PRESS INFORMATION from

The Dairy Group

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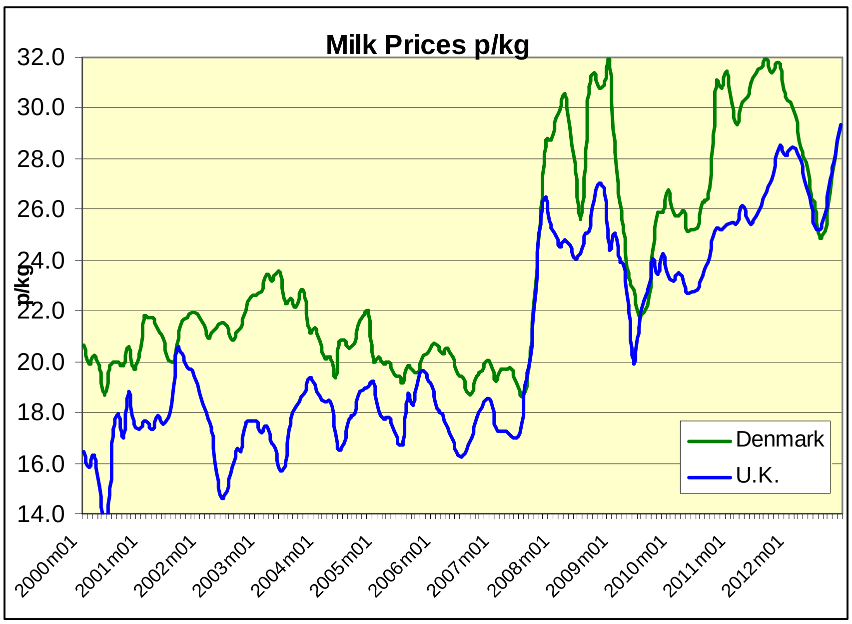
The Market Price Equivalent (MPE) Report January 2013

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

Merger proves to be tough on Milk Link members

"Amid great optimism, the marriage of Milk Link and Arla sailed through all checks and was well supported by the members and the industry at the time, but more recently it has turned a little sour. The exchange rate led cut in milk price this month while others are creeping forward, has left the Milk Link members price languishing at the bottom of the price league while the non-member suppliers enjoy at least a 2ppl advantage," says Nick Holt-Martyn of The Dairy Group. He goes on to ask "were we mislead or are Milk Link members just very, very unlucky?



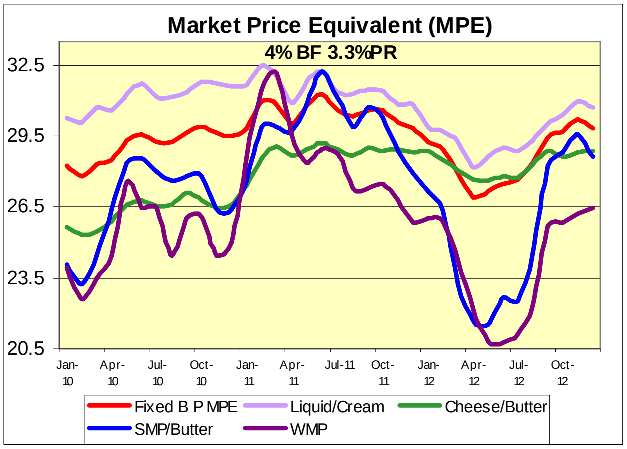
Source: The Dairy Group

The graph shows the Danish and UK average prices based on Commission data for the last 12 years. In that time the UK has underperformed the Danish price by 15.2% with only 2 brief periods in 2007 and 2009 when the UK got ahead and also in the last 6 months. Looking further back over the last 35 years the average difference in favour of the Danes is 20.4%. At the time of the merger the question being asked was how would Arla Amba members feel about subsidising UK members during periods of significant lower UK returns. The answer is now the opposite. How long will UK members tolerate propping up the milk price league due to exchange rate difficulties when UK returns are probably higher?

By suffering pain now, when the Arla price resumes its normal relationship with the UK, former Milk Link members should see prices well above the level of UK returns. At its highest in the last 35 years the difference was +85% in 1990, although that is not likely, the highest since 2007 was +30% in 2008. With so many UK contracts linking to production costs more modest differentials are likely, but even so, Arla, although exposed to commodity markets are likely to benefit more often than not.

With David Cameron raising the prospect of an EU referendum in the next 10 years with withdraw or renegotiated terms as the 2 options; free markets, exchange rates and agricultural support will all come up for debate. While the other parties are not yet seeking votes in this area the opinion polls my cause a change in policy as the general election gets closer. With the UK dairy industry now significantly linked through Muller and Arla to the European industry this will raise concerns regarding future investments and milk pricing, particularly for Arla with 3 currencies in the mix. It is to be hoped that the re-negotiated deal is in the form of a coalition of sovereign currencies, which will include the Scandinavian and east European countries, to provide the level playing field on which dairy businesses can operate. The prospect of un-fettered free trade with the EU without market support makes for a daunting horizon which might make Arla Milk Link's members current difficulties pale into insignificance.

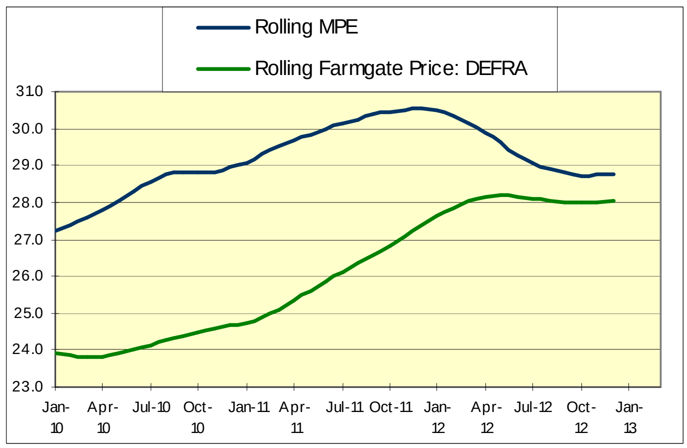
Looking at the prospects for 2013, global production is still rising slowly with the US up 1.6% in December and New Zealand with 7% growth, whilst the EU is flat-lining at 0.1%. Meanwhile markets are very stable with little difference between contract periods on the Global Dairy Trade auction and our MPE showing little change in the last 5 months. The main price driver in the UK is production costs which will reach new heights this year. With spring looking to 'drag its feet,' pressure is on cashflows with little sign that input costs are going to ease before May."



Market Prices

The Market Price Equivalent (MPE) dipped by 0.25 ppl to 29.85 ppl due to seasonal falls in cream despite an improvement in mild cheddar and SMP. Whey and WMP have improved due to the fall in exchange rate, which has probably helped mild cheddar and SMP as well. The latest Fonterra auction was up 1% with WMP firming while SMP values fell slightly. The MPE is now up 0.37 ppl on the year and up 1.9 ppl since July 2012. New Zealand supply is up 7% on last year while the US is up again, but the EU is flat. Competition for supply is the major UK issue for the liquid sector with the UK running 6 to 7% below last year and not set to ease until turnout in March/April.

Farm Gate Prices



The graph continues to show the rolling MPE levelling out at 28.77 ppl while milk prices have levelled at 28.1 ppl. With markets and prices moving to 30 ppl the gap looks set to close further until the spring flush appears. The forecast farm gate price remains at 30ppl unless further production cost rises are added. Weak profitability will reduce confidence and keep milk production low, which should encourage higher EU market returns. With the UK, milk production looks set to remain **5 to 6% below** last year and higher UK prices will be required to encourage improved supply. The weather is key to 2013 with an urgent need to replenish forage stocks in advance of any expansion.

- 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.