

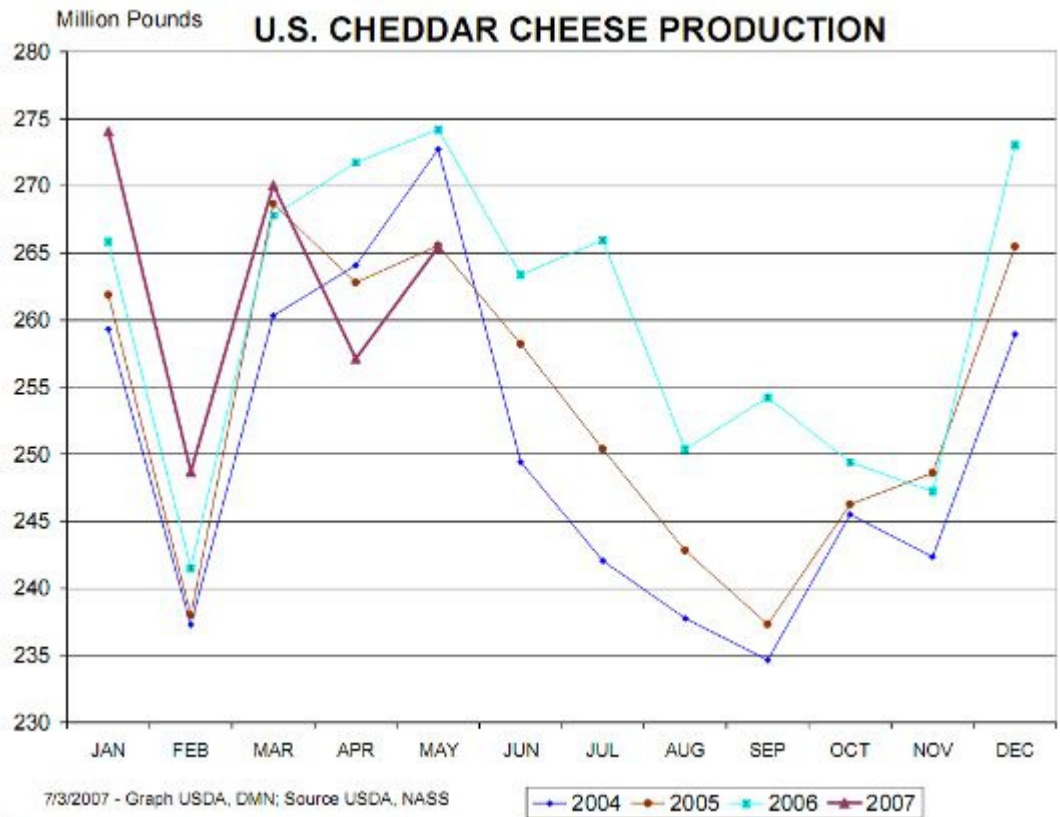


The KDM Dairy Report – July 6th, 2007

Bullish Fundamentals:

- Dairy Products Report: American cheese production in May was down 4.2% vs. a year ago, according to USDA figures released on Tuesday, the [second consecutive month](#) of declining production. Total cheese output was flat compared to last year; the first time there has not been an increase since April, 2005. In the powders, nonfat dry milk production was down 12.9%.
- NASS surveyed prices for [cheese hit \\$2.02/lb](#) for both blocks and barrels for the week ending June 20th. That represents a gain of 7.6¢/lb for blocks and 2.3¢/lb for barrels. Nonfat dry milk hit \$2.00/lb, up 0.6¢, but butter lost 1.2¢ to average \$1.47/lb and dry whey fell 1.8¢ to \$74.7¢/lb.
- Cash Market: After a major drop last week, cheese prices were able to muster minor gains this week. Blocks were up 2½¢ to reach \$1.96½/lb and barrels inched 1½¢ higher to \$1.92½/lb. Butter lost 2¢, however, closing at \$1.46½/lb today. 3 loads of blocks, 1 barrel and 7 cars of butter exchanged hands.
- Fluid Milk & Cream Review reports the extreme heat out West is having a negative affect on milk production in CA, NM and AZ. Highs in AZ are approaching 115 degrees with [nighttime lows only down to the 80's](#).
- Weekly cold storage numbers for the period 06/01 through 07/02 reflect a [4% drop in cheese stocks](#), a fall of nearly 6 million lbs. But butter stocks were up 4%, or 1.2 million lbs.
- International: Milk output is trailing last year on a cumulative basis in the UK, France and Germany, according to Dairy Market News, while demand for milk remains strong. Producers of milk powders are keeping up with internal demand, but falling short of export interest. Prices for most dairy end products are higher since export subsidies have been completely removed, but also because of recent strength in the Euro currency. Stocks of dairy products are limited, with some European suppliers even [looking to other markets for additional stocks](#). Handlers indicate butter stocks are at their lowest levels in recent memory.

Futures Month	Friday 07/06 Close	Friday 06/29 Close	Change	5-yr Average	Top 3rd Price
Ju1-07	\$20.95	\$20.10	\$0.85	\$12.25	\$13.16
Aug-07	\$19.45	\$18.88	\$0.57	\$12.41	\$13.34
Sep-07	\$19.50	\$18.71	\$0.79	\$13.11	\$13.99
Oct-07	\$18.12	\$17.60	\$0.52	\$13.19	\$13.98
Nov-07	\$16.95	\$16.50	\$0.45	\$12.88	\$13.86
Dec-07	\$16.60	\$16.23	\$0.37	\$12.92	\$14.01
Jan-08	\$15.70	\$15.45	\$0.25	\$12.50	\$13.33
Feb-08	\$15.00	\$14.90	\$0.10	\$12.53	\$13.21
Mar-08	\$14.90	\$14.75	\$0.15	\$12.78	\$13.50
Apr-08	\$14.80	\$14.70	\$0.10	\$13.09	\$14.31
May-08	\$14.76	\$14.75	\$0.01	\$13.14	\$14.49
Jun-08	\$14.84	\$14.80	\$0.04	\$12.54	\$13.63
Ju1-08	\$15.10	\$15.06	\$0.04	\$12.25	\$13.16
Aug-08	\$15.14	\$15.09	\$0.05	\$12.41	\$13.34
Sep-08	\$15.40	\$15.29	\$0.11	\$13.11	\$13.99
Oct-08	\$14.84	\$14.75	\$0.09	\$13.19	\$13.98
Nov-08	\$14.74	\$14.72	\$0.02	\$12.88	\$13.86
Dec-08	\$14.50	\$14.49	\$0.01	\$12.92	\$14.01
J1y-Dec Avg	\$18.60	\$18.00	\$0.59		
2008 Avg	\$14.98	\$14.90	\$0.08		



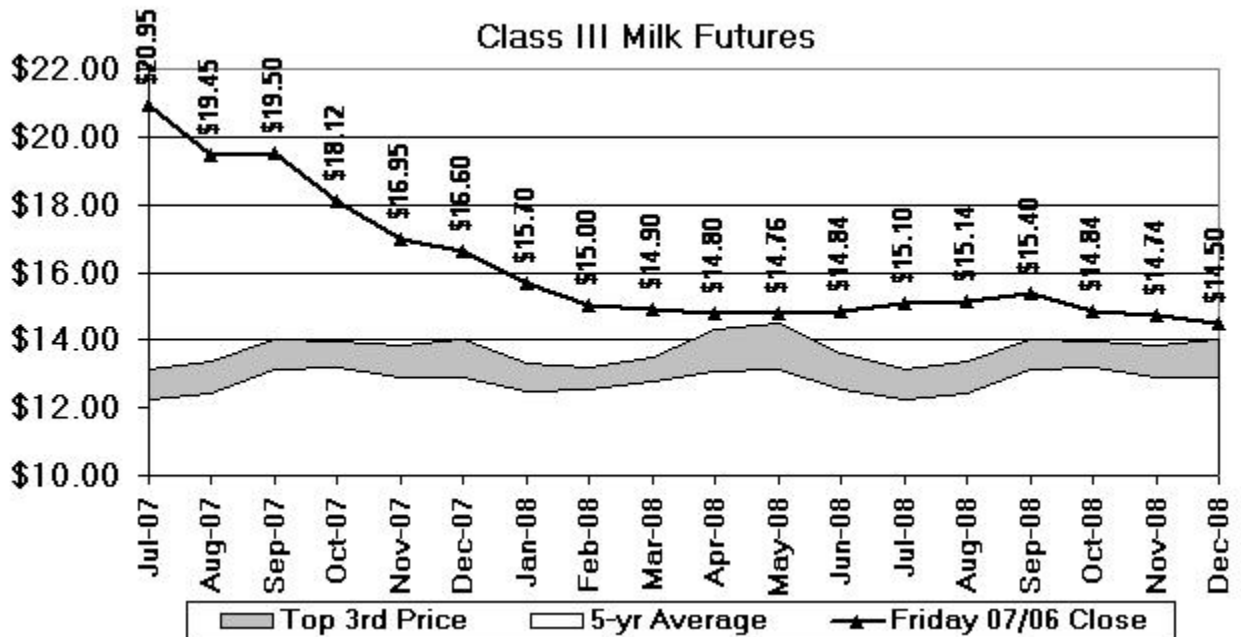
- International: Milk output in May for Australia was down 11.6% vs. last May, according to Dairy Market News. Orders for dairy products are being filled from inventoried stocks that are [very near depleted levels](#). The new milking season begins in six to eight weeks, and handlers indicate there will be no carryover stocks, with some reaching into new production to fulfill current commitments.
- Dairy Market News reports Western butter suppliers are continuing to hear from [European buyers](#) looking to source commercial butter for overseas shipment.
- Prices for nonfat dry milk remain firm, according to Dairy Market News. Supply is still limited, with most current production moving out under contract. Exports continue to clear product with new export deals being negotiated. Cheese producers are [taking less nonfat dry milk](#) to fortify the vat since it's not economically viable at these prices.

Bearish Fundamentals:

- Central [whey supplies are "burdensome"](#), according to Dairy Market News. Whey production is strong so some manufacturers are discounting prices in order to reduce inventory.
- More milk was available to balancing plants in the Eastern region of the country this week, according to Fluid Milk & Cream Review. High prices have started to [lower fluid milk sales](#), sending more milk into condensed skim or nonfat dry milk production. Florida exported 192 loads of Grade A milk vs. 133 last week and only 6 last year.
- Dairy cow slaughter for the week ending 06/23 was [down 1,300](#) head from last year. 39,800 head were culled vs. 41,000 during the same week a year ago.

Recommendation:

After a precipitous drop last week and a sharply lower open on Monday, surprisingly, Class III futures were able to rebound and make back about half their losses in a holiday-shortened trading week. It's important to note that it was a holiday week as it's



likely many market participants took the week off, making it a stretch to say that this week's price action was a legitimate recovery. We remain concerned about further correction in the front months, especially when we have days like today when cheese moves higher in the cash market but we finish the day lower. It remains difficult, if not impossible, to predict where this market will go in the short term, but we still have a negative bias. If cheese were to decline to \$1.80/lb and dry whey fell from 70¢+ to 50¢, Class III would calculate out to about \$18.25/cwt. At the current futures prices, we would not be heavy sellers but would look to protect August and September against a correction. Buy the Aug 19.00 PUT and the Sep 18.25 PUT for 40¢. If you get them, enter orders to sell 17.00 PUTs for 40¢. If the market heads lower, the sold PUT options will pay for the ones bought previously and you can pick up a maximum of \$2/cwt. If prices recover, you paid nothing for the PUTs and your milk is not locked in at lower prices. Longer term we still feel that international demand is going to play a role in a market rebound, so remain patient on Q4 and 2008.

We are currently visiting farms in WI and MN! If you would like us to stop by, please call 877.695.8538 to set up an appointment!

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