PRESS INFORMATION from

The Dairy Group

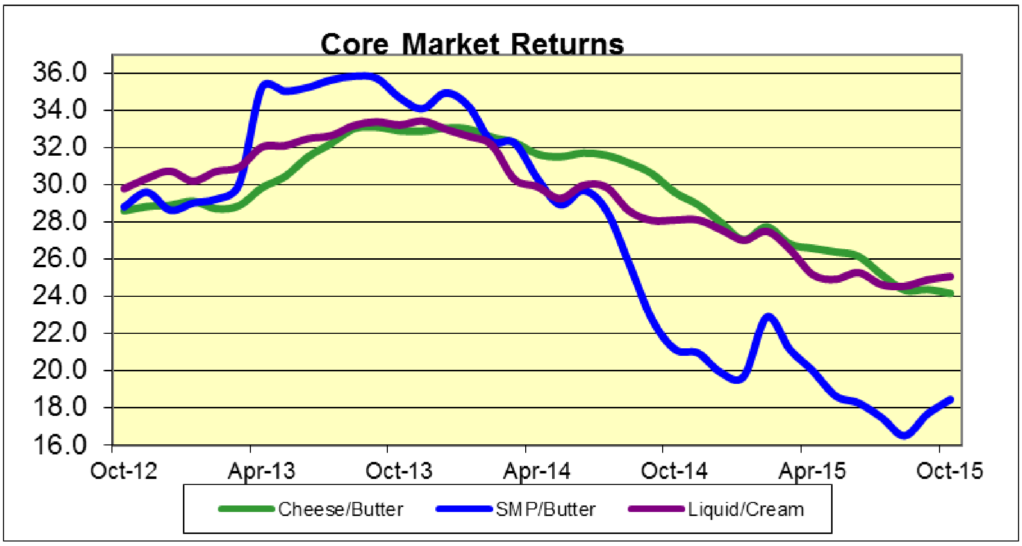
31st October 2015

The Market Price Equivalent (MPE) Update October 2015

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

Dairy Commodities Offer More Risk than Reward!

"Despite the latest 4.6% fall in the GDT MPE to 18.7 ppl at the last auction, the 60% rise since early August suggests that markets have found a "real" base level and that the 11.7ppl bottom was an artificial construct following a period of volatile tonnages offered to the auction. At a time of weak markets increasing tonnages by 50-60% between auctions defies logic and hopefully that practice will remain firmly in the past" says Nick Holt-Martyn of The Dairy Group. He goes on to say "The easing of New Zealand production by 7.5% in September is welcome but is overshadowed by the EU production running at +3%, with even the UK increasing to 3.8% in October. The Global availability of dairy commodities is unlikely to be adversely affected as EU production is 7 times as big as New Zealand, so 3% of the EU equates to 20% of New Zealand, but there will be a shift in market focus from New Zealand to the EU. With EU production still rising it is reasonable to expect Arla to increase their offer to the GDT, while Fonterra should limit any reductions in tonnages to the decline in New Zealand milk output. A stable global supply should still translate into a stable tonnage offered on the GDT.

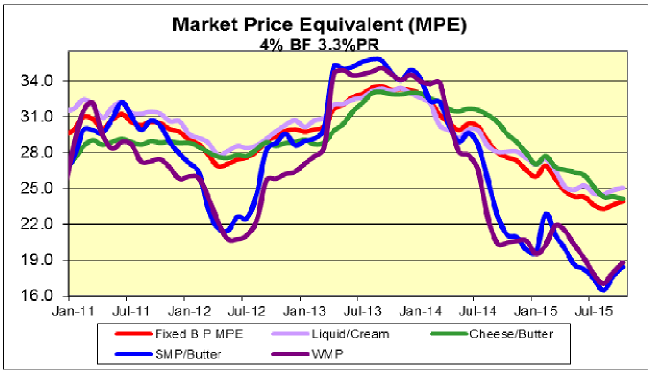


Source: The Dairy Group

The graph above shows the market returns from the 3 key UK sectors over the last 3 years with the encouraging upturn just visible over the last 2 months. Liquid and cheese take the majority of the supply, Liquid/Cream 52%, Cheese/Butter 28% and SMP/Butter 14%, so they are the key drivers of UK farm gate pricing. The volatility in the SMP/Butter sector shown above has been common for the last 9 years with more time spent below the returns from Cheese and liquid than above. The key feature of milk powders is their long shelf life and therefore marketing window compared to liquid and cheese, so SMP in particular is used to manage supply to the market through long term storage. In the EU this is seen as a market management tool through PSA (Private Storage Aid) and more recently Intervention.

Given this inherent weakness in dairy commodities there is clearly a greater risk of long term low prices than rewards for short term periods of high prices. Dairy companies should be more transparent to suppliers regarding their exposure to these sectors as they will undermine their pricing at various times in the cycle. Farmers supplying a highly exposed dairy company will need to pitch their production costs at a lower level than those supplying liquid or cheese sectors for any hope of a sustainable future. With an average cost of production still around 32 ppl and even the Top 25% around 27 ppl, sustainability requires other enterprises and environmental payments to make up the shortfall, so not really sustainable at all.

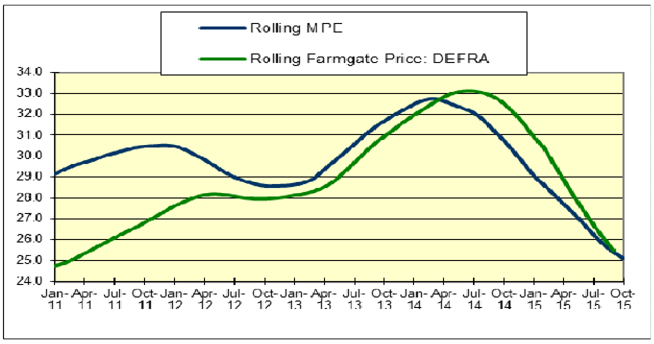
With market improvements showing in this month's MPE another cut by Dairy Crest Davidstow from 1st December by 0.6 ppl is disappointing, but at least this is held until March 2016 when markets may have moved forward to increase upward price pressure. There continue to be price cuts announced, with Wyke cutting by 1 ppl from 1st December and Glanbia by 0.75 ppl, although there are additional retailer liquid payments appearing in some prices. The prognosis is for the milk price to remain under pressure until clearer production signals are seen with EU growth balancing New Zealand decline. For the moment there is little upside or downside to suggest that 2016 will herald any improvement and the challenging business conditions look set to continue.



Market Prices

The Market Price Equivalent (MPE) has risen again by 0.29 ppl to 23.95 ppl due to rises in commodity products. The range across the sectors narrows to 6.5 ppl due to rises in powder returns. SMP has now risen above Intervention at £1300/t and £109/t below the last GDT auction, which slipped back 4.6% in Sterling equivalent. The GDT price equivalent (GDTPE) is up to 18.7 ppl. The latest 5 GDT auctions have seen stable tonnage offered, but 30% down on 2014. The MPE is down 3.7 ppl on the year and down 0.9 ppl since April 2015. US production is running at +0.4% and New Zealand was -7.5% in September, while the EU was at +3.6% in July.

Farm Gate Prices



The graph shows the familiar pattern of rolling milk prices following market returns, although there are clear signs of the curves flattening out. October weather has been excellent overall and UK production has risen to +3.8%, bucking earlier trends. Sterling has strengthened to €1.39 dropping the SMP Intervention price below market returns. UK production in September has been reported +0.8% at 1156 million litres and October is forecast at 1170-1200 million litres. There remains concern that production has surged in October despite low prices, but our forecast for the year remains +1.5 to 2.0%.

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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.