

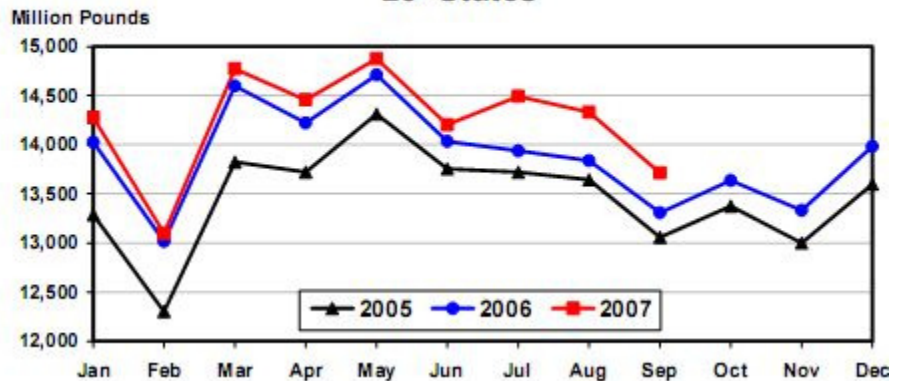
The KDM Dairy Report – October 19th, 2007

Bullish Fundamentals:

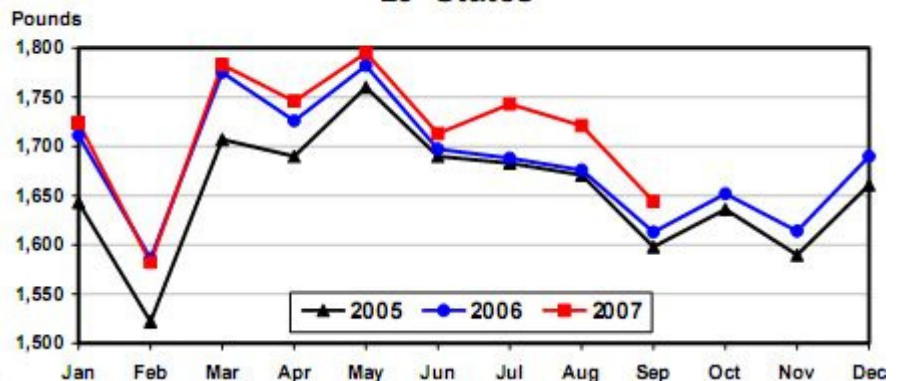
- Milk Production Report: September milk production in the U.S. was up 2.6% vs. a year ago and cow numbers were up 56,000 head. Why is that bullish? [Expectations were for a larger increase](#), and USDA revised July and August cow numbers down from previous month's reports. Milk production in July was up 3.7% and August was up 3.2%, so the September increase of only 2.6% despite very high milk prices during this period is encouraging. Finally, production per cow was up 55lbs in July, 45lbs in August and only 31lbs in September (see graphics below).
- Dairy cow slaughter numbers were [up sharply](#) at 53,400 head, the highest weekly number since the first week in April (see graphic at bottom).
- 501 loads of Grade A milk were shipped into Florida and the Southeast region of the country this week, according to Fluid Milk & Cream Review. Last week 441 loads were imported and a year ago only 328 loads came in. Strong bottling activity due to [heavy retail buying](#) is limiting milk for manufacturing purposes.
- Exports of butter and milkfat for the first eight months of the year are [up 85%](#) compared to 2006, according to Dairy Market News. However, the volumes are not as heavy as hoped for so are having little impact on butter prices. Cheese exports during the same period were up 34.7%.
- Demand for dry whey from export markets is [increasing](#), according to Dairy Market News, and the market tone is now steady to firm. Buyers sense that a bottom has been put in and are back looking for product. Some sellers are now listing prices as much as 5¢ over the market average.
- Cash Market: Blocks finished the week right where they started, at \$1.84¾/lb, and barrels managed to gain a penny to settle at \$1.87¾/lb. Though sellers were persistent, buyers took 14 loads of blocks off their hands and 1 load of barrels. Butter gained a half cent to settle at \$1.29/lb, with 13 cars exchanging hands.

| Futures Month | Friday 10/19 Close | Friday 10/12 Close | Change | 5-yr Average | Top 3rd Price |
|--------------------|--------------------|--------------------|---------------|--------------|---------------|
| Oct-07 | \$18.53 | \$18.47 | \$0.06 | \$13.19 | \$13.98 |
| Nov-07 | \$17.88 | \$17.55 | \$0.33 | \$12.88 | \$13.86 |
| Dec-07 | \$17.37 | \$17.07 | \$0.30 | \$12.92 | \$14.01 |
| Jan-08 | \$16.52 | \$16.40 | \$0.12 | \$12.50 | \$13.33 |
| Feb-08 | \$16.05 | \$15.75 | \$0.30 | \$12.53 | \$13.21 |
| Mar-08 | \$15.94 | \$15.65 | \$0.29 | \$12.78 | \$13.50 |
| Apr-08 | \$15.74 | \$15.50 | \$0.24 | \$14.14 | \$15.36 |
| May-08 | \$15.60 | \$15.42 | \$0.18 | \$14.50 | \$15.85 |
| Jun-08 | \$15.65 | \$15.57 | \$0.08 | \$14.54 | \$15.63 |
| Jul-08 | \$15.82 | \$15.80 | \$0.02 | \$14.66 | \$15.57 |
| Aug-08 | \$15.90 | \$15.90 | \$0.00 | \$14.47 | \$15.40 |
| Sep-08 | \$16.07 | \$16.02 | \$0.05 | \$15.14 | \$16.02 |
| Oct-08 | \$15.62 | \$15.61 | \$0.01 | \$13.19 | \$13.98 |
| Nov-08 | \$15.46 | \$15.44 | \$0.02 | \$12.88 | \$13.86 |
| Dec-08 | \$15.35 | \$15.39 | (\$0.04) | \$12.92 | \$14.01 |
| Oct-Dec Avg | \$17.93 | \$17.70 | \$0.23 | | |
| 2008 Avg | \$15.81 | \$15.70 | \$0.11 | | |

**Monthly Milk Production
23 States**



**Monthly Milk per Cow
23 States**

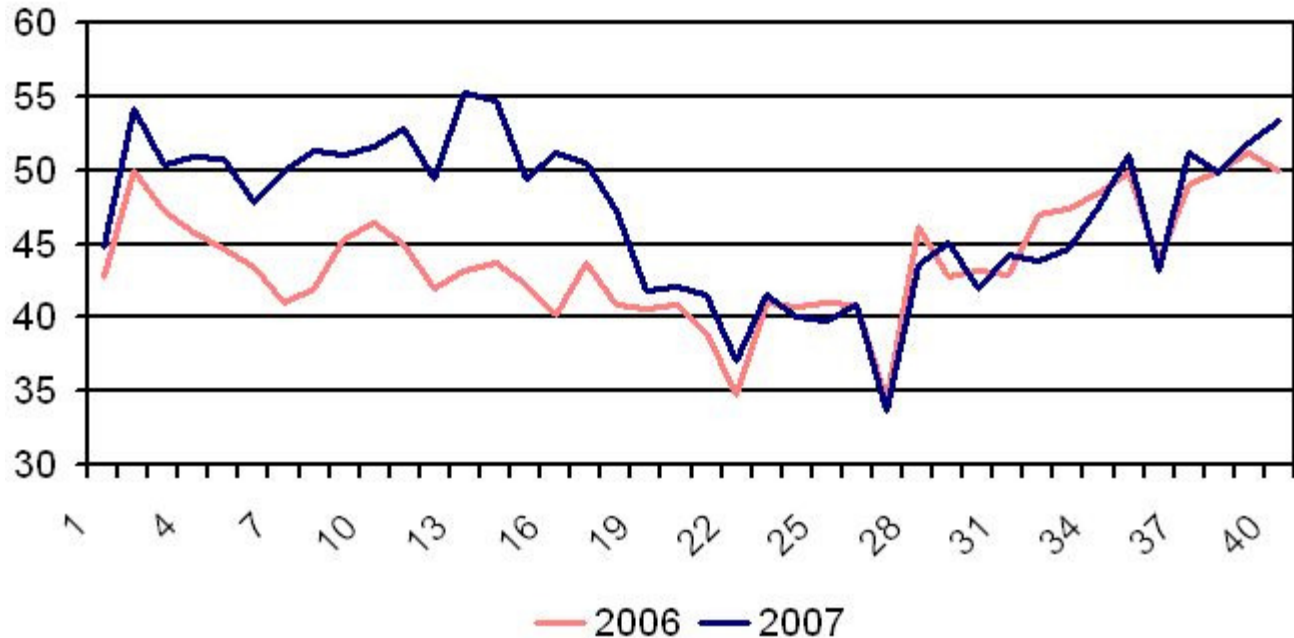


Bearish Fundamentals:

- NASS cheese prices [fell again](#) this week, as expected. 40-lb blocks averaged \$1.90/lb, down 5.2¢ and 500-lb barrels lost 2.6¢ to \$1.93/lb. Butter shed 3.5¢ to average \$1.29/lb and dry whey came in at 41¢, down just 0.3¢. Finally, nonfat dry milk continued to race higher, gaining 3.2¢ to reach \$2.09/lb.

- Milk supplies for cheese making in the Northeast are adequate, with [7-day schedules not uncommon](#) for many manufacturers. Holiday ordering for most commodity cheeses has been slow in developing.
- Western cheese buyers are taking a "wait and see" attitude toward purchases. Many are covered for the next 2-3 weeks and are [in no hurry to add additional inventory](#) at current prices. There's a consensus that cheese prices will weaken by mid November, so they are content to wait.

Dairy Cow Slaughter - by week



Recommendation:

It was another fairly quiet week for the milk market as most were anticipating the Milk Production Report. Numbers came in below expectations, and our milk per cow numbers seem to indicate higher feed costs, hay shortage and less use of rBST are affecting production. Futures prices recorded double-digit gains for the week in most of the front months, adding 11¢/cwt to the 2008 average. Cheese seems to be in balance and milk production is still a little heavy west of the Rockies, in balance in the Midwest and somewhat tight in the East. At over \$2/lb, cheese plants are not using nonfat dry milk to improve yields, and are limiting production to avoid building inventory at \$1.85 levels. Excess milk seems to be going to butter/powder operations. The limited cheese production and impending holiday period seem to be what is holding cheese prices up for now. We wouldn't rule out a correction some time in November post holiday purchasing, but think it would be rather short lived. We have no change in our opinion on 2008. Limited downside risk gives little reason to sell outright at these levels. Think about it this way; selling at the current \$15.81 average is selling at \$1.60 cheese. Not bad but in light of next year's input costs, we still think the upside risk is higher. Keep looking at Nov/Dec PUT options to protect against a post-holiday cheese buying correction.

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