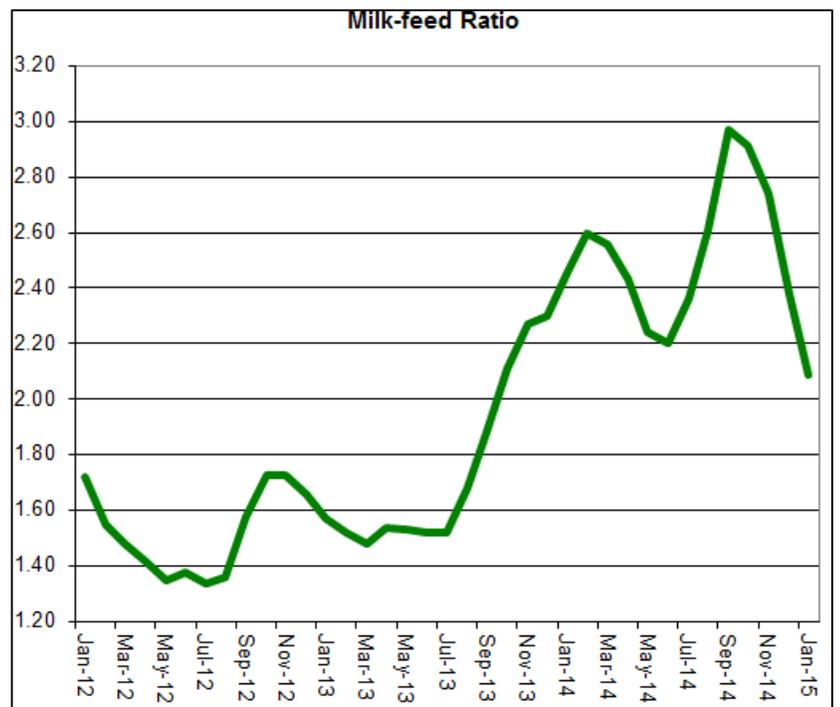


**The KDM Dairy Report – February 27<sup>th</sup>, 2015**

**What's Bullish:**

- Spot Market: Blocks finished the week unchanged at \$1.54½/lb on 8 trades, but barrels managed a ¼¢ increase to settle at \$1.54½/lb on 10 trades. NDM picked up 4¢ to close at \$1.15½/lb on a big 34 trades, while butter gave up 2¼¢ on 23 trades to close at \$1.69½/lb. Buyers appeared to the be aggressors for most of the action.
- Ag Prices Report: The Jan milk-feed ratio fell to 2.09, from 2.38 the prior month, making it the 3<sup>rd</sup> monthly decline in a row. Declining milk prices are mostly to blame.
- Cheese stocks at USDA-selected storage centers have declined 3.8 million lbs (-4%) over the period 02/01 through 02/23. Usually cheese stocks increase during the month of Feb.
- Dairy cow slaughter for the week ending 02/14 totaled 63,700 head, up 10.2% vs. the same period a year ago. Producers are culling more aggressively; YTD 20,000 more dairy cows have been removed from the herd than in 2014.
- Fluid Milk Southeast: The region continues to encounter hampering winter conditions including bitter temperatures, snow, sleet, and freezing rain. Disruptions to milk distribution have consisted of 2 to 3 day delays in some instances. Milk production is steady, but producers are concerned about haulers ability to pick up loads. Retail milk sales are strong, as limited loads clear into manufacturing. This week, Florida's milk demand is balanced with no import or export spot loads. Class I demand rose slightly. Farm-level production is mostly level, due to a slight decline in cow comfort due to variations in temperatures. Class II cream demand picked up with increased usage in cream cheese and ice cream production.
- Fluid Milk Central: Fluid milk production is nearing year ago levels after being higher earlier in the season, due to the colder temperatures in most parts of the region. Some bottling plants are seeing good demand and are running at full production. Current retail promotions are being used to increase sales. Ice cream manufacturers are increasing production levels as sales are starting to increase.
- Fluid Milk West: CA milk production continues to build throughout the state, but some dairy producers report the expected bump from fresh feed has been minimal. This is reportedly related to feed quality. Some problems with rising somatic cell counts are also challenging herd managers. Sales to bottling plants are mostly steady. January 2015 Pool Receipts of milk in were 4.0% lower compared to January last year.
- Butter Northeast: Manufacturers are churning at seasonally high rates. Demand for Easter and Passover holiday production has begun and is expected to continue over the next few weeks. Inventories are mixed, with a few plants building supplies to back impending holiday sales.
- Butter Central: Sales are increasing though inventory levels are also building. Demand is moving up as the spring holidays near. Cream levels are mixed as some reports indicate a tight market, while others are showing surplus.
- Butter West: Print butter demand remains good as staging for Easter/Passover retail needs are progressing. Some buyers are cautious at current pricing levels, and export demand is generally light. But there is a decent call from higher Class products and butter producers are willing to make and hold butter.
- Cheese Midwest: Even with more milk going into cheese than would be typical in past years, discounted milk being available, and expectations of more milk arriving soon during the Spring flush, cheese markets have been quite stable. The potential impact of uncertainty involving near future cheese production is minimized for the present as markets seem to reflect a comfortable balance between demand and supply of cheese. Manufacturers have strong cheese production schedules but cheese buyers are stepping up and adding to inventory levels. Buying interest is spread between retail buyers, brokers and resellers, as well as cut and wrap operations. Cheese is going into inventories for retail sale as well as aging programs. Market prices are remaining quite stable as this buying process continues. Whatever impact the likely spring milk flush will have on cheese prices is not something that is curtailing cheese buying this week. There seems to be an interest among many buyers in possessing inventories and current price levels are leading to cheese changing hands. The likely fact that there will soon be even more milk being made into cheese and thus, more cheese being offered, seems not to be slowing current production or cheese purchasing.

Futures Month	Class III 02/27	Class III 02/20	Change	Dry Whey 02/27	Dry Whey 02/20	Change	Cheese 02/27	Cheese 02/20	Change
Feb-15	\$15.49	\$15.54	(\$0.05)	52.500¢	53.000¢	(0.50¢)	\$1.543	\$1.546	(\$0.003)
Mar-15	\$15.69	\$15.53	\$0.16	49.250¢	48.500¢	0.75¢	\$1.575	\$1.567	\$0.008
Apr-15	\$15.87	\$15.32	\$0.55	47.700¢	45.500¢	2.20¢	\$1.606	\$1.565	\$0.041
May-15	\$16.13	\$15.66	\$0.47	44.250¢	43.400¢	0.85¢	\$1.650	\$1.607	\$0.043
Jun-15	\$16.93	\$16.28	\$0.65	44.250¢	42.500¢	1.75¢	\$1.738	\$1.673	\$0.065
Jul-15	\$17.41	\$16.74	\$0.67	43.500¢	42.625¢	0.88¢	\$1.799	\$1.727	\$0.072
Aug-15	\$17.84	\$17.15	\$0.69	42.675¢	42.525¢	0.15¢	\$1.840	\$1.772	\$0.068
Sep-15	\$17.83	\$17.22	\$0.61	42.175¢	41.725¢	0.45¢	\$1.843	\$1.785	\$0.058
Oct-15	\$17.85	\$17.34	\$0.51	42.000¢	42.000¢	0.00¢	\$1.823	\$1.801	\$0.022
Nov-15	\$17.71	\$17.25	\$0.46	41.500¢	41.000¢	0.50¢	\$1.830	\$1.785	\$0.045
Dec-15	\$17.33	\$16.98	\$0.35	42.000¢	41.500¢	0.50¢	\$1.800	\$1.748	\$0.052
Jan-16	\$16.85	\$16.55	\$0.30	43.000¢	41.700¢	1.30¢	\$1.750	\$1.730	\$0.020
<b>12 Mo Avg</b>	<b>\$16.91</b>	<b>\$16.46</b>	<b>\$0.45</b>	<b>44.567¢</b>	<b>43.831¢</b>	<b>0.74¢</b>	<b>\$1.733</b>	<b>\$1.692</b>	<b>\$0.041</b>



- Cheese West: Production in the region is steady to slightly higher as milk production trends are moving upwards on a weekly basis. But there is good demand for other milk utilizations yet overall milk supplies are adequate for processor needs. Cheese sales are generally fair to good. Buyers are finding adequate offerings of cheese in the marketplace to fill needs.

#### What's Bearish:

- Spot Market:
- Fluid Milk Northeast: Northeast farm-level milk production is seasonally strong. Processors' milk intakes are heavy. Class I demand is steady. Mid-Atlantic milk production is steady to higher. Milk supplies clearing to manufacturing are ample.
- Fluid Milk Southwest: Intakes of farm milk by AZ processors are higher as milk production notches seasonal increases. Some milk loads are stairstepping across the Southwest to find room at drying facilities. Bottler demand trended lower at the beginning of the week but suppliers anticipate an uptick in sales early next week, to coincide with March's lower Class I milk prices. Farm milk production in NM is strong and continues to build from week to week. Sales into bottling drifted lower this week as the pipeline is generally full at current volumes.
- Fluid Milk Pacific Northwest: Milk production in WA and OR is steady to building slightly. Processing plants are running on planned schedules with some milk being shopped and shipped around. Weather conditions have been mild and conducive for milk cow comfort. Milk output trends across UT and ID continue to move higher on a weekly basis at levels above a year ago. Farm level conditions are fair to good for milk growth. Lower feed prices are helping offset the sting of lower milk prices. Cheese plants are staying at or near capacity.
- Dry Whey Northeast: Prices are steady to lower as the market continues to soften. Heavy milk supplies are clearing to cheese vats and providing the wherewithal to maintain dry whey output levels in the region. Some manufacturing whey streams are being channeled to higher protein products. Stocks are moderate.
- Dry Whey Central: Prices are moving lower as some manufacturers are offering discounts to decrease the high inventory levels. The market tone is weak on a quiet week. Production rates are steady. Domestic demand is fair to good and international interest is decreasing.
- Dry Whey West: Prices were lower this week and the market undertone remains weak. Exporting remains a struggle, and even as the port shipping situation eases, the backlog is expected to take time to move. General buying interest is light and mainly moving under supply contracts. Offerings are available from most producers and from the resale market. Stocks are moderate to heavy.
- Cheese Northeast: In general, cheese production is strong. Inventories are building on the strength of available milk supplies, as plants with the capacity run full 7 day schedules. Adequate interest is noted in both the retail and food service sectors, as orders are good through Easter. Swiss cheese sales are trending above expected levels. Export sales are light.

#### Recommendation:

Milk production in California is below year-ago levels and there are some concerns about feed quality and high somatic cell counts. East of the Rockies, much of the country is suffering under abnormally cold conditions, pushing Class I demand higher and causing some disruptions in both milk production and delivery. Today's Ag Prices report shows that profitability on the farm has dropped for the third month in a row; cull numbers are up. Meanwhile, domestic cheese demand is strong as aging programs continue to restock while cheese prices remain stable. This seems to have taken the edge off the decline in demand due to falling exports. Cheese plants we spoke to this week indicate they are generally producing at high levels, but that buyers are there to take on the product. We still expect a correction lower once this demand is satisfied, but maybe we won't head back to the \$13 range as we did earlier in Q1. Time will tell. Short term it appears buyers will continue to show up at the spot market and support prices, making us think Class III prices will continue to climb over the next few weeks. Hedgers can sell in to this but we would do so lightly. Better yet, buy PUT options Apr-Jun as these are likely the most vulnerable months.

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