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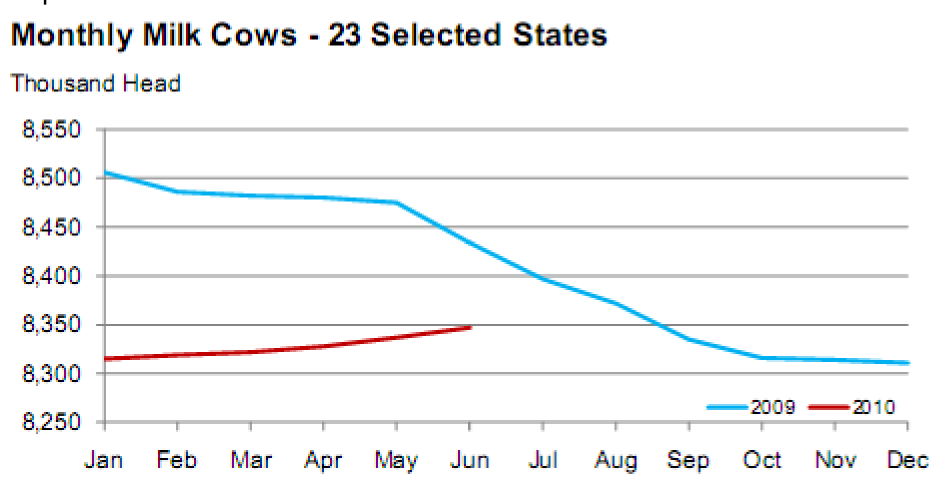
The KDM Dairy Report – July 23rd, 2010

What's Bullish:

Futures Month	Class III 07/23 Close	Class III 07/16 Close	Change	Dry Whey 07/23 Close	Dry Whey 07/16 Close	Change
Jul-10	$13.73	$13.76	($0.03)	36.50¢	36.50¢	0.00¢
Aug-10	$14.91	$14.90	$0.01	35.75¢	35.75¢	0.00¢
Sep-10	$15.15	$14.98	$0.17	34.83¢	35.25¢	(0.42¢)
Oct-10	$14.93	$14.92	$0.01	34.75¢	35.00¢	(0.25¢)
Nov-10	$14.70	$14.68	$0.02	33.75¢	33.50¢	0.25¢
Dec-10	$14.65	$14.72	($0.07)	33.75¢	34.00¢	(0.25¢)
2010	**$14.68**	**$14.66**	**$0.02**	**34.89¢**	**35.00¢**	**(0.11¢)**
Jan-11	$14.34	$14.44	($0.10)	32.50¢	32.50¢	0.00¢
Feb-11	$14.27	$14.42	($0.15)	29.75¢	29.50¢	0.25¢
Mar-11	$14.37	$14.53	($0.16)	30.00¢	30.00¢	0.00¢
Apr-11	$14.34	$14.50	($0.16)	30.00¢	30.00¢	0.00¢
May-11	$14.48	$14.52	($0.04)	28.00¢	31.00¢	(3.00¢)
Jun-11	$14.43	$14.43	$0.00	30.00¢	30.00¢	0.00¢
Jul-11	$14.57	$14.50	$0.07	32.00¢	32.00¢	0.00¢
Aug-11	$14.64	$14.52	$0.12	33.00¢	33.00¢	0.00¢
Sep-11	$14.73	$14.65	$0.08	34.00¢	35.00¢	(1.00¢)
Oct-11	$14.85	$14.80	$0.05	33.00¢	33.00¢	0.00¢
Nov-11	$14.85	$14.80	$0.05	34.00¢	34.00¢	0.00¢
Dec-11	$14.87	$14.80	$0.07	33.00¢	33.00¢	0.00¢
2011	**$14.56**	**$14.58**	**($0.01)**	**31.60¢**	**31.92¢**	**(0.31¢)**

- Cash Market: Cheese and butter prices continued to march higher this week. Blocks gained 2¾¢ from last Friday to close at $1.60¼/lb while barrels increased 3½¢ to settle at $1.56/lb. Butter picked up 2½¢ to close at $1.80/lb. 6 blocks, 8 barrels and 1 load of butter exchanged hands.
- Most Class III components were higher in this week's NASS survey. 40-lb blocks averaged $1.44/lb, up 2.6¢ from last week, while 500-lb barrels jumped 5.6¢ to $1.48/lb. Butter continued to climb higher, increasing 2.4¢ to average $1.74/lb. Nonfat dry milk inched 0.1¢ higher to average $1.23/lb, but dry whey lost 0.1¢ to 36.2¢/lb.
- Livestock, Dairy & Poultry Outlook Report: USDA revised their Class III price forecast slightly higher from last month, citing economic recovery in Asia and South America improving demand and weaker production in Oceania tightening global dairy supplies. Cow numbers are expected to decline slightly, but output per cow is expected to make up for it and increase total production.
- Cold Storage Report: Butter stocks in June were down 25% compared to a year ago and fell 7% from May, according to USDA.
- Double digit increases in U.S. cheese sales has prompted Denmark-based Arla Foods to expand its dairy in Hollandtown, Wisconsin. The company sees continued high potential in the market for specialty cheeses.



- Fluid Milk & Cream Review reports the recent heat wave has left the NE but is persisting in the Mid-Atlantic and SE regions. In Vermont, the recent heat reduced milk production 15-20% and production has still not fully recovered. Milk sales are flat in the Southeast, but high temps have decreased shipments out of Florida to 131 loads, from 250 last week. Milk supplies are getting tight, prompting some processors to purchase spot market cream to meet contract commitments.
- Hot, muggy summer weather has reduced milk intakes and tightened supplies in the Central region, according to Fluid Milk & Cream Review. Extra fluid and cream interest is going unsatisfied despite current prices. Combined with additional declines in milk components, lower manufacturing yields are causing some operators to call current fluid receipts "white water".
- California milk production is trending lower due to hot and humid conditions, according to Fluid Milk & Cream Review. Plant capacity is more than adequate to handle the milk supply and cheese producers are taking all the milk they can get. Manufacturing of other products is often lower due to milk declines and lower fat and protein tests. Hot and humid weather in Arizona is impacting production and components. Cooling systems are not able to adequately work well. Cream remains tight.
- The butter market remains firm and cream supplies limited from coast to coast, according to Dairy Market News. Often churning is for immediate needs, making inventory buildup slow to occur. Butter inventories are much lower than desired for this time of the season.

- Lower yields and falling milk production in the Northeast is affecting many cheese manufacturers, according to Dairy Market News. In the Midwest, the cheese market continues to firm as hot, muggy weather has caused declines in July milk receipts and yields. Current cheese volumes are tighter, with additional reductions expected when Class I use increases prior to the start of the new school year. Western cheese plants are comfortable with cheese inventories and movement. Wholesale prices are higher, yet sales remain adequate to move available offerings.
- International: Recent hot temperatures and dry conditions in Western Europe are accelerating milk production declines, according to Dairy Market News. Milk volumes are tightening and manufacturers are trying to procure as much as they can and generate stock for future needs. Supplies of finished dairy products are available, but often stocks are not as heavy as desired and prices are on the increase. Butterfat remains tight and prices reflect the situation.

What's Bearish:

- Milk Production Report: June milk production was up a surprising 2.4% vs. a year ago, and cow numbers jumped 11,000 head from May (see graph above). While cow numbers are still 108,000 head behind last year at this time, milk per cow jumped 64 lbs to account for the increase. Gains were led by WI up 5.1%, WA and MI up 4.7% and AZ up 4.4%. CA added 1,000 head from May, the first time the state has added cows since Dec 2008.
- Cold Storage Report: American cheese stocks in June were 4% higher than in 2009 and increased 2% from May. Total cheese stocks were 4% higher and up 1% respectively.
- Cattle Report: USDA released their bi-annual report on today. Total replacement heifers swelled to 4.05 million head, compared to 3.95 million head last year, and the most since 1994. When compared against the current size of the milking herd, there are 44.5 replacements for every 100 cows, up from 42.9 last year. Groan.
- Cow Slaughter Report: 214,200 dairy cows were culled in June, down 41,800 head, or 16% from last June. Jan-Jun the 2010 cull is 75,800 head behind.
- Dairy cow slaughter for the week ending 07/10 totaled just 42,900 head, the lowest weekly cull this year, and down from 48,400 head during the same period a year ago.
- Fluid Milk & Cream Review reports warms days and cool nights are keeping the cows content and production up. Milk output is higher than last year due partly to increased cow numbers, especially in Idaho. Manufacturers are happy to see the increased volumes.
- The nonfat dry milk market remains weak, with concerns over the slow pace of sales and accumulating stocks. Dairy Market News reports buyers have become less willing to make purchases and are often waiting to better prices. Export sales are limited.
- International: Traders and handlers in Oceania state that buyer interest has slowed greatly and are only seeking product for short term or immediate needs, according to Dairy Market News. They also note that it appears China may be backing away from the marketplace as their milk production comes more in line with needs.

Recommendation:

Traders largely brushed aside bearish milk production and cold storage reports, considering the current factors of hot weather and low components enough to at least support prices where they are at. Indeed, for the week prices were largely unchanged. 2011 prices were hit slightly as the realization that we increased cow numbers month-to-month and have replacement animals to spare, could limit how high prices go even with improving demand. Current cash prices work out to about $15.00 milk, putting most months at a slight discount. The market seems to be predicting rather stable, but sub $15 prices for the foreseeable future. Sep hit a high of $15.20 this week, almost triggering some of our sell orders. We could continue to scale-in selling of your production, starting at $15.25 (Aug-Sep) and $15.15 (Oct-Dec) and every 25¢ thereafter.

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