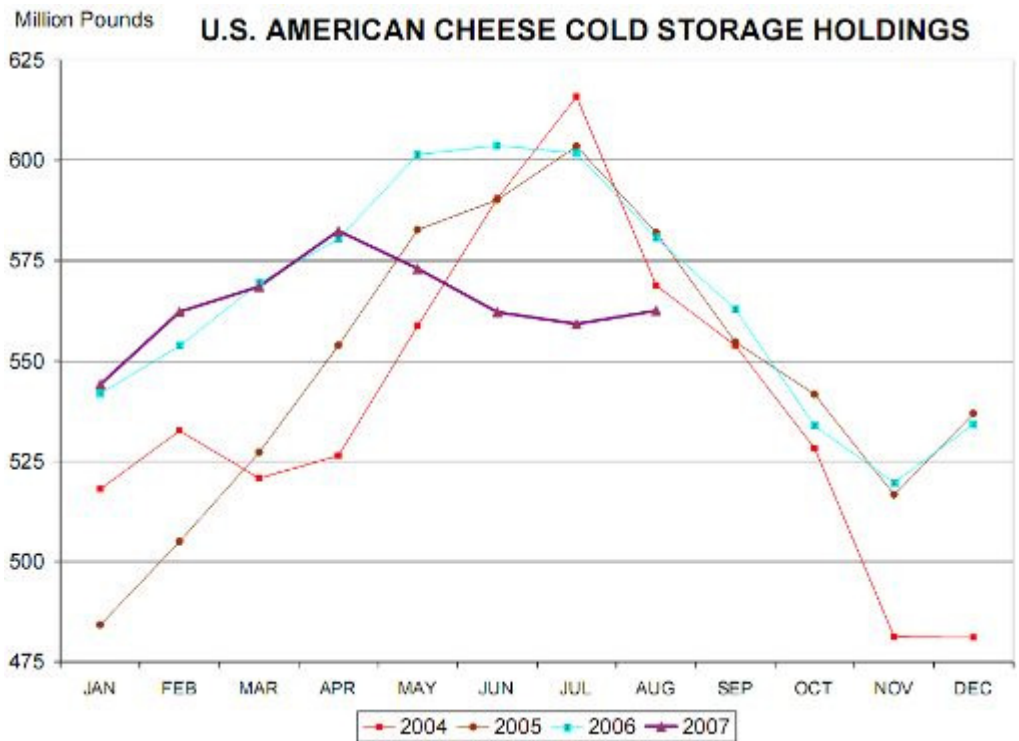


The KDM Dairy Report – September 21st, 2007

Bullish Fundamentals:

- Cold Storage Report: American cheese stocks in cold storage at the end of August were [down 3%](#) vs. last year, according to USDA, and total cheese stocks were down 2%. Butter inventory, however, was up 21% over a year ago.
- Livestock, Dairy & Poultry Outlook Report: USDA's monthly look at the domestic dairy industry remains largely positive. Despite the recent increases in milk output, high feed prices and tight alfalfa supplies could limit production per cow in 2008. Much importance was placed on the "global" factor. USDA cited tight milk supplies worldwide, rising incomes in Asia, depleted stocks of dairy end-products in Europe and a slow recovery from drought in Australia as factors supporting a [historically high Class III milk price in 2008](#), which they expect to average \$16.85/cwt for the year.
- NASS surveyed cheese prices were up this week, but in light of recent developments in the cash market, are likely to start heading right back down. Nonetheless, blocks were up 6.9¢ from last week to average \$2.04/lb and barrels gained 6¢ to \$2.03/lb.
- Fluid Milk & Cream Review reports good Class I sales in the Midwest and continued fluid shipments to the Southeast is keeping [demand for Class III milk above available supply](#). Reduced culling has reports of higher somatic cell counts, which is hurting premium payouts, and hay availability continues to be a concern. Producers are also facing sharply higher grain and energy costs.
- Cheese [stocks were down 3%](#) for the period 09/01 through 09/17, according to weekly storage numbers. During this time, 3.9 million lbs have been pulled from inventory.
- International interest in dry whey is increasing as some resellers are reporting [improved trade activity](#), indicating the market may be approaching a bottom. Stocks are in better balance than last month, but still heavier than desired, according to Dairy Market News.
- U.S. cheese exports, Jan-July totaled 120.3 million lbs, up 36.2% from last year, according to the Foreign Ag Service. Top destinations were Mexico (37%), Japan (11%), Korea (9%) and Canada (8%).
- Economy: The Federal Reserve Board cut the prime lending rate by a half percent this week, giving a shot in the arm to the stock market and pushing the value of the U.S. dollar to multi-year lows, which could be further stimulus for dairy exports.

Futures Month	Friday 09/21 Close	Friday 09/14 Close	Change	5-yr Average	Top 3rd Price
Sep-07	\$20.17	\$20.10	\$0.07	\$13.11	\$13.99
Oct-07	\$18.26	\$18.75	(\$0.49)	\$13.19	\$13.98
Nov-07	\$17.41	\$17.81	(\$0.40)	\$12.88	\$13.86
Dec-07	\$17.15	\$17.46	(\$0.31)	\$12.92	\$14.01
Jan-08	\$16.47	\$16.73	(\$0.26)	\$12.50	\$13.33
Feb-08	\$15.93	\$15.98	(\$0.05)	\$12.53	\$13.21
Mar-08	\$15.97	\$15.88	\$0.09	\$12.78	\$13.50
Apr-08	\$15.76	\$15.70	\$0.06	\$13.09	\$14.31
May-08	\$15.73	\$15.61	\$0.12	\$13.14	\$14.49
Jun-08	\$15.79	\$15.70	\$0.09	\$12.54	\$13.63
Jul-08	\$15.98	\$15.81	\$0.17	\$12.25	\$13.16
Aug-08	\$16.04	\$15.87	\$0.17	\$12.41	\$13.34
Sep-08	\$16.16	\$15.99	\$0.17	\$13.11	\$13.99
Oct-08	\$15.71	\$15.58	\$0.13	\$13.19	\$13.98
Nov-08	\$15.53	\$15.41	\$0.12	\$12.88	\$13.86
Dec-08	\$15.40	\$15.25	\$0.15	\$12.92	\$14.01
Sep-Dec Avg	\$18.25	\$18.53	(\$0.28)		
2008 Avg	\$15.87	\$15.79	\$0.08		



Bearish Fundamentals:

- Cash Market: Where's the bottom? Blocks shed 17½¢ since last Friday, settling at \$1.81½/lb today, while barrels hung in there, losing 9¢ to close at \$1.90/lb. Butter lost only a quarter cent to settle at \$1.37/lb. Buyers got 16 loads of blocks, 10 barrels and 20 cars of butter in active trade.
- Milk Production Report: August milk production in the 23 major states was up 3.6% vs. a year ago, according to USDA, and July's production was revised higher, from 3.9% to a 4.0% increase. Production per cow was up 45 lbs and the number of milk cows was

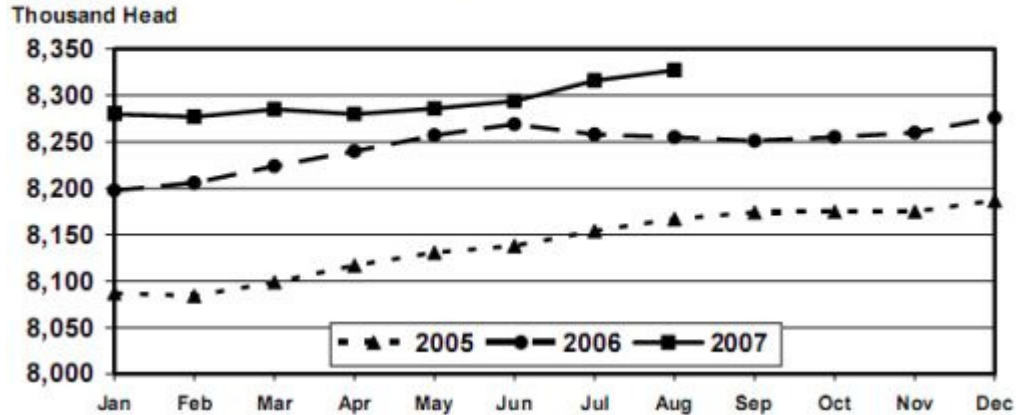
72,000 head more than last August, and [11,000 head more than July](#). AZ led the way with an impressive 11.5% gain, followed by MI up 9.7% and CO and IA up 6%. CA was up 4.9% and WI up 4.5%.

- Livestock Slaughter Report: While YTD the dairy cow slaughter Jan-Aug is up 8.9% on strong first-half culling, Aug '07 numbers, at 211,900 head, were [2.1% below last August](#), demonstrating producer response to strong milk prices.
- Same story as last week. NASS cheese prices were up, but [other Class III components were down](#). Butter lost 0.7¢ to average \$1.38/lb, nonfat dry milk decreased 2.2¢ to \$2.04/lb and dry whey fell 3.3¢ to 47.2¢/lb.

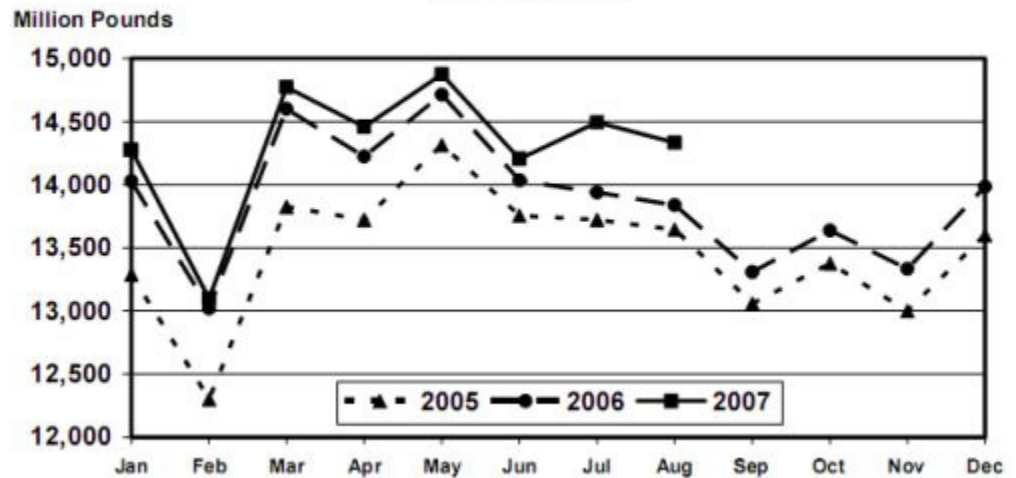
- Cheese buyers have [slowed down their orders](#) to take advantage of recent declines in the cash cheese market, according to Dairy Market News. Buyers using weekly averages will wait to see if prices decline further before reordering. However, current stocks of mozzarella, cheddar and American varieties remain tight.

- Fluid Milk & Cream Review reports milk production in the Eastern region of the country is holding steady despite heavy Class I utilization, as some late freshening cows are sustaining output. Some cheese operations are reporting improved milk availability as the fill of the school pipeline eases. Milk bound for [Class III use was up 31.4%](#) in August, compared to last year, for Federal Order #1.
- Processing facilities in California are [back to running on extended schedules](#) as milk output has rebounded from the late-August heat wave. Some milk is moving out of state to find a home as bottled milk needs have leveled off.

Monthly Milk Cows 23 States



Monthly Milk Production 23 States



Recommendation:

Producers are responding to higher prices. From Jan to August we added 33,000 head to the milking herd to bring us to 9.168 million head, the highest we've been since 2001. If we continue to increase the herd size at this rate, it will be difficult for demand to keep up with supply. Key to whether prices sink our swim, in our opinion, is international demand. Global dairy stocks are tight, and with a weakening U.S. dollar, there is an incredible opportunity to market U.S. dairy products to the world. The cost of domestic milk production is going up as we're seeing a repeat of last year with grain prices rising in September. World grain stocks are tight and with \$80+/barrel crude, energy prices look to be heading higher, as well as improve margins for the ethanol/biodiesel industry. Domestic and international demand for grain should support high protein prices in 2008 as dairymen compete with industry and foreign buyers for available supply. We're not convinced you should take a large stake in 2008 yet, but we would now consider selling up to 25% of your production at \$15.90 or higher, if that is a profitable price for your operation. Basis varies by region of the country, so know your costs. In the short-term, it's hard to know what will happen. It appears some commercial players want the price of cheese lower in order to stimulate sales and clear inventory. After last week's loss in the cash cheese market, buyers bid the price back up on Wednesday and Thursday, only to be faced with a resounding response today. We're still fairly certain that much of the holiday needs are still not covered, so we may head lower in the near term, only to see another rally later this fall. Continue to look for opportunities to buy cheap CALL options Oct-Dec to cover milk already sold. Oh, and take some Dramamine as it still appears we're on the Class III rollercoaster!

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.