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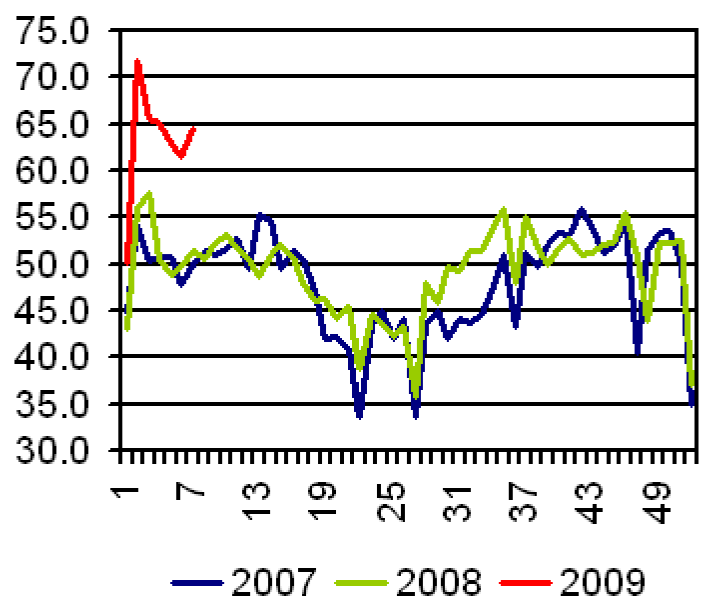
The KDM Dairy Report – February 27th, 2009

What's Bullish:

Futures Month	Friday 02/27 Close	Friday 02/20 Close	Change
Mar-09	$10.23	$10.40	($0.17)
Apr-09	$10.40	$10.48	($0.08)
May-09	$10.75	$10.94	($0.19)
Jun-09	$11.30	$11.58	($0.28)
Jul-09	$12.44	$12.63	($0.19)
Aug-09	$13.24	$13.40	($0.16)
Sep-09	$13.71	$13.96	($0.25)
Oct-09	$14.02	$14.10	($0.08)
Nov-09	$14.33	$14.50	($0.17)
Dec-09	$14.41	$14.46	($0.05)
Jan-10	$14.50	$14.63	($0.13)
Feb-10	$14.50	$14.62	($0.12)
Mar-10	$14.60	$14.79	($0.19)
Apr-10	$14.70	$14.75	($0.05)
May-10	$14.75	$14.85	($0.10)
Jun-10	$14.80	$14.80	$0.00
Mar-Dec	**$12.48**	**$12.65**	**($0.16)**
Q1Q2 2010	**$14.53**	**$14.68**	**($0.15)**

- Most Class III components were up again in this week's NASS survey. 40-lb blocks increased 3.9¢ to average $1.17/lb, while 500-lb barrels were up 5.2¢ to $1.20/lb. Butter gained 0.5¢ to average $1.08/lb and dry whey was up 0.4¢ to 15.9¢/lb, but nonfat dry milk lost 0.4¢ to average 81¢/lb.
- Cheese stocks at USDA selected storage centers were down 3% for the period 02/01 through 02/23. However, butter stocks were up 30%.
- Dairy cow slaughter numbers continue to be strong (see chart). 64,500 head were culled during the week ending 02/14, compared to 51,400 during the same period a year ago. YTD, the 2009 cull is 84,300 head above last year's.
- Manufacturing milk interest in the Midwest remains good, according to Fluid Milk & Cream Review. Availability of spot loads of milk is limited, with prices ranging from $0.75 to $1.50 over class.
- Dairy Market News reports churning in the country was lighter this week, as competition for cream picked up from other users such as ice cream can cream cheese plants. Retail butter sales are good due to decent feature activity.
- Western dry whey prices are slowly increasing, as sellers are in much better balance than they were a few weeks ago, according to Dairy Market News. New export sales are reported, with some buyers indicating that they are having trouble finding all the whey that they want. Tighter whey supplies in the West have brought a few extra sales to Central dry whey manufacturers, and reports of shortages on shipping containers have arisen.
- Dairy Market News reports both private label and mozzarella cheese demand remains particularly strong in the Eastern region. Promotions are helping move product, and while cheese output is very heavy, there continues to be strong demand for production.
- Barrel cheese is tight in the Midwest, according to Dairy Market News. Process orders have been good, especially from food service locations. Cheese production remains heavy, but plant inventories are generally limited. Some plants looking for extra milk to help fill orders are finding supplies limited.
- Dairy Market News reports some Western cheese buyers remain very aggressive in trying to buy more cheese for immediate needs. Retail store features are still in place, based on lower prices, and are moving very good volumes of cheese because of the promotions.

Dairy Cow Slaughter - by week

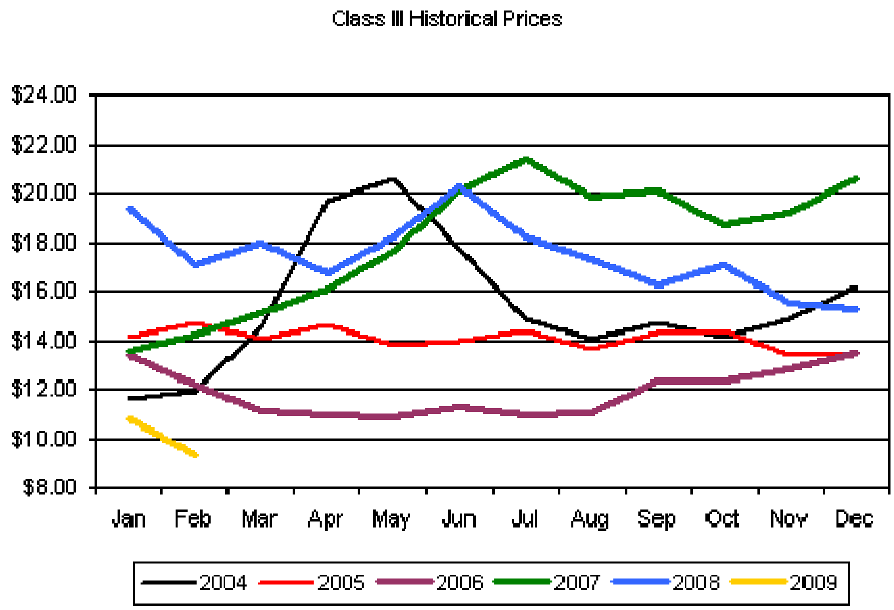


What's Bearish:

- Cash Market: Sellers took control of the spot market, letting go of a massive 71 loads of blocks and 25 barrels. Blocks fell 13½¢ in the process to settle at $1.17½/lb, while barrels lost 9¢ to close at $1.18/lb. After weeks of inactivity, spot butter woke up with bidders getting 16 cars, moving the price up 3½¢ to $1.15/lb.
- February Class III was announced today at $9.31, the lowest milk price in 70 months. The last month to close lower was March, 2003, which settled at $9.11.
- Milk production in the Eastern region of the country is exceeding demand, according to Fluid Milk & Cream Review. Plant intakes are heavy, and cows have responded to more favorable weather conditions. Retail milk sales are flat, forcing balancing plants to clear excess volumes. As they struggle to handle the milk supply, many are running on weekends.
- Most processing plants in the Southwest are running on extended schedules to handle local supplies, according to Fluid Milk & Cream Review. Despite some record heat in Arizona, heat abatement measures have been effective and production is not showing any signs of dropping.

- Nonfat dry milk demand remains slow for both domestic and export accounts, according to Dairy Market News. Prices remain around the support level of 80¢, while sales to the government support program continue. Inventories continue to be heavy.
- Economy: The U.S. economy contracted at a staggering 6.2% pace in the fourth-quarter of 2008, according to the Commerce Department. It's the worst the economy has performed in 26 years, as both consumers and businesses ratcheted back spending.
- International: For their 08/09 production season, YTD cheddar production in Australia is up 13% compared to a year ago, according to Dairy Australia.

Recommendation:



Cheese sales across the country appear to be strong, as retail promotions move product. Re-ordering for immediate needs perhaps gave us the bump up in cheese last week, and buying continues. However, sellers in the cash market overwhelmed buyers this week, many times leaving 20 to 25 loads on offer at the close. It's remarkable that Mar-Jun did not fall further, considering the cash price works out to about $9.85 milk. Market behavior continues to defy logic, with some days seeing a gain in the cheese price and futures respond lower, while other days cheese would drop and futures would respond higher. For example, this morning futures were up double digits in the front months, only to be taken off their highs after the cheese trade. April traded as high as $1.60, before settling at $10.40. May got to $10.92 but finished at $1.75. It's once again difficult to predict near-term action. Bulls would point out that buyers took in 96 loads of blocks and barrels and were looking for more. During some spot cheese sessions, three to four different buyers were present, showing that multiple entities wanted cheese, while for most of the week there was really only one prominent seller. Even so, the bears would point out that with the amount of cheese coming to market, there appears to be little upside for cheese near term. We agree. With the cash price calculating back out to sub-$10 milk, Apr-July remain particularly vulnerable. We continue to recommend buying at-the-money PUT options for these months to protect your operation, especially in light of an economy that doesn't look to support a rebound in demand any time soon. Stay open the second half of the year on any unsold milk, and continue to work on purchasing CALL options to protect sold positions.