# The Dairy Sector

July 2013

## Introduction

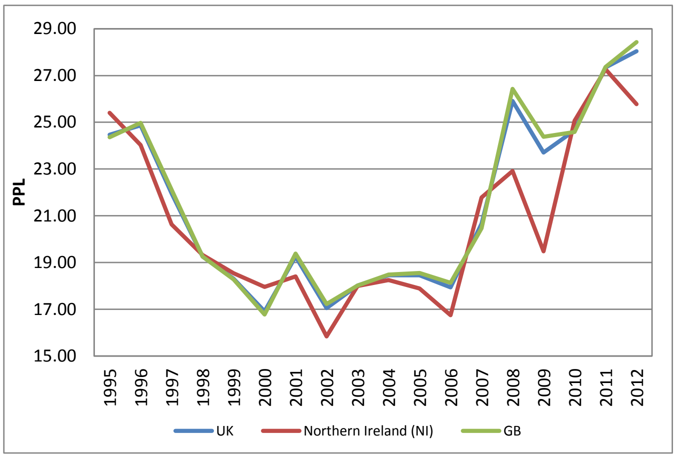
This research note gives an overview of the current state of the UK dairy sector with particular reference to the Welsh dairy industry. Dairy farming is the single largest agricultural sector in the UK, accounting for around 17 per cent of UK agricultural production by value, and **30 per cent** in Wales.[1,2] Numbers of dairy farmers in Wales have decreased. This has been associated with continued cost pressures. Farmgate prices for milk increased but by less than rises in inflation and production costs.[3]

## UK Farmgate Prices

UK average yearly farmgate prices for milk in 2012 were up by **2.5 per cent** year-on-year, reaching a high of 28.04 pence per litre (ppl).[4] This represents a **10.99ppl** UK rise from **17.05ppl** in 2002.[5] However, it is important to note that on-farm input costs have also risen.[6]

Estimates for 2010 showed that although the farmgate price rose by approximately 5 per cent the main dairy input costs of feed, fertilisers and fuel rose by around 7per cent over the year.[7]

**Figure 1: Average Yearly Farmgate Milk prices since 1995[8]**




*Source: Dairy Co Datum*

Several milk processors have increased their prices since October 2012, following a series of price cuts in the preceding months. Milk prices have increased by up to 3.1 ppl in the first six months of 2013.

The UK average yield per cow per year stood at **7,617 litres** in 2011/12.[9] Based on the average UK farmgate price for 2011/12 of **28.04ppl**, each cow's milk would be valued at **£2,136 per year**, to the nearest pound. The 3.1ppl maximum price rise would be equivalent to an extra £236 per cow in a year.

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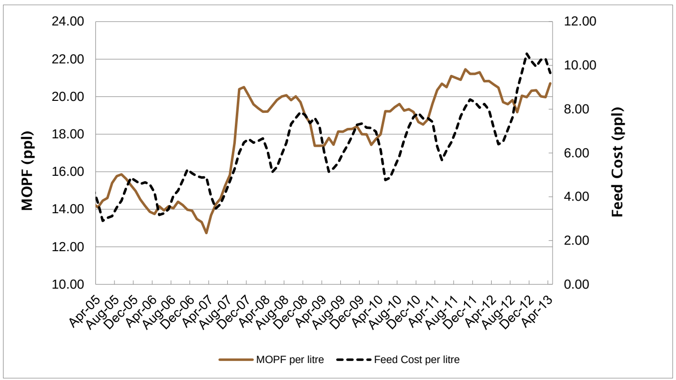
[1] Defra, ***Dairy farming and schemes*** [accessed 2 July 2013]
[2] Welsh Government. **Aggregate Agricultural Output and Income, 2012**, February 2013 [accessed 4 July 2013]
[3] House of Commons Welsh Affairs Committee, ***The Voluntary Code of Practice in the dairy sector***, May 2013 [accessed 4 July 2013]
[4] Dairy Co ***Liquid Milk Margins*** [accessed 4 July 2013]
[5] Dairy Co ***UK,NI and GB Farmgate Milk prices*** [accessed 4 July 2013]
[6] Dairy Co ***Liquid Milk Margins*** [accessed 4 July 2013]

[7] ibid
[8] Dairy Co ***UK,NI and GB Farmgate Milk prices*** [accessed 4 July 2013]
[9] Dairy Co ***Average Milk Yields***[accessed 4 July 2013]

## Cost of Production

Although feed costs have been rising over the period 2005-2013, this has been mitigated to an extent by the long term trend of increases in milk price and average yield per cow.[10] The margin over purchased feed (MOPF) increased slightly by **0.3 per cent** from 20.64ppl in April 2012 to 20.71ppl in April 2013.[11]

**Figure 2 Margins over Purchased Feed (MOPF) Costs 2005-2013 - UK[12]**




*Source: Dairy Co Datum*

This MOPF calculation reflects changes in feed price and does not account for changes in other associated costs such as fuel and fertiliser. Red Diesel fuel prices increased by about **14pence per litre** between 2008 and 2012, reflecting the rise in crude oil price over the same period.[13] Fertiliser prices have been rising steadily since 2010 although they have fallen slightly since a peak in May 2012.[14]

## Dairy Supply Chain Margins

In the past it has been possible to estimate profit margins for processors and retailers of liquid milk, however reliable information for processor selling prices for liquid milk is no longer available due to consolidation within the liquid milk processing sector. Whilst farmgate milk prices have risen in the past year, retail prices have not risen and so it seem likely that processor margins have not increased.

Across the market, retail sellers have avoided large changes in their profit margins. This is mainly due to the inability of processors to pass on higher input costs to retailers in the case of liquid milk[15] and retailers increasing retail prices to offset increases in processor prices in the case of mature and mild cheddar.[16]

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[10] Dairy Co ***Promar Milkminder Dairy Costings*** [accessed 4 July 2013]
[11] ibid
[12] Dairy Co ***Promar Milkminder Dairy Costings*** [accessed 4 July 2013]
[13] Dairy Co ***Fuel Prices*** [accessed 4 July 2013]
[14] Dairy Co ***UK Fertiliser Prices*** [accessed 4 July 2013]
[15] Dairy Co ***Liquid Milk Margins*** [accessed 4 July 2013]
[16] Dairy Co ***Mature Cheddar Margins*** [accessed 4 July 2013]

**Table 1: UKDairy Supply Chain Margins**[17]

*Gross Profit Margins (ppl)*

| | Liquid Milk (2010/11) | | Mature Cheddar (2011/12) | | Mild Cheddar (2011/12) | |
|---|---|---|---|---|---|---|
| **Supply Chain** | **ppl** | **margin (%)** | **ppl** | **margin (%)** | **ppl** | **margin (%)** |
| Farmgate milk price | 25.1 | – | 28.1 | – | 28.1 | – |
| Processor gross margin | 13.6 | **35** | 5.9 | **17** | 3.2 | **10** |
| Processor selling price | 38.7 | – | 34.0 | – | 31.3 | – |
| Retail gross margin | 20.2 | **34** | 32.2 | **49** | 27.8 | **47** |
| Retail price | 58.9 | – | 66.2 | – | 59.1 | – |

*Source: Dairy Co Datum*

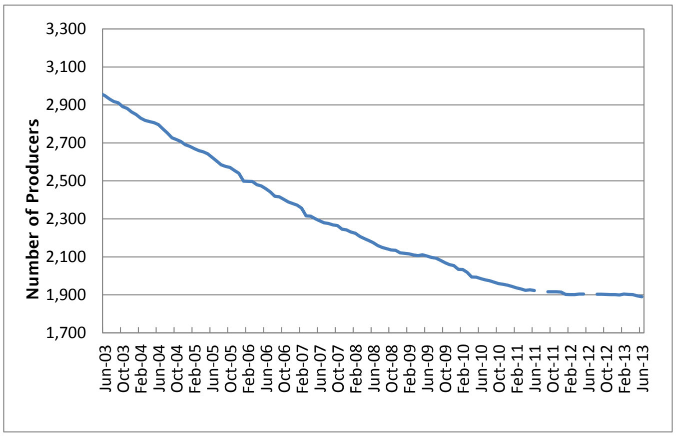
## Milk Supply

UK daily milk deliveries to dairies for 2012-13 were generally lower than the 3 year average, with an average of 35.5 million litres/day.[18] Liquid milk production for the 12 months ending April 2013 was **down 2.9 per cent** on the previous year with production at 6.85 million tonnes.[19] For the same period, cheese production was down by **5.3 per cent**, and butter production was up by **4.4 per cent**.[20]

## Welsh Milk Producers and Production

In July 2013 there were 10,540 dairy producers (cattle, sheep, goats) across England and Wales, a **51 per cent decline** from 2000 (21,772 producers).[21] Of the remaining farms 1,890 are in Wales, with the greatest numbers in the Dyfed (1,095 producers) and Clwyd (350 producers) agricultural regions.[22] In 2013 there were 220,032 dairy cows in Wales, a **25 per cent decrease** since 2006.[23]

**Figure 3: Welsh Dairy Producers Numbers Since 2003**




*Source: Welsh Dairy Co Datum*

## Milk Contract Availability in Wales

The availability of milk contracts to suppliers varies across Wales, with producers in the east having typically more contract opportunities than their counterparts in the west.[24] Wales is not unique in this situation, producers closer to large consumer populations generally have greater access to contracts than those located in remote areas.[25]

[17] Dairy Co ***Dairy Supply Chain Margins*** [accessed 4 July 2013]
[18] Dairy Co ***UK Daily Milk Deliveries*** [accessed 4 July 2013]
[19] Dairy Co ***UK Dairy Product Production*** [accessed 4 July 2013]
[20] Dairy Co ***UK Dairy Product Production*** [accessed 4 July 2013]

[21] Dairy Co ***UK Producer Numbers*** [accessed 4 July 2013]
[22] Dairy Co Wales ***Wales Producer Number*** [accessed 4 July 2013]
[23] Dairy Co Wales ***Wales Dairy Cow Numbers*** [accessed 4 July 2013]
[24] Dairy Co Wales ***Scoping Study of the Welsh Dairy Processing Sector*** 2011 [accessed 4 July 2013]
[25] ibid

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**Table 1: Welsh League Table – Annual Average Contract Price (May 2013)**

*pence per litre (ppl)*

| Company | Annual Average Price |
|---|---|
| First Milk Tesco [1] | 32.49 |
| Arla Foods AFMP | 29.98 |
| Meadow Foods Compositional - Level | 29.94 |
| Meadow Foods Compositional - Seasonal | 29.88 |
| First Milk Liquid A | 29.43 |
| Arla Milk Link Llandyrnog Direct - Seasonal | 28.95 |
| South Caernarfon Creameries | 28.93 |
| Joseph Heler | 28.89 |
| Saputo - Level | 28.8 |
| First Milk Liquid B (Manufacturing pool) | 28.79 |
| Arla Milk Link Llandyrnog Direct - A&B | 28.76 |
| First Milk Compositional | 28.58 |
| Saputo - Seasonal | 28.42 |
| Glanbia Llangefni | 28.34 |

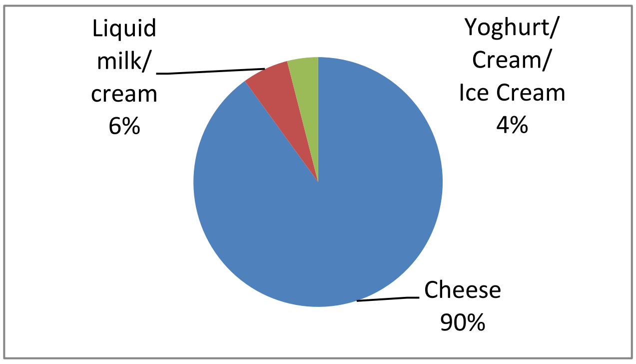
[1] Included is a 0.50ppl bonus which farmers get when they signed up with the Promar costings survey.

## Dairy Products 'Made in Wales'

Around 51 per cent of milk produced in Wales is then processed in Wales, the remaining 49 per cent is processed in England. The Welsh dairy processing sector is dominated by cheese processing; totalling 20 of the 45 recognised dairy processing establishments. Most of the milk processed in Wales is converted in to cheese.[26] Cheese contracts are traditionally lower priced than liquid milk.[27] Cheddar and Mozzarella / pizza cheese are two of the main cheese products produced, with Cheddar and other hard pressed cheese amounting to 60 per cent of Welsh cheese production[28].

[26] Dairy Co Wales ***Scoping Study of the Welsh Dairy Processing Sector*** 2011 [accessed 4 July 2013]
[27] ibid
[28] ibid

**Figure 4: Dairy Products Produced in Wales in 2010[29]**




*Source: Welsh Dairy Co Datum*

The relatively small local population and the distances from dairy farms to large consumer centres such as London or Birmingham have been identified as reasons for the prevalence of cheese processors.[30] There is also no 'large scale' liquid milk processor in Wales capable of supplying the major supermarkets.[31]

## Voluntary Code of Practice

In September 2012, after a series of price cuts by milk processors in the summer of 2012, a **voluntary code of practice** for contractual relationships between dairy processors and producers was introduced.[32] The code applies to Wales, England and Scotland. As of March 2013, an estimated 85 per cent of British milk is bound by the principles of the voluntary code.[33] The code allows individual farmers to negotiate contracts and gives them the ability to leave contracts more easily if price changes occur. In June 2013 Alun Davies, Minister for Natural Resources and Food stated that a review of the effectiveness of the code would take place in 2 years time.[34]

[29] Dairy Co Wales ***Scoping Study of the Welsh Dairy Processing Sector*** 2011 [accessed 4 July 2013]
[30] ibid
[31] Dairy Co Wales ***Scoping Study of the Welsh Dairy Processing Sector*** 2011 [accessed 4 July 2013]
[32] House of Commons Welsh Affairs Committee, ***The Voluntary Code of Practice in the dairy sector***, May 2013 [accessed 4 July 2013]
[33] ibid
[34] Welsh Government, Alun Davies, ***Consultation responses to Dairy industry***, Cabinet (Written) Statement, June 2013 [accessed 4 July 2013]

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## Further information

For further information about **the Dairy Sector**, please contact **Nia Seaton** (**Nia.Seaton@Wales.gov.uk**), Research Service.

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**Enquiry no: 13/1791**