



The KDM Dairy Report – October 8th, 2004

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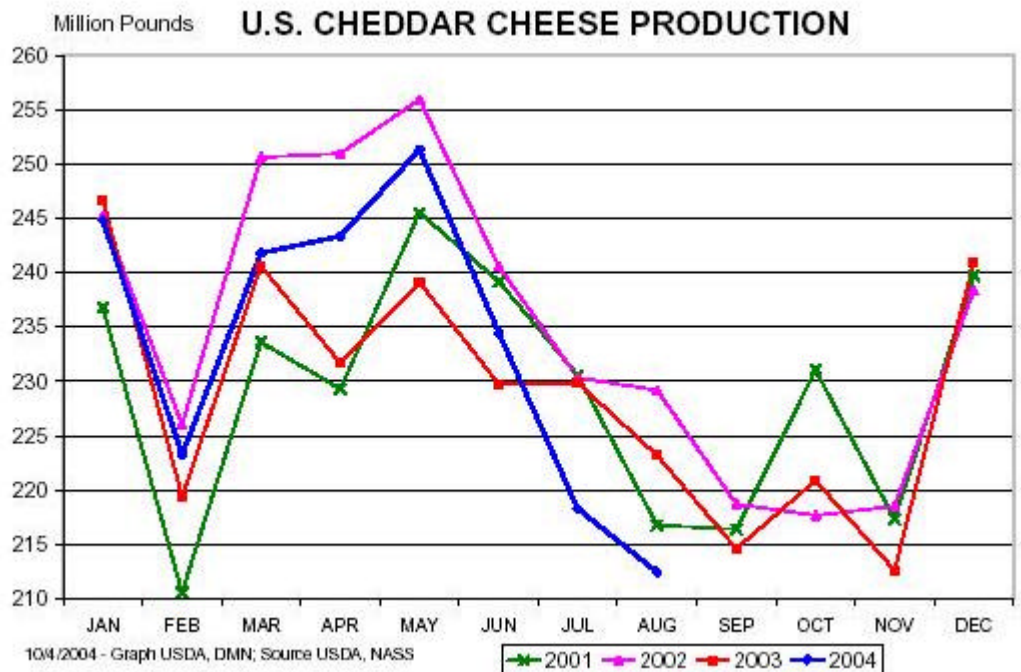
On the bright side:

- Dairy Products Report: Released Monday, the report had cheddar cheese output 4.8% below August 2003, and 2.7% below July 2004 (see chart below). Expectations were for a slight increase from a year ago.
- The weekly cold storage holdings report showed that from Sept. 1st through October 4th, butter inventories in selected storage centers declined by 36%, and cheese inventories fell 5%.
- Butter stocks in CME approved warehouses continues its drawdown. For the week ending Oct 2nd, butter stocks on hand were 61.1 million lbs, vs. 134.8 million lbs a year ago, a drop of 54.7%. Inventories are less than half of what they were a year ago.
- Florida continues to import milk at above seasonal averages, and from greater distances, as milk production is recovering slower than expected, according to Fluid Milk & Cream Review. 241 loads were shipped into the state, vs. 140 last week.
- Continued heavy rain in the Texas panhandle and parts of New Mexico is affecting production, according to several producers we talked to this week. Cows are getting sick, and with near record beef prices and falling milk prices, culling is picking up in a big way.
- Monsanto announced in an earnings call on Wednesday, that the limited supply of Posilac would last well into 2005. They had expected to be able to lift the limits by the end of 2004.

Futures Month	Friday 10/08 Close	Friday 10/01 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Oct-04	\$13.86	\$13.95	(\$0.09)	\$12.98	\$13.82	\$14.65
Nov-04	\$12.57	\$12.94	(\$0.37)	\$11.92	\$12.97	\$14.00
Dec-04	\$12.20	\$12.30	(\$0.10)	\$11.92	\$12.97	\$14.01
Jan-05	\$12.04	\$12.00	\$0.04	\$11.89	\$12.71	\$13.52
Feb-05	\$11.95	\$12.00	(\$0.05)	\$11.34	\$11.90	\$12.45
Mar-05	\$12.00	\$12.05	(\$0.05)	\$11.66	\$12.34	\$13.01
Apr-05	\$12.03	\$12.00	\$0.03	\$12.08	\$13.31	\$14.52
May-05	\$12.00	\$12.00	\$0.00	\$12.21	\$13.60	\$14.98
Jun-05	\$12.28	\$12.35	(\$0.07)	\$12.26	\$13.38	\$14.49
Jul-05	\$12.70	\$12.75	(\$0.05)	\$12.70	\$13.62	\$14.53
Aug-05	\$13.10	\$13.13	(\$0.03)	\$13.25	\$14.21	\$15.16
Sep-05	\$13.30	\$13.35	(\$0.05)	\$13.72	\$14.66	\$15.58
Oct-05	\$12.75	\$12.70	\$0.05	\$12.98	\$13.82	\$14.65
Nov-05	\$12.12	\$12.12	\$0.00	\$11.92	\$12.97	\$14.00
Dec-05	\$12.00	\$12.04	(\$0.04)	\$11.92	\$12.97	\$14.01

however....

- The CME spot cheese market crashed this week, with blocks falling 21.25¢ to settle at \$1.3725/lb today, and barrels dropping 11.75¢ to settle at \$1.3150/lb.
- Dairy Products Report: While American cheese output was down, Total cheese output was 1.7% above August 2003 and 0.6% above July 2004. Butter production was 25.4% above August 2003, however, with inventories as low as they are, and butter prices strengthening, more milk was attracted to the churn. The cool summer continued to affect ice cream production, down 4.7% vs. a year ago.
- NASS average prices for cheese fell for the third straight week. Blocks dropped 0.3¢ to \$1.56/lb while barrels fell

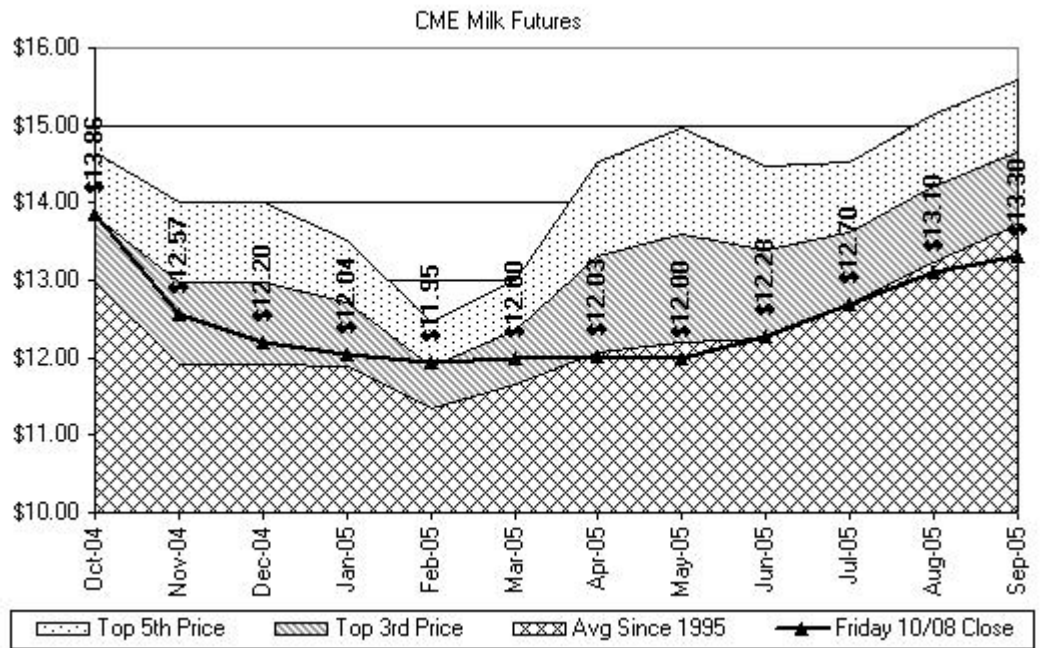


1.6¢ to \$1.53/lb. Other components were weak as well. Butter decreased 0.2¢ to \$1.79/lb and nonfat dry milk slipped 0.5¢ to 86.2¢/lb.

- Dairy cow slaughter continues to trend lower. For the week ending Sept. 25th, 45,600 head were culled, vs. 61,900 during the same period a year ago, a 26.% drop.
- Milk production in California continues to build at levels "noticeably above a year ago", according to Fluid Milk & Cream Review.

Recommendation:

The lone buyer stepped aside and cash cheese fell this week. But did it go too far? Maybe. Jerry Dryer, in this week's Dairy & Food Market Analyst, says these price levels will attract a lot of buyers stocking up for holiday needs, and it may trigger more promotional activity, which would improve sales and support prices. Perhaps the market figured this out as well, since the '04 contracts were up sharply today. December opened at \$11.90, which was just too low, considering CWT will help keep this cheese price near \$1.40. The contract rallied 30¢ today to close at \$12.20.



Those October \$14.25 PUTs we bought last Friday for 15¢ are now worth 40¢. We may take profits early since it looks like the October contract could continue to move up over time.

For the balance of 2004, we once again would remain open to the market, unless we see a significant rally.

For 2005, consider this strategy. Over the next two months, commercial dairy products companies will be looking at covering their risk for higher prices in 2005 on a percentage of their business. This lends support to the Class III futures prices in 2005, and gives you opportunities to price some milk production in 2005 at profitable levels. Targeting to sell at prices 15 to 25 cents higher than current futures would be a place to start, with a more aggressive target if needed when we get into December.

The Moore Research Dairy Report has a trade strategy for on or about today (10-8-04) based on 6 years of history, to buy July '05 futures (currently at 12.70) and look at exit opportunities on November 21st. The 6 year history shows a profit of 28¢ on average, or \$560 per contract. This appears to collaborate the commercial buying for this time period, discussed above, that usually pushes prices higher. This can also be used to protect contracted milk in 2005, until the new year arrives and call options become affordable.

If you would like to discuss this, or other hedge opportunities further, please call us toll free - 877.695.8538

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