



## The KDM Dairy Report - March 16<sup>th</sup>, 2007

### Bullish Fundamentals:

- CWT announced on Thursday the 4<sup>th</sup> round of the herd retirement program would [take out 54,000 cows](#), or about 1.03 billion lbs of annual milk production. That total equals 0.6% of the nation's dairy supply and reduces USDA's projected 2007 milk increase by 45%. A total of 1,397 bids were submitted to the program, more than the combined total in rounds two and three of the program, indicating interest was very high.
- Milk Production Report: February milk production in the U.S. was up 0.9% in the 23 major dairy states, and [up only 0.4%](#) in all 50 states, marking the second month in a row of declining milk production. Milk per cow was flat, the first time without an increase since February, 2005. Finally, the number of milk cows was up 71,000 head vs. last year, but down 3,000 head from the previous month.
- NASS prices for Class III components were all up this week. Dry whey [shot another 4.5¢ higher](#) to reach 69.8¢/lb while nonfat dry milk increased 1.6¢ to \$1.16/lb. Butter gained 5.8¢ to \$1.26/lb, cheddar blocks up 0.6¢ to \$1.33/lb and barrels were \$1.34/lb, up 0.7¢.
- January 2007 exports of nonfat dry milk were up 22.2% vs. last year, according to Dairy Market News. Unfilled protein demand in the world market is keeping supplies tight. Buyers report delays in contracted shipments and warn that if deliveries do not increase soon, certain edible end-products that include nonfat dry milk will [cease production](#).
- Dairy Market News reports dry whey sold for between 75-78¢/lb in the Central region this week, a little over a penny increase from last week. Buyers are wondering [when the market will peak](#), while demand from edible and feed markets is retreating as they displace or reduce the whey component in the formulations.
- Western whey moved sharply higher from new export sales, according to Dairy Market News, trading between 64-75¢/lb. Whey [exports were up 27%](#) vs. last year and accounted for 40% of total production. Buyers are aggressive and willing to bid higher to get more supplies. The top five buyers, accounting for 68% of exports were: China, Korea, Canada, Japan and Thailand.
- Dairy cow slaughter for the week ending 03/03 was [strong at 51,000 head](#), up from 45,400 head during the same period last year.
- Butter inventories are not gaining as rapidly as they have in the past five weeks, according to Dairy Market News. [Sales activity is picking up](#) for the Easter/Passover season and producers are beginning to ship to food service and retail accounts. Cream supplies are still heavy, but an early heat wave across the Southwest has the ice cream business starting in earnest.
- The strong whey market has [helped improve demand](#) for manufacturing milk in the Central region, according to Fluid Milk & Cream Review. Spot loads of milk are trading as high as \$1.25/cwt over class. Cream demand is strong as manufacturers prepare for spring sales.
- Western barrels are in higher demand than blocks, keeping a price premium. Dairy Market News reports that for the first ten weeks of 2007, there have been 162 barrel sales and 95 block sales on the CME. In 2006, there were only 7 barrel sales and 28 block sales during the same period. Quite an increase! Contacts also reported strong interest in mozzarella cheese, with freezer stocks [at their lowest point in years](#).
- Strong Class I sales combined with heavier culling and an overall decrease in the cow population is leaving the Eastern region with [less milk than desired](#), according to Fluid Milk & Cream Review. Balancing plants are hoping for a good

Futures Month	Friday 03/16 Close	Friday 03/09 Close	Change	5-yr Average	Top 3rd Price
Mar-07	\$14.93	\$14.87	\$0.06	\$11.89	\$12.61
Apr-07	\$15.30	\$15.01	\$0.29	\$13.09	\$14.31
May-07	\$15.15	\$15.00	\$0.15	\$13.14	\$14.49
Jun-07	\$15.15	\$14.97	\$0.18	\$12.54	\$13.63
Jul-07	\$15.52	\$15.37	\$0.15	\$12.25	\$13.16
Aug-07	\$15.88	\$15.73	\$0.15	\$12.41	\$13.34
Sep-07	\$16.08	\$15.83	\$0.25	\$13.11	\$13.99
Oct-07	\$15.85	\$15.63	\$0.22	\$13.19	\$13.98
Nov-07	\$15.55	\$15.27	\$0.28	\$12.88	\$13.86
Dec-07	\$15.25	\$15.00	\$0.25	\$12.92	\$14.01
Jan-08	\$15.08	\$14.87	\$0.21	\$12.50	\$13.33
Feb-08	\$15.04	\$14.85	\$0.19	\$12.53	\$13.21
Mar-08	\$15.10	\$14.85	\$0.25	\$11.89	\$12.61
Apr-08	\$14.99	\$14.85	\$0.14	\$13.09	\$14.31
May-08	\$15.05	\$14.90	\$0.15	\$13.14	\$14.49
Jun-08	\$15.05	\$14.93	\$0.12	\$12.54	\$13.63
Jul-08	\$15.15	\$15.09	\$0.06	\$12.25	\$13.16
Aug-08	\$15.17	\$15.11	\$0.06	\$12.41	\$13.34
Sep-08	\$15.35	\$15.20	\$0.15	\$13.11	\$13.99
Oct-08	\$15.06	\$14.95	\$0.11	\$13.19	\$13.98
Nov-08	\$14.81	\$14.66	\$0.15	\$12.88	\$13.86
Dec-08	\$14.60	\$14.55	\$0.05	\$12.92	\$14.01
<b>Mar-Dec Avg</b>	<b>\$15.47</b>	<b>\$15.27</b>	<b>\$0.20</b>		
<b>2008 Avg</b>	<b>\$15.04</b>	<b>\$14.90</b>	<b>\$0.14</b>		

spring flush, but milk volumes are below historical levels as milk is called to higher class uses. Churning and drying activity in the region is lower, yet many plants are reporting interest is beyond current milk supply levels.

- Milk output in New Mexico is trending higher, but still well below last year's levels, according to Fluid Milk & Cream Review. Milk per cow declines are the major cause as producers continue to deal with the rising cost of production.
- International: Dairy Market News reports that while milk production in Europe was strong in February and early March, supplies for dairy end-products remain limited and are [unable to fill export interest](#). Prices of skim milk are increasing rapidly.
- International: Drought conditions in Australia continue to impact milk production, now estimated to be down 10.9%. In New Zealand, a recent lack of moisture has milk production trending lower more rapidly than in past weeks. Stocks of dairy end-products remain fully committed, while [demand continues to outpace supply](#). The latest milk production projections have Australia's milk output on the down side again during the next season, with some recovery in 2008 – 2009.

#### **Bearish Fundamentals:**

- There's too much milk in California! Fluid Milk & Cream Review reports milk volumes are becoming more of a challenge to handle, and there are some reports that not all milk is being picked up and processed. Plants are running on extended schedules as [milk intakes keep building](#).
- Weekly cold storage numbers show [cheese stocks continuing to grow](#) in March. For the period 03/01 to 03/12, 1.45 million lbs have been added to warehouses, an increase of 1%.
- Cash market: Block cheese lost 4¼¢ from last Friday, settling today at \$1.35/lb, while barrels were down 3¼¢ for the week to close at \$1.35¾/lb. Butter was also down, losing 2¼¢ to \$1.30/lb. Buyers were numerous, however, collecting 11 loads of blocks, 39 barrels and 15 cars of butter.

#### **Recommendation:**

This week's CWT announcement, continued increases in the dry whey price, rBST use tapering off and a supportive milk production report should provide continued strength for Class III futures next week, and that's after tacking on another 20¢ to the 2007 average and breaking \$15 for 2008! The fact that there were nearly 1,400 bids in the CWT program, more than double the number of bids in the two previous rounds combined, indicates there are a lot of dairies under financial stress. In past rounds, some operations made quite a bit of money on high bids, but this time we heard reports of bankers crunching numbers and all but telling producers what figure to put in. CWT's own press release stated, "... we were able to select bids at a much lower cost...", and indicated there would likely be further herd retirements in the future. Word on the street is that it could be sooner rather than later. High feed costs are finally cutting into milk production as output per cow was flat vs. last year. Culling has been very aggressive as seen in the monthly decrease, and cow numbers should continue to decline for several months as the CWT program kicks in. At this point, we would switch to a PUT option strategy on even the front months. Today we filled April-December 14.50 PUTs at 25¢ average for each. That's a great floor. The market looks like it could move ever higher next week, so we would target higher support levels. May-December 14.75 PUTs currently average 35¢ each. Enter a long-term order to buy them for 25¢. For 2008, PUT options are still quite expensive and we're not willing to sell milk outright, but those prices are very tempting. What's a producer to do? For up to 25% of your production in first quarter 2008, consider a min-max strategy. Here are a couple options. Buy the 14.50 puts Jan-Mar at 67¢/ea average and at the same time **sell** the Jan-Mar 15.50 calls for 76¢/ea. The net is that you receive 9¢ credit less transaction costs and leaves you with an effective floor of 14.59 but a cap or ceiling on your milk price of 15.59. Not a bad range for basically no cost! Or, you could expand the range and accept a lower floor. Buy the 14.00 put options Jan-Mar for an average of 48¢/ea and **sell** the 16.50 call options for 40¢/ea for a net cost of 8¢. This would still yield an effective floor of 13.92 but give you upside all the way to 16.42, where your price would be capped. Sound confusing? Give us a call and we'll step you through this cost-effective strategy.

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