



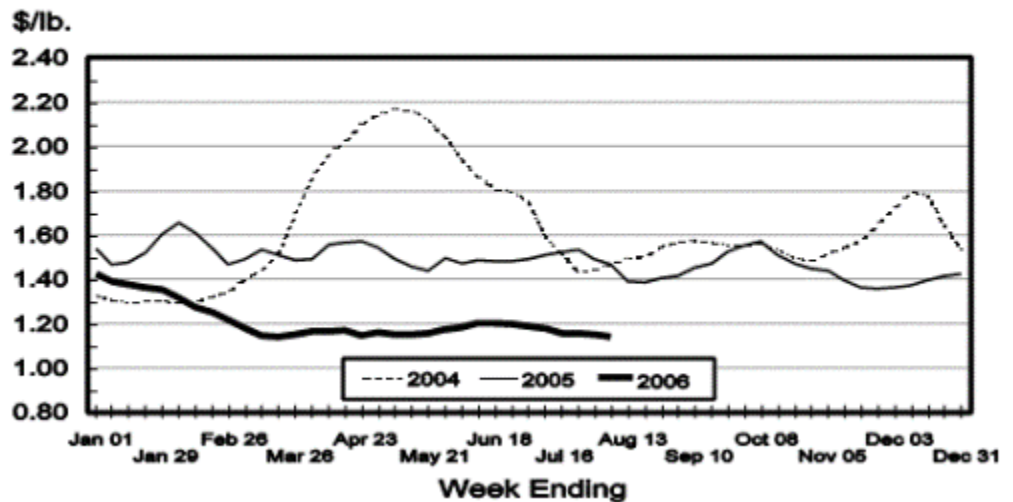
**The KDM Dairy Report - August 11<sup>th</sup>, 2006**

**Bullish Fundamentals:**

- World Ag Supply & Demand Report: USDA reduced the milk production forecast for 2006 and [increased their price forecast](#) for 3<sup>rd</sup> and 4<sup>th</sup> quarter due to the heat wave that hit the country. Production for the last two quarters is estimated at 88.8 billion lbs, down 700 million lbs from last month's guess. The average price in the 4<sup>th</sup> quarter has been revised up 25¢/cwt to \$13.10.
- The [cheese market is firming](#), according to Dairy Market News. Orders have increased as buyers who were waiting for a bottom have jumped back in after recent cash price increases on the CME. At the same time, current cheese offerings are down as some manufacturers are selling milk to bottlers for use in other areas due to a better return.
- The cash market [continued to move higher](#) this week. Blocks increased ½¢ to \$1.20/lb, barrels gained a strong ¾¢ to reach \$1.19¼/lb and butter was up ½¢ to \$1.29/lb. 8 loads of blocks, 9 barrels and 42 loads of butter exchanged hands.
- Milk [supplies are tight to short](#) in the Central region of the U.S., according to Fluid Milk & Cream Review. Class I sales have improved, while at the same time bottlers out East are pulling heavily from manufacturing operations in MI, WI and MN to supplement fluid supplies. Spot milk prices have jumped sharply, going for \$2-3 over class. Tight NDM supplies have forced cheese makers to switch to condensed skim to supplement cheese yields.
- Milk is tight out East as well. The heat from the past few weeks has [production down 8-10%](#) and handlers are scrambling for milk, according to Fluid Milk & Cream Review. 340 loads were imported into the area this week, compared to 268 last week and only 165 a year ago. School milk bottlers are trying to fill pipelines, but most think it won't be until we're well into fall before supply and demand come into balance.
- Dairy Market News reports nonfat dry milk prices are firm. Production has been [limited by supply](#), especially out East where milk has shifted south to satisfy Class I demand.
- Sales of fluid milk products in June were [up 1.7%](#) according to USDA statistics. More skim, 1% and 2% milk were consumed, but whole milk sales were down.
- NASS survey [prices rose for all Class III components](#) this week. Cheddar blocks increased 1¢ to \$1.14/lb while barrels were up 1.5¢ to match blocks at \$1.14/lb. Butter gained 1¢ to average \$1.15/lb, nonfat dry milk increased 0.9¢ to 84.6¢/lb and dry whey was up 0.4¢ to 28.8¢/lb.
- Slaughter numbers for the week ending 07/29 show 43,200 dairy cows were culled vs. 39,400 during the same period a year ago. Increases in dairy cow slaughter have pushed YTD numbers [ahead of 2005](#) for the first time.

Futures Month	Friday 08/11 Close	Friday 08/04 Close	Change	10-yr Average	Top 3rd Price
Aug-06	\$10.99	\$10.96	\$0.03	\$13.28	\$14.19
Sep-06	\$11.90	\$11.92	(\$0.02)	\$13.78	\$14.67
Oct-06	\$12.58	\$12.55	\$0.03	\$13.21	\$14.00
Nov-06	\$12.75	\$12.64	\$0.11	\$12.32	\$13.34
Dec-06	\$12.80	\$12.65	\$0.15	\$12.44	\$13.53
Jan-07	\$12.78	\$12.70	\$0.08	\$12.27	\$13.08
Feb-07	\$12.50	\$12.43	\$0.07	\$11.68	\$12.34
Mar-07	\$12.45	\$12.45	\$0.00	\$11.82	\$12.51
Apr-07	\$12.75	\$12.65	\$0.10	\$12.30	\$13.47
May-07	\$12.70	\$12.65	\$0.05	\$12.32	\$13.61
Jun-07	\$12.72	\$12.70	\$0.02	\$12.39	\$13.44
Jul-07	\$13.20	\$13.13	\$0.07	\$12.82	\$13.71
Aug-07	\$13.45	\$13.28	\$0.17	\$13.28	\$14.19
Sep-07	\$13.34	\$13.33	\$0.01	\$13.78	\$14.67
Oct-07	\$13.19	\$13.16	\$0.03	\$13.21	\$14.00
Nov-07	\$13.08	\$13.00	\$0.08	\$12.32	\$13.34
Dec-07	\$12.82	\$12.82	\$0.00	\$12.44	\$13.53

**Cheddar Cheese Prices, U.S.  
40 lb. Blocks**



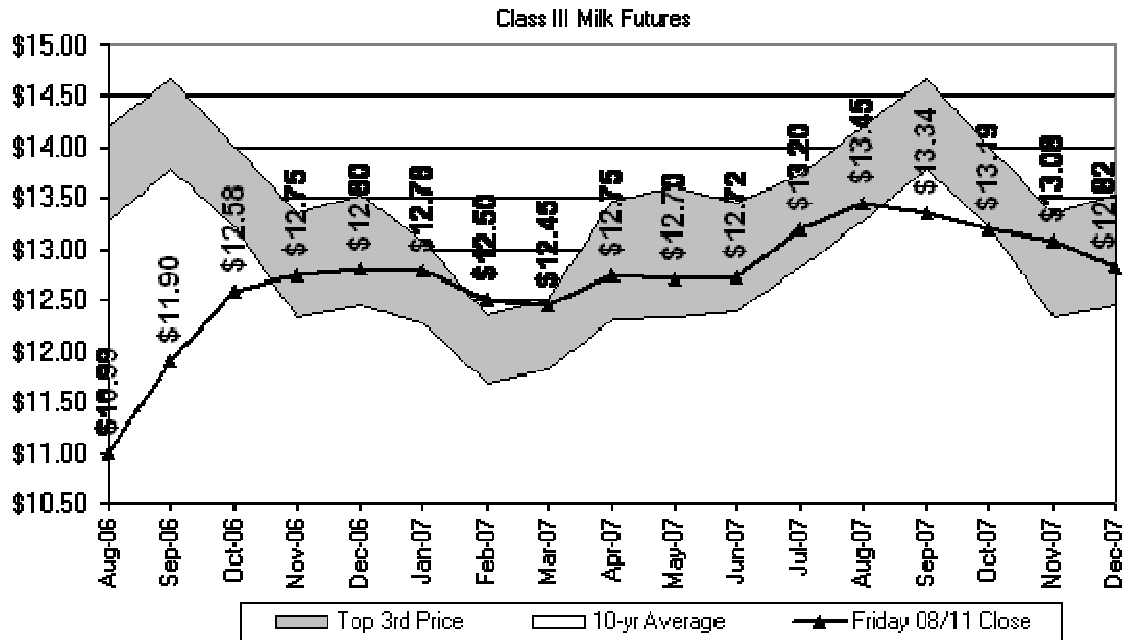
- The butter market is firm, according to Dairy Market News. Cream [supplies are tight](#) due to lower milk production and butterfat tests, while the butter in inventory is not in the form of need.
- Butter stocks at CME-approved warehouses continue to be pulled at a quicker rate than last year. A net 6.2 million lbs were removed during the week ending 08/05, the [largest weekly drawdown this year](#), and more than the 4.0 million lbs pulled during the same period last year.

**Bearish Fundamentals:**

- Milk production in California has [come back surprisingly well](#), according to Fluid Milk & Cream Review. Levels are nearing pre-heat volumes and solids content is on the rise. In New Mexico, milk output has been steady with enough to supply both local needs and outside contracts. Our own proprietary monitoring shows receipts in CA have come back more than half way, with lots of producers freshening new cows as well.
- Weekly cold storage numbers are showing a [1% gain in cheese stocks](#) for the week ending August 7<sup>th</sup>.
- Too much bullish news!

**Recommendation:**

It seems that the heat wave that rolled across the country over the last several weeks affected the country in stages. First we had the big losses in CA, then the Midwest was hit, and now the East appears to be feeling the after-effects of the heat. Reports from our contacts and from Fluid Milk & Cream Review indicate the eastern region of the country is tightest on milk at this time, having difficulty



meeting even fluid demand. That is likely to change over the coming weeks, however, as the cows rebound. Speaking of rebounding, it's nothing short of amazing how far production has come back in California. We would have expected the cows to be down the remainder of their lactation, but evidence shows they have recovered more than half of their pre-heat production. Producers we work with are freshening a lot of cows this month as well. If August gets extremely hot, production could suffer again, otherwise further recovery is expected. With that said, the uncertainty of the market has increased dramatically, making it much more difficult to predict where prices are headed. If production rebounds substantially across the country, prices will be depressed, but if they don't, there will be good support. We still expect prices to rally but the window may be shorter. Strength in the cash market helped move Class III futures higher this week. The 2007 average increased 6¢ to \$12.92. If you have nothing hedged and can make money here, consider selling up to 25% of your production if we hit \$13.00. July-Dec '07 hit a \$13.18 average. Consider selling additional production if we hit \$13.25. For the balance of 2006, target Oct at \$12.90 and Nov/Dec at \$13.00.

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.