



The KDM Dairy Report - May 21st, 2004

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On the bright side:

- Milk Production Report: April became the ninth consecutive month of declining milk production, as output in the 20 major states was down 0.9% from April 2003. In addition, output in all 50 states was down 1.2%, and the number of milk cows was 81,000 head less than April 2003.
- Cold Storage Report: April butter stocks were 41% lower than a year ago, and American and Total cheese holdings were 1% under the prior year.
- The June Class I mover was announced today at \$21.13, which should eliminate any negative PPD for that month.
- Dry whey almost broke the 30¢ barrier, climbing to 29.9¢ per lb in the latest NASS Dairy Product Price weekly survey. NDM tacked on 0.5¢ to average 84¢ per lb.
- Fluid Milk & Cream Review notes consumption patterns do not seem to have been impacted yet by higher prices despite the media attention.
- Pizza Hut's U.S. store sales jumped 10% for the four weeks ended May 15th, according to Pizza Marketplace.
- Butter appears to be well supported at current prices (\$2.06). 38 loads traded in the cash market this week, within a 4¢ range, and Dairy Market News reports butter producers continue to voice concern about not having sufficient butter volumes for this time of year, setting up for a possible shortage in the fall. Food service orders are stronger as vacation and resort areas prepare for the upcoming Memorial Day holiday and the summer vacation season.

Futures Month	Friday 05/21	Friday 05/14	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-04	\$20.48	\$20.40	\$0.08	\$11.27	\$11.94	\$12.59
Jun-04	\$15.86	\$15.85	\$0.01	\$11.65	\$12.48	\$13.30
Jul-04	\$14.11	\$14.52	(\$0.41)	\$12.46	\$13.38	\$14.28
Aug-04	\$14.12	\$14.50	(\$0.38)	\$13.16	\$14.17	\$15.17
Sep-04	\$14.15	\$14.35	(\$0.20)	\$13.61	\$14.59	\$15.56
Oct-04	\$13.95	\$14.30	(\$0.35)	\$12.98	\$13.82	\$14.65
Nov-04	\$12.85	\$13.00	(\$0.15)	\$11.92	\$12.97	\$14.00
Dec-04	\$11.95	\$12.15	(\$0.20)	\$11.92	\$12.97	\$14.01
Jan-05	\$11.95	\$11.95	\$0.00	\$11.89	\$12.71	\$13.52
Feb-05	\$12.05	\$12.00	\$0.05	\$11.34	\$11.90	\$12.45
Mar-05	\$11.95	\$11.95	\$0.00	\$11.66	\$12.34	\$13.01
Apr-05	\$12.00	\$12.06	(\$0.06)	\$12.08	\$13.31	\$14.52
May-05	\$12.15	\$12.00	\$0.15	\$11.27	\$11.94	\$12.59
Jun-05	\$12.10	\$12.05	\$0.05	\$11.65	\$12.48	\$13.30
Jul-05	\$12.50	\$12.50	\$0.00	\$12.46	\$13.38	\$14.28
Aug-05	\$12.60	\$12.50	\$0.10	\$13.16	\$14.17	\$15.17
Sep-05	\$12.75	\$12.75	\$0.00	\$13.61	\$14.59	\$15.56

however....

- Support for cash cheese dropped another notch, as blocks fell 20¢ today to finish at \$1.80/lb. 73 loads exchanged hands for the week. Barrels dropped 22¢ today to settle at \$1.61/lb. Barrels fell a total of 32¢ from last Friday.
- Dairy Market News describes the cheese market as "weak", with buyers limiting purchases in anticipation of lower prices.
- Milk Production Report: Despite the Posilac shortage, output per cow in the 20 major states was 3 pounds above April 2003, March production was revised upwards 0.2%, and the number of milk cows increased 2,000 head from March 2004. And, while April's production level was below a year ago, it was 1.4% above March output. Finally, despite lower output per cow, California production was up 1.2% on higher cow numbers.
- Cold Storage Report: While below year-ago levels, analyst expectations were for more than a 1% decrease. In addition, American and Total cheese holdings were up 1% vs. the prior month. While this is historically typical, analysts were expecting a month-to-month drop.
- Through the 17th of this month, cheese holdings in selected storage centers is up 4%, according to the Weekly Cold Storage Holdings report.
- Livestock Slaughter Report: The April dairy cow slaughter of 178,700 was 39,200 head fewer (18%) than March, 60,600 head fewer (25%) than a year ago, and the lowest monthly total in ten years.
- AMPI announced it is closing its Glencoe, MN facility on June 19th due to the continued drop in Minnesota milk production. Mark Furth, general manager, says continued drop in production could, "cost us about one processing plant a year".

- NASS averages for both block and barrel cheese dropped for the first time in 15 weeks. Blocks averaged \$2.16/lb, down 0.8¢ and barrels were \$2.13/lb, down 7¢. Butter decreased 1.4¢ vs. the prior week, at \$2.16/lb.
- Fluid Milk & Cream Review reports spot loads of manufacturing milk going for \$2 to \$5 under class.

Recommendation:

A week full of reports, and none of them very supportive of the market. The drop in milk production can be attributed mainly to the smaller milking herd, leaving one to wonder if there is anything to the "Posilac factor". Either producers have been doing a fantastic job managing without it, or like several farmers we talked to this week, had a reasonable amount stockpiled prior to the cutbacks. It may take until mid summer to determine whether or not it's a non-factor or will have some meaningful impact on production.

Likewise, the month-to-month growth in cow numbers from the dramatically lower cull rate has been a demonstration of good ol' American capitalism, but with a rapidly decreasing milk price and warmer weather ahead of us, it remains to be seen whether there will be enough financial incentive for producers to continue to milk marginal animals. So, the big question is, where will cheese find support? Today, blocks were allowed to fall to \$1.7775 before a lone buyer purchased 14 loads to bring the price back to \$1.80. Will they support this price for two weeks like they did at the \$2.15 and \$2.00 level? We don't know, but they'll have to buy a lot of cheese to do it. With 19 loads going unsold today, it's a given that more cheese will show up next week. If blocks hold at \$1.80 and barrels don't slip further, expect the June and July contracts to rise. However, if sellers overwhelm buyers, we'll continue to see price pressure until this current glut of product is gone. It will be interesting to see where we are by mid summer, as we are now at the height of the spring flush and production should start to trend lower for the rest of the year.

Our recommendation remains unchanged from last week. July - December do not warrant selling and PUT options are extremely expensive. However, CALL options have gotten significantly more affordable this week. Buy June - September CALLs at 15.00 to 16.00 strike prices for between 35-50¢ premium. We're think there's a good possibility for a double-peak in cheese, so when/if these months recover, you'll have the courage to sell your milk close to the strike price of your CALL. At that time, you'll have a floor price for your milk, but unlimited upside with the CALL option purchased prior to locking in.

To discuss this and more advanced strategies, call us! 877.695.8538

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