



## The KDM Dairy Report – April 13<sup>th</sup>, 2007

### Bullish Fundamentals:

- World Ag Supply & Demand Report: USDA continues to play catch-up to the futures market with their monthly estimates, but they did increase their price forecasts for Class III milk, nonfat dry milk and dry whey. They now expect Class III to average \$14.90/cwt, up 50¢/cwt from last month's guess. Nonfat dry milk is predicted to average \$1.21/lb, up 7½¢, and dry whey is supposed to average 66½¢, up 5½¢ from last month's numbers. In addition, USDA [lowered their milk production estimate](#) for 2007 by 300 million lbs due to a continued decline in milk per cow.
- Cash market: Although relatively subdued, buyers in this week's cash market were tenacious and unflinching in their willingness to own cheese at these prices. Blocks gained a half cent over last week, settling at \$1.42½/lb, while barrels managed only a ¼¢ increase to reach \$1.41¼/lb. Butter made the biggest move, up 1¾¢ to \$1.37½/lb. 6 loads of blocks, 20 of barrel and 5 cars of butter exchanged hands.
- NASS surveyed [prices continue to climb](#). Dry whey climbed 1.7¢ to average 76.3¢/lb while nonfat dry milk gained 5.5¢ to \$1.35/lb. In addition, USDA revised the previous three week's nonfat dry milk prices up nearly a dime on a reporting error. 40-lb blocks moved 0.4¢ higher to average \$1.38/lb, barrels were up 0.9¢ to \$1.41/lb and butter gained 1.5¢ to reach \$1.32/lb.
- The CWT cull has started! Weekly dairy cow slaughter for the week ending 03/31 [shot up to 55,300 head](#), compared to only 43,100 head during the same period last year.
- Butter stocks at CME-approved warehouses sit at 117 million lbs, 2 million lbs [less than a year ago](#) at this time.
- Class I sales in the Southeast are [coming back strong](#) after Spring Break, according to Fluid Milk & Cream Review. Balancing plants in the region have had loads pulled back that were originally intended for them, to satisfy fluid milk add-on orders. Condensed skim sales are strong too. Calls for product are outstripping supply, and some loads are clearing as far as the upper Midwest.
- Supplies of Central nonfat dry milk are tight, according to Dairy Market News. There has been some increased production, but [nothing to offset demand](#). Producers are expecting prices to keep rising in light of strong export interest; buyers are bidding above current prices in an effort to secure future supplies. Out East, purchasers of condensed skim milk are drawing milk away from dryers, keeping Eastern production well below historical levels. Operators of drying plants are far behind their year-to-date output projections.
- Western barrel and processing solids buyers continue to [come up short of their needs](#), according to Dairy Market News. Current blocks are also getting tighter, even though plants in the Southwest are running at capacity levels.
- International: Although weather has been ideal in Western Europe and there is generally a favorable outlook to the beginning of the milking season, demand for dairy end-products remains strong for both internal and international buyer interest. Suppliers, however, have been hesitant to commit future production, since intervention stocks, used as a supply source when stocks tightened, are at zero. According to USDA, stocks [haven't been this low since 1964](#). Prices for manufactured dairy goods continue to go up and are often establishing record highs on a daily basis. Buyers are reluctant, but realize if they don't buy at these levels, they will go without.
- International: As they head into fall, pastures remain brown in Australia despite the occasional rain. Lack of water at these grazing operations is [impacting milk to the tune of 10.8%](#) below last year for the month of February. Early projections for next season, which begins in July for them, are for another slight decline, with hope that production will then rebound. That recovery hinges on favorable rainfall needed to replenish ground water and reservoir levels.

Futures Month	Friday 04/13 Close	Thursday 04/05 Close	Change	5-yr Average	Top 3rd Price
Apr-07	\$16.05	\$15.87	\$0.18	\$13.09	\$14.31
May-07	\$16.45	\$16.07	\$0.38	\$13.14	\$14.49
Jun-07	\$16.43	\$15.89	\$0.54	\$12.54	\$13.63
Jul-07	\$16.59	\$16.04	\$0.55	\$12.25	\$13.16
Aug-07	\$16.52	\$16.23	\$0.29	\$12.41	\$13.34
Sep-07	\$16.65	\$16.25	\$0.40	\$13.11	\$13.99
Oct-07	\$16.27	\$15.95	\$0.32	\$13.19	\$13.98
Nov-07	\$16.04	\$15.69	\$0.35	\$12.88	\$13.86
Dec-07	\$15.85	\$15.39	\$0.46	\$12.92	\$14.01
Jan-08	\$15.57	\$15.24	\$0.33	\$12.50	\$13.33
Feb-08	\$15.37	\$15.10	\$0.27	\$12.53	\$13.21
Mar-08	\$15.15	\$14.92	\$0.23	\$12.78	\$13.50
Apr-08	\$15.09	\$14.98	\$0.11	\$13.09	\$14.31
May-08	\$15.13	\$15.09	\$0.04	\$13.14	\$14.49
Jun-08	\$15.19	\$15.14	\$0.05	\$12.54	\$13.63
Jul-08	\$15.28	\$15.20	\$0.08	\$12.25	\$13.16
Aug-08	\$15.36	\$15.24	\$0.12	\$12.41	\$13.34
Sep-08	\$15.52	\$15.32	\$0.20	\$13.11	\$13.99
Oct-08	\$15.22	\$15.15	\$0.07	\$13.19	\$13.98
Nov-08	\$14.96	\$14.92	\$0.04	\$12.88	\$13.86
Dec-08	\$14.72	\$14.62	\$0.10	\$12.92	\$14.01
<b>Apr-Dec Avg</b>	<b>\$16.32</b>	<b>\$15.93</b>	<b>\$0.39</b>		
<b>2008 Avg</b>	<b>\$15.21</b>	<b>\$15.08</b>	<b>\$0.14</b>		

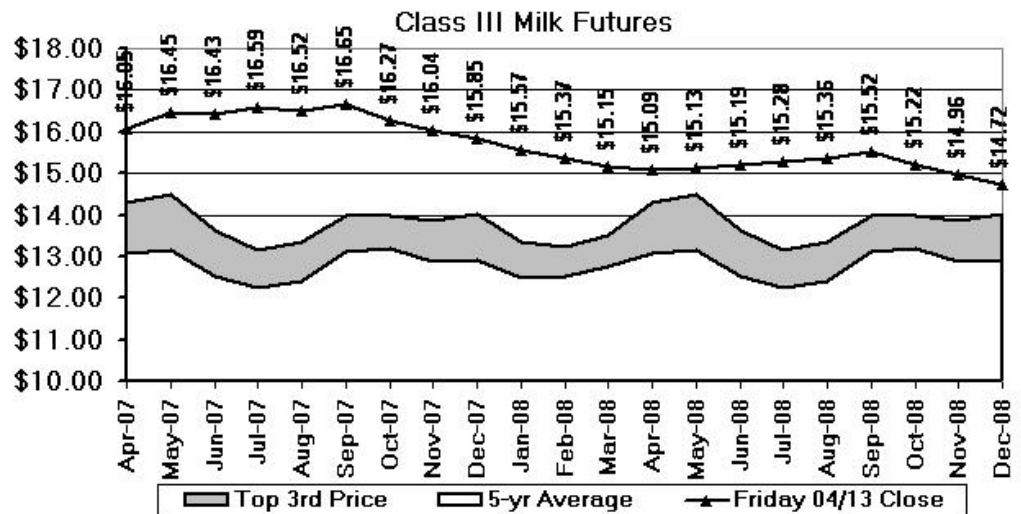
International demand for dairy end-products continues to build, but according to the USDA report, "Oceania is out of this market."

**Bearish Fundamentals:**

- Weekly cold storage numbers for the first week in April show a net [gain in both butter and cheese stocks](#). For the period 04/01 through 04/09, 900,000 lbs of butter and 659,000 lbs of cheese were added to selected storage centers.
- Fluid Milk & Cream Review reports [milk intakes are steady to higher](#) in the Midwest while Class I sales are erratic as school districts come on and off Spring Break. Retail interest is average and Class II specialty production is lighter, but churning remains active with heavier volumes available over the holiday weekend.
- Milk production in California continues to increase, according to Fluid Milk & Cream Review. Plants are [unable to take any down days](#) in order to handle the milk. Output has been boosted by new crop hay and green chop, increasing pressure on the infrastructure to handle the milk on a timely basis.
- There's a standoff in the dry whey market, with buyers [only willing to bid well below the market](#), and sellers not giving in to them, according to Dairy Market News. Offerings of whey are on the rise, but few sales are occurring.
- Demand for Western dry whey is not as aggressive as it was during the winter, according to Dairy Market News. Both export and domestic [sales have slowed due to price resistance](#) and the search for substitutes to replace high priced dairy products.
- Dairy Market News reports that despite the highest cash butter price since August 2006, cream supplies are more available, now that holiday needs have declined sharply. Churning activity across the country is [exceeding demand](#), so inventories are beginning to build again.

**Recommendation:**

A late winter storm in the Midwest causing a jump in corn prices and fears of alfalfa loss, along with a larger than expected jump in the NASS dry whey number, were all that was needed to light a fire under Class III futures for the second Friday in a row. Sellers taking profits as well as producer hedging appeared to have the upper hand most of the week, but trading Friday opened higher across the board and never looked back. The world powder situation appears to remain tight and bodes well for continued strong exports. In addition, the Euro is trading



near its highest level vs. the U.S. dollar since March, 2005, making our exports all that more attractive to foreign buyers. Sure, there is buyer price resistance at current levels, particularly for dry whey, but it probably means any price decreases will be somewhat limited. We find it ironic that USDA reports current block and barrel cheese is getting tight out West, despite very heavy milk production. However, DFA did shut down a jointly owned cheese plant this week in Lovington, NM which produced about 65 million lbs of 40-lb block cheddar per year. We're also hearing from our cheese plants that they are just not able to get the nonfat dry milk they need to improve yields. We know there is a lot of cheese in storage, so the million dollar question is, are commercials buying cheese now because there is good demand, or are they continuing to buy in advance so when July comes they'll stop buying? Or both! Either way, it's presenting some fantastic hedging opportunities for dairy producers. We stick with our recommendation from the past two weeks. Use PUT options to establish a floor but leave your upside open. Buy the May 16.00 PUT for 10¢ (currently 11¢). Enter orders to buy the June 15.50 PUT for 10¢, July 15.50 PUT for 15¢, Aug 15.25 PUT for 15¢ and Sep 15.25 PUT for 15¢. Wait for premiums to come down for Oct-Dec. For 2008, consider a min-max strategy for Q1 on 25% of your production, buying the 14.75 PUT and selling the 16.50 CALL for a net cost of 15¢. That would give you a minimum price of 14.60, with upside to 16.35 where your price would be capped. In order to reach your max price, or ceiling, Jan-Mar would have to settle above \$16.50/cwt, something it's never done before, ever. In our opinion this is a good trade-off, and a cheap way to establish a very high minimum price, while at the same time having your milk capped at what would be all-time record prices. Hard to go wrong there!

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