PRESS INFORMATION from
The Dairy Group

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The Market Price Equivalent (MPE) Update October 2014
***By Nick Holt-Martyn,* The Dairy Group**

Who is gaining from the milk price fall?

"The rapid fall in the farm gate price across all milk buyers suggests that both retail and wholesale prices should be falling in all dairy sectors, but are consumers seeing a benefit at the checkout or is someone else taking the margin?" says Nick Holt-Martyn of The Dairy Group.

Best Price Whole Milk Price ppl									
	Size Distribution %	Waitrose	Tesco	Sainsburys	ASDA	Morrisons	Lidl	Average	Change Since March
1 Pint	8	86	86	86	86	86	79	**85.0**	**-0.0%**
2 Pint/1 litre	15	78	78	78	79	78	69	**76.8**	**0.1%**
4 Pint/2 litres	67	44	44	44	44	44	42	**43.7**	**-5.5%**
6 Pint	10	43	43	43	43	58	42	**45.5**	**-5.3%**
Weighted Average		**52.0**	**51.9**	**51.9**	**52.1**	**53.6**	**48.5**	**51.7**	**-3.6%**
Change Since March		**-20.0%**	**0.0%**	**0.0%**	**-0.0%**	**2.6%**	**0.1%**	**-3.6%**	

Source: DairyCo & The Dairy Group (Surveyed 29/10/14)

He goes on to say "The table above shows an update of a survey we last carried out in March 2014 of the retail milk price for a selection of retailers. The change since March is shown as a percentage by company and by category size. The 4 pint pack is the key reference size due to the proportion of the market (67%). The actual distribution by pack size will vary by retailer but the evidence of price matching is clear. Morrisons have lifted their 4 pint back up to 44 ppl from 42 ppl in recent weeks and still charge more for 6 pints than anyone else. So apart from Waitrose unit income hasn't fallen in the last 7 months, with Morrisions seeing an increase! So we come back to our question; who is gaining from the milk price fall?

The utilization of milk data for the September 2013 to August 2014 shows an increase in supply of 1200 million litres, from which liquid has increased by 300 million litres, cheese 250 million litres, and powders/milk concentrate 480 million litres. So if liquid milk volumes have increased by 4.4% and prices haven't changed why is the liquid farm gate price falling?

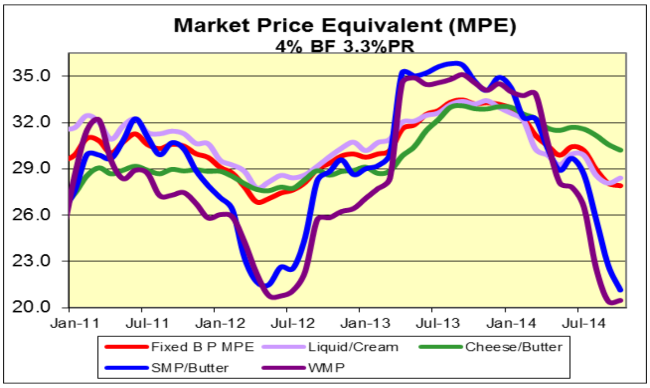
A similar observation can be made for cheese with DairyCo unable to report a mature cheddar wholesale price for the third month in a row due to a lack of trading activity. Mild cheddar has fallen, but this only accounts for around 25% of the UK cheddar market and anecdotal evidence of good cheddar prices shows retailers are still charging around £10,000/t at the checkout.

For those companies exposed to commodity markets, particularly product coming out of Westbury or previously trading into Russia, there is no doubt prices have fallen as the GDT prices are real and the UK SMP is now down to just £1550/t (-38% in the last 6 months). Both First Milk and Arla are in this situation and many companies will be affected by falling wholesale cream values which are down 32% on the year and 14% in the last 6 months, so price falls are inescapable in this market environment.

Allowing for the increased commodity utilization of raw milk, UK market returns in the last 6 months have fallen by around 9%, but for liquid and cheese it's only about 5% (1.5 ppl) on about 77% of the overall milk supply. This takes account of the significant fall in the value of surplus butterfat utilized as cream or butter. The market falls were double last winter but prices were not changed. On this analysis it does appear that prices are being cut too quickly with the normal time lag eroded allowing the supply chain (probably retailers but also some processors) to increase margin at the expense of the farmer. The long held belief that prices fall in response to markets quicker than they rise appears to be well founded.

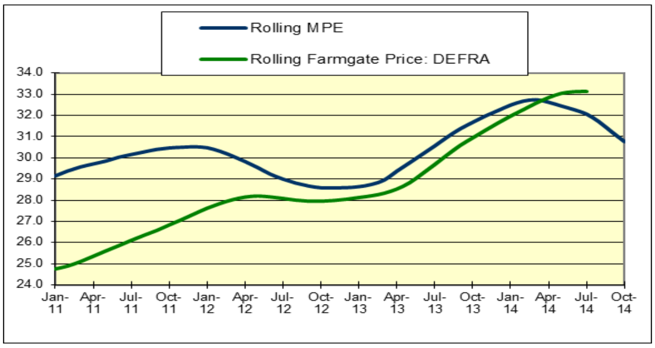
For those on formula pricing again the folly of linking to commodities is all to clear, powder prices have nothing to do with liquid or cheese pricing. Formulas should only be linked with the wholesale values of the core products of the company or even the dairy plant in question. There is no place for powder values in liquid or cheese price formulas.

Global markets are showing signs of stability, albeit values should not go any lower or product would need to be withdrawn from markets. Supply is still increasing by around 4% in the major exporting blocks, so no respite there despite comments of market improvements in 2015. Without a reduction in global milk supply it is likely that markets will remain weak in 2015. Farmers will need to look critically at their own business to find improvements in efficiency and to take advantage of lower feed costs."



Market Prices

The Market Price Equivalent (MPE) has levelled out at 28.45 ppl with rises in liquid, cream and WMP offset by falls in mild cheddar, butter and SMP. The range across the sectors has reached 9.7 ppl between cheese/butter and WMP which would be expected to weaken cheese prices going forward. The latest GDT auction was up +1.4% due to butter +3.9% and WMP +3.1% while SMP fell -3.6%, which suggests the market is levelling off and the price changes are just the products finding their relative level. The MPE is down 4.77 ppl on the year and down 2.07 ppl since April 2014. New Zealand has favourable weather and milk production is running +4.5% in August which is line with trend growth over the last 6 years. The US production is increasing as feed prices have fallen and is now running +4.0% in September, while the EU is +4.5% in July. For the major exporters supply is growing at around 4% and accelerating which can only weaken markets in 2015.



Farm Gate Prices

The graph shows the rolling MPE falling back as market returns drop away. The rolling farm gate price is also starting to reduce from its peak of 33 ppl. The weather continues to be benign with maize harvest mainly complete and generally producing good quality silage. Feed prices are lower, but insufficient to offset the lower milk price for most. UK production is running 6.5% ahead of last year with October forecast at 1160 million litres and November 1130 million litres, which would keep the UK on track to finish the last ever quota year at 14.6 billion litres, 700 million litres below quota, subject to butterfat adjustment. There is no evidence that lower milk prices are affecting milk production at present.

- Ends -

<u>For further information please contact:</u>

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- **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.