dependent on support (SP and ELS) to produce a business surplus. The results this year are shown in the table below;

Loam Farm Budgets - £/Ha	2007	2008	2009
Gross Margin	630	756	618
Overhead Costs	283	336	361
Rent and Finance	126	126	143
Drawings and Tax	100	100	100
Margin from Production	121	194	14
Single Payment and ELS	225	236	229
Business Margin	346	430	243

On this well-managed business, margin from production after farmer's drawings and a modest rent and finance charge is budgeted at £121 per hectare and £194 per hectare in 2007 and 2008 respectively. After support, business surplus rises to £346 and £430 respectively. But the 2009 budget shows a dramatic fall with a margin from production of just £14 per hectare once all cost increases have come through.

The worrying point from this example is that profitability without support could be short lived in the combinable crop sector unless output prices start to climb again. Although these businesses have the cushion of the Single Payment until 2012, the ELS will come to an end on many farms after 2009 and the Loam Farm example seems likely to be caught in the progressive modulation proposals due to start in 2009. This could have a big impact on many larger businesses that now exist.

CONCLUSION

The evident buoyancy of this sector needs to be balanced with caution over rising costs and future loss of support. Over the next few months decisions are expected on NVZ, water framework and post set-aside cross-compliance (UK), and the availability of key pesticides (EU). World wide government concerns over rising food cost and security of supply might induce EU and UK regulators to take some pressure off UK farmers……we will see. Farmers will respond given the price incentive and freedom to produce. Andersons' consultants are well placed to assist businesses to chart a profitable and environmentally responsible course in these volatile and exciting times.

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ARABLE BRIEF

2008

Better Prospects - Will They Last?

June 2008

ANDERSONS

the FARM business CONSULTANTS

INTRODUCTION

Since Cereals 2007 there have been unprecedented rises in grain, oilseed and pulse prices. This has led to some misguided conclusions about the profitability of the combinable crop sector. Average UK cereal yields in 2007 were 9% down and much wheat was sold forward at well below £90 per tonne – less than half the peak price for feed wheat. Prices for 2008 and 2009 are now around £130 per tonne, but volatility remains, and costs are rising frighteningly fast. So prospects have improved, but for how long? Many UK growers will find their costs of production for 2009 harvest approaching £130 per tonne. This article looks at the factors involved, and the actions that farmers can take to secure a profitable future.

PRICE PROSPECTS

The world went into 2007 harvest with very low all-grain stocks, and approaches the 2008 harvest with even lower stocks – especially for wheat. High global wheat plantings mean that, given normal harvests, wheat stocks should build whilst overall grain stocks would hold their own. The world market fundamentals are therefore still very finely balanced.

On the demand side no single factor can be held to account for the increased demand: population rise, economic growth, consumption habit change and biofuel use all contribute. It is the last (marginal) tonne (the difference between total demand and total supply) that determines price so a small change in consumption can make a major difference to price. Global grain demand is rising at approximately 2% per year and given a price incentive the world's farmers can meet this demand through planting more hectares and/or increasing yields. With more land in production and higher yields world grain stocks can easily start to re-build, but weather factors and imperfect economic conditions are just as likely to keep demand/supply tight and prices volatile.

Other factors such as currency and speculation have also played a part recently. The weak Pound against the Euro has favoured UK grain amongst European buyers, but beyond the EU the weak US Dollar has made grain from outside the EU more attractive. Speculation has added froth to volatile markets by as much as £25 per tonne, but speculation will only add volatility rather than affect fundamental price direction.

With the UK cereals market dominated by wheat, local supply and demand is important. Higher plantings and a return to normal yields could mean an additional 3 million tonnes to dispose of in 2008/09. Human, industrial and animal feed usage should increase as new plants come on stream and wheat regains its place in animal feed rations. However, wheat exports are almost certain to need to double from 1.2 million tonnes to at least 2.4 million tonnes from the 2008 harvest; maybe more if the planned bio-ethanol plant does not come on stream. With world wheat stocks expected to build this does make UK wheat price prospects uncertain especially if there is a very wet harvest affecting quality. For the 2009 harvest, bio-ethanol production could absorb more UK wheat thus limiting the need to export, but this will depend on price.

POLICY

CAP reform is set to be a minor policy player for the arable business – at least until after 2012. The Health Check proposals just published by the EU Commission will make changes affecting arable farmers, but none are likely to have a major effect. The main arable proposals are:-

- The permanent end to set-aside in 2009
- Further limitations on intervention (little UK effect)
- An end to the €45 per hectare aid for energy crops from 2010
- An end to the €55 per hectare protein crop premium from 2010
- Possible reduction in Single Payment from modulation/capping and National Envelope measures.

The above policies are expected to be agreed before the end of 2008. The currency effect should boost Single Payments from 2008 onwards depending on the rate at 30th September each year - currently the rate is 13% higher than for 2007. Some of any increase could be offset by increased modulation for larger farmers. For businesses receiving over €300,000 the proposed modulation rate would increase to 22% in 2012 compared to 13% for businesses receiving up to €100,000. At present it is not known how this modulation would interact with UK voluntary modulation.

The main policy effect on arable farms is likely to be the use of grains and oilseeds for biofuels. The main exporting regions of Brazil, the US, Canada and the EU have policies in place to encourage, through subsidies, the use of crops for biofuel production. Actual usage will depend on the price relationship between grains/oilseeds and fuel. If governments were to remove the encouragement to use biofuels for fear of the effect on food prices/security there will be a market effect. In the UK there is currently little production from the few bio-diesel plants in place and it remains to be seen whether two major bio-ethanol plants (using wheat) will go ahead.

PERFORMANCE

High output prices do not necessarily mean higher profit. With the lower yield in 2007 the cost of production per tonne rose considerably. For example Andersons' Loam Farm example had estimated costs of producing wheat of £97 per tonne which would have resulted in losses on some of the forward sales, but still substantial margins on later marketed crop. For 2008, and on the major assumption that fertiliser was mostly bought in autumn 2007, the estimated cost of production remains at £97 per tonne. This is because of an expected return to 9 tonnes per hectare yield, and is after allowing for very substantial fuel increases and additional depreciation from machinery replacement. For 2009 the cost of production rises to £115 a tonne because of increased fertiliser cost and further fuel increases. In addition some rental increase has also been assumed.

All businesses need to be aware of their cost of production on all crops and pay particular attention to the use of much more expensive inputs. Unfortunately the price of fertilisers is unlikely to reduce in the foreseeable future. As always, labour and machinery are a major part of the cost per tonne and with considerable re-equipping evident, depreciation costs on many farms will have increased considerably. It is to be hoped that the mistakes of the mid 1990's have been remembered and that over equipping and bidding up rents to unsustainable levels is avoided. If costs of production continue to rise, and crop prices fall back, combinable crop businesses will once again be dependent on the Single Payment to provide a profit.

PROFITABILITY

The prospects for profitability on combinable crop farms have changed dramatically in the last year. Andersons' Loam Farm example (600 Ha) was budgeted at last year's Cereal Event to be making a loss from production for 2007 and 2008 of £70 - £80 per hectare with the business