PRESS INFORMATION from
The Dairy Group

31st August 2012

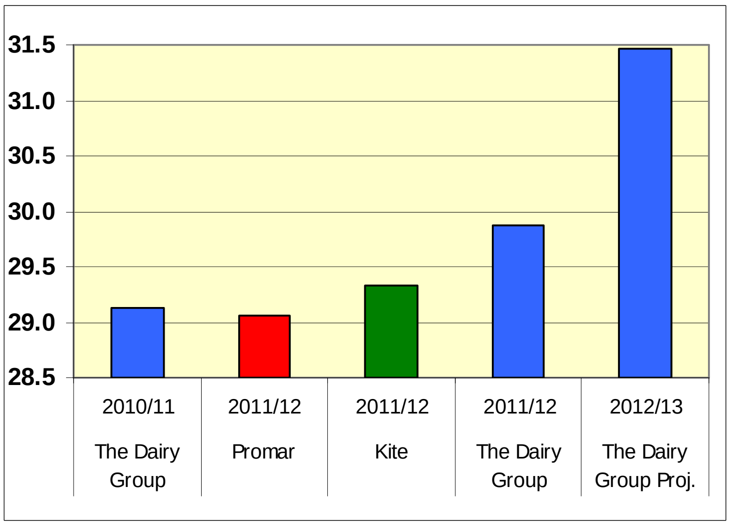
The Market Price Equivalent (MPE) Update August 2012

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

"Strengthening dairy markets will help to lift milk price this winter"

"The Market Price Equivalent (MPE) rose sharply by 0.8 ppl to 28.35 ppl due to the rise in all commodities, with the exception of mature cheddar" says Nick Holt-Martyn of The Dairy Group. He goes on to say "The market price is increasing due to lower than expected supply in the EU and falling production in the USA, whilst the southern hemisphere is still between milk production seasons. The latest Fonterra auction was up sharply, with an overall rise of 7.8%, both in longer term contracts and especially by firming values in short term contracts. The MPE is now down 2.0 ppl on the year and 0.9 ppl lower since January 2012. With EU supply weaker in many northern countries including the UK and Ireland and doubts about winter production levels, markets are likely to rise further until New Zealand production levels are known.

The cost of production has been published by The Dairy Group, Promar and Kite, which is summarised in the table below together with The Dairy Group projection for 2012/13.



Source: The Dairy Group

The chart shows that the published production costs are remarkably similar from these three independent organisations. The chart also shows a milk price increase is needed this winter just to meet the rise in milk production costs.

The strengthening global dairy market combined with an industry wide recognition of the rising cost of production should help to deliver a higher milk price this winter, with the longer term prospect of a fairer price mechanism based on the NFU 10 point plan. The NFU 10 point plan is welcomed as a medium term goal, but there is an immediate need to rebalance the relationship between processors and dairy farmers. The immediate points are firstly 6 weeks buyer notice of price changes; secondly, 4 weeks notice of farmer contract termination and thirdly, farmers to be able to supply one or more contracts.

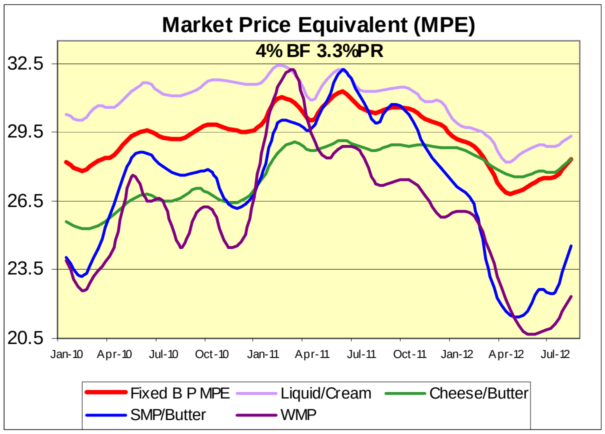
Whilst there may be some post-quota opportunities after 2015, there is the distinct possibility that EU production will soar, which would make the 2012 market conditions look like a minor skirmish! If the market cannot deliver a sustainable price when EU production is limited by quota what are the realistic expectations when quotas no longer apply?

Jim Begg's concern regarding cost of production driven prices being unsustainable should also recognise that liquid prices below cheese prices are also unsustainable. Due to the very domestic liquid market the only market price driver for liquid prices is competition for supply against cheese in particular and commodities to a lesser extent. Processors need to pay enough to ensure supply especially in the production trough to ensure the cheese makers release their supply.

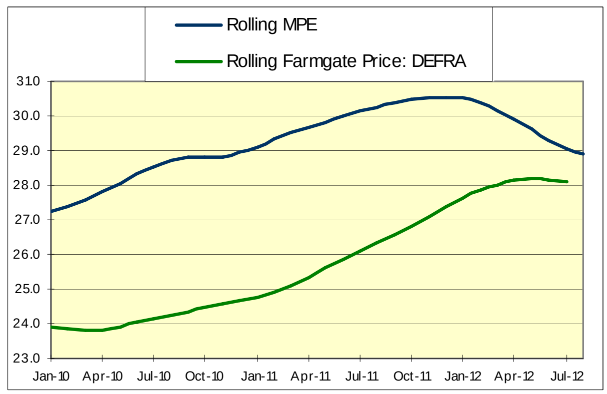
The irony is that Jim Begg is correct insofar as saying that by paying the average cost of production prices will see the weakest 25% exit the industry, which in turn lowers the average cost of production and hence the milk price for everyone that is left. Without the added complexities of global commodity markets it is almost a self defeating proposition. A market element is needed to deliver flexibility into the price setting and prevent the lowest common denominator being the only goal.

Whilst the initial threat to profitability of an unjustified price cut has abated, the forecast 10% increase in production costs over the next 12 months will heap new pressure on dairy farmer profitability. Retailers and processors need to start looking to real price increases or face the prospect of increased volatility in milk supply. The lesson of 2012 is that the liquid market does not exist in isolation and production costs are not the only milk price indicator."

Market Prices



The Market Price Equivalent (MPE) rose sharply by 0.8 ppl to 28.35 ppl due to the rise in all commodities, with the exception of mature cheddar. The market price is increasing due to lower than expected supply in the EU and falling production in the USA, whilst the southern hemisphere is still between milk production seasons. The latest Fonterra auction was up sharply, with an overall rise of 7.8%, both in longer term contracts and especially by firming values in short term contracts. The MPE is now down 2.0 ppl on the year and 0.9 ppl lower since January 2012. With EU supply weaker in many northern countries including the UK and Ireland and doubts about winter production levels, markets are likely to rise further until New Zealand production levels are known. The New Zealand trough production has been up 3 to 4% year on year in June and there are reports of a positive start to their new season. Butter in EU private storage will limit the butter/cream upside, but weaker powder and cheese production will help commodities in general.



Farm Gate Prices

The graph shows rolling MPE starting to level out at 29 ppl, while milk prices start to level out at just over 28 ppl. The prospects of a partial restoration of the spring cuts are possible now that returns have recovered to March 2012 levels, but processor margins will still be under pressure. With rising commodity markets and higher milk production costs there is increasing pressure for prices to rise from their current level in to the winter. Tighter supply throughout the EU will increase pressure on processors and more importantly retailers to permit dairy product inflation on the back of rises in commodity prices and milk production costs.

- 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.