



Dairy Market Update

2 April 2009

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Ensuring a sustainable dairy supply chain

Although it is common across many primary production industries, for the primary producer of a commodity product to bear the vast majority of the price volatility within a supply chain; it is becoming increasingly clear that the current price fluctuations due to imbalances in global supply and demand may, in time, prove unsustainable for the British dairy farmer.

This week DairyCo has launched a new report entitled '*Ensuring a sustainable dairy supply chain*' which outlines where the industry currently stands and presents a number of points that the whole supply chain needs to consider.

The report stresses that the long term prospects for the global dairy industry remain positive, however the current period of increased volatility which is adding additional pressure to our domestic farmers over the short to medium term raises a number of concerns. If we continue to lose production, it could have the knock on effect of destabilising dairy processing, affecting economies of scale and processor investment. This in turn will mean that retailers may find it increasingly difficult to offer their consumers the current range of high quality British dairy products at an affordable price.

The report shows that 14% of dairy farmers responding to the 2009 DairyCo intentions survey stated they will leave the industry within two years and only 18% said they have the confidence to expand – the lowest figure since the survey started. If farmers carry out these intentions, UK milk production will fall to 12.1 billion litres by the 2010/2011 milk year, as the number of farmers expanding their business will not be sufficient to compensate for those leaving the industry. If this trend continues, by 2030 UK production could be just 7.5 billion litres meaning over 50% of dairy products will have to be imported.

Gross margins at different levels of the supply chain are also examined in the report. For mild Cheddar, the report shows that the retail price has increased by the equivalent of 10.38pppl when comparing 2008/09 with the previous milk year. Of this 10.38pppl extra paid by the consumer, analysis suggests that 9.70pppl was used to increase retailer gross margin. The price processors received increased by 0.69pppl, however processor margin fell by 2.06pppl as a result of farmgate prices increasing by 2.75pppl over the period.

The analysis suggests that on a number of occasions during recent months, processor gross margin has slipped to below 2pppl for mild Cheddar. It is unlikely that this 2pppl gross margin was sufficient to cover costs let alone allow for a profit margin.

Margins and prices for mild Cheddar						
	98/99		07/08		08/09	
	ppl	margin	ppl	margin	ppl	margin
Farmgate price	19.11		22.85		25.60	
Processor gross margin	3.32	15%	5.50	19%	3.44	12%
Processor selling price	22.43		28.35		29.04	
Retail gross margin	13.65	38%	16.37	37%	26.06	47%
Retail price	36.08		44.72		55.10	

While acknowledging the positive improvements made in the industry in recent years, for example the establishment of dedicated retail supply chains for liquid milk, the report also indicates a need for all parts of the dairy supply chain to recognise the potential vulnerability of the supply base and work together to build farmer confidence. This would boost domestic milk production and provide a platform for a sustainable dairy industry.

In context

If the supply chain works together to ensure the chain remains sustainable, then there can be continued investment in increasing efficiency and the development of new products throughout the chain, as well as securing future supplies which could help to safeguard against the issues of inability to meet consumer needs, food security and increasing global protectionism by other countries. Copies of the report can be obtained by calling 01285 646510 or downloaded from the DairyCo website www.dairyco.org.uk

Tesco announces price of 27.43pppl

Following a review of its Promar cost tracker, Tesco has announced that from 1 April, all members of the Tesco Sustainable Dairy Group (TSDG) who have signed up to Promar FBA costings will receive 27.43pppl for the next six months. Members who have not signed up to Promar costings will not receive the associated 0.5pppl premium and will receive a milk price of 26.93pppl.

The results of the Promar cost tracker revealed production costs had fallen by 1.05pppl compared with the previous budget. Most notably variable costs, including feed, fertiliser, AI and costs associated with rearing replacement heifers, fell from 14.23pppl in 08/09 to 13.48pppl in 09/10; a fall of approximately 5.3%. There was also a 4.6% fall in overhead costs, including fuel, wages, water, rents, rates and interest charges. The overall price reduction of 1.32pppl also consists

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of 0.27ppl as a result of the removal of the 'market adjustment' reflecting reductions in the value of cream over recent months.

In context

In the past, movements in the TSDG milk price have been seen to influence the price paid by other milk buyers. However, with many processors already having cut prices by more than the 1.32ppl announced by Tesco it is likely that the gap in price between farmers on dedicated liquid contracts, and those who are on non-aligned liquid contracts or who supply markets more susceptible to commodity price movements, may widen.

Prices increases at the latest UDF auction

The United Dairy Farmers (UDF) auction for March reported 45m litres of milk sold on one month contracts, at an average price of 18.83ppl, a 1.01ppl (5.7%) rise from the previous month's auction. However, this price is 3.78ppl (16.7%) below the average price reported at the March 2008 auction.

An increase in the average world price of Whole Milk Powder (WMP) by \$250/tonne (13.5%) to \$2,100/tonne may have partly influenced the increase, as Northern Ireland is a significant producer of WMP. The continued weakness of Sterling makes WMP from NI more attractive on European and world markets. Reasons for the increase in the price of WMP include the amount of uncommitted product available from New Zealand falling between February and March; there is also a renewed interest from buyers.

On the world market, Cheddar cheese, Skimmed Milk Powder (SMP) and butter also saw an increase in value between February and March. There was increased demand for products from the EU and New Zealand over the period, due to a fall in the value of the US\$ making offers in Euros and NZ\$ relatively more attractive. UK wholesale prices remained sta-

ble at February levels with the exception of bulk cream which increased £30/tonne (4.0%) to £780/tonne.

In context:

It appears that price support policies such as intervention, export refunds and Private Storage Aid (PSA) are now beginning to stabilise prices close to intervention levels (IMPE currently stands at 19.9ppl). This situation is further helped by supplies falling due to various factors such as the weather and low returns.

In the UK the value of Sterling has increased intervention prices (set in Euros) by approximately £100/tonne for both butter and SMP, equivalent to around 1ppl. This has reportedly resulted in milk supplies in the UK being diverting into butter and SMP production. By 6 March, around 25% of February's UK butter production (2,023 tonnes) and more than 50% (3,570 tonnes) of SMP produced in February had been sold into EU intervention. In a continuing volatile climate, and with considerable stocks of butter and SMP building in the EU, it is unlikely that there will be any significant increase in domestic commodity markets in the short term.

Dairy Crest sells its share in joint venture

Dairy Crest (DC) has sold its 49% stake in joint venture, Yoplait Dairy Crest (YDC), to Yoplait S.A.S. The sale is worth £63.5m and will see DC's net debt reduced to £435m. News of the sale caused the processor's share value to increase by 15% (33.0p) to 257.5p on the day the sale was announced. The move comes as DC looks to concentrate on its core brands, with the company reporting sales of Cathedral City, Country Life and Clover all performing well over the past year.

DairyCo's Dairy Wizard, including the popular Slurry Wizard, now includes the most up to date information on the NVZ regulations. To order a copy email suze.attaway@dairyco.org.uk or ring 01285 646510.

Quota Prices (4.00%)	Clean	Lease	Exchange Rate €/£		Average Farmgate Milk Price: January				
	30/03/09	0.20ppl	0.10ppl	0.92960	2009	25.57ppl	2008	25.81ppl	
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)	
	March 09	19.9	19.6	24.63	4.42	1950	1550	2500	780
	February 09	19.3	19.6	24.52	4.25	1950	1550	2500	750
	March 08	16.8	25.8	28.06	5.21	2150	2100	2850	930
Retail Prices	Liquid Milk (retail) (ppl equivalent)		Doorstep (ppl equivalent)		Butter Branded (p/250g)		Mild Cheddar Non-branded (p/kg)		
March 09	68 (average price for the 4 weeks ending 22/02/09)		100 (average price for the 4 weeks ending 22/02/09)		106		661		
% change vs March 08	7.9% (average price for the 4 weeks ending 24/02/08)		7.5% (average price for the 4 weeks ending 24/02/08)		-12.4%		+8.7%		

*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.

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