DairyCo Datum.

Dairy Market Update

The rollercoaster of 2012

For many dairy farmers 2012 was a rollercoaster year, with the weather being the key driver of events. However, some of what transpired in 2012 (weather or otherwise) began the previous year.

Global dairy commodity values, which had been increasing, started to weaken in autumn 2011. This was in part due to increases in global milk production of approximately 3% during the 2011/12 milk year. As is often the case, the UK took time to see global changes come into domestic markets and effect farmgate prices.

UK milk production in Q1 of 2012 was up 3% on previous year volumes, and milk prices averaged 28.85ppl, 10% higher than the Q1 average in 2011. This was in part due to higher milk prices globally. This fitted with the DairyCo farmer intentions survey and DairyCo forecasts, of an increase in production for the 2012/13 milk year.

However, the situation in the UK changed from the spring. Drought in the UK led to worries over grazing and crop production with feed prices increasing. At the same time, the reductions in dairy commodity values fed down to the farmgate with price cuts announced in May and June.

The summer saw weather conditions go from one extreme to the other, with the second wettest summer on record. This meant that in addition to rising feed costs, silage production both in terms of quantity and quality was poor. This set the scene for the strength of feeling exhibited by farmers when a second round of milk price cuts were planned for August.

The successful campaign by the coalition of dairy farmers and farming unions led to the cancellation of the announced price cuts, and contributed to the agreement of a Voluntary Code of Practice on contractual arrangements.

Production levels in the UK continued to decline into the autumn as the weather failed to improve. The autumn also saw an increase in the number of dairy cows culled. As discussed later, this was likely impacted by the reduced availability of forage, high feed costs and high cull prices.

While feed costs show little signs of falling, the reduction in milk supplies has helped to support farmgate prices as domestic milk buyers have had to compete for increasingly scarce milk. Production forecasts (as mentioned in the 6 December Dairy Market Update) indicate that milk supplies will remain around 7% down on previous year levels for the remainder of the 2012/13 milk year. The article below picks up areas to look out for in 2013.

What to look out for in 2013 - supply and demand

Weather is expected to play a big part again. Milk supplies in the UK and elsewhere remain tight. While New Zealand, a major dairy exporter, is expecting an increase in production; other dairy export regions are expecting supplies to stay roughly the same or possibly reduce slightly. At a UK level, weather impacts on feed and grazing conditions will contribute significantly to production levels. However, as the UK accounts for less than 2% of grain produced, prices will largely depend on what happens elsewhere in the world.

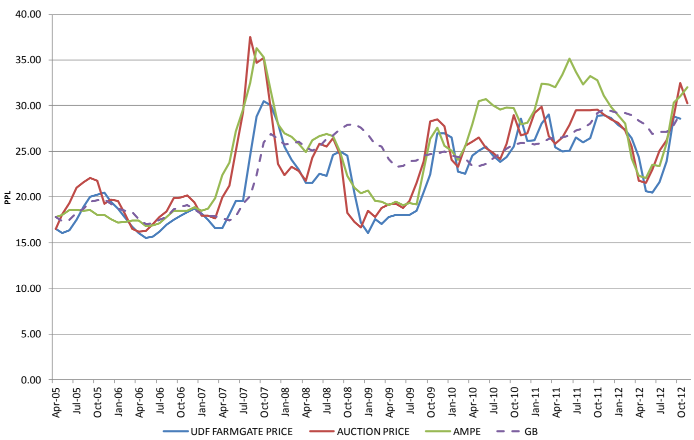
Nevertheless, looking at better utilisation of grass or employing new buying techniques will be vital to exploit any opportunities that become available through increasing milk production.

From a demand perspective, tighter milk supplies have seen dairy commodity prices increase since the summer. While there is expected to be a seasonal lull after Christmas, prices are not expected to fall in the same way during 2013 as they did in 2012 due to available supply. At a farmgate level, prices have started to reflect scarcity of supply with increases announced into early next year. In addition, several processors will be looking to discuss and/or launch new pricing systems for the milk they buy. GB farmers should keep informed about any changes proposed and work with their milk buyer or farm representative about any suggested models. Linked to this will be the voluntary code of conduct and how this is adhered to in these negotiations.

The other end of the scale – market related pricing

Following feedback about the article on cost of production pricing models in the last Dairy Market Update, this article looks at the other end of the spectrum; when prices are derived solely on the basis of what can be returned from commodity markets.

The closest example of market related pricing would be the price paid by United Dairy Farmers (UDF), where the base price of the contract is indirectly related to the UDF auction price. The chart below compares this price (using the DairyCo milk price league table) along with the UDF auction price, AMPE and the average GB farmgate price. It must be noted that AMPE is exclusive of transportation costs.



As can be seen in the graph, the UDF farmgate price closely follows movements in these publically available price series that reflect market returns, subject to a small time lag. GB farmgate prices have also shown some changes but the correlation isn't as strong.

However, there are a couple of points to consider. Firstly, having a price more closely related to market returns will mean that the price received will be volatile, prone to sudden downward as well as upward movements. Secondly, because the price is related to the end product (butter, milk powders etc) it may not rise at the same time that input costs

do, which has been the case this year with feed prices.

In context: At present, market related pricing may not be the most preferred option for many dairy farmers due to lower dairy commodity returns in comparison to higher feed prices. Therefore, with this pricing model the competitiveness of the supply chain (farmers and processors) is vital in order to weather downturns in the market. However, for farmers and processors that are in a position to absorb the volatility, this pricing model will reflect changes in market values more quickly allowing the supply chain to benefit from upturns in the market.

Whey – still the by-product of cheese?

Historically, whey has been perceived as a by-product of cheese production. Over the last couple of years however, with the increasing demand for whey proteins, the balance might have begun to shift.

With obesity a common topic in the media, there has been increasing interest amongst consumers about nutrition. According to Kantar consumer data (52 weeks ending 25 Nov 12), the value of the GB powdered sports nutrition market has risen by 17% year-on-year to £10.5m.

Evidence of the growth potential and value of this market segment is the recent entrance of Coca-Cola into the US market. They have moved into the market via a distribution deal for Core Power, a small drink brand owned by Fair Oaks Farms Brands, a co-operative of about 90 family owned dairy farms.

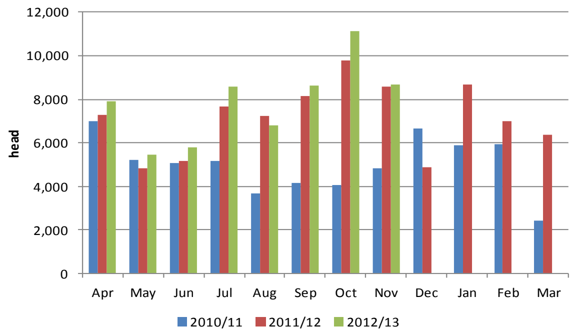
Some dairy processors within the UK have also seen this potential. Milk Link has a strategic partnership with Volac to process high value whey while, in May this year, First Milk purchased CNP Professional, a company that specialise in sports nutrition supplements.

For cheese processors, the growing market for high-protein energy drinks and the resulting increase in demand offers an additional market for their whey production. This offers processors the ability to get more value from the milk they process and potentially support milk prices paid to producers.

Culling figures up

Latest figures from AHDB/EBLEX show that the number of GB dairy sired cull cows sold at auction reached 8,680 in November, an increase of 1.4% on numbers sold in the same month last year. On a cumulative basis, 2012/13 (Apr-Nov) has seen 62,977 cull cows, 7.4% more than the same period in 2011/12. It must be noted that these figures correspond to animals going through auctions as opposed to abattoirs.

GB dairy sired cull cows



As can be seen above, 2012/13 figures have been consistently above those of the previous year. This is likely due to a combination of reasons. Firstly cull cow prices, while not as high as the previous year, are still almost 30% higher than 2010/11. Together with pressure at the farmgate from increasing feed costs and low forage availability, this may have given farmers an incentive to reduce herd sizes. Age profile information from BCMS shows that older cattle, over 42 months, appear to be the main focus for culling with numbers in this age category falling by 3% in October 2012 compared with the previous year.

In context: With feed costs increasing and the availability of forage limited or of poor quality, taking less productive cows out of the herd is potentially one way to manage the situation. Another way of managing feed costs is to optimise grass use. Calving data from BCMS shows that total calvings in February and March were 10% up on the previous year, suggesting that some herds may be moving to a more spring-based system in an effort to reduce costs and make better use of grazing.

Feed Prices (Range £/tonne)	Intensive energy rations	High protein concentrates	Exchange Rate €/£ (aver. December 2012)		UK Average Farmgate Milk Price: October			
November 2012	278-291	371-380	0.8099		2012	29.06	2011	29.09
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)
November 12	17.2	32.0	32.41	8.67	2,850	2,400	2,925	1,480
October 12	17.3	31.0	32.26	7.88	2,750	2,350	2,925	1,350
November 11	18.5	31.1	32.68	8.30	3,150	2,150	2,925	1,450
Retail Prices	Liquid Milk (retail) (4 w/e 28/10/12)		Doorstep (4 w/e 28/10/12)		Butter (28/11/12) Branded (p/250g)		Mild Cheddar (28/11/12) Non-branded (p/kg)	
October 2012	0.59		1.16		167		562	
% change v October 2011	-2.21%		1.8%		1.6%		-0.7%	

*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.