



Dairy Market Update

16 September 2010

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Commodity prices rising again

After a few months of declining prices, there are signs that the protein market is rising again. The strongest signal came from the Fonterra auction where the latest average price for SMP reached \$3,229/tonne for delivery between November and May, 16.6% higher than in July and the equivalent of £2,089/tonne, above the UK SMP price which stood at £1,900/tonne in August. Some commentators explain that this surge is probably due to the drought in Russia, which impacted domestic production. Russia is the world's largest importer of dairy products and imported around 100,000 tonnes of SMP in 2009. This drought could therefore increase the demand of dairy products on the world market. On the European market, the EU managed to sell 1,700 tonnes of SMP at €2,110 to €2,130/tonne (£1,750/tonne) from intervention stores for the first time since the intervention opened in 2009. Although the quantities remain small, this is another indication that prices are firming, despite 33,000 tonnes that came out of intervention since May under the 'deprived persons' scheme to charities. The latest quotation in Kempen in Germany confirmed this trend by reporting this week a rise of €125/tonne to €2,325/tonne (£1,942/tonne) in the average price of food SMP.

In context:

Most operators are expecting the fat market to firm during the autumn. The outlook of the protein market was more uncertain due to the high level of SMP in EU intervention stores and uncertainties over the supply and demand situation on the world market. However, the latest news would suggest that SMP prices could rise as a result of a buoyant world market. This could result in a rise in the UK farmgate price, which is still lagging well behind the current market: AMPE stood at 29.6ppl in August.

GB processors at the bottom of EU league table

The latest Dutch LTO EU league table shows that the two GB processors Dairy Crest (Davidstow) and First Milk stood at the bottom of the table at the 14th and 16th position respectively with only Kerry from Ireland slipping in between the two. Between July 09 and July 10, GB processors have increased their price by less than the majority of their European counterparts. Back then, Dairy Crest and First Milk were paying a price close to the average but have since fallen down the league table.

Rank	Companies (ppl)	July 09	July 10	Diff 09 vs 10
1	Hameenlinnan.O. (FI)	33.19	31.56	-1.64
2	Danone (FR)	26.31	30.81	4.50
3	Sodiaal (FR)	28.26	29.61	1.35
8	FrieslandCampina (NL)	19.50	27.44	7.93
9	Arla Foods Denmark (DK)	21.72	26.68	4.95
10	Humana Milch Union (GER)	20.26	26.49	6.23
14	Dairy Crest Davidstow	24.80	25.71	0.91
15	Kerry (IR)	19.38	25.66	6.29
16	First Milk	21.80	22.47	0.67
	Average	22.59	27.33	4.74

In context:

This league table confirms the fact that GB processors have increased their price by much less than the majority of the other EU processors over the last year. This is in part due to the structure of the UK dairy industry which is less dependent on fluctuations in the commodity markets. This means that UK milk prices resist better than others when markets are down but are also less reactive when markets are up. However British dairy farmers receive one of the lowest prices in Western Europe over the long run.

Low fat milk proving popular

Latest information from Kantar Worldpanel shows that the low-fat milk category (including 1% fat milk) has experienced substantial growth in the last year. Data for 52 weeks ending 8 Aug 2010 shows low-fat milk at 311m litres, an increase of 166m litres over the previous year. This gives the category a 6.6% share of the retail market compared to 3.2% for the same period last year. Low-fat milk has gained some market share at the expense of the three other categories.

In context:

With low-fat milk doubling its market share, the amount of butterfat required for the retail liquid milk market has fallen from an average of 1.85% per litre in August 09 to 1.82% per litre in August 10. This means that the equivalent of around 4,000 tonnes of additional cream would have been made by liquid milk processors as a direct result of this change in the pattern of liquid milk consumption. This represents only 1.6% of the UK production and would therefore have only a minor impact on the market for bulk cream. The change in the butterfat percentage at the farmgate level, of which the annual rolling average fell by 0.07 percentage point to 3.97% between the August 09 and August 10, would have had a greater impact.

CAP reform – what we can expect by 2015?

Herman Versteijlen, director of agricultural markets at the European Commission, gave a presentation at the DairyUK annual conference about proposed CAP reforms for the 2014 -2020 period and the first conclusions of the High Level Milk Group (HLG).

One of the most important points of the reform will be the budget. Despite lots of speculation that the CAP budget would fall as a result of Member States facing financial pressure, Mr Versteijlen believes that CAP funding will at least continue at its current level beyond 2015. This matters as many EU and UK farmers rely on CAP payments such as the Single Farm Payment to remain profitable.

The CAP reform is likely to follow the trend started in 1992: less money towards market support and more towards

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decoupled direct payments and rural development. Market instruments would only provide a safety net and he stated that the Commission was committed to phase out quota. The challenge of the future CAP will be to find alternative ways of managing supply and demand in order to reduce price volatility.

In context:

The CAP reform is still at an early stage: the Commission will communicate its views in November 2010 and make legal proposals in the summer 2011 which will have to be approved by the Council of the EU and the European Parliament. If Mr Versteijlen's tentative conclusions are right, the overall level of support from the CAP to European farmers would remain the same thanks to an unchanged budget. Some questions remain around the consequences of the removal of quotas and which alternatives would be implemented to manage supply and demand and make the supply chain work efficiently and fairly.

Retail cheese market grows at fastest pace ever

The UK cheese market continues to grow strongly, with Kantar Worldpanel data showing that sales volumes were up 5% year on year to 404,000 tonnes in the 52 weeks ending 11 July – equivalent to a rise of 19,000 tonnes, the biggest year-on-year growth ever recorded by DairyCo. A high level of retail promotion has pushed down the average retail price of a kilo of cheese by 2.3% to £5.96/kg.

In the Cheddar market sales were up 5.8% to 223,000 tonnes, with branded Cheddar showing the greatest growth up 21.9%. This was largely at the expense of value label, which declined by 18.5%. Promotions have pushed down the average price of branded cheddar cheese, which is now 6.1% lower than standard supermarket label Cheddar and only 13% higher than value cheddar.

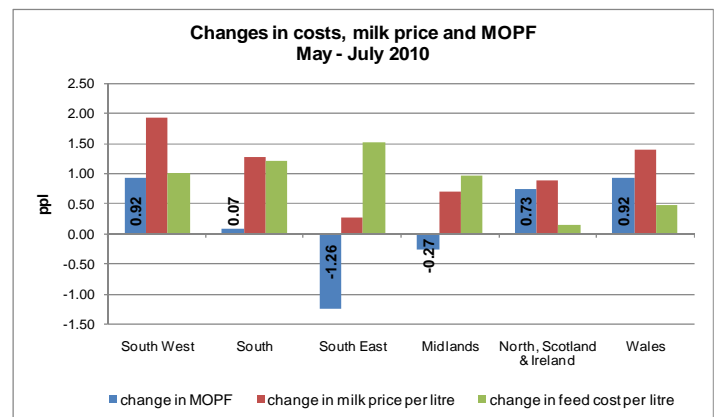
In context:

In the Cheddar category, the rise of branded sales should be a positive signal for domestic cheese makers as it enables

them to add value to milk. However, the question is whether branded Cheddar will continue to be sold at a lower price than own-label Cheddar and if not, would consumers be loyal to brands or revert back to own-label Cheddar?

Regional variations highlighted in Kingshay data

Feed costs per litre increased between May and July across all regions of the UK according to the most recent data from Kingshay. However, as the graph below shows, there are some important variations between regions with the South East experiencing the largest rise over the period while the increase was much less in North England, Scotland and Ireland. But increases in milk price are also variable from one region to another meaning that the changes in the Margin Over Purchased Feed ranged between -1.26ppl in the South East and +0.92ppl in Wales and the South West.



In context:

These data show that regions have been affected differently by factors such as feed costs, the weather and milk prices. Looking forward, with concerns over availability of winter feed and increasing feed costs, the milk price received will be critical in determining whether dairy farmers can maintain their margin over purchased feed.

Quota Prices (4.00%)	Clean	Lease	Exchange Rate €/£		UK Average Farmgate Milk Price: July				
	10/09/10	0.25	0.10	1.19700		2010	24.11	2009	22.99
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)	
	August 10	17.7	29.6	30.03	7.84	3,300	1,900	2,800	1,420
	July 10	18.0	30.0	29.68	7.95	3,300	1,950	2,800	1,430
	August 09	18.4	19.2	25.18	5.41	2,040	1,450	2,500	950
Retail Prices	Liquid Milk (retail) (ppl equivalent)		Doorstep (ppl equivalent)		Butter Branded (p/250g)		Mild Cheddar Non-branded (p/kg)		
August 10	66		101		129		633		
% change v August 09	-2.0%		+0.5%		+16.2%		+8.0%		

*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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