



The KDM Dairy Report - February 9th, 2007

Bullish Fundamentals:

- Dry whey [increased an amazing 4.9¢](#) in this week's NASS price survey, with the average reaching 53.3¢/lb. Since January 3rd, the whey price has increased 10¢, adding 60¢/cwt to Class III. Also in this week's report, 500-lb cheddar barrels increased 0.3¢ to average \$1.34/lb, but 40-lb blocks decreased 1.2¢ to \$1.30/lb and nonfat dry milk was down 0.8¢ to \$1.08/lb. Finally, butter made an incremental gain of 0.6¢ to average \$1.22/lb.
- Despite current price increases, [export interest remains strong](#) for dry whey, according to Dairy Market News. The mostly price in the Central region shattered new highs, with sales from 60¾¢ to 69½¢ per pound!
- CWT announced a [4th herd retirement program](#) Tuesday, but didn't specify how many cows or pounds of milk they were targeting. Instead, they will look to take the best bids, which are due by March 3rd. After talking with a few Western producers and lenders, our own thought is that despite higher milk prices ahead in the future, there will be plenty of interest in the program. The first three rounds resulted in a reduction of 147,000 cows.
- World Ag Supply & Demand Report: USDA increased their milk production estimates for both 2006 and 2007 from last month's report, but also revised expected Class III prices for 2007 much higher. Strong international demand is expected to keep supplies of nonfat dry milk and dry whey [tight until at least the second half of the year](#).
- Weekly dairy cow slaughter numbers continue to [outpace last year](#) by a substantial margin. 50,900 head were culled for the week ending 01/27, vs. 45,800 during the same period last year, an increase of 11%.
- Fluid Milk & Cream Review reports extreme cold in the upper Midwest had [cows using more energy](#) to keep warm. Milk receipts at some locations were lower, while cheese yields were down as component levels decline.
- On a calendar adjusted basis, [fluid milk sales in December were up 2.4%](#) vs. December 2005, according to Dairy Market News. Sales of 2%, 1%, skim, flavored low-fat and buttermilk increased, while sales of whole milk and flavored whole milk were lower.
- Milk production in the Northeast is [lagging below projections](#), according to Fluid Milk & Cream Review. Some handlers believe poor feed quality is to blame. Class I demand is steady, while balancing plants are receiving less milk than anticipated.
- A new [BSE case in Canada](#) could put the reopening of the Canadian border in jeopardy.
- rBST – hearing more talk on the street over a major cooperative potentially going 100% rBST-free. In addition, despite this being mainly a fluid milk consumption issue, we're starting to hear that some cheese plants may be considering it as well. More to come.
- Producers in the Pacific Northwest are facing [increasing feed pressures](#), according to Fluid Milk & Cream Review. Some are looking at feeder hay instead of dairy quality hay, but most feeder hay is also gone. Fat and protein tests are moving lower and plants have extra capacity to handle available milk.
- Supplies of nonfat dry milk are typically plentiful at this time of year, but the opposite is true. Dairy Market News reports some suppliers are unable to deliver anticipated loads, and [anxiety is increasing](#) over the nonfat dry milk supply for the duration of 2007.

Futures Month	Friday 02/09 Close	Friday 02/02 Close	Change	5-yr Average	Top 3rd Price
Feb-07	\$14.24	\$14.14	\$0.10	\$12.02	\$12.70
Mar-07	\$14.55	\$14.26	\$0.29	\$11.89	\$12.61
Apr-07	\$14.70	\$14.60	\$0.10	\$13.09	\$14.31
May-07	\$15.00	\$14.85	\$0.15	\$13.14	\$14.49
Jun-07	\$15.07	\$14.94	\$0.13	\$12.54	\$13.63
Jul-07	\$15.49	\$15.35	\$0.14	\$12.25	\$13.16
Aug-07	\$15.67	\$15.55	\$0.12	\$12.41	\$13.34
Sep-07	\$15.80	\$15.65	\$0.15	\$13.11	\$13.99
Oct-07	\$15.51	\$15.30	\$0.21	\$13.19	\$13.98
Nov-07	\$15.04	\$14.90	\$0.14	\$12.88	\$13.86
Dec-07	\$14.80	\$14.71	\$0.09	\$12.92	\$14.01
Jan-08	\$14.68	\$14.61	\$0.07	\$12.50	\$13.33
Feb-08	\$14.62	\$14.60	\$0.02	\$12.02	\$12.70
Mar-08	\$14.69	\$14.55	\$0.14	\$11.89	\$12.61
Apr-08	\$14.69	\$14.54	\$0.15	\$13.09	\$14.31
May-08	\$14.64	\$14.50	\$0.14	\$13.14	\$14.49
Jun-08	\$14.75	\$14.60	\$0.15	\$12.54	\$13.63
Jul-08	\$14.88	\$14.75	\$0.13	\$12.25	\$13.16
Aug-08	\$15.05	\$14.95	\$0.10	\$12.41	\$13.34
Sep-08	\$15.07	\$14.85	\$0.22	\$13.11	\$13.99
Oct-08	\$14.85	\$14.70	\$0.15	\$13.19	\$13.98
Nov-08	\$14.60	\$14.40	\$0.20	\$12.88	\$13.86
Dec-08	\$14.50	\$14.30	\$0.20	\$12.92	\$14.01
Feb-Dec Avg	\$15.08	\$14.93	\$0.15		
2008 Avg	\$14.75	\$14.61	\$0.14		

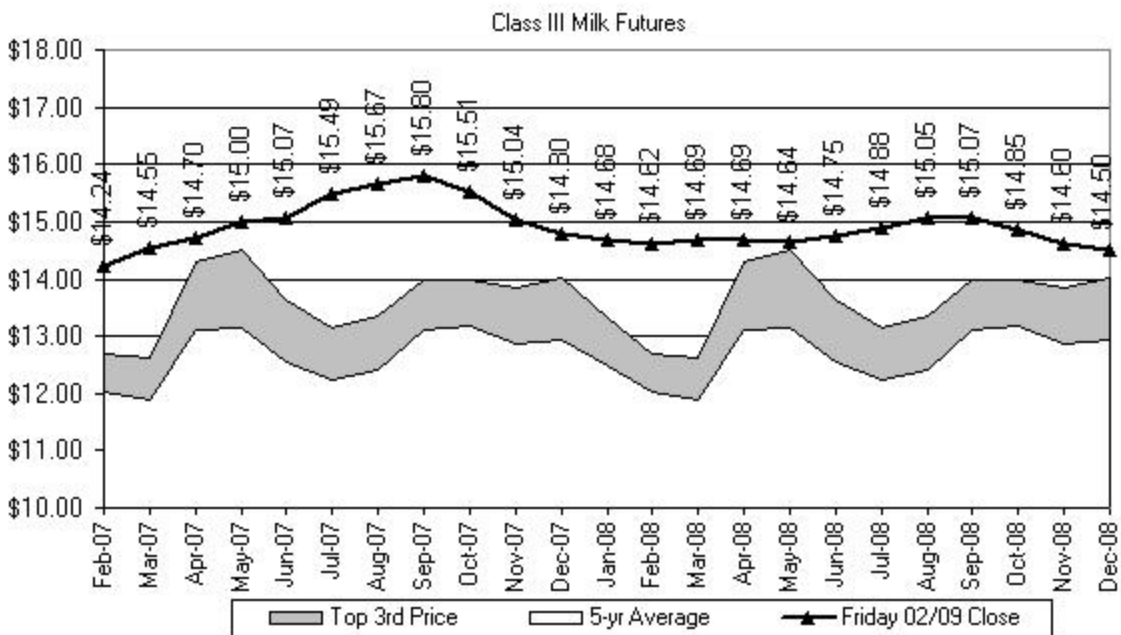
Bearish Fundamentals:

- California is having perfect milking weather and production is trending higher, according to Fluid Milk & Cream Review. Our own internal monitoring shows that output is coming on strong as of late. The article mentions an uptrend in milk cow numbers into the state, which is the likely cause.
- No changes in the butter market. Dairy Market News reports churning activity continues to [exceed demand](#) so surplus butter is clearing to inventory. CME butter stocks stood at 96 million lbs this week, vs. 56 million lbs at this time last year.
- The cheese market is not as firm as recent price increases suggest, according to Dairy Market News. Cheddar [blocks appear to be very plentiful](#), while barrels are not as tight as in recent weeks.
- Cash Market: Reflecting the apparent availability of cheese, sellers had their way this week, dumping 29 loads of barrels and 14 loads of blocks. The barrel prices declined 5½¢ to finish at \$1.32/lb today, while blocks still managed a gain of 1¼¢ to close at \$1.34½/lb. Butter is range-bound but lost ½¢ to close at \$1.22/lb, with 3 cars trading during the week.

Recommendation:

Cheese down, Whey up, Class III steady

Last week we cautioned that the market was getting nervous and expressed concern over the front months. While we finished higher in every month on a weekly basis, the front months did come off their highs posted earlier in the week. Western dairies continue to struggle with input costs, with some of the less efficient ones needing \$13.50 to \$15.00 mailbox to break



even. We think these dairies will bid aggressively to participate in the CWT herd buyout. Will rBST be a management practice of the past? There are many other possibilities that could drive prices higher or lower on the rollercoaster of Class III. Several producers this week took a hard look at PUT options and did buy some at 14.50 in March for 14-15¢ and 14.25 in other months. Others looked at the average price and just sold some milk. Yes, we could see \$18.00 if all the stars align, but on the way there we will be in for some big price swings. These swings can scare you away from the market, or they can provide opportunities to make your existing positions better. Look at buying calls on any sold milk if the market corrects further to the downside. Outright selling of the front months April to June on small rallies looks like a good move. Consider getting up to 50% of your production covered here. The cheese market is sloppy, and with extra product could up for the next 2 months. Call us and we'll help you put together a marketing strategy!

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