

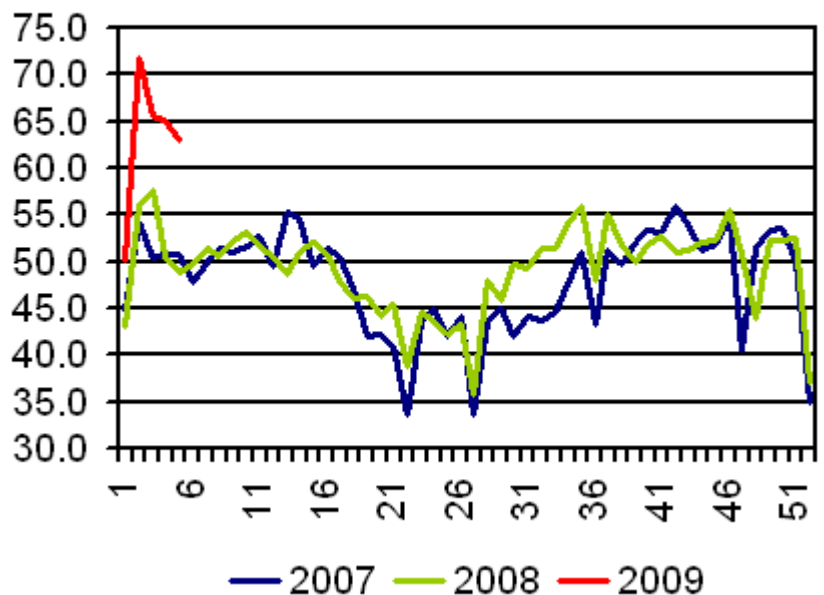
The KDM Dairy Report – February 13th, 2009

What's Bullish:

- Cash Market: Cheese continued its steady climb higher as blocks and barrels both gained 7¼¢ this week to settle at \$1.24/lb and \$1.23/lb respectively. 24 loads of blocks were purchased, mainly in the first half of the week, while only 4 barrels exchanged hands. Butter remained locked at \$1.10¼/lb, unchanged for the week, with only 1 trade.
- Weekly cold storage numbers are indicating good cheese demand so far in February. Over the first nine days of the month, cheese holdings are down just over 1 million lbs at USDA selected storage centers.
- Dairy cow slaughter for the week ending 01/31 was still strong. 63,000 head were culled compared to 48,800 during the same period a year ago. YTD, 59,500 more dairy cows have exited the herd than last year at this time. It appears feasible we could eliminate 300,000 head even without a CWT herd retirement program, if milk prices stay low enough the first half of the year.
- Manufacturing milk interest in the Central region has improved, and supplies have tightened, according to Fluid Milk & Cream Review. A few handlers are having problems sourcing extra volumes, as improvement in cheese prices and a resurgence in orders has buyers more interested in purchasing extra milk supplies than in selling.
- The cheese market in the Midwest is showing signs of strength, as packagers and processors are working overtime to fill orders, according to Dairy Market News. Retail demand for cheese is good for this time of year as promotions help keep product moving. Current cheese offerings have tightened and good seasonal interest is noted in barrels.
- As Western cheese buyers have watched prices move up, they have become much more aggressive in looking for additional cheese supplies, according to Dairy Market News. Now they want to make purchases before prices move any higher. Some new orders are being delayed as offerings are not sufficient to meet all of the current interest. Under grade cheese is clearing easily, and at higher prices. Some are questioning how long this firming market will last, but in the short run, it appears buyers want more cheese.
- Western dry whey prices were steady to higher this week, as less discounting was noted, according to Dairy Market News. Inventories are in much better shape than a few weeks ago, with contacts noting some strength in the market.
- December fluid milk sales were up 1.3% compared to last December, according to USDA.
- Hearing reports that interest in dry whey and nonfat dry milk have picked up. Previous end users, who had abandoned their use when prices got too high, are now reformulating to begin using them again in their products.

Futures Month	Friday 02/13 Close	Friday 02/06 Close	Change
Feb-09	\$9.27	\$9.26	\$0.01
Mar-09	\$10.44	\$10.20	\$0.24
Apr-09	\$10.65	\$10.90	(\$0.25)
May-09	\$11.25	\$11.37	(\$0.12)
Jun-09	\$11.85	\$12.07	(\$0.22)
Jul-09	\$12.81	\$12.85	(\$0.04)
Aug-09	\$13.58	\$13.52	\$0.06
Sep-09	\$14.13	\$14.04	\$0.09
Oct-09	\$14.16	\$14.14	\$0.02
Nov-09	\$14.54	\$14.35	\$0.19
Dec-09	\$14.61	\$14.39	\$0.22
Jan-10	\$14.62	\$14.51	\$0.11
Feb-10	\$14.65	\$14.44	\$0.21
Mar-10	\$14.76	\$14.65	\$0.11
Apr-10	\$14.70	\$14.75	(\$0.05)
May-10	\$15.10	\$14.90	\$0.20
Jun-10	\$15.05	\$15.05	\$0.00
Feb-Dec	\$12.48	\$12.46	\$0.02
Q1Q2 2010	\$14.68	\$14.53	\$0.14

**Dairy Cow Slaughter -
by week**



What's Bearish:

- World Ag Supply & Demand Report: USDA revised their 2009 Class III milk price forecast lower, in response to weak demand and burdensome supplies. They now predict milk to average \$10.05/cwt, down 95¢/cwt from last month's forecast. USDA also pegged the all-milk price for 2009 at \$11.30/cwt, which if realized, would be a 30-year low.
- The hype of the much anticipated CWT press release turned out to exactly that, just hype. A specific number of cows, widely thought to be about 300,000, were expected to be part of the announcement, but it turned out to be much more vague. CWT members voted to fund the program another two years, contingent on getting 67% participation of the US milk supply, a goal they have not yet reached. The only real specifics in the announcement were changes to

the prior program, which include: bids which are accepted will agree to cease dairy production for one year, and that farmers who have already participated in a previous buyout, will be allowed to bid in the current program.

- Like other producers, several of our customers have been more aggressively culling. Two reported back this week that even with fewer cows, they are producing more milk than before.
- 40-lb blocks increased 1.3¢ to average \$1.10/lb in this week's NASS survey. However, all other Class III components fell. 500-lb barrels decreased 2¢ to average \$1.12/lb, butter was down a slight 0.1¢ to \$1.07/lb, nonfat dry milk lost 1¢ to 82¢/lb and dry whey decreased 0.5¢ to 15.3¢/lb.
- Milk volumes are increasing and plants are running on heavier schedules in much of the Eastern region, according to Fluid Milk & Cream Review. Though retail sales of fluid milk are strengthening, many plants are drying and churning heavily. Balancing plants in the Mid-Atlantic area are taking in large volumes of milk, and this situation is expected to continue into the immediate future. Churns are running 7-days a week, with some plants buying additional spot cream to increase butter production.
- Despite more aggressive culling and adjustments to feed rations, California processing plants are generally full and working hard to handle the available milk supply, according to Fluid Milk & Cream Review. In New Mexico and Arizona, milk production is several percentage points above year ago levels, and plants are running full.
- Western sourced butter is still moving to the government via the support program, according to Dairy Market News. 454,997 lbs moved there during the week, bringing the YTD total to 4.1 million lbs. Churning remains very active across the country, with excess clearing to inventory. Retail sales have been good, but food service accounts are in worse shape, due to the economy.
- Dairy Market News reports that nonfat dry milk prices drifted below the support price of 80¢ this week. Producers not wanting to sell to the government are trying to find a pricing level that will secure interest. There is a general lack of buying interest from either domestic or export accounts. Buyers appear confident that prices will remain around current levels and see no need to hold stocks.
- US dairy exports fell for the fourth straight month in December, according to Wednesday's Daily Dairy Report. Quoting USDA Foreign Ag Service data, December export sales totaled \$205 million, down 34% from a the December 2007.
- Economy: The U.S. House of Representatives approved a \$787 billion stimulus plan. While still needing approval by the Senate, many economists think it's too little, too late and will not do much good in 2009. In addition, many pork-barrel pet projects were slipped in by lawmakers, including \$8 billion for a high speed, magnetic-levitation rail line between Disneyland in California, and Las Vegas, \$600 million to pay for a fuel-efficient federal auto fleet, \$300 million for "green" golf carts for government workers and \$150 million for honeybee insurance. The bill is over 1,500 pages long.

Recommendation:

Cheese buyers kept up the pressure this week as they aggressively pushed the spot market higher. However, the Apr-Jul contracts finished lower for the week, an ominous sign. In the short term, it appears cheese demand is strong and current cheddar supplies are tightening. That gives buyers on the cash market even more confidence to keep bidding. But whether this new buy interest lasts another week or three, let's not kid ourselves into thinking that our supply problem is fixed and that prices can now continue to rally from now through the end of the year. Milk production is high and despite heavy culling, is still growing (see bullet about more production from fewer cows above). Producers have not even received their first truly bad milk check, being that Dec settled at \$15.28. Hopes that CWT would announce a large and sudden herd retirement are dashed at this point, deflating expectations of a quick recovery. Take advantage of the current rally in cheese. Should buyers hang in there for another week or two, we could see some short-covering rallies develop. The Apr-Jul contracts remain the most vulnerable due to the simple fact we can get rid of cows only so fast. We would target to sell Apr above 11.00 to 11.25, May above 11.50, Jun above 12.25 and July over 13.00.

Note: There will be no trading on Monday for Presidents' Day. Our offices will reopen on Tuesday.

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