



The KDM Dairy Report – March 18th, 2005

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On the bright side:

- Weekly NASS numbers showed nice gains for cheese. Blocks averaged \$1.53/lb, up 4¢ from the previous week, while barrels were \$1.51/lb, up 4.3¢.
- Milk Production Report: In a mostly negative report, one positive was the 13,000 fewer milk cows we had in February vs. January. It marked the 5th straight month of declines and is 30,000 less head than we had at our peak last September. In addition, when compared to 2003, production was up only 0.7%.
- Nonfat dry milk prices remain firm, with shipment delays of more than a month, according to Dairy Market News. Traders and users are trying to build inventory, amid growing concern over late summer, early fall availability.
- Dairy Market News reports that cheese sales have improved in the West, with some buyers aggressively looking for additional cheese. Inventories have come down more rapidly in recent days, and stocks are being held with more confidence.
- The latest international update confirms milk production is still lagging in other parts of the world. New Zealand output is trailing last year by 3-4%, and Australia is off 0.7%. Suppliers have been looking at outside sources to acquire additional stocks to fulfill their commitments. In another update, Dairy Market News reports that the strong Euro against the U.S. dollar has resulted in powder for international needs being sourced by the U.S. instead of from Europe.
- The cash cheese markets moved higher this week with blocks gaining 1¼¢ to finish at \$1.48/lb. Barrels climbed half a cent to 1.44½/lb. More encouraging is the fact that cash sessions have finished with unfilled bids on the board.

Futures Month	Friday 03/18 Close	Friday 03/11 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Mar- 05	\$14.05	\$14.06	(\$0.01)	\$11.66	\$12.34	\$13.01
Apr- 05	\$14.01	\$14.07	(\$0.06)	\$12.08	\$13.31	\$14.52
May- 05	\$14.07	\$14.40	(\$0.33)	\$12.21	\$13.60	\$14.98
Jun- 05	\$14.10	\$14.40	(\$0.30)	\$12.26	\$13.38	\$14.49
Jul- 05	\$14.35	\$14.70	(\$0.35)	\$12.70	\$13.62	\$14.53
Aug- 05	\$14.65	\$15.00	(\$0.35)	\$13.25	\$14.21	\$15.16
Sep- 05	\$14.69	\$14.95	(\$0.26)	\$13.72	\$14.66	\$15.58
Oct- 05	\$13.80	\$14.20	(\$0.40)	\$13.10	\$13.91	\$14.71
Nov- 05	\$13.51	\$13.75	(\$0.24)	\$12.22	\$13.29	\$14.34
Dec- 05	\$13.06	\$13.40	(\$0.34)	\$12.34	\$13.49	\$14.61
Jan- 06	\$12.90	\$13.10	(\$0.20)	\$12.10	\$12.93	\$13.74
Feb- 06	\$13.00	\$13.00	\$0.00	\$11.64	\$12.33	\$13.00
12- month avg			\$13.93	(\$0.26)		

however....

- Milk Production Report: February output far exceeded even the high side of expectations, with a 2.8% increase (adjusted for leap year) in the 23 top-producing states. Output for all 50 states was up 2.5%, while output per cow rose a strong 36 lbs, the largest gain since August 2002. Despite adverse conditions, California managed a 3.2% increase, with Idaho up 9.8%.
- Fluid Milk & Cream Review reports that manufacturing milk interest is very slow in the Midwest, with cheese plant inventories a growing concern. In addition, schools across the country will be taking spring break over the next couple weeks.
- Florida shipped 182 loads of Grade A milk out of state this week, vs. 125 last week and 125 the previous year, according to Fluid Milk & Cream Review.
- The pace of the weekly dairy cow slaughter has slowed dramatically since the first part of the year. For the week ending 03/05, only 42,200 head were culled, vs. 51,900 during the same period a year ago, a drop of 23%.
- Weekly cold storage numbers for the period 03/01 through 03/14 indicate a slow build in inventory. Cheese stocks were up 2% with butter stocks up 6% month-to-date.

Recommendation:

Effective trading is sometimes not very exciting but the results can be satisfying. Two of our clients have recently made trades we would like to highlight.

Producer #1 - On February 28th, sold April milk at 15.48 and on March 1st sold April milk at 15.75 for an average price sold of 15.64. On March 3rd bought call options for the same amount of milk sold, 1550 April calls at 25¢. The

contracts sold were through the milk plant, with the calls purchased on the brokerage account. No margin was required for the transaction, just the premium of \$500 per call purchased.

After today's closing prices, the plant contracts are worth \$1.72/cwt or \$3,440 each. The value of the 1550 calls is at 1 cent. If April were to settle at today's futures price of 14.03, this hedge would add to your milk check \$2,940 per contract/call combination.

In the unlikely event that April milk would settle at 16.75, your milk check would have a deduct of \$1.11/cwt or minus \$2,220 per contract, but your brokerage account would have a net gain of \$1.00/cwt or plus \$2,000 gain. The two together at 16.75 produce a \$220 net loss combined. That net loss would stay the same even if prices increased to the highs of last year's \$20+.

Producer #2 - On February 1st we bought an April 1550 call 25¢. After the call was purchased, we placed an open order to sell April milk at 15.75. On March 1st that order filled. The same math applies to this example as to the one above, with the exception that there is no net loss if the April milk contract closes above 15.75. The call option will offset all of the loss on the milk plant contract.

Our recommendation remains largely unchanged from last week. Target to buy calls in May through September at 1500 to 1650 strikes for 25-40¢. With the extreme market volatility, all we need is a one day move (like the March 1st 1575 price) and you have a hedge position with unlimited upside potential. Granted it doesn't always work out; we currently have some May 1550 calls that we might not be able to use. But with our current milk market, volatility it is still a possibility.

Call and let's work out a program to limit your risk and capture some of those great milk prices.

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