



The KDM Dairy Report - February 2nd, 2007

Bullish Fundamentals:

- January Class III was announced at \$13.56/cwt, the highest closing price in 14 months.
- Ag Prices Report: USDA's monthly look at agricultural prices reveals feed grains and hay prices in January were up 6% from last month and a huge 54% from a year ago. Corn was up 22¢/bu from last month and \$1.23/bu over last January. The all hay price at \$112/ton increased 4\$/ton over December and \$18.90/ton vs. last January. As a result, the [milk-feed ratio dropped](#) from 2.41 last month to 2.34 in January. Last year the ratio was 3.17.
- Commercial Disappearance: [Domestic demand for dairy products appears to remain strong](#). Use of milk in all products for the period Sep-Nov was up 1.3% vs. a year ago. American cheese use during the same period was up a more impressive 4.1%, while use of other than American cheese was up 3.8%. Commercial use of butter was up a more modest 1.8%, and use of nonfat dry milk was down 15.7%, which makes sense due to its limited availability.
- Cash market: Both blocks and butter were down vs. last week, but barrels were up. Given the limited downward move before buyers stepped in, the market looks fairly well supported. Barrels gained a penny for the week to stand at \$1.37½/lb, but blocks lost 1½¢ to settle at \$1.33¼/lb and butter fell 4½¢ to close the week at \$1.22½/lb. 2 loads of blocks, 18 of barrels and 3 cars of butter exchanged hands.
- Dairy cow slaughter for the week ending 01/20 was 50,400 head, [3,200 more](#) than the same period last year. So far this year, the cull rate is up more than 6%.
- Barrel [demand is firm](#) and even blocks seem to have tightened up, according to Dairy Market News. Buyers are looking for additional cheese for immediate needs as well as future sales. Undergrade cheese clearing easily.
- Class I [demand is strong](#) in the Northeast, according to Fluid Milk & Cream Review, while at the same time, processors are experiencing a loss of patrons due to decisions to exit the business. Milk volumes to balancing plants are less than desired, with some commenting that feed costs and transitioning to rBST-free status are to blame.
- High feed and energy costs continue to be big issues in the Southwest, according to Fluid Milk & Cream Review. Milk production in California has been rising more slowly, while Class I demand remains good. In Arizona and New Mexico, bottlers are [taking bigger than expected volumes of milk](#).
- Dairy Market News reports nonfat dry milk offerings are lighter than anticipated for this time of year. Buyers are reporting [delays on loads](#) expected in January.
- Traders are becoming wary of dry whey prices, but [no one is certain where prices will peak](#), according to Dairy Market News. Buyers continue to express dismay at rising prices, and feed users are having difficulty affording the current market. The mostly price in the Central region ranged from 56¾¢ to 60¢ per pound. Expectations are for those numbers to eventually make their way into the weekly NASS numbers.
- Dairy Market News reports Western whey prices continue to move sharply higher. Buyers are aggressive but are [often going unsatisfied](#). An expected slow-down in shipments related to the Chinese New Year has not materialized as offerings are easily cleared.
- International: Recent rains have greened up pastures in Australia, but not significant enough to replenish moisture levels. Milk processors are having to choose which dairy products are in the most need or generate the best return, often going with milk powders. Demand remains strong for all dairy products and most [supplies are fully committed](#).

Futures Month	Friday 02/02 Close	Friday 01/26 Close	Change	5-yr Average	Top 3rd Price
Feb-07	\$14.14	\$14.22	(\$0.08)	\$12.02	\$12.70
Mar-07	\$14.26	\$14.50	(\$0.24)	\$11.89	\$12.61
Apr-07	\$14.60	\$14.95	(\$0.35)	\$13.09	\$14.31
May-07	\$14.85	\$15.15	(\$0.30)	\$13.14	\$14.49
Jun-07	\$14.94	\$15.20	(\$0.26)	\$12.54	\$13.63
Jul-07	\$15.35	\$15.45	(\$0.10)	\$12.25	\$13.16
Aug-07	\$15.55	\$15.75	(\$0.20)	\$12.41	\$13.34
Sep-07	\$15.65	\$15.84	(\$0.19)	\$13.11	\$13.99
Oct-07	\$15.30	\$15.45	(\$0.15)	\$13.19	\$13.98
Nov-07	\$14.90	\$15.17	(\$0.27)	\$12.88	\$13.86
Dec-07	\$14.71	\$14.95	(\$0.24)	\$12.92	\$14.01
Jan-08	\$14.61	\$14.63	(\$0.02)	\$12.50	\$13.33
Feb-08	\$14.60	\$14.55	\$0.05	\$12.02	\$12.70
Mar-08	\$14.55	\$14.54	\$0.01	\$11.89	\$12.61
Apr-08	\$14.54	\$14.40	\$0.14	\$13.09	\$14.31
May-08	\$14.50	\$14.44	\$0.06	\$13.14	\$14.49
Jun-08	\$14.60	\$14.40	\$0.20	\$12.54	\$13.63
Jul-08	\$14.75	\$14.50	\$0.25	\$12.25	\$13.16
Aug-08	\$14.95	\$14.58	\$0.37	\$12.41	\$13.34
Sep-08	\$14.85	\$14.66	\$0.19	\$13.11	\$13.99
Oct-08	\$14.70	\$14.49	\$0.21	\$13.19	\$13.98
Nov-08	\$14.40	\$14.25	\$0.15	\$12.88	\$13.86
Dec-08	\$14.30	\$14.20	\$0.10	\$12.92	\$14.01
Feb-Dec Avg	\$14.93	\$15.15	(\$0.22)		
2008 Avg	\$14.61	\$14.47	\$0.14		

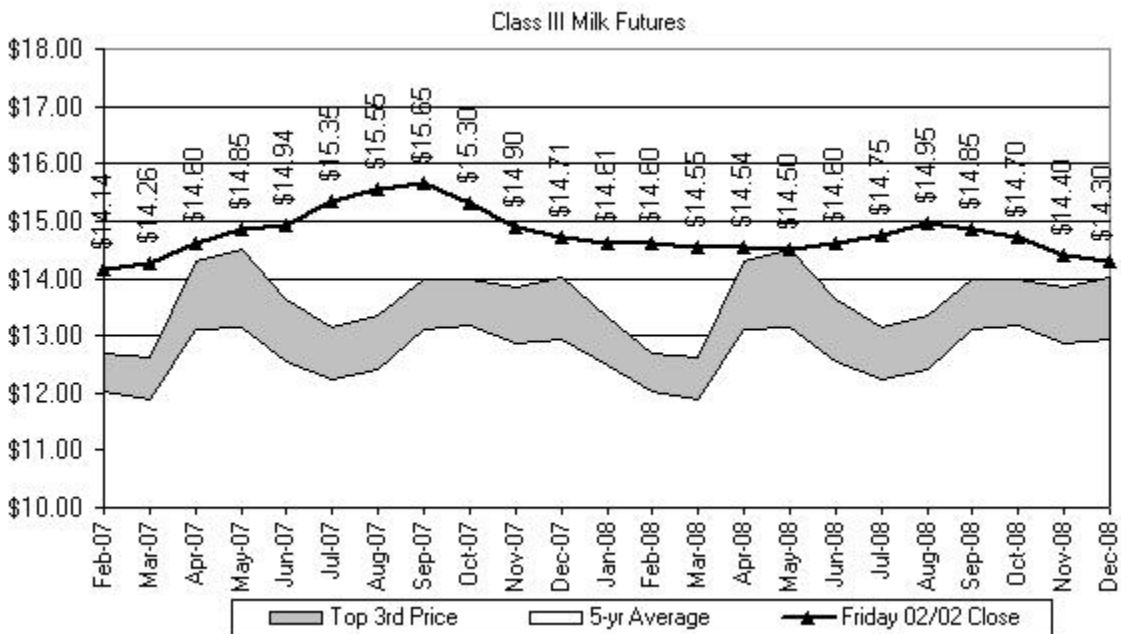
- International: USDA reports that at the most recent Dairy Management Committee meeting in Europe, the export [subsidy for whole milk powder was completely eliminated](#) as of January 1st. The effect will be to make foreign powder even more expensive and could aid in maintaining strong U.S. exports of our lower cost powder.
- Brett Favre is coming back for another year!

Bearish Fundamentals:

- Dairy Products Report: Cheddar cheese output in December was up 4.7% vs. the prior year and 9.7% than November, according to USDA figures released today. American cheese output was up 3%, Total Cheese output was up 3.8% and butter was up 9.5% vs. December 2005. On a positive note, dry whey production was down 12.8%.
- Cattle Inventory Report: USDA's quarterly look at cattle inventory has the number of milk cows as of January 1st at 9.13 million head, up 1% from last January. The number of milk replacement heifers was also up 1%, standing at 4.31 million head. The [ratio of replacement animals to the milking herd continues to be strong](#).
- NASS numbers were a little flat this week, with only butter and whey making gains. Block [cheddar dropped 2.2¢](#) to average \$1.31/lb and barrels were unchanged at \$1.33/lb. Nonfat dry milk decreased 0.3¢ to \$1.09/lb, but dry whey tacked on 0.8¢ to reach 48.4¢/lb and butter gained 1.7¢ to \$1.21/lb.
- Weekly cold storage numbers for the period 01/01 thru 01/29 show butter stocks [increased 30%](#), while cheese stocks were up 1%.
- Butter inventories are [growing at a horrendous rate](#). Stocks at CME-approved warehouses increased 9.1 million lbs for the week ending 01/27, leaving 88.9 million lbs in storage. Last year at this time there were only 55.9 million lbs on hand, so current stocks represent a 59% increase.
- Fluid Milk & Cream Review reports dip and sour cream production has slowed since Super Bowl [needs have been filled](#). Demand for cream is low so most is clearing to the churn, and Class I interest has been lighter.
- Dairy Market News report churning activity is running heavier than anticipated for this time of year, [exceeding demand](#). More cream is available due to the desire to maximize nonfat dry milk production, while other cream users are not using as much as anticipated.

Recommendation:

To sum up the week – the market is very nervous at these levels. Any hint of weakness in either the cash cheese or whey numbers has the market pushing 15-30¢ lower as we saw both on Monday and today. However, by the end of the session, we seem to come significantly off the lows of the day, showing there is still strength in the market. We're beginning to be get more concerned about a possible correction in the front months which



have nudged close to \$15/cwt. It may take more time before the full effects of feed rationing, less rBST use and financial stress impact production, so we think it's more urgent that you get some protection March – June. Buy 14.00 PUT options which settled today at an average of just over 22¢ each. That would yield an effective floor of \$13.78/cwt base price plus leave you open to higher prices if we stay strong. For protection further out, consider buying the same 14.00 PUT options, March-September for an average of 25¢ each. Give yourself some peace of mind and get covered!

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