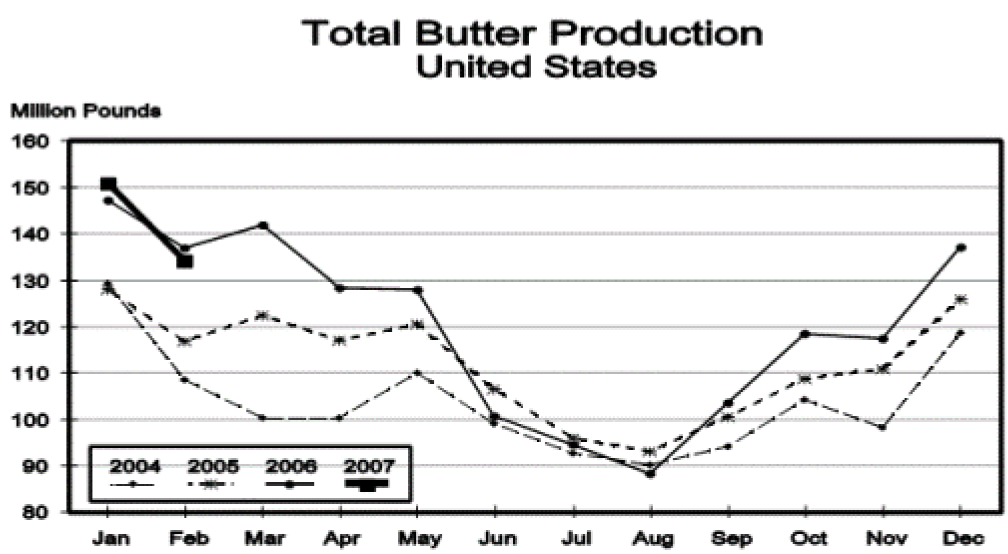
The KDM Dairy Report – April 5th, 2007

Bullish Fundamentals:

Futures Month	Thursday 04/05 Close	Friday 03/30 Close	Change	5-yr Average	Top 3rd Price
Apr-07	$15.87	$15.77	$0.10	$13.09	$14.31
May-07	$16.07	$15.54	$0.53	$13.14	$14.49
Jun-07	$15.89	$15.50	$0.39	$12.54	$13.63
Jul-07	$16.04	$15.50	$0.54	$12.25	$13.16
Aug-07	$16.23	$15.90	$0.33	$12.41	$13.34
Sep-07	$16.25	$16.14	$0.11	$13.11	$13.99
Oct-07	$15.95	$15.79	$0.16	$13.19	$13.98
Nov-07	$15.69	$15.55	$0.14	$12.88	$13.86
Dec-07	$15.39	$15.18	$0.21	$12.92	$14.01
Jan-08	$15.24	$15.10	$0.14	$12.50	$13.33
Feb-08	$15.10	$14.98	$0.12	$12.53	$13.21
Mar-08	$14.92	$14.88	$0.04	$12.75	$13.47
Apr-08	$14.98	$14.93	$0.05	$13.09	$14.31
May-08	$15.09	$14.95	$0.14	$13.14	$14.49
Jun-08	$15.14	$15.00	$0.14	$12.54	$13.63
Jul-08	$15.20	$15.11	$0.09	$12.25	$13.16
Aug-08	$15.24	$15.18	$0.06	$12.41	$13.34
Sep-08	$15.32	$15.29	$0.03	$13.11	$13.99
Oct-08	$15.15	$15.00	$0.15	$13.19	$13.98
Nov-08	$14.92	$14.74	$0.18	$12.88	$13.86
Dec-08	$14.62	$14.54	$0.08	$12.92	$14.01
Apr-Dec Avg	$15.93	$15.65	$0.28		
2008 Avg	$15.08	$14.98	$0.10		

- Dairy Products Report: In quite a surprise to expectations, USDA reported February American cheese production was down 0.7% compared to last year, the first time it's declined for the previous year since November, 2003. Cheddar output was down 0.3% and butter production was down 2% (see chart below). More milk went in to alternative cheese varieties, however, as total cheese output was up 3.3%. Other dairy end-products were down in output as well, with Feb nonfat dry milk production down 16.5% and skim milk powder down 25.2%. Dry whey production was up 0.4% vs. last Feb, but end-of-month stocks were down a strong 12.4%.
- Cash Market: Cheddar blocks picked up a penny and barrels gained a half cent in this holiday-shortened week. Blocks settled at $1.42/lb and barrels at $1.41½/lb. The biggest move was seen in butter, which increased 2¾¢ to reach $1.35¾/lb. 6 loads of blocks, 5 of barrel and 6 cars of butter exchanged hands.
- NASS surveyed prices came out a day early this week, but showed gains in all Class III components. Most significantly, dry whey, which had made small incremental gains the past couple weeks, added 1.7¢ to reach 74.5¢/lb, a new high for the survey. Nonfat dry milk gained 0.4¢ to $1.24/lb, while butter increased 0.9¢ to $1.30/lb. Cheese was up as well with blocks up 2.5¢ to $1.38/lb and barrels up 2.6¢ to $1.40/lb.
- Butter stocks at CME-approved warehouses fell below year-ago levels for the first time in 2007. For the week ending March 31st, 111 million lbs were on hand, vs. 114.6 million lbs during the same week last year. In addition, there was a net drawdown of 2.8 million lbs, compared to a gain of 3.8 million lbs in 2006.
- Weekly slaughter numbers continue to be strong, as 49,400 head of dairy cows were culled during the week ending 03/24. During the same week last year only 42,300 head were culled.



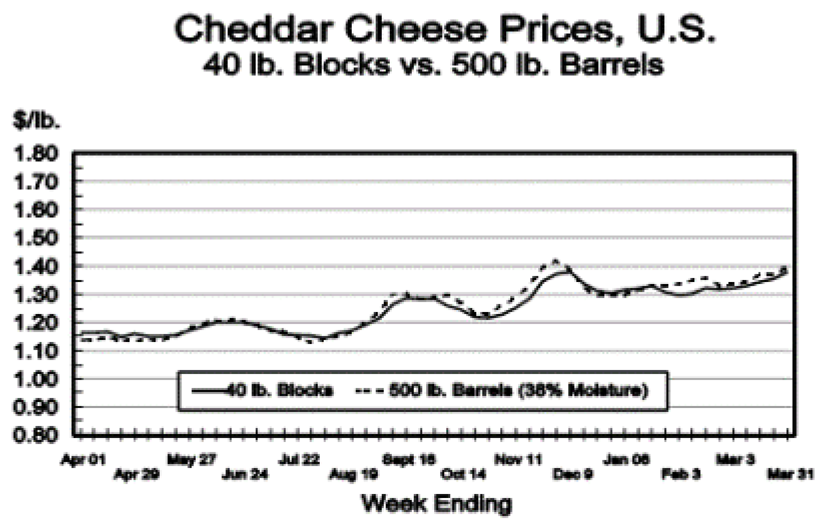
- In the Pacific Northwest, many dairy producers are out of hay and feeding more silage and even straw, according to Fluid Milk & Cream Review. New crop hay will not be available for some time, so dairies are rebalancing their rations to save money.
- Dairy Market News reports sellers have not been able to push the Western dry whey price higher, however, stocks are not building and domestic sales are steady at current prices. Prices for Western dry whey increased from last week and averaged 70-78¢/lb.

- Dry whey futures finished limit up 2¢ today in the April – July futures contracts on the CME, showing there is still a lot of support at current price levels. Some had thought the peak was over and prices would head into the 50¢ range, but the April and May contracts finished above 70¢ while June settled at 69¢.
- Both buyers and sellers of nonfat dry milk remain concerned about availability of product for the duration of the year, especially when stocks are as tight as they are during the seasonal flush. Dairy Market News reports both export and domestic interest is high, and plant operators have expressed surprise at the number of purchasers who are undeterred by current price levels.
- Cream pricing is starting to strengthen as a result of butter producers benefiting from improved buttermilk sales, according to Dairy Market News. In addition, ice cream production is on the rise and is absorbing good volumes of available cream.
- Cheese buyers are continuing to aggressively look for additional supplies for immediate needs and future sales, according to Dairy Market News. Many are ramping up purchases even as prices edge higher. Supply and demand are about in balance, but barrels for processing remain tighter than blocks.

Bearish Fundamentals:

- For the month of March, weekly cold storage stats report a 3% gain in cheese stocks.
- Schools on spring break have resulted in a drop in fluid milk consumption, while milk production is on the rise. Fluid Milk & Cream Review reports Class I sales are slower and some bottlers had to send milk back to balancing plants. In Florida, production is surplus to area needs, so they shipped 161 loads of Grade A milk out of the state, compared to 109 last week.
- Milk production in California is still strong and milk processors expect to be stressed again over the holiday weekend, according to Fluid Milk & Cream Review. Surplus milk is building but trucks available to haul are difficult to find. Ideal milk conditions and the availability of new crop hay has output in Arizona pushing higher. Nights are cool with little humidity.

Recommendation:



After last week's correction to the downside, fireworks were saved for today as yesterday's bullish Dairy Products Report and further strength in the dry whey and nonfat dry milk market set off a buying spree across the board. May, June and July hit new contract highs, and May was up as much as 70¢ at one point, but closed up 62¢ to 16.07. The inability for cheese sellers to put pressure on the cheese market has also been a factor, with the aggressive buying we're reading and hearing about leading us to believe cheese prices may be about to press higher. Last week we mentioned dry whey may pass the baton to cheese; the long-term trend in cheese prices looks to keep moving higher (see chart at right). With strong commercial disappearance numbers for cheese and a drop in production in Feb, the stage could be set for new strength in cheese and more volatility in Class III futures. Also in the mix has been a solid rebound in grain prices after last Friday's prospective plantings report set off two limit-down days in corn. Feed is still expensive.

Our recommendation remains unchanged. Keep your upside open for potentially higher prices; establish a floor using PUT options. Buy the May 15.50 PUT for a measly 10¢ - that's cheap insurance! Enter orders to buy the June 15.25 PUT for 10¢, July 15.25 PUT for 15¢, Aug 15.00 PUT for 15¢ and Sep 15.00 PUT for 15¢. Wait on the Oct-Dec PUTs for now as time value will eat in to them and should cause them to be cheaper later.

Note: The markets will closed at noon today and will be closed all day Friday, April 6th in observance of Good Friday. We will re-open on Monday, April 9th. We wish you and your families a wonderful Easter!

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