

The KDM Dairy Report – May 7th, 2010

What's Bullish:

- Dairy cow slaughter for the week ending 04/24 totaled 54,000 head, up 3,900 head from a year ago. Culling remains aggressive as beef prices remain firm.
- NASS butter and powder prices increased in this week's survey. Butter jumped 3.4 cents to average \$1.55/lb, nonfat dry milk increased 4 cents to \$1.22/lb and dry whey inched 0.5 cents higher to average 35.7 cents/lb.
- Current milk output in California is being helped by new crop hay and green chop being fed to cows, but economic conditions and low milk prices are keeping a damper on growth, according to Fluid Milk & Cream Review. Plants are easily handling the milk supply. In Arizona, the peak is now past and the cream market is firm. Cream supplies are tightening while demand has been strong from butter operations. Tighter tanker availability and higher freight costs are both noted.
- Dairy Market News reports butter manufacturers continue to churn additional volumes and hold inventory with confidence. Most indicate they are able to procure their desired cream levels, but anticipate supplies will tighten in the near future as Class II demand improves. Butter stocks are lower than desired for this time of season, while food service orders have improved.
- With a tight international butter supply, Western manufacturers are busy using additional cream supplies to build inventory, according to Dairy Market News. Supplies continue to lag year ago levels and extra product is welcomed for use later in the year.
- Central dry whey demand was stronger this week, as various buyers who ship to China pressed for earlier shipping dates, according to Dairy Market News. Product is available to on the spot market, but somewhat short of meeting current contract needs.
- Dairy Market News reports Western nonfat dry milk prices were higher in a firm market. The most recent Global Dairy Trading auction held prices steady, which

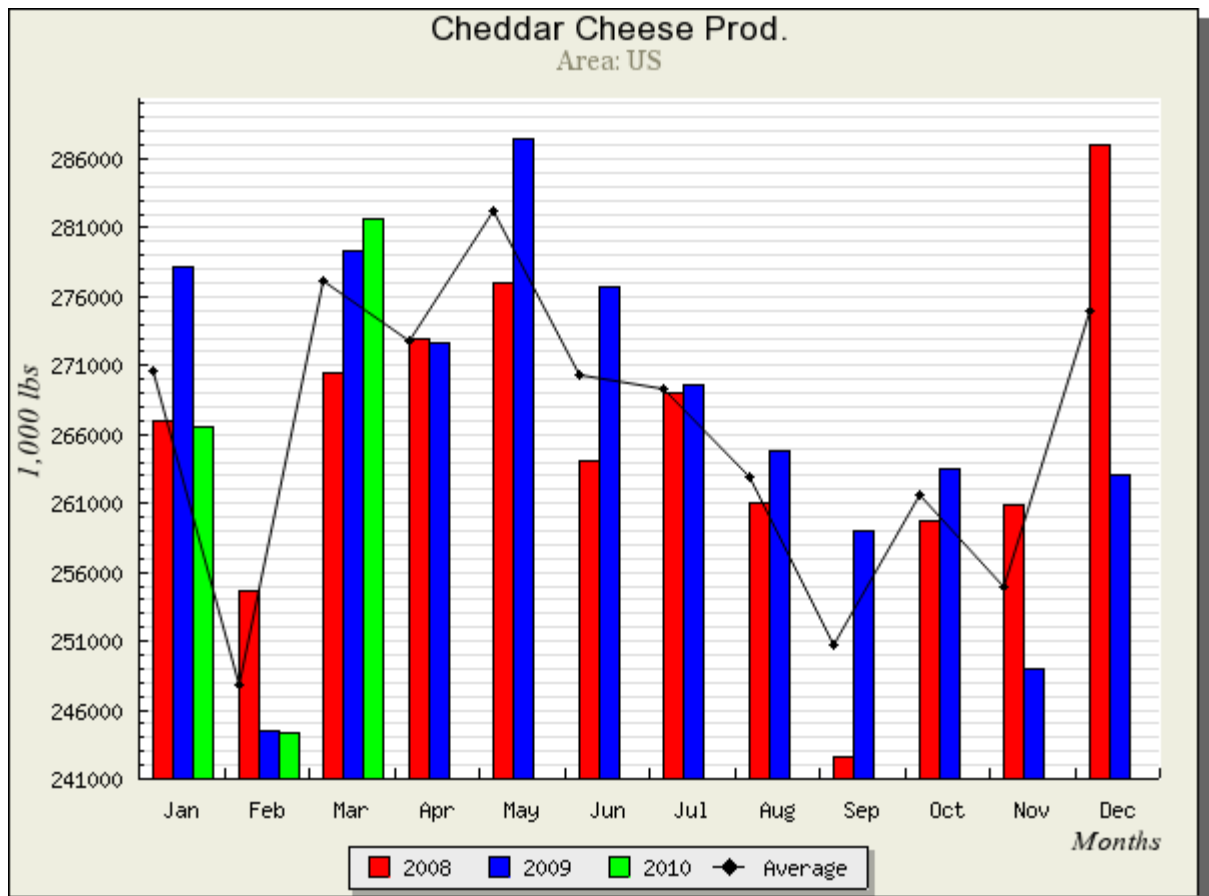
Futures Month	Class III 05/07 Close	Class III 04/30 Close	Change
May-10	\$13.24	\$13.38	(\$0.14)
Jun-10	\$13.64	\$13.99	(\$0.35)
Jul-10	\$14.37	\$14.55	(\$0.18)
Aug-10	\$15.15	\$15.05	\$0.10
Sep-10	\$15.35	\$15.15	\$0.20
Oct-10	\$15.15	\$15.04	\$0.11
Nov-10	\$15.17	\$15.00	\$0.17
Dec-10	\$15.01	\$14.80	\$0.21
2010	\$14.64	\$14.62	\$0.02
Jan-11	\$14.75	\$14.58	\$0.17
Feb-11	\$14.80	\$14.50	\$0.30
Mar-11	\$14.79	\$14.65	\$0.14
Apr-11	\$14.70	\$14.56	\$0.14
May-11	\$14.80	\$14.65	\$0.15
Jun-11	\$14.70	\$14.61	\$0.09
Jul-11	\$14.76	\$14.76	\$0.00
Aug-11	\$14.72	\$14.69	\$0.03
Sep-11	\$14.88	\$14.88	\$0.00
Oct-11	\$14.98	\$14.98	\$0.00
Nov-11	\$15.10	\$15.10	\$0.00
Dec-11	\$15.10	\$15.10	\$0.00
2011	\$14.84	\$14.76	\$0.09

are well above U.S. prices. Domestic demand is fair, but export demand is good and committing more powder at higher prices.

- Economy: A burst of hiring in April added 290,000 new jobs, the highest monthly total in four years.

What's Bearish:

- Cash Market: Cheese prices slipped lower this week. Blocks and barrels both gave up ¾¢ to settle at \$1.38/lb and \$1.37¼/lb respectively. Butter fell six



cents on Wednesday, but rallied back to \$1.60½/lb, down 1½¢ for the week. Trading was light with 8 loads of blocks, 10 barrels and 8 cars of butter exchanging hands. Grade A nonfat dry milk jumped 2¾¢ on 6 trades to settle at \$1.32¾/lb.

- Dairy Products Report: Cheddar cheese output in March was up 0.9% compared to last March (see chart), and adjusted on a daily basis, up 4% from Feb. Total cheese output was up 2.3% vs. a year ago, but butter output fell 4.3% over the same period.
- Butter stocks at CME-approved warehouses increased 2.7 million lbs for the week ending 05/01, compared to a 1.1 million lb jump a year ago. Stocks on hand remain 20 million lbs below year ago levels, however.
- NASS cheese prices fell in this week's survey. 40-lb blocks declined 1.3 cents to average \$1.43/lb and 500-lb barrels slipped 2.7 cents to \$1.39/lb.
- Milk production in the Northeast continues to increase as the flush strengthens, according to Fluid Milk & Cream Review. Class I bottlers are pushing milk back, which is adding to the already heavy manufacturing milk supplies. Dryers continue to run on heavy schedules to help clear the surplus milk. Manufacturing milk supplies are heavy and auxiliary cheese plants continue to be operated in order to assist with handling the supply. Class I sales are flat and cream supplies are fairly tight. Florida exported 203 loads of Grade A milk this week, up 3 from last week.
- Manufacturer in most upper-tier states are running on schedules heavier than a year ago, according to Fluid Milk & Cream Review. Milk intakes continue to rise, while some collegiate schools are coming to a close, reducing fluid demand.
- Western dry whey supplies are growing as spring flush adds to available milk supplies, according to Dairy Market News. Stocks are above year ago levels and prices were steady to weak.
- Cheese supplies are ample in the Midwest, according to Dairy Market News. While the pull for milk is strongest from butter/powder, most plant capacity in the Midwest is geared to cheese production, with plants running on heavy schedules. For this reason, many traders feel cheese prices will remain under pressure in the near term.
- Western cheese prices are steady to weak, according to Dairy Market News. Cheese plants are operating on heavy schedules as milk supplies continue to increase. Buyers are cautious about making purchases at higher asking prices.
- Dairy Market News reports cheese production is building in most parts of the country as the milk flow peaks. Stocks are often heavier than last year at this time and some cheese makers are trying to limit new production.
- Economy: Concern over Greek debt and contagion to other Euro-zone countries resulted in a multi-year high for the dollar vs. the euro. On Thursday, that concern spilled into the stock market, where all of 2010's gains were erased. The stronger USD will make exports more expensive and could hurt the dairy sector.

Recommendation:

For most of the week, Class III futures were sold off as each day in the cash market saw cheese prices slip. As we expected, June, which was carrying a \$1 premium to the cash price last Friday, had much of that removed during the week, with a low of \$13.30 put in today. However, the markets are sending mixed signals as today futures were solidly higher across the board. We think this is another opportunity to sell June. Scale in your selling, starting at \$13.85, which is close to \$1.50 cheese. We hit a high today of \$13.75. With most milk output in the Midwest headed to the vat, the cheese supply will likely stay high for the foreseeable future. If cheese prices fail to go higher next week, June will head right back down, and fast. Current cheese prices work out to about \$12.75 milk. Get it done! For that matter, we'd lightly sell July at \$14.75 or higher, with the idea to buy it back at some point to pull the profit from the hedge. Beyond July we would focus on PUT options. Long-term fundamentals suggest exports are improving and that there will be a strong pull for butter/powder for quite some time. This week's Global Dairy Trade confirmed that last month's big jump in prices was no fluke, and reflects real world supply/demand. Every operation is different, so call us next week and we'll help you put a hedge plan together!

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