



The KDM Dairy Report - June 24th, 2005

On the bright side:

- Weekly cold storage numbers are showing a 0% increase in cheese stocks for the period 06/01 to 06/20 in selected storage centers.
- In the cash markets, butter was the real star, gaining 16¼¢ to settle at \$1.65/lb today. Cash cheese continued to be supported as well. Blocks increased ¾¢ to \$1.50¾/lb and barrels followed, rising ¼¢ to \$1.45½/lb.
- Despite excess milk going into butter and powder operations, butter at CME-approved warehouses experienced a net out-movement of 1.2 million lbs during the week ending 06/18. the first decrease in 12 weeks. During this same week a year ago there was a 714,000 lb increase.

Futures Month	Friday 06/24 Close	Friday 06/17 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Jun-05	\$13.95	\$14.00	(\$0.05)	\$12.26	\$13.38	\$14.49
Jul-05	\$14.44	\$13.93	\$0.51	\$12.70	\$13.62	\$14.53
Aug-05	\$14.99	\$14.38	\$0.61	\$13.25	\$14.21	\$15.16
Sep-05	\$15.02	\$14.50	\$0.52	\$13.72	\$14.66	\$15.58
Oct-05	\$14.06	\$13.85	\$0.21	\$13.10	\$13.91	\$14.71
Nov-05	\$13.56	\$13.48	\$0.08	\$12.22	\$13.29	\$14.34
Dec-05	\$13.25	\$13.29	(\$0.04)	\$12.34	\$13.49	\$14.61
Jan-06	\$13.00	\$12.99	\$0.01	\$12.10	\$12.93	\$13.74
Feb-06	\$13.00	\$12.99	\$0.01	\$11.64	\$12.33	\$13.00
Mar-06	\$12.88	\$12.82	\$0.06	\$11.88	\$12.60	\$13.30
Apr-06	\$12.80	\$12.83	(\$0.03)	\$12.31	\$13.52	\$14.71
May-06	\$12.95	\$12.93	\$0.02	\$12.35	\$13.69	\$15.01
12-month avg		\$13.66	\$0.17			

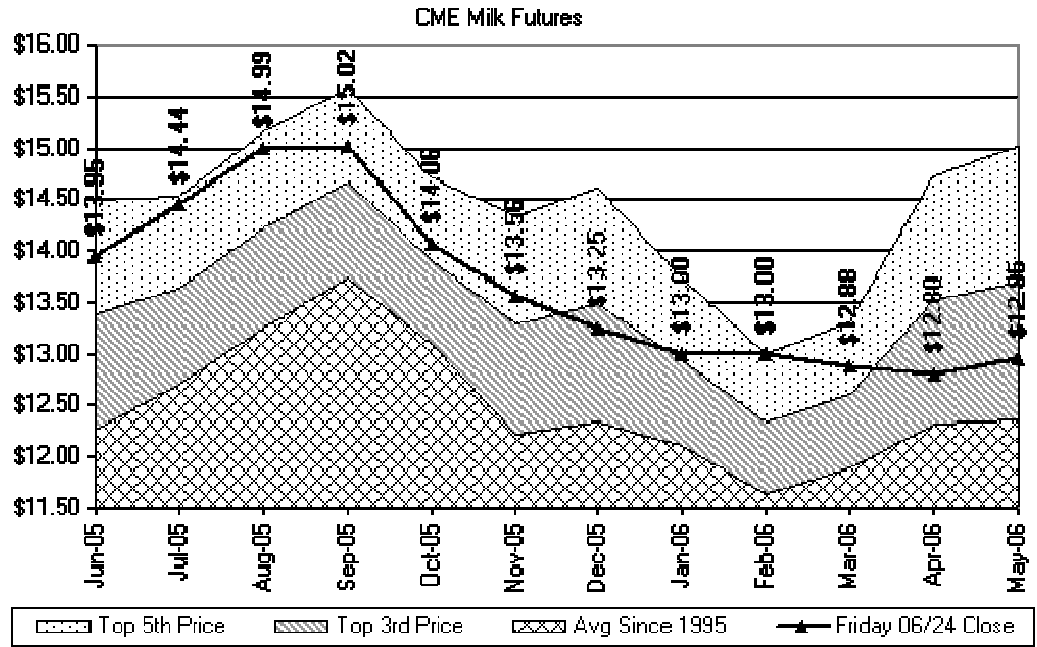
- Grains continue to rocket to new highs. Those that did not lock in the input costs will be paying more for feed.
- Higher temperatures have arrived in the Midwest. Fluid Milk & Cream Review reports that intake declines have been more pronounced, and dry areas in Wisconsin are experiencing less-than-normal alfalfa regrowth.
- Florida looks set to switch back to a milk-deficit state. Only 53 loads of milk were exported this week vs. 127 in the prior week.
- International update: During the most recent EU Dairy Management committee meeting on June 16th, export refunds (subsidies) were reduced for many dairy products, according to Dairy Market News. This will make U.S. products more competitive on the world market.
- Dairy Market News reports that butter churning in Western operations is declining rapidly as warm weather is drawing more cream into ice cream operations. At the same time, quota imports of butter for the first five months of the year are down 12.1%.
- In Western regions, demand for current blocks and barrels is excellent, according to Dairy Market News. Milk output is declining in the region, with lower fat and protein tests hurting cheese yields.

however....

- Cold Storage Report: Stocks of American cheese in May increased 4% vs. a year ago and were 5% higher than in April, according to USDA numbers. Butter stocks were up 5% vs. a year ago and 14% higher than in April. But total cheese stocks were up only 1% vs. May 2004.
- Livestock Slaughter Report: May dairy cow slaughter was 163,600 head, down 1.7% vs. May 2004, when 166,500 head were culled. YTD the cull is down 5.25%. For the first five months of 2005, 936,700 head exited the milking herd vs. 988,600 during the same months in 2004.
- Dairy cow slaughter for the week ending 06/11 was 37,400 head vs. 39,300 during the same period a year ago.
- Output in California has been holding up very well for this late in the production season, according to Fluid Milk & Cream Review. Nights have been very cool.
- Winn-Dixie, a major grocer in the Southeast, has declared bankruptcy and is closing 326 stores and laying off 22,000 employees. They will also close six dairy and culture plants and a pizza plant.

Recommendation:

Once again, the market shrugged off a bearish USDA report and moved higher. Last week we absorbed a 4.4% increase in milk production with aplomb, and this week's bearish cold storage numbers did nothing to move the market lower. It goes to show that you need more than just government-supplied information to have any chance at determining market direction. Certainly these reports are important, but they are just one piece



of the pie. Having sources on the commercial side helps. Here's our take on things. Cheese plants we work with indicate sales are strong, with one actually turning down a couple new cheddar orders. We've also heard that warehouses are near full for some major players in the industry. Initial reaction would be that this is negative for prices, but ask yourself if these players now want the price of cheese to fall, now that they have full warehouses? We don't think they do. The dramatic rise in the cash butter price, in spite of recent heavy churning, also bodes well for prices going forward. Historically, cheese prices eventually follow butter as less milk becomes available for the vat and heads to the more profitable churn. Then we have a wild-card. The USDA announced today that the tissue samples sent to England for a non-ambulatory cow tested positive for BSE, confirming the second U.S. case of Mad Cow disease. Countries that had just re-opened for imports of U.S. beef are now likely to halt them. Expect cattle prices (and cull prices) to drop, at least temporarily. If history is any lesson however, the result of the 1st case ultimately was beneficial to the milk market, as the original cow was traced back to Canada and the border was shut tight. In addition, U.S. consumers correctly knew there was no threat to the milk supply and did not change their drinking habits.

Our recommendation remains unchanged from last week. Stay open to higher prices July through October, buying PUT options to obtain a floor. This week we bought August 14.50 puts for 25¢. Enter orders to buy the August and September 14.50 puts for 25¢. Sell a percentage of your milk November, December and all of 2006, which is currently averaging \$13.03/cwt.

Give us a call and we'll help you put together a plan for your operation!

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