

2009

PROFITABILITY ROLLER-COASTER FOR CEREALS

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CONSULTANTS

INTRODUCTION

Last year we warned that high crop prices might not last, but we did not foresee the extent of the world price collapse. Some good profits have been made from the 2007 and 2008 harvests, although results have been variable depending upon region and timing of sales. Now many farmers have high-cost crops in the ground, often not looking too good, and it seems unlikely that crop prices will rise sufficiently to secure a profit from production in 2009. However, 2010 could be different. This brief article summarises some of the factors at play in these turbulent times and gives pointers as to how farmers can react.

OUTLOOK FOR PRICES

The very high prices in the 2007/08 marketing period were the result of many factors coming together, the main one being very low world stock levels after the 2007 harvest. High prices bring extra production and with no major weather events affecting the 2008 harvest world grain stocks were substantially rebuilt, particularly wheat. But they have not been rebuilt massively.

Recent low cereal prices are expected to result in lower world production for the 2009 harvest, but, with world recession dampening demand, usage may only just exceed production. Wheat stocks are expected to build further, but other grains will be in deficit. So the finely balanced situation means prices could move either way. Currently ex farm prices for feed wheat for November 2009 are around £125 per tonne. The combination of a poor harvest and a pick up in the world economy could see prices rise. A good world harvest and stagnant world growth could see prices fall.

World prices set the background for the UK producer, but local factors can be important – particularly currency and internal demand/supply balance. UK feed wheat price was typically about £84 per tonne ex-farm in autumn 2008, but if the Pound had not weakened against both the Dollar and Euro prices would have been as low as £65 per tonne. Currently the Pound is gaining in strength against both currencies, putting downward pressure on price, but world prices are rising because of some weather factors and that finely balanced situation. Currency is likely to remain volatile until the banking crisis is clearly behind us and the relative depth of recession in the UK compared to other economies is more certain.

The other major factor likely to influence UK wheat prices in 2009/10 and beyond is the prospect of a step change in

internal demand. The Ensus bioethanol plant on Teesside should be fully on stream for the 2009 harvest. This is on top of the new plant in Manchester now processing glucose and starch from UK wheat. Even allowing for a bigger than usual carry-over of wheat stocks, our estimates are for an exportable surplus for the 2009 wheat harvest of only about 1m tonnes compared to over 4m in 2008. For 2010, even allowing for increased planting and higher yields the addition of another ethanol plant on Humberside could reduce that exportable surplus to below 1m tonnes.

How quickly these new influences affect the UK market depends on the timing of plants coming on stream, but for 2009 and 2010 a large exportable surplus overhanging the market, as it did in 2008, does not look likely. Regional price differences could become marked, with the whole of the north of England (where all the new industrial plants are located) joining Scotland as a wheat deficit region. Any rise in feed wheat price is likely to be much lower in the south of England.

Currently world prices for oilseed rape and for protein crops are much stronger than they were, although still not high enough in many cases to leave a profit from production.

POLICY

The EU's Health Check of the CAP was agreed last November and looks likely to have even less impact on arable farmers than we outlined last year. The main effects will be:

- The end of set-aside, but mitigation proposals for English growers.
- 2009 is the last year for the €45 per Ha energy crop premium.
- The €5 per Ha protein crop premium is to go by 2012 – exactly how in the UK is still to be decided.
- No change to total modulation in England or Scotland (some increase for a few very large Welsh growers).

This all means that the current Single Payment (SP) should continue until 2012 with little change, and if the Pound stays weak specialist combinable crop growers can expect their SP to remain fairly similar to that in 2008. There is currently a proposal to top slice (under Article 68) all SP's in Scotland by 10% and redistribute the support to livestock farmers in the hills. This seems unlikely to be agreed. In England there seems little enthusiasm to adopt similar measures.

The most likely outcome from the protein premium is that growers will continue to claim it in 2010 and 2011 (worth

£10m in England to 5,400 growers) and then the money will be allocated to all entitlements in 2012.

The EU Budget Review will get underway in 2009 or 2010 and ultimately will have a major influence on the CAP after 2012. As it is of no immediate consequence we will only repeat our view that beyond 2012 there will still be a Single Payment (SP), but getting progressively smaller for arable farmers, and more emphasis will be placed on Rural Development support.

The set-aside mitigation proposals are of major concern for English arable farmers. The best way forward would be for DEFRA to drop this proposal and to concentrate on achieving the same objectives by working with Natural England and the industry to create a re-vamped ELS that attracts farmers either to renew or to join for the first time. With high quality environmental measures the required outcomes can be achieved with a relatively small area in environmental management.

Although support policy is taking a relative back seat for a while there will be plenty of other regulation to concern arable farmers: NVZ regulations, various pesticide issues, the Water Framework Directive and a new RB209. Other areas are climate change and the renewable incentives and these offer opportunities for arable farmers.

PROFITABILITY ROLLER-COASTER

Crop yields, crop prices and input costs have all been highly volatile over recent seasons. These are the main factors behind the changes in Andersons' Loam Farm example farm (600 ha) results set out in the table below:

LOAM FARM BUDGETS - £ per Ha	2008 Result	2009 Budget	2010 Budget
Gross Margin	685	471	598
Overhead Costs	366	333	335
Rent and Finance	128	139	154
Drawings and Tax	100	110	110
Margin from Production	91	111	1
Single Payment and ELS	255	267	265
Business Margin	346	156	264

On this well managed business, margin from production after farmer's drawings and a modest rent and finance charge was a profit of £91 per Ha in 2008, and is budgeted as a loss of £111 and £1 per Ha in 2009 and 2010 respectively. After support, business surplus rises to £346, £156 and £264 per Ha respectively.

The main reason for the drop in gross margin between 2008 and 2009 is a 230% increase in fertiliser costs. Overhead costs are budgeted lower in 2009 and 2010 mainly because of assumed lower fuel usage and price. As we forecast last year, profitability without support (achieved in 2007 and 2008) looks like being short lived, with the 2009 budget in heavy deficit before support and 2010 about breakeven. Taking feed wheat as an example, cost of production moves from £101 per tonne in 2008, to a budgeted £121 per tonne in 2009 and dropping to £113 per tonne in 2010. The influence of yield in cost of production per tonne is important; 2008 was exceptionally high, 2009 assumed to be below average and 2010 recovering to average. The main improvement in 2010 is a considerable drop in fertiliser price, and it would not require much of a lift in crop prices to get back to profit without support. If direct support is phased down after 2012 as we expect, combinable crop farmers will either require higher grain prices or have to improve their efficiency to remain as profitable as now.

CONCLUSION

British farmers can take some comfort that the recession in the UK economy has no direct link to farm incomes. However, world commodity prices are affected by global recession and combinable crop farmers are perhaps more exposed to volatility than other sectors. A weak currency is highly beneficial and has prevented a sharper downturn in profits.

It is important that arable farmers have a long term plan for the business to take into account financial, family and personal objectives. After 2012 the market will take on an even greater role as the SP decreases. It will become more important that farmers know the cost of production for the whole rotation, including break crops where appropriate, and that they have an input purchasing policy as well as a selling policy. Andersons' consultants are well versed in all aspects of both short term and longer term strategic planning of farm businesses.

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