



## The KDM Dairy Report - February 23<sup>rd</sup>, 2007

### Bullish Fundamentals:

- Livestock Slaughter Report: USDA's monthly look at livestock slaughter indicates the dairy cull in 2007 is starting out very strong. 227,700 head were removed from the herd during the month, an [increase of 13%](#) vs. last January, when only 201,500 were culled.
- Livestock, Dairy & Poultry Outlook Report: USDA revised their Class III price forecast for 2007 up 12¢/cwt in their latest forecast, now expecting 2007 to average \$13.55/cwt. They cite robust demand for dairy products, a lower milk-to-feed ratio, employment growth and rising wages in the U.S. economy. The biggest revision came in dry whey. In last month's report they expected it to range from 35½ to 38½ cents per pound, but that was increased to 45½ to 48½ cents per pound in this month's report. Strong export demand from major markets such as Mexico and Algeria to maintain feeding programs for their populations, while [they are cash rich](#) from petroleum sales, is expected to keep foreign buyers coming despite higher prices.
- Cash Market: Buyers came out in force this week looking to secure product, and in the process pushed cheese prices higher. Blocks jumped 7½¢ to settle at \$1.37/lb while barrels gained 7¾¢ to \$1.35/lb. Butter was stagnant and unchanged from last week at \$1.21/lb. 7 loads of blocks, 12 barrels and 5 cars of butter exchanged hands. There was also a rare Grade A nonfat dry milk trade that pushed the price up 7½¢ to \$1.52½/lb.
- Dry whey continued [setting new record highs](#) in the weekly NASS survey, coming in at 61.4¢/lb this week, up 3¢ from last week. Cheese was up as well, with blocks gaining 2.1¢ to average \$1.32/lb and barrels increasing a penny to \$1.36/lb. Nonfat dry milk appears range-bound but managed to gain 0.3¢ to average \$1.10/lb, while butter lost 1.3¢ to sit at \$1.21/lb.
- The weekly update from Dairy Market News indicates dry whey traded mostly between [69-70¢/lb](#) in the Central region of the country. Supplies are more available but the market is still firm.
- We're hearing a lot about cheese inventories building, but USDA weekly cold storage numbers for the period 02/01 through 02/19 show a [4% decrease](#) in cheese stocks.
- Dairy cow slaughter is still [running well ahead](#) of last year. For the week ending 02/10, 47,800 head were culled vs. 43,400 head during the same period in 2006.
- Butter moving to storage [might be slowing down](#). Only 2.76 million lbs of butter were added to CME-warehouses this week, compared to 7.8 million lbs added last year at this time. However, inventories are still well above 2006 levels.
- Fluid Milk & Cream Review reports shipments of [milk out of Florida dropped](#) to 60 loads this week, compared to 75 last week and 96 last year. Milk output appears steady, but balancing plants are easily able to handle any fluid volumes headed to manufacturing.
- There is [no dairy hay available](#) and stocks of feeder hay are fast running out in the Pacific Northwest, according to Fluid Milk & Cream Review. Contacts are beginning to wonder if hay supplies will run out before new crop offerings are available. Producers are buying feed week to week as they are unable to contract at favorable prices, and production per cow is expected to falter this spring as a result.
- Despite higher prices, both domestic and international demand for nonfat dry milk is strong, according to Dairy Market News. Foreign buyers would take more product [if they could get it](#), but supply is limited. Some contracted loads are being delayed as producers are behind on filling contracts.

Futures Month	Friday 02/23 Close	Friday 02/16 Close	Change	5-yr Average	Top 3rd Price
Feb-07	\$14.17	\$14.30	(\$0.13)	\$12.02	\$12.70
Mar-07	\$14.62	\$14.36	\$0.26	\$11.89	\$12.61
Apr-07	\$14.72	\$14.55	\$0.17	\$13.09	\$14.31
May-07	\$14.90	\$14.86	\$0.04	\$13.14	\$14.49
Jun-07	\$14.95	\$14.94	\$0.01	\$12.54	\$13.63
Jul-07	\$15.45	\$15.39	\$0.06	\$12.25	\$13.16
Aug-07	\$15.68	\$15.55	\$0.13	\$12.41	\$13.34
Sep-07	\$15.80	\$15.67	\$0.13	\$13.11	\$13.99
Oct-07	\$15.50	\$15.45	\$0.05	\$13.19	\$13.98
Nov-07	\$15.16	\$15.00	\$0.16	\$12.88	\$13.86
Dec-07	\$14.85	\$14.83	\$0.02	\$12.92	\$14.01
Jan-08	\$14.80	\$14.65	\$0.15	\$12.50	\$13.33
Feb-08	\$14.75	\$14.62	\$0.13	\$12.02	\$12.70
Mar-08	\$14.77	\$14.62	\$0.15	\$11.89	\$12.61
Apr-08	\$14.82	\$14.72	\$0.10	\$13.09	\$14.31
May-08	\$14.75	\$14.70	\$0.05	\$13.14	\$14.49
Jun-08	\$14.90	\$14.75	\$0.15	\$12.54	\$13.63
Jul-08	\$15.05	\$14.89	\$0.16	\$12.25	\$13.16
Aug-08	\$15.10	\$15.03	\$0.07	\$12.41	\$13.34
Sep-08	\$15.20	\$15.10	\$0.10	\$13.11	\$13.99
Oct-08	\$14.95	\$14.86	\$0.09	\$13.19	\$13.98
Nov-08	\$14.66	\$14.61	\$0.05	\$12.88	\$13.86
Dec-08	\$14.55	\$14.46	\$0.09	\$12.92	\$14.01
<b>Feb-Dec Avg</b>	<b>\$15.07</b>	<b>\$14.99</b>	<b>\$0.08</b>		
<b>2008 Avg</b>	<b>\$14.86</b>	<b>\$14.75</b>	<b>\$0.11</b>		

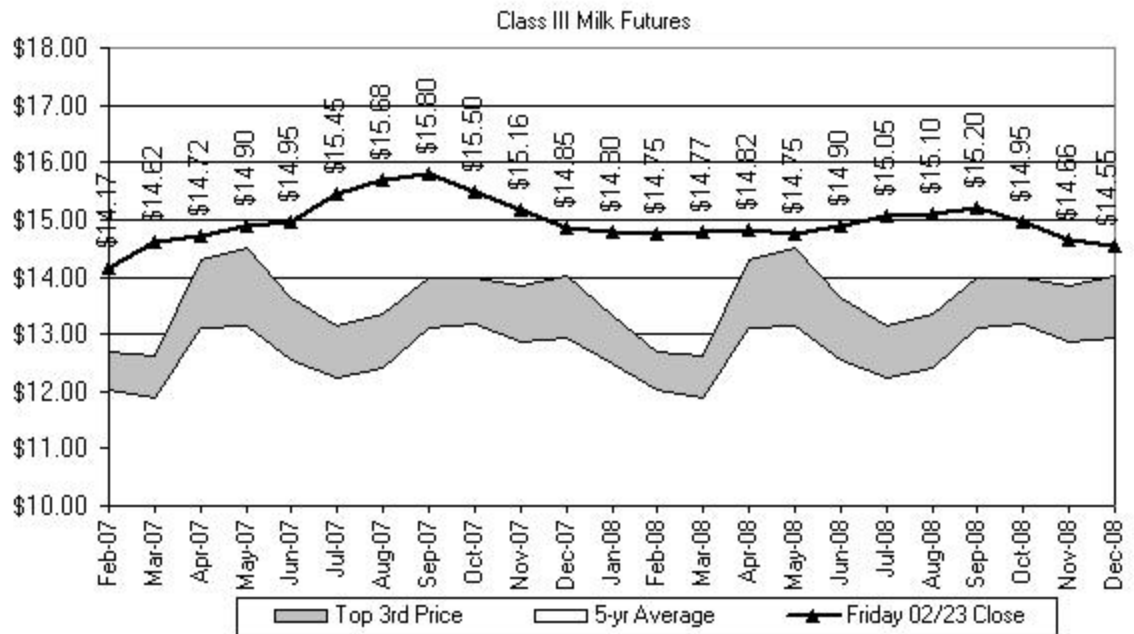
- Western [demand for barrels and undergrade cheese is excellent](#), with some shortages noted, according to Dairy Market News. Blocks are more available, but appear to be in balance.
- Grain prices. Enough said.

### Bearish Fundamentals:

- Cold Storage Report: Dairy product [inventories increased](#) in January. Butter stocks were up 24% vs. last year and up 43% from December, according to USDA numbers released this week. American cheese stocks were up 3% compared to January 2006 and up 4% since the prior month, while Total cheese stocks were up a strong 11% vs. a year ago and up 3% vs. December.
- Just like last year, we may be seeing an early "flush" in California. Weather has been ideal and milk receipts are up 3-5%, according to Fluid Milk & Cream Review. Fears are once again arising from processors about their ability to handle the growing milk supply. Some processors are reporting daily intakes at [levels near last year's peak](#). In Arizona, heavy supplies of cream are noted, with some surplus loads having difficulty finding a home.
- Heavy butter [output is overwhelming current demand](#), according to Dairy Market News. More cream is coming from cheese plants that are skimming rather than fortifying due to the high price and lack of nonfat dry milk.

### Recommendation:

A bearish Cold Storage report combined with a hearing that overruled the injunction on the new make allowance caused most of the selling pressure today. The hearing clears the way for the new make allowance to come into affect as of the February 2007 milk contract and removes 25¢/cwt from the Class III formula going forward. However, prices for the most part came off their lows by the end of the day, and with the exception of February,



all contracts were higher for the week, due mainly to the bullish aspects of this week's cash cheese trade and the continuing performance of dry whey. And this week's Cold Storage report may not be as bearish as it appears on the surface. We think commercial holders of cheese are trying to figure this market out as well, and are concerned about what their cheese supply will be like six, twelve or even eighteen months from now. The prospects of a CWT herd buyout, less r-BST use, tight powder supplies and high feed costs has them (and us) wondering what impact all that will have on milk production as we get deeper into the year. It's possible they could be building inventory more aggressively now in anticipation of less availability later; and this would explain the jump in the Cold Storage numbers. That said, we still remain concerned with the Mar-Jun contracts as clearly dairy inventories are building and milk production is heading higher. Our monitoring of milk production in California indicates they are cranking up output and are at their highest all-time levels. A significant correction to the downside in the front months is possible, while we still believe there will be a lot of support July and beyond. So, consider again selling the front months an rallies, covering up to 50% of your production, and cover the rest with PUT options. For the last half of 2007 we would stick with PUT options for any unsold milk. If prices keep moving higher, you will still have the option of selling your milk outright on those months.

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