



Dairy Market Update

8 January 2009

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Commodity prices down, but some relief for the UK

All World and EU commodities fell in value between November and December, with the exception of EU whey powder which increased by 2.6%. This pressure on dairy commodity prices was reflected in the latest Fonterra auction on 6 January which saw the price of Whole Milk Powder fall for the sixth month in a row to average \$2,017/tonne (£1,387/tonne). Despite a fall of 9.3% since December's auction, this is the lowest month-on-month percentage fall seen since the auction began in July 08 suggesting WMP prices may be bottoming out.

However, the weakness of Sterling has helped isolate the UK market from the falls seen on the EU and World markets, with SMP being the only UK dairy commodity to fall between November and December, by £50/tonne to £1,750/tonne. The weakness of Sterling has helped to boost export earnings while protecting the industry from lower priced imports. It has also caused the value of intervention for butter to rise by 8.6% between November and December to £1,900/tonne. Despite intervention not opening until March, the increase has allowed UK sellers to raise prices for bulk cream and butter to continental buyers.

The effect of the weakening of Sterling can be seen quite dramatically in the table below that shows cheese price changes over the past twelve months. Although German Emmental has fallen on the Continent in Euro terms by 9.3% (€4,300/tonne down to €3,900/tonne), when allowing for the change in the €/£ exchange rate over the year, the price in Sterling terms has actually risen by 11.5% (£3,100/tonne up to £3,458/tonne). This has helped isolate the UK market from falling prices and the price of cheddar in the UK has remained relatively unchanged. This is further highlighted by fact that the market indicator Milk for Cheese Value Equivalent (MCVE) actually rose by 0.15ppl between November and December due to the strengthening whey powder price, and now stands at 27.19ppl.

Cheese price per tonne	December 08	Exchange rate	December 07	Exchange rate	% diff. 07-08
World market					
Cheddar	\$3,200 £2,137	\$/£ 0.668	\$5,500 £2,723	\$/£ 0.495	-41.8% -21.5%
EU market					
German Emmental	€3,900 £3,458	€/£ 0.887	€4,300 £3,100	€/£ 0.721	-9.3% +11.5%
UK market					
Mild cheddar	£2,750		£2,850		-3.5%
Mature cheddar	£3,300		£3,300		nc

Milk purchasers announce price cuts

A number of milk processors have cut the price they pay farmers for their milk, with the cuts being implemented from the beginning of January. Arla and Saputo are both cutting their price by 2.0ppl with First Milk and Wyke Farms lowering their prices by 1.25ppl and 0.7ppl respectively.

Arla's primary focus is the liquid milk sector but according to data from AC Nielsen, sales of Arla's butter brands, Lurpak and Anchor, have grown by 19.9% and 15.3% to £228m and £90.4m respectively during 2008. This puts them both in the top three butter brands in UK. However, these brands are imported and the weakening of Sterling has made them considerably more expensive to get to UK supermarket shelves. Arla has stated in a downgrade of its profit expectations that its Continental European operations are under pressure due to the falling commodity markets. It is also having to include a provision for losses in the Chinese market as a result of the melamine crisis.

From 1 August 2008, First Milk managed to negotiate with Asda an additional £300/tonne for its cheese; from this date First Milk put its contracts up by 1.0ppl. It is now reported that during ongoing negotiations, Asda is looking for some of this money back, as cheaper parcels of cheddar appear on the market. It is also understood First Milk has not received the returns it initially envisaged from the companies to which it sells liquid milk, again putting pressure on its margins.

In context

It appears that some of the recent price cut announcements cannot wholly be justified by the falling commodity markets. This also appears to have been the case when DFOB announced its 2ppl cut in December. It is still evident that the majority of the volatility experienced by processors is passed back to farmers instead of being shared by the whole supply chain. Although DairyCo has been advocating the need for fairer contracts between farmers and processors since 2005, the need for change is becoming ever more pressing.

Farmgate milk price cuts in Oceania

The wave of milk price cuts recently seen in the UK and Continental Europe is also being experienced in Oceania. Fonterra has recently announced a cut in farmgate milk prices from February due to unfavourable trading conditions and declining commodity prices. The cut corresponds to the withdrawal of the November step-up payment of 7c/kg butterfat and 17c/kg protein (2.6p/kg and 6.3p/kg protein). The Fonterra chairman also warned milk suppliers that the co-operative is in the process of reviewing its pricing levels for the February to June 2009 period. He therefore urged farmers to be cautious in their planning for the year.

The independent NZ co-op Westland Milk Products has reviewed its forecast milk payout for the current season. The payout will now be between NZ\$4.10/kg and NZ\$4.40/kg of milk solids for the current season when last season's payout reached a record of NZ\$8.29/kg.

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Finally, one of the leaders in the Australian dairy industry, the co-operative Murray Goulburn is planning to cut the price it pays for milk by 26% from 1 February to AUS\$0.31/litre – about 15ppl.

In context

The global fall in commodity prices has led many dairy processors worldwide to cut the price they pay producers. These cuts will inevitably result in a slowing of the growth in global production. In the longer term, if global consumption growth returns to its underlying levels following the economic downturn, it is likely the global commodity markets will recover at least some of the value lost in recent months. Dairy farmers around the world have no choice but to adapt to this increasing volatility and structure their businesses to cope with the imminent price swings.

Input costs volatile

As oil prices in December fell to \$38.60/barrel (£26.03/barrel) their lowest monthly level in the last three years, fertiliser prices fell back with blended 20:10:10 bags falling by £20/tonne to an average of £414/tonne. However, with OPEC cutting oil production by 14.5% to 24.85 million barrels a day from January, due to declining demand for oil, oil prices could start to move upwards again preventing further declines in fertiliser prices.

In the feed market, the weakness of Sterling has seen some imported feed costs increase, with rapeseed meal increasing by 7.0% to average at £138/tonne between November and December, while most other feed prices fell slightly. In the feed wheat market, prices have lifted slightly with the average price for December at £102/tonne. This increase may in part be due to wheat future prices in the US now being back above US\$6/bushel as reports emerge a potential fall in supply due to the acreage of US winter wheat falling 5% and the cold weather expected to affect production in some areas of the US.

The increase in feed wheat has also been helped by US soybeans increasing to \$10/bushel, a three month high. Prices

of soybeans increased on the back of dry weather in Argentina and Brazil affecting production and strong export demand. Some of the export demand may be linked to the US 'Roundup Ready 2' - soybeans being passed safe for import by the EU, who in 2007 imported 10% of US soybean exports.

Mozzarella cheese market is growing

World production of mozzarella has reached approximately 2.5 million tonnes per annum in recent years – close to the production levels of cheddar, the most processed cheese in the world. The growth of the mozzarella market has recently been around 2% per annum, aligned to the rising world consumption of ready meals and pizzas. A number of dairy processing companies including Fonterra in NZ and the Eural - Ingredia joint-venture in France, have recently invested in mozzarella cheese plants (34,000 tonnes and 30,000 tonnes annual manufacturing capacity respectively) to cash in on this growing world demand.

Defra statistics provisionally report UK mozzarella manufacture was about 51,000 tonnes in 2007 – 2% of world production. The main UK manufacturer of mozzarella cheese is the Leprino - Glanbia joint-venture which operates two factories at Llangefni, Anglesey in North Wales and at Magheralin in Northern Ireland. The second largest company processing mozzarella in the UK is Saputo which is the 15th largest dairy processor in the world. It operates the Newcastle Emlyn factory in South West Wales and now processes about 84 million litres of milk a year delivered by approximately 120 dairy producers.

In context

Although mozzarella is one of the fastest-growing cheese markets, prices are under pressure. Saputo cheese UK recently announced a 2ppl milk price cut from 1 January 2009. Even though the UK operations performed well in fiscal year 2008, the German operations faced difficult market conditions throughout the year which has impacted on the Saputo's Dairy Products Division Europe (Germany and UK) as a whole.

Quota Prices (4.00%)	Clean	Lease	Exchange Rate €/£		Average Farmgate Milk Price: October			
					2008	27.31ppl	2007	26.51ppl
07/01/2008	0.20ppl	0.10ppl	0.90140		2008	27.31ppl	2007	26.51ppl
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)
December 08	19.2	20.4	27.19	4.53	1750	1750	2750	800
November 08	17.9	21.0	27.04	4.42	1750	1800	2750	780
December 07	15.4	28.0	28.84	4.63	2100	2350	2850	825
Retail Prices	Liquid Milk (retail) (ppl equivalent)		Doorstep (ppl equivalent)		Butter Branded (p/250g)		Mild Cheddar Non-branded (p/kg)	
December 08	68		100		111		672	
% change vs December 07	+9.7%		+8.7%		-9.0%		+10.5%	

*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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