



## The KDM Dairy Report - December 29<sup>th</sup>, 2006

### Bullish Fundamentals:

- Commercial Disappearance: Use of American cheese in October by commercial entities was [up a very strong 6.5%](#) vs. last year, according to USDA figures released this week. And use of Other-than-American cheese rebounded from a drop of 3.4% in September, to a 5.6% increase vs. October 2005. Commercial use of butter in October was up an even more impressive 13.2%, while nonfat dry milk use was down 5.7%, due most likely to shortage of stocks. Finally, to cap off a strong report, commercial use of milk in all products for October increased 4.9%. YTD, use of milk in all products is up 2.1%.
- Ag Prices Report: USDA's monthly look at prices paid and received by U.S. farmers indicates profit is getting harder to come by milking cows. The December milk-to-feed ratio fell 4 points to 2.42 (November was revised up from 2.34 to 2.46). Historically, milk production and the herd size [tend to trend lower](#) when the ratio is below 3.0.
- Cash market: In another week of quiet, holiday trading, a major seller was absent. This allowed buyers to bid blocks up a modest ½¢ from last week's price, with blocks settling at \$1.33/lb today. Barrels remained unchanged at \$1.29/lb, however butter continued to slide, down 3¢ to \$1.20/lb. 2 loads of blocks, 2 of barrel and 4 cars of butter exchanged hands.
- Culling continues at a [rapid pace](#). For the week ending 12/16, 53,100 dairy cows went to slaughter vs. 47,200 during the same period last year, an increase of 12.5%.
- Fluid Milk & Cream Review reports that feed issues are impacting milk production in the Pacific Northwest more than the winter storms they are receiving. [Ration costs are being reduced](#) and production per cow is being impacted.
- Dairy Market News reports the nonfat dry milk market remains firm, despite extra milk available over the holiday period. Some operations have been able to catch up a bit, but [export demand remains more aggressive](#) than the domestic side of the market.
- Most plants of [no dry whey to offer](#) on a cash basis, according to Dairy Market News. Grade A supplies traded for over 50¢/lb this week and many plants have fully contracted their 2007 production at premiums of 1-6 cents above the market. Some end-users have been unable to secure the same amount of product in 2007 as they did in 2006.
- NASS surveyed prices for nonfat dry milk and dry whey were up again this week. NDM was up a strong 2.4¢ to average \$1.04/lb, while dry whey increased 0.4¢ to stand at 41.4¢/lb.
- The Kansas City Commodity Office announced plans to invite bids for the [purchase of several varieties of cheese](#), in 500-lb barrels. The cheese will be used to supply domestic programs, and includes process blend, Mozzarella, and Natural American.
- International: USDA reported the international price for nonfat dry milk in November averaged \$2,906 per metric ton, or about \$1.31/lb. That should keep foreign buyers interested in our product since the current NASS average of about \$1/lb is substantially lower.

Futures Month	Friday 12/29 Close	Friday 12/22 Close	Change	5-yr Average	Top 3rd Price
Dec-06	\$13.46	\$13.47	(\$0.01)	\$12.58	\$13.68
Jan-07	\$13.20	\$13.10	\$0.10	\$12.16	\$13.00
Feb-07	\$13.32	\$13.17	\$0.15	\$12.02	\$12.70
Mar-07	\$13.42	\$13.30	\$0.12	\$11.89	\$12.61
Apr-07	\$13.71	\$13.60	\$0.11	\$13.09	\$14.31
May-07	\$13.93	\$13.85	\$0.08	\$13.14	\$14.49
Jun-07	\$14.09	\$14.00	\$0.09	\$12.54	\$13.63
Jul-07	\$14.45	\$14.30	\$0.15	\$12.25	\$13.16
Aug-07	\$14.65	\$14.50	\$0.15	\$12.41	\$13.34
Sep-07	\$14.78	\$14.64	\$0.14	\$13.11	\$13.99
Oct-07	\$14.39	\$14.31	\$0.08	\$13.19	\$13.98
Nov-07	\$14.21	\$14.12	\$0.09	\$12.88	\$13.86
Dec-07	\$14.04	\$13.90	\$0.14	\$12.58	\$13.68
Jan-08	\$14.00	\$13.80	\$0.20	\$12.16	\$13.00
Feb-08	\$13.90	\$13.80	\$0.10	\$12.02	\$12.70
Mar-08	\$13.85	\$13.80	\$0.05	\$11.89	\$12.61
Apr-08	\$13.85	\$13.80	\$0.05	\$13.09	\$14.31
May-08	\$13.85	\$13.80	\$0.05	\$13.14	\$14.49
Jun-08	\$14.00	\$13.80	\$0.20	\$12.54	\$13.63
<b>2007 Avg</b>	<b>\$14.02</b>	<b>\$13.90</b>	<b>\$0.12</b>		
<b>Jan-Jun '08</b>	<b>\$13.91</b>	<b>\$13.80</b>	<b>\$0.11</b>		

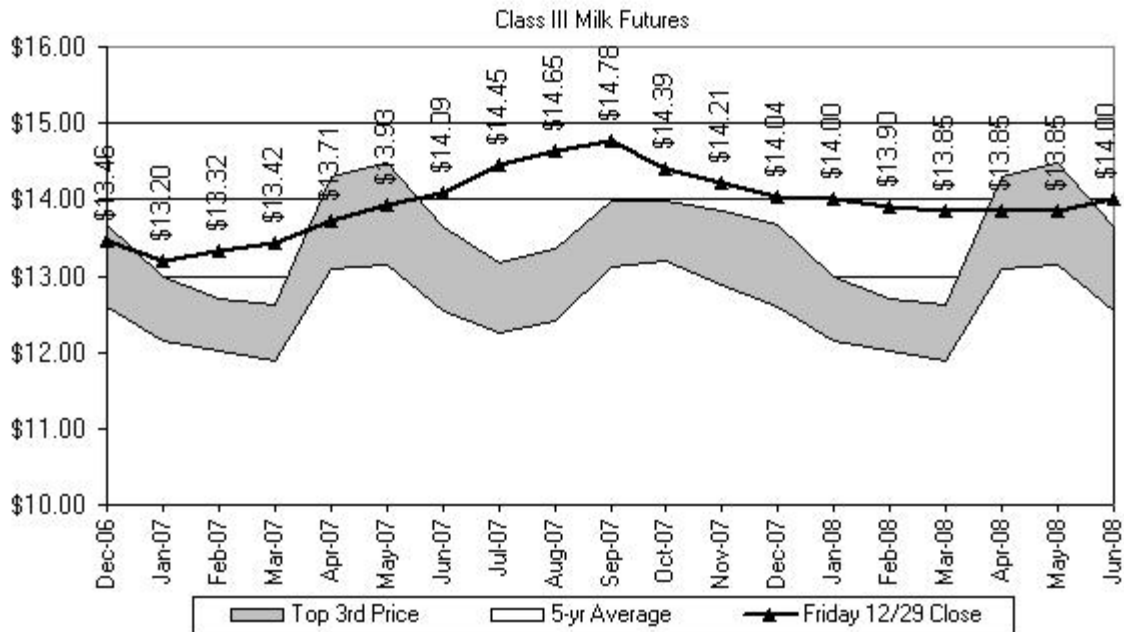
### Bearish Fundamentals:

- NASS surveyed cheese and butter prices continued to decline. 40-lb blocks averaged \$1.31/lb, down 2½¢ from last week, and 500-lb barrels fell 2.9¢ to \$1.30/lb. Butter declined a more modest 0.2¢ to average \$1.24/lb.
- Fluid Milk & Cream Review reports cream prices in the Midwest are sharply lower as a result of [very slow Class I demand](#) over the Christmas break. The extra milk was sent to butter and cheese operations, which ran on heavier schedules.

- Reduced bottling needs is also allowing more milk to enter Northeast butter/powder operations, according to Fluid Milk & Cream Review. Manufacturers are receiving many more loads of milk than they have in prior weeks. After importing 31 loads of Grade A milk last week, [Florida became an exporter](#), at least for this week, of 140 loads, the second highest amount for this week in five years.
- Butter stocks at CME-approved warehouses [continue to build](#). For the week ending 12/23, 1.7 million lbs of new butter were placed in storage. During this week last year, we were still pulling butter out, with a drawdown of 0.8 million lbs.
- Dairy Market News reports cheese [demand is slowing and production is increasing](#) as we come to the end of the year. Supply and demand remain in balance, but inventories are growing.

### Recommendation:

It was another week of quiet trading between holidays. There is not really a lot to report on, other than we're seeing continued commercial end-user hedging (buyers) which is supporting the market. Producers (sellers) are quietly putting on hedges at the \$14.00 and higher level, which is a great place to start your hedge program if you haven't already. Uncertainty on milk prices in 2007 still abounds, with some advocating much higher



prices than where we are today, and some convinced prices are headed back down because they weren't low long enough. With so many unknowns, the tendency and easiest option is to freeze and make no marketing decisions, but is that really the best strategy? There are legitimate arguments for both the bulls and the bears, which begs the question, in an uncertain market, what are you, the business owner, doing about it? Many of you run businesses with multi-million dollar revenues, AND multi-million dollar risks. Consider that if today's closing prices were to hold, the 2007 calendar year would finish with an average price of \$14.02. It would be the 4<sup>th</sup> highest annual average in the last 10 years and within 4¢ of being the 3<sup>rd</sup> highest average. Cost of production could vary greatly this year, so we never want to hedge at a negative cash flow, but for many producers, good money can be made at a \$14 base price. If you have not begun your hedge program yet, get started on up to 25% of your production for the year, perhaps more for the first half. Protect additional milk for first quarter using PUT options. Jan-Mar 13.25 PUTs now average 23¢, which yields an effective floor just over \$13 while leaving your milk open to higher prices. In real dollars, if you were to protect 1 million lbs of production per month, you would buy a total of 15 PUT options at a cost of \$6,900 ( $\$0.23 \times 2,000/\text{cwt per contract} \times 15$ ). Buy these now! If you lose your money on the PUTs, it just means the milk price is higher than \$13.25 which is a "win" for you! In other words, you can protect 1 million lbs at a \$13 floor for a cost of \$2,300 per month. That's pretty cheap insurance. Give us a call next week and we'll help you put together a hedge program for your operation.

Finally, KDM would like to wish you a Happy New Year! May the dairy industry be blessed in 2007!

**NOTE:** Our offices will be closed on Monday, January 1<sup>st</sup> in observance of New Year's Day, AND Tuesday, January 2<sup>nd</sup> as a national day of mourning has been declared on the passing of former President Ford. All U.S. financial markets will be closed on these days. Our offices will reopen on Wednesday, January 3<sup>rd</sup>.

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.