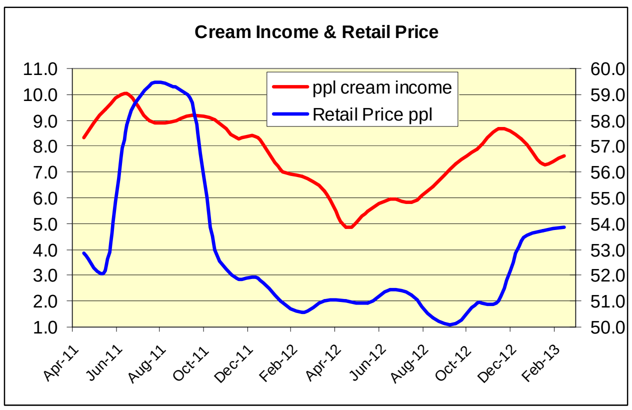
PRESS INFORMATION from
The Dairy Group

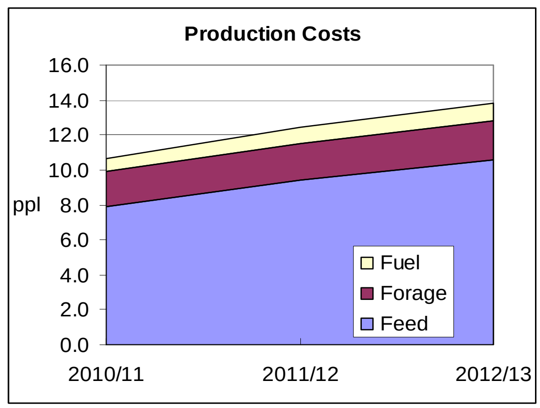
6th March 2013

The Market Price Equivalent (MPE) Update February 2013
***By Nick Holt-Martyn,* The Dairy Group**

New Price Formula in Exchange for 3 months notice?

"Dairy Crest non aligned suppliers are being offered a choice – the new formula milk price or continuing on pricing at the buyer's discretion. One key difference is the formula price means that suppliers will continue on 12 months notice, whereas the existing discretionary price should provide 3 months notice based on the Voluntary Code of Best Practice." says Nick Holt-Martyn of The Dairy Group. He goes on to say "the Dairy Crest formula price is based on 5 variable elements that drive the variance from the base price. Set the base price too high and Dairy Crest lose out, get it too low and farmers may be locking in to a price below the cost of production. The 5 variable elements are the price of cream, the retail price for 4 pints of milk, and the cost of feed, fertilizer and fuel.





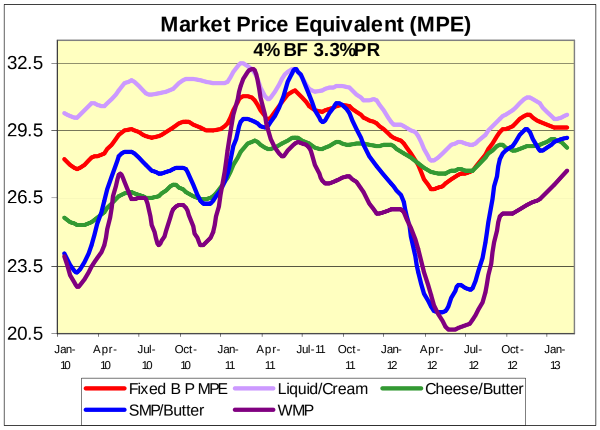
Source: DairyCo and The Dairy Group

As the graph shows, over the past two years the cream income has varied from 4.9 ppl to 10.0 ppl with an average of 7.7 ppl, with the current value of 7.6 ppl close to the average. Meanwhile the retail price has varied from 50.1 to 59.3 ppl and has averaged 52.9 ppl, but more importantly there has been a rise of 3 ppl in the last 3 months.

On the cost side of the formula the direction has been one way, up, for the last 3 years with feed being the dominant factor. Feed, forage and fuel accounted for 37%, 40% and 42% of the cost of production respectively in each of the last 3 years, with feed the dominant factor at 27%, 30% and 32%. Of the 5 parameters cream income and feed costs have been the most volatile and will have the largest effect on pricing going forward.

Both the cream and retail milk price are currently in the middle of the value range, whereas the input costs are all high. Cream is expected to vary over the next 12 months in a "normal" way, whereas liquid is currently supported by a supply deficit which is likely to weaken if production improves during the summer, reducing the potential upside for liquid. On costs there may be some respite with a lower protein price through the summer and with some easing of the forward wheat price. Fertilizers are relatively stable, albeit at high levels and oil shows no sign of weakening, despite weak global GDP growth.

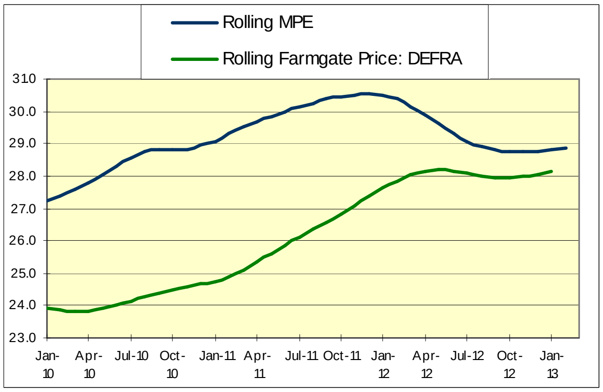
The Dairy Group forecast the average production cost to reach 33 ppl for 2012/13, due to the loss of milk production and high costs associated with the 2012 season. Whilst the formula does provide some transparency in the calculation of the base price it really depends where this base price is set and how this compares with price movements by other milk buyers. The formula provides the benefit of insurance against further increases in the cost of feed, fuel and nitrogen, but markets could react against a positive EU spring flush if New Zealand and Australia also see an improvement to their season end production. This would lower the market elements in the formula with costs stuck at a high level, which may not be a comfortable position for dairy farmers, especially as suppliers would be giving up the 3 months exit provided by the Voluntary Code if there was a price cut."



Market Prices

The Market Price Equivalent (MPE) held steady at 29.93 ppl due to a seasonal rise in cream and butter values and gain from the exchange rate fall, countering a sharp fall in the whey price. The weakness in whey is a concern, although markets in most commodities look to be in balance. The fall in exchange rate has probably helped hold the mild cheddar and SMP price. The latest Fonterra auction was up 3.1% with WMP firming again, while SMP values rose slightly. The MPE is now up 0.74 ppl on the year and up 1.5 ppl since August 2012. New Zealand supply is running up 6.7% and finishes 2012 up 8.5% on the year, but is heading into dry weather which is starting to reduce late season production. The US is up 0.5% in January 2013 and the EU ended 2012 up 0.6%, but currently running at -0.3%. Competition for supply remains the major UK issue for the liquid sector, with the UK running 6% below last year and the forecast for March is a slow cold spring which will delay the spring peak.

Farm Gate Prices



The graph continues to show further levelling off in both markets and prices, with the rolling MPE at 28.86 ppl while milk prices have levelled at 28.1 ppl. With markets and prices no longer moving to 30 ppl the gap looks set to hold a bit longer until market signals become clearer. The forecast farm gate price remains at 30ppl although it may take longer to reach. Weak profitability and now a cold spring will tend to keep confidence low until milk production starts to recover. With the UK production set to track the forecast of **5% below** last year until May/June, higher UK prices will be required to encourage improved supply.

- 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.