

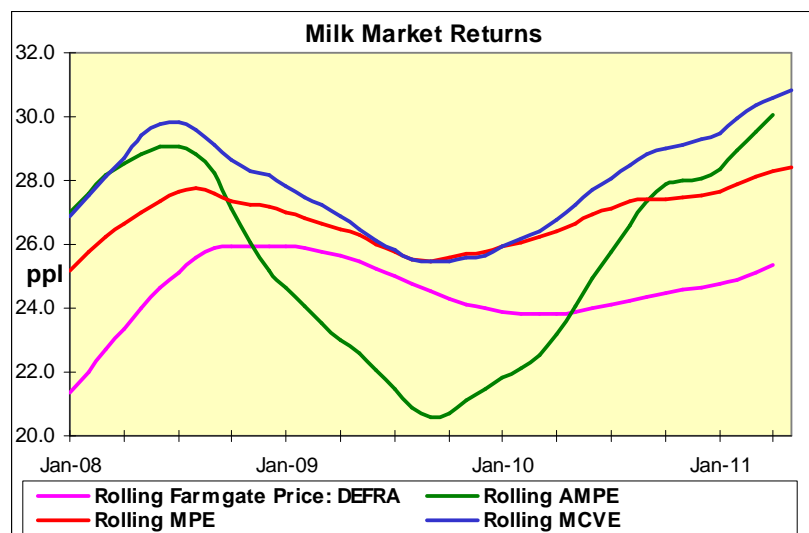
PRESS INFORMATION from *The Dairy Group*

27th May 2011

The Market Price Equivalent (MPE) May 2011 By Nick-Holt Martyn, The Dairy Group

Liquid Premium Consigned to History?

“The latest annual results of Wiseman Dairies and Dairy Crest suggest that the liquid sector is not the jewel in UK dairy crown it once was. Wiseman’s profits warning came true with a 30% decline in pre-tax profits. They have managed to increase their average sale value by 1.4% in the 2nd half of the year, but most of that appears to have been passed on to milk producers. This suggests that the retailers, large and small are taking advantage of food inflation to massage their margins at the expense of the supply chain leaving processors and farmers to take the pain!” says Nick Holt-Martyn, The Dairy Group. He goes on to say “This highlights the problem with a formula price; unless the milk buyer can secure higher returns from the rising wholesale markets they put themselves at risk. If the formula is generic everyone is in the same position, but then it may run foul of competition law. Formula pricing has to be dairy specific and relate to the product mix of that dairy. A company like Dairy Crest would need several formula prices due to their complex product mix. However, if it is a measure or indicator of market returns that is required then we have been publishing a whole market indicator (MPE) for nearly 10 years.”



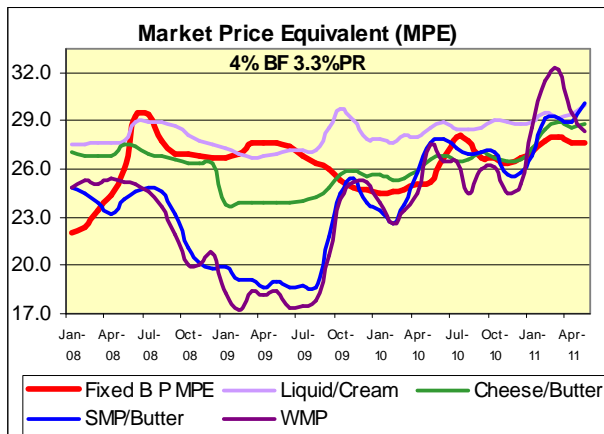
As the graph shows MPE tends to run a less volatile course reflecting the more stable nature of mature cheddar and liquid sectors, but still swayed by commodity volatility. AMPE and MCVE are driven by the price of butter, SMP, mild cheddar and whey, all of which are highly volatile and account for around 3 billion litres of UK milk output. MPE is driven by mature cheddar and liquid which consumes 9.5 billion litres, but is still influenced by the commodities, so better reflects market returns. The gap between MPE and market returns tends to narrow when markets fall and widen as markets rise due to the time-lag

for market returns to reach the farm gate, often 4 to 6 months. In part this is due to the time from manufacture to sale as products, such as mature cheeses, but also human nature that resists change until the direction of the trend is certain. This build up of market pressure, as seen this April, results in a flood of price increases and as one might expect the farmer owned Co-ops respond much faster, which increases the pressure on the PLCs to act. Indeed as the Co-ops get stronger and more established the greater the market pressure they can exert on the PLCs. Building a strong Co-op takes time and capital so increasingly Milk Link and First Milk will have an important role in driving the farm gate price across the industry.

There is no evidence that UK processors are “profiteering”, on the contrary they are feeling a squeeze from farmer’s legitimate claims for price increases, processing cost inflation and customers refusing to yield to food cost inflation. The problem is the structure of the UK industry with large PLCs dominating the added value areas and fledgling Co-ops doing business with an unregulated retail sector.

With the current dairy industry structure the best way forward is to extend the dedicated retail supply groups into other sectors. There may well be a place for formula pricing in a dedicated supply, but only in an agreement with the retail customer to underwrite that specific supply chain. In effect that is what happens now in liquid groups except they are driven more by production costs rather than market movements. Of course this will still leave a large volume of UK supply outside the dedicated groups which will be commodity price driven. For these producers access to flexible processors able to switch between products as the market dictates are needed, but these are in very short supply in the UK and many have tried in the past but failed. However, the fact remains that UK dairy farmers do not receive a fair and equitable share of the consumer spend on dairy products. Recognising the problem is the easy bit, but solving it is a greater challenge”

Market Prices

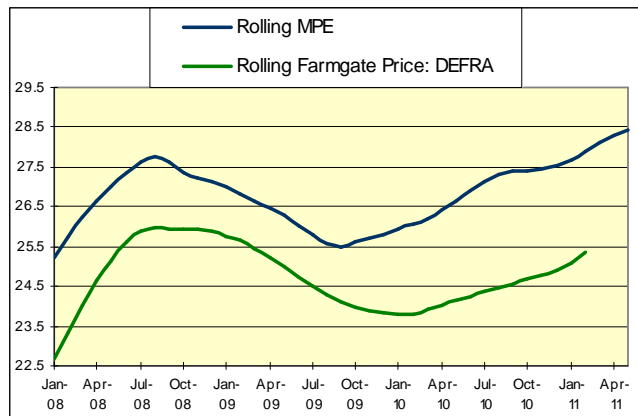


The fears of drought are starting to impact on EU commodity prices to raise the Market Price Equivalent (MPE) by 0.63 ppl to 29.68 ppl. The Northern Ireland auction price slipped again to 25.85 ppl as the commodity returns ease. The Fonterra auction saw prices ease a little due to a strong seasonal finish and expectations grow for a good start to the new season. The (MPE) is up 1.8 ppl since November 2010 and up 1.9 ppl on last year. The market fundamentals are firming with dry weather accelerating the post spring flush

decline in the EU. Globally markets are stable waiting for the first signs of the next New Zealand season.

Farm-gate Prices

Milk price rises came through quickly after the PLCs financial years finished to significantly lift the UK farm gate price in April by around 10%. The recent rise in the mild cheddar price suggests the cheese sector has more to give if the rise moves into the mature cheddar prices. The UK is destined to stay in the lower levels of the EU price league until commodity prices fall due to market structure. With firming market returns across the UK milk prices should continue to edge up as the summer progresses.



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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.