



The KDM Dairy Report – May 4th, 2007

Bullish Fundamentals:

- USDA announced the April Class III settlement price of \$16.09/cwt, a \$1/cwt higher than last month and the [highest price since December 2004](#).
- Cash Market: Block cheese continued its relentless move higher, gaining a stunning 15¼¢ during the week to settle at \$1.70¼/lb. Barrels went for the ride, up 14¢ to close at \$1.63½/lb. Butter is starting to make some stronger moves as it shot up 4¾¢ to reach \$1.45½/lb. The biggest move was reserved for Grade A nonfat dry milk, which was bid up 35¢ to \$2/lb.
- Dairy Products Report: March butter production was down 1.1% vs. last year, according to USDA numbers released today. Cheddar cheese output was [only 0.8% higher, and down 1.9%](#) vs. February on a daily basis. Total cheese output was up 1.9% vs. March 2006, but down slightly from last month. Nonfat dry milk production was down 8.8% compared to last year, while dry output was down 2.3%.
- Dairy cow slaughter for the week ending 04/21 was 51,200 head, [still very strong](#) compared to last year when only 40,200 head were culled.
- Butter stocks at CME-approved warehouses [remain below last year](#). For the week ending 04/28, 125.7 million lbs were on hand vs. 132.5 million lbs last year at this time.
- Cheese plants without a good whey stream income are trying to minimize cheese production and financial losses by [sending additional loads of milk to bottlers](#), according to Fluid Milk & Cream Review. Some plants have made deals to ship milk away from the vat for the next month or two.
- Strong demand in the Central and Eastern regions for condensed skim from Class II and III facilities is [keeping a significant volume of milk](#) from entering dryers, according to Dairy Market News. Nonfat dry milk remains in tight supply, and some handlers think the price will peak as high as \$2.27/lb, far higher than today's NASS number of \$1.52/lb.
- Western nonfat dry milk supplies remain tight as well. Dairy Market News reports prices were sharply higher this week, reflecting strong demand from the world market. Buyers are [worried about availability](#) in the coming months, and loads offered for resale are trading at a premium.
- Western whey prices [continue to strengthen](#), largely on very strong export sales. Product is easy to move with some buyers receiving less than desired quantities, according to Dairy Market News. Production is strong now, but some contacts are wondering what will be like in a few months when milk production declines.
- Dairy Market News reports some butter operations are indicating that their [stocks are quite a bit less](#) than last year at this time. End users are stockpiling for fall needs in anticipation of lower availability later this year.
- The Central cheese market is firm, according to Dairy Market News. Buyers are able to secure contracted loads but [extra volumes are limited](#). Some buyers have managed to build cushion stocks for later in the year, but others have not.
- Some Western cheese buyers are aggressively trying to find additional loads before prices move higher, according to Dairy Market News. Others are waiting on the sideline for a drop in price, but offerings of current blocks and barrels is reportedly [on the tight side](#). Under grade cheese is clearing easily.
- NASS [prices for cheese increased](#) this week, along with butter and nonfat dry milk. 40-lb blocks averaged \$1.42/lb, up 1.6¢ from last week, and 500-lb barrels were \$1.45/lb, up 2.1¢. Butter gained 2¢ to \$1.37/lb and nonfat dry milk continued its strong move higher, up 3.1¢ to \$1.52/lb. Dry whey, however, was down for the first time in weeks (months?), losing 1.2¢ to average 78.1¢/lb.

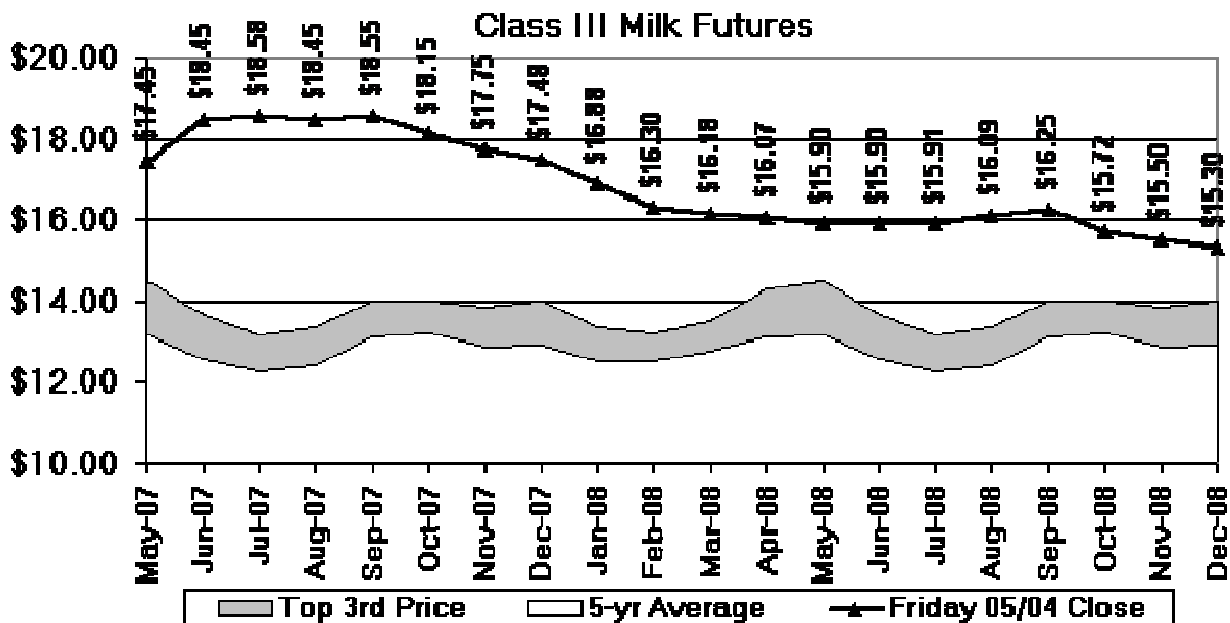
Futures Month	Friday 05/04 Close	Friday 04/27 Close	Change	5-yr Average	Top 3rd Price
May-07	\$17.45	\$17.35	\$0.10	\$13.14	\$14.49
Jun-07	\$18.45	\$17.96	\$0.49	\$12.54	\$13.63
Jul-07	\$18.58	\$17.95	\$0.63	\$12.25	\$13.16
Aug-07	\$18.45	\$18.03	\$0.42	\$12.41	\$13.34
Sep-07	\$18.55	\$18.12	\$0.43	\$13.11	\$13.99
Oct-07	\$18.15	\$17.55	\$0.60	\$13.19	\$13.98
Nov-07	\$17.75	\$17.40	\$0.35	\$12.88	\$13.86
Dec-07	\$17.48	\$17.05	\$0.43	\$12.92	\$14.01
Jan-08	\$16.88	\$16.54	\$0.34	\$12.50	\$13.33
Feb-08	\$16.30	\$16.16	\$0.14	\$12.53	\$13.21
Mar-08	\$16.18	\$16.06	\$0.12	\$12.78	\$13.50
Apr-08	\$16.07	\$15.77	\$0.30	\$13.09	\$14.31
May-08	\$15.90	\$15.67	\$0.23	\$13.14	\$14.49
Jun-08	\$15.90	\$15.65	\$0.25	\$12.54	\$13.63
Jul-08	\$15.91	\$15.75	\$0.16	\$12.25	\$13.16
Aug-08	\$16.09	\$15.84	\$0.25	\$12.41	\$13.34
Sep-08	\$16.25	\$16.00	\$0.25	\$13.11	\$13.99
Oct-08	\$15.72	\$15.60	\$0.12	\$13.19	\$13.98
Nov-08	\$15.50	\$15.35	\$0.15	\$12.88	\$13.86
Dec-08	\$15.30	\$15.18	\$0.12	\$12.92	\$14.01
Apr-Dec Avg	\$18.11	\$17.68	\$0.43		
2008 Avg	\$16.00	\$15.80	\$0.20		

Bearish Fundamentals:

- Ag Prices Report: USDA's monthly look at agricultural prices showed the April milk-to-feed ratio [climbed 14 points](#) from last month, to 2.54. While still well below 3.0, milk prices have increased enough to start bringing the ratio higher. And with what we know about May and June prices, the milk-to-feed ratio is very likely to continue rising in the months to come.
- Florida exported 136 loads of milk out of state, compared to 104 last week. Bottlers continue to pare back operations as [buyer interest continues to drop](#). Weather has been comfortable for the cows, with cool mornings, and this is aiding milk production.
- Although milk production in California is on the decline, plants continue to [run on extended schedules](#) to handle the milk, according to Fluid Milk & Cream Review. Excess volumes are being sent to other locales for processing.
- Central whey [prices are under pressure](#) as inventories continue to be heavy in certain areas, according to Dairy Market News. Multiple loads traded this week into the export markets at steady to lower prices.

Recommendation:

Class III futures continued to take its cue from the cash cheese market and dry whey prices. While we finished substantially higher for the week, today's ¾¢ drop in barrels during the cash session, and a drop in the NASS dry whey number were enough



to trigger profit taking on a big scale today. Prices finished today's session 45-58¢ lower Jun-Nov. As farmers come in from field work and look at their DTN's today, we could see some follow-through selling on Monday as producers decide to lock in some profitable numbers. Going forward, it will take further gains in the cash cheese market to turn the market back around. Cheese is reportedly getting tighter as cheese plants continue to make product without the benefit of nonfat dry milk to improve yields. Today's Dairy Products report shows the important cheddar category was up only 0.8% in output compared to last year, and actually down vs. February on a daily basis. With Australia and New Zealand heading in to winter, we don't anticipate the tight global powder situation will fix itself much before 2008, which should keep further losses in the dry whey price to a minimum. In fact, though the NASS dry whey price dropped, dry whey futures on the CME made gains the entire week. This type of pull-back is healthy for this market, however. We couldn't keep climbing like we were indefinitely. So, what to do. If you're inclined to sell some milk here, go ahead. We could just advise, no, **insist** you buy CALL options to protect yourself immediately! There are still a lot of supportive fundamentals to this market. Weekly we see more news items on rBST being pulled from use and it may just be a matter of time before it's no longer used. We're also hearing rumblings about premium structure changes coming in the Midwest, which would lower producer income and make it harder to expand operations. Going forward, we would advise NOT including your premium pay when making hedging decisions. Make sure you can cash flow at base prices you hedge at. Finally, with a bias towards a long-term move higher, we're still more comfortable recommending producers stick with PUT options to buy floor price protection. Call us and we'll help you develop a risk management plan for your operation!

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