



The KDM Dairy Report - September 8th, 2006

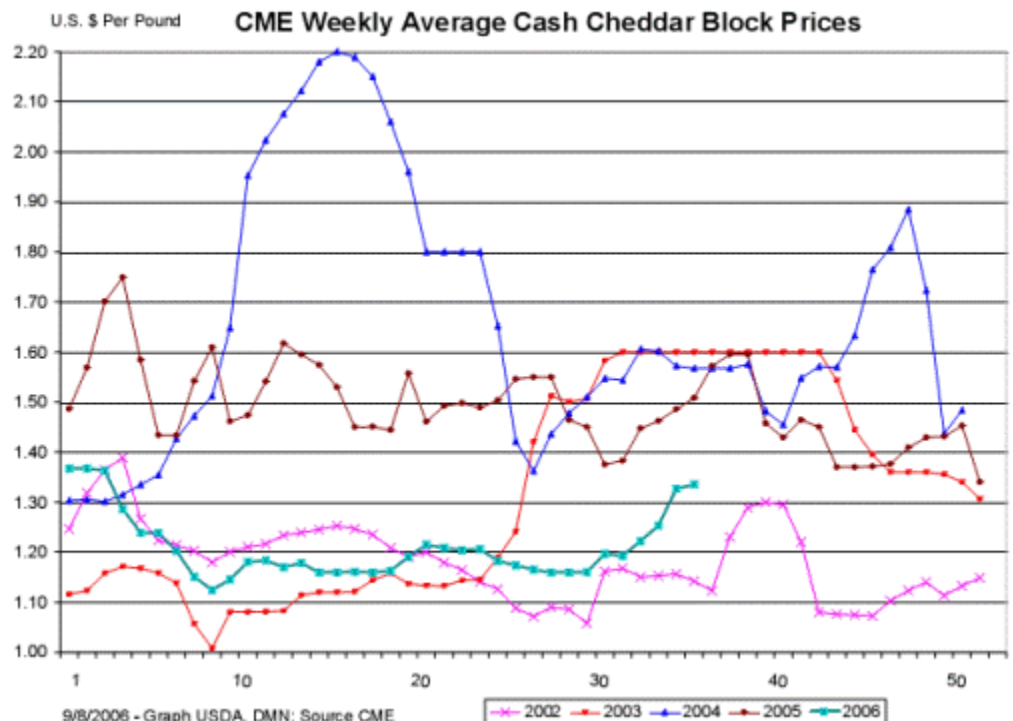
Bullish Fundamentals:

- Weekly NASS numbers [continue to make gains](#). Block cheese gained 2.2¢ to average \$1.22/lb, while barrels were up a stronger 3.7¢ to \$1.24/lb. Butter shot up 6.8¢ to \$1.31/lb and dry whey increased 0.7¢ to 31.1¢/lb.
- Weekly dairy cow slaughter seems to [picking up](#) even though we're past the hottest part of summer. For the week ending 08/26, 48,500 head were culled vs. 42,600 during the same week last year.
- Fluid Milk & Cream Review reports the milk supply in the Midwest remains tight, as Class I sales are strong and bottlers pull milk away from manufacturers. Spot prices are going from \$2-3 over class and truck availability remains limited, and an increasing number of cheese plants are [running on reduced schedules](#).
- Milk receipts in California are steady, but parts of the Central Valley were heating up again and production there is down slightly, according to Fluid Milk & Cream Review. Manufacturing plants are able to run on expected schedules, but they are [seeking additional milk](#) to process.
- Exports of dry whey remain strong, according to Dairy Market News. Some exporters will [take up to mid-October](#) to catch up on orders.
- Dairy Market News reports barrel and Mozzarella cheese supplies [remain tight](#) in the Midwest, as final school openings this week pulled extra fluid supplies away from cheese production.
- Fluid [milk sales in July were 0.7% higher](#) than in 2005, according to Dairy Market News. Consumption was up for flavored whole milk, 2%, 1% and skim, while sales of whole milk, buttermilk and flavored fat-reduced milk was lower.

Futures Month	Friday 09/08 Close	Friday 09/01 Close	Change	10-yr Average	Top 3rd Price
Sep-06	\$12.18	\$12.35	(\$0.17)	\$13.78	\$14.67
Oct-06	\$12.29	\$12.75	(\$0.46)	\$13.21	\$14.00
Nov-06	\$12.28	\$12.60	(\$0.32)	\$12.32	\$13.34
Dec-06	\$12.34	\$12.54	(\$0.20)	\$12.44	\$13.53
Jan-07	\$12.31	\$12.46	(\$0.15)	\$12.27	\$13.11
Feb-07	\$12.25	\$12.32	(\$0.07)	\$11.68	\$12.37
Mar-07	\$12.25	\$12.33	(\$0.08)	\$11.82	\$12.54
Apr-07	\$12.46	\$12.49	(\$0.03)	\$12.30	\$13.51
May-07	\$12.48	\$12.50	(\$0.02)	\$12.32	\$13.67
Jun-07	\$12.63	\$12.64	(\$0.01)	\$12.39	\$13.49
Jul-07	\$13.30	\$13.30	\$0.00	\$12.82	\$13.74
Aug-07	\$13.40	\$13.45	(\$0.05)	\$13.23	\$14.17
Sep-07	\$13.52	\$13.50	\$0.02	\$13.78	\$14.67
Oct-07	\$13.23	\$13.22	\$0.01	\$13.21	\$14.00
Nov-07	\$13.10	\$13.10	\$0.00	\$12.32	\$13.34
Dec-07	\$12.93	\$12.92	\$0.01	\$12.44	\$13.53
2007 Avg	\$12.82	\$12.85	(\$0.03)		

Bearish Fundamentals:

- Cash Market: The rug was pulled out from under cash cheese as the significant buyer from last week was not there to defend the price today. Blocks lost 4¾¢ for the week (all today) to close at \$1.30/lb today while barrels fell the same amount, settling at \$1.26½/lb. Butter also continued to lose ground, decreasing 6¾¢ to \$1.30/lb. 18 loads of blocks, 3 barrels and 17 loads of cars exchanged hands.
- Dairy Market News reports that supplies of cream are building. As ice cream season winds down, more cream ends up in the churn, relieving the tight fresh butter situation of the past few



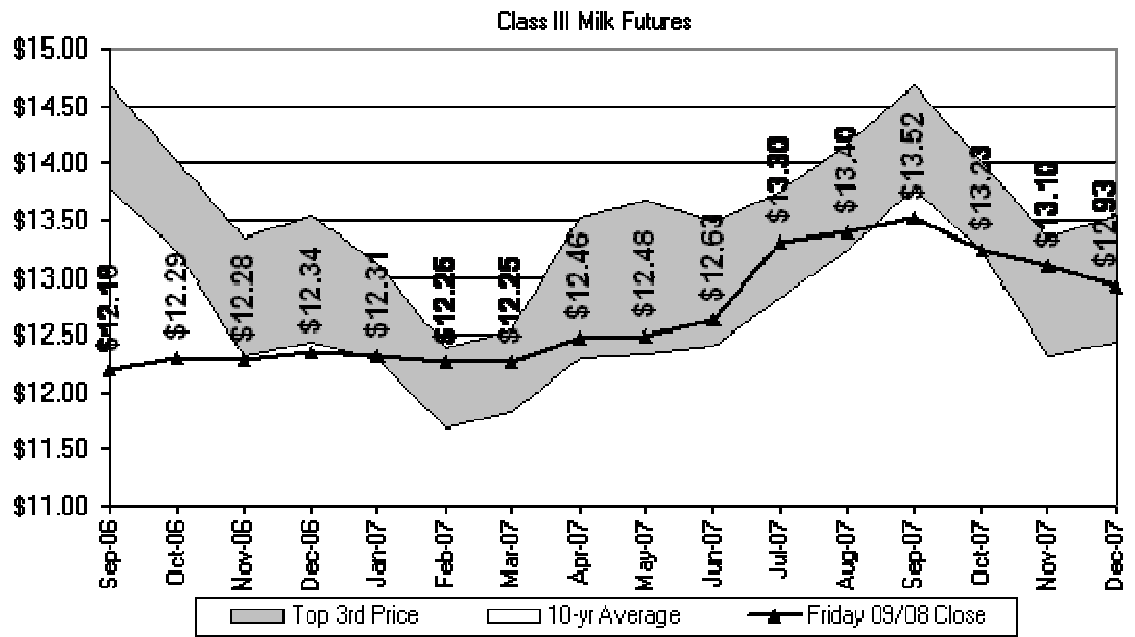
months. Butter demand from food service operators as slowed, perhaps as a result of more indications from trade reports showing a [drop in restaurant traffic](#).

- Barrel [demand has weakened](#) and blocks are available out West, according to Dairy Market News, and cheese production was heavier over the holiday weekend.

Recommendation:

Volatility creates opportunity.

Class III futures had little movement this week until we reached today's cash cheese session. Usually Friday is a "do nothing day in cheese", but today we saw prices fall more than 4¢ in blocks and barrels. Futures followed and quickly fell as much as 44¢ in October. Several contacts out West indicate that they have incurred operational losses on their dairies. Several more months of these lower milk prices could lead to large scale operational cost cutting. One large well-managed dairy operation estimated losses of \$250,000 per month for the last 6 months.



One trade opportunity from this volatility to the downside is to buy call the 13.00 call in November and December for 15¢. It seems a bit premature at this point (we hope) to think that this was it for cheese. Seasonal holiday buying has yet to start in earnest, and we believe another rally in the cheese price is very possible. Buying the Nov and Dec 13.00 calls now while they are cheap will allow you to sell your milk with confidence later this fall should we have that second rally, as you will already have your upside covered.

2007 contracts were not affected as much by the lower cash cheese trade and are trading at a \$12.82 average for the year. Hopefully this move down will spur some demand and prices will come back the other direction, giving us a chance to sell 2007 at or near 13.00. Be patient.

Give us a call and we'll help you put together a risk management plan specific to your operation!

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