

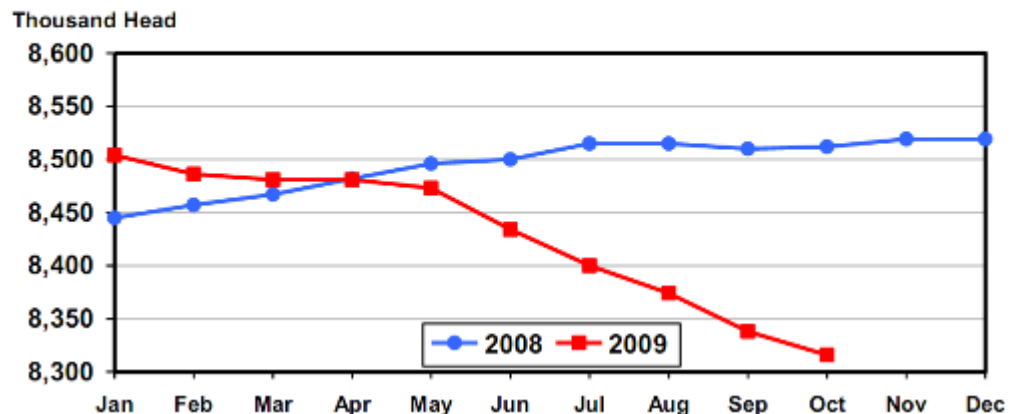
The KDM Dairy Report – Nov 20th, 2009

What's Bullish:

- Cash Market: Blocks up 2½¢ to \$1.60/lb and barrels up 5¾¢ to \$1.50/lb. Nonfat dry milk up 2¢ to \$1.40/lb and butter unchanged at \$1.52½/lb.
- Milk Production Report: U.S. milk production in October fell 1.1% from a year ago, the largest drop since March, 2004. Cow numbers fell 24,000 head from Sep and were 226,000 fewer than in Oct 2008. The largest decline was in AZ which fell 10.6% on 20,000 fewer cows. CO was down 8.9%, MO down 5.4% and CA down 5.3%. CA and MO were the only 2 of the top 23 milk producing states to show declines in milk-per-cow, while CA also shed 78,000 cows from 2008. Biggest production gains were seen in IN, up 4.4% and WI, up 3.5%.
- Livestock, Dairy & Poultry Outlook Report: "Rising world demand for dairy products and lower than expected milk production, both internationally and in the U.S., will lead to tightening stocks and rising milk prices for the remainder of 2009 and into 2010", according to USDA. Cow numbers are expected to continue to decline throughout 2010 as well, with the herd forecast to drop 2% in 2010. USDA predicts a strong rebound in 2010 for exports, especially for butter/powder. Improved economic recovery in Asia combined with lower-than-forecast milk production in Oceania for the basis for the robust forecast. Despite high levels of domestic cheese stocks, the improved demand outlook and prospect for less milk next year will tighten stocks in 2010, strengthening prices across the board. USDA now expects Class III to average \$15.40/cwt in 2010, up \$1.10/cwt from last month's forecast. Cheddar cheese is expected to average \$1.64½/lb, up from \$1.56/lb in last month's report.
- NASS survey numbers were mostly higher this week. 40-lb blocks averaged \$1.50/lb, up 3¢ from last week, while 500-lb barrels inched 0.8¢ higher to \$1.51/lb. Butter jumped 8.6¢ to average \$1.40/lb and dry whey increased 0.3¢ to 34.7¢/lb, but nonfat dry milk slipped 0.7¢ to average \$1.11/lb.
- Weekly cold storage numbers are showing a big butter drawdown. For the period 11/01 through 11/16, butter stocks at USDA selected storage centers fell by 20%. Cheese stocks were down as well, dropping 2%, or 3 million lbs.
- A net 5.6 million lbs of butter were pulled from CME-approved warehouses during the week ending 11/14, up from 4 million lbs in 2008. Stocks still on hand total 56 million lbs, closing in on the 42 million lbs in storage a year ago at this time.
- Dairy cow cull for the week ending 11/07 was a robust 52,700 head, up 500 head from a year ago. Through 45 weeks of 2009, total dairy cow cull is up 240,300 head vs. 2008.
- Milk supplies remain tight in the Northeast as demand for Class I, II and III are all strong in preparation for the upcoming holidays. Fluid Milk & Cream Review reports milk production is near its seasonal low for the region and demand has outpaced production.
- Processing plants in California expect no problems handling the milk supplies over the upcoming holiday weekend, according to Fluid Milk & Cream Review. In fact, milk and components are being brought into the state to help mitigate needs. Milk volumes in Arizona are reported as lower than needed and processors have been forced to reduce and rebalance production schedules around the incoming milk supply. Cream in the area is tight, with buyers looking for cream for manufacturing purposes from long distances.
- Dairy Market News reports tight cream supplies in the Northeast due to seasonal production declines. Plants continue to microfix inventories in order to fill holiday orders.

Futures Month	Class III 11/20 Close	Class III 11/13 Close	Change
Nov-09	\$14.06	\$14.05	\$0.01
Dec-09	\$14.72	\$14.41	\$0.31
Jan-10	\$14.86	\$14.55	\$0.31
Feb-10	\$14.95	\$14.67	\$0.28
Mar-10	\$15.24	\$14.89	\$0.35
Apr-10	\$15.50	\$15.20	\$0.30
May-10	\$15.67	\$15.40	\$0.27
Jun-10	\$15.79	\$15.50	\$0.29
Jul-10	\$16.02	\$15.72	\$0.30
Aug-10	\$16.05	\$15.75	\$0.30
Sep-10	\$16.03	\$15.78	\$0.25
Oct-10	\$15.90	\$15.68	\$0.22
Nov-10	\$15.85	\$15.72	\$0.13
Dec-10	\$15.86	\$15.69	\$0.17
2010	\$15.64	\$15.38	\$0.26

**Monthly Milk Cows
23 States**



- Dairy Market News reports cream supplies in the West have tightened to the point that cream is moving westward from the Central part of the country. Heavy promotional activity is clearing large volumes of print butter, and traders and handlers continue to report international buyer interest. Some handlers expect foreign interest to pick up even further in 2010.
- Central dry whey prices were higher this week, according to Dairy Market News. Though supplies are adequate to handle current contract commitments, interest from offshore buyers is active, and the limited availability of Western spot loads is helping move prices higher.
- Western whey powder prices continue to increase as buyers look for additional loads with limited success, according to Dairy Market News. Export sales continue while most cheese plants are not getting as much milk as they anticipated.
- Whey powder production in the East is limited and being utilized to fill current contracts, according to Dairy Market News. Some whey powder users unable to secure adequate supplies in the East are buying spot loads from the Midwest.
- Northeast cheese production continues to be limited by strong Class I demand and milk production declines, according to Dairy Market News. Due to the tight fluid supplies, some cheese makers have modified their production schedules to include weekends, when milk supplies are more readily available.
- Western cheddar blocks are in a much tighter position than barrels, according to Dairy Market News. Some operations have decided to move additional milk into cheese production, but others are doing the opposite and moving milk out of cheese and towards butter/powder production. Mozzarella interest is better than anticipated.
- International: The Foreign Ag Service reported Jan-Sep 2009 exports of butter totaled 31.7 million lbs, an 81% increase vs. 2008.

What's Bearish:

- Cold Storage Report: Total butter stocks at the end of October were 31% higher than a year ago, according to USDA. American cheese stocks were 7% higher and total cheese stocks 17% higher.
- Livestock Slaughter Report: October dairy cow slaughter totaled 226,800 head, which was 9,400 head fewer than in Oct, 2008. However, Jan-Oct, the cull is still ahead 161,000 head, or 7.5%.
- Fluid Milk & Cream Review reports milk volumes and components in the Midwest are starting to increase seasonally. Bottlers appear to have little difficulty in getting extra loads if needed and increased volumes of milk and cream are expected to backup into manufacturing plants during the long holiday weekend due to schools letting out. Some excess upper-Midwest cream was hauled to California to supplement regional supplies.
- Many Midwest cheese makers have stockpiled finished product in recent weeks, according to Dairy Market News. Current interest is fairly good, but supplies of most regular varieties are adequate. Process movement is steady to lighter, with little overtime necessary, while barrels remain available from producers. Components have rebounded and are generating good cheese yields.
- International: According to the Foreign Ag Service, Jan-Sep 2009 cheese and curd exports totaled 170.6 million lbs, down 26% from 2008. That works out to a weekly decline of 1.5 million lbs.

Recommendation:

Buyers of cheese earlier this summer, when prices were in the \$1.1x/lb levels, may have been some of the smartest folks out there. While we had another dull, "bearish" Cold Storage Report showing how much excess inventory is sitting in warehouses, we find block cheese in the spot market making a new annual high at \$1.60/lb and several 2010 contracts making new highs over \$16/cwt. Could it be that these buyers anticipated what is growing to be a realization, that we may very well have tight milk supplies in 2010? If so, it was then very shrewd of them to get their coverage while they could, and one must almost write-off the "bearishness" of the Cold Storage Report. The week certainly didn't start off so bright, with both block and barrel offers in the spot market at unchanged levels encouraging further selling. But today, bidders took blocks to a new high for the year and barrels reluctantly followed. This resulted in a huge short-covering rally that ended with both Dec & Jan up 50+ for the day and early week losses erased in every month. USDA seems to be making an about-face as well in their long-term predictions. We don't normally put a lot of stock into the Livestock, Dairy & Poultry Outlook Report, but their bullish view on exports for 2010 is matching some reports we're hearing in the biz, with definite butter exports already happening. We've said it before, the damage to the U.S. milk supply has been done; add to that an improving export outlook and we could see some high prices out in 2010 and beyond. Before one is tempted to declare "Happy days are here again", we would point out that the U.S. economy is still a weak point. If holiday dairy product sales are less than robust, we may very well see a post-holiday correction, followed by a recovery. Prices look likely to move higher in the holiday-shortened week ahead. Focus on PUT option protection for Q1, and if you sold milk based on prior recommendations, get CALL options purchased to protect those positions.

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