



The KDM Dairy Report – February 18th, 2005

Dan Schindler, Mark Potter, and Keith Schnese
877-695-8538

www.kdmtrading.com

On the bright side:

- Milk Production Report: USDA added Colorado, Kansas and Oregon to the top milk-producing states. The 23 states now account for 91% of U.S. milk production. January production was up 1.3% in the 23 states, and up 0.9% for all 50 states. This was in line with expectations. There were 15,000 fewer milk cows in January than there were in December. California production was up 2.8%, but that was less than the 4.6% increase from the prior month. Wet weather likely played a role. Texas production was flat, whereas last year they had a 9.1% increase in January. Similarly, New Mexico was down 4.7%, but last year saw a 5.9% increase.

Futures Month	Friday 02/18 Close	Friday 02/11 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Feb- 05	\$14.73	\$14.75	(\$0.02)	\$11.34	\$11.90	\$12.45
Mar- 05	\$13.66	\$13.84	(\$0.18)	\$11.66	\$12.34	\$13.01
Apr- 05	\$13.75	\$13.97	(\$0.22)	\$12.08	\$13.31	\$14.52
May- 05	\$13.90	\$13.90	\$0.00	\$12.21	\$13.60	\$14.98
Jun- 05	\$13.90	\$13.90	\$0.00	\$12.26	\$13.38	\$14.49
Jul- 05	\$14.45	\$14.75	(\$0.30)	\$12.70	\$13.62	\$14.53
Aug- 05	\$14.63	\$14.84	(\$0.21)	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.68	\$14.78	(\$0.10)	\$13.72	\$14.66	\$15.58
Oct- 05	\$13.75	\$13.80	(\$0.05)	\$13.10	\$13.91	\$14.71
Nov- 05	\$13.05	\$13.10	(\$0.05)	\$12.22	\$13.29	\$14.34
Dec- 05	\$12.86	\$12.85	\$0.01	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.60	\$12.55	\$0.05	\$12.10	\$12.93	\$13.74
12- month avg		\$13.83	(\$0.10)			

- Weekly cold storage holdings for the first two weeks of February is showing a net drawdown of 212,000 lbs of cheese. While the amount is small, relative to total holdings, this is typically a time when inventories build.
- Weekly dairy cow slaughter numbers are running very close to last year's pace, despite continued high milk prices and the incentive to keep animals. For the week ending February 5th, 49,100 head were culled from the milking herd, vs. 50,000 during the same period a year ago. In addition, the CWT Herd Retirement program has already removed most of the 50,000 animals slated to be slaughtered, so this week's number is not artificially high.
- Despite additional cheese showing up in the cash market, blocks managed a 1¾¢ gain for the week, settling at \$1.43¾/lb, while barrels were up a penny to \$1.39/lb. 18 loads of blocks and 5 barrels exchanged hands.
- Weather: After a brief respite, rainy conditions have returned to California. The forecast is for several more days of rain (see Chino outlook at right).

- Nonfat dry milk supplies remain tight, according to Dairy Market News. Suppliers are reporting that additional loads may not be available until April or May.
- Cheese plants we work with are indicating sales are steady to quite good for this time of year.

Today	Tomorrow	Sun	Mon	Tue
Rain	Rain	Showers	Rain	Showers
High: 60° Low: 50°	High: 58° Low: 48°	High: 59° Low: 48°	High: 60° Low: 46°	High: 61° Low: 43°

however....

- Livestock, Dairy & Poultry Outlook Report: Released Tuesday, the report pointed out that the number of replacement heifers per 100 cows stands at a record 45.9. Heifers expected to calve in 2005 is up 3%, and even without availability of Canadian heifers, replacement of more than 31% of the milking herd should be possible in 2005.
- Milk production is steady in the Northeast and increasing in the Southeast, according to Fluid Milk & Cream Review. Florida sent 148 loads of Grade A milk out of state this week, vs. 126 last week and 96 a year

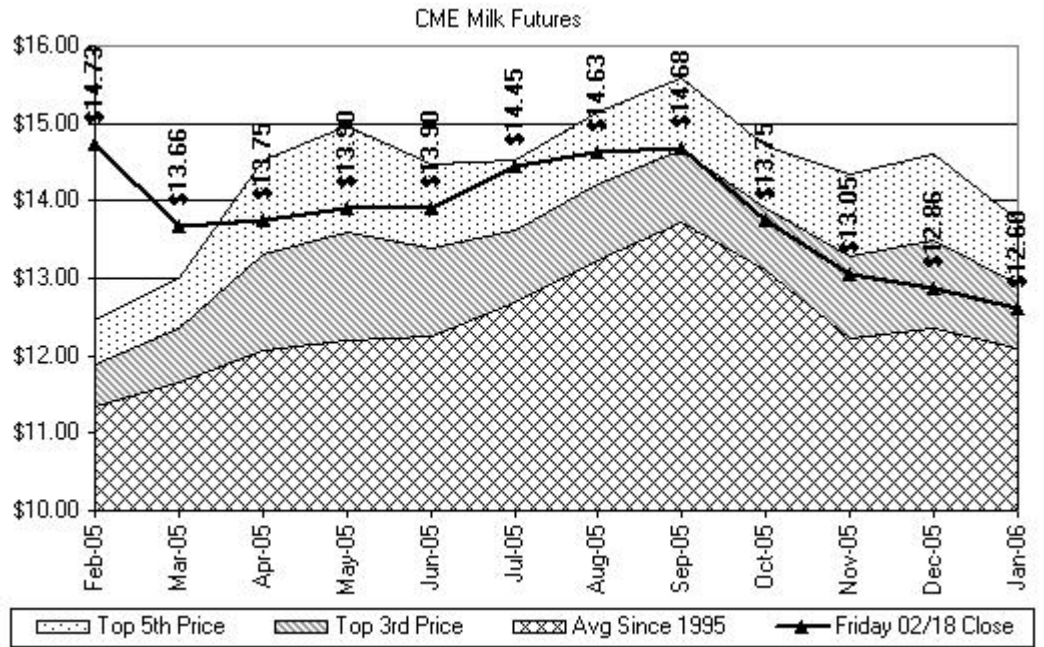
ago.

- NASS cheese prices started moving lower, in line with recent declines in the cash market. Blocks averaged \$1.61/lb, down 4.8¢ from the previous week, while barrels fell 4¢ to \$1.61/lb.
- Cash butter fell 5¼¢ vs. the prior week, settling at \$1.58/lb today. 45 loads exchanged hands.
- Economy: The Producer Price Index increased 0.8% in January, its fastest pace in six years, according to numbers released by the Labor Department. The index measures the prices manufacturers receive for their products, with higher prices generally indicating higher costs that have been passed on to consumers, which in turn limits disposable income.
- Output appears to be increasing in Wisconsin. A milk tester we spoke to this week works with 60 herds, and all are up substantially.

Recommendation:

The cash market appears to have found equilibrium, with sellers keeping the lid below \$1.45, and buyers willing to take on product above \$1.40. We may trade in this range over the next few weeks as cheese appears more readily available. However, that means more pressure on the front months is likely, as they're still trading at a 30 to 50 cent premium over the cash market. Last week, we recommended

selling March at \$13.90 or higher, and in fact, it traded as high as \$13.96 on Monday, before settling at \$13.66 today. We'd continue to look for opportunities to sell March on any rallies.



If cheese trades in a tight range over the coming weeks, the volatility in the market should decrease. Since volatility is one of the factors priced into options, we may see the premiums for both puts and calls drop over time. There may be some opportunity to pick up inexpensive call options to sell into later, or put options to get a floor under your milk. Consider buying the June 12.75 PUT for 30¢, July 13.00 PUT for 30¢, August 13.00 PUT for 30¢ and September 13.00 PUT for 30¢. That would give you an effective floor of 12.45 for June and 12.70 floor for July through September, with unlimited upside on 100% of your production.

NOTE: We will be closed on Monday in observance of President's Day. Financial markets are closed, so there will be no milk trading on that day. We will be back in the office on Tuesday.

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