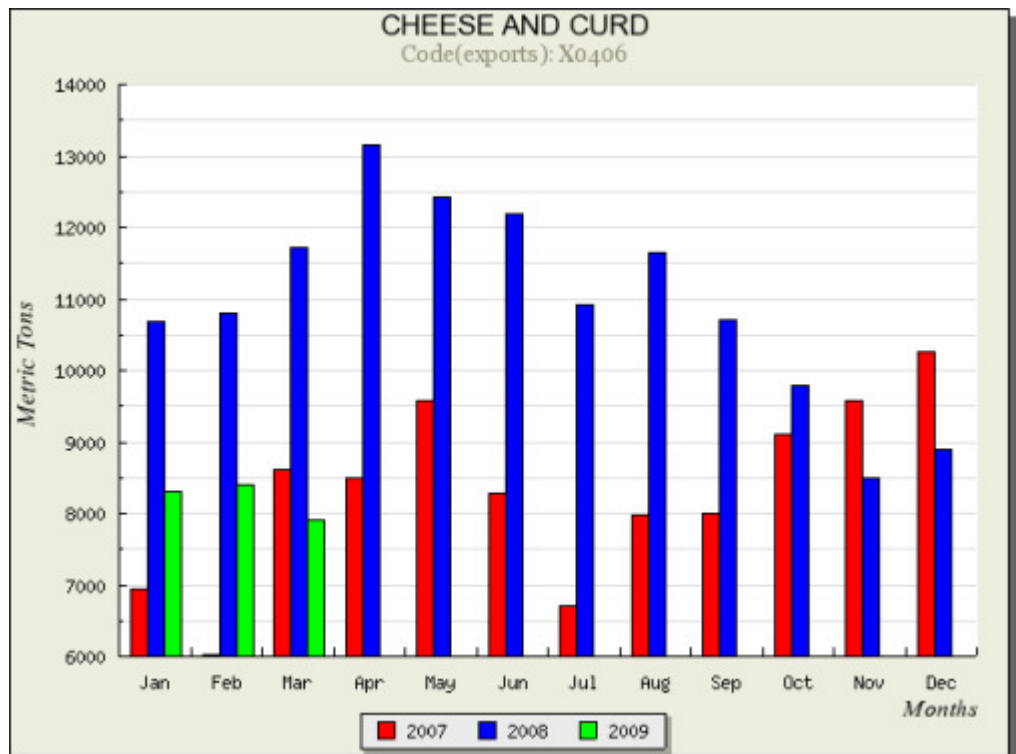


The KDM Dairy Report – May 15th, 2009

What's Bullish:

- On Wednesday, CWT announced it would remove 103,000 cows in their largest-ever herd retirement program, representing 2 billion lbs of milk production. They also promised that this would be the first in a series of herd retirements over the next 12 months.
- World Ag Supply & Demand Report: Milk production is expected to decline in 2010 as the sector responds to weak 2009 returns. Cow numbers are forecast to decline as well and commercial exports are expected to increase as the world economy improves. As a result, USDA predicts firmer butter, cheese, whey and Class III prices in 2010. Class III is forecast to average \$14.30/cwt in 2010, up from \$10.80 in 2009.
- For the first 11 days of May, both cheese and butter stocks declined at USDA selected storage centers. Cheese stocks fell 1%, or 971,000 lbs, while butter stocks dropped 2%, or 451,000 lbs.
- NASS powder and butter prices continued climb higher this week. Butter averaged \$1.20/lb, up 0.6¢ from last week, nonfat dry milk increased 0.4¢ to 83¢/lb and dry whey jumped 1.7¢ to 23¢/lb.
- Milk output in California continues to lag behind last year, according to Fluid Milk & Cream Review. Cow numbers and production per cow are down, and a number of contacts believe that several producers will be exiting in the near future due to continued financial stress. 100 degree heat is expected in the Central Valley by the weekend.
- Demand for Western dry whey is "excellent", according to Dairy Market News. Stocks are tight and any offerings are clearing very easily. Production has been lower than last year, while exports have been stronger, giving the market a firm undertone. Some Western buyers are resorting to Central suppliers to fill orders. The Foreign Ag Service reports exports of whey for Q1 were up 19% vs. 2008.
- Full and multiple loads of dry whey are hard to come by in the Eastern region, according to Dairy Market News. Buyers believe dry whey is being held by resellers who are waiting for prices to strengthen further before depleting holdings.
- Offerings of Western nonfat dry milk to the government price support program were the lightest they have been in quite a few weeks, according to Dairy Market News. Just 3.4 million lbs were offered during the week ending May 8th.
- The failure of New Frontier Bank of Greeley, CO has left many dairy owners struggling to find lines of credit. The bank financed nearly one in three Colorado dairy cows, forcing some dairies to sell cows and lay off workers to remain solvent.
- International: Milk production in Western Europe for the first two months of the year was off 3% from a year ago, according to Dairy Market News. Traders also indicate buyer interest is starting to improve due to limited stock with the international marketplace, and European prices becoming more competitive when combined with EU export subsidies.

| Futures Month | Friday 05/15 Close | Friday 05/08 Close | Change |
|---------------|--------------------|--------------------|----------|
| May-09 | \$9.83 | \$9.77 | \$0.06 |
| Jun-09 | \$10.32 | \$10.55 | (\$0.23) |
| Jul-09 | \$11.85 | \$11.90 | (\$0.05) |
| Aug-09 | \$13.29 | \$13.10 | \$0.19 |
| Sep-09 | \$14.15 | \$13.94 | \$0.21 |
| Oct-09 | \$14.72 | \$14.56 | \$0.16 |
| Nov-09 | \$14.91 | \$14.62 | \$0.29 |
| Dec-09 | \$14.99 | \$14.77 | \$0.22 |
| Jan-10 | \$15.11 | \$14.88 | \$0.23 |
| Feb-10 | \$15.05 | \$14.94 | \$0.11 |
| Mar-10 | \$15.36 | \$15.14 | \$0.22 |
| Apr-10 | \$15.57 | \$15.40 | \$0.17 |
| May-10 | \$15.67 | \$15.55 | \$0.12 |
| Jun-10 | \$15.86 | \$15.64 | \$0.22 |
| May-Dec | \$13.01 | \$12.90 | \$0.11 |
| Q1Q2 2010 | \$15.17 | \$14.99 | \$0.19 |



- International: Dairy market news reports stocks of finished dairy products in Oceania are in close balance with needs, and minimal, if any, stock is available for spot buyer interest.

What's Bearish:

- Cash Market: Block prices lost ½¢ from a week ago and settled at \$1.13¼/lb today in heavy trading. Barrels managed to gain 2½¢ to settle at \$1.08/lb. A total of 99 loads exchanged hands (58 blocks and 41 barrels) as sellers hit bids whenever they showed up. Butter increased 2½¢ for the week to close at \$1.26½/lb on just 8 trades.
- While butter and powder prices increased, NASS cheese prices continued to stumble. U.S. 40-lb blocks averaged \$1.18/lb, down 3.3¢ from last week, and 500-lb barrels lost 3¢ to average \$1.11/lb.
- Dairy cow slaughter for the week ending 05/02, while marginally above a year ago, was not particularly strong. Just 47,300 head were culled compared to 46,000 head a year ago. Producers were likely holding off prior to the completion of the CWT bid process.
- Milk production in much of the eastern region of the country is nearing peak levels, according to Fluid Milk & Cream Review. Production of Class II products is up from last year and sales of condensed skim, particularly for Class III cheese production, are reported as strong. Retail milk sales are expected to decline in the coming weeks as schools begin closing for summer. Manufacturing is described as having been "strong and constant" since the beginning of the year. Florida exported 213 loads of Grade A milk this week, up from 198 last week and 102 a year ago.
- Cheese milk interest in the Central region is slower, as weaker cheese prices and increased production of milk and cheese has buyers less interested in extra volumes. Fluid Milk & Cream Review also reports the increased milk volumes have plants operating on heavy seasonal schedules.
- Price weakness has not curbed cheese manufacturing in the Northeast, according to Dairy Market News. Plants report seasonally heavy manufacturing, and balancing plants continue to report that cheese plants are taking "lots of milk".
- Extra loads of barrels in the Midwest are being stored at freezing temperatures to extend the "current cheese" window, according to Dairy Market News. Many buyers are building inventory for later year use, and are able to acquire needed regular products under standard lead times.
- Offerings of Western cheese seem to be more frequent and of heavier volume this week, according to Dairy Market News. Demand is ok, but not aggressive, while cheese production is heavy seasonally. Exports are lighter and stocks are growing, with buyers looking for only 1-2 loads at a time.
- Butter and milkfat exports for the first quarter of 2009 were down 77% from the same period a year ago, according to the Foreign Ag Service. Exports of nonfat dry milk and skim milk powder were down 52%, cheese and curd exports were down 26% and cheddar exports fell 56% (see graph above).
- International: Annual milk production for the '08-09 season in New Zealand is predicted to be running 7.5% above last season, according to Dairy Market News. Australian output is forecast 2.2% higher. The cumulative figures are stronger than most had anticipated. Traders indicate sales activity out of Oceania is minimal, with no significant new business being reported.

Recommendation:

Wednesday's CWT announcement spurred a 60¢ rally in futures that was a classic sell the rumor, buy the fact play. Sure, it's good that 103,000 cows will be heading to slaughter, but that represents just a little over 2-weeks of our average weekly dairy cow cull. We get rid of nearly 50,000 head every week! In addition, it will take until early July for CWT to complete farm audits, and longer for all the cows to actually go to slaughter. As we stated before, it does nothing to help June, July and probably August. The most positive part of the announcement was the promise that there would be several more herd retirements planned over the next twelve months. With this week's announcement doing little to stimulate milk prices, the next buyout is likely to get good interest. The cash market remains in the firm grip of sellers. Buyers can't be blamed for stocking up on cheese near or below government support prices, but it was clear sellers were in complete control as buyers took on 99 loads of cheese and blocks still fell while barrels ticked only a little higher. June made a new contract low this week post CWT-selloff as traders took out premium these months were trading relative to cash cheese prices. On the positive side, butter and powder prices look downright bullish and could really help get things going in Q4 and into 2010, while export interest continues to improve. Hedgers should continue buying call options to protect milk sold in the deferred months, especially if near-term weakness brings option prices lower.

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