

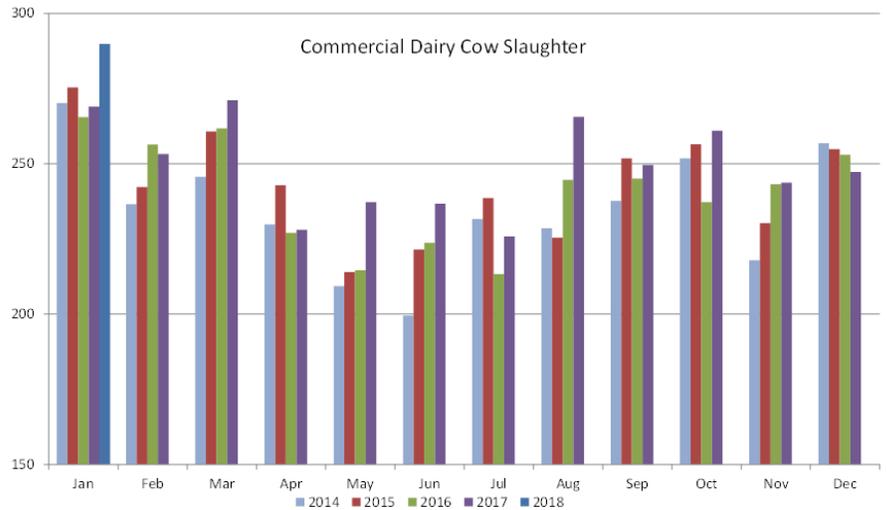
The KDM Dairy Report – February 23rd, 2018

SPOT MARKET	2/16	2/23	Change	Trades
Cheddar Blocks	\$1.5400	\$1.4950	(\$0.0450)	3
Cheddar Barrels	\$1.4800	\$1.4600	(\$0.0200)	31
Butter	\$2.1000	\$2.1725	\$0.0725	43
Grade A NDM	\$0.7050	\$0.6725	(\$0.0325)	11

Futures Month	Class III 02/16	Class III 02/23	Change	Dry Whey	Dry Whey 02/23	Change	Cheese 02/16	Cheese 02/23	Change
Feb-18	\$13.49	\$13.42	(\$0.07)	25.000c	25.000c	0.00c	\$1.479	\$1.477	(\$0.002)
Mar-18	\$14.10	\$13.87	(\$0.23)	25.250c	24.250c	(1.00c)	\$1.542	\$1.522	(\$0.020)
Apr-18	\$14.06	\$13.86	(\$0.20)	26.700c	26.250c	(0.45c)	\$1.532	\$1.514	(\$0.018)
May-18	\$14.34	\$14.06	(\$0.28)	26.875c	26.700c	(0.18c)	\$1.555	\$1.527	(\$0.028)
Jun-18	\$14.75	\$14.61	(\$0.14)	27.875c	27.500c	(0.38c)	\$1.595	\$1.583	(\$0.012)
Jul-18	\$15.31	\$15.21	(\$0.10)	28.600c	28.000c	(0.60c)	\$1.644	\$1.638	(\$0.006)
Aug-18	\$15.69	\$15.57	(\$0.12)	29.000c	28.700c	(0.30c)	\$1.676	\$1.673	(\$0.003)
Sep-18	\$15.87	\$15.84	(\$0.03)	29.500c	29.100c	(0.40c)	\$1.695	\$1.695	\$0.000
Oct-18	\$16.01	\$15.95	(\$0.06)	29.850c	29.100c	(0.75c)	\$1.709	\$1.706	(\$0.003)
Nov-18	\$15.96	\$15.81	(\$0.15)	30.200c	29.000c	(1.20c)	\$1.701	\$1.698	(\$0.003)
Dec-18	\$15.85	\$15.72	(\$0.13)	31.000c	29.500c	(1.50c)	\$1.685	\$1.677	(\$0.008)
Jan-19	\$15.54	\$15.54	\$0.00	31.100c	31.000c	(0.10c)	\$1.667	\$1.666	(\$0.001)
12 Mo Avg	\$15.08	\$14.96	(\$0.13)	28.413c	27.842c	(0.57c)	\$1.623	\$1.615	(\$0.009)

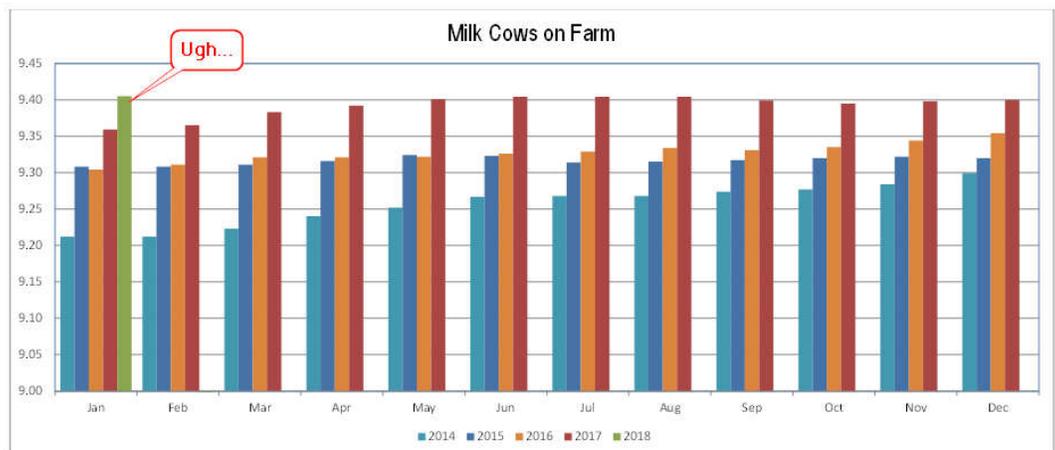
What's Bullish:

- Livestock Slaughter Report: 289,800 dairy cows were removed from the milking herd in January, up nearly 21,000 head (7.7%) vs. a year ago, and the highest monthly total since Jan, 2013 (see graph).
- Cold Storage Report: American cheese stocks at the end of January were 2% higher than a year ago, but were down 8.6 million lbs vs. December. This is a substantial, anti-seasonal move, suggesting demand was very strong during this period.
- Butter Northeast: Interest is seasonally strong as retail orders have picked up. Producers butter stocks are adequate to meet the demand, but there is a steady to firm undertone.
- Butter Central: Cream supplies are tightening up for butter production in the region. Upper Midwest butter makers suggest increased Class II production is beginning to cut into the recent accessibility of cream.
- Butter West: Higher prices in some international markets may offer more export opportunities for U.S. butter. Domestic retail orders for the spring holidays are strong and building, though supplies are still abundant.
- Dry Whey: Though cheese output is strong and whey powder production is active, inventories are pretty stable as output is purchased not long after it is made. Some industry participants believe that dry whey prices will not move any lower than they are. As the result, they are ready to make purchases again. Due to higher prices in Europe, export interest of USA dry whey to Southeast Asia and Japan is growing.
- NDM Northeast: Supplies are strained in the region, as several drying facilities had a significant hiatus. Sources suggest multiple producers are sold out of product, beyond regular customer accounts.
- Foreign Cheese: EU cheese inventories are adequate to satisfy buyers' requests. However, in Germany, the availability of uncommitted cheese is limited. As so, sliced cheese prices are trending up in Germany.
- CWT has accepted 11 requests for export assistance to sell 2.895 million lbs of Cheddar, Gouda and Monterey Jack cheese to customers in Asia, Europe, the Middle East and North Africa. The product has been contracted for delivery in the period from February through June 2018.
- International: Dec milk production in New Zealand was down 2.6% vs Dec '16.



What's Bearish:

- Milk Production Report: January milk output in the U.S. was 1.8% higher than a year ago, and the milking herd grew 5,000 head from January to 9.405 million head. The herd has not been this large in the last 20 years.
- Butter stocks at CME-approved warehouses increased 24% (3.4 million lbs) over the period 02/01 through 02/19.
- Fluid Milk East: Northeast milk production is fairly steady as market participants report available milk supplies for full production schedules. Southeast milk production is steadily climbing.



- Fluid Milk Central: Contacts question how spring flush will alter milk availability, but a number of market actors expect only slight deviations from the current surplus. Bottling reports are unchanged after weeks of lackluster sales. Milk into cheese plants ranged from \$1 to \$3 under Class.
- Fluid Milk Southwest: Some California handlers report that because of an early spring flush, their milk intakes from the dairies are up. In Arizona, some processors are struggling to find homes for their milk. Milk production is abundant this week, and it is expected to remain the same as the state heads to the spring flush. A number of manufacturers have started to send some milk to California to clear off more loads.
- Fluid Milk Pacific Northwest: Manufacturers report no problems getting the milk needed for processing. Industry contacts in the mountain states of Idaho, Utah and Colorado report that although milk production is at low tide for the year, copious volumes of milk are available. In some cases, the milk is discounted \$3 to \$4 under Class III prices to open up a home.
- NDM West: Demand from Mexico is sluggish as buyers from that country are cautious over trade policies and currency. In the U.S., production is ongoing prompted by large farm milk intakes. Accordingly, NDM inventories are steady to building.
- Cheese Northeast: Market participants report steady milk loads clearing into facilities, allowing production schedules to be full. With constant cheese output, supplies are stable to building. The current demand is steady to seasonally sluggish.
- Cheese Midwest: Manufacturers are generally running busy production schedules. Milk continues to flow into cheese vats at a discount. Spot milk loads ranged from \$1 to \$3 under Class III. Cheese sales are steady to higher, and some mozzarella producers have reported upticks in demand this week. However, buyers are hesitant to purchase when prices are on the rise.
- Cheese West: Some plants are reviewing their production schedules to avoid further accumulation of cheese in storage. Overall, the current stocks of cheese are ample. The U.S. cheese market seems to be competitive compared to the rest of the world, however, domestic sales are flat.
- After 3 straight increases, this week's GDT auction saw the price index decline 0.5%, led by a 3% drop in SMP. Cheddar cheese was down 1.3% to a U.S. equivalent \$1.67/lb.
- International: July-Jan milk production in Australia was 3.1% higher than the same period last season, according to Dairy Australia.
- International: Dec EU milk production was 4% higher than Dec '16, according to government stats released this week.

Recommendation:

We're not sure how barrels can be tight for just one week, but that appears to be the case. After hitting a high of \$1.49/lb on Wed, offers started coming on strong and pushed prices to a 2¢ loss for the week. Block offers began showing up as well, leaving a 4½¢ loss by Friday. This week's Milk Production Report certainly caught some off guard, with a sizable gain in output and increase in cow numbers. News regarding the international milk supply is not good either, with a jump in milk production in the EU and Australia. On the demand side, domestically we are in a slow period, until grilling season gets under way. That said, our Cold Storage Report showed a nice drawdown in American cheese stocks. Product is moving, perhaps through CWT assistance. Big numbers in the Livestock Slaughter Report, yet the herd still grew. If prices head back to sub-\$14 levels, we'd expect culling to get more aggressive. About the only bright spot is butter, where we're rapidly closing in on March 1st, the date only "new crop" butter can be sold in the spot market. Easter is also approaching, which tends to help butter demand more than cheese. Current spot prices work out to about \$13.65 Class III. With NASS survey premiums built in, we're probably closer to \$14.10 or so. The March contract is currently trading a discount to spot, so the sentiment is for further decline in cheese prices. However, if buyers dig in somewhere around here, we could actually see March pop a bit higher. As we head in to the flush period, however, we just don't see a lot of positive Apr-Jun. Producers looking for coverage should buy "disaster insurance" in the form of cheap PUT options, through June. We'd still leave the 2nd half mostly alone.

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