

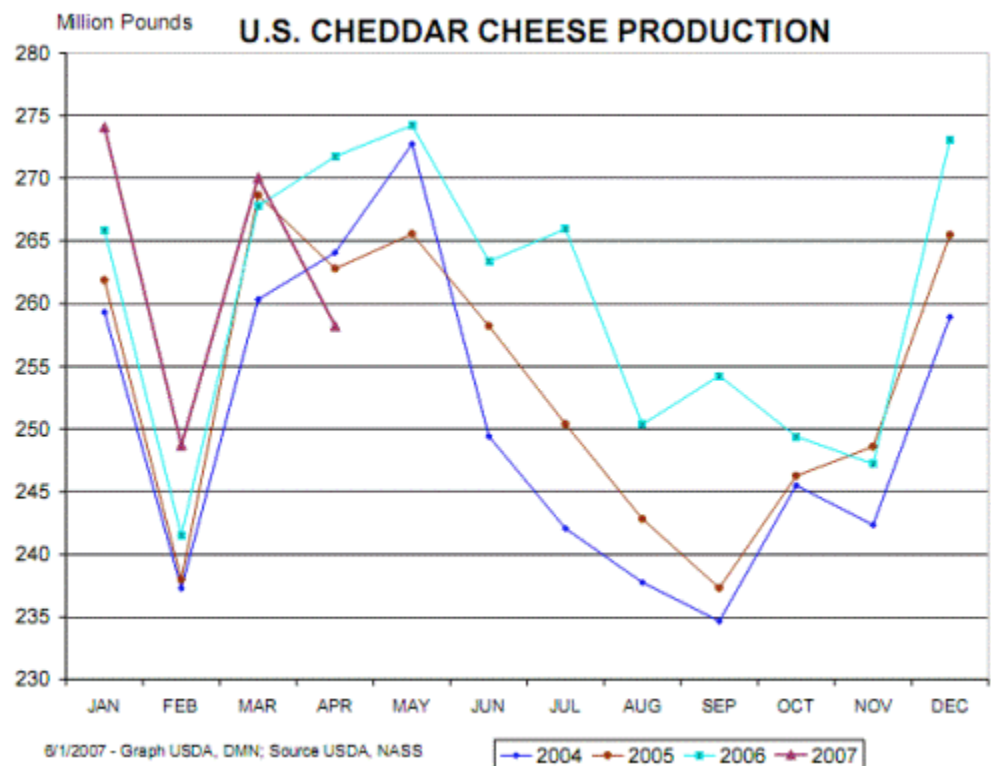


The KDM Dairy Report – June 1st, 2007

Bullish Fundamentals:

- Cash Market: Cheese buyers were aggressive again this week, but only picked up 3 loads of blocks and 3 barrels despite pushing the price significantly higher. Blocks settled today at \$1.88¼/lb, up 8¼¢ for the week, while barrels blasted 11¢ higher to reach \$1.91/lb. Butter has been slower to respond, but still managed to gain 3½¢ to \$1.54½/lb. Spot nonfat dry milk continued to wake up. Bidders were unsuccessful in obtaining any product, but pushed the Grade A price up 5¢ to \$2.11/lb and the Grade X price 8¢ to \$1.93/lb.
- Weekly NASS prices have a long way to go to catch the cash market, but they are [making headway](#). This week's survey had 40-lb cheddar blocks up 3.4¢ from last week to average \$1.66/lb, while 500-lb barrels reached the same price with an increase of 4.4¢. Butter was up 4.2¢ to \$1.47/lb and nonfat dry milk shot up 12.3¢ to average \$1.79/lb. Dry whey held about steady at 75.3¢/lb.
- Dairy Products Report: April cheddar [cheese production was down 5.0%](#) vs. last year and off 4.4% vs. March. Today's Daily Dairy Report says this is the "biggest single-month drop-off in more than 3½ years". Total cheese production, however, was up 1.2% vs. last year and butter output was 5.2% higher.
- Ag Prices Report: The milk-to-feed ratio [increased only slightly](#) in May to 2.52, compared to 2.50 in April. That's still well below the 3.0 typically associated with dairy expansion. Milk prices were higher, but so were feed prices, limiting the move up.
- Class III May milk settlement was announced today at \$17.60/cwt, which is the highest price since June 2004.
- Fluid Milk & Cream Review writes in their Central bulletin this week, "The expectation of lower cheese production in the Southwest as early milk shipments are made into the Southeast in June is expected to [tighten cheese supplies](#) and may eventually lead to even higher cheese prices by fall."
- [Hay shortages](#) are occurring in the Southeast due to below average yields and poor quality, according to Fluid Milk & Cream Review. Above normal temperatures and below normal precipitation has soil moisture

Futures Month	Friday 06/03 Close	Friday 05/25 Close	Change	5-yr Average	Top 3rd Price
Jun-07	\$20.16	\$19.68	\$0.48	\$12.54	\$13.63
Jul-07	\$20.74	\$19.57	\$1.17	\$12.25	\$13.16
Aug-07	\$19.78	\$18.85	\$0.93	\$12.41	\$13.34
Sep-07	\$19.15	\$18.65	\$0.50	\$13.11	\$13.99
Oct-07	\$18.35	\$17.97	\$0.38	\$13.19	\$13.98
Nov-07	\$17.69	\$17.35	\$0.34	\$12.88	\$13.86
Dec-07	\$17.30	\$16.90	\$0.40	\$12.92	\$14.01
Jan-08	\$16.55	\$16.39	\$0.16	\$12.50	\$13.33
Feb-08	\$15.69	\$15.63	\$0.06	\$12.53	\$13.21
Mar-08	\$15.54	\$15.55	(\$0.01)	\$12.78	\$13.50
Apr-08	\$15.54	\$15.55	(\$0.01)	\$13.09	\$14.31
May-08	\$15.35	\$15.35	\$0.00	\$13.14	\$14.49
Jun-08	\$15.49	\$15.40	\$0.09	\$12.54	\$13.63
Jul-08	\$15.53	\$15.40	\$0.13	\$12.25	\$13.16
Aug-08	\$15.65	\$15.59	\$0.06	\$12.41	\$13.34
Sep-08	\$15.85	\$15.74	\$0.11	\$13.11	\$13.99
Oct-08	\$15.33	\$15.26	\$0.07	\$13.19	\$13.98
Nov-08	\$15.12	\$15.12	\$0.00	\$12.88	\$13.86
Dec-08	\$14.91	\$14.94	(\$0.03)	\$12.92	\$14.01
May-Dec Avg	\$19.02	\$18.42	\$0.60		
2008 Avg	\$15.55	\$15.49	\$0.05		



levels rated short to very short, contributing to the poor hay situation. The higher temperatures are also creating cow comfort issues.

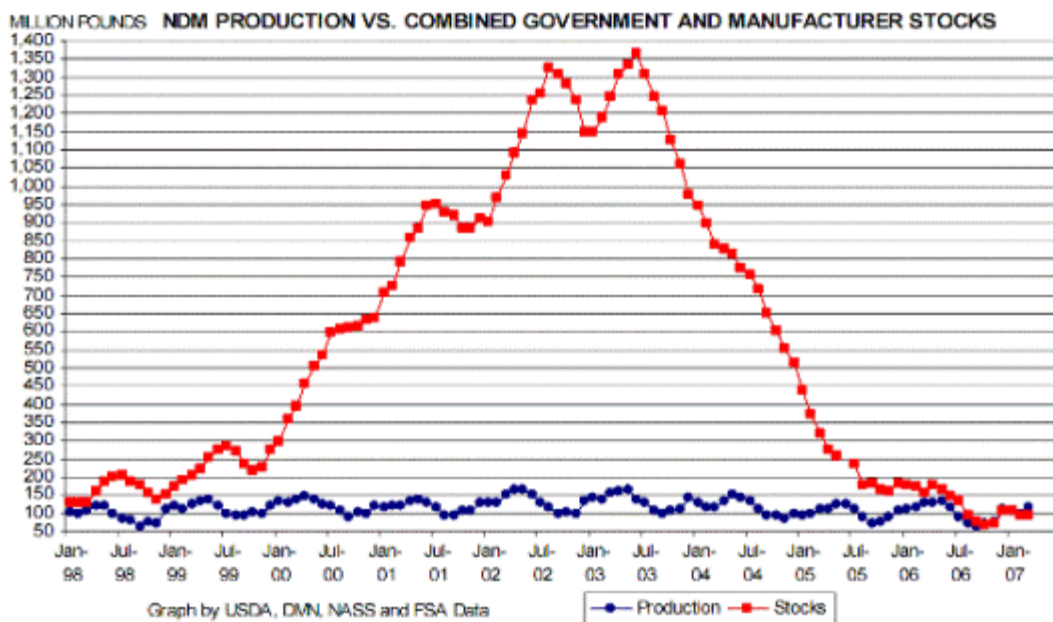
- Nonfat dry milk production was heavier in the Central region this week, but [supplies still remain short](#), according to Dairy Market News. Some manufacturers are shorting contracted loads by a pallet or two to extend supplies.
- Cream supplies for churning were more available over the Memorial Day holiday, but were not as heavy as anticipated, according to Dairy Market News. Surplus milk volumes were [not as heavy as projected](#) and plants were not as stressed as they have been in past years.
- Dairy Market News reports both cheddar blocks and barrels are tight in the Midwest, and a few bulk buyers are worried about a [supply cutback](#) from a large cheese plant. In addition, the price gap between Class IV and Class III milk is giving incentive to handlers to divert milk away from cheese production and into drying facilities.
- Despite higher prices, cheese buyers in the Western region have continued to purchase normal volumes, according to Dairy Market News. The bottom line is [they need the product](#) for current and futures needs, and cheese production has peaked at some operations and is now on the decline. Additionally, buyers are worried about the possibility of more milk heading to the Southeast to handle fluid demand, as well as a shift from cheese into butter/powder operations due to better returns.

Bearish Fundamentals:

- Weekly cold storage holdings for the period 05/01 through 05/28 indicate a [4% increase](#) in butter stocks and 1% increase in cheese stocks.
- Weekly dairy cow slaughter numbers [continue to cool off](#) in light of the completion of the CWT herd buyout program and strong milk prices. For the week ending 05/19, 42,100 head were culled vs. 40,800 during the same period last year.
- Florida exported 234 loads of Grade A milk out of the state as demand from milk bottlers continues to trend lower. Many school districts are finishing classes and decreasing orders.

Recommendation:

The front months led the way again this week as it appears we are destined for \$2 cheese. Current (aged 30 days and under) cheese is tight in both the block and barrel variety, and our industry contacts believe it may stay that way for some time. Dry whey has refused to move lower and may be setting up for another run higher later this summer as production declines seasonally. The price of nonfat dry milk, while not a component in Class III pricing, is nonetheless pulling milk away from the vat and



into drying operations due to the higher return, limited production and tight stocks (see chart above). While the Dairy Products Report does not usually have a big impact on the market, the 5% drop in cheddar production (see chart above) was far below expectations and may cause further concern and ambition for buyers looking to secure additional product. We expect more upside next week, particularly in the July-Sep contracts, but it may spill over into Q4 and 2008 as well. This is fantastic news for the producer, but it is not the time to sit on the sidelines! As prices continue higher, there will be a vacuum of both buyers and sellers with volatile price moves expected. If cash cheese prices move over \$2/lb over the next one to three weeks, hedgers should be buying PUT options July-Dec to protect against a potential correction. Yes, prices could stay strong for quite some time, but we also envision the possibility of very high prices, followed by an extended correction to the downside, followed by another run higher this fall. At these prices it is silly not to protect your operation! Call us and we'd be more than happy to help you plot out a risk management plan!

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