IFA SPECIAL EDITION LIQUID MILK NEWSLETTER

Issue 1
Volume 5

August 2010

DAIRIES MUST CO-OPERATE ON THE IRISH MARKET

Message from the Chairman

Padraig Mulligan
Chairman, National Liquid Milk Committee

While dairy markets and creamery milk prices have thankfully recovered closer to viable levels in 2010, securing a viable liquid milk price, especially over the coming winter months, will prove challenging for producer groups and their negotiators.
This is because, especially over the last 12 months, the retail returns secured by dairies from the multiples have come under unprecedented pressure. While the large supermarkets are unrelenting in their demands for ever better terms, so that providing value to consumers does not imply reducing their own margins, the fact is that our dairies are not innocent in the process.

With approximately 11 Republic of Ireland dairies operating 15 plants competing on the market—to say nothing of the few Northern Irish players—it has been easy for the multiples to play one off against the other. However some dairies have also unilaterally given away margin to retailers in a bid to increase their market share, or have done so to protect their volume in the face of challenges by competitors.

The trouble is that what used to be a high value consumer market contributing significant cash flow into the co-ops involved, is now getting closer and closer to returning only marginally more than commodities.
Who pays for these unwise moves is always the farmer, and not just the liquid milk producer who finds it difficult to secure a sufficient price to cover the cost of winter and/or year-round production.
The significant profits returned from the liquid milk market have, over the years, made a very valuable contribution into the Irish dairy industry. When commodity prices were on the floor, liquid milk and cream sales could always be reckoned with to bring in a steady and strong cash flow into each co-op involved in the business.
It is in the best interest of all co-ops and all dairy farmers to ensure that as much as possible of the value from that sector is retained within the industry, where the bulk of the costs in the chain is incurred, and wherefrom a fair share can be returned to liquid milk producers.
This can only happen with greater co-operation and consolidation among dairies.

All co-ops involved must heed the advice from the Harvard School of Business report for Bord Bia, and practice "co-opetition" - that is they must co-operate constructively, and avoid the pointless cut-throat competition that is commoditising our business.

Padraig Mulligan

36 C/L + VAT NEEDED IN 2010 TO PROVIDE BASIC WAGE

Based on the results of the Teagasc National Farm Survey, Teagasc Spring and Winter Profit Monitors for 2009, and on figures done by IFA with FMP and Connacht Gold Liquid Milk Producers, we estimate that the cost of producing liquid milk year-round is approximately 13% above the cost of winter production, or 25% to 30% greater than the average cost incurred by a spring creamery milk producer.

Teagasc forecast that average creamery milk production costs in 2010 will be around **23c/l before own-labour**, this means that, to cover bare costs, the average year-round liquid milk producer would need an annualised milk price (the average between summer and winter price) of **no less than 30c/l.**
However, this does not factor in any payment for the farmer's own labour.

The table below outlines what prices a **300,000 litre liquid milk producer supplying half of his overall production as liquid milk** would need to break even, make a basic wage, an average industrial wage or to earn the same as the average dairy sector employee.

This is a very telling table. At current manufacturing milk prices of around 28.5 to 29c/l + VAT, this farmer would need to receive **36c/l + VAT** for the liquid milk portion of his production to make a very basic wage of €21,000. In 2009, liquid milk producers earned no more than 31c/l + VAT annualised.

An **average industrial wage** of €36,000—a very modest reward— would require a manufacturing milk price of **35c/l + VAT** and a liquid milk price of **42c/l + VAT**. Indeed, to earn as much as the **average person employed in the dairy sector**, the prices required would be respectively **36.5c/l and 43.5c/l**.

"In identifying an initial target of 36c/l + VAT annualised, the IFA National Liquid Milk Committee is setting out the very minimum producers can accept. Dairies must deliver the strong winter prices which will be needed in coming months to ensure that producers are paid a viable price in 2010,"

WHAT LIQUID MILK PRICE TO BREAK EVEN OR GENERATE A WAGE?

	Break-even*	Basic wage**	Avg indus wage***	Avg dairy sector wage***
Litres produced	300,000	300,000	300,000	300,000
Liquid - litres	150,000	150,000	150,000	150,000
Manufacturing - litres	150,000	150,000	150,000	150,000
Wage sought €	0	21,000	35,950	40,600
Profit required in c/litre	0	6	12	13.5
Prod costs on liquid milk - c/l	30.0	30.0	30.0	30.0
Prod costs on manuf milk - c/l	23.0	23.0	23.0	23.0
Liq price needed - c/l	30.0	36.0	42.0	43.5
Manuf price needed - c/l	23.0	29.0	35.0	36.5

* Break even only covers bare costs, no remuneration for farmer's own labour, no repayments
** Basic wage = as per Teagasc 5 to 8c/l - 6c/l here
*** avg industrial (Q3 2009) and dairy sector (2008) wages as per CSO's latest data

WHO GETS WHAT FROM THE LITRE OF MILK?

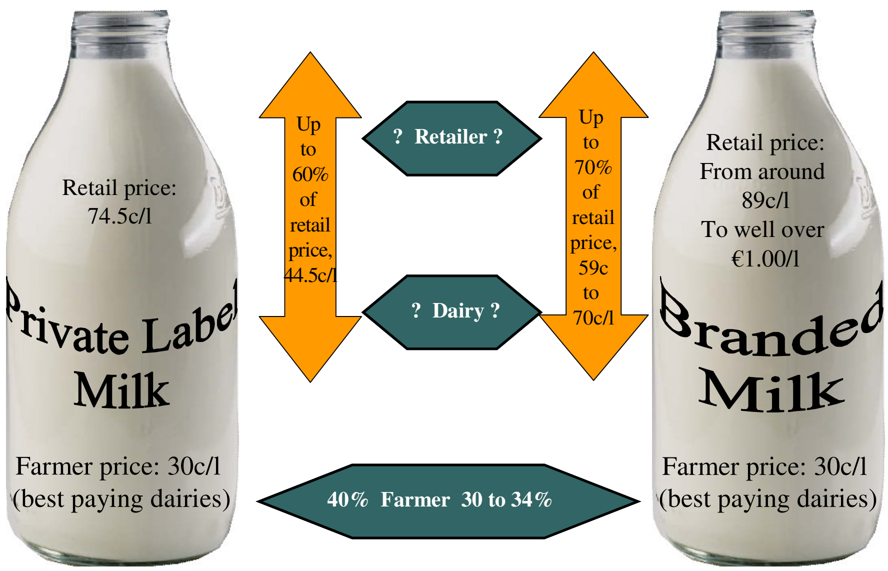
A few weeks ago, the National Milk Agency 2009 annual report revealed that the average price paid to liquid milk producers in the Republic of Ireland came to around 26% of the average retail price of milk—a historical low. Even the best paying dairies deliver only 30% to 40% of the retail price back to farmers (see right).
Measuring the producer's share based on a percentage of the retail price is a dangerous thing: a high percentage of a low retail price may not remunerate farmers adequately.

However, the limited level of transparency on margins makes them difficult to track. While the retail price is there for all to see, monitored and documented by CSO, and the price paid to the producer can be ascertained from milk statements and John Boylan's *Farmers' Journal* league, wholesale prices and the non-price elements which pass between dairies and retailers are unknown.

However, studies carried out in the UK by DairyCo, have shown that farmers' margins had been falling until very recent years, when retailers resorted to direct contracts with producers to secure supplies. Processor margins are generally holding, and retailers' margins are increasing (see graph below).

Padraig Mulligan said: "I welcome the commitment at EU level for greater transparency in the retail chain, but it must work for the benefit of primary producers as well as consumers. I also want to see greater urgency by our Government in bringing forward a legally based Code of Practice for the retail trade. This Code must be enforced by an Ombudsman whose mission must be to ensure not only that retailers do not abuse their power with suppliers, but also that primary producers receive a fair share of the retail returns".

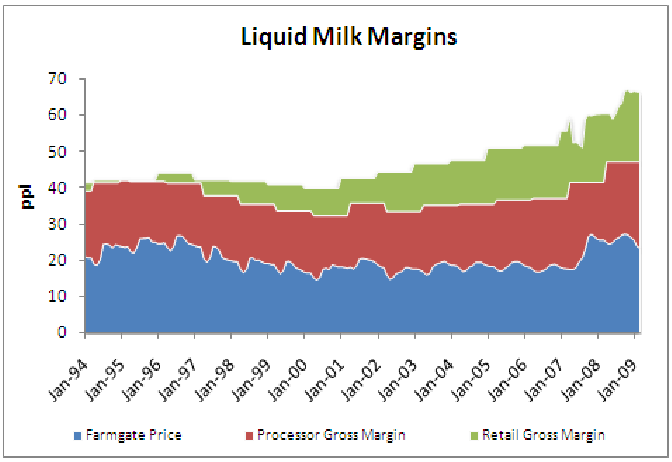
Notes: All figures below based on the price of 1 litre of ordinary milk sold in a 2 litre polybottle
The farmer price quoted is the 12 month rolling average for the best paying dairies

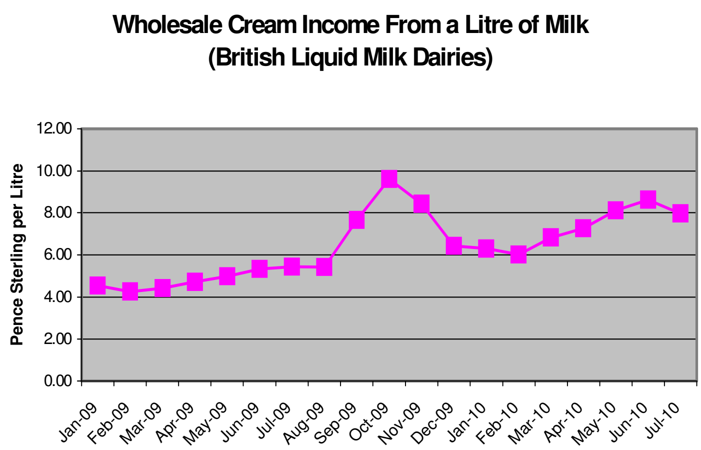


Based on published data, dairies and retailers share around 60% to 70% of the retail returns from milk. However, based on our understanding of the relative costs incurred, and bearing in mind that retailers demand additional contributions, it would appear the most generous margin relative to costs is firmly with the retailer.
If farmers are to receive a fair price allowing them to cover their costs, pay themselves a wage, and re-invest on their farm, this state of affairs must be challenged by our industry.

How much are cream sales worth to dairies?

Ongoing monitoring by the UK DairyCo (formerly the Milk Development Council) of the contribution to British dairies' profits of cream sales—which all originate from cream skimmed from liquid milk—gives us a useful insight, as equivalent figures are not available in Ireland. The graph below right, based on statistics compiled by DairyCo, shows that at the worst of the dairy slump in January 2009, British dairies were able to add over 4 pence per litre to their liquid milk income from cream alone. This figure rose to close on 10 pence per litre in November 2009, and is currently around 8 pence. At current exchange rates, this is equivalent to nearly 10 Euro cents per litre. We have no way of knowing Irish dairies earn exactly the same amounts from cream, but we can at least assume that there is an important contribution being made to their bottom line by cream on our market too.





The graph above outlines the latest figures available from DairyCo (March 2009) regarding the distribution of retail margins for liquid milk in the UK. In March 09, out of a retail price of around 66 p per litre, the retailer retained around 20p—a massive 30.3%. The producer and processor shared the remaining 70% approximately 50/50.

Compiled by: Catherine Lascurettes
Executive Secretary, National Dairy and Liquid Milk Committee
Contact: IFA, The Irish Farm Centre, Bluebell, Dublin 12
Telephone: 01 4500266 Fax: 01 455 1043
Web and email: www.ifa.ie catherinelascurettes@ifa.ie