

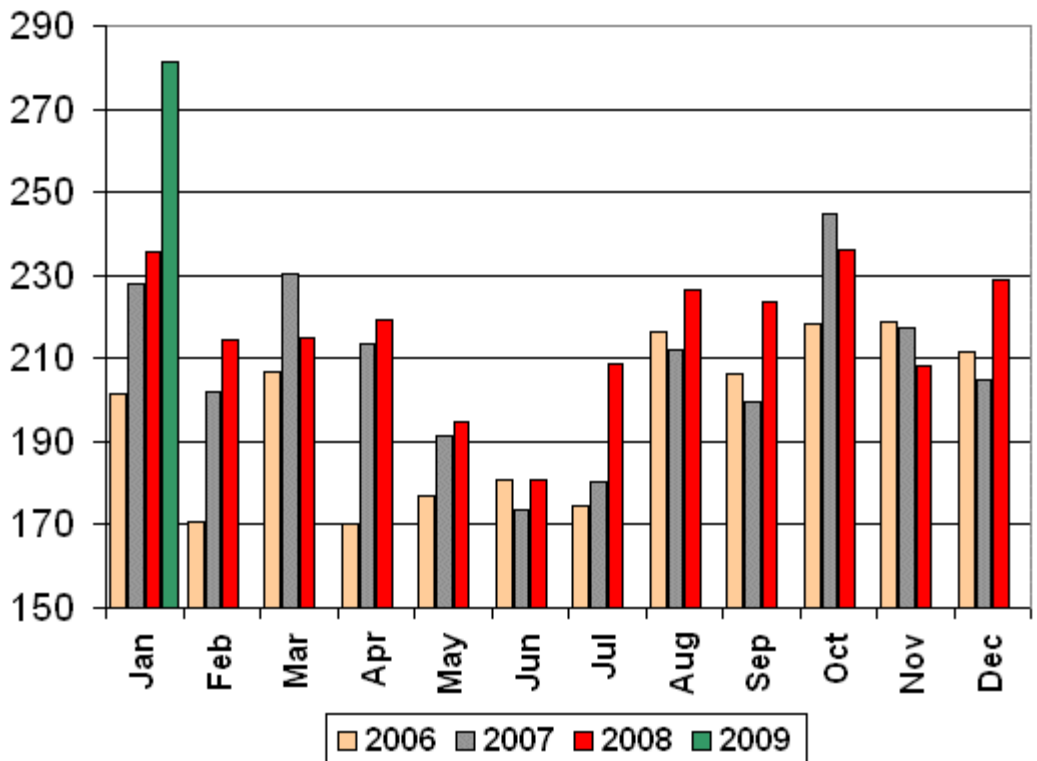
The KDM Dairy Report – February 20th, 2009

What's Bullish:

- Cash Market: Buyers were aggressive again this week, and sellers responded. 36 loads of blocks and 14 barrels exchanged hands during the week. Still, buyers managed to move the price up 7¢ for blocks, which settled at \$1.31/lb today. Barrels moved 4¢ higher to \$1.27/lb. Nothing happened at all with butter, which again settled unchanged at \$1.10¼/lb.
- Milk Production Report: Milk output in Jan was up only 0.8% compared to a year ago, the smallest increase in 22 months. In addition, cow numbers decreased 14,000 head from the prior month. Of note, CA production declined 1.4% and cow numbers were down 7,000 head from a year ago, their first decline since 1987. Wisconsin output was up 1% on 5,000 more cows and a 10 lb milk per cow increase. Largest milk production gains were seen in TX up 13%, KS up 10.6%, and NM and CO both up 5.5%.
- Livestock Slaughter Report: January dairy cow slaughter totaled 281,100 head, up 45,400 head from a year ago, a strong 19.3% increase, and the biggest monthly cull since January, 1997 (see chart), when 295,400 were beefed.
- Dairy cow slaughter for the week ending 02/07 was strong again. 61,500 head were culled, compared to 49,800 during the same period last year.
- Prices for most Class III components were higher this week, after many weeks of moving lower. 40-lb blocks averaged \$1.13/lb, up 2.7¢, while 500-lb barrels increased 2.8¢ to \$1.15/lb. Butter gained 0.9¢ to average \$1.08/lb and dry whey was up 0.2¢ to 15.6¢/lb, but nonfat dry milk lost 0.2¢ to average 82¢/lb.
- Weekly cold storage stats for the period 02/01 through 02/16 continue to reflect a pull on cheese stocks. Inventory in storage fell 4.6 million lbs, or 4%, at USDA selected storage centers. Butter stocks, however, increased 30%.
- International: Record setting temps in both Australia and New Zealand have the potential to accelerate declines in milk production, according to Dairy Market News. Production estimates continue to be adjusted lower as more producers contemplate drying off their animals earlier, and cheese output is lower as milk production has declined.. Buyer interest has picked up as the feeling that prices are at or near the bottom. Suppliers indicate prices may start to move up, if stocks continue to clear at current rates.

Futures Month	Friday 02/20 Close	Friday 02/13 Close	Change
Feb-09	\$9.28	\$9.27	\$0.01
Mar-09	\$10.40	\$10.44	(\$0.04)
Apr-09	\$10.48	\$10.65	(\$0.17)
May-09	\$10.94	\$11.25	(\$0.31)
Jun-09	\$11.58	\$11.85	(\$0.27)
Jul-09	\$12.63	\$12.81	(\$0.18)
Aug-09	\$13.40	\$13.58	(\$0.18)
Sep-09	\$13.96	\$14.13	(\$0.17)
Oct-09	\$14.10	\$14.16	(\$0.06)
Nov-09	\$14.50	\$14.54	(\$0.04)
Dec-09	\$14.46	\$14.61	(\$0.15)
Jan-10	\$14.63	\$14.62	\$0.01
Feb-10	\$14.62	\$14.65	(\$0.03)
Mar-10	\$14.79	\$14.76	\$0.03
Apr-10	\$14.75	\$14.70	\$0.05
May-10	\$14.85	\$15.10	(\$0.25)
Jun-10	\$14.80	\$15.05	(\$0.25)
Feb-Dec	\$12.34	\$12.48	(\$0.14)
Q1Q2 2010	\$14.68	\$14.68	\$0.00

Dairy Cow Slaughter (in 1000's)



- Fluid Milk & Cream Review reports sales in Florida are strong. The strength in sales resulted in 22 fewer loads of milk being shipped out of the state than last week. Demand for cream is beginning to increase, as manufacturers prepare for Easter and Passover week demand, as well as increasing ice cream production.
- Manufacturing milk interest in Wisconsin and Minnesota remains solid, according to Fluid Milk & Cream Review. Strong cheese orders have cleaned out the coolers and orders remain solid through month-end. Spot loads of milk are limited, with current demand exceeding supply.

- Processors in California are noting intake levels lower than a year ago, according to Fluid Milk & Cream Review. In New Mexico, milk production levels are flat, while culling cows and changing feed rations are being implemented to help control costs. In the Pacific Northwest, very little milk is moving around the region as heavier culling has milk production lower than anticipated. Some cheese plants are willing to take some additional milk because of excellent sales noted in the past few weeks.
- Both Central and Western dry whey prices are firming slightly, according to Dairy Market News. Deep discounts are no longer available since inventories are in much closer balance. Buying interest from both the overseas and domestic markets is improving.
- Northeast cheese makers report sales of lowfat cheese are "excellent", according to Dairy Market News. In addition, retail demand is up as favorable prices and retail promotion continue to move product off the shelves.
- Dairy Market News reports plant stocks of cheese are minimal in the Midwest, as orders have cleared extra volumes built up late last year. The market is firm, as recent price gains in the cash market are causing short term buyers to try to beat the next price increases by ordering now. Most processors and packagers have needed overtime to fill orders, which are committed through February. However, producers are concerned that March cheese commitments so far are limited.
- Western cheese buyers are aggressively looking for more cheese for immediate and future needs, according to Dairy Market News. They assume prices will continue to move higher, and want to beat daily and weekly average increases. Cheese stocks at the plant level are minimal, including under grade. End user demand is very good, with feature activity noted at both retail chains and restaurant chains.

What's Bearish:

- Cold Storage Report: American cheese stocks at the end of January were 9% higher than in 2008, according to USDA. Total cheese stocks were up 10%. Butter stocks were 5% lower than a year ago, but up 49% from Dec.
- Retail fluid milk sales in the Eastern region were described as "awful", according to Fluid Milk & Cream Review. Plants report "plenty" of milk to meet demand, despite lower intakes than a year ago. The slow fluid sales have diverted more milk into regional manufacturing, especially powder and cheese. Processing capacity is not yet max'd out, but is getting closer.
- Dairy Market News reports nonfat dry milk continues to be offered to the CCC under the support program. Prices remain weak and export shipments are slowing, as competitive offerings from other countries are below current pricing levels.
- International: Europe announced a second round of subsidy levels for some dairy products this week, with increases from 12-22% for milk powder, butter and butter oil. Stocks from last season are still available, and buyers are holding back until the most recent round of export subsidies are factored into lower prices.
- Economy: The stock market reacted unfavorably to the new stimulus plan and fears that the government would nationalize banks. The Dow hit a 6-year low at one point, and finished down 6.2% for the week.

Recommendation:

On the face of it, the report seems nearly bullish, but let's not get too excited. Cheese demand is hot and inventories are low as buyers sucked up what they could at these prices. However, we did settle the cash market lower than its mid-week high as sellers got more aggressive the last two days. And we never saw more than a day of short-covering rally as most contracts finished lower for the week, despite the rally in cheese. Our contacts tell us CWT did secure enough participation to obtain the funds they'll need for a large herd retirement, but the question remains, how quick can they get this done? Already we're hearing stories of 2-4 week waits our West at rendering plants. All this leads us to believe that trading will likely stay choppy in the near term. With the cash price now equal to about \$10.90, the Mar and Apr contracts are predicting cheese prices will drop, while May is at parity and Jun trades at a premium. Should cheese sellers get the upper hand next week, be prepared for another round of selling across the board. That does not mean, however, that we're recommending you sell the second half of 2009. We're encouraged by the dry whey market, which is showing signs of putting in a bottom, as whey futures have actually been climbing slightly. This week's production report shows that the trend is for milk output to head lower, and we think, at an increasing rate. In the next report or two, we could actually see a negative number. In addition, if milk prices stay this low until May or June, we believe it sets up the last half of the year for higher prices than we have out there today. Those with unsold milk in Q2 should consider buying at-the-money PUT options to protect your operation from prices falling further. Those with milk sold in the second half should continue slugging away at getting CALL options purchased to cover your upside. Second half prices have held fairly steady in both the ups and downs of the cash cheese market, so there is apparently a fair amount of support out there at these levels.

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