PRESS INFORMATION from

The Dairy Group

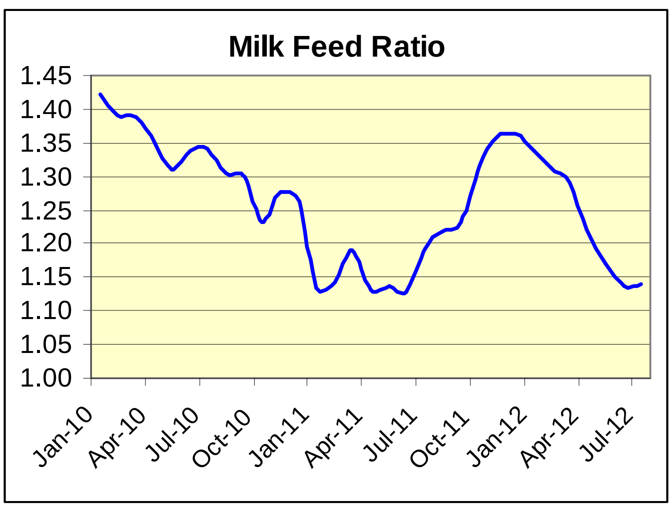
30th September 2012

The Market Price Equivalent (MPE) Update September 2012

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

Milk price will need to increase by a further 10% in January 2013

"The decision to arbitrarily cut milk prices in July in spite of weakening milk supply and poor summer weather has done irreparable damage to producer confidence. This has been compounded by the rocketing feed prices as summer progressed into autumn" says Nick Holt-Martyn of The Dairy Group. He goes on to say "this fall in confidence has not been limited to the non-aligned liquid sector but pervades aligned and cheese contract suppliers as well. The reason is the financial outlook which has deteriorated so rapidly and seems to have been completely ignored with price cuts which were not based on falling market returns, but on processors sacrificing the farm gate price to gain market advantage. Despite the recent sudden turnaround with companies promising to pay 29.5 ppl the outcome is that producers have no confidence that processors can deliver a cost of production price or will continue to pay a sustainable price into the future.



Source: The Dairy Group

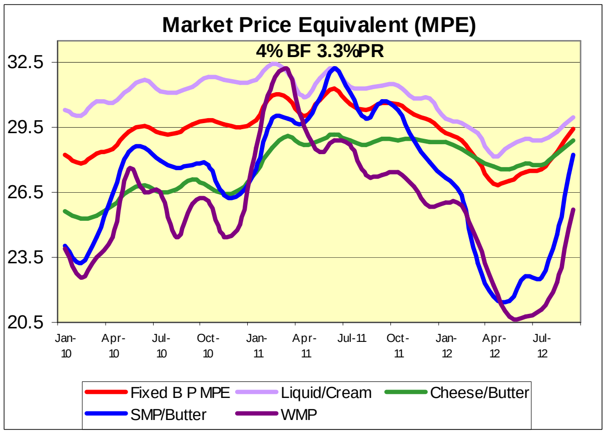
As the graph shows the decline in the Milk Feed Ratio this year coupled with poor summer weather has encouraged farmers to feed less or feed lower quality feeds to limit the cost exposure. The effect has been the sharp decline in production in July and August which looks set to continue well into the winter. With milk prices rising processors will hope the declining supply can be arrested, but unfortunately feed costs are only just starting to impact at the farm gate. As the table below shows, based on the ratios in the graph above at July 2012 (1.14) and January 2012 (1.34), once the high price of wheat and protein feeds is seen in the price paid on farm then the demand for further price rises will increase. The difference in the ratio at £250/t is a staggering 4.9 ppl which shows the decline in profitability in 2012 and the reason for such loss of confidence in dairy producers.

Feed Price £/t	Jul 12 Ratio Equiv. Milk Price	Jan 12 Ratio Equiv. Milk Price
250	28.5	33.4
260	29.7	34.8
270	30.8	36.1

The recent milk price rises are only sufficient to bring the ratio back to July 2012 levels which were unsustainable and saw production fall. If the January 2012 levels are to be achieved then milk prices will need to rise significantly in the coming months. Without price rises of this order confidence will not be restored and production will continue to decline.

As for markets returns, they are up 1 ppl in the last month and 2.5 ppl since the trough in April 2012 and the most recent Fonterra auction is up 2.4%. For the next 6 months markets look set to firm on weaker supply in the northern hemisphere. Thereafter it will depend on the weakness or otherwise of the northern hemisphere spring flush and any effects on the southern hemisphere of the currently weak El Nino weather event. With feed costs at record levels and feed in short supply northern hemisphere production would be expected to be depressed for the next 12 months. The result could be sharply rising markets in 2013 which will have to feed back to farm gate prices by the autumn.

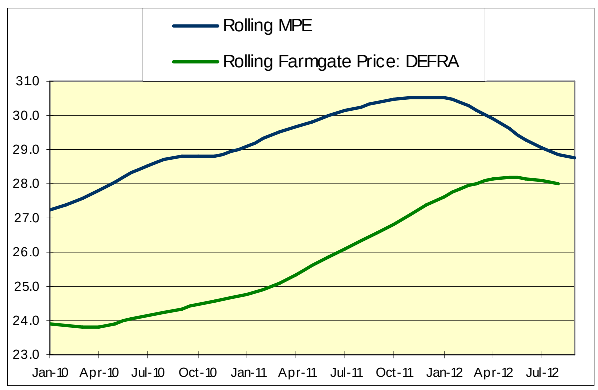
The January 2013 farm gate milk price needs to rise by another 10% to ensure there is sufficient production capacity left in April to take advantage of an improved set of weather and market conditions. We said last month that processors should get on and pay 29 ppl without prevarication as an absolute minimum. Now we are saying by January 1st 2013 that figure needs to be 32 ppl just to stand still, with market returns almost 30 ppl and rising there will be no excuses. ”



Market Prices

The Market Price Equivalent (MPE) rose sharply again by 1.1 ppl to 29.44 ppl due to the rise in all commodities, still with the exception of mature cheddar. The market price is increasing due to lower supply in the northern hemisphere, whilst the southern hemisphere, despite starting strongly, is still at a low level as yet. The latest Fonterra auction was up generally, overall a rise of 2.4%, mostly by firming values in short term contracts. The MPE is now down 1.1 ppl on the year but up 0.6 ppl since February 2012. With EU supply weak through the late summer and high feed costs for the winter, supply is set to be weak throughout the winter. The New Zealand annual production is still rolling at +10% and July was up 20% on the year, but the expectations are to remain up 3 to 4% year on year for the new season. Commodity returns have recovered to those of cheese and liquid sectors but are not yet forcing those sectors higher in competition for supply, that may come about before the year end which will lift the whole market.

Farm Gate Prices



The graph shows rolling MPE starting to level out at 29 ppl while milk prices start to level out just over 28 ppl. The arbitrary setting of a floor price at 29.5 ppl will arrest the decline in farm gate prices although there will still be sectors below. The rising commodity markets will increase pressure for prices to rise for those not benefiting from the floor price. Weak producer confidence may lead to lower supplies through the winter which will increase pressure on processors and more importantly retailers to permit dairy product inflation on the back of rises in commodity prices. Production costs will reach un-precedented levels this winter which will require un-precedented milk prices if profitability is to be maintained.

- 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.