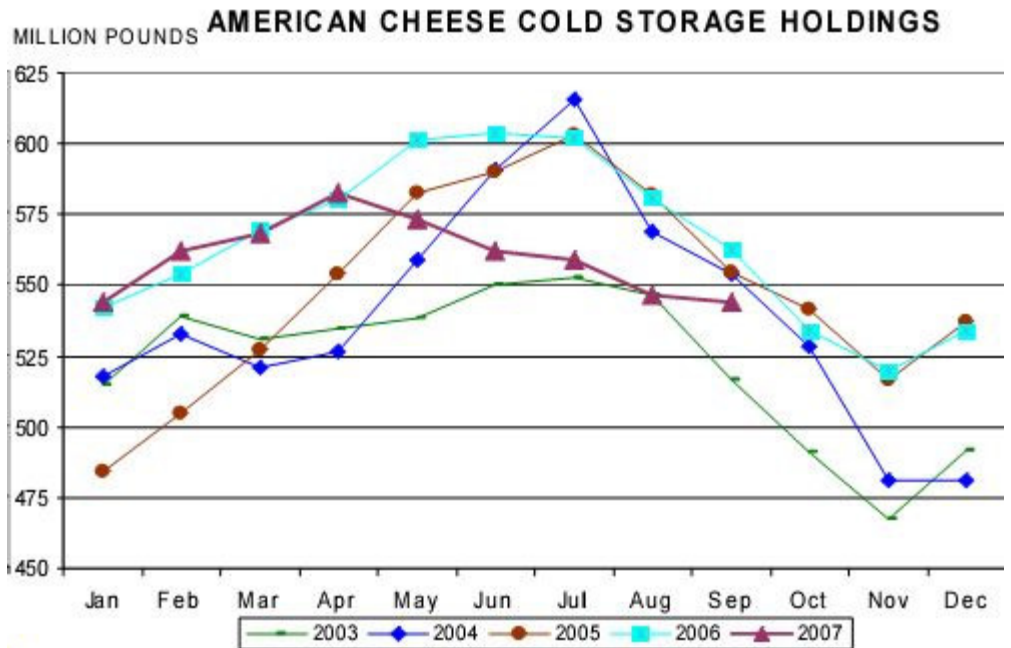


The KDM Dairy Report – October 26th, 2007

Bullish Fundamentals:

- Cash Market: After trading as low as \$1.79/lb this week, block buyers came roaring back, bidding the price up 17¢ in 3 days to close the week at \$2.00/lb, buying 28 loads in the process. Barrels tried to keep up but only gained 3¼¢ to settle at \$1.91/lb on only 2 trades. Butter was unchanged at \$1.29 with 11 cars exchanging hands.
- Cold Storage Report: American cheese stocks in September were [down 3%](#) vs. a year ago (see graph below) and unchanged from the prior month, according to USDA stats released this week. Total cheese stocks were also down 3% compared to last year and were down 1% vs. August.
- Dairy cow cull numbers [remain strong](#). For the week ending 10/13, 53,100 head left the milking herd for good, compared to 48,700 during the same period a year ago.
- While all other Class III components fell, dry whey increased [for the first time in months](#) in this week's NASS report, confirming a bottom has been made. USDA Extra Grade dry whey averaged 41.5¢/lb, up 0.5¢ from last week.
- Fluid milk shipments into the Southeast region of the country were down slightly this week, but still far ahead of last year. 471 loads of Grade A milk came in to the area this week vs. only 329 during the same period last year. Fluid Milk & Cream Review reports the winter resident population in Florida is building and should translate into [higher fluid sales](#) over the next few weeks.
- The Central dry whey market is "steady to firm", according to Dairy Market News. Prices are generally higher, and [improved interest](#) is noted from the export markets.
- A strike by more than 100 workers at a Dawson, MN AMPI plant has [halted production](#) of their 640-lb block cheese line since Tuesday afternoon. AMPI is sending milk to their other 15 locations, but no new talks between the union and AMPI have been set.
- International: Dairy Market News reports EU milk quota levies are down 38% from last season, indicating milk producers have not responded to higher prices. Cheese supplies are tight and overall dairy end product inventories are [lower than in recent years](#).
- International: New Zealand milk production is up 1½-2% vs. last year, but less than the 2-3% projected according to Dairy Market News. In addition, despite a promising start, limited follow-up rainfall from July onward has impacted grain production and hurt dairy grazing operations in Australia. Initial milk production figures for the first 2 months of the season indicate [output is down 9%](#) vs. last year, which had a good start. Prices for dairy products are firm with no spot supplies available.

Futures Month	Friday 10/26 Close	Friday 10/19 Close	Change	5-yr Average	Top 3rd Price
Oct-07	\$18.62	\$18.53	\$0.09	\$13.19	\$13.98
Nov-07	\$18.73	\$17.88	\$0.85	\$12.88	\$13.86
Dec-07	\$17.90	\$17.37	\$0.53	\$12.92	\$14.01
Jan-08	\$16.91	\$16.52	\$0.39	\$12.50	\$13.33
Feb-08	\$16.37	\$16.05	\$0.32	\$12.53	\$13.21
Mar-08	\$16.18	\$15.94	\$0.24	\$12.78	\$13.50
Apr-08	\$15.90	\$15.74	\$0.16	\$14.14	\$15.36
May-08	\$15.85	\$15.60	\$0.25	\$14.50	\$15.85
Jun-08	\$15.89	\$15.65	\$0.24	\$14.54	\$15.63
Jul-08	\$15.98	\$15.82	\$0.16	\$14.66	\$15.57
Aug-08	\$16.05	\$15.90	\$0.15	\$14.47	\$15.40
Sep-08	\$16.20	\$16.07	\$0.13	\$15.14	\$16.02
Oct-08	\$15.80	\$15.62	\$0.18	\$13.19	\$13.98
Nov-08	\$15.61	\$15.46	\$0.15	\$12.88	\$13.86
Dec-08	\$15.54	\$15.35	\$0.19	\$12.92	\$14.01
Oct-Dec Avg	\$18.42	\$17.93	\$0.49		
2008 Avg	\$16.02	\$15.81	\$0.21		

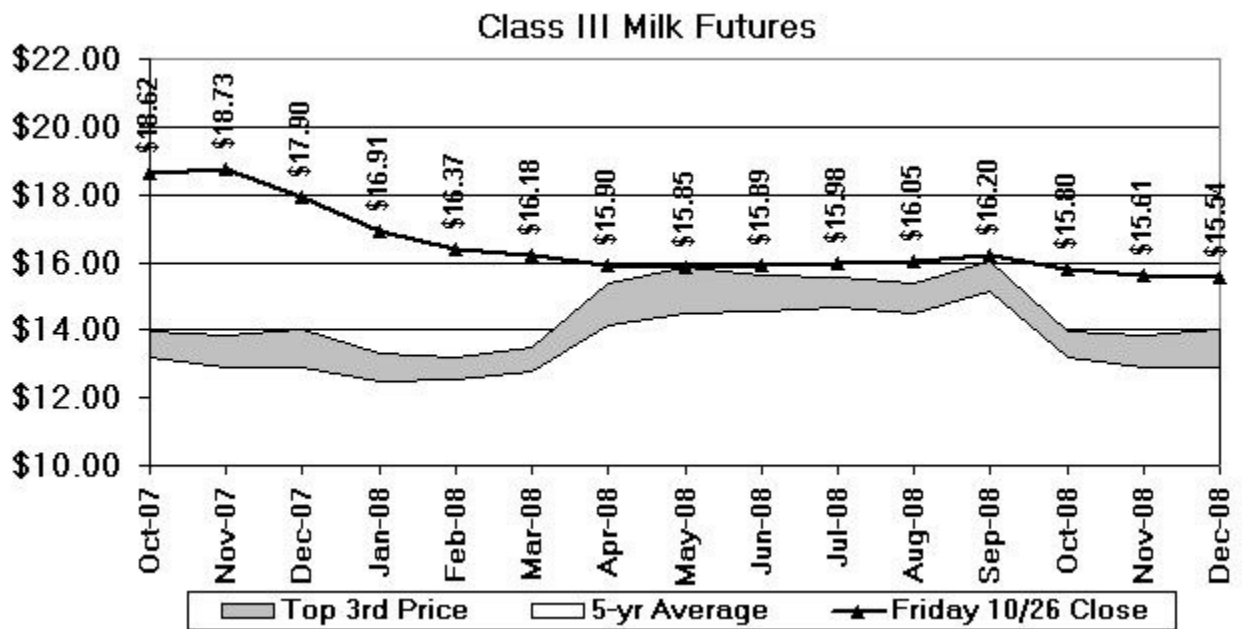


Bearish Fundamentals:

- Livestock Slaughter Report: While the Jan-Sep dairy cow slaughter is still up 7.4% vs. a year ago, the cumulative gain is dropping with each successive monthly slaughter report. In particular, the Sep dairy cow cull was 3.3% below last year due to [6,800 fewer head](#) going to market.
- Livestock, Dairy & Poultry Outlook Report: USDA's monthly look at the domestic dairy market had [little positive to note](#). Strong prices now will result in increased milk production in 2008, pressuring prices, they say. In addition, higher cow numbers and a resumption of heifer imports from Canada could further add to the milk supply, while high retail prices have dampened consumption and slowed exports. USDA now expects Class III to average \$16.00 for the year in 2008 and for cheese to average \$1.64/lb.
- 40-lb blocks fell 2.5¢ to average \$1.87/lb and 500-lb barrels slipped 2.6¢ to \$1.90/lb in this week's NASS survey. Butter averaged \$1.27/lb, down 2.1¢ from last week and nonfat dry milk decreased 1.6¢ to \$2.07/lb.
- Butter stocks at CME-approved warehouses [continue to languish](#) far above last year. For the week ending 10/20, 104.6 million lbs were on hand, compared to only 74.8 million lbs a year ago.
- Milk is [readily available](#) for cheese production in the Northeast, according to Dairy Market News. Some plants are adding 1 or 2 days of production during the week to cover increasing interest in cream cheese, while plants are on steady to higher production schedules in response to building low fat cheddar orders.
- Cheese orders in the Midwest are [somewhat disappointing](#) compared to last year, according to Dairy Market News. Some plants are finding better returns producing other than cheddar varieties, and then just spot buy cheddar on the CME as needed to fill orders.
- Dairy Market News reports milk supplies in the Western region are [keeping cheese plants as full](#) as they want to be, and barrels are becoming more available.

Recommendation:

Wow! The week started with cheese sellers in control, but news that workers had gone on strike at a block production facility, combined with a flood of late holiday cheese buying propelled the cash market dramatically higher. Cheese buyers had been waiting for a further dip in



prices, but not seeing one materialize has sent them on a buying spree to secure product in time for the holidays. 4th quarter ended the week up 49¢ while the 2008 average climbed back over \$16 for the first time since May. We're hearing local stories about cheese plants not getting enough milk to satisfy orders, so the plants are going to the CME spot market to pick up extra loads. We're not sure how high or how long this will last, but it appears like more of a short-term phenomenon than anything. This is a great opportunity for hedgers! The front months will be most vulnerable to a pull back once the cheese buying stops, so get out there and buy some floor price protection. Target to buy the Nov 18.25 PUT for 25¢ (currently 33¢) and the Dec 17.50 PUT for 25¢ (currently 40¢). We'd still hold off on 2008 despite this week's gain, unless the Q1 contracts move significantly higher next week in response to a further cheese price rally. Then, the best strategy may be to use a fence (buy PUT, sell CALL) vs. selling outright. Call us for specifics.

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