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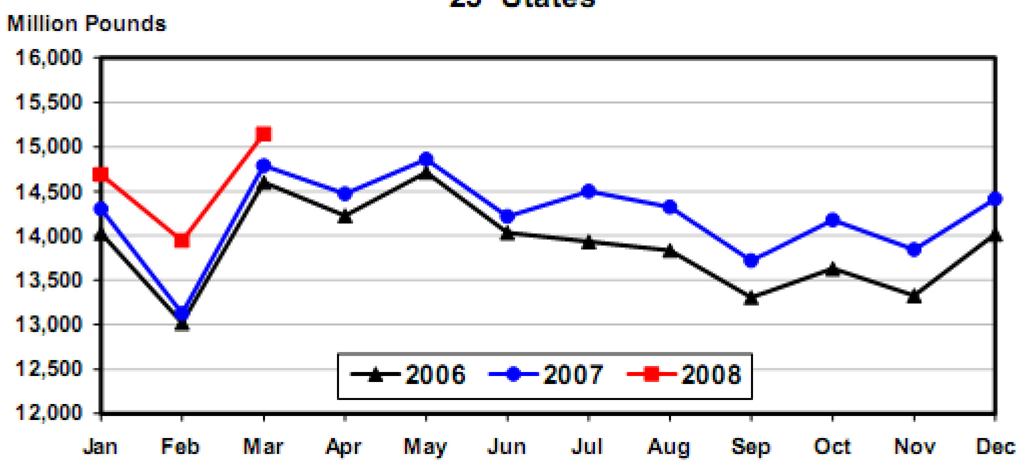
The KDM Dairy Report – April 18th, 2008

What's Bullish:

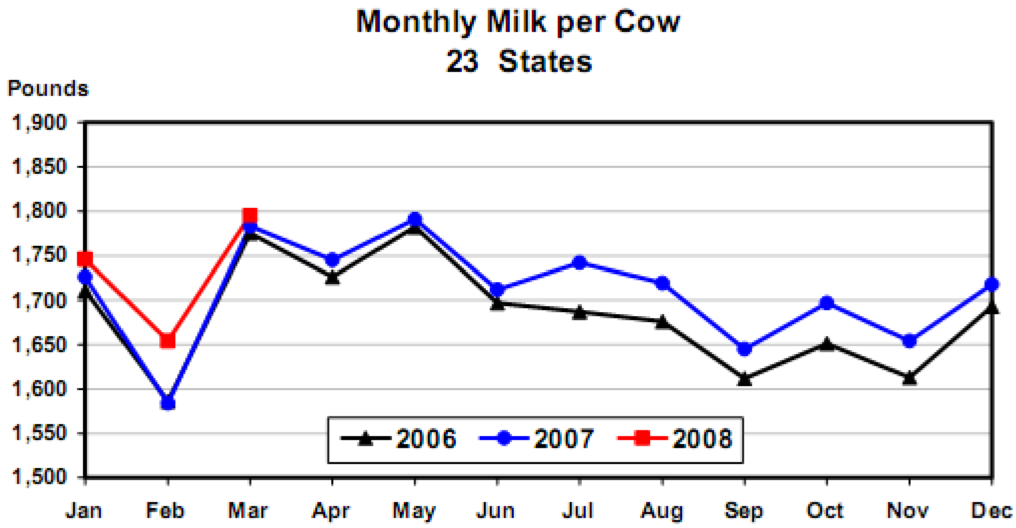
- Livestock, Dairy, & Poultry Outlook Report: USDA's monthly look at domestic ag industries includes a positive outlook for dairy. Milk production in 2008 is expected to increase, but by the smallest amount in 3 years. Output per cow is forecast to be up less than 1% on a per day basis, due to higher feed costs and 2% fewer hay acres, while commercial use of dairy products is expected to rise 3% above 2007. Exports have helped boost demand, with both cheese and butter shipments much higher than a year ago. As a result, USDA has increased their forecast for milk and cheese prices. They write that cheese prices could move substantially higher as supplies remain tight. In 2007, cheese averaged $1.738/lb, but USDA expects cheese to average between $1.775 and $1.825 per pound in 2008.
- Cash Market: Both blocks and barrels posted impressive gains this week, despite heavy milk production and a weak process market. Blocks jumped 7¢ to settle at $1.90½/lb, while barrels increased 9¢ to settle at $1.84/lb. Clearly there are more barrels around than blocks as barrel buyers needed to pick up 17 loads to keep the spread within reason, while block bidders came up empty. Butter was up just ¼¢ to $1.39¼/lb on 2 trades for the week.
- Weekly cold storage holdings numbers are showing a 3% drop in both butter and cheese stocks during the period 04/01 through 04/14. A net drawdown of 3.1 million lbs of cheese and 1.1 million lbs of butter is being reported for USDA selected storage centers.
- Butter stocks at CME-approved warehouses are now below last year's levels for the first time in 2008. 124.1 million lbs are on hand, compared to 124.6 million during the same period a year ago.
- Fluid Milk & Cream Review reports milk production in California is moderating, as base plans put in place by several processors take affect. There are reports of cows being sold so that producers can maintain base levels without penalties being imposed.
- Buyers from across the country are purchasing good volumes of butter for future needs much earlier in the year than normal, according to Dairy Market News. The reason most often given for the early buying is the large amount of butter currently being exported, and its potential impact on future domestic availability.
- Cheese is available in the West, but not in large offers, according to Dairy Market News. Regular buyers can find 1-2 leads easy enough, but anyone looking for 5-10 loads will probably come up empty. The market remains in close balance, as it has for much of the winter.

Futures Month	Friday 04/18 Close	Friday 04/11 Close	Change	5-yr Average	Top 3rd Price
Apr-08	$16.74	$16.70	$0.04	$14.14	$15.36
May-08	$17.78	$17.20	$0.58	$14.50	$15.85
Jun-08	$18.55	$18.12	$0.43	$14.54	$15.63
Jul-08	$19.33	$19.05	$0.28	$14.66	$15.57
Aug-08	$19.62	$19.39	$0.23	$14.47	$15.40
Sep-08	$19.77	$19.55	$0.22	$15.14	$16.02
Oct-08	$19.47	$19.16	$0.31	$14.78	$15.58
Nov-08	$19.51	$19.20	$0.31	$14.75	$15.73
Dec-08	$19.45	$19.20	$0.25	$15.09	$16.18
Jan-09	$19.40	$19.20	$0.20	$14.40	$15.24
Feb-09	$19.14	$19.05	$0.09	$14.00	$14.69
Mar-09	$19.05	$18.80	$0.25	$12.78	$13.50
Apr-09	$18.90	$18.61	$0.29	$14.14	$15.36
May-09	$18.85	$18.50	$0.35	$14.50	$15.85
Jun-09	$18.86	$18.53	$0.33	$14.54	$15.63
Jul-09	$18.84	$18.56	$0.28	$14.66	$15.57
Aug-09	$18.90	$18.60	$0.30	$14.47	$15.40
Sep-09	$18.97	$18.71	$0.26	$15.14	$16.02
Oct-09	$18.67	$18.55	$0.12	$14.78	$15.58
Nov-09	$18.63	$18.54	$0.09	$14.75	$15.73
Dec-09	$18.66	$18.60	$0.06	$15.09	$16.18
Apr-Dec	$18.91	$18.62	$0.29		
2009 Avg	$18.91	$18.69	$0.22		

Monthly Milk Production
23 States



What's Bearish:



- Milk Production Report: March milk production was up 2% in the U.S., according to USDA. Milk per cow increased 13 lbs and the milking herd was up 117,000 head from last March, and up 7,000 head from February. States with the biggest percentage gains were CO up 11.4%, TX up 10.1%, NM up 8.3% and ID up 8.2%. CA was up 2.4% and WI up 1.7%.
- Milk production is climbing seasonally in much of the Northeast, Mid-Atlantic and Southeast, according to Fluid Milk & Cream Review. Most butter/powder plants are very active in order to clear milk intakes, as well as milk coming from the Southwest. Northeastern plants are moving away from traditional spring heavy production patterns, perhaps due to falling discretionary consumer income levels negatively affecting overall sales and current production needs.
- Cheap milk and components from California and the Southwest are impacting prices and interest in the Midwest, according to Fluid Milk & Cream Review. Discounts on spot loads of milk are common, as most plants have about all the milk that they need to fill orders. Sales of many non-American cheese varieties are sluggish, limiting cheese maker interest in extra loads of milk.
- Most Class III components were lower in this week's NASS survey. 40-lb blocks averaged \$1.80/lb, up 0.3¢ from the previous week, but 500-lb barrels were \$1.78/lb, down 1.1¢. Butter increased 0.6¢ to average \$1.35/lb, but nonfat dry milk decreased 0.8¢ to \$1.24/lb and dry whey was 0.6¢ lower at 25¢/lb.
- Dairy cow slaughter for the week ending 04/05 was 51,000 head, 3,700 fewer than during the same period a year ago. After being slightly ahead of last year, the YTD dairy cow cull is now equal to year ago levels.
- Dairy Market News reports the Midwest cheese market is unsettled, with good interest for American varieties, but below average for process. Export interest for blocks is keeping offerings to a minimum, but most packaging operations are running on slow to fair schedules at best.

Recommendation:

After several weeks of wild increases, the markets took a breather this week with much calmer trade. The Apr-Dec '08 and 2009 contracts still posted solid gains for the week, and now both average \$18.91/cwt. Depending on where you think dry whey will be priced, that's roughly \$1.95/lb cheese from now until 2010! As we said last week, we think these prices are justified, we just did not expect them so soon. But, the market's job is to anticipate the future and that's exactly what it's doing. Just to recap the main bullish factors as we see it: 1.) Exports. Probably the most important one as they are allowing our milk production to grow without flooding the domestic market. 2.) Feed costs. Cost of production is way up and milk per cow is likely to suffer this year. Hay will be very tight as hay acres are swallowed by grain acres. 3.) Weak U.S. dollar. Fed is expected to lower interest rates one more time by ½% to kick-start our economy. 4.) Milk quotas in California will limit growth in milk output this year. 5.) Prices for dry whey and nonfat dry milk are rebounding. Near term, however, our herd size is still growing and production is up. As we approach peak production in the U.S., there is the very real possibility prices will correct, especially after the massive run-up we've made in the last month. We would target to buy PUT options to get a floor under your milk. Target the May 17.75 PUT at 25¢ and the June 18.00 PUT at 30¢. Continue to target the July-Oct 18.00 PUTs at an average price of 30¢. Last week these averaged 68¢, but this week they fell to 52¢.