PRESS INFORMATION from

The Dairy Group

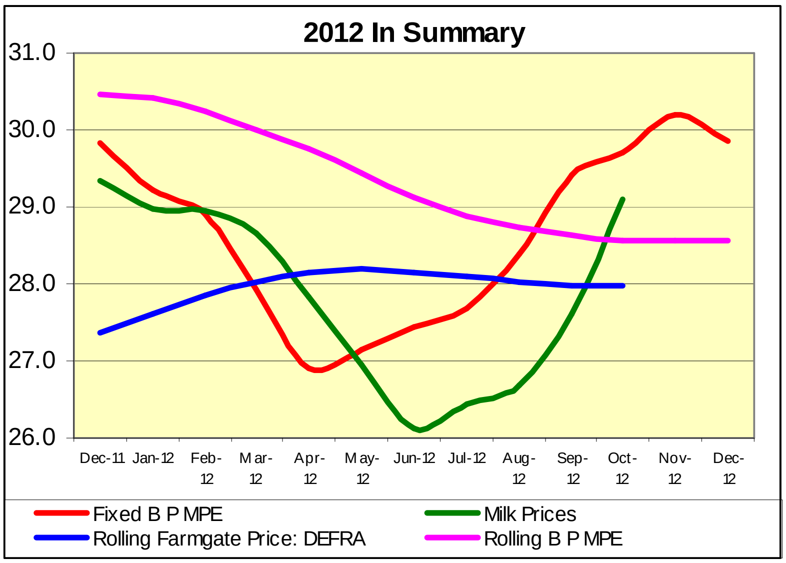
3rd January 2013

The Market Price Equivalent (MPE) Update December 2012

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

2012 review & outlook for 2013

"With 2012 consigned to the record books it is worth reflecting how we arrived at the start of 2013 with stability all around ~ even the weather has calmed down" says Nick Holt-Martyn of The Dairy Group. He goes on to say "the markets finished the year exactly where it started, but the route we took to get here was full of twists and turns and a great number of surprises.



Source: The Dairy Group

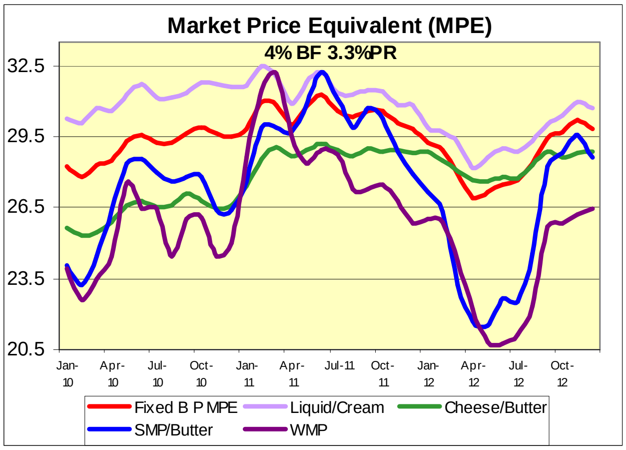
As the graph shows the market values (shown in red) dropped away sharply in the spring which encouraged the 1st price cut in the UK liquid sector, but markets rallied as the weather took its toll on the northern hemisphere production peak in both the EU and the US. By August markets had returned to the previous winter level which made the 2nd price cut look more baffling. As it turned out people power from the dairy sector, farming and the wider general public, coupled with the continuing wet weather caused the cut to be rescinded. This severely weakened the position of the liquid processors who now had to go back to the major retailers to ask for more money. This in turn lead to the cost of production (COP) being the preferred methodology of retailers and processors to set fair liquid sector prices, while the manufacturing sector, with little exposure to commodity weaknesses managed to cope with the markets.

The autumn and winter have seen the supply side slump in the UK and Ireland, firming the short term domestic market and helping the manufacturing sector to deliver higher farm gate prices. Finally, having chosen cost of production as the main price setting marker, retailers and processors are now learning the effects of such a difficult summer with production costs soaring as feed costs feed into farm accounts. Domestically at least the prospects in 2013 for further COP driven price rises looks inevitable.

One issue that will need to be resolved rapidly in 2013 is a standard practice for determining dairy production costs. The RABDF and DairyCo have been instrumental in pushing this forward and it needs to be fixed. Production cost measurements that discount Single Farm Payments or environmental income or fail to account for all the resources used in milk production are under estimating the real cost of producing milk. With so many contracts becoming linked to COP an agreed standard is urgently required, modifications thereafter for a particular milk price agreement are possible, but this must not be confused with the actual cost of production.

The prognosis for 2013 is for production costs to dominate the debate, even where it is not formally part of the price setting process. The knowledge that it has reached around 33ppl this winter and that winter milk supply is running 6% below 2012 will focus minds on what milk price is needed to sustain production. Production costs tend to reflect milk price over the longer term such that to remain in business a profit has to be made, so if your milk price is consistently in the bottom quartile your production costs will tend to reflect the lower milk price and leave a small and inadequate profit.

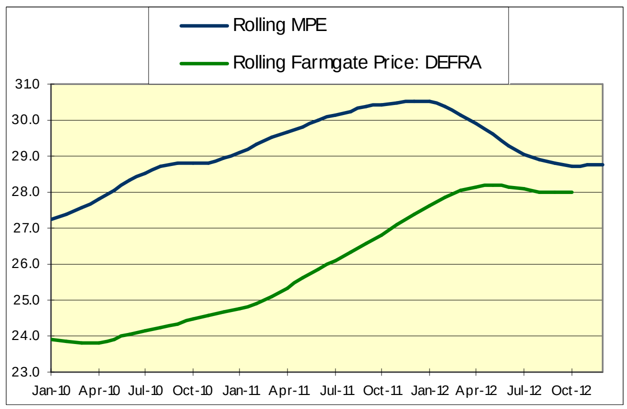
EU and US production are stable, with New Zealand +7% and Australia +1%, so globally supply is stable, which is reflected in markets with little indication of price movement across the next 6 month contract period. Which means that for the next 6 months, or more likely much of 2013, it will be weak domestic supply that determines UK pricing. When coupled with the high cost of production these two drivers should lift prices above 30 ppl by April. On balance 2013 is likely to be less political than 2012 with the debate centred on issues of supply, market returns, production costs and no doubt the weather will play its part."



Market Prices

The Market Price Equivalent (MPE) dipped by 0.35 ppl to 29.85 ppl due to seasonal falls in butter and cream coupled with a weaker SMP. Whey has stabilised and is in line with the SMP equivalent and there is continuing stagnation in cheese with prices unchanged on December 2011. The latest Fonterra auction was up with SMP firming in the short term contracts; WMP still lags SMP/butter values. The MPE is now up just 0.03 ppl on the year but up 2.4 ppl since June 2012. EU and US supply have stabilised, while New Zealand is up 7% on last year. Manufacturing returns have stabilised with competition for supply a UK issue for the liquid sector with the UK winter production running 6% below last year.

Farm Gate Prices



The graph shows the rolling MPE levelling out at 28.75 ppl while milk prices have levelled at 28.0 ppl. With markets and prices moving to 30 ppl the gap looks set to remain at its current low level into the spring whilst the stability is maintained. The forecast farm gate price is now 30ppl for April provided markets remain stable through the rest of the winter. Weak profitability will affect confidence across the EU which will keep milk production low and encourage higher EU market returns. With the UK winter production forecast 6% below last year, 2013 will see higher UK prices, but this will require market returns to rise to support the manufacturing sector. 2013-2014 milk production will all depend on the spring and summer weather to recover yield losses and replenish forage stocks for next winter.

- Ends -

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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.