



The KDM Dairy Report – July 27th, 2007

Bullish Fundamentals:

- Cash Market: The spot market stabilized this week after last week's big sell-off. Both blocks and barrels managed to stay above \$1.80/lb and actually increased during the week. Blocks were up 1¢ to settle at \$1.85½/lb today, while barrels increased 1¾¢ to reach \$1.84¾/lb. Butter went the other way, falling 1¢ to \$1.51/lb. Block buyers showed their presence, purchasing 4 loads, but there were no barrel trades. Eight cars of butter exchanged hands as well.
- Commercial Disappearance: Dairy Market News reports commercial disappearance of dairy products during the first 5 months of 2007 was up 2.9% vs. the same period in 2006. Butter use was up 15.5%, [American cheese up 1.6%](#), all other cheese use up 4.3% and milk in all products up 1.2%. On a monthly basis, use of American cheese in May was up 4.7% vs. last May
- For the period 07/01 through 07/23, weekly cold storage numbers are indicating a [7% drop in cheese stocks](#), representing a drawdown of 8.8 million lbs.
- Florida is still in a milk surplus situation, but they were down to 79 loads shipped out this week compared to 118 last week. In addition, Fluid Milk & Cream Review reports milk intakes in the Mid Atlantic region are [markedly lower](#) this week, by up to one third, due to increasing Class I sales, while hay throughout the region remains short of needs.
- Dairy Market News reports there's plenty of nonfat dry milk now, but producers are forewarning buyers that product [availability may become limited](#) as more milk is diverted to Class I use as schools open, and demand from holiday buying picks up.
- Cheese buyers who base purchases using a weekly average are waiting until next week to take advantage of the recent price decline, according to Dairy Market News.

Futures Month	Friday 07/27 Close	Friday 07/20 Close	Change	5-yr Average	Top 3rd Price
Ju1-07	\$21.43	\$21.29	\$0.14	\$12.25	\$13.16
Aug-07	\$19.30	\$19.10	\$0.20	\$12.41	\$13.34
Sep-07	\$18.15	\$17.80	\$0.35	\$13.11	\$13.99
Oct-07	\$17.47	\$17.30	\$0.17	\$13.19	\$13.98
Nov-07	\$17.10	\$16.89	\$0.21	\$12.88	\$13.86
Dec-07	\$16.38	\$16.27	\$0.11	\$12.92	\$14.01
Jan-08	\$15.60	\$15.48	\$0.12	\$12.50	\$13.33
Feb-08	\$15.09	\$15.05	\$0.04	\$12.53	\$13.21
Mar-08	\$15.14	\$15.04	\$0.10	\$12.78	\$13.50
Apr-08	\$15.16	\$15.03	\$0.13	\$13.09	\$14.31
May-08	\$15.03	\$14.96	\$0.07	\$13.14	\$14.49
Jun-08	\$15.02	\$15.03	(\$0.01)	\$12.54	\$13.63
Ju1-08	\$15.15	\$15.16	(\$0.01)	\$12.25	\$13.16
Aug-08	\$15.23	\$15.20	\$0.03	\$12.41	\$13.34
Sep-08	\$15.40	\$15.35	\$0.05	\$13.11	\$13.99
Oct-08	\$15.00	\$14.88	\$0.12	\$13.19	\$13.98
Nov-08	\$14.78	\$14.74	\$0.04	\$12.88	\$13.86
Dec-08	\$14.63	\$14.58	\$0.05	\$12.92	\$14.01
J1y-Dec Avg	\$18.31	\$18.11	\$0.20		
2008 Avg	\$15.10	\$15.04	\$0.06		

Bearish Fundamentals:

- Consumer Price Index: The cost for all food is up 4.1% from June 2006, according to the U.S. Dept of Labor, but the cost of dairy products went up 6.6%. Leading the charge was fresh whole milk, up 13.3%.
- Weekly NASS prices were [lower across the board](#). 40-lb block cheddar cheese decreased 2.3¢ to average \$1.97/lb and barrels gave up 2.5¢ to \$1.95/lb. Butter averaged \$1.47/lb, down 1.9¢ from last wee, while in the powders, nonfat dry milk lost 1.8¢ to \$2.02/lb and dry whey was off 1.0¢ to 72.5¢/lb.
- The pace of the weekly dairy cow slaughter continues to lag

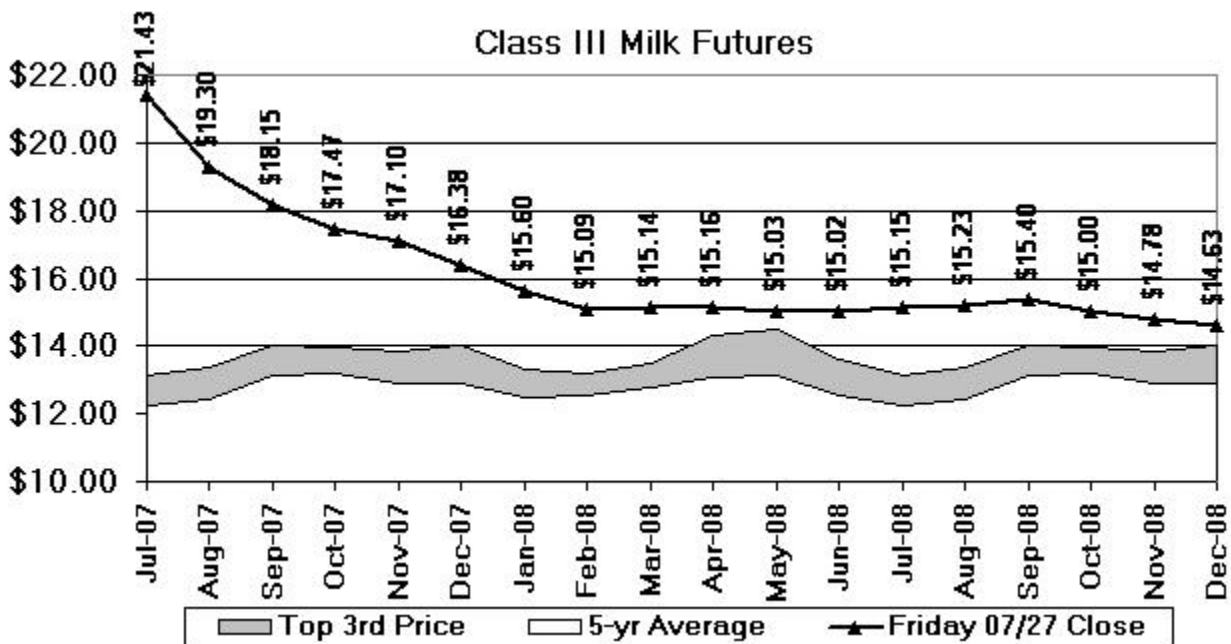


last year. For the week ending 07/14, 43,600 head were culled vs. 46,200 during the same week last year.

- Butter stocks at CME-approved warehouses [continue to increase anti-seasonally](#). For the week ending 07/21, 1.45 million lbs of butter were added to inventory, compared to a typical drawdown during the same period last year of 1.7 million lbs.
- Farmers are keeping cows longer due to high milk prices, weather has been favorable and fresh cows are entering the herd in California, according to Fluid Milk & Cream Review. As a result, [plants are running again at capacity](#) and processors are looking for outside help to find a home for all the milk, but cheese plants desire to take less milk in order to balance inventories.
- Dry whey supplies [continue to be heavy](#) in the Central region, according to Dairy Market News. Dealers are trying to move product into Western and export markets in order to clear inventory.
- Out West, domestic interest for dry whey is lower than from export sources, but [offers remain on the table](#), according to Dairy Market News. Production is heavier than anticipated and inventories higher than desired.

Recommendation:

Local cheese plants we spoke to this week indicated they were trying to limit cheese production and send extra loads of milk to butter/powder operations. This helps explain the contra-seasonal increase we're seeing in butter stocks as they grow



instead of decline in July. There's no doubt the high cheese prices have slowed buying by commercial purchasers as well as consumers, but it appears cheese holders are digging in to current inventory to meet their needs. This may help explain why the weekly cheese stocks took a sudden drop this week, reflecting a 7% decrease in stocks. Cheese buyers, some of whom base purchasing decisions on the previous weekly average, are only buying for immediate needs, hoping for further price declines before jumping back in. That may or may not happen. Cheese prices have stabilized and actually went up a bit this week. From what we're hearing, very little fall/holiday needs have yet been purchased, which could lead to a potentially volatile scenario should cheese prices fail to drop further. It could set up a situation where buyers are suddenly scrambling for product before prices increase again. But, on the negative side, we seem to have plenty of milk in the country at the moment as most areas are milking well. The Southwest in particular is benefiting from mild weather. And higher food prices seem to be affecting consumer spending. Dairy quality hay is becoming a bigger issue in TX/NM and the Southeast, but it remains to be seen how and if it will affect production. California Dairies, Inc. is set to be rBST-free on August 1, but due to the high milk price in July, our contacts in the state indicate producers are going to use the stuff right up to the end of the month and maximize profits. It will be interesting to see if the cull rate goes up in CA after July 31st, as many of the animals may not be worth milking after that. Trade volume was extremely low this week and our outlook is relatively unchanged. We could still see downward pressure on the market over the next few weeks due to the extra milk and slow cheese movement we're currently experiencing. Once schools open en-mass, we'll need to reassess supply and demand. Continue to target buying CALL options for milk you've already sold. For example, the October 18.00 CALL traded today at 49¢. That might not be a bad buy if things pick up this fall. Hold off on sales in 2008.

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