



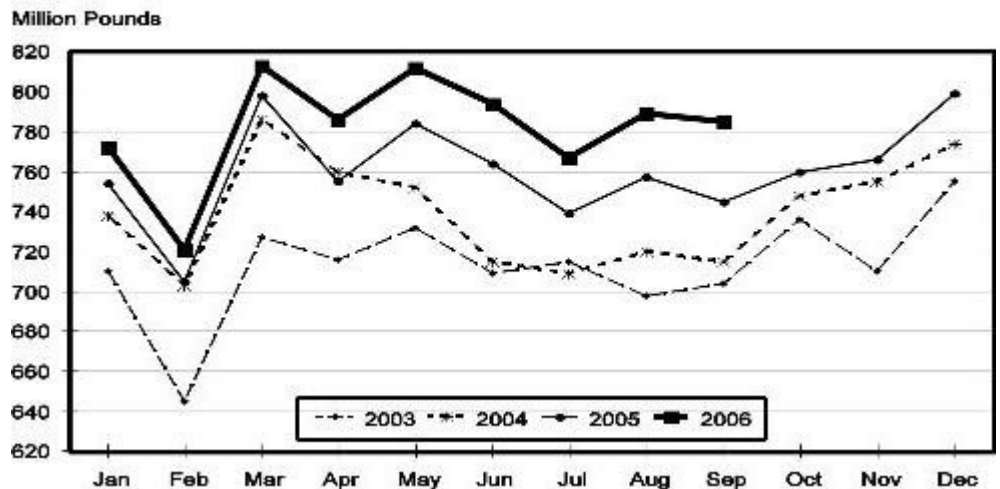
## The KDM Dairy Report - November 3<sup>rd</sup>, 2006

### Bullish Fundamentals:

- Cash market: While dropping more than a nickel in today's session alone, cash blocks and barrels were up sharply for the week. Blocks had a net gain of 7¾¢ from last Friday, settling at \$1.31¾/lb today, while barrels were up, 6½¢ to \$1.31¼/lb. Butter remained unchanged at \$1.27½/lb. 3 loads of blocks, 1 of barrel and 10 cars of butter exchanged hands.
- USDA cumulative cold storage numbers for the month of October reveal a [strong 27% drop](#) in butter stocks and 4% decline in cheese stocks, according to numbers released this week.
- The dairy cow slaughter continues to [outpace year-ago](#) numbers. For the week ending 10/21, 51,900 head were culled vs. 51,500 during the same week last year.
- In the Midwest, Class I demand is very good and Class II interest is growing, according to Fluid Milk & Cream Review. That's [leaving little for Class III](#). Strong fluid sales and increasing production of dips, sour cream and other holiday specialties has resulted in demand "easily exceeding the supply". Most cheese plants are running on light schedules.
- 250 loads of Grade A milk were shipped into Florida this week vs. 205 last week, according to Fluid Milk & Cream Review. Strong fluid [demand has been helped](#) by the return of Florida snowbirds and increasing cruise ship activity. Milk handlers who thought that supplies would be more in balance near Thanksgiving are now thinking it may take longer before that happens.
- Higher grain prices are causing stress on some dairy producers in the Pacific Northwest, according to Fluid Milk & Cream Review. Forage quality continues to be an issue as well, and milk processors are running at less than capacity levels. Some plants are attempting to acquire additional milk but are having limited success.
- Significant increases in production and availability of nonfat dry milk is [not anticipated for at least a month](#), according to Dairy Market News. Strong Class I interest is continuing to limit the amount of milk available for Class III and IV facilities, which also means less nonfat dry milk is available to fortify the vat.
- Delivery of nonfat dry milk orders is being broken down into pallet-sized loads from truckloads, in an effort to service the weekly needs of more customers, according to Dairy Market News. Some producers are working to fill orders that were [due six to eight weeks ago](#).
- Dry whey in the Central region of the country sold for between 39½¢ to 44½¢ per pound this week, according to Dairy Market News. [Supplies remain light](#), and buyers looking to contract their needs in 2007 are facing significant premiums by producers.

Futures Month	Friday 11/03 Close	Friday 10/27 Close	Change	10-yr Average	Top 3rd Price
Nov-06	\$12.72	\$12.53	\$0.19	\$12.32	\$13.34
Dec-06	\$13.32	\$12.95	\$0.37	\$12.44	\$13.53
Jan-07	\$13.42	\$13.02	\$0.40	\$12.27	\$13.11
Feb-07	\$13.41	\$13.01	\$0.40	\$11.68	\$12.37
Mar-07	\$13.55	\$13.14	\$0.41	\$11.82	\$12.54
Apr-07	\$13.66	\$13.35	\$0.31	\$12.30	\$13.51
May-07	\$13.77	\$13.38	\$0.39	\$12.32	\$13.67
Jun-07	\$13.86	\$13.49	\$0.37	\$12.39	\$13.49
Jul-07	\$14.28	\$13.98	\$0.30	\$12.82	\$13.74
Aug-07	\$14.35	\$14.20	\$0.15	\$13.23	\$14.17
Sep-07	\$14.40	\$14.34	\$0.06	\$13.79	\$14.68
Oct-07	\$14.05	\$14.00	\$0.05	\$13.19	\$13.98
Nov-07	\$13.83	\$13.88	(\$0.05)	\$12.32	\$13.34
Dec-07	\$13.63	\$13.75	(\$0.12)	\$12.44	\$13.53
Jan-08	\$13.60	\$13.35	\$0.25	\$12.27	\$13.11
Feb-08	\$13.45	\$13.10	\$0.35	\$11.68	\$12.37
Mar-08	\$13.45	\$12.99	\$0.46	\$11.82	\$12.54
Apr-08	\$13.45	\$12.90	\$0.55	\$12.30	\$13.51
May-08	\$13.20	\$12.86	\$0.34	\$12.32	\$13.67
Jun-08	\$13.30	\$12.95	\$0.35	\$12.39	\$13.49
<b>2007 Avg</b>	<b>\$13.85</b>	<b>\$13.63</b>	<b>\$0.22</b>		
<b>Jan-Jun '08</b>	<b>\$13.41</b>	<b>\$13.03</b>	<b>\$0.38</b>		

### Total Cheese Production United States



- Dairy Market News reports dry whey supplies are down in the Western region because [cheese output is below anticipated levels](#) at many plants. Buyers are facing longer wait times until delivery.
- While butter stocks in cold storage remain higher than a year ago, 61.3 million lbs were pulled from CME-approved warehouses in the last 10 weeks, vs. 31.5 million lbs during the same period last year. Due to strong Class I and II demand, butter producers have

been limited in the amount of cream they can obtain, so [churning schedules are less than desired](#). Fresh butter demand is exceeding supply, so inventories are being drawn out of storage to meet needs.

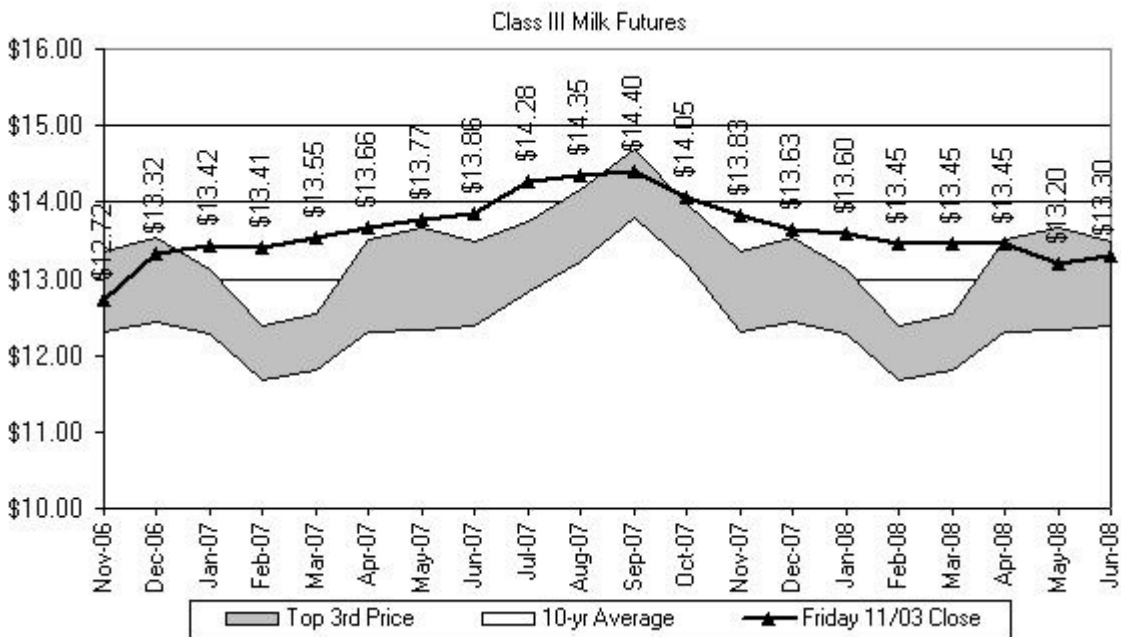
- The cheese market is firm, according to Dairy Market News. Holiday demand for regular and specialty cheeses plus the lack of nonfat dry milk for cheese vat use has [tightened the supply](#) of current (under 30 day's age) cheese. Buyers are experiencing delays on fresh mozzarella and provolone orders, while at the same time, some operations have switched from cheese to more profitable butterfat/skim solids production.

**Bearish Fundamentals:**

- Dairy Products Report: Cheese output in September was [higher than most analyst expectations](#). Cheddar production was up a strong 7.9% vs. September 2005, and 2.6% higher than August. Total cheese production was 5.3% higher than last year, while butter output was 2% above a year ago and 16.3% higher than last month. YTD, cheddar production is 3.7% above 2005.
- October Class III was announced at \$12.32/cwt, \$2.03/cwt less than last year and below its 10-yr historical average of \$13.19/cwt.
- NASS prices for most Class III components made a [surprising drop](#) this week. Dry whey, which has been strongly higher the last couple weeks, was actually down 0.4¢ to 36.7¢/lb. Time will tell if this was just an anomaly or we're nearing the top. 40-lb cheddar blocks fell 0.4¢ to \$1.22/lb and butter decreased 1.1¢ to \$1.30/lb. 500-lb cheddar barrels did manage a small 0.2¢ gain to average \$1.23/lb and nonfat dry milk was up 2.4¢ to 94.2¢/lb.
- Near ideal milking conditions in the Southwest is helping keep milk production in balance with demand, according to Fluid Milk & Cream Review. Cheese plants in CA and NM are receiving [adequate milk supplies](#), while fluid needs are being met.

**Recommendation:**

Despite the big drop in today's cash cheese session, long-term fundamentals continue to support the market. Dec corn briefly went above \$3.50/bu on the Chicago Board of Trade, with deferred contracts in the \$3.70's to \$3.80's. Feed costs are already biting budgets as we heard reports this week about producers using less corn in their TMR. If grain prices remain strong, more substitutions will be made, with the result being a drop in milk production. Strong fluid demand, in the Southeast in particular, is pulling milk away from



cheese operations. More consumption of this product with such a short shelf life is very helpful in clearing milk. Once it's gone, it's gone. Finally, the tight global supply of milk powders is drawing even more milk away from the vat. We have a shortage of cheese-making milk, and it appears it could stay this way well in to the New Year. The 2007 average hit \$13.91 earlier this week and stands at \$13.85 after today's close. We continue to recommend getting 25% of your milk sold here. For additional coverage, consider buying 13.00 put options Jan-May at an average cost of 37¢ each. If the market were to break to the downside after the purchase, we would attempt to sell 12.00 puts for the same months at 20¢ average price each, which would reduce your net cost to 17¢ (37¢ paid less 20¢ received). This would net you an effective floor of \$12.83 with unlimited upside on your milk, and protection down to \$11.83, after which you would receive the market price. Sound confusing? Call us and we'll help you work through the numbers!

Finally, we came across a neat web site this week, designed for dairy producers to exchange ideas. If you have questions (or advice) on nutrition, milk quality, herd health, reproduction, or facilities, just to name a few, check out [www.dairyforums.com](http://www.dairyforums.com) and join their growing list of members. It's free!

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