PRESS INFORMATION from

The Dairy Group

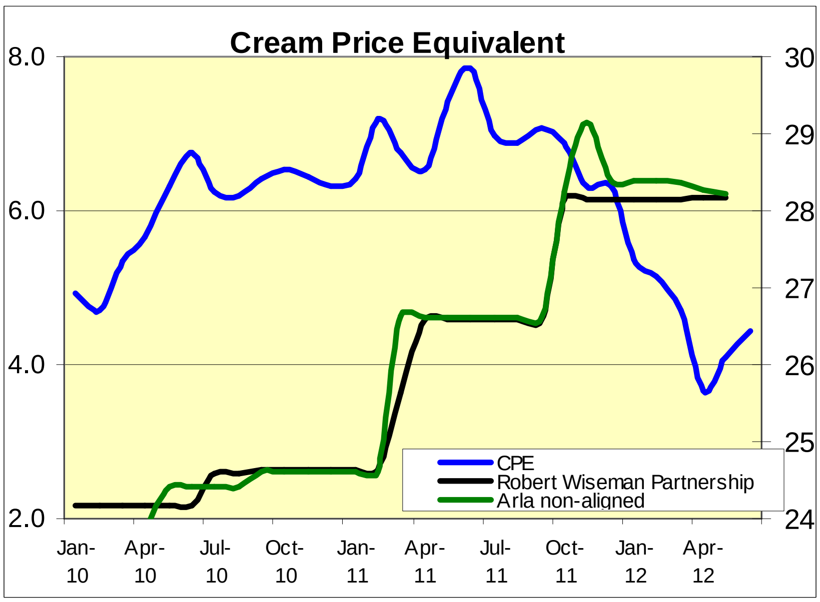
15th July 2012

The Market Price Equivalent (MPE) July 2012

***By Nick Holt-Martyn,* The Dairy Group**

Who's Taking The Cream?

"The precipitous collapse of milk prices in the non-aligned liquid sector this summer has certainly raised the political temperature, with almost 25% of UK dairy farmers affected. The much repeated processor mantra that it is all due to cream values, while the retailers hold the line that they haven't adjusted the aligned contracts does little to make a 15% price cut in 3 months any more bearable" says Nick Holt-Martyn of The Dairy Group. He goes on to say "the problem with the cream argument is that it can only be played when the evidence supports the story. How much of the cream income finds its way to the farm gate and how responsive were prices when cream rocketed to £1800/t in 2011?



Source: DairyCo Datum and The Dairy Group

The graph above identifies the net cream price equivalent from wholesale cream prices from January 2010 to June 2012 as compared to the price changes in Wiseman and Arla non-aligned suppliers. With the same scale on both sides the conclusion is that cream values have little impact on farm gate prices on the up slope, but appear to provide the excuse on the down slope. In fact the nearest indicator for rises in milk price appears to be the cheese market returns, which suggests it is competition for supply rather than direct market returns informing the price setting process.

So why are prices falling now, what has changed to enable these reductions to be considered let alone be implemented in just 3 months? The factors other than cream price that may have an influence are milk supply, cost of production, processor competition and retailer competition.

Milk supply having peaked in the unseasonably warm period in early April 2012 has been washed away by the rain to be left running at **-1.5%** down on last year, a reduction of

600,000 litres per day in late June. Short supply normally leads to tightening markets and price increases ~ not savage price falls.

The cost of production is soaring to new levels with any reduction in next season's fertilisers and fuel being completely overtaken by dramatic rises in cereals and protein feeds. The Dairy Group cost of production for 2010/11 was 29.1 ppl, with a forecast for 2012/13 of 30.5ppl, which will rise further unless feed prices fall back this autumn. Rising production costs might also be expected to restrict supplies as marginal production becomes less economic, which means the supply side looks set to underperform 2011 for the rest of the year.

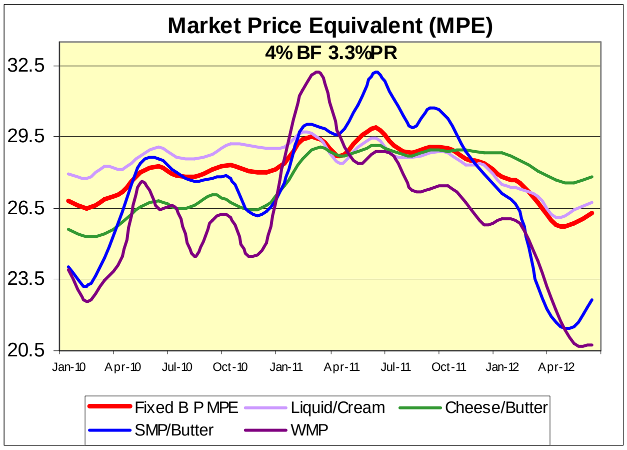
The May price cut was blamed in part at least on the loss of a retail supply contract by Dairy Crest which lead to the rationalisation of some processing plants and a cut in milk price. This quickly spread to the other processors, but with blame placed on the cream market. For which it has to be said, as the graph above shows, there is some evidence that cream income had fallen.

Around the same time Muller took full control of Wiseman Dairies which was bound to change the view of the market drivers and the relationships with customers and competitors. With the shuffling of contracts it is possible that a new level of competition between the major liquid processors is taking place with the only beneficiaries the retailers and maybe consumers.

With prices falling, despite a contraction on the supply side, it looks much more likely that retailers and processors are favouring their own margins at the expense of dairy farmers' livelihoods. It is more likely that processors are falling over themselves to gain market share by sacrificing farm gate prices. At least 50% of liquid milk is caught in this price trap which equates to 25% of all UK supplies. Ultimately it will be harmful to consumers if the most recent price cuts stick as it is supply in 2013 and 2014 that is being put at risk.

As with MPs and bankers if normal behaviour leads to adverse manipulation of markets then there needs to be regulation that is vigorously applied to ensure a return to normal behaviour. It cannot be right that milk can be sold below the cost of production, a cost that is widely and independently calculated throughout the industry and known by all the main protagonists. The performance of the UK in the EU farm gate price league (22nd out of 27 countries in 2011) should be a source of great embarrassment to Defra, the retailers and processors. How can a world class industry with a captive domestic market deliver so pitifully at the farm gate. It is an industry structure that is weighted in favour of the consumer and against the primary producer. Not by design, however, but by a combination of successive governments without a food policy allowing an unregulated market to evolve to the lowest common denominator. It is time for Defra to take a proactive role and not wait for the "industry" to muddle through as too many livelihoods are at stake."

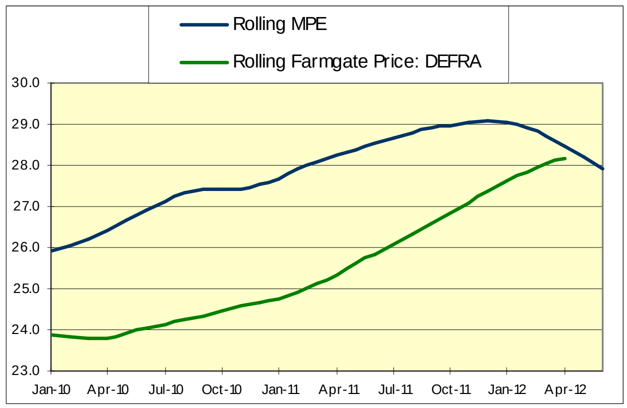
Market Prices



The Market Price Equivalent (MPE) rose again by 0.43 ppl to 26.31 ppl due to the rise in Butter, SMP, Cream and Whey and despite the fall in mild cheddar. The latest Fonterra auction was mixed with a fall in SMP but a rise in WMP, overall a fall of 0.5%, falls in short term contracts countered by firming values further ahead. The MPE is now down 3.6 ppl on the year and 2.1 ppl lower since Dec'11. It is now 3.6 ppl below peak. EU supply is up 4% this year but strong sales to Russia and Algeria is holding markets stable.

Farm Gate Prices

The graph shows rolling market returns continue to fall while milk prices start to level out before the 2nd round of price cuts recently announced with Wiseman leading the way with a 1.7ppl price cut from the 1st August, with Dairy Crest, Arla and First Milk also announcing price cuts of between 1.65ppl and 2ppl, giving a milk price of between 24.5ppl and 25ppl for these milk buyers. A few other milk buyers have since announced their own price cuts including Paynes and Meadow Foods.



- Ends -

For further information please contact:

- **Nick Holt-Martyn,** The Dairy Group (01823 444488/e-mail: nick.holt-martyn@thedairygroup.co.uk)
- **Visit www.thedairygroup.co.uk**
- The MPE is calculated from the weighted actual wholesale prices for liquid milk, cheese, butter and powders after the normal processing costs. The MPE accounts for 90% of the UK market utilisation of milk. The MPE is calculated from wholesale market values, whereas IMPE (Intervention Milk Price Equivalent) accounts for just 11% of UK milk production and is effectively determined by the Council of Ministers and the prevailing exchange rate. The MPE provides a far superior indicator of the wholesale value of milk and therefore the likely market returns available to the dairy farmer.