

The KDM Dairy Report – August 29th, 2008

What's Bullish:

- Commercial Disappearance: Use of milk in all products in June was up 2% vs. last year, according to USDA figures released this week. A big boost came from butter use, which was up 19.2% and nonfat dry milk, up 21.8%. However, American cheese use fell 3% and use of other-than-American cheese was down 4.1%.
- The lower cheese prices in the CME cash market have spurred buyers into ordering to replenish stocks and for fall needs. Several varieties of cheese are now in tight supply due to the big boost in orders, and there's not enough age on the cheese to allow for proper cutting.
- Many manufacturers in the Northeast report that cheese demand in the foodservice sector has been more steady than retail. It's attributed to people squeezing in final vacations at the end of summer, and increased demand from schools and colleges resuming classes. Some cheese plants have asked customer to push delivery out slightly to accommodate heavy production demands.
- Current interest in extra manufacturing milk supplies in the Midwest exceeds the supply, according to Fluid Milk & Cream Review. Cheese manufacturing schedules were lighter this week due to slight reductions in milk receipts and increased calls for milk from bottlers. These bottlers will likely be more active over the holiday weekend to cover extra orders, while retailers may do additional promotions next week as a lower Class I mover takes affect in September.
- Hotter weather conditions in California and Arizona are taking a toll on milk production, according to Fluid Milk & Cream Review. Manufacturing plants are able to handle current milk receipts and some are running on reduced schedules. In the Pacific Northwest, many producers have taken cottonseed out of rations due to cost, and this is impacting production. Many have not yet covered their fall and winter hay needs, but some don't have the cash flow to do anything now and are hoping for lower prices.
- Central dry whey prices fell again slightly this week. However, they are very near the cost of production, so buyers are more interested making purchases, according to Dairy Market News. Their reasoning is that there is minimal downside risk from here. Inventories are getting in better balance.
- Dairy Market News reports Western butter is still coming out of storage to meet current needs, even with heavy production levels. Domestic demand is fair to good, but export interest was slower than earlier this summer.
- Weekly cold storage holdings indicate a strong 15% drawdown in butter stocks at USDA selected storage centers for the period 08/01 through 08/25.
- Dairy cow slaughter was above 50,000 head for the second week in a row. For the week ending 08/16, 51,400 head were culled, vs. 44,600 head during the same period a year ago.

Futures Month	Friday 08/29 Close	Friday 08/22 Close	Change
Aug-08	\$17.27	\$17.18	\$0.09
Sep-08	\$15.83	\$16.30	(\$0.47)
Oct-08	\$16.13	\$16.75	(\$0.62)
Nov-08	\$16.53	\$17.00	(\$0.47)
Dec-08	\$16.71	\$17.08	(\$0.37)
Jan-09	\$16.58	\$17.00	(\$0.42)
Feb-09	\$16.75	\$17.10	(\$0.35)
Mar-09	\$16.88	\$17.18	(\$0.30)
Apr-09	\$17.11	\$17.43	(\$0.32)
May-09	\$17.18	\$17.46	(\$0.28)
Jun-09	\$17.63	\$17.85	(\$0.22)
Jul-09	\$17.78	\$18.05	(\$0.27)
Aug-09	\$17.83	\$18.07	(\$0.24)
Sep-09	\$18.09	\$18.37	(\$0.28)
Oct-09	\$18.11	\$18.40	(\$0.29)
Nov-09	\$18.04	\$18.36	(\$0.32)
Dec-09	\$18.12	\$18.44	(\$0.32)
Aug-Dec	\$16.49	\$16.86	(\$0.37)
2009 Avg	\$17.51	\$17.81	(\$0.30)

What's Bearish:

- Cash Market: No dramatic price decreases this week, but they were nonetheless lower than a week ago. Blocks settled at \$1.70¼/lb today, down a penny from last Friday, and barrels closed at \$1.63¼/lb, off 3¢. Trading was very heavy with 44 loads of blocks and 40 barrels, representing 3.7 million lbs of cheese, exchanging hands. Butter was a ¼¢ higher for the week, settling at \$1.61¼/lb. 10 cars of butter traded.
- Milk production in the Eastern region in August was among the strongest in recent years, according to Fluid Milk & Cream Review. Cool weather and higher milk production in the Carolinas, Virginia, Georgia and Florida have helped reduce the number of loads shipped in to the region from 422 last year to only 213 this year.
- Central cream supplies are up and available for churning, according to Dairy Market News. Some butter producers indicated that they are getting offerings of cream from suppliers that they have not heard from all summer. Active churning through the upcoming holiday weekend is expected as operations take advantage of additional cream offerings. Food service orders are lighter as the end of the summer vacation season arrives.
- The Central nonfat dry milk market is weak, according to Dairy Market News. Interest is light and most producers have supplies available, while buyers appear to be working down inventory before reordering.
- Western nonfat dry milk buyers sense a weaker trend and are holding back on purchases, according to Dairy Market News. Few new export orders are being placed, while stocks are building.

- Dairy Market News reports western dry whey producers are seeing prices fall at a faster rate as they encounter more competition from other regions and overseas. Inventories are growing, while other dairy proteins are also a factor in the market weakness.
- While butter stocks were down, cheese stocks at USDA selected storage centers for the period 08/01 through 08/25 were up 3%, or 2.65 million lbs.
- Butter stocks at CME-approved warehouses fell only 472,000 lbs for the week ending 08/23, compared to a drawdown of 3.0 million lbs last year. While ending stocks are still below year-ago levels, it's the first time in months the weekly drawdown has been lower than the prior year.
- NASS surveyed cheese prices continued to fall in line with recent moves in the cash market. 40-lb blocks averaged \$1.83/lb, down 7.5¢ from last week, while barrels were down 3¢ to \$1.76/lb. Butter prices increased 3.1¢ to average \$1.63/lb and nonfat dry milk was up 3.6¢ to \$1.40/lb, but dry whey decreased 0.3¢ to average 24.3¢/lb.
- International: Western Europe milk production is often under allowable quota levels, but stocks of dairy end-products are available for both current and future needs, according to Dairy Market News. Prices are edging lower, so manufacturers are diverting milk towards the best return, cheese. Buying interest remains slow as summer holidays are still ending.
- International: Heavy rainfall in parts of New Zealand and Australia are getting the new milking season off to a strong start, according to an article in "The Southland Times". Dairy giant Fonterra is anticipating record milk production this season. With 90 new dairy conversions, milk production in New Zealand is expected to increase 9% this year. Money is also incentive for producers, as the payout is strong.

Recommendation:

A whopping 84 loads exchanged hands in this week's cash market, representing 3.7 million lbs of cheese. If USDA's weekly cheese updates are correct, it appears buyers are digging in here for awhile, content that \$1.70-ish is decent value. Sellers were equally committed to letting go of product, so we basically ended the battle in a stalemate. With little price movement in the cash market, futures were not given much direction, but sold off due to the premium futures are currently pricing in. Negatives we're concerned about are weak export interest and healthy precip in Oceania. We're hopeful that come September, export interest will improve, but if Oceania continues to get timely moisture, they will take export market share away from the USA, being much better positioned in proximity to Southeast Asia. Stay tuned as we monitor that situation. Next week the cheese battle will continue, and one thing we can say, is that dramatic moves may occur when one side runs out of bullets. Currently, Sep through Mar are trading under \$17/cwt. If that holds, we believe it could set up the last half of 2009 for some real upside. Our rec from last week remains unchanged: buy Oct-Dec 19.00 or 19.25 CALL options. Then enter orders to sell your milk at \$18.50 or higher in Q4. If you know you can make money at 2009 prices, you can sell, but you MUST buy call options to protect yourself from a rally.

Note: Our offices will be closed from noon on Friday through Monday, Sep 1st, in observance of Labor Day.

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