18.00	(\$0.09)	51.750¢	52.000¢	(0.25¢)	\$1.812	\$1.808	\$0.004
May-15	\$17.93	\$18.01	(\$0.08)	51.225¢	52.000¢	(0.77¢)	\$1.810	\$1.815	(\$0.005)
Jun-15	\$17.94	\$18.01	(\$0.07)	51.000¢	51.300¢	(0.30¢)	\$1.812	\$1.815	(\$0.003)
12 Mo Avg	\$19.19	\$19.20	(\$0.01)	56.960¢	57.742¢	(0.78¢)	\$1.893	\$1.889	\$0.005



- Cheese Midwest: Supplies are tight. Some manufacturers now receiving domestic orders for August deliveries are telling customers they will have to reduce what they have ordered because supplies won't be up to the level of orders. Many cheese manufacturers are commenting on cheese supply tightness for customer delivery, as well as blocks and barrels in general. There is no consensus reason that manufacturers cite; some note heavier demand or less than expected cheese volumes manufactured. A number of cheese manufacturers have not been able to find any surplus milk even after contacting numerous potential sources. Cheese inventory levels are tight for some manufacturers. A cheese plant in Wisconsin is in the process of being closed by a multi-plant manufacturer.
- Cheese West: Production is lower as hot weather and typical seasonal declines reduce available milk for manufacturing. Cheese demand remains good from retail accounts, but buyers are price sensitive and reluctant to increase orders at higher levels. Export demand has slowed.

What's Bearish:

- Livestock Slaughter Report: Just 199,500 dairy cows were removed from the milking herd in June, down 9.4% vs. a year ago and the lowest monthly cull total since June 2008. Through June, the dairy cull is down 175,600 head vs. 2013.
- Spot Market: Blocks finished the week 5¾¢ lower to \$1.97/lb while barrels slipped 11¾¢ to \$1.95½/lb. 11 loads of blocks and 14 loads of barrels exchanged hands. Grade A NDM was down 2¢ to \$1.67½/lb on just 2 trades, but butter gained 11¢ to settle at \$2.59/lb on 10 trades.
- Fluid Milk East: Manufacturing milk supplies in the Northeast and Mid-Atlantic regions are steady to heavy. Declines in Class I demand have increased milk volumes going to plants and have more than offset the seasonal declines in milk production. Seasonally warm weather has covered both regions. Adequate rainfall has most crops and pastures in good to excellent condition. Mild weather in the Southeast has prompted some milk production increases. Class I demand is weak and some bottling plants are taking reduced loads due to scheduled maintenance projects. The seasonally heavy milk volumes are causing increased utilization of auxiliary manufacturing plants. Florida's milk production is declining in the face of frequent rains and hot, humid weather, but producers have not begun to dry off cows in earnest due to the good milk price and margins. A majority of pastures in the state are in good to excellent condition. Strong pulls for cream continue from ice cream and cream cheese makers.
- Dry Whey Northeast: Prices for dry whey moved lower this week. Production of dry whey is increasing as cheese production expands to fill new orders ahead of the upcoming school year. Spot sale pricing is below contract pricing, providing the market with a weak undertone.
- NDM Northeast: Steady to heavy manufacturing milk supplies in the region are keeping drying schedules very active. Most NDM manufacturers are focusing on low heat NDM production as a way to most quickly clear the heavy milk volumes channeled to dryers. Inventories are building. Demand has declined as buyers are opting to limit purchases to cover immediate needs in a downward trending market.
- NDM Central: The market tone is weakening as supplies are outpacing current demand. Milk production is seasonally declining while a few plants are drying additional volumes of NDM. Domestic demand is light as purchasers are in a wait-and-see approach. Export interest is weak as Mexico and China have slowed orders considerably.
- NDM West: The market tone is weak. Buyers are only filling near term needs on the spot market. A few market participants indicate Mexico has yet to return to the market in a big way. Milk supplies are steady to lower, but NDM inventories are building due to the light interest.



Recommendation:

Friday's semi-annual Cattle Inventory report (not released last year due to sequestration, so comparisons are to 2012) sheds some light on how the dairy herd has grown, even though total cattle numbers are at their lowest levels since 1973. The dairy herd is slightly larger even though the number of replacement heifers is 5% lower. A big slowdown in culling, as seen in this week's slaughter report, is responsible for the increase. Going forward, however, it will be expensive to expand. The overall low cattle numbers will support beef, and thus cull cow prices, encouraging dairy operations to cull more aggressively, putting upward pressure on already costly replacement heifers. As for this week, the Class IV complex looks increasingly weaker as NDM prices/demand continue to sag, though butter prices continued to trek higher. Class III, trading at nearly a \$3 discount to Class IV, might begin closing that gap. Despite ample milk supplies in the East, cheese is generally tight, with some Q3 sales even being pushed back or reduced. This, when school pipelines are about to reopen and football season provides a boost to pizza (mozzarella) sales. Though spot cheese prices lost some ground this week, we think buyers will get more aggressive if prices decline much further. A bullish Cold Storage report and the realization the cheese prices may be supported around the \$2 region well into the 3rd quarter prompted a rally in Q3 Class III, with Sep finishing the week up 39¢. A battle looks to be shaping up next week between spot buyers and sellers. With so many dynamics in play, uncertainty is high. Producers should continue to look to PUT options for price level protection. Enter target orders to buy the Sep 19.75 put for 20¢, Oct 18.50 put for 25¢ and Nov 18.25 put for 30¢.

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