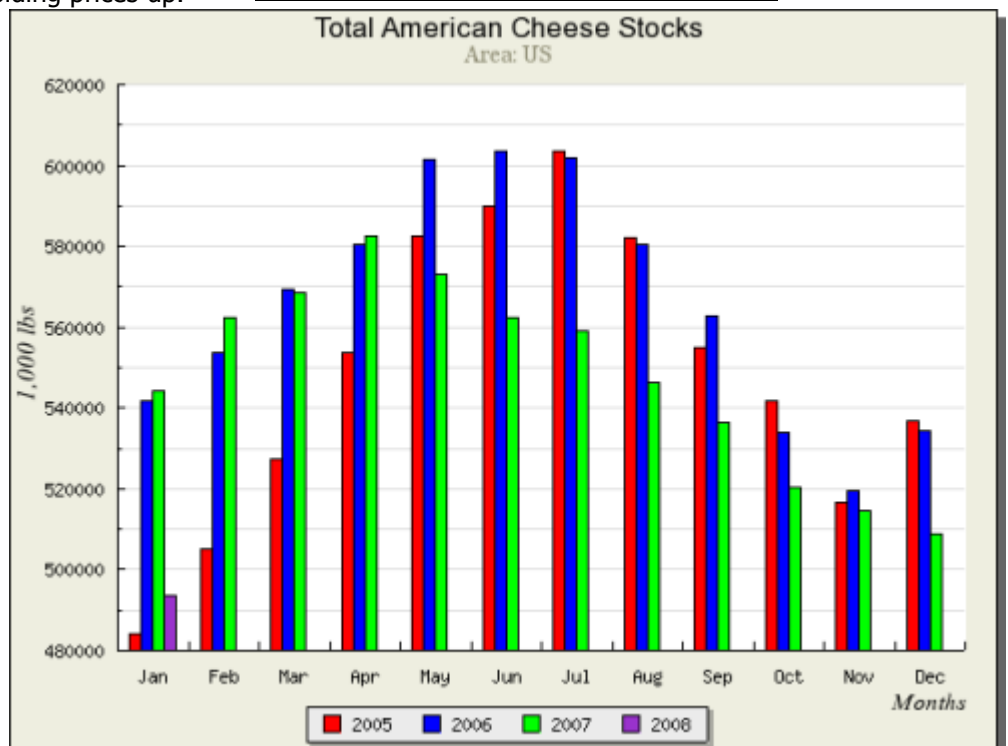


The KDM Dairy Report – February 22nd, 2008

What's Bullish:

- Cold Storage Report: American cheese stocks in January were [down a shocking 10%](#) vs. a year ago and down 3% from December, according to USDA (see graph). Total cheese stocks were down 8% vs. last year and down 2% from the prior month.
- Cash Market: Blocks picked up 2¼¢ this week to close at \$2.07/lb while barrels gained 3¢ to \$2.02/lb. Butter dropped to its lowest price since mid 2006, falling 2½¢ to \$1.17¾/lb. Just 2 loads of blocks, 1 barrel and 12 cars of butter exchanged hands.
- Livestock Slaughter Report: January dairy cow [slaughter was strong](#) as 2008 faces much higher feed costs than a year ago. 235,700 head were culled, a 3.5% increase over last year, when 227,700 head exited the milking herd.
- Dairy cow slaughter for the week ending 02/09 was [49,700 head compared to 47,800](#) during the same week last year. YTD, 305,700 head have been culled vs. 298,800 in 2007.
- Current natural American cheese is tight to short in the Midwest, according to Dairy Market News. Packagers are having problems finding enough of it with an adequate minimum age for cutting. Natural orders are surprisingly good and improving for other varieties. [Cheese exports continue to impact the volumes available for domestic needs.](#)
- Western cheese buyers continue to [operate with only minimal stocks](#) as they attempt to buy on price dips. This leaves them in a hand-to-mouth buying strategy, and even though offerings in the region are increasing, strong exports are believed to be holding prices up.
- NASS [cheese prices were up](#) in this week's survey as they start to catch up with the cash market. Blocks increased 2.1¢ to average \$1.76/lb and barrels were up 2.9¢ to \$1.86/lb. Expect a bigger jump next week. Butter is still stuck in a rut but was up 0.3¢ to \$1.22/lb.
- Weekly cold storage numbers continue to indicate a [drawdown in cheese stocks](#) during a period of the year we're typically building inventory. Through the first 18 days of Feb, cheese holdings are down 1 million lbs at selected USDA storage centers.
- Fluid Milk & Cream Review reports that some processors in California are looking at [implementing a base program](#) for producers in an attempt to control milk growth that current plant capacity cannot handle. Customers we work with

Futures Month	Friday 02/22 Close	Friday 02/15 Close	Change	5-yr Average	Top 3rd Price
Feb-08	\$17.03	\$17.17	(\$0.14)	\$12.53	\$13.21
Mar-08	\$18.38	\$17.83	\$0.55	\$12.78	\$13.50
Apr-08	\$17.30	\$16.88	\$0.42	\$14.14	\$15.36
May-08	\$16.95	\$16.53	\$0.42	\$14.50	\$15.85
Jun-08	\$16.87	\$16.48	\$0.39	\$14.54	\$15.63
Jul-08	\$16.96	\$16.67	\$0.29	\$14.66	\$15.57
Aug-08	\$17.12	\$16.79	\$0.33	\$14.47	\$15.40
Sep-08	\$17.27	\$16.97	\$0.30	\$15.14	\$16.02
Oct-08	\$16.95	\$16.73	\$0.22	\$14.78	\$15.58
Nov-08	\$17.04	\$16.73	\$0.31	\$14.75	\$15.73
Dec-08	\$16.95	\$16.73	\$0.22	\$15.09	\$16.18
Jan-09	\$16.85	\$16.45	\$0.40	\$14.40	\$15.24
Feb-09	\$16.58	\$16.31	\$0.27	\$12.53	\$13.21
Mar-09	\$16.53	\$16.31	\$0.22	\$12.78	\$13.50
Apr-09	\$16.50	\$16.24	\$0.26	\$14.14	\$15.36
May-09	\$16.57	\$16.22	\$0.35	\$14.50	\$15.85
Jun-09	\$16.60	\$16.28	\$0.32	\$14.54	\$15.63
Jul-09	\$16.64	\$16.30	\$0.34	\$14.66	\$15.57
Aug-09	\$16.66	\$16.35	\$0.31	\$14.47	\$15.40
Sep-09	\$16.76	\$16.36	\$0.40	\$15.14	\$16.02
Oct-09	\$16.76	\$16.35	\$0.41	\$14.78	\$15.58
Nov-09	\$16.70	\$16.30	\$0.40	\$14.75	\$15.73
Dec-09	\$16.70	\$16.30	\$0.40	\$15.09	\$16.18
Feb-Dec 2008	\$17.17	\$16.86	\$0.30		
2009 Avg	\$16.65	\$16.31	\$0.34		



in the state confirm that a "quota" system is in the works, which would limit how many lbs of milk would be paid for.

- Dry whey [sales continue to improve](#) as buyers see value at current prices, according to Dairy Market News. Inventories are in better balance and prices are not falling as steeply as in prior weeks.
- Grains: Beans hit new contract highs in several months this week, with the March – Sep contracts all trading well over \$14. Meal is trading as high as \$372.80/ton in July with the "bargain" in 2008 at \$348.20/ton in Dec.

What's Bearish:

- NASS surveyed powder prices continue to look for a bottom as nonfat dry milk lost 7.3¢ to average \$1.31/lb and dry whey decreased 1¢ to 26.2¢/lb.
- Butter inventories at CME-approved warehouses increased by 4.8 million lbs for the week ending Feb 16th, compared to a 2.7 million lbs increase during the same period a year ago. Total butter stocks have climbed to 120.8 million lbs, [14.7% more](#) than the 105.3 million lbs we had at this time last year.
- Milk production in the Eastern region of the country continues to increase seasonally, according to Fluid Milk & Cream Review. Plants in the Northeast are at or [close to capacity](#), which is causing concern on how the spring flush will be handled. In Florida, fluid demand is down slightly, resulting in 102 loads of Grade A milk shipped out of the state. Last week only 56 loads were exported.
- Midwest bottlers are expecting fairly [quiet fluid sales](#) until March, according to Fluid Milk & Cream Review. Manufacturing milk interest is weak as overall milk production is well above a year ago. Spot loads of milk are more plentiful than buyers as cheese makers remain nervous about making spec loads at current milk and cheese prices.
- Fluid Milk & Cream Review reports California is [still awash in excess milk](#). Weather conditions have been favorable for production increases and plants in the state are full to overfull. Excess milk is still moving to calf ranches and other animal feed operations. Bottles milk demand has slowed and orders from bottlers are down sharply. In Arizona, milk production is higher and plants are running on heavier schedules to accommodate local and out-of-state milk. And in the Pacific Northwest, milk is on the heavy side for this time of year, compared to what plants had planned on.
- Dairy Market News reports churning activity across the country remains strong as cream supplies are readily available. Domestic retail orders have been quite good, but international buyer interest [has not been as aggressive](#) as some had anticipated. Prices dipped to their lowest levels since mid 2006.

Recommendation:

Despite overall high milk production in most of the country, strong cheese production and the utilization of nonfat dry milk to improve yields, it appears we still don't have enough cheese. We haven't had American cheese stocks in January this low since 2005, after which they quickly went up (see graph). Will that happen in 2008? The lack of sellers in the cash market the past couple weeks has allowed the block price to once again trade above \$2/lb, and now we know why. It appears they didn't have any to sell, or weren't will to part with it. But if we're making more cheese and producing more milk, where is it all going? At this point, it appears strong exports are making a difference. Note the bullet points above about cheese exports impacting the volumes available for domestic needs. The rest of it is going to butter/powder operations, and in CA, being dumped and sold to calf ranches. This sounds very supportive, big picture, but does it mean prices are going nowhere but up? The scariest part about this market is how bullish everything appears; almost too bullish. But we have learned from experience it's usually when everyone is convinced prices are going higher that the unexpected happens. This week we bought a slug of March 18.00 PUT options for 15¢. You should too. Hey, we're as thrilled as anybody that the current market outlook is positive, but we're not too smug to think it can't go back down in the short term either. We are in the March calculation, so this is short-term insurance. But with cheese trading near the upper end of its range, it's possible a big player could come in next week and offer cheese lower. If prices continue to rally, you lose your investment in the options, but take the higher price for your milk. Win-win. Leave the rest of 2008 and 2009 alone. Buyers came in fairly strong volumes, pushing the July-Dec avg to a new high, and moving the 2009 average up 34¢. Apparently anything priced at \$16.50 or below was seen as value and bought. The buyers could be right.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.