



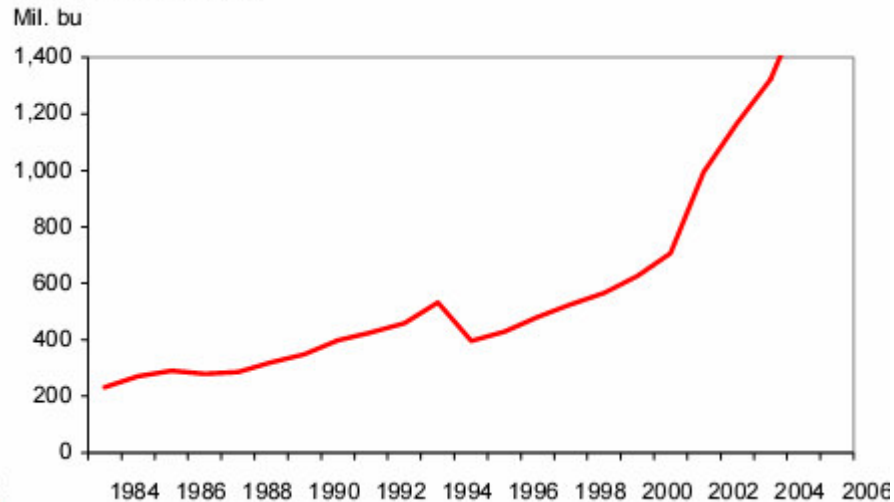
The KDM Dairy Report - January 19th, 2007

Bullish Fundamentals:

- The NASS weekly whey price was [up a stunning 3.3¢](#) to hit a new record high of 47¢/lb. In one week, that move added 20¢/cwt to Class III. Cheese continued to make small gains as blocks were up 0.5¢ to average \$1.32/lb and barrels were up 1.7¢ to \$1.31/lb. Nonfat dry milk and butter were each down just 0.1¢, at \$1.05/lb and \$1.19/lb respectively.
- Feed Outlook Report: USDA's monthly look at feed stocks notes hay supplies as of December 1st were [down 8%](#) from last year and at their lowest level since 1988. Hay production totaled 142 million tons compared to 151 million tons last year. Corn for silage in 2006 was 2% lower than in the previous year as the silage yield fell 1.8 tons/acre. Feed grain supplies for 2006/07 are down 2% from December and down 6% from 2005/06. Finally, corn used for ethanol production from Sep-Nov 2006 was estimated at 475 million bushels, up from 364 million bushels during the same period in 2005, an increase of 30% (see graph).
- Recent ice storms in central states such as Missouri are affecting milk receipts, according to Fluid Milk & Cream Review. Limited hay supplies combined with \$4/bu corn and high meal prices are causing producers to review culling levels in light of current milk prices and profitability.
- Fluid Milk & Cream Review reports [fluid sales are very strong](#) throughout the Eastern region of the country. In the Northeast, some bottling plants are in the process of becoming rBST-free bottlers, and in Florida, 43 loads of milk were imported vs. 12 exported in the prior week, as more and more winter residents arrive.
- Prices for dry whey remain firm, according to Dairy Market News. Most plants [do not have any to offer](#) on a spot basis, and prices as high as 60¢ delivered were noted in the resale market. Most users are hanging on to whatever supplies they have as cheese plants reduce output in light of higher nonfat dry milk prices for fortification.
- Western whey prices are sharply higher but are still finding willing buyers, according to Dairy Market News. Foreign buyers who thought the price might drop after the New Year are [jumping back in and paying up](#) to procure needs. Domestic buyers are competing for the powder but many times are not able to pay the top dollar that exporters are willing to pay.
- Dairy Market News reports whey brokers and traders in the Northeast are fielding more calls than can be satisfied with the current dry whey supply, and in some instances are having to [turn away customers](#). Milk inflows have been restricted at some operations due to very strong bottling needs. Manufacturers are generally oversold and are concerned about meeting contractual obligations, which may affect product availability through December.
- Economy: Falling crude oil prices are translating into much lower prices at the pump. U.S. consumer sentiment jumped to a [3-year high](#) in January, according to figures released today. Lower fuel prices leaves more money in consumers' pockets, which could mean strong restaurant sales.

Futures Month	Friday 01/19 Close	Friday 01/12 Close	Change	5-yr Average	Top 3rd Price
Jan-07	\$13.49	\$13.40	\$0.09	\$12.16	\$13.00
Feb-07	\$13.70	\$13.63	\$0.07	\$12.02	\$12.70
Mar-07	\$13.85	\$13.80	\$0.05	\$11.89	\$12.61
Apr-07	\$14.05	\$14.02	\$0.03	\$13.09	\$14.31
May-07	\$14.46	\$14.40	\$0.06	\$13.14	\$14.49
Jun-07	\$14.59	\$14.50	\$0.09	\$12.54	\$13.63
Jul-07	\$14.82	\$14.70	\$0.12	\$12.25	\$13.16
Aug-07	\$15.05	\$14.99	\$0.06	\$12.41	\$13.34
Sep-07	\$15.25	\$15.15	\$0.10	\$13.11	\$13.99
Oct-07	\$14.88	\$14.75	\$0.13	\$13.19	\$13.98
Nov-07	\$14.70	\$14.60	\$0.10	\$12.88	\$13.86
Dec-07	\$14.40	\$14.35	\$0.05	\$12.92	\$14.01
Jan-08	\$14.15	\$14.25	(\$0.10)	\$12.16	\$13.00
Feb-08	\$14.15	\$14.08	\$0.07	\$12.02	\$12.70
Mar-08	\$14.15	\$14.08	\$0.07	\$11.89	\$12.61
Apr-08	\$14.11	\$14.08	\$0.03	\$13.09	\$14.31
May-08	\$14.10	\$14.18	(\$0.08)	\$13.14	\$14.49
Jun-08	\$14.18	\$14.18	\$0.00	\$12.54	\$13.63
2007 Avg	\$14.44	\$14.36	\$0.08		
Jan-Jun '08	\$14.14	\$14.14	\$0.00		

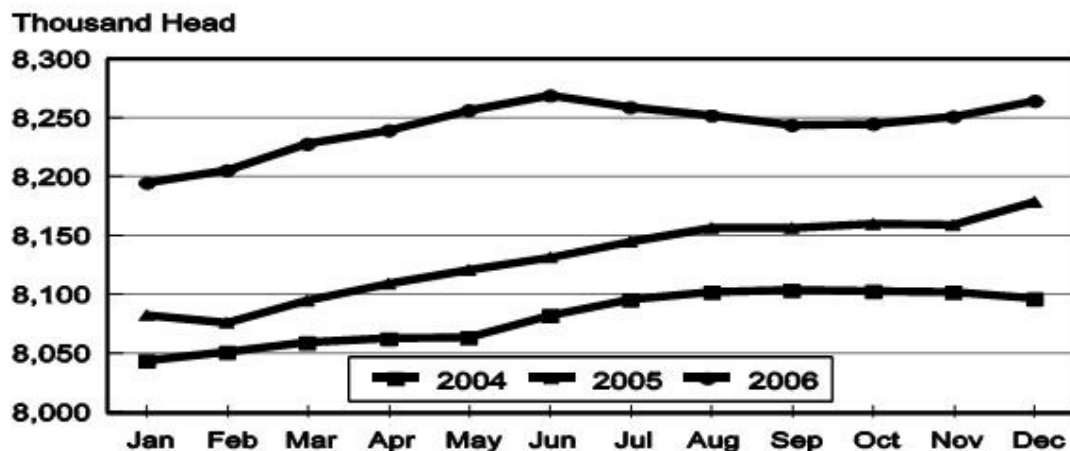
Corn use for ethanol



Bearish Fundamentals:

- Milk Production Report: December milk production in the 23 major states was up 2.7% from December 2005, according to USDA figures released Thursday. Production per cow averaged 1,689 lbs, up 26 lbs from last year, but the most negative aspect of the report was a [large increase in milk cows of 13,000 head](#) from Nov to Dec. Ouch! For all 50 states, December production was up 2.4%, and for all of 2006 we averaged a 2.7% increase. Gains were led by CO, up

Monthly Milk Cows 23 States



- 10.1%, TX up 9.7% and MI up 6.2%. CA was up a solid 3.9% and WI gained 2%. Finally, USDA revised November production up 13 million lbs, or 0.1% higher than originally reported.
- Cash Market: Blocks, barrels and butter all fell in the spot market this week, as there appears to be plenty of product available, at least in the near term. Blocks lost 2¢ to close at \$1.28¾/lb, barrels shed 2¼¢ to finish at \$1.30¾/lb and butter fell ½¢ to settle at \$1.22½/lb. The lower prices interested more buyers are 13 loads of blocks, 5 loads of barrels and 4 cars of butter exchanged hands for the week.
- Weekly cold storage figures show a 12% gain in butter stocks and 1% [increase in cheese stocks](#) at selected USDA storage centers during the first fifteen days of January.
- Dairy cow slaughter for the week ending 01/06 was 44,800, which was [2,000 head more](#) than the same period last year.
- Manufacturing milk interest in the Midwest is sluggish, according to Fluid Milk & Cream Review. Cheese makes are trying to [clear the extra cheese](#) produced during the yearend holiday period.
- Butter stocks at CME warehouses grew by 23.9 million lbs during the first three weeks of the year, according to Dairy Market News. They have [never grown that fast](#) at this time of year before. Churning activity remains heavy as there is still quite a bit of surplus cream available.
- Dairy Market News reports the [cheese market is weak](#). Current cheddar block supplies are adequate as producers continue to market extra product produced with yearend milk.

Recommendation:

Last week as we commented on the upcoming Milk Production Report, we wrote, "...it may not matter a whole lot if cow numbers continue to go up (slightly!) or production is up..." Well, cow numbers were up more than slightly, and most expected Class III futures to open significantly lower on this bearish report. We did open a penny or two lower, but by the end of the day today we set a new annual high for 2007 of \$14.44/cwt. Part of the reason for the muted lower open was the surprising NASS dry whey increase of 3.3¢ to reach 47¢. Call it luck, but we happened to comment on dry whey last week as well, predicting it could hit 50¢/lb soon. Currently the Class III market seems to be disconnected from cash cheese and production reports what show growth in cow numbers and milk production. Traders seem unwilling to push prices lower in light of high grain prices and strong export potential. Expect a more volatile market ahead. We're hearing anecdotal evidence as well that many commercial end users of milk and cheese have not hedged their input costs yet. These hedgers buy milk futures to protect against higher prices, and will be looking for any decent break in the market to get some coverage. The last three quarters of 2007 look very well supported, but that does not mean you should sit on the sidelines! We are at the second highest historical average of all time, and while the ride could continue (great!), you need to be taking steps now to get some floor price protection in place. Who can guarantee there will be no crash in the economy? Is there anyone who can foretell if there will be a domestic terrorism event this year? Our intention is not to be a fear monger; we certainly hope and pray neither occurs. But the tendency for many is to assume that the current prices will continue to increase, or at a minimum stay where they are. While our bias certainly remains positive for the market, at these lofty levels there is no excuse not to take some appropriate risk management action. Sell up to 25% of your production at 14.50 or higher. For any unsold milk, buy PUT options, which give you a floor but leave your milk open to higher prices. Currently the February through December 13.50 PUT averages 26¢ each. Place orders to buy them at a 25¢ average, which would give you an effective floor of 13.25 for the year, but leave you open for higher prices. Get this done!

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