



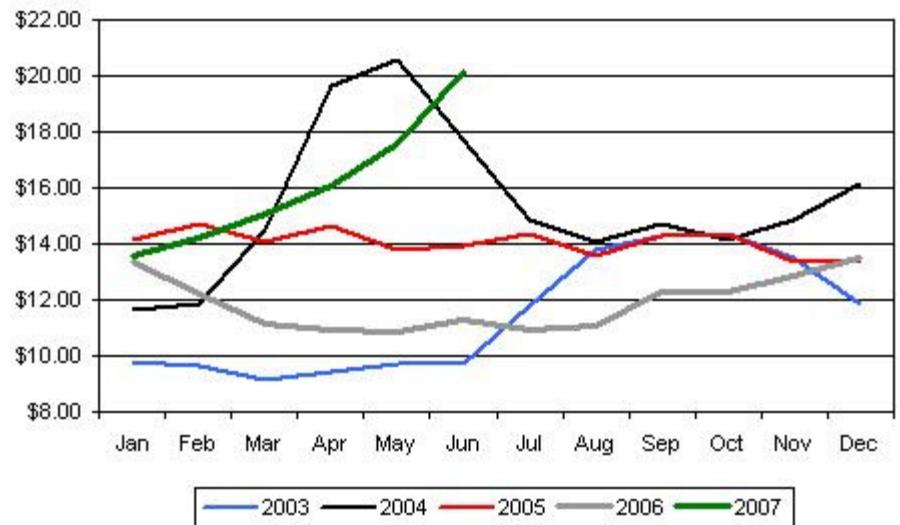
The KDM Dairy Report – June 29th, 2007

Bullish Fundamentals:

- June Class III settlement was announced at \$20.11/cwt, the highest close since May 2004, which settled at \$20.58.
- NASS surveyed prices for both cheese and dry products [continue to track higher](#). 40-lb blocks increased 7.8¢ to average \$1.94/lb and barrels shot up 12¢ to \$1.99/lb. Nonfat dry milk gained a strong 7.7¢ to average \$1.99/lb while dry whey was up 0.3¢ to 76.4¢/lb. Butter was the lone loser, dropping 1.6¢ to \$1.48/lb.
- Commercial Disappearance: Commercial use of American cheese was down 3.7% in April, according to the latest USDA figures, however, use of all other types of cheese was [up a strong 10.6%](#) vs. a year ago. Use of butter was down 12.2%, but use of nonfat dry milk was up 25.8%.
- From the Gulf Coast to Mid Atlantic region, producers are facing a hay shortage as a result of lower yields, according to Fluid Milk & Cream Review. Hay prices are up 35%, so dairies are turning to distiller's grains to supplement rations. In the Northeast, more processors are announcing they will only accept rBST-free milk. The new policy is expected to be in place [before the end of the year](#). Finally, in the Southeast, heat and humidity are causing milk production to decline, but fluid demand from bottlers is steady to slight higher.
- Milk production in the Southwest is falling as temps reach in to the 100's. Plants [have additional capacity](#) to handle more milk, and demand from cheese plants has increased as they try to build inventory.
- Weekly cold storage numbers continue to show a [drop in cheese stocks](#) during the month of June. For the period 06/01 through 06/25, cheese inventories fell 4%, of 5.2 million lbs.
- Dairy Market News reports that as butter stocks in Europe have fallen recently, churning facilities have received [increased EU-based inquiries](#) into butter availability for overseas delivery.
- Strong Class II demand and declining milk volumes are tightening the cream supply for churning operations, according to Dairy Market News. Surplus butter is still moving to storage, but the volumes are getting lighter. Food service orders are reported as steady, and customer traffic at restaurants is [holding up well](#); a good sign in light of higher fuel costs.
- The nonfat dry milk market is still steady to firm, according to Dairy Market News. Buyers are concerned about current high prices, but [stocks are light](#) and production is trending lower as milk production declines.

Futures Month	Friday 06/29 Close	Friday 06/22 Close	Change	5-yr Average	Top 3rd Price
Jul-07	\$20.10	\$22.15	(\$2.05)	\$12.25	\$13.16
Aug-07	\$18.88	\$21.04	(\$2.16)	\$12.41	\$13.34
Sep-07	\$18.71	\$20.85	(\$2.14)	\$13.11	\$13.99
Oct-07	\$17.60	\$19.67	(\$2.07)	\$13.19	\$13.98
Nov-07	\$16.50	\$18.20	(\$1.70)	\$12.88	\$13.86
Dec-07	\$16.23	\$17.72	(\$1.49)	\$12.92	\$14.01
Jan-08	\$15.45	\$16.71	(\$1.26)	\$12.50	\$13.33
Feb-08	\$14.90	\$16.00	(\$1.10)	\$12.53	\$13.21
Mar-08	\$14.75	\$15.65	(\$0.90)	\$12.78	\$13.50
Apr-08	\$14.70	\$15.55	(\$0.85)	\$13.09	\$14.31
May-08	\$14.75	\$15.45	(\$0.70)	\$13.14	\$14.49
Jun-08	\$14.80	\$15.55	(\$0.75)	\$12.54	\$13.63
Jul-08	\$15.06	\$15.60	(\$0.54)	\$12.25	\$13.16
Aug-08	\$15.09	\$15.70	(\$0.61)	\$12.41	\$13.34
Sep-08	\$15.29	\$16.00	(\$0.71)	\$13.11	\$13.99
Oct-08	\$14.75	\$15.55	(\$0.80)	\$13.19	\$13.98
Nov-08	\$14.72	\$15.35	(\$0.63)	\$12.88	\$13.86
Dec-08	\$14.49	\$15.05	(\$0.56)	\$12.92	\$14.01
July-Dec Avg	\$18.00	\$19.94	(\$1.94)		
2008 Avg	\$14.90	\$15.68	(\$0.78)		

Class III Historical Prices



Bearish Fundamentals:

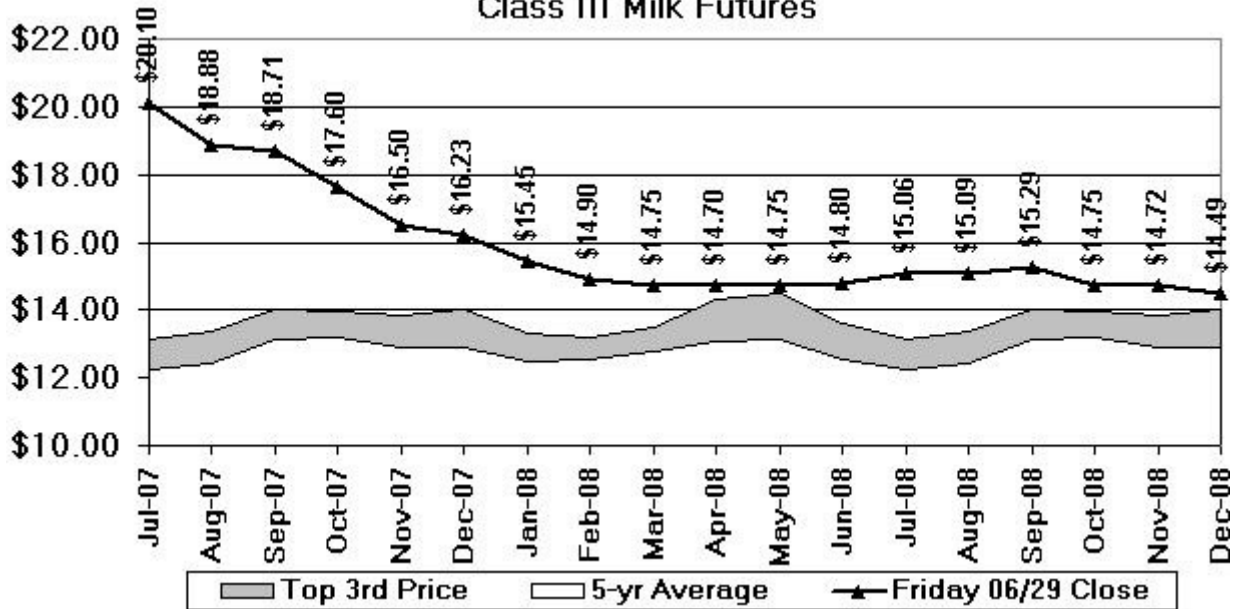
- Cash Market (or should we say the Crash Market): Blocks fell 16¢ from last Friday, most of it in a dramatic 13¢ drop on Thursday, to close at \$1.94/lb today. Barrels plummeted 13¾¢ for the week, settling at \$1.91. Butter lost only a half-cent from last Friday, closing at \$1.48½/lb. 16 loads of blocks, 1 barrel and 4 cars of butter exchanged hands.

- The cheese market is showing signs of short-term weakness as buyers react to \$2+ cheese with [slower and smaller orders](#), according to Dairy Market News. They're putting off any reordering while they use inventory built at lower prices. At the same time, some are trying to reduce or slow down committed bulk cheese supplies since putting \$2 cheese into aging programs is financially stressful.
- Ag Prices Report: The June milk-to-feed ratio [shot up 22 points](#) from May to reach 2.76, according to USDA figures released Thursday. While still below the theoretical 3.0 necessary to encourage expansion, it has been steadily increasing and appears headed that way.
- Weekly dairy cow slaughter numbers [fell below](#) last year's for the first time this year. 40,100 head were culled during the week ending 06/16, compared to 40,700 during the same period last year.
- The second highest Class I base price in history has bottlers and handlers expecting July fluid milk [sales to weaken](#). Current demand is already sluggish, according to Fluid Milk & Cream Review.
- Dairy Market News calls the dry whey market "weak" as offerings and [inventories are building](#). Export interest from China is down as their needs are reportedly covered for the near term.

Recommendation:

Three weeks ago we said, "**Buy your protection while you can.**" Two weeks ago we recommended selling July-Dec at \$20 avg because "**Many anticipate a strong correction is in store.**" Last week we left our recommendation to sell the last half of 2007 at \$20 and said, "**Those we speak to in the industry still expect a major correction at some point, and the market remains very nervous at these levels. We are supported by a house of cards, and it only takes one load of cheese that nobody wants to cause it to collapse. At that point, there will be nobody to sell to.**" With July-Dec trading limit down two days in a row, losing nearly \$2/cwt in the process, we are certainly in the midst of a strong correction, and more may be in store next week. Early in the week we were able to get a few producers covered as we did hit and go above our \$20 avg target (now at \$18 avg). We were also able to purchase some great PUT options that have more than doubled in value since the crash. But not nearly enough. Unfortunately, many were reluctant to sell, and as has been the case in the past, got comfortable with where prices were. The bids literally disappeared this week, and as quoted above, there was no one to sell to. So, what do we do with this? All is not lost. For one, this provides a great opportunity for those that sold milk at lower prices to buy CALL options against them in the event prices recover (we think they will). Give us a call and do it! You may not get another chance! Secondly, be patient. While we're hearing more erosion in the cash cheese market is likely, which should move Class III futures lower still, we do believe there will be a recovery later this summer. Production in CA, the Southwest and the Southeast is dropping off due to heat. Rainfall in West Texas, a heat wave in Europe and slow milk production recovery in Oceania should keep international demand strong. Near-term, prices look to be under pressure, but longer term the outlook still looks pretty good.

Class III Milk Futures



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