



The KDM Dairy Report - July 28th, 2006

Bullish Fundamentals:

- Weekly cold storage numbers show a continued [decline in cheese stocks](#) which are down 3% through 07/24.
- Dairy cow [cull numbers were strong](#) again this week. 45,900 head went to slaughter vs. 40,300 during the same period last year.
- People are [scrambling for butter](#) in response to the hot weather. 1.7 million lbs were pulled out of CME warehouses for the week ending July 22nd, the largest weekly decrease since November. That compares to a net gain of 629,000 lbs during the same period last year.
- "It's just white water." Comment from an operator regarding the [drop in solids levels](#) due to the heat. Milk volumes have also dropped, with reduced load sizes and some cancelled loads, according to Fluid Milk & Cream Review.
- Heat in the Southeast has pushed [milk receipts down 6-10%](#) over the past few weeks, according to Fluid Milk & Cream Review. 88 loads of milk were imported into the area, vs. only 16 last week. Bottlers are starting to fill pipelines in preparation for school openings and foresee increased needs into the future.
- Fluid Milk & Cream Review reports milk production in California is being hardest hit by the long hot spell, with milk [volumes down 14 to 25%](#). Processors are not getting scheduled loads of milk resulting in production schedules below expectations. Cow mortality rates are way up, with rendering plants not able to handle the increase in dead animals. As a result, several counties have relaxed disposal guidelines, allowing carcasses to be sent to land fills. Cows are eating less under the stress and breeding activity has come to a halt.
- An AP news story estimates [25,000 cows have died](#) in Central California since July 14th, and milk receipts at a Land O' Lakes creamery are down 18%. Experts estimate as much as 2% of the state's dairy herd could die; that works out to more than 35,000 animals.
- More of the same in the Pacific Northwest where inland temps have also risen to over 100 degrees. Fluid Milk & Cream Review reports declines in milk output in the 10-15% region. Nights are not cooling off enough to give much relief to the cows. Plants are looking for additional loads of milk but are not able to find it.
- Dairy Market News reports the nonfat dry milk market is firming due to the decline in milk production. Schedules at drying plants are down sharply and [supplies are short of buyer interest](#).
- As the cream supply has tightened the butter market has firmed, according to Dairy Market News. Demand for bulk and print butter is excellent and there is a [shortage of unsalted butter](#). At the same time, there is increased competition for available cream supplies.
- Cash markets: Blocks managed a ¼¢ gain for the week to close at \$1.16¼ today. Barrels increased ½¢ to settle at \$1.12. Butter made a big move, increasing 4¾¢ to \$1.20/lb. Probably the bigger story is that buyers were much more aggressive, perhaps due to fears about product availability later this year due to the current heat. 16 loads of blocks, 12 barrels and 24 cars of butter exchanged hands.

Futures Month	Friday 07/28 Close	Friday 07/21 Close	Change	10-yr Average	Top 3rd Price
Ju1-06	\$10.95	\$10.93	\$0.02	\$12.85	\$13.75
Aug-06	\$11.02	\$11.04	(\$0.02)	\$13.28	\$14.19
Sep-06	\$12.17	\$11.70	\$0.47	\$13.78	\$14.67
Oct-06	\$12.75	\$12.20	\$0.55	\$13.21	\$14.00
Nov-06	\$12.80	\$12.20	\$0.60	\$12.32	\$13.34
Dec-06	\$12.73	\$12.17	\$0.56	\$12.44	\$13.53
Jan-07	\$12.73	\$12.31	\$0.42	\$12.27	\$13.08
Feb-07	\$12.54	\$12.20	\$0.34	\$11.68	\$12.34
Mar-07	\$12.52	\$12.19	\$0.33	\$11.82	\$12.51
Apr-07	\$12.72	\$12.44	\$0.28	\$12.19	\$13.36
May-07	\$12.70	\$12.55	\$0.15	\$12.22	\$13.51
Jun-07	\$12.75	\$12.65	\$0.10	\$12.31	\$13.36
Ju1-07	\$13.15	\$13.10	\$0.05	\$12.85	\$13.75
Aug-07	\$13.55	\$13.20	\$0.35	\$13.28	\$14.19
Sep-07	\$13.45	\$13.28	\$0.17	\$13.78	\$14.67
Oct-07	\$13.30	\$13.09	\$0.21	\$13.21	\$14.00
Nov-07	\$13.15	\$12.95	\$0.20	\$12.32	\$13.34
Dec-07	\$12.95	\$12.70	\$0.25	\$12.44	\$13.53

Bearish Fundamentals:

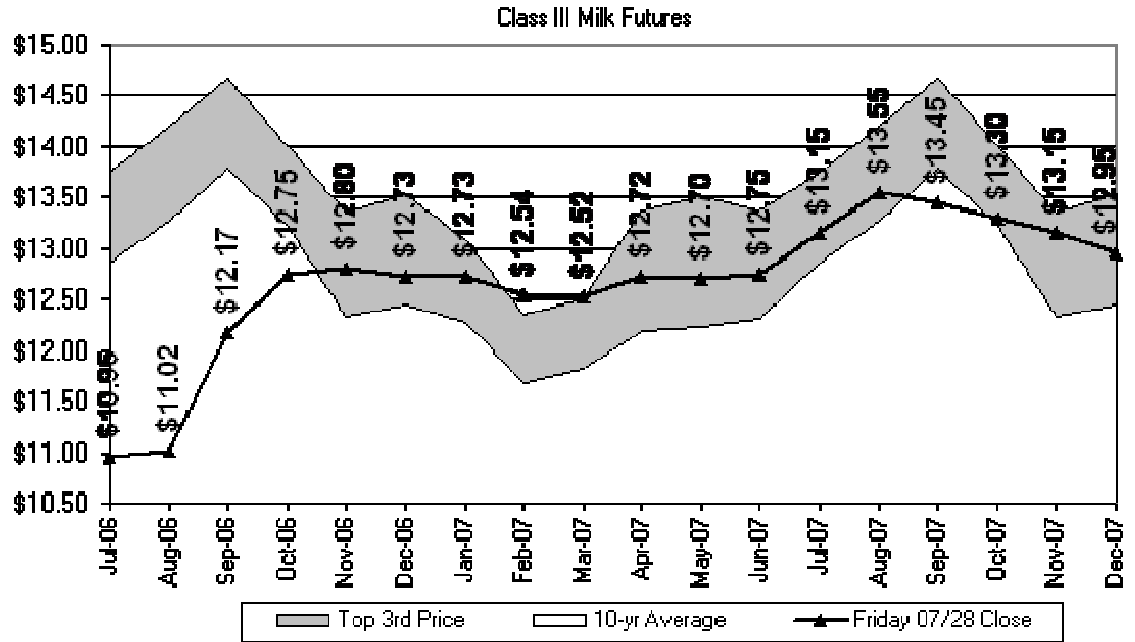
- We still have plenty of cheese. Dairy Market News reports this week that supplies of cheese are getting ahead of demand, and some locations have [offerings on the heavy side](#). Prices are often at a discount to keep cheese moving. Some operations are fortifying the vat with NDM to increase yields.
- NASS cheese prices [continued to slip](#) this week. U.S. 40-lb blocks decreased 0.3¢ to average \$1.16/lb, while 500-lb barrels gave up 1.9¢ to average \$1.15/lb.
- Friday's semi-annual USDA Cattle report indicated the number of milk cows in the U.S. had climbed to 9.15 million, up 1% from July 2005 and up 2% from two years ago. And there are [plenty of replacement heifers](#) despite the

continued closure of the Canadian border to imports. USDA tallied 3.8 million destined for the milking herd, up 3% from last year.

Recommendation:

Opening comment: The first thing we need to say this week is that our hearts go out to the farms that have suffered such losses the past couple weeks. While heat has been the catalyst that has moved prices higher, it doesn't lessen the economic challenges these producers now face.

With that said, as news hit the air about the impact heat was having literally countrywide, milk



futures took an about-face and roared higher. Despite recent bearish fundamentals, suddenly commercial interest became worried about price protection this fall and began to buy the market. Concern over the availability of product later this year brought aggressive buying in the cash market as well. Current supplies will probably limit the upside for Aug and Sep, however, Oct-Dec could trade over \$13 before this is over. For those that have not yet hedged, this presents a great opportunity. The market is emotional and will probably overdo it to the upside. Take advantage of that and be ready to get some price protection over the coming weeks. At a minimum, look at buying some PUT options should the prices move significantly higher.

2007 contracts were also the beneficiary of the heat as the cows affected will not likely recover much this lactation. Breeding activity has come to a stop as well. You may recall our recommendation was to wait for a \$12.90 average to get 25% sold. We eclipsed that to reach a record average high of \$13.00 after yesterday's close, and gave back a few cents today to \$12.96. These are great levels to start your hedge program, particularly 1st quarter, where Feb and Mar are above top-third historical prices. We could target additional sales if 2007 reaches a \$13.20 average.

Please give us a call if you would like help putting together a marketing plan for your operation. Let us know if you'd like us to visit your farm in person. We travel!

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