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The KDM Dairy Report – June 11th, 2010

What's Bullish:

Futures Month	Class III 06/11 Close	Class III 06/04 Close	Change	Dry Whey 06/11 Close	Dry Whey 06/04 Close	Change
Jun-10	$13.55	$13.50	$0.05	36.90¢	35.25¢	1.65¢
Jul-10	$13.48	$13.25	$0.23	34.50¢	33.00¢	1.50¢
Aug-10	$13.95	$13.86	$0.09	34.50¢	33.00¢	1.50¢
Sep-10	$14.56	$14.53	$0.03	34.00¢	33.50¢	0.50¢
Oct-10	$14.72	$14.65	$0.07	34.50¢	33.75¢	0.75¢
Nov-10	$14.75	$14.75	$0.00	33.50¢	33.25¢	0.25¢
Dec-10	$14.60	$14.71	($0.11)	33.08¢	33.00¢	0.08¢
2010	**$14.23**	**$14.18**	**$0.05**	**34.43¢**	**33.54¢**	**0.89¢**
Jan-11	$14.55	$14.64	($0.09)	32.03¢	32.03¢	0.00¢
Feb-11	$14.51	$14.60	($0.09)	29.58¢	30.50¢	(0.93¢)
Mar-11	$14.40	$14.67	($0.27)	28.05¢	29.00¢	(0.95¢)
Apr-11	$14.35	$14.56	($0.21)	27.00¢	27.05¢	(0.05¢)
May-11	$14.43	$14.53	($0.10)	25.03¢	26.00¢	(0.98¢)
Jun-11	$14.35	$14.52	($0.17)	24.58¢	24.78¢	(0.20¢)
Jul-11	$14.70	$14.70	$0.00	25.25¢	25.25¢	0.00¢
Aug-11	$14.66	$14.66	$0.00	26.03¢	26.03¢	0.00¢
Sep-11	$14.80	$14.80	$0.00	27.50¢	27.50¢	0.00¢
Oct-11	$14.90	$14.95	($0.05)	28.00¢	28.00¢	0.00¢
Nov-11	$14.90	$14.90	$0.00	28.25¢	28.25¢	0.00¢
Dec-11	$15.00	$15.00	$0.00	28.50¢	28.50¢	0.00¢
2011	**$14.63**	**$14.71**	**($0.08)**	**27.48¢**	**27.74¢**	**(0.26¢)**

- World Ag Supply & Demand Report: USDA increased their Class III price projection for 2011 by 10¢ from last month, to $14.85/cwt. Though they also raised milk production projections, prices were increased based on higher than expected 2010 exports, and with generally light world supplies, the expectation that exports will remain strong in 2011.
- Most Class III components were higher in this week's NASS report. 40-lb blocks jumped 3.6¢ to average $1.47/lb while 500-lb barrels increased 2.5¢ to $1.48/lb. Butter gave up 4.3¢ to average $1.54/lb, but nonfat dry milk gained 1.5¢ to $1.30/lb and dry whey inched 0.2¢ higher to 37.2¢/lb.
- Cash Market: Spot butter prices increased 3½¢ on unfilled bids, settling at $1.61/lb.
- Cream has become very tight in the Eastern region, according to Fluid Milk & Cream Review. Availability was near zero early in the week as demand has increased from ice cream, cream cheese and butter producers.
- Fluid Milk & Cream Review reports in the Central region, some buyers have been unable to secure needed cream volumes. Ice cream manufacturers who did not build good pre-season inventory are likely in for a long, expensive summer, as prices are well above year-ago levels. Some cream is being shipped from California to the Midwest to supplement local supplies. Milk production is about normal in the region, but component levels, particularly butterfat tests, are lower than in recent years. Poorer feed quality from an immature corn crop in 2009 is cited as a likely cause.
- Cream supplies in the Northeast have tightened considerably since Memorial weekend, according to Dairy Market News. Increased Class II demand and slightly lower milk production have combined to limit supply, while butter makers continue to bid for cream as they want to build further inventories.
- Dairy Market News reports Central cream volumes are tightening as competition for available supply increases. Churning schedules are active, but some cream has been brought in from great distances to satisfy needs. Retail orders are slowly building again, following the holiday weekend.
- Western cream handlers believe prices and demand will continue to be firm into the near future. Dairy Market News reports good demand from ice cream makers, while butter stocks remain tight.
- Dairy Market News reports Western cheese stocks are higher than year ago levels but are manageable. Contracted supplies continue to move in an orderly fashion, though spot sales and exports are lower.
- The CWT program announced this week additional export assistance awards totaling 750 metric tons (1.65 million lbs) of cheddar cheese to the Middle East.

What's Bearish:

- Cash Market: Though things improved at the end of the week, blocks still gave up 2¾¢ for the week to settle at $1.37/lb. Barrels were also down 2¾¢ from last Friday, closing at $1.33/lb. Trading was active with 31 loads of blocks and 32 loads of barrels exchanging hands.
- Butter inventories at CME-approved warehouses increased by 7.9 million lbs for the week ending 06/05. The jump was likely aided by the holiday weekend, and was 5.2 million lbs higher than a year ago at this time.
- Fluid Milk & Cream Review reports production is at its peak in the Northeast and declining only slightly in the Mid-Atlantic. Manufacturing supplies of milk are still fairly heavy. Production in the Southeast is declining, but auxiliary cheese plants are still being utilized to handle excess milk. Florida exported 342 loads of Grade A milk this week, up from 334 last week and 244 a year ago. While milk output is falling, Class I demand is falling faster.
- Weather conditions continue to be favorable for milk production in California, while temps in the 100's are having little impact in Arizona. Fluid Milk & Cream Review reports misters and fans are running full force to keep the herd

comfortable. In the Pacific Northwest, pastures are in excellent condition and milk production remains above year-ago levels. Class I usage is lower due to the remainder of schools letting out for the summer.

- Dry whey prices are steady to weak across the country, according to Dairy Market News. Production continues at increased levels, while export demand has weakened due to a stronger U.S. dollar. Supplies are more than adequate to meet domestic demand.
- Western nonfat dry milk stocks are building and export sales are slower, according to Dairy Market News. The strength of the U.S. dollar has been part of the problem, with some contacts thinking the situation could get quite a bit worse.
- Though milk production is beginning to decline, most cheddar cheese makers in the Eastern region have more milk than they need, according to Dairy Market News. In the Midwest, heavy milk and cheese production is keeping the market under pressure. Interest is light and buyers are having little difficulty in acquiring needed supplies of standard varieties of cheese. Many cheese plants are having problems keeping supplies from accumulating.
- April fluid milk sales in the U.S. were down 1.6% compared to 2009, according to Dairy Market News.
- Economy: May retail sales fell 1.2% vs. an expectation of a 0.1% increase. It was the first decline in 8 months and indicates consumers may be pulling back on spending again.
- International: A late spurt in milk output at the end of the season in Australia has brought YTD output back even to last year. April production was up 2.7% compared to 2009. Substantial rainfall has helped bring water tables back to acceptable levels in drought-hit areas, increasing optimism for the start of the next season.

Recommendation:

Cream and butter remain the lone bright spot in the dairy complex. Cream is expected to remain tight for the foreseeable future, which has pushed spot butter prices 25¢/lb higher than cheese prices. Looking forward, November butter futures settled at $1.70/lb today. The question is, can butter keep cheese prices from falling? While the reward ratio for channeling milk into butter production is better than for cheese, the problem is that the areas of burgeoning milk production, the NE and Midwest, are geared more for cheese than butter output. The part of the country that produces most of the nation's butter, the Southwest, has about steady production. The current butter/cheese spread, then, may be with us for awhile. Anecdotal evidence from folks in the biz we talked to this week indicate cheese warehouses are full. Cheese was under pressure in the cash market for most of the week, but as prices fell, buyers became more aggressive. In today's spot session, cheese prices increased for the first time in 11 sessions, with a 10-lot bid for barrels left after the close. Summer heat could roll in soon and help us a bit as the grilling season gets under way, but we're just not expecting prices to take off here. On the other hand, we're not ready to outright sell milk either, unless you can lock in $1.50-$2.00 profit margin. Current prices are still cash-flow negative for many Western producers and we feel we're near the bottom of the range in prices. Economically, things continue to look bleak from an international/currency standpoint, while domestically things continue to sputter along. We could continue to look for opportunities to get "disaster" insurance in place, buying July-Dec PUT options. Consider the 13.50 PUT, July-Dec which averages 34¢/mo. Bid up to 40¢/mo to get it done, which will give you a minimum base price of $13.10. We realize it's not much to get excited about, but it's a lot better than $11, should it come to that. Current cash prices work out to about $12.80 milk and with July futures beginning its calculation next week, the front months are still vulnerable. Use the rally the last 2 days to get something done! While we just completed 18-months of low prices, current macro-economics could keep us range bound for quite some time.