



Dairy Market Update

24 January 13

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What is driving the trend towards larger farms?

Since 1970 there has been a steady trend towards fewer, but larger dairy farms. This has led to much speculation as to the causes of the trend, in particular the reasons behind the reduction in the number of smaller dairy farms. To help improve understanding of this issue, DairyCo commissioned research to examine which factors actually do influence the shape of the industry.

The main finding of the report was that the decision by an individual milk producer whether to expand, contract or leave the industry is based on a range of both economic and social factors. The table lists some of the main factors and the degree of impact they have on producer decisions to expand or exit the industry. The longer the bar the greater the impact of that factor.

| EXPANSION | FACTOR | EXIT |
|-----------|-----------------------|-----------|
| Short bar | Presence of successor | Short bar |
| Short bar | Absence of successor | Long bar |
| Short bar | Younger age | Short bar |
| Short bar | High profit level | Short bar |
| Short bar | Low profit level | Short bar |
| Short bar | Cost levels | Long bar |
| Short bar | Milk price | Short bar |
| Short bar | Larger herd size | Short bar |

Despite common perceptions, milk prices were found to have only a weak impact on business intentions, primarily through their effect on business profits. Farms achieving a higher milk price were no more likely to expand than other producers.

Instead, one of the biggest single factors found to affect business intentions was the presence or otherwise of a successor. Those businesses with a successor in place were found to be considerably more likely to be looking to increase production than those without.

Cost levels were also found to be a major driver influencing decision making as they account for the majority of variation in profit. Interestingly, while farms with high levels of profit were more inclined to consider expansion, farms with low profit levels were just as likely to expand as to exit the industry.

Current herd size was not found to be a significant factor in decisions to expand or exit the industry. In fact, it was found that the average herd size of businesses looking to expand was not substantially different to those looking to exit the industry.

The full report, titled "*The structure of the GB dairy farming industry – what drives change*", with detailed analysis of the factors affecting structural change will be available to download from the DairyCo website by the end of this month.

Mixed fortunes in retail dairy market performance

Retail sales of dairy products recorded year-on-year growth in 2012 according to the latest data from Kantar Worldpanel. The total value of dairy products sold for home consumption increased to £10.32bn in 2012, up 2.8% from an estimated £10.04bn in 2011. This increase has primarily been driven by an overall growth in the volume of dairy products sold as

average prices at retail level across all dairy products increased by less than 1%.

However, not all segments of the dairy market recorded positive growth over the year, as can be seen in the table.

| Segment | % growth (volume) | % growth (price) | % growth (value) |
|--------------------------|-------------------|------------------|------------------|
| Total Milk | 0.9 | -2.0 | -1.1 |
| Total Cheese | 1.9 | 3.6 | 5.6 |
| Yogurt | -2.5 | 7.8 | 5.1 |
| Margarine | -0.7 | 0.4 | -0.3 |
| Butter | 2.0 | 2.8 | 4.8 |
| Fresh Cream | 1.5 | 0.6 | 2.1 |
| Yogurt Drinks And Juices | 3.5 | -1.7 | 1.7 |
| Fromage Frais | 4.6 | 1.7 | 6.4 |
| Dairy Products | 2.4 | 0.5 | 2.8 |

Source: Kantar Worldpanel (52 w/e 23 December 2012)

The cheese and fromage frais segments recorded strong growth in 2012, in terms of both value and volume sales. While sales of yogurt declined in 2012, an increase in unit price of 7.8% meant the value of the segment increased over the year (see [10 January DMU](#) for more analysis of the yogurt market).

Despite relatively stable sales volumes, the value of the milk segment declined between 2011 and 2012 by 1.1% as the average price of a litre of milk dropped 2.0%, from 63 pence to 61 pence.

In the yellow fats segment, butter performed well, with total market value increasing by 4.8% on the back of increased prices. However, this was likely at the expense of margarine, which recorded declines in both the volume and value of retail

In context: Changes in market trends and consumer preferences impact directly on the market returns available from the sale of various dairy products, which in turn affects the profitability of the supplying companies. For dairy farmers, it is important to understand which market segments your milk buyer is currently involved in, as its ability to pay a competitive price will be affected by how well it is performing in the market. For those companies with a significant involvement in a declining segment, it is then important to determine if it has a strategy to deal with the possibility of declining market returns. DairyCo produce reviews of the major milk buyers in GB, which give valuable insight into how well it is exploiting market developments. For instance, an updated review of Arla for 2013 has been published and is available in Processing and Trade section at www.dairyco.org.uk/marketinformation.

Price transparency and post-quota situation dominate discussions at Semex Conference

At the recent Semex Conference in Glasgow, two central themes emerged - the shape of the industry post-quota, particularly the impact from potential growth in Ireland, and the level of transparency in milk prices.

The focus of the post-quota discussions was on the potential threat faced by the GB industry by growth of the Irish dairy industry. While the strategy put forward was to increase milk



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production in Ireland by 50%, challenges facing the industry mean that a 25-30% increase was seen to be more realistic. Access to credit and financial resources for investment, the risk of superlevy, volatility of margins and uncertainty associated with CAP reform may restrict the ability of the Irish dairy industry to reach the proposed target.

Peter Kendall, President of the NFU, addressed questions regarding potential issues post-quota for the UK dairy industry. He noted the importance of leadership and innovation but ultimately believed the UK can be competitive (a finding supported in the 2012 report by the International Farm Comparison Network – see [DMU 22 November 2012](#)).

In terms of price transparency, the view from Europe appears to be that legislation will be needed to ensure this improves. Domestically, it was questioned whether the Voluntary Code of Practice would bring the transparency that farmers are asking for, although it was emphasised that time would be needed to assess whether the voluntary route is working. A more detailed summary of what was discussed at the conference can be found in the [News section](#) of the DairyCo website.

UK farmers to benefit from Arla Foods Strategy 2017?

Global dairy cooperative Arla Foods has stated it will be seeking profitable market opportunities beyond the EU for the 970m litres of extra milk it anticipates its members will produce per annum when EU milk quotas are abolished in 2015, an 8% increase on current production levels.

Arla will continue to develop its core markets in Europe such as the UK, Sweden, Germany, Denmark, Finland and the Netherlands. However, according to Åke Hantoft, (Chairman of Arla Foods Board), the anticipated increase in milk volumes cannot be sold as profitable products in European markets as growth in these markets is expected to remain low.

Consequently, the cooperative is looking for market opportunities beyond Europe to support its returns and thus the milk price paid to its dairy farmer owners. As part of its new [Strategy 2017](#), the cooperative is looking to increase its involvement in Russia, China, Africa and the Middle East.

Arla expects its revenue streams from these emerging

markets to grow by €870m (£722m) as a result of increased investment in marketing, distribution networks and partnerships. The cooperative will continue to focus on its

In context: As a result of the Milk Link merger in 2012, Arla is now the largest dairy company in the UK, accounting for around 26% of milk collected from UK farms. UK dairy farmers also supply just over a quarter of Arla Foods global milk requirements.

If the 2017 strategy is successful in improving market returns, farmer members of Arla Milk Link should benefit directly both through their milk price and also through an annual supplementary payment once they obtain full membership status.

GB dairy outlook at AHDB conference

The outlook for the GB dairy market will be one of the topics discussed at the AHDB Outlook Conference on Wednesday 13 February at One Great George Street, Westminster, London. The opening session will look at the global economy and the driving forces behind higher feed costs. After this, breakout sessions will take place which will focus on individual livestock sectors.

Specific to dairy, Matt Johnson, Senior Analyst will present an outlook for GB. This will cover a review of the key events of 2012/13, and factors which will play a role going into 2013/14. Mark Voorbergen, an independent global dairy consultant, will present a view from outside GB, looking at conditions in the rest of Europe. A discussion on the key opportunities and challenges facing the GB dairy industry going forward will then take place, led by Ian Potter.

Following the conference, there will be a specially organised briefing to launch the latest Milkbench+ dairy benchmarking report. Milkbench+ analyst Karolina Klaskova will highlight the report's key findings on the main sources of variation in business performance in the 2011/12 financial year across farming systems.

For more information on the AHDB Outlook Conference 2013, including how to book your place, please click [here](#). Those wishing to attend only the Milkbench+ briefing should email kate.clay@dairyco.ahdb.org.uk to reserve a place.

| Feed Prices (Range £/tonne) | Intensive energy rations | High protein concentrates | Exchange Rate €/£ (aver. December 2012) | | UK Average Farmgate Milk Price: November | | | | | | | | |
|--|--|---------------------------|--|---------------|--|-------|---|------------|------|-------|-------|-------|-------|
| | | | December 2012 | 0.8126 | 2012 | 30.02 | 2011 | 29.45 | | | | | |
| Wholesale Prices and Market Indicators | IMPE | AMPE | MCVE (Milk for Cheese Value Equivalent) | Cream Income* | Butter | SMP | Mild Cheddar | Bulk Cream | | | | | |
| | | | | | (£/t) | (£/t) | (£/t) | (£/t) | | | | | |
| | | | | | December 12 | 30.8 | 17.4 | 32.58 | 8.26 | 2,800 | 2,300 | 2,925 | 1,410 |
| | | | | | November 12 | 32.0 | 17.2 | 32.41 | 8.67 | 2,850 | 2,400 | 2,925 | 1,480 |
| December 11 | 29.9 | 18.3 | 32.73 | 8.34 | 3,000 | 2,100 | 2,925 | 1,450 | | | | | |
| Retail Prices | Liquid Milk (retail) (4 w/e 23/12/12) | | Doorstep (4 w/e 23/12/12) | | Butter (16/01/13) Branded (p/250g) | | Mild Cheddar (16/01/13) Non-branded (p/kg) | | | | | | |
| Latest Month | 0.60 | | 1.19 | | 167 | | 558 | | | | | | |
| % change v December 2011 | 0.0% | | +4.4% | | +3.2% | | -2.0% | | | | | | |

*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.

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