



## The KDM Dairy Report – April 20<sup>th</sup>, 2007

### Bullish Fundamentals:

- Livestock Slaughter Report: Dairy cow slaughter for the month of March was up 11.5% compared to last year. USDA reported 230,400 head were culled in March vs. only 206,600 the prior year. For the period Jan-Mar '07, 660,000 head have exited the milking herd vs. only 578,700 during the same period last year. The increase of 81,300 head being culled represents a [strong 14% increase](#) vs. last year.
- Livestock, Dairy & Poultry Outlook Report: USDA's monthly look at US Ag concludes [milk prices are likely to continue to rise](#). Despite a slight year-over-year projected increase in output per cow and a 1.1% gain in milk production, higher feed costs, alfalfa shortages and the CWT herd retirement program are likely going to tighten the milk supply. That and continued demand growth for milk and dairy products caused USDA to increase their Class III price forecast by 50¢/cwt from last month, now expecting it to average \$14.90/cwt. They also raised their price projections for cheese, butter, nonfat dry milk and dry whey as a result of continued demand and tightening supplies. USDA expects the milk-to-feed ratio to remain below 2.5.
- This week's NASS survey reflected gains in all Class III components, with [powder leading the way](#) again. Nonfat dry milk jumped 4.2¢ to average \$1.39/lb and dry whey increased 1.7¢ to reach 77.9¢/lb, another new NASS record. US 40-lb block cheese averaged \$1.40/lb, up 1.2¢ from last week, while 500-lb barrels managed a 0.7¢ gain to \$1.41/lb. Finally, butter averaged \$1.32/lb, up 0.9¢ from the previous week.
- Cash Market: Buyers continued to control the cash market this week as they pursued more product from sellers on the defensive. Blocks shot up 5¾¢ for the week, settling at \$1.48¼/lb today, and barrels tacked on an even more impressive 7¼¢ to close at \$1.48½/lb. Butter started climbing too, up 1½¢ to \$1.39/lb, reaching its highest price since January 6<sup>th</sup>, 2006. 9 loads of blocks, 13 barrels and only 1 car of butter exchanged hands during the week.
- The cheese market in the Midwest is firm, according to Dairy Market News. Current cheddar and natural American [supplies are clearing easily](#), with Mozzarella still very tight.
- Current cheese (aged 30 days and under) is also clearing easily in the Western region, according to Dairy Market News. Despite heavy milk production, buyers are [not able to find all the cheese they want](#) on the schedule they need, and most are assuming the price won't go below \$1.40/lb in the near term. Mozzarella stocks are declining on very good sales, with the lack of nonfat dry milk normally used to fortify the vat.
- Output of nonfat dry milk in the Central region is being [limited by good Class I interest](#) and strong usage of condensed skim, according to Dairy Market News. Buyers are becoming skeptical of further price increases, but producers anticipate continued strength in the market from limited production and strong domestic and international demand.
- Dairy Market News reports export demand for Western nonfat dry milk is [going unfilled](#). World buyers are looking to the U.S. to try and fill the world dairy protein shortage, but there is little to offer.
- Western whey prices pushed to new highs this week on strong exports, according to Dairy Market News. Though whey production is heavy, [no stock is building](#) and sellers were able to raise prices.
- Fluid Milk & Cream Review reports Class I sales are back up as bottlers replenish pipelines following the school holidays. Milk production is increasing, but [volumes available for manufacturing are tightening](#) due to the pull for fluid use. Spot milk prices ranged from \$0.50 - \$1.25 over class this week, spurred by increased use by cheese plants as they seek to maintain production levels with less nonfat dry milk or condensed milk solids to improve yields.

Futures Month	Friday 04/20 Close	Friday 04/13 Close	Change	5-yr Average	Top 3rd Price
Apr-07	\$16.10	\$16.05	\$0.05	\$13.09	\$14.31
May-07	\$17.20	\$16.45	\$0.75	\$13.14	\$14.49
Jun-07	\$17.37	\$16.43	\$0.94	\$12.54	\$13.63
Jul-07	\$17.70	\$16.59	\$1.11	\$12.25	\$13.16
Aug-07	\$17.78	\$16.52	\$1.26	\$12.41	\$13.34
Sep-07	\$17.87	\$16.65	\$1.22	\$13.11	\$13.99
Oct-07	\$17.35	\$16.27	\$1.08	\$13.19	\$13.98
Nov-07	\$17.25	\$16.04	\$1.21	\$12.88	\$13.86
Dec-07	\$16.75	\$15.85	\$0.90	\$12.92	\$14.01
Jan-08	\$16.10	\$15.57	\$0.53	\$12.50	\$13.33
Feb-08	\$15.65	\$15.37	\$0.28	\$12.53	\$13.21
Mar-08	\$15.58	\$15.15	\$0.43	\$12.78	\$13.50
Apr-08	\$15.45	\$15.09	\$0.36	\$13.09	\$14.31
May-08	\$15.41	\$15.13	\$0.28	\$13.14	\$14.49
Jun-08	\$15.45	\$15.19	\$0.26	\$12.54	\$13.63
Jul-08	\$15.50	\$15.28	\$0.22	\$12.25	\$13.16
Aug-08	\$15.61	\$15.36	\$0.25	\$12.41	\$13.34
Sep-08	\$15.80	\$15.52	\$0.28	\$13.11	\$13.99
Oct-08	\$15.40	\$15.22	\$0.18	\$13.19	\$13.98
Nov-08	\$15.12	\$14.96	\$0.16	\$12.88	\$13.86
Dec-08	\$15.10	\$14.72	\$0.38	\$12.92	\$14.01
<b>Apr-Dec Avg</b>	<b>\$17.26</b>	<b>\$16.32</b>	<b>\$0.95</b>		
<b>2008 Avg</b>	<b>\$15.51</b>	<b>\$15.21</b>	<b>\$0.30</b>		

- Butter buyers are trying to build heavier stocks than normal as an insurance policy against a possibly [much tighter market this fall](#), according to Dairy Market News. Retail accounts are reordering after the holidays and sales are better than anticipated.
- Things are tightening up in the Northeast as well, according to Fluid Milk & Cream Review. Some milk handlers in the region report that [receipts are as much as 5% behind](#) last year at this time, due to limited and poor quality winter feed stocks. Not much growth in milk per cow is expected until new feed becomes available. In Florida, contacts report they are past the spring peak. At the same time, Class I demand has strong throughout the Eastern region, resulting in 44 fewer loads being shipped out of the state this week.
- Milk production in New Mexico is lower primarily from output per cow losses, according to Fluid Milk & Cream Review. Poor winter weather, limited feed and less use of rBST are all contributing to the decline, even though the number of milk cows is holding steady.
- Weekly dairy cull numbers were [strong again](#). For the week ending 04/07, 54,700 head went to slaughter vs. only 43,700 head during the same period last year.

### **Bearish Fundamentals:**

- Milk Production Report: March milk production was up 1.1% vs. last year in the 23 major states, according to USDA figures released this week. Production was up 0.9% for all 50 states. Production per cow increased 7lbs, while the number of milk cows was 24,000 head more than March 2006, and [4,000 more than the prior month](#). For the first quarter, milk output increased 1%. Gains were led by Idaho, up 6.5% and Michigan, up 5%. CA and WI were up 3.5% and 1.6% respectively.
- Cold Storage Report: Total [cheese stocks in March were up 8%](#) vs. last year and up 2% vs. February, according to USDA. However, American cheese stocks were up only 1% vs. 2006 and butter stocks were down 1%.
- While Western whey still appears to be tight, Dairy Market News calls the Central whey market "weak". Supplies are adequate to heavy and buyers have been slow to pick up their loads, causing [warehouses to fill](#). Buyers are resistant to current prices and feed whey supplies are becoming increasingly available.
- California continues to produce milk at a level [several percentage points above last year](#), according to Fluid Milk & Cream Review. Finding a home for all the milk has been a challenge this week, with some processors sending milk away to other areas. However, the high cost of trucking and surcharges is making this financially painful. Near ideal weather and new crop alfalfa are combining to boost milk output at the farm.
- Butter stocks at CME-approved warehouses increased by 7.2 million lbs for the week ending 04/14. Total stocks, which were briefly below last years levels, have now recovered and we once again have [more butter on hand](#) than we did a year ago at this time.
- Dairy Market News reports [churning schedules continue to outpace demand](#), leading to more butter heading to inventory. Right or wrong, some butter producers are not taking advantage of the cream that is available now, thinking that prices will fall as the milk flush season develops.

### **Recommendation:**

Wow! Consider the baton passed! For the last two weeks we've talked about dry whey topping out and passing the price leadership to cheese. That happened in a big way this week as the cash cheese market erupted with solid gains. Despite being in heavy milk production season across the nation, buyers are attempting to hoard cheese in anticipation of a much tighter situation this fall. However, cheese plants, which have depended for years on the cheap availability of nonfat dry milk to improve yields, are not able to secure it at the price they need, so appear to be running more milk through the plants but with a drop in yields. As we pointed out last week and was mentioned again by Dairy Market News this week, California is flush with milk and processors are having a hard time finding a home for all of it, yet supplies of current blocks and barrels is tight. This drop in cheese yield may be part of the reason. **A word of caution:** Expect volatility and emotion in the Class III futures market to go higher. A good amount of short-covering occurred this week and prices may do things over the coming weeks that are not rational. We think prices are justified, but were not expecting these moves this soon. There is definitely some potential for short-term weakness in the dry whey price, though some months were limit up today, so expect dramatic moves up and down from here on out. Despite this, we still believe PUT options are the way to go. In fact, if you purchased PUTs 2-4 months ago, now is a great time to roll those up. For many months, a \$1.50-\$2.50 higher floor can be obtained for as little as a 10¢. This is a no-brainer. We've held off on Oct-Dec PUTs, but now is the time to start buying as premiums dropped significantly this week. Prices change daily, so give us a call next week and we'll help you get protected!

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