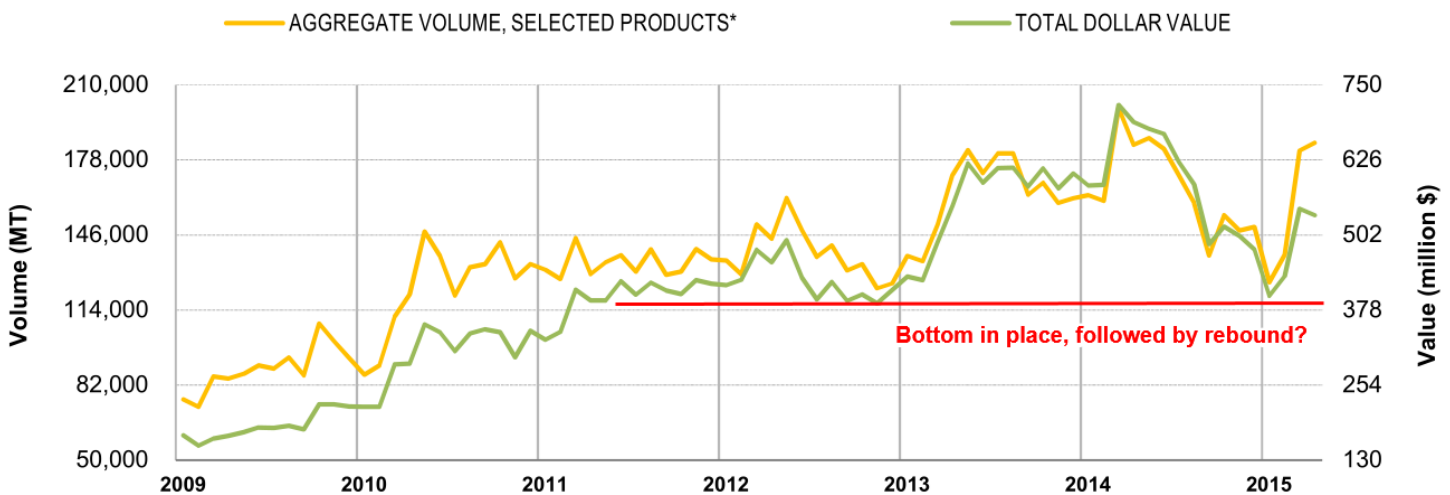


The KDM Dairy Report – June 5th, 2015

What's Bullish:

- Dairy Products Report: Butter output in April fell 1.7% vs. last year while cheddar cheese output was 1.8% lower than a year ago. Total cheese output increased 1.9% compared to last April, but cheese inventories are not burdensome, indicating stronger commercial disappearance (demand) is in play.
- Dairy Cow Slaughter for the week ended 05/23 totaled 51,800 head, up 7% vs. the same period a year ago, and the 10th consecutive week of higher cull numbers.
- Fluid Milk Sales YTD indicate that whole milk consumption is on the rise, with sales up for the third consecutive month. Flavored milk sales also saw a small increase.
- Cream East: Cream supplies have tightened as loads are not as easy to obtain as in past weeks. Shipments to the Midwest are fewer. Prices are inching higher, reflecting increases in multiples and basing points around the butter price. Ice cream and ice cream mix production is active.
- Fluid Milk West: Milk output in CA continues decreasing every week. The warmer weather and poor feed quality are negatively affecting cow productivity. Some dairy farmers are reporting higher operation costs due to water charges. The drought severity is extreme. AZ milk production is lower, as weather is getting warmer and the humidity begins to increase. Milk volumes in NM are slightly lower this week, according to milk haulers. Class I sales are down from last week, but Class II sales are up.
- Butter: Production is steady to lower as some manufacturers concentrate on balancing inventory levels. A tighter cream supply was also a factor this week, as ice cream manufacturers were pulling heavy. Most butter manufacturers are content with inventory levels, but some are concerned about a lack of stocks for Q3 demand.
- Cheese: Sales are strong all over. Many plants are sold out and unable to accommodate new inquiries from buyers, at least buyers who lack an ongoing relationship with the plant. Even requests for additional volumes from existing contract customers are not always able to be honored. Part of the demand is current consumption but a number of manufacturers have come to believe that buying patterns are different this year from some recent years. These manufacturers believe that faced with prevailing cheese prices toward the end of 2014, a number of cheese buyers decided to defer re-stocking inventories and allowed sales to deplete stocks below traditional levels. This view believes that some of 2015 sales strength is attributable to replenishing inventories by such buyers, as well as efforts to further build inventories as cover should prices toward the end of the year follow similar trends as last year.
- Exports: U.S. dairy exports in April increased for the third straight month, according to the U.S. Dairy Export Council. April export volumes reached their second-highest level ever and were equivalent to 16.7% of milk solids production, the most since June 2014. YTD export volumes still trail

Futures Month	Class III 06/05	Class III 05/29	Change	Dry Whey 06/05	Dry Whey 05/29	Change	Cheese 06/05	Cheese 05/29	Change
Jun-15	\$16.70	\$16.82	(\$0.12)	41.500c	42.800c	(1.30c)	\$1.717	\$1.725	(\$0.008)
Jul-15	\$16.91	\$17.42	(\$0.51)	38.850c	41.500c	(2.65c)	\$1.758	\$1.792	(\$0.034)
Aug-15	\$17.08	\$17.42	(\$0.34)	36.900c	41.000c	(4.10c)	\$1.793	\$1.803	(\$0.010)
Sep-15	\$17.26	\$17.56	(\$0.30)	36.750c	39.500c	(2.75c)	\$1.805	\$1.823	(\$0.018)
Oct-15	\$17.21	\$17.56	(\$0.35)	36.200c	39.700c	(3.50c)	\$1.808	\$1.820	(\$0.012)
Nov-15	\$17.26	\$17.51	(\$0.25)	36.100c	39.250c	(3.15c)	\$1.818	\$1.822	(\$0.004)
Dec-15	\$17.10	\$17.31	(\$0.21)	36.000c	38.400c	(2.40c)	\$1.806	\$1.802	\$0.004
Jan-16	\$16.71	\$16.84	(\$0.13)	36.250c	38.325c	(2.08c)	\$1.763	\$1.765	(\$0.002)
Feb-16	\$16.71	\$16.86	(\$0.15)	37.000c	39.500c	(2.50c)	\$1.762	\$1.755	\$0.007
Mar-16	\$16.75	\$16.89	(\$0.14)	37.500c	40.250c	(2.75c)	\$1.762	\$1.763	(\$0.001)
Apr-16	\$16.77	\$16.86	(\$0.09)	38.675c	40.700c	(2.03c)	\$1.763	\$1.753	\$0.010
May-16	\$16.77	\$16.90	(\$0.13)	40.000c	41.000c	(1.00c)	\$1.755	\$1.755	\$0.000
12 Mo Avg	\$16.94	\$17.16	(\$0.23)	37.644c	40.160c	(2.52c)	\$1.776	\$1.782	(\$0.006)



year-ago levels by 11%, however.

What's Bearish:

- Spot Market: Block cheese managed a 2c gain for the week to settle at \$1.71½/lb on 6 trades, but barrels lost 2¾c to close at \$1.64¼/lb on 29 trades. NDM fell 3¾c to 88c/lb on 8 trades while butter plunged 10½c to \$1.90/lb on just 2 trades.
- Fluid Milk Northeast: "Out of control" is the prevailing sentiment amongst some milk processors as heavy milk volumes flood into regional balancing plants. Most everyone in the supply chain is feeling the impact of seasonally heavy milk supplies, although output does vary in areas of the region. Accordingly, peak production is steady in the Mid-Atlantic. Fluid milk sales have declined marginally. Manufacturing plants are

operating at capacity levels, as balancing plants find milk volumes generally burdensome. Production in the Northeast is growing at marginal rates. Milk orders have adjusted lower as traditional schools have closed for the summer months. Manufacturing is full.

- Fluid Milk Southeast: Farm-level milk production is steady to slightly lower with output remaining ample. Florida's milk production is slowing as daytime and nighttime temperatures move higher. However, sales dropped off sharply with school closings, causing milk export shipments to jump up 50 loads from last week, to a total of 120 loads this week. Condensed skim supplies are plentiful, well above seasonal demand. Dryers are operating at beyond capacity levels.
- Fluid Milk Central: Milk production is steady this week, but there is a surplus in supply. Some contacts report milk that is not able to be processed throughout the region. Bottling demand is decreasing as more educational institutions let out for the summer. Some sources indicate that as tourism starts to pick up, some of that milk will clear there. Spot milk loads are available at \$3-5 under Class, with limited reports showing as less as \$1 under and as much as \$10 under.
- Fluid Milk Pacific Northwest: Milk production has leveled off but there is still plentiful milk. The end of school terms have reduced milk bottling, making more available for manufacturing. Some manufacturers report strong consumer demand for ice cream. First crop hay production is a little ahead of schedule in most parts of the region. ID and UT milk production is strong. With ample supplies of milk, many manufacturers report they are running at capacity. Recent rains has helped replenish reservoirs.
- Dry Whey Northeast: Prices were lower and production levels higher this week as cheese makers adjusted schedules due to increased milk supplies. Dry whey trading in general has been sluggish.
- Dry Whey Central: Prices were steady to lower this week. Buyers are taking contract loads on time but there have been few spot loads. Demand is limited to light in a weak market.
- Dry Whey West: Most industry contacts report long inventories. Sales activity was mixed as some contacts report stagnancy and others report generally steady activity for contract sales. Limited spots sales occurred.
- NDM: In the East, continued high milk production is forcing high dryer activity in order to process all the milk. Prices moved lower, due mainly to lower spot sales. Things are more in balance in the Central region, though sales are very slow. In the West, inventory levels are adequate and the market tone is weak.
- Cheese: The continuing high volumes of milk available in all regions, but particularly the Midwest, is keeping national cheese production at very high levels. Some cheese plants in the Midwest have reached production levels not previously thought attainable, straining machinery and human endurance to a degree that can't be maintained in the long run. In the immediate term, these volumes of milk drive current production. Surplus milk below Class prices, especially in the Midwest, is available and aggressively shopped around. In Ohio, milk offered at \$5.00 below Class is characterized as an unusually low price. Iowa surplus milk is offered at \$3.00 to \$5.00 under and in Wisconsin, down to \$7.00 under. Some cheesemakers have pressed milk storage capacity not used for some time back into service to accommodate the milk bargains currently available until the milk can be run through plants.

Recommendation:

After beginning the week with continued bids pushing prices higher, sellers made their presence felt mid-week, particularly in the barrel market, where 29 loads exchanged hands. Butter, too, saw pressure on offers, with few buyers willing to take on loads. As a result, Class III futures finished well in to the red this week. Extremely heavy cheese production finally started to impact dry whey futures as well, with multi-cent losses in futures. While we scolded ourselves last week for being wrong, maybe it turns out we were right after all (but who knows, this is a very complicated market right now!). We would expect to see continued pressure in all spot market categories next week as nearly all schools are closed and manufacturing milk is all the more available, oftentimes for significant discounts to Class. There is every incentive to make cheap cheese from this milk, which should keep a lid on major rallies in the near term. On the other hand, cheese sales continue to be a bright spot, with many plants sold out into Q3 and some through Q4. Amazing. And the international picture appears to be picking up. April export numbers were encouraging. It may mean that we just remain range-bound in Class III for the near to intermediate term, within a \$16.00 - \$17.50 level. Producers who bought options may want to consider selling some premium around those levels to help pay for those initial purchases. Hedgers with contracts locked in with plants should consider upside protection in the form of call options, Aug-Dec. Look at the 18.50 and 19.00 calls and wait for premiums to come down to the 15-20¢ level.

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