

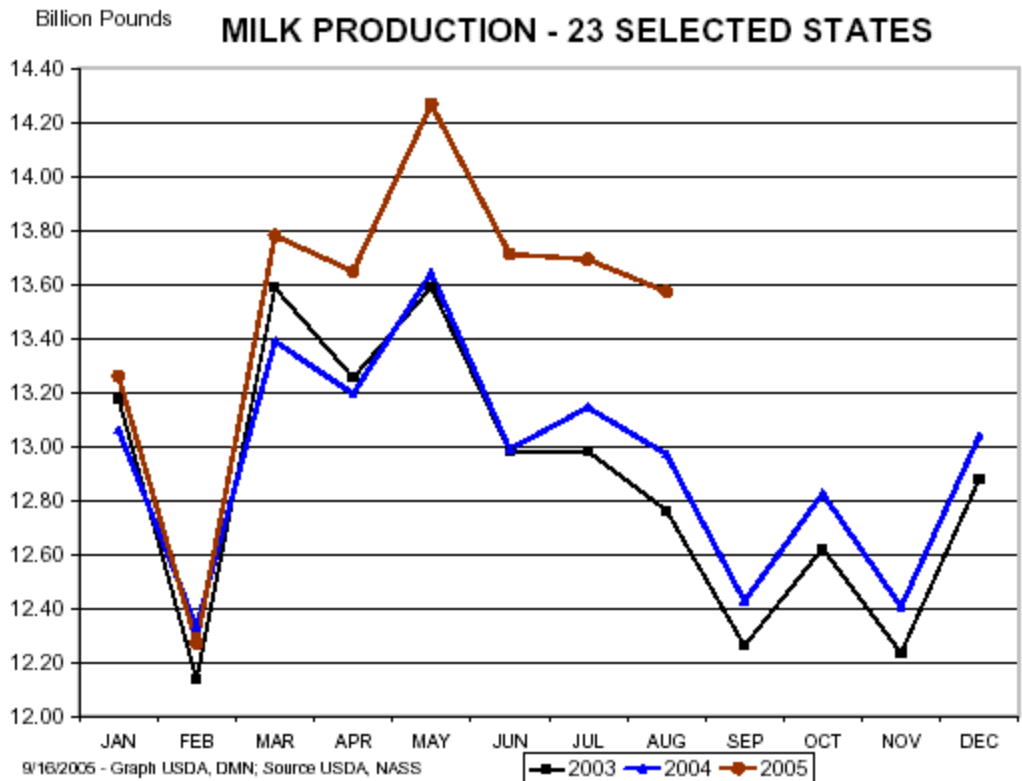


The KDM Dairy Report - September 16th, 2005

On the bright side:

- [Aggressive bidding](#) finally returned to the cash market, with blocks bid up 6½¢ for the week, closing at \$1.59½ today. Barrels moved along to preserve the spread, up 6¾¢ to close at \$1.55¾. Butter continued to be range-bound, but did improve 3¢ to settle at \$1.72½. A relatively light 3 loads of blocks and 5 barrels traded during the week.
- NASS numbers this week continued to follow cash higher, with a [healthy 3.5¢ increase in blocks](#) to average \$1.45/lb. Barrels went up 3.1¢ to \$1.49/lb. Dry whey increased 0.1¢ to 29.4¢/lb, getting close to 30¢, which it hasn't seen for months.
- Weekly cold storage numbers are continuing to reflect a [seasonal drawdown](#) in product. Through the first 12 days of September, butter stocks are down 3%, or 1.3 million lbs, and cheese stocks are down 518,000 lbs.
- Butter stocks at CME-approved warehouses [continue to decline](#). 74.9 millions lbs were on hand for the week ending 09/10, vs. 80.7 million lbs last year.
- Fluid Milk & Cream Review reports that in the central part of the country, milk [supplies were noticeably tighter](#). Shipments continue to move out of the region into the Southeast at the same time manufacturing interest has increased.
- The U.S. government has issued an invitation to buy up to 24 million lbs of UHT milk to help with the Katrina disaster relief effort.
- Dairy Market News reports both export and domestic demand for dry whey is good to very good. Demand is typically greater than supply, and orders have 2-3 week lead times. [Exports through July were 46% higher](#) than last year, with China taking in the most at 73 million lbs, a 63% increase.
- Tighter milk supplies have reduced current cheese production, according to Dairy Market News. Some plants are [making less cheddar](#) in favor of flavored varieties like pepper jack. Lead times on orders are increasing.
- Dairy Market News reports strong demand for block cheese out West. Sellers are fully committed on current production and are [not taking on new orders](#).

Futures Month	Friday 09/16 Close	Friday 09/09 Close	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
Sep-05	\$14.29	\$14.26	\$0.03	\$13.72	\$14.66	\$15.58
Oct-05	\$14.44	\$14.45	(\$0.01)	\$13.10	\$13.91	\$14.71
Nov-05	\$13.75	\$13.81	(\$0.06)	\$12.22	\$13.29	\$14.34
Dec-05	\$13.40	\$13.51	(\$0.11)	\$12.34	\$13.49	\$14.61
Jan-06	\$12.89	\$12.83	\$0.06	\$12.10	\$12.93	\$13.74
Feb-06	\$12.55	\$12.55	\$0.00	\$11.64	\$12.33	\$13.00
Mar-06	\$12.61	\$12.60	\$0.01	\$11.88	\$12.60	\$13.30
Apr-06	\$12.55	\$12.45	\$0.10	\$12.31	\$13.52	\$14.71
May-06	\$12.69	\$12.57	\$0.12	\$12.35	\$13.69	\$15.01
Jun-06	\$12.90	\$12.85	\$0.05	\$12.41	\$13.50	\$14.56
Jul-06	\$13.23	\$13.32	(\$0.09)	\$12.85	\$13.75	\$14.64
Aug-06	\$13.38	\$13.45	(\$0.07)	\$13.28	\$14.19	\$15.09
Sep-06	\$13.75	\$13.66	\$0.09	\$13.72	\$14.66	\$15.58
Oct-06	\$13.22	\$13.10	\$0.12	\$13.10	\$13.91	\$14.71
Nov-06	\$12.93	\$12.85	\$0.08	\$12.22	\$13.29	\$14.34
Dec-06	\$12.86	\$12.80	\$0.06	\$12.34	\$13.49	\$14.61

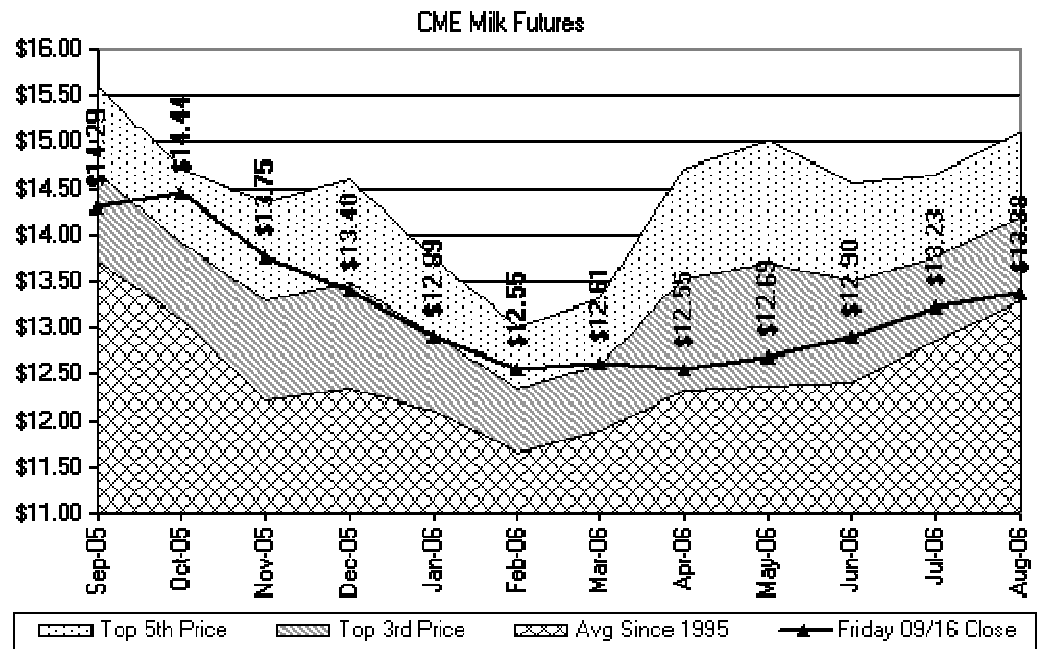


however....

- Milk Production Report: OUCH! August [milk production was up 4.6%](#) vs. a year ago in the 23 major producing States, production per cow was up 64 lbs and 12,000 cows were added to the herd from the prior month. Gains were led by ID up 13.4% and TX up 10.9%. CA was up 2.6% while WI was up 4.6%. Milk production in all 50 states was up 4.3%
- Livestock, Dairy & Poultry Outlook Report: USDA's latest analysis alludes to continued expansion in milk output for 2006. They [expect larger price declines in 2006](#) as demand growth will not be able to handle a second straight large increase in milk output. USDA predicts a \$1-2/cwt drop in price and expects the annual 2006 price to average \$11.57 - \$12.75.
- For the week ending 09/03, 43,300 dairy cows were culled vs. 49,000 during the same period a year ago, according to USDA Market News.
- Ice cream season is winding down.
- Cooler weather has milk [production is rebounding out East](#), according to Fluid Milk & Cream Review. Florida continued to import milk, but the number of loads was down to 209 from 253 last week.
- Fluid Milk & Cream Review reports that [ideal milking conditions](#) has milk output stable to slightly higher in CA and the Southwest.
- International: Dairy Market News reports that milk production in New Zealand and Australia is [up 1-2% from a year ago](#), and increasing.

Recommendation:

Short-term comment: While it's great to see this seasonal push in the cheese price, as we said last week, we think the support is limited to several weeks before buyers' needs are met and they pull away. In this scenario, a PUT option is not as effective as a straight sale to your plant or selling futures direct, because you will get a higher floor price from the direct sale. Our bias is for near-term support, followed by a drop, so enter sell orders to target the highs. The big milk production report will have little effect on October and November futures, which will follow the cash market. And if cheese is supported as long as we think it might, it is probably best to just leave October open to the market. However, enter orders to sell November at \$13.90 and December at \$13.55. If you are a larger operation, sell 25-50% of your milk at these levels and then target more at a dime higher.



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Long-term comment: Successive big production reports are starting to give bears more compelling reasoning in regards to 2006. Were it not for strong demand and a decent economy, prices would be much lower already, but so far, improved dairy consumption has been able to clear current production. Most producers we've spoken with this year have higher output. Near normal availability and increased utilization of BST and more cows appear to have trumped summer heat and heifer shortages. The CWT herd retirement program will remove 70,000 animals, but when we add 12,000 per month, the effect will not last long! We appear to have plenty of corn, and meal below \$200/ton. This week we did some light selling of Jan - Dec 2006 at a \$12.95 average. Continue this strategy, targeting 25-50% of your production at \$13.00 or higher. Sell additional milk at \$13.10 or higher.

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