



## The KDM Dairy Report - April 13<sup>th</sup>, 2006

### On the bright side:

- Milk [production is leveling off](#) in the Southeast, according to Fluid Milk & Cream Review. 97 loads were shipped out of Florida last week, compared to 134 loads during the same period last year. Fat and protein tests are decreasing seasonally.
- International: Milk production in Oceania is below projected levels, according to Dairy Market News. While New Zealand output is about flat, parts of key production areas in Australia are [down as much as 2.6%](#) due to heat during December and January.
- The barrel [supply remains tight](#), according to Dairy Market News. And some mozzarella orders are committed out into May.
- Western regions report that [cheddar is moving well with good demand](#). Buyers have stepped back in to purchase for current needs now that the price has stopped dropping. Sales of shreds are better than projections, while several national pizza chains are running promotions.
- Weekly dairy cow slaughter [jumped back over year ago numbers](#), with 43,100 head being culled vs. 41,300 head during the same period last year.
- NASS average cheese prices increased vs. the previous week. Blocks came in at \$1.17/lb, up 1.2¢, while barrels were \$1.14/lb, up 0.4¢.

### however....

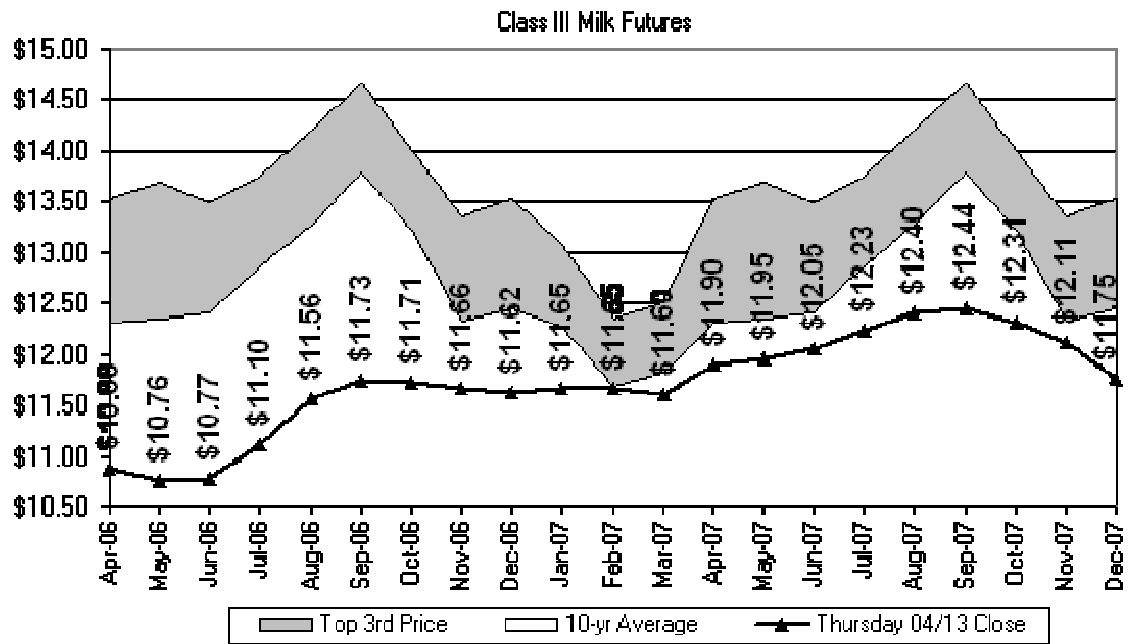
- World Ag Supply & Demand Report: USDA raised their milk supply forecast for 2006 from last month, citing continued strong growth in milk supplies during February. At the same time, they [lowered their Class III price forecast](#) a dime from last month, now expecting it to average \$11.70 for 2006, due to an expectation of lower cheese prices.
- For the first ten days of April, [butter holdings are up 7% and cheese up 1%](#), according to USDA weekly cold storage numbers.
- Butter stocks at CME-approved warehouses increased 5.3 million lbs for the week ending 04/08, vs. an increase of only 2.4 million lbs during the same week a year ago. Total holdings increased to [120 million lbs vs. 70 million lbs](#) last year.
- Butter [demand is fair at best](#), according to Dairy Market News, and handlers are surprised at the lack of interest. Many thought that the low cash price would have stimulated stronger buyer interest, but it hasn't happened.
- Manufacturing milk demand is light in the Midwest, according to Fluid Milk & Cream Review. Managers are choosing to limit production rather than warehouse more product. Spot loads of milk are readily available at \$1 under class as overall receipts remain [well above year ago levels](#).
- Dry whey [fell yet again](#) in this week's NASS survey. It now sits at 31.8¢/lb, down 1.2¢ from last week. NDF decreased 1.8¢ to 84.2¢/lb while butter was down 0.9¢ to \$1.14/lb.
- There is talk of butter clearing to the government support program, according to Dairy Market News. The current support price is \$1.05/lb.
- Out West, Fluid Milk & Cream Review reports the rains and [wet conditions are not having much impact](#) on milk production, as output remains 4-6% higher than year ago levels. Handling all the milk has been a struggle for processors, and the holiday weekend is expected to add more stress as fluid orders have declined and some plants take an extra day off. More of the same in the Pacific Northwest as rains in the region have not hurt milk production. Processing plants are expected to be running at capacity over the holiday weekend as milk backs up from bottling operations.
- Dairy Market News reports prices paid for slaughter cows at both Wisconsin and St. Paul auctions has dropped about \$10/cwt compared to last year, and now average \$49.62/cwt.

Futures Month	Thursday 04/13 Close	Friday 04/07 Close	Change	10-yr Average	Top 3rd Price
Apr-06	\$10.88	\$10.92	(\$0.04)	\$12.31	\$13.52
May-06	\$10.76	\$10.90	(\$0.14)	\$12.35	\$13.69
Jun-06	\$10.77	\$10.91	(\$0.14)	\$12.41	\$13.50
Jul-06	\$11.10	\$11.25	(\$0.15)	\$12.85	\$13.75
Aug-06	\$11.56	\$11.64	(\$0.08)	\$13.28	\$14.19
Sep-06	\$11.73	\$11.79	(\$0.06)	\$13.78	\$14.67
Oct-06	\$11.71	\$11.73	(\$0.02)	\$13.21	\$14.00
Nov-06	\$11.66	\$11.70	(\$0.04)	\$12.32	\$13.34
Dec-06	\$11.62	\$11.64	(\$0.02)	\$12.44	\$13.53
Jan-07	\$11.65	\$11.67	(\$0.02)	\$12.27	\$13.08
Feb-07	\$11.65	\$11.67	(\$0.02)	\$11.68	\$12.34
Mar-07	\$11.60	\$11.67	(\$0.07)	\$11.82	\$12.51
Apr-07	\$11.90	\$11.95	(\$0.05)	\$12.31	\$13.52
May-07	\$11.95	\$11.98	(\$0.03)	\$12.35	\$13.69
Jun-07	\$12.05	\$12.05	\$0.00	\$12.41	\$13.50
Jul-07	\$12.23	\$12.25	(\$0.02)	\$12.85	\$13.75
Aug-07	\$12.40	\$12.50	(\$0.10)	\$13.28	\$14.19
Sep-07	\$12.44	\$12.45	(\$0.01)	\$13.78	\$14.67
Oct-07	\$12.31	\$12.30	\$0.01	\$13.21	\$14.00
Nov-07	\$12.11	\$12.10	\$0.01	\$12.32	\$13.34
Dec-07	\$11.75	\$11.75	\$0.00	\$12.44	\$13.53

- NDM prices continue to trend lower as [offerings across the country increase and demand slows](#), according to Dairy Market News. Instead of purchasing a month in advance, buyers are procuring just days in advance. Inventories continue to build as production remains heavy as dryers are being afforded little down time in order to handle excessive volumes of surplus milk.
- Dairy Market News reports the [dry whey market remains weak](#). Surplus loads are available as drying has been actively processing whey solids from milk moving into cheese plants. Buyers are tending to purchase for only immediate needs as prices decline, and exports for Jan-Feb were 9.7% lower than a year ago.

**Recommendation:**

In a holiday-shortened trading week, not much happened. Milk production remains strong and the whey price continues to drop. There does not appear to be much upside potential for Class III prices through June. This week we focused on buying upside protection for our sold positions. Let's look at two different strategies. First, the conservative hedge would be to simply by cheap calls for a dime



or less. For example, many of our clients have July sold near a \$13.20 average. Today, we purchased July \$12.25 calls for 9¢. Now, it doesn't matter what July prices do; you're covered. In fact, the potential is there to outperform the market should prices close above \$12.25. For example, if July were to settle at \$12.50, the producer would get \$12.50 from their plant, add \$0.70 gain from their sold position and a \$0.25 gain on their call option, for a total Class III base price of \$13.45. That's \$0.25 higher than what it was sold for. Similar strategies can be used for Aug-Dec. A more aggressive hedge would be to use an at-the-money bull call spread. For example, you could buy an August \$11.75 call for 45¢ and sell the August \$12.75 call for 15¢ for a net cost of 30¢. If prices were to retrace even back to the mid 12-dollar range, you could add significantly to your milk check. If you had sold August at a \$13.35 average and August settled at \$12.50, you would receive \$12.50 from your plant, a gain of \$0.85 from your sold position, and a net gain of \$0.45 from the bull-call-spread (75¢ gain less 30¢ cost). This would result in a final August Class III base price of \$13.80/cwt. There are many different strategies you can use to protect the upside of your sold position, but the bottom line is you should take some action. We will be focused on the milk production report next week, which should show another 5%+ gain. However, the April production report, out in mid May, might not show as big a percentage increase since April 2005 was when our milk output really started picking up. Whether rational or not, the smaller percentage increase might have enough emotional impact to help the back months move higher. Make sure you have your upside protection in place before then!

**NOTE:** Our offices will be closed Friday in observance of Good Friday. We wish everyone a wonderful Easter weekend.

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