



The KDM Dairy Report – August 8th, 2007

Bullish Fundamentals:

- July Class III milk was announced today at an all-time record price of \$21.38/cwt.
- Cash Market: The spot cheese market made a strong move higher this week, with blocks settling at \$1.90¼/lb, up 4¾¢ for the week, and barrels coming in at \$1.86¼/lb, up 1½¢. Butter finished down ¾¢ at \$1.50¼/lb. Cheese buyers seemed more aggressive as bidders got 6 loads of blocks and barrels and 2 cars of butter.
- Weekly cold storage holdings are reflecting a [7% drop in cheese](#) and 2% drop in butter stocks for the period 07/01 through 07/30.
- Dairy cow [slaughter numbers were higher](#) than last year's levels for the first time in several weeks. For the week ending 07/21, 45,100 head were culled vs. 42,800 during the same period a year ago.
- Fluid Milk & Cream Review reports Class I and cheese sales are slow in the Midwest, but that the current dry spell may force some producers to [increase culling](#) in order to match herd numbers to the amount of feed available in the region.
- The cheese market is unsettled, but Dairy Market News reports barrels are tighter than blocks in the Western region, and [cheese orders were higher](#) as buyers took advantage of recent price declines. Spot offerings of cheese vary from tight to moderate. Some cheese producers are trying to limit production as they don't want to pay high milk prices to make high priced cheese to store.
- In the Northeast, cheese buyers were taking advantage of lower prices and ordering to [cover short term needs](#), according to Dairy Market News. With the end of the summer season still a month away, food service accounts at vacation locations have still been active buyers.
- International: Current milk supplies in Europe are limited for the strong demand of most all dairy end-products, according to Dairy Market News. Manufacturers and handlers are aggressively seeking additional milk supplies, while butter producers are looking to outside sources to supplement shortages on the continent. Most interest is directed toward the U.S. Cheese demand is building and many traders feel [Europe will not be an exporter](#) for the balance of 2007.
- International: Much needed precipitation fell over parts of Australia over their winter, but milk producers and handlers state they need much more to fill runoff basins which were depleted during the 2006-2007 drought. Supplies of dairy end-products [remain limited](#) and traders will need to reach into the new production season to fulfill commitments made last season. Most traders are not entertaining any new buyer interest.

Futures Month	Friday 08/03 Close	Friday 07/27 Close	Change	5-yr Average	Top 3rd Price
Aug-07	\$19.99	\$19.30	\$0.69	\$12.41	\$13.34
Sep-07	\$19.40	\$18.15	\$1.25	\$13.11	\$13.99
Oct-07	\$18.35	\$17.47	\$0.88	\$13.19	\$13.98
Nov-07	\$17.80	\$17.10	\$0.70	\$12.88	\$13.86
Dec-07	\$17.09	\$16.38	\$0.71	\$12.92	\$14.01
Jan-08	\$16.10	\$15.60	\$0.50	\$12.50	\$13.33
Feb-08	\$15.63	\$15.09	\$0.54	\$12.53	\$13.21
Mar-08	\$15.65	\$15.14	\$0.51	\$12.78	\$13.50
Apr-08	\$15.57	\$15.16	\$0.41	\$13.09	\$14.31
May-08	\$15.48	\$15.03	\$0.45	\$13.14	\$14.49
Jun-08	\$15.48	\$15.02	\$0.46	\$12.54	\$13.63
Jul-08	\$15.55	\$15.15	\$0.40	\$12.25	\$13.16
Aug-08	\$15.65	\$15.23	\$0.42	\$12.41	\$13.34
Sep-08	\$15.78	\$15.40	\$0.38	\$13.11	\$13.99
Oct-08	\$15.32	\$15.00	\$0.32	\$13.19	\$13.98
Nov-08	\$15.09	\$14.78	\$0.31	\$12.88	\$13.86
Dec-08	\$14.99	\$14.63	\$0.36	\$12.92	\$14.01
Aug-Dec Avg	\$18.53	\$17.68	\$0.85		
2008 Avg	\$15.52	\$15.10	\$0.42		

Bearish Fundamentals:

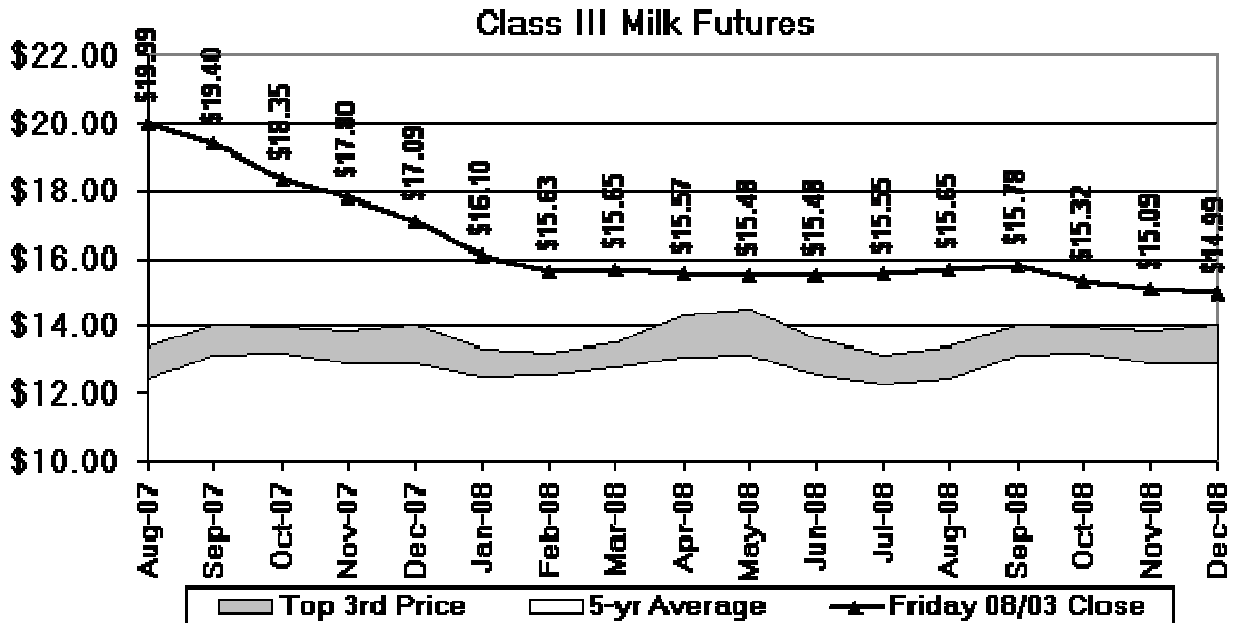
- Ag Prices Report: USDA's monthly look at prices paid and received by farmers shows the July milk-to-feed ratio climbed to 3.19, up from 2.88 in June and its [highest level since December 2005](#). Generally when the ratio is above 3.0, it encourages expansion.
- NASS surveyed prices [continued to drop](#) for most Class III components this week. Blocks lost 3¢ and barrels were down 2¢ as both averaged \$1.94/lb. Butter managed to gain 1¢ to average \$1.48/lb, but in the powders, nonfat dry milk lost 1.2¢ to \$2.01/lb and dry whey was down 3.5¢ to 69¢/lb.
- Milk production in California remains strong and [above projections and expectations](#). Weather has been great and high milk prices are giving incentive for the flow. Processing plants are having to work hard to handle all the milk and are looking to move milk out of state.
- Milk output in the Eastern region of the country remains [above expected levels](#), according to Fluid Milk & Cream Review. Some handlers are even referring to it as a "second flush". Class I sales are slow and bottlers indicate consumer resistance to higher shelf prices is the cause. The higher production and slower demand has resulted in a

surplus milk situation. In the Southeast, 79 loads of Grade A milk were exported vs. last year when 268 loads were imported.

- Drying schedules are moderate to heavy in the Western region, according to Dairy Market News. Higher than anticipated milk production, especially in California, is resulting in [excess volumes heading to dryers](#).
- The domestic whey market remains weak, according to Dairy Market News. Resellers have [ample stocks](#) and until they clear, are unlikely to make further purchases. In the Central region, the price had recently been in the 70's but this week drifted to between 58½ to 64 cents.
- International: The European whey powder markets are weak with prices continuing to decline, according to Dairy Market News. Strong cheese demand should keep [whey volumes in good supply](#), so buyers are anticipating further weakness.

Recommendation:

We're by no means convinced we're out of the woods yet, but this week's cash market was certainly encouraging. While we still seem to have plenty of milk floating around the country, cheese buyers were more aggressive, pushing prices higher. We wouldn't be surprised if



cheese moved lower again at some point, but as we wrote last week, it is August, and buyers waiting for further price declines before starting their fall/holiday buying are running out of time. We could be heading for more volatility in the coming weeks, although our longer-term bias is still positive. It remains to be seen what kind of impact the international piece will play in milk prices going forward, but it certainly looks supportive. Dairy end-products are in very tight supply in both Europe and Oceania, with the U.S. available as an alternative supplier. That and schools starting back up soon could tighten things up as we head in to September. On the other hand, the milk-to-feed ratio going over 3.0 is NOT a good long-term sign as it generally indicates expansion and eventual over-production. But due to the continued disparity in farmgate milk prices and the cost of feed, we still feel that if prices head below \$16/cwt, those in the Southwest getting roughly \$1 under class for their mailbox check have a tougher time cash flowing. Almost unnoticed this week was a pretty dramatic recovery in the 2008 contracts, up 42¢ from last week. It's for the reason just stated that we think \$16/cwt for 2008 is a reasonable natural floor, and we wouldn't begin our sell program before then. Continue to hold of sales in 2008. Buy PUT options for the balance of 2007 to protect against volatile swings. Target to buy the September 18.75 PUT for 25¢ (currently 37¢). This would yield an effective floor of 18.50 while leaving your upside open. Have a great weekend!

Trading futures and commodities involves substantial risk and may not be suitable for all investors. You should carefully consider whether the risks involved in trading in commodities is suitable for you or your organization in light of your financial condition. While the information we gather and present is deemed to be reliable, it is in no way guaranteed. Neither the opinions expressed on this website nor in "The KDM Dairy Report", shall be construed as an offer to buy or sell any futures or options on futures contracts. In addition, past performance is not necessarily indicative of future results.