



The KDM Dairy Report – October 1st, 2004

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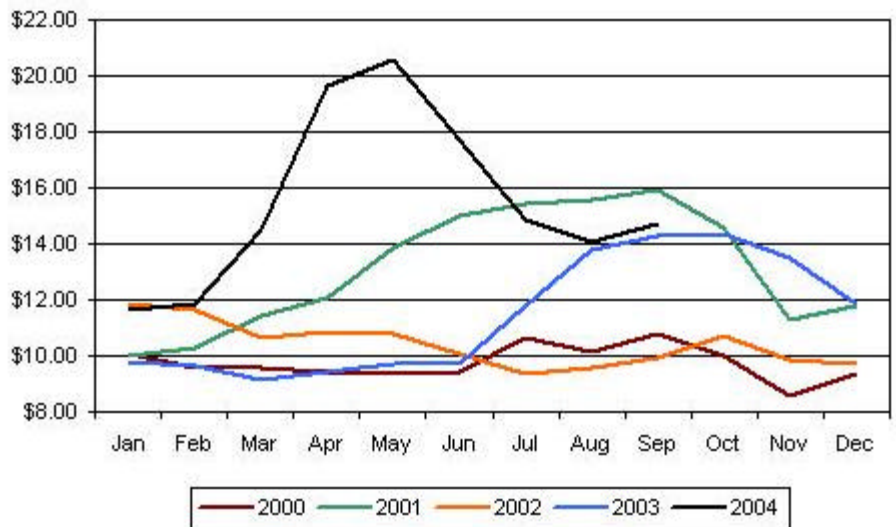
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On the bright side:

- NASS prices for butter increased 2.5¢ to \$1.79/lb this week, while NDM inched 0.2¢ higher to 86.7¢/lb and dry whey increased 0.1¢ to 21.7¢/lb.
- The price for blocks on the cash market rose 1.75¢ for the week, to finish at \$1.5850 today. However, they bidder had to purchase 23 loads today to keep it there. 29 loads exchanged hands for the week.
- Weekly cold storage holdings in selected storage centers show a decrease of 22% in butter stocks for the period 9/1-9/24. In addition, cheese stocks were down 5%.
- Dairy Market News reports butter production is not keeping pace with demand, and buyers are starting to question if there will be sufficient supplies in the last quarter. In addition, international supplies as a source for additional butter is very limited.
- International: Milk production in Australia and New Zealand appears to be lagging last year's levels, according to Dairy Market News. July output was down 1.2% in Australia, compared to last season, and manufacturers state that their production has been fully committed for the first half of the year. Milk production in Western Europe also appears to be trailing last season, with supplies of dairy products often lighter than desired.
- Heavy rainfall and flooding from hurricane Jeanne hampered milk production and processing in Florida, Georgia and the Carolinas, according to Fluid Milk & Cream Review.
- Livestock, Dairy, and Poultry Outlook Report: Released Tuesday, the USDA predicts that the unusual retention of last lactation cows is likely to end, and milk cow numbers will resume declines by autumn. However, they predict much lower prices in 2005, but expect them to stay above the lows of 2002 and 2003.
- Economy: Manufacturing activity was strong in September, according to numbers released by the Commerce Department. Construction spending jumped to its highest level ever, double what economists had been forecasting. And new home sales jumped 9.4% in August, the biggest increase in four years.
- Economy: Inflation was held in check during August and July, according to the Federal Reserve, easing fears of an increase in interest rates.
- Economy: The Commerce Department reported that U.S. personal incomes increased by 0.4% in August, and the personal savings rate increased to 0.9%.

Futures Month	Friday 10/01 Close	Friday 09/24 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Oct-04	\$13.95	\$13.95	\$0.00	\$12.98	\$13.82	\$14.65
Nov-04	\$12.94	\$12.89	\$0.05	\$11.92	\$12.97	\$14.00
Dec-04	\$12.30	\$12.44	(\$0.14)	\$11.92	\$12.97	\$14.01
Jan-05	\$12.00	\$12.15	(\$0.15)	\$11.89	\$12.71	\$13.52
Feb-05	\$12.00	\$12.10	(\$0.10)	\$11.34	\$11.90	\$12.45
Mar-05	\$12.05	\$12.10	(\$0.05)	\$11.66	\$12.34	\$13.01
Apr-05	\$12.00	\$12.01	(\$0.01)	\$12.08	\$13.31	\$14.52
May-05	\$12.00	\$12.09	(\$0.09)	\$12.21	\$13.60	\$14.98
Jun-05	\$12.35	\$12.35	\$0.00	\$12.26	\$13.38	\$14.49
Jul-05	\$12.75	\$12.78	(\$0.03)	\$12.70	\$13.62	\$14.53
Aug-05	\$13.13	\$13.15	(\$0.02)	\$13.25	\$14.21	\$15.16
Sep-05	\$13.35	\$13.38	(\$0.03)	\$13.72	\$14.66	\$15.58
Oct-05	\$12.70	\$12.75	(\$0.05)	\$12.98	\$13.82	\$14.65
Nov-05	\$12.12	\$12.15	(\$0.03)	\$11.92	\$12.97	\$14.00
Dec-05	\$12.04	\$12.05	(\$0.01)	\$11.92	\$12.97	\$14.01
Jan-06	\$11.90	\$11.80	\$0.10	\$11.89	\$12.71	\$13.52

Class III Historical Prices



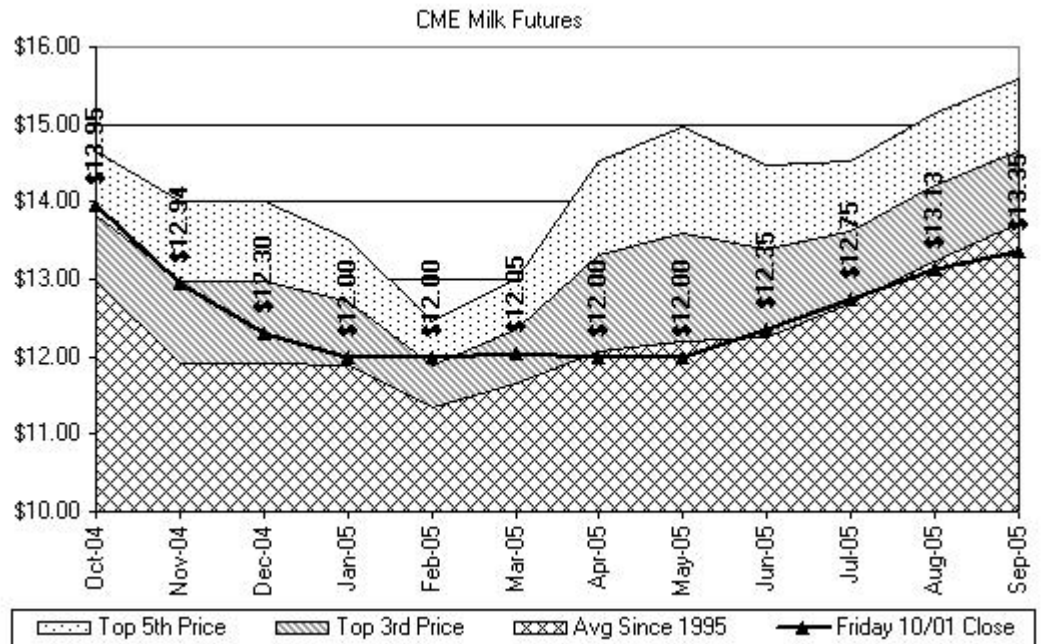
however....

- NASS cheese prices for both blocks and barrels fell this week. Blocks were down 0.9¢ to \$1.56/lb and barrels were down 1.5¢ to \$1.55/lb
- The price for barrels on the cash market fell 7¢ for the week, including a 6.5¢ drop today, to settle at \$1.4325.
- The situation with cow numbers is not improving, as this week's dairy cow slaughter of 46,000 head was off 21.5% vs. the same period a year ago, when 58,600 head were removed from the herd.
- Block demand is firm, but barrel demand is weak, according to Dairy Market News. And buyers aren't being as aggressive as is usual for this time of year, because they think prices could weaken in the near term.
- Weather conditions are near ideal in California, and expansion plans are moving forward, reports Fluid Milk & Cream Review. However, the continuing heifer shortage is limiting growth.
- Livestock, Dairy, and Poultry Outlook Report: The high cost of milk earlier this year had a negative impact on commercial disappearance numbers for most dairy products. July butter use was down 9.3% vs. a year ago, American cheese use was off 10.2% and Other cheese use was down 3.2%. Only Nonfat Dry Milk was able to make a gain, up 18.1%.
- Cheese prices are expected to fall gradually, according to an article in Pizza Marketplace.
- Economy: U.S. consumer confidence fell for the second straight month in September, an economic research group reported. The two point drop in the index was caused primarily by a drop in consumer job outlook.

Recommendation:

September officially went on the books at \$14.72/cwt, its highest settlement since \$15.90 in 2001 (see chart above). Now the question is, where do we go from here? Blocks and barrels took divergent paths and now sit at an unsustainable 15.25¢ spread. Our bias is for barrels to eventually make a comeback, as barrel production slows and cut and wrap operators start converting. However, we also don't expect to see \$1.50+

blocks through the end of the year, either. Last week, we said to leave the balance of 2004 alone, unless a significant rally justified taking price protection. While October finished the week unchanged, it did experience a rally with intraday highs above \$14.30 on Wednesday. We took the opportunity to purchase cheap floor price protection, getting a few \$14.25 October PUT options bought today for 15¢ before cash cheese traded. They may very well expire worthless, but if cheese continues to come to the exchange in large quantities, they may come in handy. Likewise, November shot up on Wednesday, settling at \$13.29, before falling back to \$12.94 today. We sold November outright for several of our producers this week, anywhere from \$13.15 to \$13.30. This week, we also made progress on 2005, selling up to 50% of April - December production at a \$12.50 or higher average. Going forward, our recommendation remains unchanged. Take advantage of remaining rallies in 2004 to either sell, lock in with your plant or buy PUT options. Potential targets: Oct - \$14.50 or higher, Nov - \$13.25 or higher, Dec - \$12.75 or higher. For 2005, look to sell April - Dec at a \$12.50 average or higher, then buy cheap upside protection in the form of 30-40¢ CALL options for selected months.



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