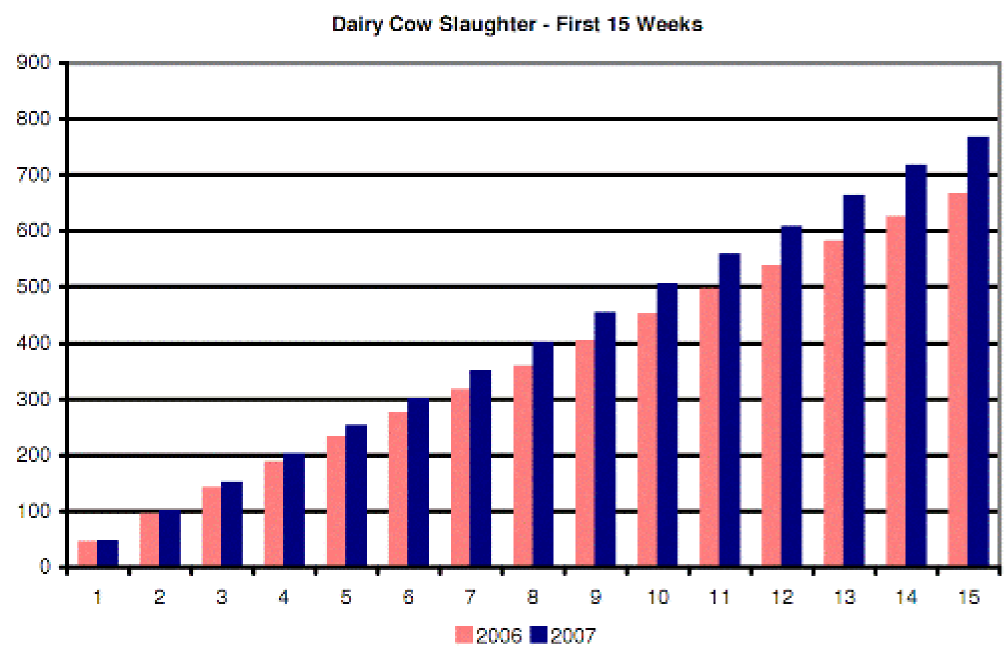
The KDM Dairy Report – April 27th, 2007

Bullish Fundamentals:

Futures Month	Friday 04/27 Close	Friday 04/20 Close	Change	5-yr Average	Top 3rd Price
Apr-07	$16.10	$16.10	$0.00	$13.09	$14.31
May-07	$17.35	$17.20	$0.15	$13.14	$14.49
Jun-07	$17.96	$17.37	$0.59	$12.54	$13.63
Jul-07	$17.95	$17.70	$0.25	$12.25	$13.16
Aug-07	$18.03	$17.78	$0.25	$12.41	$13.34
Sep-07	$18.12	$17.87	$0.25	$13.11	$13.99
Oct-07	$17.55	$17.35	$0.20	$13.19	$13.98
Nov-07	$17.40	$17.25	$0.15	$12.88	$13.86
Dec-07	$17.05	$16.75	$0.30	$12.92	$14.01
Jan-08	$16.54	$16.10	$0.44	$12.50	$13.33
Feb-08	$16.16	$15.65	$0.51	$12.53	$13.21
Mar-08	$16.06	$15.58	$0.48	$12.78	$13.50
Apr-08	$15.77	$15.45	$0.32	$13.09	$14.31
May-08	$15.67	$15.41	$0.26	$13.14	$14.49
Jun-08	$15.65	$15.45	$0.20	$12.54	$13.63
Jul-08	$15.75	$15.50	$0.25	$12.25	$13.16
Aug-08	$15.84	$15.61	$0.23	$12.41	$13.34
Sep-08	$16.00	$15.80	$0.20	$13.11	$13.99
Oct-08	$15.60	$15.40	$0.20	$13.19	$13.98
Nov-08	$15.35	$15.12	$0.23	$12.88	$13.86
Dec-08	$15.18	$15.10	$0.08	$12.92	$14.01
Apr-Dec Avg	**$17.50**	**$17.26**	**$0.24**		
2008 Avg	**$15.80**	**$15.51**	**$0.28**		

- Cash Market: Cheese buyers continued to push for more product this week. Blocks gained 6¾¢ to close at $1.55/lb today and barrels added a penny for the week to settle at $1.49½/lb. Butter ended the week at $1.40¾/lb, up 1¾¢. 9 loads of blocks, 16 barrels and 6 cars of butter exchanged hands.
- NASS numbers marched higher for all Class III components again this week. Dry whey added another penny to average 78.9¢/lb while nonfat dry milk was up a sharp 9.6¢ to $1.49/lb. Butter increased 2.3¢ to $1.35/lb, cheddar blocks were up 0.8¢ to $1.40/lb and barrels jumped 2.3¢ to $1.42/lb.
- USDA released commercial disappearance numbers this week which were generally supportive of the dairy market. Use of milk in all products in February was up 1.4% vs. last year, butter utilization was up 4.9% and use of other-than-American cheese was up a strong 5.4%. However, American cheese use was down 2.3%.
- Dairy cow slaughter for the week ending 04/14 dropped below 50k head but was still 6,900 higher than the same week a year ago. The 49,400 head were culled puts YTD numbers up 15% vs. 2006 (see chart).
- Cheese plants without the ability to process and generate income from their whey byproduct are in a difficult situation when having to pay for the component side of the milk they use. Fluid Milk & Cream Review reports cheese makers are still taking extra fat out of cheese vats rather than using higher priced nonfat dry milk to extend cheese yields. However, components are now showing their usual spring decline, which will make cheese production even more challenging.
- Milk production in California is still strong, but intakes appear to be declining, according to Fluid Milk & Cream Review. The number of cows currently freshening has slowed due to the heat spell last summer, so cows being dried up are not being replaced in the parlor. The peak has come and gone in Arizona and New Mexico, with processing plants able and wanting to handle additional milk. Production in New Mexico continues to be down from last year due to weather and feed issues. In the Pacific Northwest, some herds that were accepted into the CMW program are now gone, impacting some manufacturing plants, while hay supplies remain extremely tight. New crop hay is still 4-5 weeks off.



- Butter stocks at CME-approved warehouses dropped by 2.9 million lbs for the week ending 04/21, compared to a 3.3 million lb gain a year ago. Stocks on hand are now 5.9 million lbs lower than last year at this time.
- The cheese market is surprisingly firm, according to Dairy Market News. Behind it are buyers concerned with cheese offerings for summer and fall, so they're trying to build an extra cushion in their stocks before anticipated price increases. Mozzarella remains in very tight supply, due to the limited supplies of nonfat dry milk used in fortifying the vat. Mozzarella plant efficiencies are lower as a result, and some buyers are unable to secure desired volumes of product.
- The Western region continues to be light on both block and barrel cheese offerings, according to Dairy Market News. Product is clearing easily and discounts for under-grade cheese are declining to minimal amounts.
- Demand continues to outpace supply of nonfat dry milk in the Central region, according to Dairy Market News. Prices are higher and the market remains firm, with spot loads ranging from $1.44¾ - $1.96/lb, a level that most cheese plants cannot afford to fortify their vats. However, European prices are about $2.20/lb, keeping U.S.-sourced product attractive.
- Dry whey supplies are still tight out West, according to Fluid Milk & Cream Review. The weakening U.S. dollar has made U.S. exports more competitive and new sales of powder into international channels were reported this week.
- International: Demand for all dairy products in Europe is strong from both internal and international buyers, according to Dairy Market News. Prices continue to rise, with powder prices in particular setting new highs on nearly a daily basis. Lack of supply is noted as the main cause for the firm market, so buyers are reluctantly paying the higher prices rather than do without.
- International: In Australia, the Federal Government spoke on water availability in an area containing one third of Australia's dairy farms. If significant rainfall does not occur within the next 3-4 months, use of water for irrigation will be extremely limited, if at all. Australian suppliers have virtually no uncommitted stocks available for buyers, and manufacturers are looking to next season's production to fulfill this year's commitments. Most traders feel that firm prices and questionable supplies will be a factor for the next six to twelve months.

Bearish Fundamentals:

- Feed is getting cheaper. Soybean meal on the Chicago Board of Trade is now sitting below $200/bu for May and July, and not much higher for the balance of the year. Corn has come off its highs too, although all contracts are still above $3.50/bu. Further declines in the corn price will eventually result in better feed rations and more milk.
- Dairy Market News calls the Central dry whey market weak. Prices were lower this week and supplies are building as buyers have pulled back from purchasing loads unless they are offered at significant discounts.
- While butter stocks are down 4% for the first 23 days in April, cheese stocks are up 2%, according to USDA's weekly cold storage numbers. Over 3 million lbs of cheese have been added to selected storage centers over this period.
- Cow comfort in Florida is high due to mild temperatures and low humidity, according to Fluid Milk & Cream Review. 104 loads of Grade A milk were shipped out of the state last week, compared to only 56 during the same period last year. In addition, fluid milk sales are tapering as winter residents leave the state.

Recommendation:

Peak milk production out West has come and gone and a lot of animals are being dried off without fresh animals to replace them. At the same time, cheese plants are being forced to make cheese more inefficiently because the cost of nonfat dry milk is too great and availability too little; yields are down. Warehouses are full of cheese, but holders are hanging on to it with confidence with the growing expectation that the milk supply will be tighter this summer and fall. And the cash market remains active as multiple buyers continue to drive the price higher in their quest for additional product. Sources tell us sales are still good. The international powder market looks like it will remain tight well in to next year, while the U.S. dollar hit a multi-year low this week which should encourage international buyers to keep coming. At this point you may be wondering why you need to take any type of protective action at all, but we would caution anyone from getting complacent. Remember how long we had $20 milk the last go-round. We would continue to use the simple PUT option to buy yourself a floor. Get the June 17.00 PUT at 15¢, July-Sep 16.75 PUT at 25¢ (currently avg 28¢) and Oct-Dec 15.50 PUT at 25¢ (currently 27¢). Finally, on up to 25% of your production, considering buying the Jan-Mar 15.50 PUT and selling the 17.00 CALL for a net credit of 4¢, which would cover your transaction costs. Milk may indeed go a lot higher, but this strategy would give you a 15.50 floor and a cap of 17.00 on your milk for Q1 2008 at no cost. Something to think about.