ANDERSONS

Outlook
2018

ANDERSONS
the FARM business CONSULTANTS

Contents

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Outlook 2018 has been compiled with contributions from Partners, Directors and Consultants within the Andersons businesses. It is published by Andersons the Farm Business Consultants Ltd, which co-ordinates the presentation of the Andersons businesses throughout the UK.

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INTRODUCTION TO Outlook 2018

Welcome to Andersons Outlook 2018.

Seventy years ago, the UK Government created a comprehensive policy for the farming industry for the first time. Although the basis of payment has changed over time, the principle is unaltered – financial support with few conditions.

It is becoming clear, not least from the articulate observations of the Secretary of State, that future policy will be different from that of the past. In time, income support will be largely, if not entirely, replaced by payments for measures that create identifiable benefits for society as a whole. Those already involved in environmental schemes will know that this financial support will come at a cost.

Whilst this may seem a significant threat to UK farming profits, what is evident is that 'income support' has in many cases held back productivity and simply increased farmers' cost of production. This conversion of subsidy into increased costs needs no better illustration than the unrealistically high short-term rents that some UK farmers are prepared to pay for the right to farm land.

Andersons' consultants' experience is that there are opportunities for improvements in productivity, and therefore reductions in the costs of production, in all sectors of our industry. Without the clouding of the economics by income support, producers will be better able to see the true financial consequences of their management decisions. The prospect of a new farming policy might be daunting, but in time it will lead to a more robust, business orientated industry, much better equipped to meet future challenges.

We hope that you find Outlook 2018, written by members of all the Andersons' businesses, both informative and stimulating and, as ever, wish you all the best for a successful 2018.

John Pelham Nick Blake James Severn David Siddle Richard King

FARM BUSINESS OUTLOOK

Economic Prospects

Graham Redman

Despite the dire warnings beforehand, the UK economy has performed quite strongly since the Referendum in June 2016. Indeed, the short-term impacts of the Referendum have been positive in many respects; weaker Sterling makes UK goods more competitive to export, and imports dearer into the UK. Also, foreign currencies can buy more Pounds, so globally operating firms make more UK profit when their overseas income is repatriated to the UK. This also explains why shares have risen, making those with investments feel richer.

Yet growth slowed in 2017 and inflation rose to outstrip it, meaning real terms growth has vanished. Wage inflation remains minimal, despite the lowest unemployment rate since 1975, resulting in declining household spending power and people starting to feel poorer. A tight labour market would normally suggest rising wages levels (as with all resources, prices rise when supply is short). Indeed, the Bank of England (BoE) suggests the current rate of unemployment, at 4.3%, is what they refer to as 'full capacity' employment (there are always some people out of work for various reasons). This trend of high employment, but low wage growth, is not unique to the UK, but seen globally. The BoE cites two factors. The first is the growth of the new 'gig' economy, where people are employed for specific tasks, such as a taxi ride, rather than being in traditional full-time employment. This is making the labour market more fluid and transparent, with a wider range of employment options being created, albeit low-paid ones. Secondly, and arguably more fundamental, is the role that computers are taking in the workforce. Many 'middle ground' jobs are being replaced by software and algorithms, leaving high-earning entrepreneurs and managers at one end and unskilled workers on minimum wages at the other. Thus, the overall shift of work is becoming less skilled and of lower value.

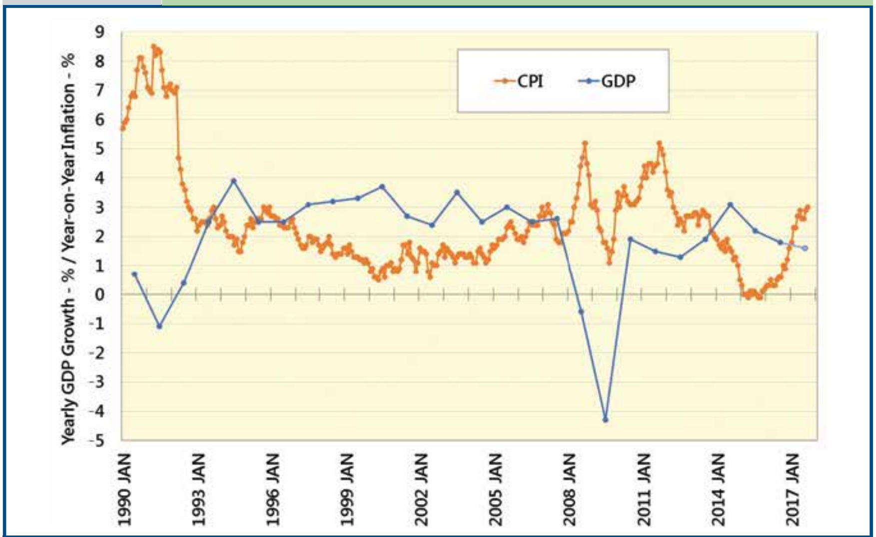
To some extent we see this in agriculture and the Brexit process might accelerate this if it affects the availability of seasonal migrant labour. The farm of tomorrow might have fewer workers with computers operating machines, one manager/computer operator and low paid staff to sweep barns, shovel manure or pick cauliflowers.

At the time of writing, members of the Monetary Policy Committee of the BoE are gently preparing the marketplace for a base rate rise in the short term, possibly even before Outlook is printed. Indeed, we may see two rises before the spring. Most in UK farming have minimal borrowings, but some will be affected by rising variable rates. Others will benefit from higher interest rates on savings. Arguably the greatest impact might be on land values, where very low-cost borrowed money has supported the market since 2009 (when base rates fell to half-a-percent for the first time ever). With higher costs of finance, and a greater incentive to hold cash, land prices might continue their downward trend. Of course, we recognise many other factors also affect the value of land (see later article).

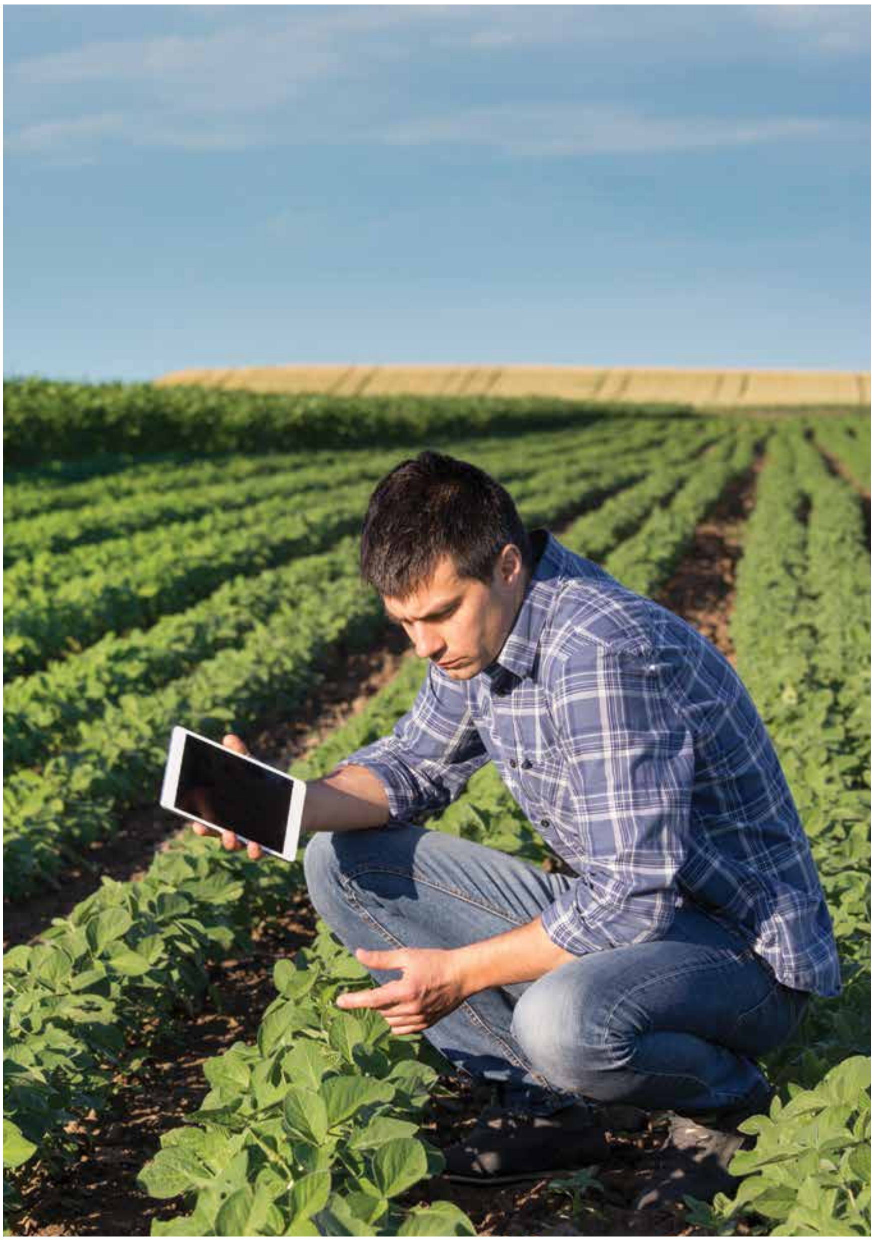
The trend of high employment, but low wage growth, is not unique to the UK but seen globally.

The outlook for the UK economy remains uninspiring, with most forecasts projecting growth of about 1.5% in 2018. This is partly reflecting the delay in business investment, whilst the mist of Brexit uncertainty hangs in the air. Once clarity on the future political and trading intentions is established, some confidence may be restored and entrepreneurs and senior managers will be able to make decisions on which areas of business to develop. This is true for large internationally trading businesses, but also smaller firms where prices are heavily influenced by global markets and trade flows, such as agriculture.

Figure 1 **Inflation and Growth - 1990 to 2017**



Source: ONS/Andersons



FARM BUSINESS OUTLOOK

Farm Policy

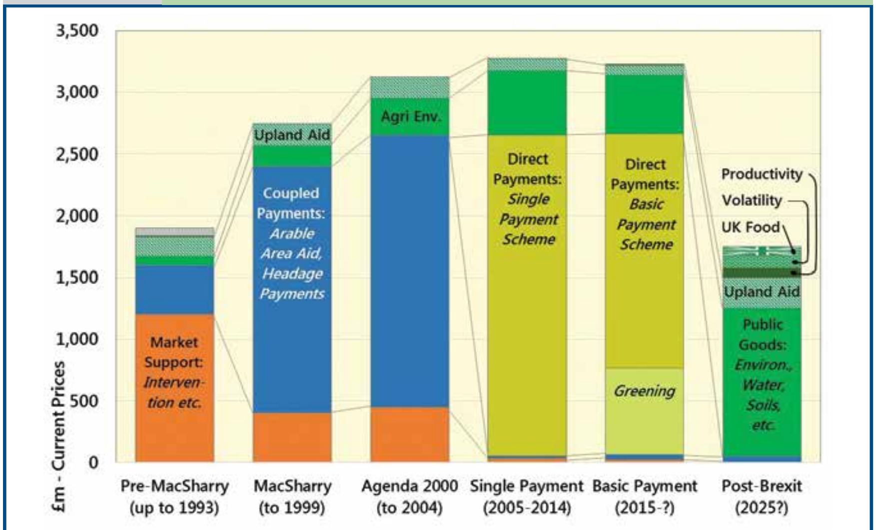
Caroline Ingamells

Support for UK agriculture has predominantly been through the Common Agricultural Policy (CAP) since the UK joined the European Economic Community (EEC) as it then was, in 1973. The vote to leave the EU means this will be no longer be the case and the UK will be able to draw up its own agricultural policy and set the rates for any support that comes with it. But until we leave the EU, UK farmers will continue to receive support through the CAP. The Government has also announced the agricultural sector will receive the same level of funding until 'the end of the current Parliament'. This is scheduled to be 2022, but could potentially be earlier. Whilst this guarantees the level of funding, it is not saying that the Basic Payment Scheme (BPS) will be with us until this date – it does not guarantee the 'system'. However, we would expect a system similar to the BPS to be rolled-over until a new policy can be agreed; this could be as late as 2021.

After Brexit funding for agricultural support will have to compete with other areas such as the NHS, education, security etc. It is our view that, over the medium-term the budget for a Domestic Agricultural Policy (DAP) is likely to reduce. A cut of 50%, compared to current levels, phased in by 2025, is not inconceivable.

DEFRA has not yet provided any details of what a future UK agricultural policy will look like, although DEFRA Secretary, Michael Gove, has given some indications of the direction of travel. A focus on the environment, hill areas, competitiveness and risk management tools all seem at the forefront of DEFRA plans. The long-awaited 25-year Plan for the Environment, which may finally be published as Outlook 2018 is at press, may provide some further clues. In our view, whilst it seems likely that a universal, area-based, 'income support' scheme (i.e. currently the BPS) will not disappear overnight, there seems little long-term future for this type of subsidy in the English lowlands. This is despite concerted lobbying efforts from parts of the farming industry to retain a BPS-

Figure 2 **Evolution of UK Farm Support - 1990s to 2020s**



Source: DEFRA / Andersons Amounts are approximate – exclude BSE/FMD payments like payment. From our viewpoint, it seems a wasted opportunity that effort is being expended on trying to preserve existing (some would say failed) systems, rather than looking to create something much better. Similarly, the fact that the industry has not been able to come together and articulate a single vision for post-Brexit farming policy speaks volumes about the Balkanised nature of the UK farming sector.

The lobbying effort will also be feeding-in to the new Agriculture Bill, due to be presented in autumn 2018. Ahead of this there is likely to be a White Paper in the New Year. It is not yet clear whether the Agriculture Bill will be a quite 'technical' piece of legislation, just allowing existing regimes to be rolled-over into UK law, or whether it will look to be more ambitious. Mr Gove may see it as a chance to hard-wire his views into future policy before he is (inevitably) moved on from DEFRA.

Looking to the immediate future, the Basic Payment Scheme will still be available to UK farmers in 2018. There are, however, some changes to the 'Greening' rules. The much talked about ban on the use of Plant Protection Products (PPP's) on Greening Ecological Focus Areas (EFAs) is being introduced for 2018. Most notably, this means no PPPs can be applied on Nitrogen Fixing Crops (NFC's) from the time of sowing the crop to harvesting. Many who have used beans and peas to satisfy their EFA requirement will have to find alternative options.

The Government has confirmed that all Rural Development agreements 'signed off' before Brexit will be honoured. The Countryside Stewardship Scheme (CSS) has been dogged by late agreement offers, slow payments and burdensome record keeping. Even so, there is expected to be a larger uptake this year as more start to understand the application process and perhaps some are even thinking that it may not be available for much longer. The scheme is expected to open again in 2018 for 1st January 2019 start date, but whether there will be a UK funded scheme in 2019, or a funding 'break' whilst new schemes are drawn up, is not known.

It seems a wasted opportunity that effort is being expended on trying to preserve existing (some would say failed) systems, rather than looking to create something much better.

In the summer of 2017 DEFRA announced a further £200m of funding for the socio-economic schemes of the Rural Development Programme for England. This included £120m under the Countryside Productivity Scheme (CPS). It is anticipated that funds will soon be made available to support farm businesses to invest in new infrastructure and machinery. A further £45m has been made available under the Growth Programme for projects which fall under the themes of Food Processing, Business Development and Tourism Infrastructure. In addition, funding remains available for the 79 LEADER Local Action Groups in England. The message remains – if you are considering a project, money may be available.

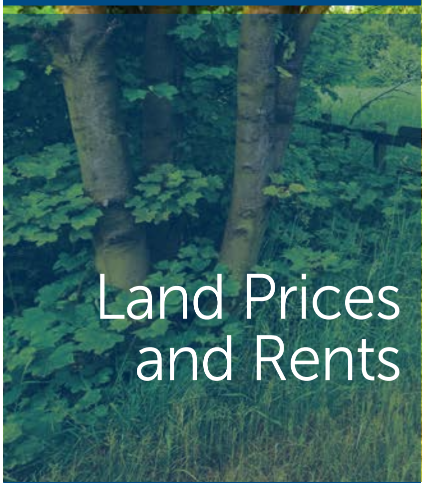
Across the Channel, the EU is preparing for the next reform of the CAP. For the past 40 years, the UK farming industry would be getting very excited about this, but Brexit has rather changed the dynamic. Still, it is important to our industry how farms in our nearest competitors are to be supported. The first official proposal for the CAP after 2020 is set to be published in November, whilst Outlook 2018 is at press.

Likewise, any trade deals negotiated by the EU will still have a big impact on our industry. The EU hopes to start talks shortly on Free Trade deals with both New Zealand and Australia. In addition, it is believed that the talks currently underway with the Mercosur block and Mexico could be concluded by the end of 2017. Agriculture remains a key-sticking point in the Mercosur talks - especially around how much South American beef may be imported into the EU. Any deals negotiated by the EU will need to be replicated by the UK on Brexit - simply to retain our existing trade advantages. The more deals the EU does, the bigger that task becomes.

Away from support and trade, bovine TB (bTB) continues to be a divisive policy issue as the disease persists in devastating the livestock industry. According to DEFRA, in 2016, more than 29,000 cattle were slaughtered in England due to bTB, costing taxpayers over £100m and taking a huge toll on many farming families. England currently has the highest rate of the disease in the whole of Europe. In autumn 2017 DEFRA announced further measures to help eradicate the disease. These include the grant of a further eleven new licences to cull badgers in areas of Devon, Wiltshire, Somerset, Dorset and Cheshire. Licences have also been granted for supplementary badger control in parts of Gloucestershire and Somerset which have completed their original four-year licence. A new bTB Advisory Service was also launched in October, offering advice to farmers.

FARM BUSINESS OUTLOOK

Land Prices and Rents



George Cook

In recent years the general trend for both capital and rental values for farmland has been upwards. The last couple of years has seen this growth halt and long-term trends in future prices are unclear, with Brexit adding to short term uncertainty.

As suggested last year, land prices in the last 12 months have at best been stationary and there is evidence in some areas of a modest fall. Market reports indicate that the difference between the parcels located in more 'desirable' areas and those in less accessible locations is widening further. The best land can still sell well, especially when there are a number of serious, interested parties. But vendors of 'second quality' farmland are being disappointed by the offers received and, in some cases, have been unable or unwilling to sell at all.

The coming year may well see some further softening of values as factors conspire to make buyers cautious. It is well known that the profitability of farming is not actually a large influence on land prices. Even so, the uncertainty over trade arrangements and the direction of support after March 2019 is already influencing sentiment and will continue to do so. The predicted rise in interest rates (see other articles in Outlook) will still leave borrowing cheap in historic terms, but it will signal that the cost of servicing debt is on the rise. The tax advantages of owning farmland have helped drive prices upwards over the last 15 years. If a hard-left Government under Jeremy Corbyn was to be in power the existing reliefs such as Agricultural Property Relief may be under threat. Whole new taxes such as a Property or Land Tax may be dreamt-up.

Against these drivers must be set the inherent desire of most farmers to own (more) land. Infrastructure projects and general development squeeze the supply available and release funds in the form of compensation or 'rollover' money which looks for land to buy. Therefore, a collapse in values seems unlikely, but the ever-upwards trend of recent years does seem to have ended.

A similar trend is emerging with rents, and particularly Farm Business Tenancy (FBT) rents, which have seen some weakness. Agricultural Holding Acts (AHA) are usually less volatile and have remained largely static.

> ***The coming year may well see some further softening of [land] values as factors conspire to make buyers cautious.***

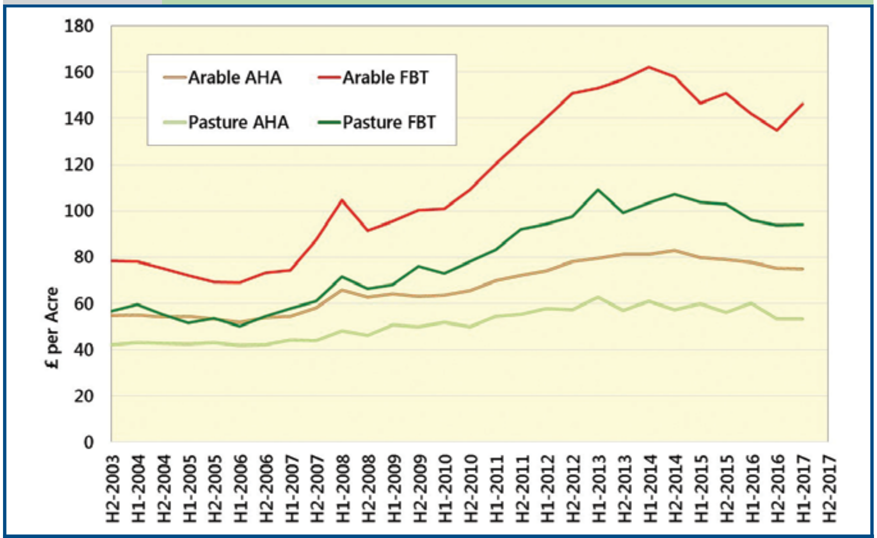
Any review of AHA rents is based on the future earning capacity of the holding. The recent rises in grain, meat and milk prices driven by currency have helped incomes recover. This renders the calculated figures more supportive of current rental levels than would have been the case 12-18 months ago, when rent notices might have been served. If a review is triggered, and even a small change in rent results, this 'resets the clock' for the next three-year period under most AHAs. Tenants may be faced with some significant changes in farm profitability before the next rent review comes along to account for this.

For those renting land on FBT's the 'open market' is the determining factor for rents payable. There is now evidence that at least some business managers are starting to look at returns from rented land far more closely.

In this market factors other than business commerciality may feature. These include the need to secure land for biofuel cropping for a fixed term or the requirement for extra area to meet NVZ compliance.

The desire to farm more land to spread the cost base of ever-larger machines for both arable and grassland work can also be a major feature for some in their calculations. The caution is that the marginal costings exercise works until the inevitable upgrade that takes place when machinery is replaced.

Figure 3 **Rental Figures (England & Wales, Surveyors' Opinions) – 2003 to 2017**



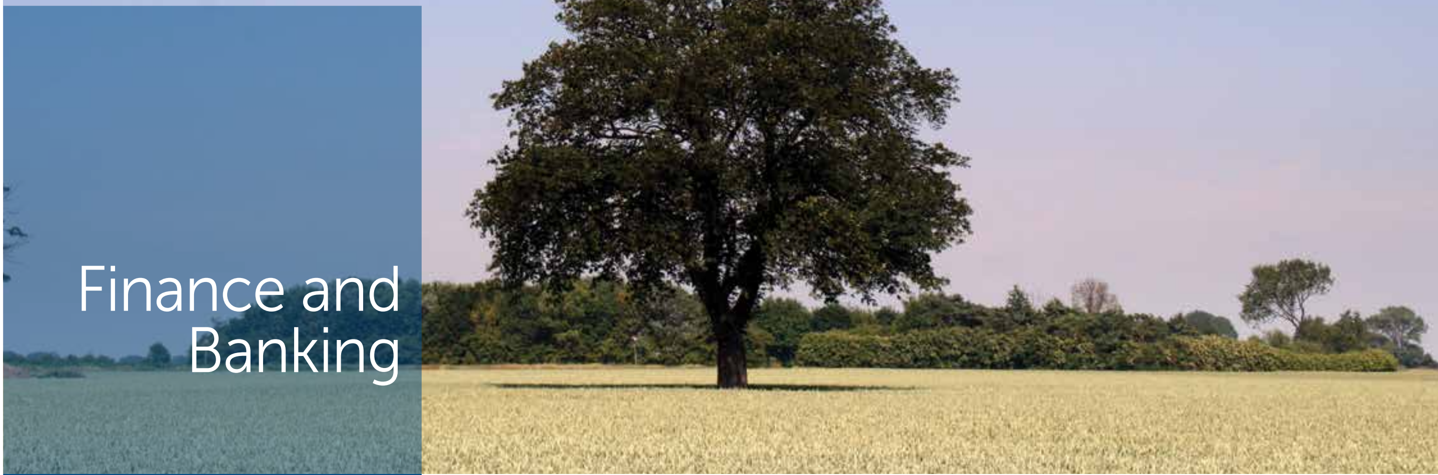
Source: RICS&RAU / Andersons

However, there is evidence that current management practices such as block cropping, extensive use of stale seedbeds, and the application of high volumes of nutrient rich organic manures in one application are having wider environmental impacts. Reductions in soil organic matter over the last 50 years have affected soil health and stability, and biodiversity above and below ground, to a point where the value of the core asset, the land, will start to reflect these declines. Other factors may include increasing weed seed burdens, a reduction in the availability of chemical-based controls and wider restrictions to improve water quality and other environmental impacts.

Such trends will require longer-term integrated strategies to stabilise and then start to repair these problems. Land owners, their agents and those charged with managing day-to-day operations all have a responsibility for formulating such policies, which still have to generate a profit from the farming activity. This might suggest lower FBT rents combined with better targeted use of farming resources.

Overall it is perhaps time to be considering more carefully future management practices to address these matters more proactively if land and, particularly, rental values are to be maintained.

FARM BUSINESS OUTLOOK



Finance and Banking

Greg Ricketts

2017 has seen a number of farmers investing significant funds in an array of opportunities. These range from increasing the scale of an existing enterprise and/or intensifying the farming operation, through to the development of new farming enterprises, diversification into alternative enterprises (i.e. not farming) and investment in land and property. Furthermore, several farmers have purchased complete farms.

The majority, if not all of the investment that we have seen, has been undertaken by farmers, not outside investors, and this leads us to suspect that some are seeing opportunity in the current uncertainty and believe that growth and expansion is the key to developing a successful, sustainable, farming business for the long-term.

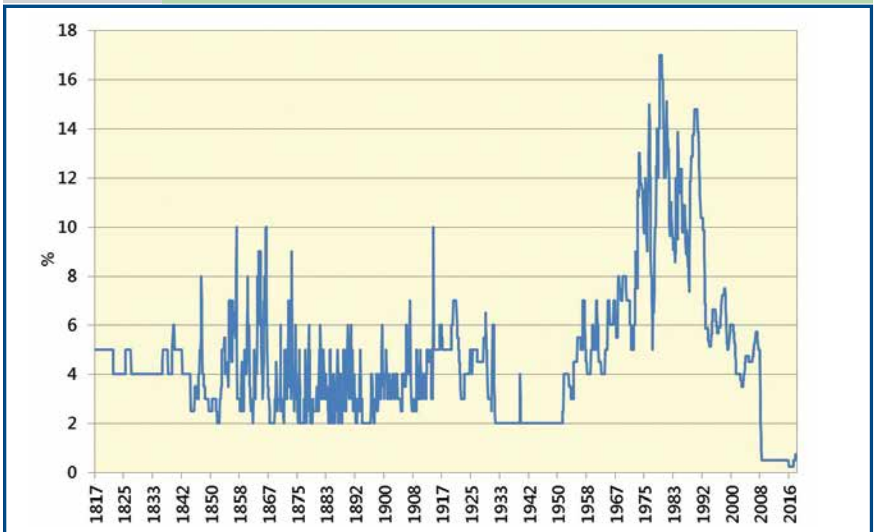
Whilst we have cautioned against reckless shopping sprees in the past (purchasing unnecessary machinery and equipment), we are not against taking on additional debt, providing the capital will be utilised to generate increased profit. Perhaps now more than ever, the farming sector needs to take a really long hard look at existing operations and current viability. Available resources, the skills and expertise of staff and management, plus the availability of capital, are all crucial when developing a long-term strategy.

Rather than looking only 1-2 years ahead, perhaps every farming family and farming business should draw up a 10, or even 20, year plan, including the investment decisions, which may be required to take the business forward positively for the long term.

For those looking to invest, finance is cheap and we believe this presents a real opportunity. Figure 4 shows Base rates over the last 200 years, and this highlights how low they have been for some considerable time, as compared with peak rates in the late 1970s and early 1980s, which were in the region of 19%.

Long-term rates have never been so good and while there are pros and cons to locking into fixed interest rates for the future, with the risk of penalties should debt need

Figure 4 **UK Base Rates - 1817 to 2018**



Source: Bank of England / Andersons

to be repaid before the term of the loan expires, we believe that for those undertaking significant capital investment, it merits consideration and represents an opportunity to protect against interest rate rises.

We have anticipated interest rate rises in recent editions of Outlook, and to date we have been proved wrong! However, it now seems a consensus is emerging within the Monetary Policy Committee at the Bank of England (those who set base rates for the UK economy) for an increase.

"Some are seeing opportunity in the current uncertainty and believe that growth and expansion is the key to developing a successful, sustainable, farming business for the long-term."

We anticipate lending to UK agriculture will increase again in 2018, perhaps by as much as £1bn. This would suggest that total bank debt would rise to £19.5bn. This may seem like a very high figure, but when compared with the total asset base of UK agriculture (circa £250bn), it is very low and highlights the strength the industry has with regard to investment proposals. For those farmers with good ideas, a sound business plan and good commercial acumen, access to capital should not be a barrier to investment in 2018.

FARM BUSINESS OUTLOOK

Farming Profitability Prospects

Richard King

For most sectors of UK farming, the 2017 year has continued the better returns seen in the second half of 2016. Of course, this is largely a function of exchange rates. The weakening of Sterling since the referendum on exiting the EU has been well documented and is discussed elsewhere in Outlook 2018. But it is easy to forget just how important this has been to the prosperity of UK farming. If the Pound had been at €1 = 70p (£1 = €1.43) in the autumn of 2017 instead of circa 90p (£1 = €1.11) then, all other things being equal, feed wheat would have been around £100 per tonne and the pig price about 125ppkg.

During 2017 there were also some cyclical improvements in certain commodity markets. Global dairy markets recovered from their lows, as output reduced in the major dairy exporting regions and there was robust demand (especially for fats). The pig cycle also saw an upswing, as prices in continental Europe rose, supply became more in balance with demand.

A guide to the overall financial health of the UK agricultural and horticultural industry is provided by DEFRA's Total Income from Farming (TIFF) series. This shows the total profit from all UK farming businesses on a calendar year basis. It measures the return to all entrepreneurs for their management, labour and capital invested. In simplistic terms it is the profit of 'UK Farming Plc'.

> ***There should be a significant recovery in profitability in 2017 compared to 2016.***

A single yearly figure showing the returns from farming must, by its very nature, hide significant variation between sectors, regions, or even individual businesses. The articles that follow in Outlook provide greater detail on many aspects of our industry. However, TIFF is useful as a gauge to measure how farming, in the round, is performing.

The latest TIFF figures relate to the 2016 calendar year. These show returns (in real terms) falling 7% compared to 2015, to £3.61bn. This was a little surprising as we thought that profitability might rise (again, driven by currency). However, lower grain yields and reduced production of milk meant that sales for the year fell, despite higher prices. The TIFF figures are often subject to quite large revisions as more data comes through to the statisticians in DEFRA.

Looking to the current 2017 year, physical outputs in key sectors will be higher. Also, there will be a full-year of higher sale prices, rather than only 6-months as seen in 2016. It was thought that input costs might rise sharply in 2017 - Sterling's weakness also pushes up the cost of imported products – especially those denominated in Dollars. In fact, whilst there has been some upwards inflation, this has been relatively muted. Certain costs, such as fertiliser, will have actually been cheaper for some producers in 2017. The level of Basic Payments will also be slightly boosted by a more favourable conversion rate.

All this means that there should be a significant recovery in profitability in 2017 compared to

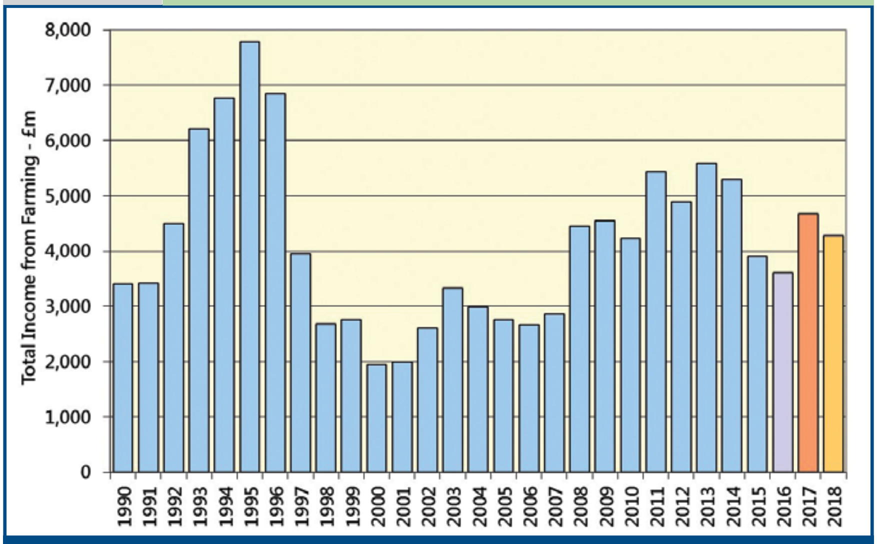
2016. Andersons run a model that tracks the TIFF figures and forecasts their future direction. Given all the factors discussed above, we believe that the UK's aggregate farm profit for 2017 could increase by somewhere around 30% compared to the 2016 figure. This would leave it (in real terms) around the £4.7bn mark. The first DEFRA official estimate will be published in April 2018.

The prospects for 2018 also currently look reasonably benign. Much, as ever, will depend on movements in currency. Until there is more clarity on Brexit, we would expect Sterling to remain within the €1 = 85-90p range. Should the talks look to be in trouble, then a movement towards parity might provide a further (short-term) boost to farm incomes. Ironically, the better the negotiations go, the worse it may be for UK farming's immediate prospects.

In farming terms, some of the inflationary pressures on costs that did not appear in 2017 may simply be delayed until 2018. This may take the edge off returns. Our modelling work predicts a slight fall in TIFF in 2018 of around 8% - back to £4.3bn. Whilst not spectacular, this is around the average level of return of the last decade.

With the next few years potentially seeing massive changes in the economics of UK farming we have modelled some Brexit scenarios onto TIFF. Should there be no free-trade deal between the UK and EU, and if the UK starts to sign deals with other countries that liberalise the import of farm goods, then TIFF could drop by over £1bn from trade-effects alone. Any cuts in support funding after 2022 would further add to the reduction. This would see returns drop to the levels seen in the late-1990s / early 2000's.

Figure 5 **Total Income From Farming - 1990 to 2018 (Real terms, 2016 prices)**



Source: DEFRA / Andersons

Topical Issue- 'Brexit'

Michael Haverty

We make no apology for returning to Brexit as our 'topical issue' again this year. As the biggest change facing farming in three generations, and an area where there remains little clarity, it seems worthy of analysis once more. Indeed, we may well be returning to the topic in Outlook 2019 . . .

– The Editors.

At the time of writing there are around 500 days until the UK formally leaves the EU. A significant proportion of the autumn-sown crops and calves born since late spring 2017 will be marketed in a post-Brexit trading environment. Yet, the negotiations that started in June have stuttered along and much is still to be decided. Added to this is the fact that in effect there are only just over 9 months' negotiating time ahead as the 'divorce deal' needs to be completed in autumn 2018, to give sufficient time for ratification ahead of March 2019.

Three key negotiating issues were identified for the first phase of the talks:

- *The Financial Settlement*
- *Citizens Rights*
- *Ireland/Northern Ireland Border*

The EU has been adamant that sufficient progress needs to have been made on these issues before the talks can move on to discussing any future relationship between the UK and EU. From the British side, this split is seen as artificial, with it being impossible to split out discussions on, for example, the financial settlement from a future trade deal. This article looks at the issues from an agricultural perspective, and how the current impasse might be addressed.

Financial Settlement

The so-called 'exit bill' has arguably been the source of most friction between the UK and the EU so far. It is clear that the UK will need to make some financial contributions towards the functioning of the EU Single Market for at least the duration of any transition period and potentially beyond. Whilst a figure was not mentioned during Theresa May's Florence speech, a figure of £20 billion was mooted. From the EU side, the figures have unsurprisingly been much larger and at one stage €100 billion was (unofficially) suggested. More recent estimates have been in the region of €60 billion and the eventual figure is likely to end up somewhere in between this and the UK's initial offer.

This may seem to have little to do with agriculture. However, the amount that the UK eventually pays is likely to be closely linked to its level of access to the Single Market. This will be critical for UK agricultural exports, particularly for sectors such as sheep meat. Beyond the obvious issue of tariffs on trade in farm goods, there are also trade facilitation costs (e.g. customs checks, official controls etc.). If Single Market access is restricted these could become significant. In a study undertaken by Andersons for the Livestock and Meat Commission (LMC) in Northern Ireland it was calculated that such costs (related to non-tariff barriers) ranged from between 3% to 6% of product value, depending on how heavily such controls were implemented. In the agri-food processing sector, where profit margins are often 2% or less, additional costs such as these are significant.

To resolve this matter, it is apparent

that both the UK and the EU need to agree a robust yet flexible methodology for arriving at a figure to fund a future UK-EU partnership, once the detail of such a relationship is known. All the talk of coming to a figure now, whilst the future relationship has not been decided, seems premature and goes against the principle that 'nothing is agreed until all is agreed'.

Citizens' Rights

This has been by far the most emotive issue in relation to Brexit and, in many respects, is closely related to the role and jurisdiction of the European Court of Justice in the UK post-Brexit. It deals with the rights of those from the EU who have already come to the UK and also UK citizens currently living in the EU. From a farming perspective, achieving clarity for EU workers presently employed in the sector is important, but equally important is the future and having continued access to suitably skilled labour.

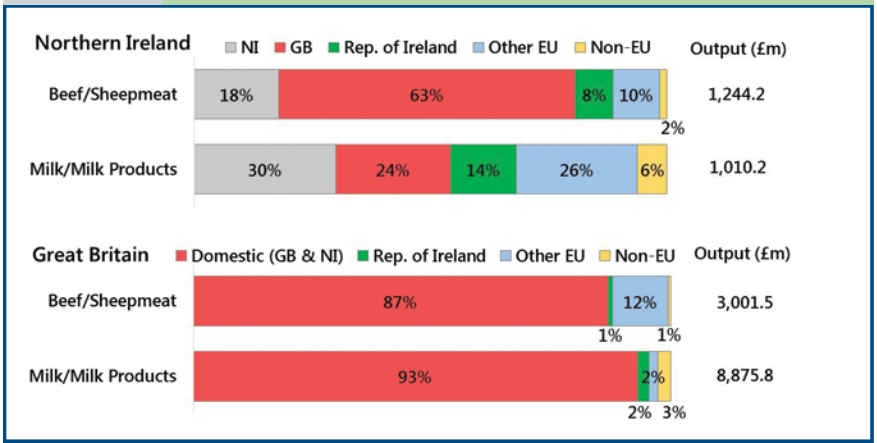
In the past year, the Andersons businesses have undertaken several studies into the make-up of labour across a range of industries. The data show that EU migrants accounts for around two-thirds of labour in beef and sheep meat processing and the vast majority of labour requirements in the soft-fruit and top fruit sectors. Migrant labour is also important in areas such as dairying and pig farming. The UK's proposal to continue to accept free movement over the transitional period should help to address more immediate concerns. Rather than focus on the immediate 'Exit' issues (perhaps better left to legal experts) below are set out some ideas to address the longer-term requirements of agriculture;

- *Set-up an Agri-Food Workers' Scheme (AFWS): this would operate similarly to the Seasonal Agricultural Workers Scheme (SAWS) previously in operation. However, the AFWS should be more ambitious by encompassing the wider agri-food sector and cover full-time labour staff who have not already achieved 'settled status' or similar post-Brexit. The AFWS needs to enable UK industry to continue to recruit in as flexible manner as possible and should not be subject to cumbersome administrative procedures.*
- *Incentives for UK Staff: the difficulties of recruiting UK staff for seasonal work have been well-documented. Government intervention in the form of tweaks to the tax and benefit system to promote seasonal work, or better official 'signposting' of the opportunities could help. The industry itself might have to collaborate better to offer more year-round employment, more focused initial training, obvious career progression and simply better working conditions – but Government can help with this. Brexit is likely to see much restructuring of agriculture. Farmers and farming families should be seen as a valuable resource to be used, especially in the food-processing sector. There could be an opportunity for a greater number of farmers to work part-time, or in some form of shared-job arrangement.*
- *Time and Resources to Adjust: just as the UK and EU will need a transitional period to adjust to the future trading relationship, it is vital that the food and farming industry has time to adapt to any new regulations that will affect how they source labour. Given production cycles in the sector, this needs to be a minimum of 12 months.*
- *Veterinary Staff: often forgotten is the role that EU-27 citizens currently play in both the on-farm and meat plant veterinary sectors. Government and industry might have to consider incentives for staff to work in these sectors post-qualification.*

Ireland

During the Referendum campaign, this issue received relatively scant attention in Britain. Yet, it is by far the most complex and sensitive challenge with perhaps the starkest ramifications of all. The nub of this issue is the challenge of continuing to have frictionless trade on the island of Ireland between the Irish Republic (an EU Member State) and Northern Ireland (part of the UK), whilst dealing with the UK Government's long-term desire to be outside both the Single Market and Customs Union. This is further complicated by the Government's stated aim to have 'no physical infrastructure' on the border with the Irish Republic.

Figure 6 **Destination of Meat and Milk Output - 2015/16**



Source: HMRC / Andersons

> ***A significant proportion of the autumn-sown crops and calves born since late spring 2017 will be marketed in a post-Brexit trading environment.***

Figure 6 compares where the output of Northern Irish beef/sheepmeat and milk/milk products is marketed compared with the rest of the UK (i.e. GB). The data shows how much more Northern Ireland is exposed to EU trade (including Irish Republic) than the rest of the UK. Given the UK Government's commitments concerning the Good Friday Agreement (GFA) and the Common Travel Area (CTA) with Ireland, it is evident that a tailored solution is required to address the Northern Irish issue.

There are no straightforward answers to this predicament. Some have proposed putting the border on the Irish sea, but this would be unpalatable for many in Northern Ireland, not least because the majority of the Province's trade is with Great Britain and such a solution would impinge on trade with its largest market.

One concept that may be worth considering further is whether Northern Ireland could be designated as a 'Special Economic Zone' within the UK. This could involve designating the entirety of Northern Ireland as a border zone so that customs checks and official controls could be performed anywhere within the territory of Northern Ireland. This would enable traffic at the border to flow with minimal restrictions. If a similar border zone was set-up in the Irish Republic, then cross-border trade could continue in a relatively frictionless manner. Admittedly, such an arrangement would necessitate changes or derogations to EU Official Controls legislation, but such concepts are worth considering to resolve this apparently intractable issue. The concept of a border zone itself is not new. The US has a 100-mile border zone extending from its frontier (i.e. coastal areas or borders with Canada and Mexico). Although this is primarily used to check for illegal immigrants, the concept could potentially be used to manage the cross-border movement of goods, whilst keeping movement at the border as smooth as possible. Given the need for companies to invest in new infrastructure (e.g. separate storage areas to handle consignments coming across the border) a longer transition period than the two years currently envisaged by the UK Government might be required.

Such an arrangement would still be challenging to implement. For instance, processing companies could potentially have to invest in new infrastructure. These volumes are significant. Nearly a quarter of the beef processed by Northern Irish meat plants originates in the Irish Republic and the volume of milk and milk products crossing the Irish border is also substantial. Such infrastructure, whether it is paid for by the companies themselves or by public funding will take time to put in place. Therefore, it suggests the need for a transition period – perhaps longer than the two years by the UK Government.

Future UK-EU Partnership

Assuming enough progress is eventually deemed to have been made in the three areas above (possibly in December), this topic will move to the forefront of talks during 2018. The Prime Minister has been clear that the future UK-EU relationship will not be based on an existing model, but rather on a 'deep and special partnership' with the EU. This includes a two-year transition to the new arrangements under which most of the existing EU rules will still apply in the UK. The extent to which the EU feels that the future relationship with the UK will be deep and special is open to question, but this appears to be the most plausible outcome at this stage. However, a reversion to WTO trading conditions under a 'no deal' scenario cannot be ruled out either.

It is challenging and somewhat speculative working out what this means for UK farming, in the absence of much clarity and detail. A number of studies were published during 2017 and these usually work through a number of scenarios to cover the range of outcomes still possible.

These have generally found that, if a bespoke free-trade deal between the UK and the EU is agreed, the effects on farming are relatively small. There is a small negative change in farm incomes due to increased trade-facilitation costs such as customs paperwork, inspections, and delays at ports.

If the UK and EU do not agree a deal, then the impacts are substantial. There is a plausible scenario where the prices for some UK farm products rise if the UK and EU impose reciprocal tariffs on each other's goods. However, this would lead to higher prices for consumers (i.e. the electorate) and it is highly questionable whether this would be tolerated politically. The alternative of the UK adopting a unilateral free trade policy (or quickly agreeing a number of free-trade deals) would lead to price decreases for all agricultural commodities, with output declines which would be particularly severe for beef and sheep meat.

The question arises of what should a UK-EU partnership model consist of from an agricultural perspective? One suggestion is a Customs Association combined with a Comprehensive Free Trade Agreement.

If the UK and EU do not agree a deal, then the impacts are substantial.

The Customs Association element would focus on ensuring that EU and UK standards would remain as closely aligned as possible. This would be most effectively achieved by continuing to uphold existing EU Official Controls legislation. This would give the EU confidence that its standards will continue to be adhered to, whilst also giving UK consumers reassurance that the stringent product standards which they value highly will continue to be upheld. For farming, such an association would give the best opportunity possible for the UK food industry to continue to access EU markets, whilst minimising trade facilitation costs when crossing the border. It is likely that some trade administration (e.g. physical checks and sampling) will be required. But, the UK should aim to have the same advantages that New Zealand produce enjoys over other countries when entering EU markets (e.g. 1% physical checks as opposed to the standard 20%).

The Free Trade Agreement element would enable UK-EU trade to continue along broadly similar lines to present. It would, though, also offer the potential for the UK to open-up new markets outside of the EU. Indeed, there is plenty of work that the Department of International Trade and DEFRA could be doing now in terms of getting UK agricultural produce, particularly meat, approved for sale in non-EU countries. With cut-backs in recent years, Government spending in this area has been neglected and it is a key reason why the UK has fallen behind other countries like the Republic of Ireland.

Concluding Remarks

Overall, there is a huge amount of work that needs to be done to ensure that the UK's exit from the EU is as smooth and orderly as possible. For UK food and farming, everyone within the industry has a responsibility to shape the future to give the UK the best opportunity possible to compete effectively both domestically and internationally. At times, this will necessitate compromise and a realistic assessment of the industry's strengths and weaknesses, as well as what consumers (i.e. the industry's customers) and the UK's partners (EU and non-EU countries) will accept. Only then can the UK begin to surmount this mammoth task and forge a more productive, and profitable, future.

Combinable Cropping

James Severn, Sebastian Graff-Baker and Joe Scarratt

The key determinant of profit from combinable crops is cost of production. It is all too easy for the industry (including Farm Business Consultants!) to embark on repeated crop production cycles, banking on low input costs and high sale prices to create sufficient profit. Unfortunately, this has resulted in the trend in feed wheat production costs shown in Figure 7.

The key components of production costs include:

- *Direct or variable costs (seeds, fertilisers, sprays etc.)*
- *Labour and power*
- *Related rent and finance*
- *Yield*

The price of direct or variable costs often respond to short-term market factors including, it sometimes appears, the ability or perceived willingness of the farmer to pay. However, labour and power costs are, for most, determined by longer term issues, including whether or not to commit to dedicated resources. For most, the assumption remains that, as a result of dedicated capacity, all areas of the farm will be cropped, irrespective of yield, with the exception of those areas required for subsidy compliance. Consequently, many such businesses commit to growing areas at a loss, and therefore rely upon improvements in the selling price and receipt of support payments to generate an acceptable overall business profit.

As Figure 8 shows, the world remains well-supplied with grains going into the 2018 year. Global prices, as indicated by US values, are at low levels. The European market has been insulated from this fall to some extent by the strength of the US Dollar against the Euro. UK prices have received an even greater 'currency boost' as a result of Sterling's weakness against both the Euro and Dollar. If exchange rates were at the same level as two years ago, UK feed wheat prices would be close to £100 per tonne. It would require a further weakening of the Pound, or a significant tightening of global grain markets, to see an upturn in UK prices over the coming months – neither of which can be relied on.

Fortunately, the opportunity to improve the profitability of the combinable crop enterprise, without relying on price increases and subsidy, is very much within our reach. Work looking at yield variation across both whole farms and individual fields shows that certain areas repeatedly produce low yields. Current evidence indicates that up to 40% of land on many farms is producing wheat at insufficient yield and therefore incurring production costs substantially above the selling price.

Inevitably the same assessment for the other crops in the rotation indicates loss making yield on up to 60% of the area used. In effect, we have an industry that is farming two types of land; profitable land, and land that makes a predictable loss under present farming techniques.

Figure 7 **Feed Wheat Production Costs 1977 to 2017**

Year	Production Costs (excluding rent and finance) - £ per tonne
1977	50
1987	81
1997	87
2007	92
2017	122

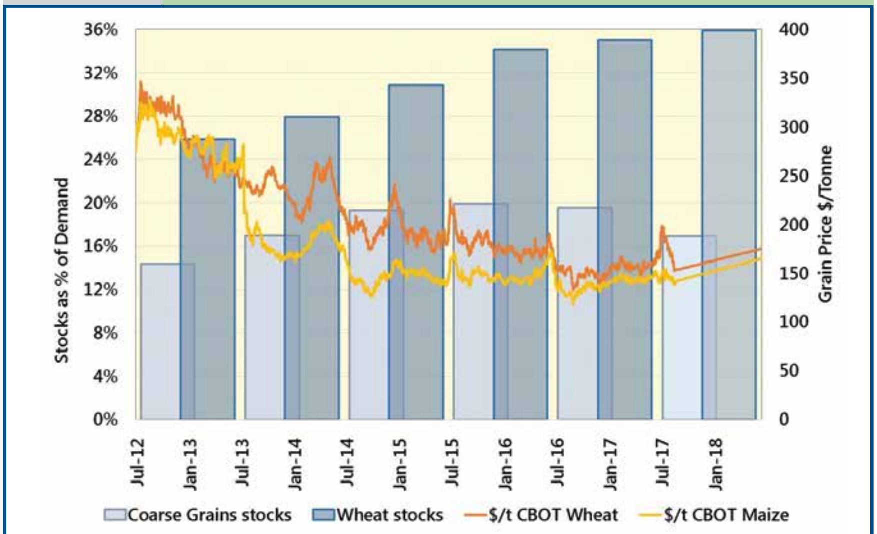
Source: Farm Business Survey sourced from John Nix Pocketbook

For many businesses this loss-making activity is masked by the profits created on the better land or the income generated by other parts of the business, including the enterprise of collecting support payments. As an industry we now have the means with which to measure and assess the financial consequences of this variation. Without such measurement, effective management is very difficult. It is fascinating to see the shift in management and approach once the underlying patterns of yield variation and associated uneconomic costs of production are both visible. Changes can include:

- *Investment in drainage*
- *Rabbit fencing*
- *Adopting long-term alternative management including Stewardship on land that consistently under performs and for which adequate improvement is unrealistic*
- *Controlled Traffic Operations*
- *Improvements to soil health whilst the land is temporarily taken out of production*
- *A thorough review of headland management*

One of the key developments in technology that farming, like many sectors, is currently exploring is the application of Artificial Intelligence (AI). The current limitation to the reliable adoption of AI to the point where one is able to delegate site specific (e.g. soil, drainage, shading and pest grazing) and seasonal (e.g. weather, disease and grass weeds) management is the length of the production cycle. The effective production cycle for most combinable crops, given the existence of site variation, is between three and six years, rather than just one. We then need to record enough production cycles in order that the data which is available to the AI system is statistically robust.

Figure 8 **World Grain Stocks and Prices - 2012 to 2018**



Source: USDA / Andersons CBOT = Chicago Board of Trade

For most, the assumption remains that all areas of the farm will be cropped, irrespective of yield.

Whilst some of the factors may be reasonably quick to record, others may take many years. Therefore, whilst the use of computers in agriculture is enormously useful in terms of storing, collating and analysing data, it would appear that, at this point in time, the ability of the computer to interpret ***all*** of the site and seasonal factors that cause yield variability using some form of AI is a considerable way off.

We often see the adoption of 'precision farming' as a distraction from the need to thoroughly address larger issues. For example, varying seed rates by +/- 30% is not, in many situations, going to change the performance of land from loss to profit. We have a substantial opportunity with ***current*** technology to improve profitability by organising combinable crop businesses so that managers knowingly commit to use only those parts of the farm which can produce yields resulting in predictable production costs below the selling price. Although AI may not be available to us now, as an industry we should support its development and as individual businesses we should adopt the techniques we already have available, even if, with time, they may be seen as rather unsophisticated. Naturally, part of the decision on how much of the farm to crop each year will need to take into account the requirements for amenity, appearance, land maintenance and future cropping as technology evolves.

The challenge that therefore currently exists for both proprietors and their advisors is to fully understand yield variation within farms and individual fields and to use this information to set up businesses to increase profits. Perhaps in the first instance, if we were to describe farms by the available 'profitable tonnage' rather than the available area, we might shift the focus towards the contribution to profit and away from simply the pursuit of scale.

CROPPING

Potatoes & Beet

Jay Wootton, and Nick Blake

Potatoes

Although it may be too early to call, perhaps the less said about the prospects for the current potato harvest the better. At the time of writing, there is a wide variation in market price being achieved, with the average being around 40% down on last year. This is largely a result of UK production (yield) expected to be up, the changeover from the 2016 to 2017 crop, and the impact of imports (up in both packing and frozen on the previous year, but down in processing).

In late September, dig results from the North-western European Potato Growers (NEPG) group covering the UK, France, Germany, Belgium and the Netherlands, suggested an increase in North European production of 14% compared to last year. This is a combination of area (+4.6%) and yield (+2.9%). Quality is understood to be reasonable, although dry matters are low in some crops, meaning more tonnes of crop will be required for processing to produce the same end quantity.

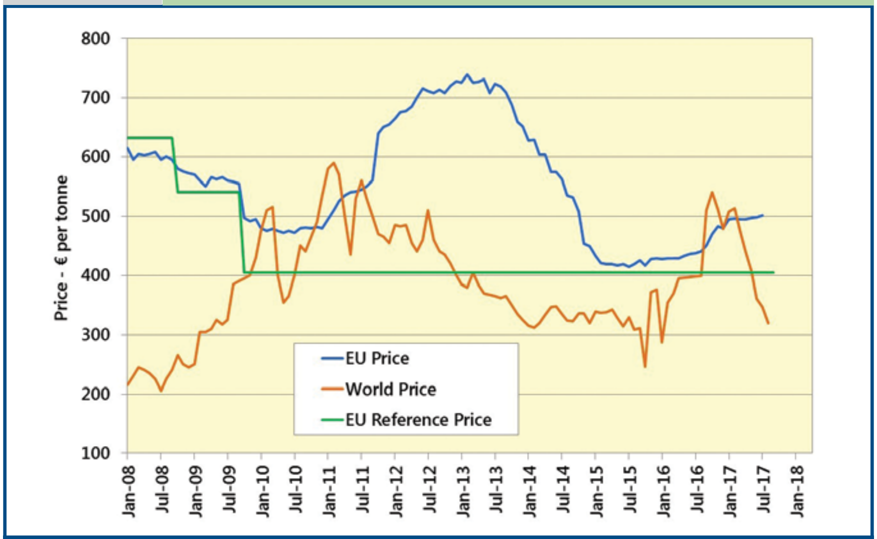
Northern Europe continues to be a threat to an already over-supplied UK market. Whilst the weak Pound reduces the competitiveness of European production, the cost of production in mainland Europe is lower than here in the UK - a factor of increased yield, and lower cost base. Our views on the perceived 'more costs less' economies-of-scale arguments are well documented in previous Outlook publications, but the small family unit tends to continue to produce lower cost potatoes when compared to larger UK businesses (there are, of course, always exceptions!). The UK market continues to show growth in processed product and the lack of investment in facilities generally is a concern, as continental processors are well placed to take advantage of the opportunities provided, and displace home-grown tonnage. The ware grower reviewing his future strategy would do well to consider the availability of processing contracts as an alternative for the future. However, the relative economics between ware and processing, and the productive capacity of their land base will be dictating factors.

The planned investment and introduction by one of the key UK processing customers of whole-crop processing is a positive move. [For Outlook readers who are not-potato experts, 'whole crop processing' sees the grower simply deliver the entire harvested potato crop without the need for grading – Ed.]. The ability for the customer to utilise more of the crop (as seen more frequently in Northern Europe) should provide both parties greater financial reward. But, the true value of this type of investment will only be realised where the grower is able to remove the associated cost base from the entire enterprise – primarily in grading and outloading, together with the associated capital employed in doing so.

> ***The UK [potato] market continues to show growth in processed product and the lack of investment in facilities generally is a concern.***

The ability to use more of the harvested crop, should clearly be an objective throughout the supply chain. At farm level, the fraction of the crop graded out can vary significantly, usually driven by the mechanisation (ability to size grade accurately), and grading labour (over/under grading). The latter could be addressed with investment in optical sorting technology which is prohibitively expensive at present for most farm businesses due to the lack of throughput.

Figure 9 **Sugar Prices - 2008 to 2018**



Source: EU Commission / Andersons

Sugar Beet

The 2017 crop has been mixed, with a difficult Spring and plenty of gappy crops early on. Surprisingly, many of these came together after June rain and have gone on to produce the prospect of a reasonably large crop for the year. The threat of the loss of more active ingredients, and in particular neonicotinoid seed dressing, is another concern for growers next year. Whilst the area has stabilised, issues such as active ingredient loss, and the increasing prevalence of Beet Cyst Nematode are all concerns for the future.

In Outlook 2017 we wrote about the 2006 EU sugar reform and closing of sugar processing factories following from that. Earlier this year, plans were announced by Al Khaleej International Ltd for a project to invest in a new sugar factory in Yorkshire, the first in the UK for around 90 years. Little further information has been made available since then, although the plant is proposed to process 24-26 thousand tonnes of crop per day during the traditional 'campaign' window. This will be the first time sugar will be refined in the county since the York factory closed in 2007, although there are still some Sugar Beet growers in Yorkshire supplying Newark. This could bring a new entrant to the market, in competition with British Sugar. It is unlikely that a second processor will provide sufficient competition in the sector to see a significant increase in price, as demonstrated with AD sugar beet in the East. However, there are other ways to attract growers other than price; haulage and harvesting arrangements, co-ordination to suit crop and soil conditions, and crop financial advances such as offered in parts of the cereal sector. The current payments terms offered by British Sugar add certainty when forecasting business cashflow, which has always been a recognised benefit.

This development is likely to provide a useful break crop alternative to growers in the North. It remains to be decided what role the NFU might have in price negotiations. One of the reasons given for the closure of the York factory at the time was low yields in the region. There has been a 25% increase in average yields in the sector in the last 10 years. Does this therefore mean that an acceptable return can now be generated for both grower and processor, or has the increasing cost base of both negated this?

The contract value of bonus over and above the base price is driven by the sugar marketing period from October 2017 to September 2018. Currently, world prices are falling from the 4-year high experienced in December 2016. The EU June 2017 price is quoted at €498 per tonne. If the price were to remain at this level, then 32p would be added to the one-year contract, or 81p on a 3 year contract. If the price falls below the minimum €475, then the price is excluded from the overall bonus calculation.

The ability for existing three-year contract holders to roll forward their commitment for the next three years (effectively tying them in for 4 consecutive years), is a useful third option for growers for 2018, whilst at the same time taking the extra 50 pence per tonne, and the uplift in bonus. At the time of writing it is understood that contracting is not yet complete, with BS looking for additional area for 2018.

CROPPING

Horticulture

John Pelham

Marketing

The industry has seen a good deal of 'musical chairs' between packers and retailers on supply. The pressure on businesses in the sector continues to be high, with the need to focus on technology to give greater efficiency in production. Automation is especially key to combat the threat of the loss of Eastern European labour through Brexit, which is already proving a challenge.

Aldi and Lidl continue to dominate growth in the sector, and the other retailers are struggling to maintain volumes; this makes for an even more uncomfortable competitive position.

Last year we noted DEFRA estimates that 22% of edible fruit and vegetables are wasted following purchase. The supply chain itself accounts for further waste (up to a similar level again) before the crop even makes it to the Supermarket shelf. Pack sizes have been reduced in some lines to reduce waste, resulting in the same units sold, but generating a lower overall volume requirement. These areas both contribute to depress returns to growers.

A necessary area of improvement identified in the 2011 'WRAP Sector Guidance Note: Preventing Waste in The Fruit and Vegetable Supply Chain' was the need for improved communications throughout the supply chain. Grading against customer specification is understood to cause the greatest loss. Clearly there is a need for the grower to ensure they are producing the right product at the right specification for the end consumer, but the retailers are also able to influence the consumer choice through product promotion/pricing, labelling, and display layout. The introduction of 'wonky veg' shows what can be done, although some question how much of this is 'window dressing' with the retailers not actually keen for too much volume to migrate from their full-priced lines. Overall, a greater level of communication from the field to the retailer has to result in less waste, and a greater return to the grower.

The continued consolidation in the industry highlights those companies that are not producing a viable return, and leaves them very vulnerable in this marketplace. Growers would do well to develop the habit of reading their customers' accounts, rather than the sports page.

Labour

The availability of seasonal labour for the establishment, husbandry and harvesting of crops has been the key management issue for growers in

Figure 10 **Horticultural Crop Output - 1997 and 2016**

Crop	Production 1997 – '000 tonnes	Production 2016 – '000 tonnes	Change - %
Dessert Apples	96.0	180.5	+88
Strawberries	32.8	118.2	+260
Cherries	0.6	1.7	+183
Asparagus	2.0	5.9	+195
Sweet Peppers	6.9	23.0	+233
Celery	39.0	53.1	+36

Source: DEFRA

2017; it will also be the critical factor in how UK horticulture evolves in the future.

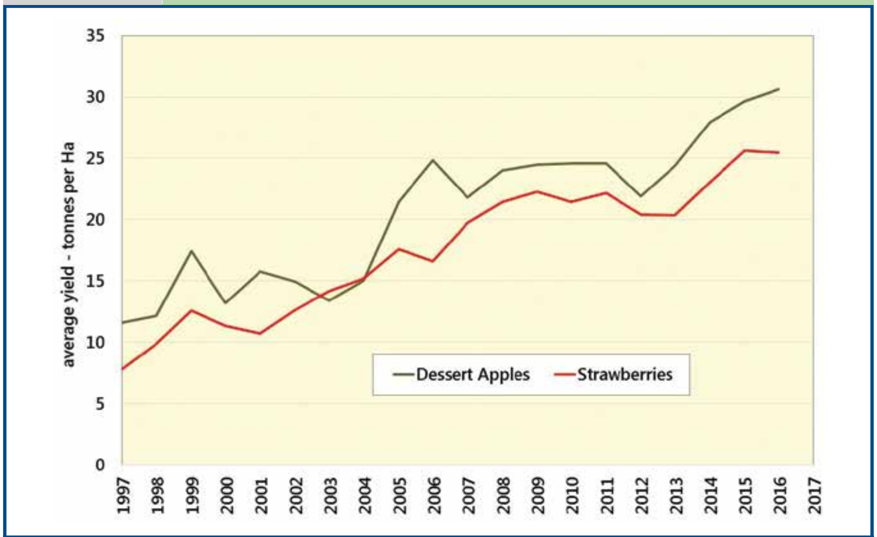
The sector currently employs some 75,000 seasonal workers annually, of which only a small fraction are UK nationals, with the majority being of European Union (EU) origin. Whilst some crops, such as roots and onions, are more mechanised and therefore less reliant on labour, many horticultural crops have a high requirement for seasonal labour, which for some represent as much as 50-70% of all production costs.

Compared to many enterprises on the UK farm, horticulture has shown considerable growth in output (and development of home-market consumption) over the last 20 years, as examples in Figure 10 show.

These increases in production have generally been achieved, not by greater crop areas, but through the adoption of a range of technical developments, including new varieties, more intensive growing systems, artificial growing media and, perhaps most importantly, crop coverings (from simple fleeces to specialist tunnel structures). To illustrate improved technical performance, the average yield of dessert apples in 1997 was 11.6 tonnes per hectare, in 2016 it was 30.6 tonnes per hectare, a level of improvement not uncommon in a number of horticultural crops.

These advances have been wonderful for the UK consumer who has seen an increasing supply of high quality, home-grown produce, with limited if any increases in price. By 2016, for example, soft fruit (principally strawberries and raspberries) represented 22% of all fruit purchases by UK consumers, a proposition that would have been unthinkable 20 years ago when these fruits were mainly available in mid-summer only. They have moved from a luxury, seasonal product to a staple of weekly shopping baskets.

Figure 11 **Yield Progression, Apples and Strawberries - 1997 to 2017**



Source: DEFRA

Yet all of this has only been possible because of access to an increasing number of seasonal workers, for both the growing and harvesting of crops. It is perhaps a sad indictment of our society that, throughout this period, almost none of these have been UK nationals, despite growers' best efforts, and it has largely been Eastern Europeans who have met this UK need.

> ***Without access to temporary labour from outside the UK, it is inevitable that home production will decline and prices to the UK consumer will increase.***

The future supply of temporary workers, the requirement for which over the next five years is estimated to increase by as much as 20%, to some 90,000, is critical to the production of the home-grown horticultural produce so valued by the UK consumer. Despite the talk of robotic harvesting as an alternative, this is unlikely to have much influence on the labour requirement in the foreseeable future, as developments are still some way from widespread commercial use and are limited only to certain crops.

Without access to temporary labour from outside the UK, it is inevitable that home production will decline and prices to the UK consumer will increase. With growers making commitments to production often 2-3 years ahead, the future intentions of the UK Government in this area are vital to the planning of horticultural businesses. It is for this reason that the sector has been making such strong representations on the need for a new 'licence' scheme to enable non-UK nationals to work on a seasonal basis for the UK horticultural industry. In such times of change, the need could arguably have not been greater to secure our home-grown supply of horticultural produce.

Let us hope that the efforts of all concerned, will secure a speedy and common-sense decision by those in government!

CROPPING

Topical Issue-Contract Farming

Jamie Mayhew

With restructuring of the agricultural sector likely to accelerate over the coming years, this article provides a background to the mechanism of contract farming and some thoughts on how such arrangements can be successfully deployed.

A Contract Farming Agreement (CFA) sees a Farmer (be they landowner or tenant) and Contractor coming together with the ultimate aim of creating a fair return for each party. These agreements are often referred to as 'joint ventures', but a key point is that there is no joint business operated; each party continues to run their own separate businesses and there is no shared liability.

Under this arrangement the Farmer provides the land and buildings/fixed equipment (if appropriate) whilst the Contractor provides labour, machinery and day-to-day management. The agreement is administered through the Farmer's bank account, from which all costs will be paid and income received.

Typically, costs might include:

- *Seed, fertiliser and sprays*
- *Crop storage and drying costs (electricity & gas)*
- *Administration costs related to the agreement*
- *Property costs (e.g. property repairs, water & drainage rates)*
- *Bank charges and interest*

The Contractor receives contracting fees in two parts. The Basic Fee (generally area based) is fixed at the start of the agreement and typically meets the Contractor's own costs. A further fee is paid to the Contractor after the year end. This is based on the financial performance of the agreement and is a proportion of the surplus that remains after the deduction of all costs from income and an initial profit (the Basic Return) has been retained by the Farmer.

Historically, the Contractor typically received a larger share of the total return - up to or over 55%. However, with the rental market still offering high returns to landowners, this gap has narrowed to nearer 50:50. The competition for new farming opportunities has resulted with some new CFAs returning a greater share to the Farmer. As a result, the number of Contractors tendering for new agreements has fallen as they fear that they will be unsuccessful compared to their competition.

From a Landowners perspective, when setting up a new CFA, careful consideration should be given to tenders submitted. For example:

Figure 12 **Pros and Cons of Contract Farming Agreements**

	For the Farmer	For the Contractor
Pros	+ Reduction in capital employed – principally from the reduction in labour & machinery + Frees up management time to focus on other projects + Possible Inheritance tax, Income tax and VAT benefits (compared with alternatives)	+ Potential economies of scale from farming a larger area + Guaranteed at least a Basic Contracting Fee even in an unprofitable year
Cons	– Reliant on another party generating you a profit margin – Possible loss of control	– Potential loss of attention to detail on core activity – Long term uncertainty – contract terms are typically 3 years

Source: Andersons

1. *The budgeted crop yields and price may be unrealistic*
2. *Although the proposed rotations generate the highest returns, consider the longer-term impact on grass weeds, soil fertility and erosion etc.*
3. *Moving to a CFA is a long-term strategy - the most successful agreements have been in place for many years, where the service provided is more than simply crop production. Therefore, the relationship between Farmer and Contractor is vital.*

In some cases, as a way to improve efficiency and returns, awkward corners and poor yielding areas have been removed from agreements and put into Environmental Schemes. This allows the Contractor to operate as efficiently as possible whilst the uncropped areas are still able to generate an income to the Farmer.

The tax advantages of CFAs have been a key reason for their popularity. The Farmer can continue to trade, with benefits for Income Tax, VAT and Capital Taxes. However, there can be cases where the tax tail wags the farming dog. The focus of advisors is often on long-term tax planning, but care has to be taken in balancing short-term complexity and cost with future gain, especially on relatively small areas of land. This has pushed some into operating 'slimline' agreements, with perhaps just an annual exchange of invoices. There is little or no case law as to how CFAs need to be run in order to be robust under tax law. But we know the Revenue is taking more of an interest. The parties should be cautious about cutting too close to the bone in terms of documentation.

Care has to be taken in balancing short-term complexity and cost with future gain, especially on relatively small areas of land.

Any future change in Government policy, especially around Agricultural Property Relief, could dent the attraction of the Contract Farming Model. Another potential issue is the profitability of arable farming – there needs to be a surplus to distribute. Potential reductions in subsidy payments and continuing inflation of Contractors' costs, make it likely that the returns to Farmers could reduce. A greater proportion of the income generated will have to go to Contractors to cover the 'cash costs' relating to the ongoing farming. Falling Farmers' Basic Fees are likely to be mirrored in the land rental market. But, with a lower likelihood of CFA returns being boosted by a share of profits, Farmers may be tempted to opt for the certainty of rental payments.

LIVESTOCK

Dairy

Mike Houghton and Tony Evans

The UK dairy sector produces a commodity, milk. As this year's Outlook is written, the milk price appears to be approaching the top of the price curve, having passed the 30 pence per litre threshold. However, what is clear is that over time the real price paid for commodities reduces year on year, as demonstrated in Figure 13. Therefore, the industry must become really focussed on improving productivity and profitability.

Whilst immediate cashflow pressure is abating for many milk producers, the time at the top of this price curve now needs to be utilised really well, as the volatility seen over the last decade is likely to remain a feature of the sector.

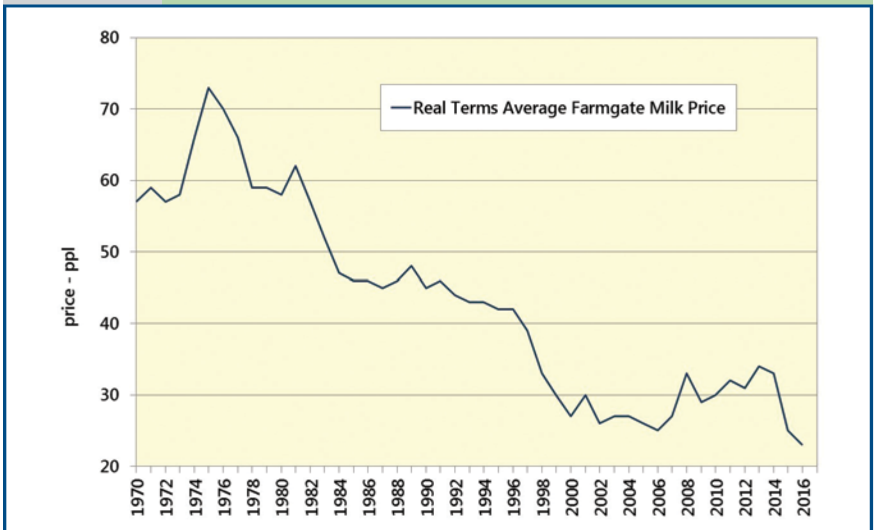
A review of the last dairy recession will help to identify strengths and weaknesses. A detailed analysis of cost of production (all costs) should be a prerequisite for all milk producers. Investments need to be reviewed to ensure that they provide a genuine return on capital and at the same time reduce costs of production.

With the continued weakness of Sterling, export opportunities are available for some processors, but there is a danger of cost price inflation for those producers heavily reliant on purchased inputs, such as soya, fuel and fertiliser.

Looking to the future, risk management should be a topic discussed by all businesses. Futures markets and options are evolving, with Yew Tree Dairies, Müller Milk & Crediton Dairies leading the way for the milk processors. Independent risk management systems are also emerging such as Dairy Stabiliser and DairyVol. Producers in the UK should also take note of Glanbia's world first of a five-year milk price

> ***"The industry must become really focussed on improving productivity and profitability ."***

Figure 13 **Real Terms Average UK Farmgate Milk Price - 1970 to 2016**



Source: DEFRA / Andersons

guarantee in Ireland equivalent to 28.0 pence per litre, with the opportunity to offset this against feed prices. This would appear to be attractive when looking at recent history, as shown in Figure 15.

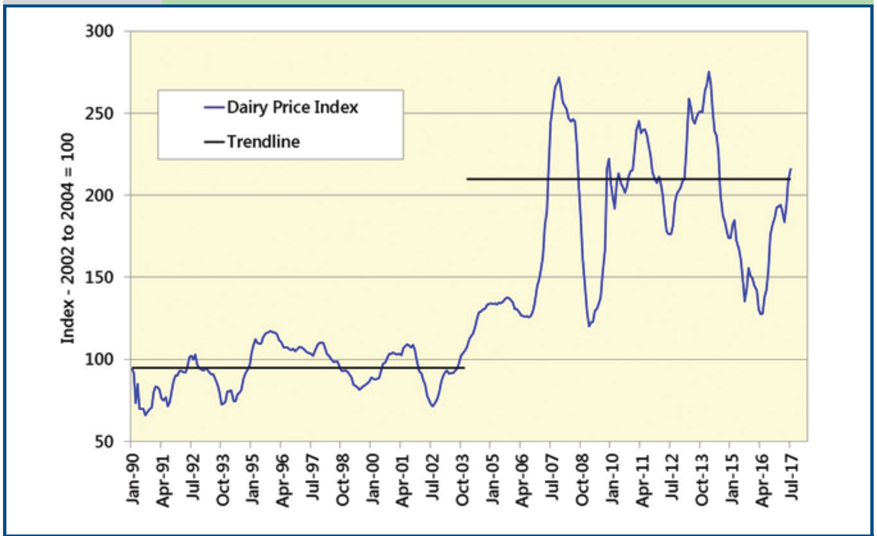
Matching supply and demand should become a much more important factor within the industry, both at home and worldwide.

> ***The UK industry should prioritise building much stronger producer / processor relationships, where there is genuine transparency and the sharing of risk and reward.***

The OECD continues to suggest that demand will increase by approximately 2% per year for the next decade. The dairy industry needs to find a way of matching this, without exceeding the requirement for milk. As a commentator in America recently stated "The economic rule of supply and demand will not be denied. Either farmers control the supply of milk, or the supply of excess will control the number of farmers producing it".

The UK industry should prioritise building much stronger producer / processor relationships, where there is genuine transparency and the sharing of risk and reward around individual factory or business models, so that sustainable long term profitability can be achieved. The recent AHDB report on systems found that 80% of GB farmers were operating all-year-round production systems. Current milk contracts encourage producers in this direction, whereas it is clear that block calving usually delivers lower costs of production.

Figure 14 **World Dairy Price - 1990 to 2017**



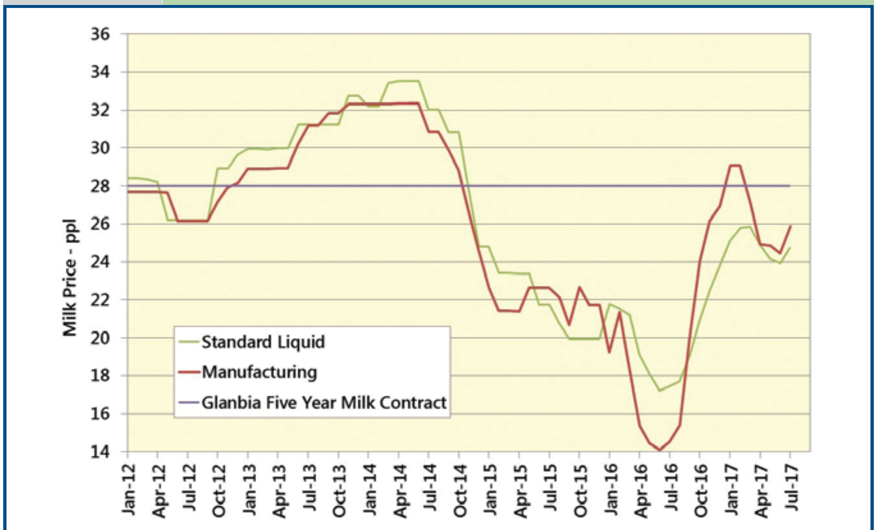
Source: FAO / Andersons

Brexit continues to be the 'elephant in the room' and is likely to continue to be a frustrating process for some years to come. Establishing certainty, positive or negative, will be helpful for most dairy businesses. However, given that our Government appears to pursue a cheap food policy, it might not be unreasonable to assume further trade liberalisation and therefore greater competition in the future.

Our industry needs to become significantly more proactive in promoting the many positive virtues of both our farm standards, animal welfare standards and food quality.

Dairy has an important role to play in most diets and several processors are now being very positive in targeting added value health, or low-fat products, that deliver additional choice to the consumer.

Figure 15 **Five Year Milk Price Comparison - 2012 to 2017**



Source: Andersons

LIVESTOCK

Beef

Ben Burton and Jack Frater

On the back of better prices, the last 12 months has brought with it some optimism amongst UK beef producers. As a result, breeding cow numbers appear to have stabilised at just under 1.6 million head after a period of gradual decline following the de-coupling of support from production back in 2005, when numbers were 1.75 million.

> ***The last 12 months has brought with it some optimism amongst UK beef producers.***

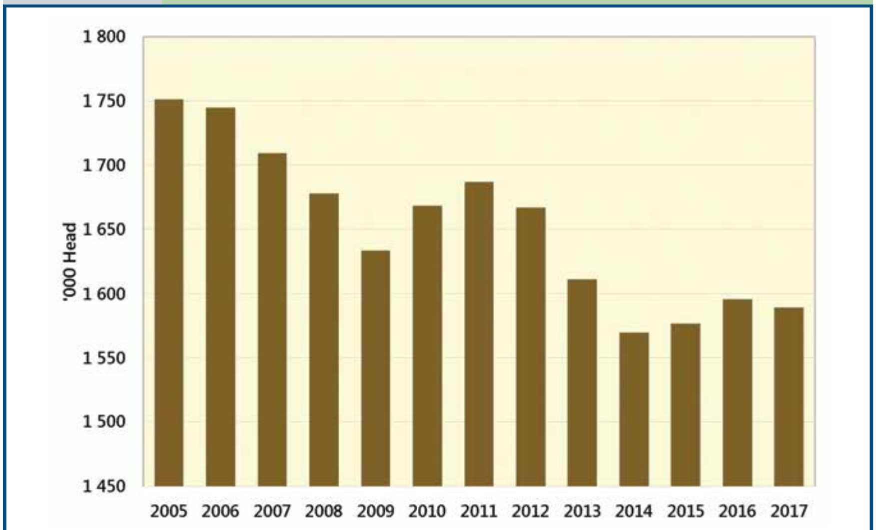
Male dairy calf registrations appear to be reducing, as the rearing of these animals for beef continues to look marginal in terms of profitability; this has been offset by higher beef calf registrations with numbers marginally increasing in recent years.

Continental breeds such as Limousin still dominate, but native breeds, primarily Aberdeen Angus and Hereford, have seen an increase in calf registrations of approximately 35,000 on the year due to consumer demand and perhaps the ability for these breeds to fit into a lower cost system and (cheaper) forage-based finishing. Attractive premiums are being offered for native breed cattle, however such an increase in supply may at some point put pressure on these premiums.

Preliminary predictions for 2018 have slaughtering figures topping 2 million head, a level not exceeded since 2011. However, with fewer cull cows, and retailers generally seeking a lighter carcass, the volume of production is unlikely to see any significant increase over the next 12 months. Prices are unlikely to improve, so producers purchasing store cattle should proceed with caution.

TB remains a constant threat. With confirmed outbreaks as far north as Cumbria, concerned Scottish producers will have one eye over the border as they try to

Figure 16 **UK Beef Cow Numbers - 2005 to 2017**



Source: DEFRA

protect their 'TB Free' status. There is no quick solution to the problem, the badger cull is expanding into new areas, but remains a highly emotive and political issue.

The Brexit process will undoubtedly have an impact on the beef sector. At present the UK is a significant net importer, but should the value of the Pound remain low, the UK market could become less inviting. This is good news for domestic producers, but could well be overshadowed by the threat of reducing subsidies, on which the beef sector is still so heavily reliant.

In 2016, 90% of beef exports went to the EU, primarily Ireland and the Netherlands. The weakening of Sterling has provided a boost as an additional 5% has been added to the value of these exports.

The availability of migrant labour is not such an issue for the beef producer, but is highly relevant for parts of the supply chain such as abattoirs and processers. There could be an argument to suggest that processing could be outsourced to places such as Ireland, should there be a shortage of labour within the UK.

The post-Brexit era will provide the opportunity to create a bespoke British Agricultural Policy. This is a chance to develop a long-term plan, promoting both scientific and technological advances to push the beef sector forwards. However, this will be subject to any trade deals, and if the UK wishes to export into the Single Market then our standards must comply with those operating throughout the EU. Domestically, new regulatory bodies will also be required, as such things like veterinary products are currently approved at an EU level.

Possible trade deals with the US have caused some concern amongst producers and consumers regarding hormone treatment and GM feed. US farming policy is designed to promote competitive markets and efficient production with consumers seemingly less concerned about such issues than those in the UK. However, we still need to look at practices in countries with lower costs of production and less reliance on support payments than ourselves to see what could work for the UK.

> ***The availability of migrant labour is not such an issue for the beef producer, but is highly relevant for parts of the supply chain such as abattoirs and processers.***

There is much that beef producers can do on a farm level to ensure that they are in the best position, regardless of what the Brexit process outcome might be. Knowing how a system is performing, both physically and financially, is key to a strong operation and can only be achieved by regular monitoring. Finishing cattle to the correct specification is still a concern, with over half of all cattle slaughtered missing the mark. This can lead to hefty deductions and eroded profit margins. Recording of feed conversion and growth rates is now common practice amongst producers and helps to manage feed costs and ensure right specifications are met. However, the top performing producers are going further, measuring, for example, the airflow through sheds to reduce the risk of respiratory diseases, improve growth rates and reduce veterinary costs. Effective handling systems can increase welfare, cut labour bills and result in a better and safer working environment.

Businesses that control fixed costs are more likely to be in the higher performing bracket. Quality Meat Scotland (QMS) figures show that, for extensive upland suckler herds selling weaned calves, the difference in fixed costs between the top and bottom third are as much as £85 per head, with labour and machinery requirements being two key factors.

Brexit has brought a short-term boost to the industry. BPS receipts and the value of exports have increased, whilst the level of imports has declined, all as a result of the weakening Pound. Therefore, this provides a prime opportunity for farmers to assess their businesses with the aim of being in the strongest position come March 2019 and beyond. Changes to farming systems, be they financial or physical, do not have to be large or widespread, sometimes small changes can lead to a significant improvement in both performance and profitability.

LIVESTOCK

Sheep

David Siddle

During 2017, the UK sheep sector has benefited from increased competitiveness as a result of the weakness of Sterling, but also a significant fall in imports from New Zealand. NZ production is at historically low levels resulting in reduced export availability; imports of sheep meat to the UK from New Zealand could well be down by over 20% in 2017 as compared with a year earlier. The weak Pound is also helping exports - up 18% for the year to June 2017.

This appears fortunate timing as the UK breeding flock has been increasing year on year from a low of 13.8 million ewes in 2010 to 14.8 million ewes today, with a resultant increase in production.

The early part of 2017 was overshadowed by poor prices for hoggets as large numbers were carried over from 2016. Were it not for weaker Sterling and low New Zealand imports prices could have been substantially worse. As increasing numbers of new season lambs came on stream, and with them the beginning of the main export period for the UK, prices during the summer were well in excess of the previous year.

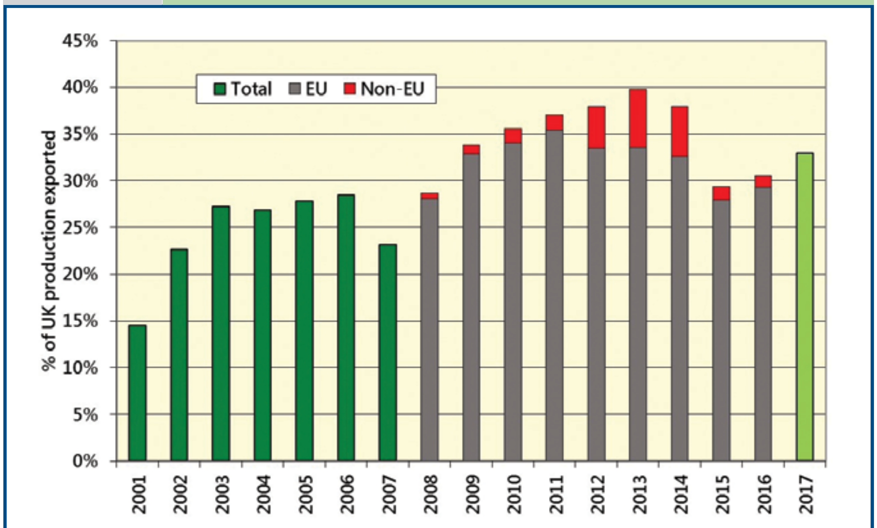
Should these better prices prevail through the remainder of 2017, and finishing conditions remain reasonable, then a lower carry over of lambs into 2018 seems likely. This indicates better price prospects for the first quarter of 2018.

Judging by the early breeding sheep sales, producers' confidence has been boosted by the better prices. Despite the profitability challenges faced by many producers and the well trailed risks posed to the sheep sector by Brexit, another increase in the breeding flock looks likely going into 2018.

"Another increase in the breeding flock looks likely going into 2018."

If prices are to be maintained in the run-up to Brexit, Sterling will

Figure 17 **UK Lamb Exports - 2001 to 2017**



Source: DEFRA

need to remain weak to underpin export volumes and supplies from New Zealand to remain at the lower levels seen recently. Whilst a significant strengthening of Sterling seems unlikely at least in the short term, low levels of New Zealand imports may not last indefinitely.

The major global exporters of sheep meat, New Zealand and Australia, have both seen their flocks hit by drought conditions and are currently in a rebuilding phase. This has come at a time when world markets have been generally stronger and demand from China, now the world's largest importer of sheep meat, is increasing. Once flock numbers are rebuilt this will lead to an increase in production and export availability. At some point this is likely to have an impact on the U.K sheep meat market.

The market for sheep meat, both in the UK and the EU, which currently takes some 90% of our exports, is a mature one, with an ageing customer base. One bright spot is that migration from the Middle East and North Africa to Europe in recent years has opened up new markets in countries such as Germany. However, in future it would seem reasonable to expect consumption at best to be static or to show a marginal decline. Post-Brexit any additional costs of accessing the European market are likely to directly affect farm gate prices.

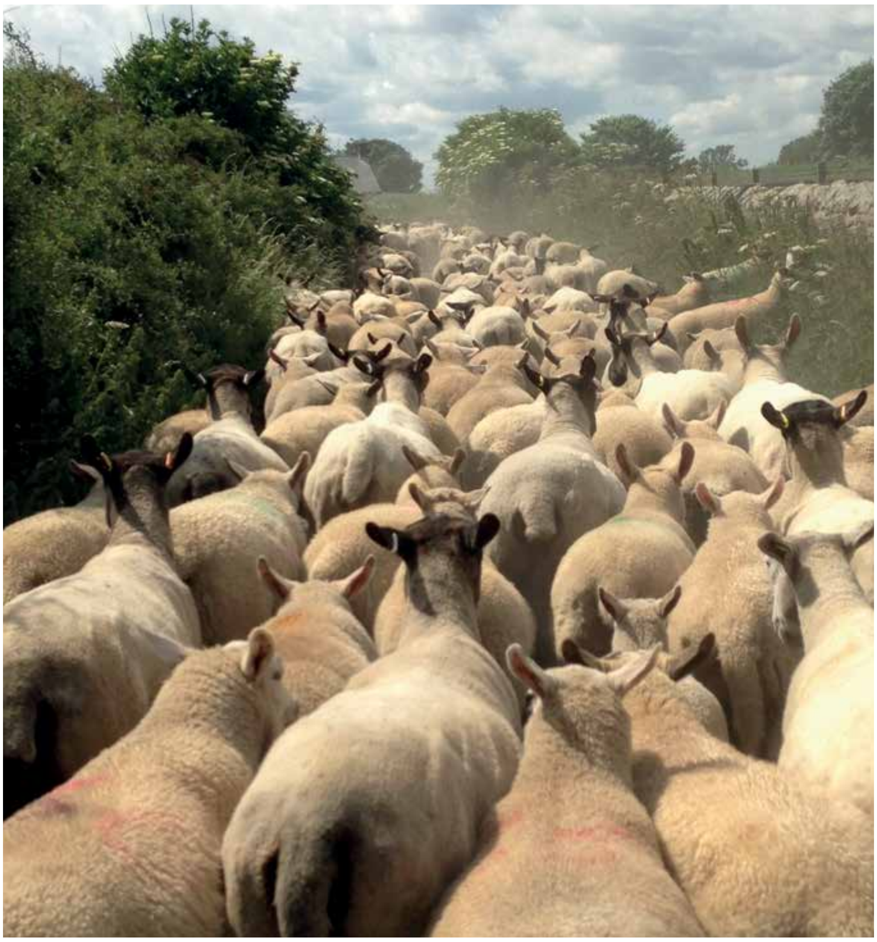
It will be difficult for the UK to break into the only real growing market for sheep meat in the world, China. Not only are Australian and New Zealand producers more competitive, but the demand there tends to be for lower quality cuts, rather than the high quality carcasses and cuts that UK exports have been built upon.

Looking further ahead, our forecast would be for a smaller but more productive UK flock made up of producers able to make sustainable profits with much lower or no support payments. The next few years are likely to see a step change in the pressure on producers to improve their competitiveness and reduce their costs of production.

The market for sheep meat . . . is a mature one, with an ageing customer base.

To achieve positive net margins flocks generally need to be able to achieve a net output, after replacement costs, in excess of £95 per ewe. This will exclude the majority of flocks not capable of producing lambing percentages in excess of 135%. Thereafter, systems need to make maximum use of forage, in particular grazed grass, with purchased feed typically below £10 per ewe. Flocks actively selecting for easy-care traits such as ease of lambing, good feet, lack of daggs, worm resistance and good mothering ability not only tend to have lower veterinary and medicine costs but also, critically, lower fixed costs, which are essential if positive net margins are to be produced.

Intensive winter housed systems targeting very high lambing percentages are increasingly struggling to cover the higher labour, machinery and conserved winter forage costs they incur. We expect a continued move to forage-based outdoor systems, with perhaps more modest lambing percentages, but lower net costs of production.



LIVESTOCK

Pigs

Jonty Lister and Harry Batt

Pig producers have experienced a turbulent two or three years. In March 2016 pig prices were the lowest they have been for 8 years, with producers losing, on average, 20-25ppkg deadweight. Just over a year later in July 2017, producers were receiving their highest prices since January 2014 (see Figure 18).

This turnaround was first triggered by a fall in EU production, helping to deflate an oversupplied market, which coincided with import demand from China increasing considerably. Following this, the Brexit referendum saw a fall in the value of the Pound, making UK exports more competitive and imports more expensive.

However, what goes up must come down? Simple economics of supply and demand, and the volatility of agricultural commodities, would suggest so. At the time of writing, output prices have slowly been tapering off as increased domestic supplies coincide with subdued demand. However, with little sign of a sustained strengthening of Sterling, producers can remain optimistic going into 2018 in terms of relatively high prices being sustained.

Medium and longer term prospects for the industry remain uncertain. The most important factor will, unquestionably, be the future trading relationship the UK has with the EU. Although not supported by direct payments, the pig industry is indirectly supported via significant import tariffs on products from outside the EU (in the range €50-€150 per 100kg). These render most imports of pigmeat uncompetitive in the Single Market.

If the UK and the EU retain tariff-free access to each other's markets after Brexit, then output price dynamics would be relatively unaffected. If no such deal is concluded, then trading between the two will default to WTO rules, which would have a significant impact on the UK pig industry.

UK producers would have an opportunity to displace EU pig meat under these conditions, as the competitiveness of EU imports would be reduced. This would

Figure 18 **Pig Price Volatility and Exchange Rate - 2005 to 2018**

Source: AHDB / Andersons

require an increase in domestic production, because the UK is only 54% self-sufficient in pig meat. Pig numbers can, of course, be built up relatively quickly, but there is potential for the market to create one problem as it solves another. The main UK deficit is in loins and legs, and so increasing numbers to meet this demand would result in more shoulders and offal to find a market for. The sector can take some confidence from the increasing demand from China. The majority of UK exports are lower-quality cuts, including offal. The UK may need to exploit new market opportunities in emerging markets in Asia and Africa to achieve carcass balance.

Without 'preferential' access to EU markets, the UK would seek to establish Free Trade Agreements further afield. If this were the case, a potential flood of cheap pork into the UK market would put severe pressure on UK producers. The industry needs to redouble the efforts of recent years to raise the profile of quality-assured British pork and thus help build non-tariff barriers to imports.

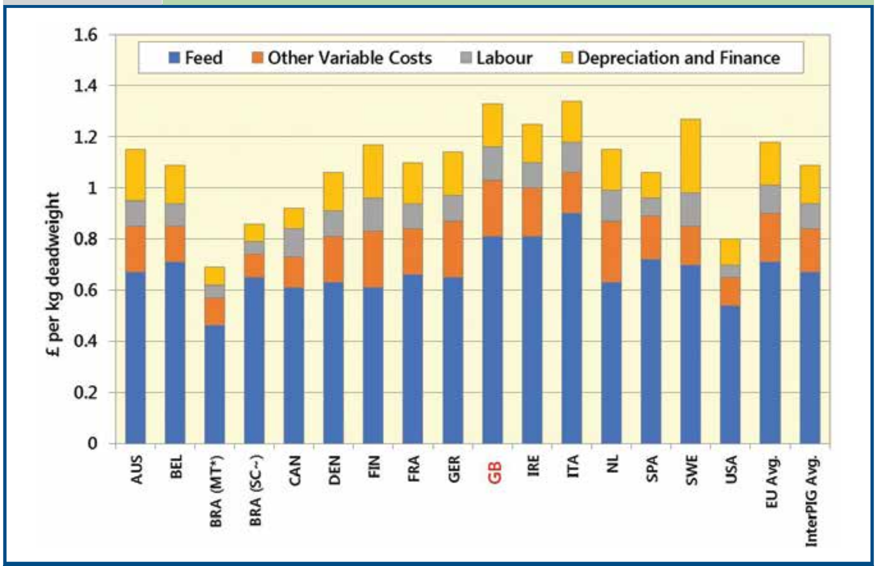
Traceability scares in recent years have prompted some supermarkets to sell exclusively British pork; Lidl and the Co-op are among the supermarkets championing home-grown products. The AHDB has also been at the forefront of promoting British pork with their Pulled Pork campaign, generating £13 million of additional sales. Future marketing campaigns should focus on the high welfare standards of British products as a way of suppressing cheap imports.

As InterPIG reports, the UK has some of the highest production costs of any country. In 2015, the costs of production in the UK averaged £1.33 per kg dw. In comparison, the EU average was £1.18 per kg, whilst the second largest exporting nation, the US, averaged £0.80 per kg. This presents a major challenge for UK producers. Some inefficiencies can be partially attributed to the variability in production methods and herd size. The UK operates with 40% of the pig herd on outdoor production systems, whilst Denmark has less than 10% of pigs outdoors. These systems tend to lag behind indoor units when it comes to productivity gains, due to the limited control of environmental conditions. Again, the UK pig sector needs to highlight its production systems to gain a marketing advantage.

Producers also need to focus on increasing feed conversion rates. UK finishing systems should consistently target a Feed Conversion Ratio of between 2.0-2.3. Businesses should also look to regularly record and monitor the margin over feed, with feed estimated to be 55% to 60% of production costs. Greater use of technology to record all key performance indicators could go a long way to improving efficiency with data analysed to more accurately inform management, i.e. breeding decisions. Producers should continue to look at risk management options; in particular forward buying of feed.

Pig producers have proven to be resilient and adaptable in the past, and are probably better prepared than most sectors for what lies ahead. However, they should not be complacent. Instead, this period of increased returns should be used to reduce additional borrowings taken on over the last couple of years, make reinvestments that will genuinely decrease costs of production, and put their business on the strongest possible footing.

Figure 19 **Global Pigmeat Cost of Production - 2015**



*Source: Interpig * Mato Grosso ~ Santa Carolina*

The pig industry is indirectly supported via significant import tariffs on products from outside the EU.

LIVESTOCK

Poultry

Lily Hiscock

The past year has been a volatile period for the poultry sector, with a divergence in fortunes between the meat and egg sectors. The broiler industry has experienced significant expansion and growth, whilst the egg market has remained more difficult. The increase in egg production has slowed with prices easing, especially in the Free Range sector. The fipronil scandal surrounding foreign egg imports for the processing sector has reduced consumer confidence.

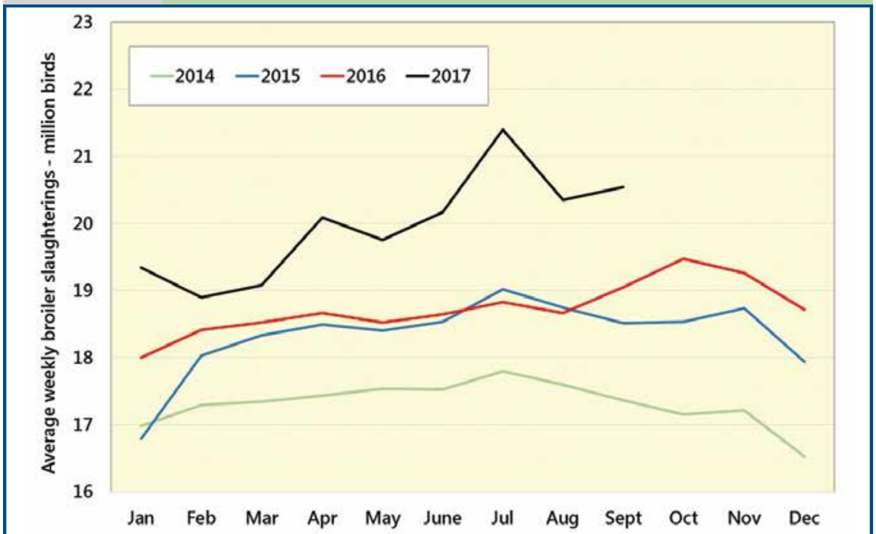
The broiler sector has benefitted from the continued move towards leaner meats by the UK consumer. Broiler chick placings increased by more than 6% (to July 2017) and the volume of poultry meat produced on a monthly basis went up by more than 12% to July 2017 (16,900 tonnes per month).

At present, the UK is the fourth largest poultry meat producer in the EU and is approximately 75% self-sufficient in poultry meat. However, the key product utilised in the UK is the breast meat, with imports of more than 462,000 tonnes in 2015. The dark meat of lower value is predominantly exported, which makes up more than three quarters of the carcass.

The broiler sector is perhaps the part of UK farming which could scale up quickly to meet consumer demand and perhaps increase self-sufficiency of poultry meat in the UK post-Brexit, if the eventual trade arrangements made imports less competitive. However, based on current imports of chicken breasts, to meet demand, UK farmers would have to produce an additional 1.1 billion birds (a 124% increase) plus find markets for, or dispose of, the remainder of the carcass which is not breast. It is understood the two key players within the broiler industry – 2 Sisters and Moy Park are currently investing significantly in processing capabilities and production within the UK.

Even without Brexit the broiler sector was one showing rapid growth. It remains an area of potential diversification for farmers wishing to develop an enterprise, which offers a regular income, the option of utilising home-grown

Figure 20 **UK Broiler Slaughterings - 2014 to 2017**



Source: DEFRA / Andersons

grain, and production of manure to benefit cropping enterprises. Sites normally operate on a contract / management fee basis.

The egg industry faces somewhat more volatility and consumer pressure. The results to July 2017 show a reduction in commercial layer chick placings of 0.40% compared to the previous year.

Following the commitment of many retailers in 2015 to stock only free-range and phase out colony eggs by 2025, there was an initial reaction with rapid growth and investment in the free range sector. By the middle of 2017, just over 50% of eggs were produced on a Free Range system – up from around 45% at the start of 2015. However, this still leaves approximately 5.2 billion eggs being produced by either Colony or Barn systems. For the UK egg industry to be completely Free Range by 2025, this would require approximately 570 more units (at 32,000 birds) to be installed over the next 7 or 8 years. This is equivalent to 1.50 units every week, and an investment in excess of £500 million in the UK egg sector, which looks very unlikely.

Furthermore, the avian flu outbreak in December 2016, which lasted until September 2017, put significant pressure on the Free Range sector. With birds having to be shut inside, a change in labelling was required, with birds no longer being deemed 'Free Range'. Although this egg sector will continue to grow, the expectation of Free Range only within the next 10 years is unattainable.

The UK egg sector was also hit by food safety concerns. In July 2017, 700,000 imported Dutch eggs were potentially contaminated with Fipronil, an insecticide product which is banned in products which are destined for the human food chain. The imported eggs were predominantly used in the processing sector, with retailers pulling products which were thought to contain the affected eggs. In this situation, the importance of British Welfare and Food standards has been highlighted with egg producers in the UK adhering to strict British Lion Code standards. In a post-Brexit environment, educating the consumer about the quality of domestic production is likely to be even more important.

The broiler industry has experienced significant expansion and growth, whilst the egg market has remained more difficult.

Although self-sufficiency in the poultry sector is unlikely, even in the long term, there are opportunities within it for significant growth and added value, particularly following Brexit. This period of change and uncertainty should be an opportunity for current poultry producers to focus on their businesses, to identify areas for improved productivity, such as feed efficiency and mortality, to ensure sustainability for the long term. This sector is also an option for other farmers looking to diversify to strengthen their farm business and spread risk.

LIVESTOCK

Topical Issue- Productivity in the Livestock Sector

Lily Hiscock

The UK livestock industry is set for some significant changes over the coming decade as Brexit occurs, new trade agreements are established and a British Agricultural Policy is formed.

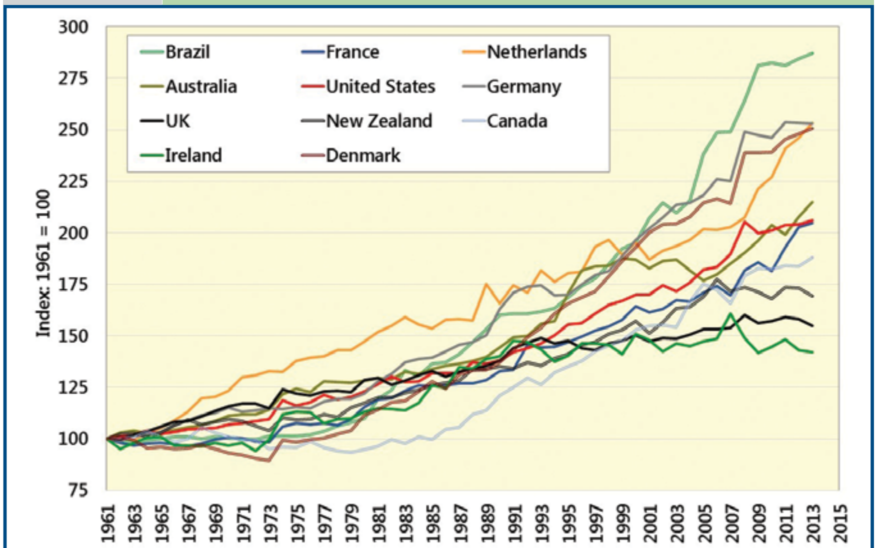
Farming has been supported in the UK since the 1930s through a mixture of support payments, market intervention and trade barriers. The UK livestock sector has evolved within this protected framework. Currently, subsidy payments are hugely important to the profitability of the beef and sheep sectors, and, to a lesser extent the dairy industry as well. Although pigs and poultry appear more 'unsupported', they receive sizeable protection from cheap imports through the EU's trade barriers. Brexit will see many of the certainties of the past 40 years swept away.

Post-Brexit, the level of support in the medium-to-long term has to be in doubt. In addition, funding is expected to be distributed differently, with a greater focus on the environment, productivity and the delivering of public goods. Market prices may also be under pressure, depending on the outcome of trade talks. Producers will need to offset these changes by becoming more productive.

It can be argued that the CAP has held back productivity gains over the past decades. However, other countries who are also members of the EU have shown greater improvements than the UK – as shown in Figure 21 below. The data is for all agriculture, not just livestock farming, but the same overall trends are likely to hold true. Total Factor Productivity (TFP) compares the volumes of outputs produced by farming with the volumes of input used. Because it focuses on physical quantities rather than prices, it shows how good the sector is at turning inputs into produce and takes out the distorting effects of market price movements. TFP is not a perfect measure of productivity, but it is a useful tool.

A key element in driving productivity is getting innovation onto a large proportion of farms. This links the themes of research and development, knowledge exchange and skills.

Figure 21 **Total Factor Productivity - 1961 to 2014**



Source: USDA

In the UK livestock sector, there is increasing polarity between the business-conscious, fully commercial operation and the smaller 'hobby' farms, frequently a lifestyle choice. The latter are far less likely to innovate and adopt modern best practice – often being happy to simply carry-on farming in the way they like and understand. This is, of course, an individual choice and perfectly legitimate, but in the future, such farmers cannot expect the public purse to support their lifestyle.

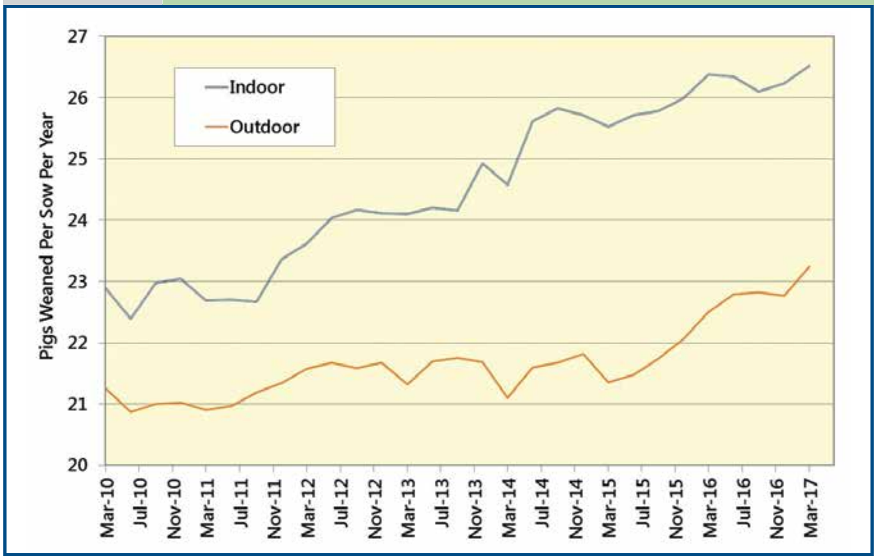
Looking to the future, the key driver for the livestock industry should be production economics. Many businesses do not understand their key costs of production. Without an understanding of the cost per unit, whether it be pence per kilogramme for meat produced or pence per litre of milk, it is nigh on impossible to identify areas for improvement for the whole business and on a more detailed individual animal basis.

The UK pig sector has demonstrated that impressive improvements in productivity are possible, if there is a focus on a few 'Key Performance Indicators'.

Productivity is not simply about producing the maximum level of output, it is about the most ***efficient*** level of production. As the dairy industry shows, the last few marginal units of output are often purchased at a high cost, often greater than the value of the additional output.

Where measures such as TFP often fall down, is that the ***right sort*** of output also needs to be produced. It is pointless being highly efficient at producing something that the market does not want to buy, or values at a low price. UK livestock products are produced to some of the highest levels of farm and animal standards in the world, with the majority of producers signed up to certification schemes such as Red Tractor. The quality of a product is often not captured in statistics, but is one form of non-tariff barrier to prevent products of lower standard entering the UK food chain, such as hormone treated beef. The introduction of a long term genetics / disease control plan might be one method for further developing UK livestock standards and inhibiting low value imports.

Figure 22 **Improvements in Pig Productivity - 2010 to 2017**



Source: AHDB / Andersons

The retailers need to take some responsibility in this area, with a focus on product labelling, to ensure consumers are aware of where products come from. For example, in the dairy sector a number of the leading cheese brands do not contain any British milk.

Technology is likely to be a key driver for the livestock industry in improving industry productivity. For example, gene mapping is an area where cost has much reduced and huge advances are being made, not only in animal genetics but also rumen microbiology. In addition, research into areas such as TB is growing and it is likely new developments will assist the livestock sector with disease reduction, feed efficiency and optimal use of inputs. As the cost of collection, storage and analysis of data has fallen, new opportunities have opened-up for the monitoring and management of livestock enterprises. The industry has only just started to exploit the potential of data to improve performance levels.

With such an uncertain future for the livestock sector, individual businesses need to understand the micro-economics of their own businesses to aid decision making and achieve objectives. Technology should be embraced where it genuinely adds value to a business and can improve resilience.

Based on the issues identified above, it will be important to focus on actions that are within the livestock sector's control. Brexit will have an impact on livestock producers, but much of the change will be out of producer's control. Brexit might just require a different way of thinking by livestock farmers.

NATIONAL ADMINISTRATIONS

Scotland

Ben Kellagher and Alex Caraffi

The 2016 and 2017 years look to have returned better profitability throughout the industry than we had previously been experiencing. There is no doubting the link between this profitability and the impact of exchange rates. All sectors have seen improved conditions from rising prices and some optimism has been returning to the industry. Meanwhile input costs have not risen quite as steeply as some may have imagined, with improved returns. Despite this, there are still challenges and this year one has been presented by Mother Nature. It has come in different guises; an exceptionally dry spell in April and May stressed a number of winter and spring crops, a late snowy spell in many hill areas also lead to significant losses, and more recently a wet summer has hindered harvest progress and quality as well as establishment of 2018 crops. However, there is still some optimism surrounding the outlook for profitability, and we have seen some promising early results for 2017.

As always looking into the crystal ball is more challenging, with many factors in the wider environment likely to affect Scottish agriculture in 2018 and beyond. Some we will look at are, in no particular order;

- *Continued failure to implement the new IT system*
- *Falling LFASS & SRDP budget*
- *Continued Land Reform*
- *Balance of power for agriculture policy between Westminster and Edinburgh*

> ***The Scottish Government still does not have an IT system which is capable of dealing with the application, processing and payment process for the BPS and Rural Development schemes.***

The Scottish Government still does not have an IT system which is capable of dealing with the application, processing and payment process for the BPS and Rural Development schemes. The Minister has announced payments under the 2017 BPS will again be delivered by a national loan scheme and made further commitments made to having a system fit-for-purpose for 2018. The whole process surrounding this system does little to provide confidence that the Scottish Government might be capable of delivering a clear, effective policy with appropriate systems for 2019 and beyond. In the meantime, however, things are working out well for recipients at the moment as they are receiving 90% of their BPS as a 'loan' before they would have received the actual payment.

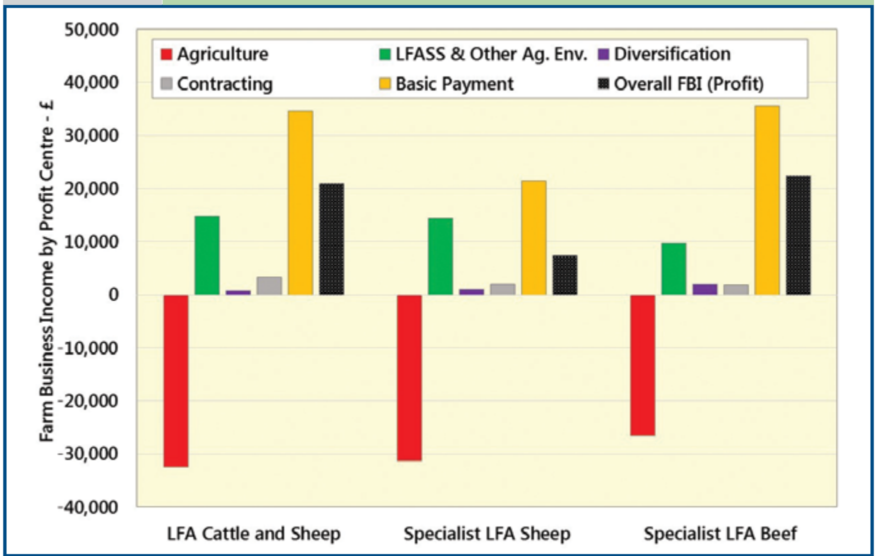
The LFASS regime had been due to change because of to EU regulations, but the impact in a monetary sense had not been quantified or recognised by the industry. It is now clear that in 2018 a 'parachute payment' equivalent to 80% of the 2017 payment will be received and a budget for 2019 has been set which is approximately 65% of 2017 funding. Livestock farmers who are recipients of LFASS are amongst those most in need of financial support. Those farmers will need to understand the impact of these reductions and ensure their businesses can adapt to bear them - whether through increased alternative income or cost savings. Meanwhile, the weakening Pound and restrictions on public funds are putting the monies available through the SRDP for other schemes under pressure. The budget will fall in coming years, potentially reducing already limited support for Young Farmers, New Entrants and Agri-environment Schemes. It would seem a great shame if funding in these areas were to disappear.

It has long been clear that the priorities of English agriculture can be somewhat different to those in Scotland. With autonomy returning to UK agriculture from 2019, it will be vital that Scotland is able to make decisions which suit it best. It is unlikely to become clear for some time what the outcome will be, but, in a situation where DEFRA controls policy, a much simplified system is likely with blunt instruments for achieving some of the nuanced challenges facing Scottish businesses. On the other hand, if Edinburgh is permitted total control it is feasible that the UK government could do so on the basis that agricultural funding is included within the block grant. This would pit the farming budget against social services and the NHS and we know which are stronger politically. In both of these scenarios it is easy to see direct support in total and in its specific delivery coming under pressure.

At present the transitional process including guaranteed budgets and systems through to 2022 is providing some security to the farming industry, which many other sectors would be grateful for.

Many column inches and hours of meetings are currently being occupied looking into future policy and the one thing that is obvious is there is no agreement on the primary objectives. The difference

Figure 23 **Contribution of LFASS to Upland Profits - 2015/16**



Source: Scottish Government

of opinion is clear; the NFUS state a desire for 'active farming and crofting' against the Scottish Land and Estates' objective of 'profitable businesses', which can be somewhat different things. What is clear is that Scotland's landscape and environment is going to be very much a part of future agricultural policy and so those hoping for a slashing of the red tape and burden of green requirements are likely to be disappointed, whilst those willing to adopt positive management actions may well be better rewarded.

> ***It has long been clear that the priorities of English agriculture can be somewhat different to those in Scotland.***

In the background to all of this is the continued implementation of the Land Reform (Scotland) Act 2016. In 2017 this has given us the two-year amnesty on tenants' improvements and the Modern Limited Duration Tenancy (MLDT). 2018 is anticipated to bring the new repairing tenancy, automatic pre-emptive right to buy, ability to assign a tenancy for compensation and finally the 'fair rent' review based on productive capacity of the holding. This is perhaps one of the more challenging and interesting aspects of the reform of the Agricultural Holdings legislation and we look forward to seeing how the group making the proposals manage to come to an agreement.

In a number of situations, as a reaction to the uncertainty and lack of clarity over tenancy reform, we have seen those with land in vacant possession seeking out alternative ways of managing the land particularly through the use of joint ventures and contract farming agreements. With continuing lack of clarity it would seem obvious these alternatives will continue to be options worth exploring.

We are sure to be in for some years of uncertainty in Scottish agriculture. Managers of individual businesses should focus on those things they can control, whilst keeping a close eye on those things which they cannot influence, and the opportunities and threats they may create.

NATIONAL ADMINISTRATIONS

Wales

David Thomas and Kerry Jerman

The current situation for agriculture in Wales might best be described as 'confused'.

Firstly, political confusion, with a Labour administration at the Welsh Government responsible for delivering a Conservative Brexit outcome. The former clearly want a 'soft' Brexit that prioritises access to the EU market. The importance of the sheep sector to Welsh agriculture, and its reliance on exports to the EU, clearly make this an issue that is perhaps even more important than in other parts of the UK. However, the potential outcome is looking far more likely to be at the 'hard' end of the spectrum.

Further uncertainty arises, as it is unclear who will be setting farm policy in the post-Brexit world. The Welsh industry has got used to a good degree of autonomy in how support is delivered, albeit within the framework of the CAP. However, Brexit, and the accompanying EU Withdrawal Act and upcoming Agriculture Act, have led to fears of a 'power grab' by Whitehall.

At the farm level, a significant number of farmers have done little or nothing to prepare themselves for a post-Brexit environment. It must be acknowledged that this is not easy when the shape of future trade and support policies is unknown.

Taking steps to improve business performance now, whilst trading conditions are relatively benign, will be worthwhile whatever the final shape of Brexit.

However, uncertainty around Brexit is often an excuse for inaction. Taking steps to improve business performance now, whilst trading conditions are relatively benign, will be worthwhile whatever the final shape of Brexit. Among those businesses that are considering their long-term strategies, many are increasingly valuing aligned supply contracts for milk and red meat in the hope UK produce will be at a premium in the domestic market.

Aside from a few dairy farms, very few producers in Wales have the scale and efficiency to trade at world prices. Therefore, the sector needs to find niches where it is not competing on price for commodities. The local Welsh food market is unlikely to be large enough to offer opportunities for the majority of Welsh producers and so work to develop markets further afield needs to continue. The building blocks are in place with great brands such as Welsh Lamb and Welsh Beef, but these need ongoing investment and the protection once we are outside the EU.

Investment in sectors like poultry and pigs, which are less reliant on the BPS, are gaining favour to spread risk and help financial sustainability. Lead in times tend to be considerable with lengthy planning and environmental tests along the way, and are mainly an option for those in an already strong trading position which they are wanting to protect.

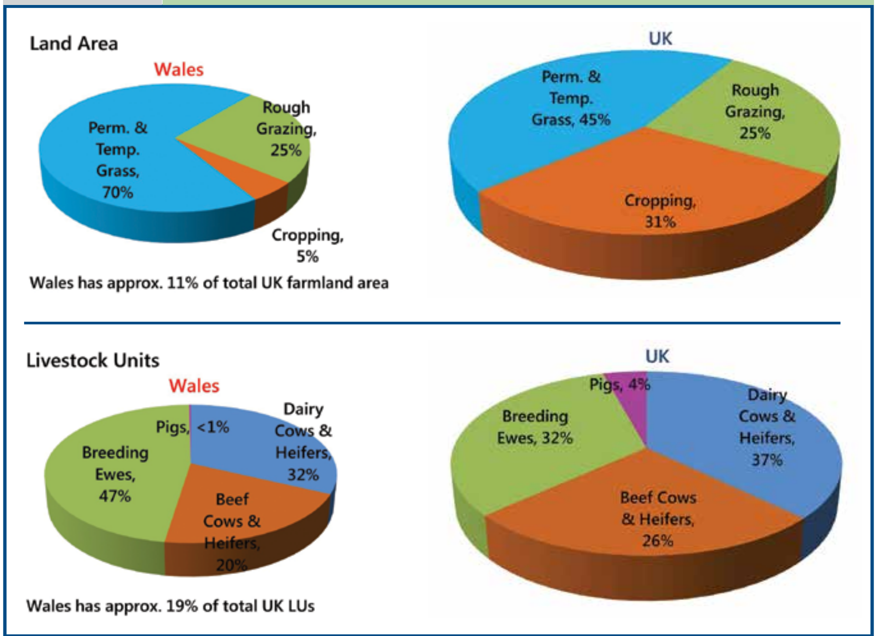
The Principality has plenty to offer in the form of leisure. Whilst many farming families have already embraced this sector, there are undoubtedly still opportunities to exploit with a large and wealthy population living within three hours' drive. With a weak Pound deterring overseas holidays and breaks, the potential for a shift to 'staycations' is clear. But it must be remembered that the customer base is increasingly discerning in the quality of accommodation and other leisure activities. With internet reviews there is no longer any hiding place for poor customer service or shoddy facilities – perhaps not always something so true in the farming sector.

> **Great brands such as Welsh Lamb and Welsh Beef need ongoing investment and protection once we are outside the EU.**

The new Welsh Government Farm Business Grant scheme offering 40% grants on capital items to improve efficiency and plant or animal welfare had a disappointing first application window. It was undersubscribed with all valid applications being successful. This is perhaps surprising, with farmers usually keen to access capital funds. Lack of confidence in the industry comes to mind.

Most studies show the beef and lamb sectors as those worst affected by Brexit. They are, of course, the backbone of the Welsh farming industry and characterise the uncertainty over the prospects for our sector. Hopefully, the Brexit fog will thin during the course of 2018 and the Welsh industry, in turn, can clear its head and start to plan for the new world in which we find ourselves.

Figure 24 **Structural Comparison, UK Versus Wales - 2016**



Source: Welsh Government / DEFRA

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