icos DairyDigest

icos Irish Cooperative Organisation Society

July 2011

Cover Story

10% More Milk at €0 Capital Cost?

One of the great challenges facing the sector as it prepares for life post quotas is how to satisfy farmer's ambitions for expansion. May milk supply this year reached 726.9 million litres, a figure which was over 5% higher than the average for the past decade, and which put enormous pressure on existing processing capacity. Given that most commentators expect a further dramatic increase in milk supply once quotas disappear, farmers and their co-ops need, collectively, to consider how to process the extra milk.

The fact that the industry has the capacity to process in excess of 700 million litres per month at peak, yet only handles about 5.2 billion litres across the year means that it is operating at below 60% of installed processing capacity. This suggests that before anyone spends hard earned money installing new plant, farmers and their co-ops should give serious consideration to flattening the peak curve, and getting more milk through existing plant. Teagasc have demonstrated that adopting the optimum supply curve at farm level, to allow for the most efficient production of milk off grass would increase plant utilisation from below 60% to 65%. This would allow for almost 9% more milk to be processed with no additional capital expenditure requirement. So why don't we do it?

The cast in stone quota calendar date of April 1st has had a lot to do with our current supply curve, as has cow fertility and other problems. However, if it makes business sense for a farmer to produce milk to a slightly flatter supply curve, then he should be encouraged to do so. Co-ops around the world use rational milk pricing signals to encourage farmers to produce milk in such a way as to maximise plant utilisation, and ultimately reduce costs and boost farm incomes. These signals invariably involve applying a small deduction to milk supplied during a narrow defined peak period, and using these funds to pay a price premium at the times of year when milk is in short supply.

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Market Insight

Dairy Markets

Commodity Prices	Butter Index	Jun-11 SMP Index	Jun-11 Fonterra Auction WMP	Holland Milk Price per litre** (Irish solids)	May-11 Ireland Milk Deliveries
July	€4,212	$2,430	$3,638	33.40c	4.4%
June	€4,122	€2,460	$3,780	30.81c	Compared with same month in 2010
May	€4,003	€2,353	$3,859	€0.3081	
	Eurex*	Eurex*	GDT	FrieslandCampina - No seasonal deduction in July	

*: Eurex Futures Cash Settlement Price

**: FrieslandCampina Price Recalculated to reflect Irish Standard Constituents of 3.6% Butterfat, 3.3% Protein.

Global Production

Global milk production from January to April 2011 is up 3.2% on the same period last year, with EU milk production up 2.8%

In the case of Ireland, production for the first four months is up 18.3% on the same period in 2010. Across the main milk producing countries of the EU, milk volumes are up with production up 6.7% in France and 2.7% in Germany.

There has been some limited relief on the drought conditions experienced throughout Europe at the start of the summer period.

Overall global milk production is up 3% in the first four months of 2011 and consumption is forecasted to grow by just under 2% for the full year, a supply correction is required.

Markets

Markets for continental cheese have weakened over the last month while cheddar prices outside the UK retail sector are stable to firm although domestic and export demand both remain sluggish.

Butter markets have weakened slightly over the last month. Traded volumes remain low and there is evidence that buyers are only prepared to cover shorter periods in anticipation of price decreases.

Skim milk powder production is up on the previous year but the market remains fragile/weak in the context of a weakish US$ and absence of significant new 3rd country sales to absorb any additional supplies.

Powder markets are cautious as the outcome of the Algerian tender is awaited. Strong demand is required (China key) to absorb current stock and Oceanic output growth in Q4. Fonterra global dairy trade action on 5 July reported 7.8% drop in price.

'Milk Package' Report Adopted

Following months of discussion and review, the 'Milk Package' report has been adopted by the European Parliament AGRI Committee.

Stated Aim of Legislation

'To boost dairy farmers' bargaining power, they must be enabled to negotiate fairer prices through producer groups, pricing practices must be made clearer throughout the distribution chain, and dairies be legally obliged to report monthly purchases.'- Comm AGRI

ICOS strongly took the position that from an Irish context, 99% of the domestic milk pool was already controlled by farmer owned co-operatives, and that these structures had to be protected from a 'one size fits all' solution from Europe that would undermine existing successful cooperative structures.

Upping the Bargaining Power of Producers

Because of issues in Eastern and Southern Europe in correcting the imbalance in bargaining power between farmers and dairies, the formation of producers' organisations in these regions are encouraged so that farmers can negotiate raw milk deliveries for them and ensure that they get a fairer share of the price paid by consumers. Commission and Parliament officials stated to ICOS that their hope is that these producer organisation would evolve in time into co-operatives.

The volume of raw milk covered by such negotiations and produced / delivered in any Member State may not exceed 40% of total national production and 3.5% of the total EU production.

Compulsory Contracts

Under the new regulation, every raw milk delivery from a farmer to a processor would have to be covered by a written contract.

These contracts would have to be concluded before delivery, and would have to state a milk price fixed for no less than one year.

ICOS lobbied with its allies to ensure that co-ops are EXCLUDED from this regulation arguing that the statutes of a farmer owned co-operative already give producers terms, and to interfere with a system that has functioned to serve farmers interests for over 130 years would not constitute best practice.

This goal was secured, but the wording was slightly ambiguous as it said that co-ops were excluded if their statutes adhered to the conditions laid out above, so we have work to do on that score as the legislation enters co-decision.

Soft Landing

ICOS lobbied to secure inclusion of a recital in the legislative report calling on the EU institutions to re look at the provision of a real <u>'soft landing' for Milk Quotas.</u> ICOS will continue to work with it's counterparts within COPA COGECA (European Co-operative Group) and the Department of Agriculture to explore the possibility of concessions in this area.

Production volumes and average prices paid for raw milk would have to be declared each month. There has been a call for a Market Monitoring Agency to be established to collect and disseminate various production and supply data in order to give early warning of possible future milk market imbalances.

The report, drafted by James Nicholson (MEP, European Conservative Group, Northern Ireland), was approved with 34 votes to 3.

Application of the New Law when Fully Enacted

It is hoped that the New Rules will come into affect in 2012 after consideration in the co-decision process by the Council, Commission and the European Parliament.

Next Steps

The report will be put to a vote by Parliament as a whole by the end of the year.

What is twitter

Twitter is a free website which allows companies like ICOS to communicate to the world in real-time. We use Twitter within our ICOS Brussels office to help communicate with our members and partners on a daily basis. Over the past three weeks, ICOS Brussels has posted numerous updates on the on-going CAP & Milk Package negotiations. Any internet user can view these updates on-line at: <u>www.twitter.com/ICOS_BXL</u>

Frozen CAP Budget will mean Real Term Decline

EU leaders have announced that the key budget for Agriculture will be frozen for the period 2014-2020. This will mean a significant decline when 7 year inflation is taken into account.

Irish farmers and co-op members currently directly receive €1.7 Billion annually from CAP, and this represents over 85% of the money Ireland gets from Europe.

The agriculture budget has come under major pressure with the other policy areas looking to eat into the 42% of the total EU budget that is currently spent on CAP. The recent food security crises in all probability saved the CAP from a worse slashing.

ICOS is actively looking at other areas of the EU budget such as Innovation, Food Health Promotion and Sustainability where Irish Agri-Coops can take advantage of funding.

ICOS helps quash 'Frozen Butter' Label Threat

A potentially disastrous new law going through the European Parliament which would have forced exports of Irish butter be labelled 'defrosted' was quashed by ICOS lobbying this week.

Irish butter for export is frozen for storage and transportation and a new labelling law that was designed to alert consumers to meat that was from frozen, was going to encompass exported butter. This would have had major implications for our industry as our butter export market, especially our key *Kerrygold* brand, is sold as a premium product.

ICOS helped secure a derogation in the law for butter by arguing using scientific papers, that unlike in meat, there was no deterioration in quality or content when butter is frozen for export purposes.

The amendment to the proposed law was passed this week in Strasbourg by the Parliament.

MEP's Block move towards 30% Emissions Cut

Centre right MEPs have undermined efforts by Parliamentarians to rally the House's support behind an unconditional EU pledge of 30% carbon emissions cuts by 2020. Despite previous recommendations in a November 2010 European Parliment report to raise the cut target. MEPs narrowly passed an amendment making any move upwards on the current 20% target conditional on similar steps by other nations. ICOS strongly welcomes the vote.

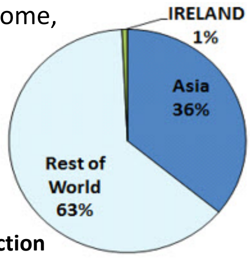
Global Milk Production

The Bi-Annual 'World Food Outlook' report by the UN Food and Agriculture Organisation published in June 2011, highlights some interesting global Milk Production Figures.

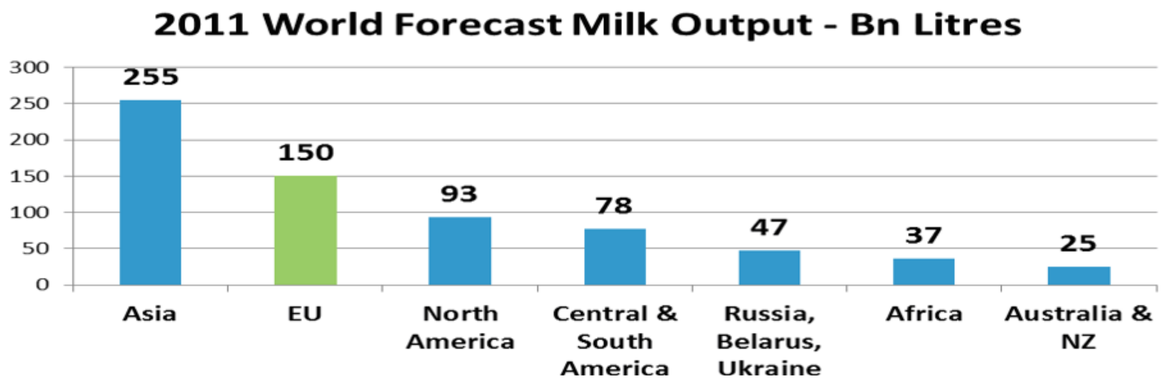
Report highlights include;

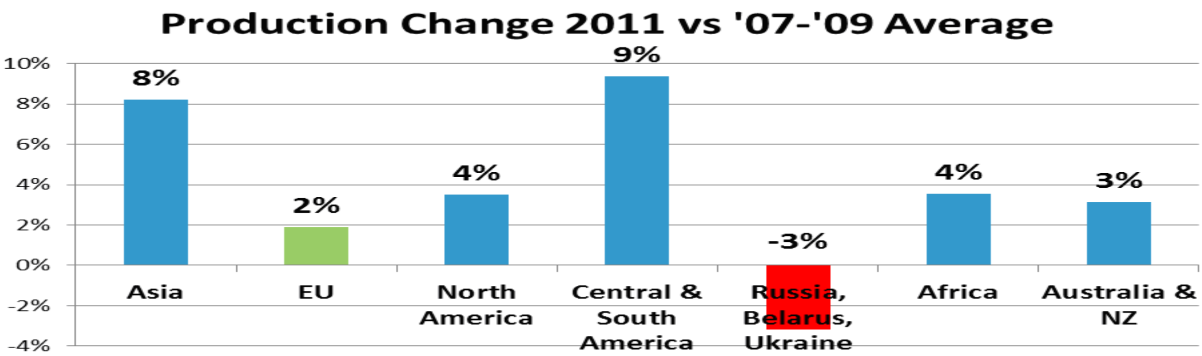
- Global Milk Production is forecast to reach 724 million tonnes (~700 billion litres) in 2011.
- World Milk Production is forecast to increase by 13 billion litres in 2011. This is equivalent to nearly 2½ times Ireland's national milk pool!
- Asia is now the largest milk producing region in the world. Asian milk production now accounts for approximately 36% of global milk production.
- Comparing 2011 Milk Production Forecast Figures with 2007 – 2009 production figures we see the highest production increase occur in Asia (+9%) and Central & South America (+8%).
- Production in India and China alone (159 million litres) exceeds that of the entire EU-27 (150 million litres).
- Continued growth in emerging markets points to both strong demand in these regions, but also highlights the evolution of the global dairy market.
- Quota restrictions in Ireland over the past 25 years have impacted upon our footprint in the global dairy milk production market. Ireland now accounts for only 0.75% of global milk production.

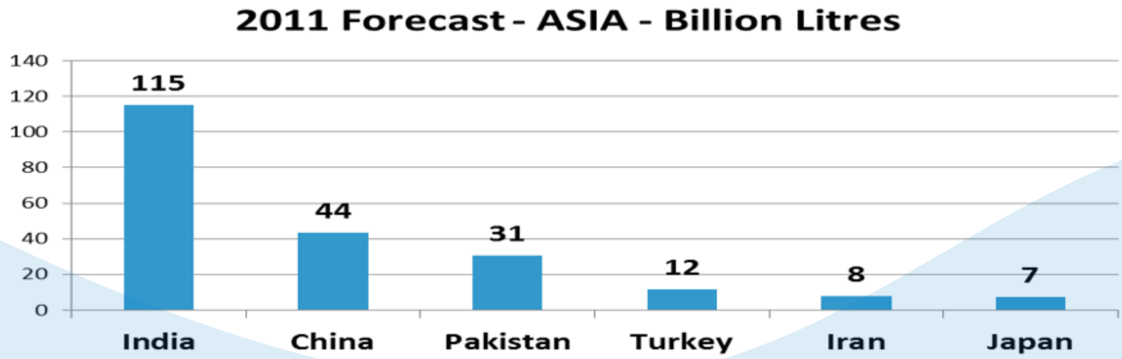
The main message for Ireland is that the world dairy scene is moving fast, and the main players are aggressively positioning themselves to achieve a position of dominance. The increasing influence of Fonterra on world markets, and the positioning of Arla and Friesland Campina within Europe and globally suggests that Ireland will face a huge challenge leading up to a after 2015. We will need to improve competitiveness at farm, plant and marketing level, with a significant increase in investment in innovation to satisfy growing and evolving markets. The recent KPMG study undertaken for ICOS and the industry proved how efficient the Irish processing industry has become, but it also highlighted the low level of profitability and investment. These will be the key challenges if we are not to be left behind by fast moving competitors.



Global Milk Production







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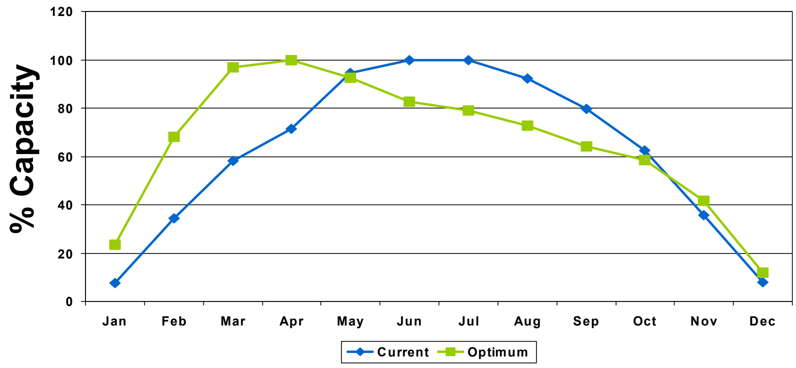
In some countries this is used to promote autumn calving for consumer foods businesses. In the Irish scenario, it would be different. What might be considered is an incentive for February, and perhaps March and November, paid for by a modest deduction in May and June. This could be done in a totally revenue neutral and transparent way, to ensure farmer confidence, and would, in effect, for the typical creamery milk producer, shift about a modest amount from May and June milk cheques, and pay it out in February, March and November, when, perhaps it would be of more value. It would also send a positive signal to producers to encourage them to adopt a more profitable milk supply curve.

It is important that this isn't interpreted as an attempt to push farmers away from efficient production from grass, or to penalise them in some way. Instead, farmers should welcome reasonable pricing signals which encourage them to produce milk more profitably, while minimising the requirement for capital expenditure on underutilised plant. It's in no-one's interest to spend several hundred million on new plant which is really only needed for a ten week period, and we should learn the lessons from other farmers and their co-ops.



Optimum Milk Supply Curve for Profitable Production Off Grass, (Source; Teagasc)

Welcome to Ireland

ICOS Welcomes Nuffield Scholarship Winners

ICOS would like to extend a warm welcome to Nuffield Scholarship winners on their visit to Ireland in July. Scholarship winners visiting include; Andrew Dewar, Robert Blatchford, Michael Inwood, Paul Lambert, and Aaron Sanderson from Australia, Dr Zoe Davies from the UK and Henk Smith and Djuke Vdmaat from Holland.

Each year, Nuffield Scholarships are presented to approximately 50 young agriculturalists in seven countries. ICOS, IFA, Farmers Journal, FBD Trust, and, the Peter Daily Trust sponsor Nuffield Scholarships in Ireland. The ICOS sponsored Nuffield Scholarship winner for 2011 is David Murphy, a Glanbia milk supplier. David's research will focus on the topic 'Dairy Co-Op's for the 21st Century'.

Snippets

Fleximilk Allocation

For the past number of years the distribution of used quota (fleximilk) required that 90% of the pool went to producers with a quota of less than 350,000 litres and 10% to producers with a quota of over 350,000 litres. This 90/10 distribution, when established in 2005, reflected the national producer profile. A current proposal from the Department, which will be confirmed later this month, is for the distribution criteria be changed to 75/25 thereby reflecting the current producer profile.

Fonterra Chairman to speak at Ulster Conference

ICOS welcomes Sir Henry van der Heyden, Chairman, Fonterra Co-operative, New Zealand to Armagh. Sir Henry will be speaking at Ulster Farmers Union, Dairy Industry Conference, in Armagh, on 8th July 2011.

Lactalis & Parmalat Merger

The European Commission has cleared the way for the proposed acquisition of Italian company Parmalat by French owned Lactalis. Lactalis made a €3.4bn bid to acquire the 71% of Parmalat that it does not already own.

Arla Continues on Acquisitions Trail

Arla Foods and Swedish owned Milko have announced that they are in discussions about possibly merging. Milko is owned by around 650 dairy farmers. Arla has made several acquisitions in recent years, including a merger with Express Dairies in the UK in 2007, and, a merger with Hansa Milch in Germany earlier this year. Arla have also announced recently that they will issue €150 million in new bonds to help finance their growth target of €10 billion sales per annum by 2015.

Market Movement

	€1 : US$	1€ : GB£	Oil Price (Brent) - US$ pbl	Carbon Spot: 1 EUA
July	$1.43	£0.895	$116.34	€13.38
June	$1.461	£0.893	$114.48	€16.70
May	$1.438	£0.877	US$112.63	€16.92

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