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Dairy Market Update

Dry weather adding pressure to future feed prices

New crop grain markets remain reactive to Northern Hemisphere weather as conditions continued to be far from ideal. Reports suggest that the UK experienced only 35% of 'normal' rainfall levels in April, following a dry March. In the US, dry weather in the south continues to stress the winter wheat crop. For wheat in 2011/12, the International Grain Council (IGC) put global wheat production forecasts at 672Mt, on par with demand forecasts, leaving stock levels tight and keeping the market firm. In Europe and the UK, the dry conditions have fuelled November French futures for wheat to rise to Eur216.75/t (£193/t) while UK November values have been supported at £174.50/t, up £60/t (52%) from one year ago.

In context

While the dry weather conditions in the UK, EU and US are impacting wheat futures, there may also be implications on grass growth for grazing in the UK. If there continues to be a lack of rain, this will impact on both the availability of grazing and, depending on the extent of the dry period, the second cut of silage. This could reduce the availability of silage later in the year, increasing reliance on buffer feeding. The combined effect of reduced grazing and supply shortages of grains for feed is likely to add further pressure on the already high prices for feeds.

Farmer union calling for formula based milk contract

The NFU Scotland has issued a proposal which is calling for the baseline price in milk contracts to be based on a market-related pricing formula. After some research and analysis of historic data, the producer working group has settled for a formula based on the market indicators of AMPE and MCVE, in a 20% and 80% split. This pricing mechanism "reflects real market indicators, and uses figures that are transparent and independently verifiable" according to the NFUS Vice President Allan Bowie. The NFU Scotland explained that this proposal aims at breaking the cycle of market failure in the supply chain and improving farmers' confidence. It also echoes the current EU proposals for stronger milk contracts with a transparent pricing mechanism. The union has organised a series of meetings at the beginning of May for the proposal to be discussed with other farmers.

In context

Although there are already some contracts with a transparent pricing formula such as the Tesco contract, the majority of them don't have any. As a result, there has been a lot of debate over the recent years to know whether farmers were getting a fair return from the market place for their product. If adopted, such a proposal would make sure that this would be the case, without damaging the competitiveness of the UK processors as the other European processors are facing the same market fundamentals. A market-related pricing formula would also enable farmers to understand how their price is set thus improving their confidence and enabling them to better adapt to the market situation. Support from other farmers and crucially from processors will be key in the next few weeks for this proposal to have a chance of being implemented.

UK wholesale prices

The UK wholesale market eased in April, with modest price changes across most products noted. Butter saw the largest fall, down by £150/t to £3,250/t, while SMP rose marginally, up £50/t to £2,150/t. The Cheddar Cheese market on the other hand continues to be sluggish, with prices for mild cheddar down by £50/t to £2,900 and mature cheddar stagnant at £3,200/t.

The UK market largely followed the recent World and EU trends. The EU market saw both French and Dutch butter prices falling to €4,080/t (£3,611/t) and €4,020/t (£3,558/t) respectively and cheese prices stalling at €3,900/t (£3,451/t). Both food and feed SMP also decreased, with the largest decline for food SMP which is down from €2,650/t (£2,304/t) to €2,250/t (£1,991/t) over the month. World markets have seen similar downward movements and levelling of prices. SMP saw the biggest change, falling $250/t to $3,350/t (£2,055/t). Cheddar Cheese price remained unchanged at $4,300/t (£2,638/t) for the fourth consecutive month.

In context

As we approach the UK annual peak of production, milk output is high and there is a good availability of product. Price drops are expected due to this seasonality, and have been reflected by the UDF auction price falling by 0.81ppl to 25.85ppl in April. However, these fluctuations in price have been relatively small and the wholesale market is remaining strong. As a result of these price changes, MCVE has decreased by 0.52ppl (1.6%) to 32.10ppl in April. With AMPE falling by 0.3ppl (0.9%) to an average of 32.0ppl, MCVE has a 0.10ppl (0.3%) premium over AMPE for the month. The general sentiment is that the market is likely to remain firm; as a result farmgate price may continue its upward trend.

Discounters' sales still rising

Since the start of 2011, Discounters (Aldi, Lidl & Netto) have led grocery market growth and in the latest 12-week period ending 17 April 2011, Aldi have increased sales by 15% and Lidl by 14% compared to the same period last year. These increased sales have been fuelled by existing shoppers sharply increasing their spending levels. There has been an even stronger performance in the milk market with Hard Discounters increasing total milk sales by 21% in value terms and 29% in volume terms in the latest 12-weeks ending 17 April 2011. Increased volume sales have been driven by semi skimmed (+31%) and whole (+48%) milk.

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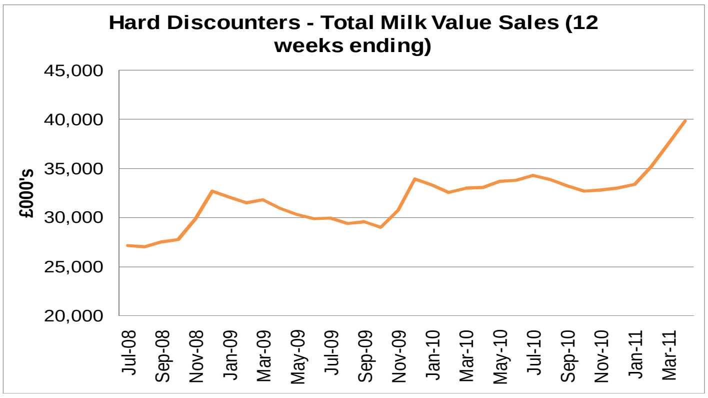

In context
Although Hard Discounters are growing quickly, they still represent a relatively small proportion of the liquid milk market: 5.2% in value terms and 6.6% in volume terms. However, with the current difficult economic situation, this share is likely to rise which means for farmers that a smaller proportion of milk would be sold from retailer aligned contracts.

Company Strategy and Performance Report – Caledonian Cheese

The Caledonian Cheese Company, one of Scotland's largest milk buyers, is the manufacturing division of Lactalis McLelland, producing 'Seriously Strong', the UK's number two Cheddar brand and third largest producer of Cheddar in the UK.

Lactalis McLelland aims to grow capacity and milk procurement at the Stranraer site by 70m litres over the next three to four years and increase cheese production to 40,000 tonnes a year. Its plan is to increase UK brand presence as well as developing export markets. 'Seriously Strong' Cheddar performed well in 2010, gaining market share, but faces strong competition from 'Cathedral City' (Dairy Crest) which is currently worth more than twice as much at retail level.

Lactalis has an ambition to become the world's largest dairy company. Last week, it placed a bid to take over Parmalat, Europe's 7th largest dairy company. If this bid is approved, with a combined turnover of 14bn Euros, this would elevate Lactalis to the second largest dairy company behind Nestlé.

In context
Investment and innovation are pivotal to the future success of the UK dairy industry. In this respect Lactalis is a company to watch - Lactalis may well seek to fulfil its global ambitions through further acquisitions of added value and innovative companies or brands within the UK market (in addition to Lubborn and Rachels). As an international player, Lactalis is in a strong position to develop dairy export growth for UK products.

Latest income from farming in the UK

Provisional figures released by Defra show that total income from farming stood at £4.38bn in 2010, a marginal increase of £3.7m (0.1%) compared to the previous year. However, in real terms (adjusting for the effects of inflation), estimated income has fallen by £198.4m (4.3%) compared to 2009.

Breaking down the results further shows that at current price levels (2010), output increased by 5.3% between 2009 and 2010 to £20.7bn. This was offset by a 3.3% increase in costs and a fall of 12% in the amount of subsidies including those from the Single Farm Payment scheme (on account of changes in exchange rates). On a positive note, the contribution of dairy to total output increased by just over £200m (6.4%) from £3.1bn to £3.3bn.

In context
While it can be seen that dairy output improved in 2010 compared to the previous year and is approaching levels seen in 2008, dairy farm income has suffered. Recent figures for farm business income in England suggest that income may fall by 25% between 09/10 and 10/11 on account of increases in costs, particularly purchased feed.

Feed Prices (Range £/tonne)	Intensive energy rations	High protein concentrates	Exchange Rate €/£		UK Average Farmgate Milk Price: March			
April 11	£225-£239	£330-£339	0.89480		**2011**	26.57	**2010**	24.10
Wholesale Prices and Market Indicators	IMPE	AMPE	**MCVE** (Milk for Cheese Value Equivalent)	**Cream Income***	**Butter** (£/t)	**SMP** (£/t)	**Mild Cheddar** (£/t)	**Bulk Cream** (£/t)
April 11	19.1	32.0	32.10	8.28	3,250	2,200	2,900	1,500
March 11	18.7	32.3	32.62	8.52	3,400	2,150	2,950	1,550
April 10	18.9	28.0	29.01	7.25	3,000	1,900	2,650	1,300
Retail Prices	**Liquid Milk (retail)** (ppl equivalent)		**Doorstep** (ppl equivalent)		**Butter** Branded (p/250g)		**Mild Cheddar** Non-branded (p/kg)	
April 11	58.9		1.06		124		635	
% change v April 10	-9.1%		5.3%		15.9%		2.3%	

*Cream income = The cream income to a liquid processor is based on the value of the excess cream created because the average level of fat on liquid milk sold through the retail market (supermarkets, local stores and doorstep) is less than the level of fat in the raw milk they receive. It assumes all the cream is sold in bulk form.