SATI – South African Table Grape Industry, Technical Bulletin
November 2018
John Giles

WHAT DOES BREXIT MEAN
FOR SOUTH AFRICA & THE REST OF THE WORLD?

The subject of BREXIT has become something of an all-consuming issue for many in the UK, and not just in the horticultural sector. Hardly a day goes past without some new angle or discussion in the media and political world about what sort of BREXIT we might be heading for.

Almost regardless of the type of BREXIT we end up with, the issues of access to migrant labour and the question of market access with the rest of the EU and the rest of the world, including South Africa, are critical ones to get to grips with.

So, while in the UK the debate over BREXIT will continue, it's worth considering how other parts of the world might be looking at this issue. The UK is probably one of the most international markets in the world, with produce sourced from the rest of the EU, as well as other countries, including South Africa, Chile, Peru, Turkey, Central America, Thailand and New Zealand. Total UK fruit imports are in the region of 3 million tonnes per annum. What happens here in the UK post-BREXIT will have implications for them all, but the full extent of which is still unknown. Based on the insight Promar has developed, it seems that a number of key themes might emerge.

For countries in the rest of the EU, such as Holland, Spain, Italy and France, the UK is an important export market for a wide range of fresh produce. It is highly likely that the growers/ exporters in these countries would want to see a relatively *soft* BREXIT whereby they still have good access to the UK market in terms of both tariff and non-tariff barriers. And the UK would still want to be able to import freely from them.

At the same time, it is known that all of these countries are actively looking at new export markets in areas such as the Middle East, Africa and South East Asia. In the mid-to-long term, the importance of the UK as a key export partner may have been downgraded anyway. This was beginning to happen with the increasing amount of produce being shipped to Russia before the trade ban was imposed on the EU which began back in 2014.

So, in the short term, it is likely that other EU growers/ exporters would still want good access to the UK market. The real issue here are the noises that are being made by the political heavyweights across Europe. On one hand, saying that they want a constructive finale to the BREXIT talks. On the other, indicating that the UK cannot be seen to leave the EU in a better position than they are now.

In other parts of the world such as South Africa, Chile, Peru, Central America and Oceania, the UK has been a prime export market for many years. However, over the last 10 years and more, there has been a strong effort to diversify exports to new markets, especially to India, South East Asia, parts of Africa and the Middle East. It is likely that all of these countries will need to negotiate new trade arrangements with the UK. In a number of cases, they will already have Free Trade Agreements (FTAs) with the EU. The simplest thing to do would be to re-vamp the details of this to allow trade to carry on with the UK in a relatively uninterrupted fashion. This would include South Africa.

In particular, countries such as Peru and Chile have developed a high degree of expertise in negotiating free trade deals with other parts of the world. They have shown they can do this in a relatively short period of time. It is likely that they will want to use this expertise to sort out new arrangements with the UK, but at the same time, they have other priorities in emerging markets to contend with too. South Africa, in contrast, has been less successful in developing Free Trade Agreements with other parts of the world.

The question of BREXIT will continue to dominate in the UK over the next 12 months and beyond. In other parts of the world, including South Africa, the issue will be brought in to sharper focus as time goes by, but in some cases, might not always be the number one priority to deal with. And there are still wider issues beyond access to and from the UK market for all growers and exporters, regardless of source, to contend with.

These include the consolidation of the supply chain and the development of sustainable and resilient trading arrangements.

This involves areas such as water usage, which is a particular issue in parts of South Africa at the moment, food waste, carbon emissions, social and ethical responsibilities and the need to make best use of the opportunities that the digital and online economies will present. BREXIT might be an all-consuming subject for some, but there are numerous other challenges and opportunities for the global horticultural sector to face up to as well. This includes South Africa, as much as anywhere.

John Giles is a Divisional Director with Promar International, the value chain consulting arm of Genus plc and has worked on fresh produce assignments in over 50 countries around the world. Promar has worked on a number of assignments with SATI and other organisations in the South African fruit sector in the past and he can be contacted at the following email: john.giles@genusplc.com

AgriTrade News
7th December 2018
Nigel Davies

Promar warns of dairy profit challenge ahead

Dairy business analyst ***Promar International*** warns that while dairy profitability is high for 2018, this is unlikely to last into the next couple of years. Therefore, herd managers and their advisers should prepare for a downturn now.

"Promar Farm Business Accounts results to March 2018 show an average profit after depreciation of £96,318 for recorded herds, significantly up from the £53,130 recorded to March 2017," notes the company's national consultancy manager Nigel Davies. "As a barometer of volatility, this profit was over 30% above the average achieved in the last five years, and only surpassed by the 2013-14 results."

Mr Davies says the projected profit for the year ending March 2019 is influenced by the challenging weather in 2018 and a number of deteriorating market factors. Consequently, he forecasts that profits for the current financial year will be lower than the five year average and also less than half the average profit to March 2018.

"While we have seen an essentially level milk price across the year so far and a continued increase in herd size and yield per cow, rises in feed costs due to increased usage and higher prices coupled with increased overheads will impact materially on profit and the balance sheet," he warns.

"We anticipate profits will remain under greater pressure in the year to March 2020 and believe farmers need to start planning now to minimise the impact of several major pinch points."

These factors include rising feed prices – currently £24/tonne or 11% higher – and energy costs; low forage stocks, which could take until late 2020 to recover to comfortable levels; and milk prices coming under more pressure.

"This is against a background of global political uncertainty, not least the impact of Brexit in terms of tariffs and exchange rates. Producers must budget for the changes to support payments, which currently equate to a total of 1.91ppl for the average farm in the Promar sample." Also, many producers will face a higher 2019 tax bill based on the higher profit achieved in 2018.

PRESSURE

"Dairying-related inflation will not slow in the coming years, with added pressure in particular on wages, feed costs and most overheads," Mr Davies continues.

"For a number of producers, there are fewer replacements in the pipeline and the poor spring and challenging summer will have adversely impacted herd reproductive performance – and hence future milk output – meaning the dilution effect on costs of producing more milk will be reduced."

"Farmers need to start planning now."

Nigel Davies

Mr Davies recommends herd managers work closely with their external advisers to plan their way to secure further business efficiency. "The better producers work more closely with their external team than the average and there is room for most producers to improve in this area.

"Implementing changes and improvement can take time, but they happen most successfully when businesses have the best possible financial information to hand and are prepared to regularly step back from their businesses and take an alternative view."

Farmers Guardian
7th December 2018
Tryphena James

BUSINESS MAKING TAX DIGITAL

With many rural businesses unaware of the impact HMRC's making tax digital initiative will have, Alex Black takes a look at what farmers need to know.

Tax to go online only for some businesses

Farm businesses looking at the looming deadline for making tax digital (MTD) should concentrate on turning an imposition into an opportunity.

Andrew Robinson, partner and head of agriculture at accountancy firm Armstrong Watson, said it was both a challenge and an opportunity.

He said with the deadline of April 1, 2019, approaching, it was essential every business was fully prepared.

Businesses will need to review their accounting software to ensure it is compliant with the new regime.

Mr Robinson said, at a minimum, this meant the business would need to process and preserve records in a digital form, create a VAT return from the digital records and provide HMRC with VAT data on a voluntary basis.

Compliant

A common misconception was all UK VAT-registered businesses needed to be compliant by April 2019, but only those with a turnover above £85,000 will need to keep digital records and submit VAT returns using MTD compatible software.

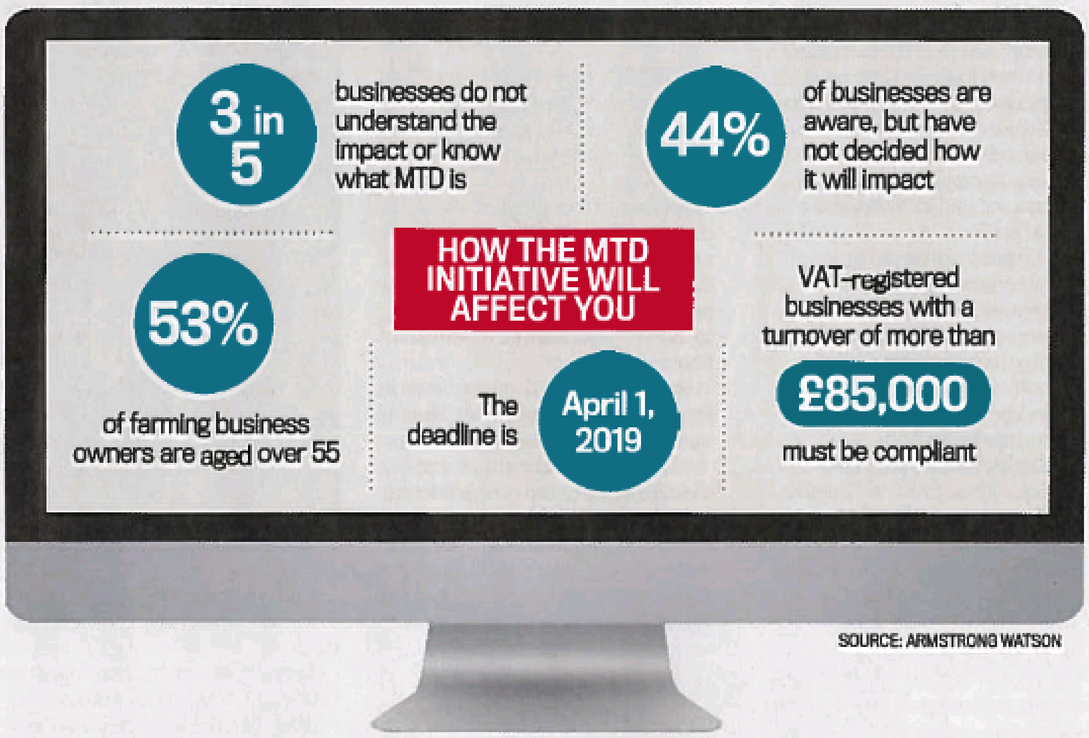
However, those not covered would need to be in future, 'likely by April 1, 2020', according to Zoe Keys at Ellacotts accountants.

There was an exemption for a very small minority with more complex requirements, with their deadline delayed until October 1.

And if this turnover dropped below the threshold after being required to comply, it still applied unless the business deregisters from VAT or meets exception criteria such as insolvency.

And 'splitting up' the business to reduce the turnover so it falls below the threshold will not mean businesses will no longer need to be compliant.

"The enterprises will still have financial, economic and organisational links, so HMRC will identify this as one business," said Ms Keys.



SOURCE: ARMSTRONG WATSON

However, businesses can maintain separate records for each enterprise in order to track income and expenses accurately and to monitor profitability and should pick software which caters to their business.

Chore

It was easy for farm businesses to look at MTD as a chore, but Promar's farm business analyst Tryphena James urged businesses instead to look at it as an opportunity.

Ms James also added there were particular challenges for the farming sector, with many still using paper-based systems now forced to move on to compliant software.

She said: "Why not go for software which gives you a lot of feedback in terms of reporting, rather than one which just ticks the box?"

She added continuously tracking finances, what a business owes or is owed, can help businesses keep better track of their cashflow.

However, many still faced challenges such as poor or no internet connections and access to a computer.

She said: "For example, I had a client last week who had no internet, so he had to use his brother's."

Mr Robinson said there were many uses for data, with businesses able to access up-to-date information all the time: "We feel this can be treated as an opportunity as well as a challenge."

This meant business owners could judge and reflect on farm performance, monitor against budgets, use data for forward planning and strategic decisions, have up-to-date information for tax planning pre-year end and the ability to benchmark against industry standards.

Dairy Farmer
December 2018
Tryphena James

Digital input of VAT becomes compulsory from April 1, 2019, and will affect all farm businesses. Promar's **Tryphena James** explains why it is important to start planning now.

Are you ready to make tax digital?

"With most dairy farms being net recoverers of VAT, it is in their interests to comply with the new legislation

Making Tax Digital (MTD) has been described as the biggest change to tax management since the introduction of PAYE.

It is a key part of the Government's plans to make it easier for individuals and businesses to get their tax right, claiming it will make tax administration more effective and efficient.

The first stage is changes to the VAT system, but other taxes, including Income Tax, will move down a digital route in due course.

MTD is a fundamental change in the way VAT records have to be kept and the way returns are submitted to HMRC.

The days of manually entering your VAT using the Government Gateway will disappear as the Government believes collecting the information automatically will increase accuracy and the amount of tax collected. The MTD rules will apply for all VAT periods starting on or after April 1, 2019.

It will no longer be possible to keep a manual cashbook and input totals on the VAT return. Equally, if you collect financial information digitally, it must be on a system which is MTD compliant and enables the VAT return to be submitted automatically.

Cashflow

With most dairy farm businesses being net recoverers of VAT, it is in their interests to make sure they comply with the new legislation to ensure cashflow is not affected.

With around half of dairy farmers reporting VAT monthly rather than quarterly, it will be essential to be ready from day one.

All records required for completion of the VAT return must be kept digitally on what is described as functional compatible software. This is software that will automatically link with the HMRC VAT Application Programming Interface system and update the VAT return with no manual intervention.

The software must be able to keep all required records in a digital form, create a VAT return from those records, and provide HMRC with that information digitally. It must also be able to receive information from HMRC about the business's compliance records.

Many software suppliers are submitting their programmes to be approved as MTD-compliant.

At Promar, our Farm Business Accounts service has been approved. However, many recording systems used on farm are still unapproved.

The content of the VAT return will not change and the records required to be held digitally to complete it fall into two categories.

The first is business descriptive information, including your business name, business address, VAT registration number and details of any VAT accounting schemes you use.

The second is transaction details for both purchases and sales. The information which drives the numbers on your return. It will involve details including the time of supply (tax point), the value of the supply (net excluding VAT) and the rate of VAT charged.

You are not being asked to record anything new, or to do anything different with it. You are just required to record it in a different way, quite likely on a new system.

It is important you start reviewing how your office procedures will need to change and to select your software as soon as possible, so you have time to get everything up and running.

There are numerous pieces of software available that will make sure you are VAT compliant. But if you are being forced to change your system and gather data electronically, this should be the opportunity to see how much more you can do with the information.

You can't avoid MTD and you should see it as a way to establish a system which gives more business information to aid decision making and planning.

Expert opinion

▸▸MTD is a fundamental change in the way VAT records have to be kept and the way returns are submitted to HMRC. The days of manually entering VAT using the Government Gateway will disappear.

Dairy Farmer
December 2018
Promar International

promar International — A Genus Company

The VAT changes are coming.
Don't get caught out!

Making Tax Digital comes into effect from 1st April and affects all farmers over the VAT threshold.

With our extensive team of skilled farm analysts using our MTD Compliant Farm Business Accounts Software we can ensure you meet all the obligations and capture real value from your financial records.

Call **01270 616800**
or email **MTD@genusplc.com**
to find out more.

Dairy Farmer
December 2018
James Dunn

Running a business that has a strong handle on costs and is fit to survive a future without subsidies should be the focus of all dairy farmers looking to prosper in the industry long-term.

How prepared are you for the future?

As a dairy farmer, are you the best you can be? Do you understand your costs, challenge yourself to innovate and develop your farm team?

According to James Dunn, managing director for Promar, it is these skills which will underpin farm businesses which survive and thrive over the next five years. Failure to adopt such thinking could see businesses crumble in a post-Brexit world.

The 'EU Dairy Towards 2020 Study' carried out by Promar in 2015 interviewed stakeholders in the European dairy industry to establish attitudes that are still relevant in 2018.

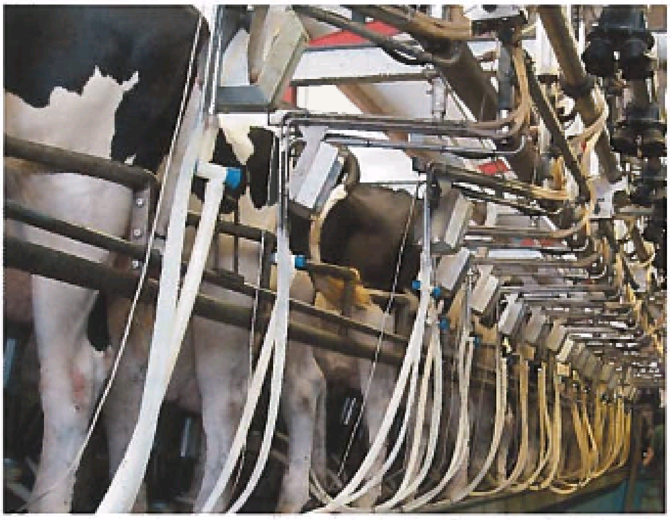
The results identified four types of farmer: survivors; doers; managers; and entrepreneurs/ leaders *(see diagram, right)*.

Survivors had a hands-on role with limited knowledge and saw high price as the only way to make profit, whereas entrepreneurs were focused on innovation, leadership and engagement.

'Be more than just a survivor'

Mr Dunn says to face the numerous challenges ahead *(see infographic on p04-05)*, all farmers need to be in the managers or entrepreneurs/ leaders category.

He says: "There are quite a lot of survivors and doers in the UK, purely due to the legacy of UK family farms and the fact a lot are passed down from one generation to the next.



As a dairy farmer, do you understand your costs, asks James Dunn.

"In Holland, they argue they have few survivors and doers, as inheritance tax laws are less favourable and usually incur a cost, so they are more focused on financial success."

It is these survivors and doers who, Mr Dunn believes, are going to have to adopt a rapid change of mindset if their businesses are to continue.

He says: "Consolidation will happen. It needs some kind of spark and that is likely to be Brexit.

"Brexit will cause reduced subsidy and there will be a big problem with labour.

"Entrepreneurs and managers will have the same problems, but they will have seen the problems coming and planned for them."

Although subsidies are set to continue until 2021, with support likely to continue to 2027 on some farms, Mr Dunn sees this as an unhelpful 'soft landing,' which is only delaying the inevitable.

He says: "Farmers need to be thinking about it now, as it will come."

Five-year business plan

On the average dairy farm, grants and subsidies make up 5% of turnover, which will contribute to net profit.

Mr Dunn advises drawing together a five- to 10-year

business plan, looking at what profit the business needs to generate to make a profit when subsidies are removed.

For example, how much profit is needed to pay for:

→Private drawings?
→Loan repayments?
→The tax bill?
→Capital purchases?

Mr Dunn says: "A subsidy is an income source that is going to disappear, so for those guys who are just making a profit, they need to find a way to replace that income.

"Is it more cows or some kind of diversification? Should there even be an exit strategy? It may spark a succession conversation."

It is important to carefully work out the cost benefits of any strategy designed to fill the income gap left by the removal of subsidies. For example, if you look to increase yield by 200 litres/cow on the same herd size, are those marginal litres economically viable? Can you produce that milk efficiently?

When looking at diversification options, consider the spend needed to diversify, whether you have the skills to do it or if you can use resources and skills already available on-farm, such as a maize maze.

Understand data

In order to truly understand business performance, monitoring and tracking financial data is also essential.

This will enable profit to be understood on a pence per litre basis and how much Basic Payments contribute to that.

Mr Dunn says: "A lot of farmers collect data, but don't use it."

With the introduction of 'Making Tax Digital' in April 2019, every business paying VAT will have to submit a VAT return in a digital format, using software which is compliant with HMRC.

Mr Dunn says that makes it a no-brainer to upgrade financial recording systems.

He says: "If you are doing that, why not invest in software that can measure financial reconciled data to understand cost of production and how much revenue will be missing should subsidy go?

"It is important to use as much data as possible to understand your shortfall, then use that data to increase production or reduce cost of production through benchmarking. That will enable you to manage volatility and be sufficiently resilient to substitute forgone revenue."

Drawing on external expertise to help buy-in knowledge and drive efficiencies is an important component to business performance.

Whether it is feed advisers, the vet, bank manager, accountant or breeding adviser, they are all vital components of the farm team.

Mr Dunn says: "For example, work with your breeding adviser to see if you have the right animals on-farm. Are you keeping enough heifers or too many? Does each pregnancy deliver a valuable product?"

The best farmers will be breeding from the best animals, producing the right number of quality replacements and investing in promoting good early growth rates to calve at 24 months.

Creating a strong team ethos which supports and develops staff is also a key attribute of these producers.

This ensures they have a framework which makes them an 'employer of choice' which will help them overcome future labour challenges *(see infographic on p04-05)*.

Feed advisers

At the same time, engaging with feed advisers helps ensure rations are balanced effectively, which maximises feed conversion efficiencies and limits environmental impact.

Mr Dunn adds: "It is a hunger for knowledge; that is what those managers and entrepreneurs are about. They are keen to innovate and use technology.

"It is then about attracting and retaining quality staff and engaging with your supply chain partners, while minimising impact on the environment."

Dairy Farmer
December 2018
Nigel Davies

Consultant Promar has just released its Farm Business Accounts for the tax year just gone and made some interesting predictions about future prospects. **Peter Hollinshead** talks to Nigel Davies, national consultancy manager, about the industry's challenges.

Prepare your business for challenges ahead

Nigel, your predictions make for gloomy reading don't they, as we look like being thrown into a cost/price squeeze with margins being eroded from both ends?

Yes, that's right. Dairy profits have been volatile for the last few years, but we are seeing quite a contrast between last year, 2018, which was relatively good, and this year, 2019, which we expect will be well below the average at year ending March 2019, because of the impact on output and costs.

Okay, we'll come onto the detailed costs in a moment, but is it true to say the milk price will be challenging looking forward and feed prices could also increase?

We have been very fortunate in the year to date that the milk price has stayed pretty level compared with what we experienced in the last financial year, but we see now that some buyers have started to implement cost reductions and we would expect further reductions after Christmas.

In terms of feed price, our Milkminder costings show average concentrate cost per tonne is cumulatively running at a little more than £20/t over the comparable period last year, so there is definitely an impact there.

But don't forget other overhead costs as well, where the oil price, at more than US$80/barrel, is having a significant impact on some of those hidden things such as the cost of transport to and from the farm, and more immediate outgoings including contractor costs.

But before we get too far ahead of ourselves, according to your latest costings, you are predicting a profit after depreciation for the current tax year of less than £40,000, which is roughly half that of the 2017-18 tax year at £96,318. However, milk price so far this year has not been too bad, so are we in for a pretty challenging last quarter to the year to bring this figure down to £40,000?

Yes, I would say there is a fair bit of challenge going on already in terms of costs. For example, last year we saw wages increase by 7.8% and power and machinery costs by 6.2%, so we are expecting similar, if not higher, increases

Farm incomes come under pressure

»Milk producers cannot sit back on last year's good results, but need to start planning ahead to get themselves in a position to weather the effects of an imminent cost-price squeeze.

According to Promar's Farm Business Accounts, the latest figures for accounting year to March 18 show a bumper profit, after depreciation, of £96,318, which was nearly double that of the previous financial year (at £53,130) and more than 60% above the average of the previous five years.

Promar's Nigel Davies says: "Total variable and overhead costs increased by 6.9% and 5.6%, respectively, but, critically as far as driving profits were concerned, the average producer in our sample increased total milk output by 74,009 litres, kept four more cows and produced an extra 188 litres per cow without increasing feed usage.

"This, in conjunction with an average milk price increase of 2.86ppl, diluted the impact of cost increases, resulting in profit after depreciation per litre rising from 3.09ppl to 5.36ppl."

Liabilities

But the gross profit figure was swallowed up by drawings and tax of £51,312, loan and hire purchase repayments of £68,160, and net capital spend of £98,477.

This has resulted in an increase in total liabilities of £16,468, but accompanying this was an increase in total assets of £77,719, one-third of which was on property. The net effect was one of showing their costed producer being £61,251 better off on paper.

But Promar's predictions for the financial year ending March 2019 is a whopping decline in profit after depreciation to less than £40,000, falling to less than half that of the last recorded year to March 18, and lower than the five-year average.

Nigel Davies, Promar National Consultancy Manager.

Looking ahead, the problem stems from a forecast decrease in the milk price for the remainder of 2018-19 tax year of maybe 1ppl below last year, and going into next spring at about 28ppl, and an increase of about £20/tonne in feed prices climbing to a £250/t average cost by early next year.

In addition, oil prices are also riding higher

already in this financial year as far as those are concerned.

But as regards your specific point on the milk price, the commodity price indicators have been falling in the last 10 or so market reports, and the shortages which were thought to happen in Northern Europe because of the drought have not really materialised.

We know New Zealand has started its production about 6% higher than it was in the same period last year, so that is significant in terms of global supply, and all these things will quite

than last year by US$20-30/barrel, which impacts on many of the inputs going into the cost of milk production on most farms.

The need to plan for the year 2020 is greater than ever and Promar's sensitivity points show each 1ppl movement in milk price equated to +/- £17,896, each £10/t change in feed price represented +/- £6558 and each 1% change in overheads was equivalent to +/- £2937.

Promar warns of the need to prepare for future years and outlines several 'pinch points' which are likely to be encountered.

In particular, it stresses the need to prepare for first half of 2019 as a cash pinch point, and the summer of 2019 as a forage pinch point stemming from the need to re-establish reserves fed this summer. In the longer term, producers need to recognise support payment demise amounting to a potential equivalent of 1.91ppl for the average of this sample, and the need to remove further inefficiencies on-farm.

rapidly start to impact on milk prices in December and into the new calendar year.

Just so we are all clear, the figure which you talk about as your 'profit', is that income after depreciation and payment of all the variable costs of production?

Yes, that's right. These businesses started with a turnover of £735,470, which is the money they have taken in, but they also need to pay for a lot of things. So there are variable costs of £345,000; overheads, wages and farm machinery are another £206,000; and then there are those for renting land.

There is a depreciation which is the written down value of those machines and capital items, not forgetting interest charges on any borrowing they might have, be it overdraft, loans, hire purchase or other finance agreements. Take all those away and it leaves us with that figure of £96,000 profit before depreciation.

Just going back one stage, that £96,000 figure from last tax year has ended up as a £61,000 increase in assets value with a £16,000 increase in liabilities. Is that mostly additional bank borrowings, and what is the current debt of the average farm?

What we have to remember is the profit figure is just the trading activity and there is non-trading activity, this being the repayment of existing loans, private drawings etc. That increase in debt shows itself primarily in the additional loans these businesses have at the end of the year compared to the start of the year, and also the increase in balances to creditors such as those people they pay from day to day. But going back to your question, they have ended up with an average borrowing of £563,000 compared to the start of the year at £546,000.

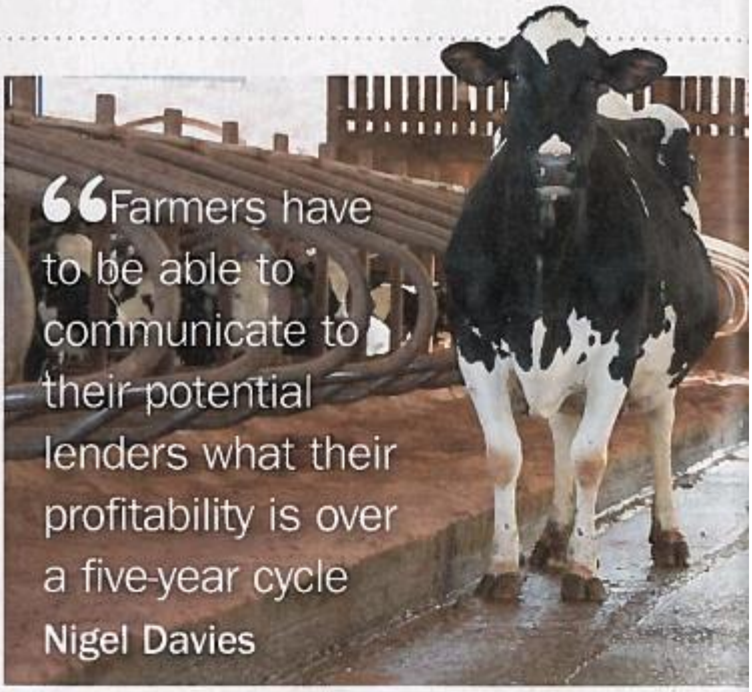
So it has gone up... is this mostly due to extra bank borrowings to sustain their business?

Yes, dairy farming is a business which requires investment in machinery and concrete for many, and most require long-term investment meaning putting new borrowing in place each year to continually reinvest in the farm.

They can't have long periods when they do not reinvest. This increase in borrowing is primarily through new debt and we see this in our sample – they have introduced new loans of more than £86,000 in this last year.

Is that level of almost continually increasing debt sustainable?

For some producers in the sample, yes, but for most, probably not. This is because to attract new debt, businesses need to demonstrate continuing viability, and as debt increases by £1000 per cow, then if the debt repayment is spread over 15 years, this is effectively an additional charge of 1ppl. So it is akin to the milk price falling that much each year. So as debt increases, it makes it more challenging.



How many would be at that level where they are increasing debt by £1000 a cow?

We don't have the specific numbers, but we know significant investment is going on and the average debt has increased from £2648 to £2674 a cow in the last year. However, I would estimate it is something of the order of 10% who may have been in that scenario over the last three or four years.

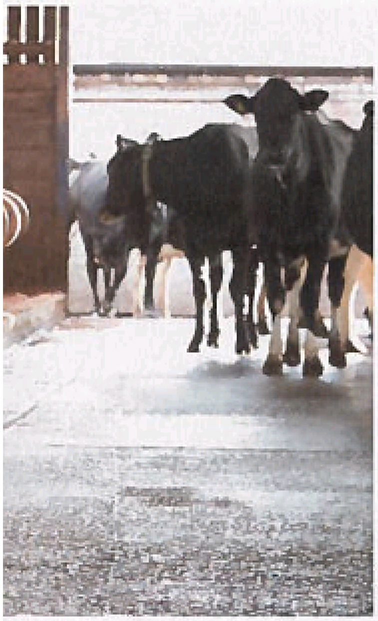
Okay, let's go back to this year's expected £40,000 profit figure after depreciation. How will your average producer manage to even squeeze out the £51,000 he took last year in drawings and tax, even if tax is less on the lower income?

This is where looking at it over four or five years is so important as there will be good years and not so good years. The challenging thing is we have only had the one good year after the tough years of 2015, 2016 and 2017, before going back into another challenging year.

They will have to continue to look at further efficiencies and think seriously about which bits of their business are making a profit and which are not. But you are right, without those efficiencies being achieved, they are going to struggle to make any kind of cash surplus.

And that is without the other payments which need to come out of that £40,000?

Which is why on an individual farm basis it is important for them to have recognised last year was a good year and to have strengthened their balance sheet over that period. The better managed businesses



will have invested in that year and/or actually managed to bring their particular borrowing down so as to leave them in a stronger position to weather the storm we say is coming in the 2019 numbers.

So, if the profit is predicted to be £40,000 for the current year and we have a challenge already with the £51,000 in drawings and tax, and we also have a repayment and loans figure of £70,000, how on earth is anyone going to make ends meet?

Yes, there is no cash from the profit we think will be generated this year to repay those existing loan agreements, so for most producers they will have to attract new borrowings into the business to repay the existing borrowing and continued investment.

Farmers have to be able to communicate to their potential lenders what their profitability is over a five-year cycle and not just a one-year cycle, as the probability for most businesses in this year is they will not be able to demonstrate their profitability to repay that £70,000 of liabilities.

Dairy farmers have to be able to demonstrate their understanding of their cash position over a five-year cycle of volatility.

Yes, but this is a bit of a vicious circle and in the meantime they have to service the debt they already have, so it is going to be a bit difficult, is it not?

If this year was the same and true for every year, then it is an unsustainable circle, as it is more than robbing Peter to pay Paul.

This is why looking at it over more than one year is so critical. By making the most of the upsides of the volatility cycle, one is in a stronger position to manage the downside of the cycle, which is what we are saying we are into now with the 2019-20 numbers.

As a former banker, how do bankers view this prospect, even in one year of maybe defaulting, not just on interest payment, but on repayment of loans?

I think bankers are still supportive where they see businesses understand this cycle and those costs in terms of the years when they will make money and those they will not, and what the combined effect of that is over a five-year cycle. I think reasonable bankers would expect many dairy producers in any five-year period to be challenged to achieve profit in each of those years, but if they are achieving it in three out of five, as opposed to one in five, then this probably makes the difference as to whether or not they are supportable cases for the bank.

What did you say was the average borrowing on your farms?

The average for the sample we have this year is £2674 per cow, but there will be a range around that.

And this is increasing?

This increased for the same farms last year from £2648/cow, and this repeats a trend we have seen over the last few years.

So are we looking at a recipe for extra borrowing this year as working capital, which may be a new thing for some farms just to stay afloat, or, in the extreme, maybe bankruptcies?

The reason why any business fails is because it runs out of cash, not necessarily because it does not make a profit. Businesses need to make sure they understand how much cash they will need, and we are saying the average business will need more cash facilities this year.

So they need to engage early with where their cash is coming from and get it in place in good time. If businesses are not able to put Plan B in place to manage this demand for cash, then conceivably some businesses might, unfortunately, have to cease trading.

In your sensitivity analysis you say the 1ppl change in milk price is equivalent for your costed farms of £18,000 a year. So in the next year, or even this tax year, if we saw a decrease of 2ppl, this would be £36,000, which would all but wipe out the £40,000 they are predicted to make?

So what you are hinting at there is as businesses become bigger, and the average total production is just short of 1.8 million litres, then small changes in unit costs make a big difference to the bottom line. We spoke earlier of how prices could come under quite a bit of pressure in the New Year and we have said 1ppl is equivalent to £18,000, so 2-3ppl carries multiples of that thereafter.

Does your figure for the current tax year take on board the cost of the extra forage having been bought to tide people through winter, or does it come off next year when they are trying to replenish strategic reserves they may have had to break in to?

Remember we are talking about the average, and some farms will have been particularly hard hit by the difficult spring and summer so their costs will be much greater than some others.

So we have to build in some allowance for costs already incurred and those likely to be incurred next spring, but I would say it is a relatively small amount compared with the other things, such as milk price, feed price and oil price.

If we are feeling this squeeze now, are you seeing it being perpetuated, and possibly exacerbated, into the next tax year?

I fear there is more likely downside than upside, given the pattern in dairy commodity and feed prices we are now seeing. The likelihood is we will start with milk prices in April 2019 much lower than in 2018 and, significantly, costs will be up because the inflation factor from the increased oil price will impact various items, particularly labour. We talk about an increase in costs of nigh on 8% year on year to 2018, and I think this will continue into the next year. So total costs next year starting next April will certainly be higher than they were in the previous year.

What is your prediction for the milk price going forward?

Global trade in terms of demand is dampened and there appears no reason to expect this to turn around. We also have the supply position in the Southern Hemisphere which looks pretty favourable and we can expect this to continue at least for their summer, while production in the EU shows no signs of falling yet.

So until we can see any changes in those influencing factors, one has to fear continued pressure downwards. Putting a number on this is challenging, but the direction of travel, I would suggest, is more likely to be downwards.

And you wouldn't care to say whether we will touch 25-26p next spring?

No, but it will be different for different people on different contracts, so the key thing for producers will be to understand the type of contract they are on. For some contracts the figure of 25ppl is quite possible.

And the cost of production for your producers would it be in excess of that?

When we talked about profitability you referred to not enough money being there to pay for the drawings etc., so the cost of production in those cases will be above the milk price they are receiving.

Above 25ppl?

Yes.

Quite a bit above?

With everything accounted for, of the order of 28-29ppl, and above for many.

What about the feed front? Wheat has found another home, being used as an industrial feedstock, and sterling continues to weaken which will make soya more expensive, so what is your feed price prediction?

We said earlier about an increase of £20/t, and there appears to be continuing increases month on month, so we could reasonably assume there will be similar increase into next year and see 2020 numbers £15-20/t higher than they were in 2019.

Is it creeping towards £300/t?

No, perhaps not that far, but certainly more than £250/t.

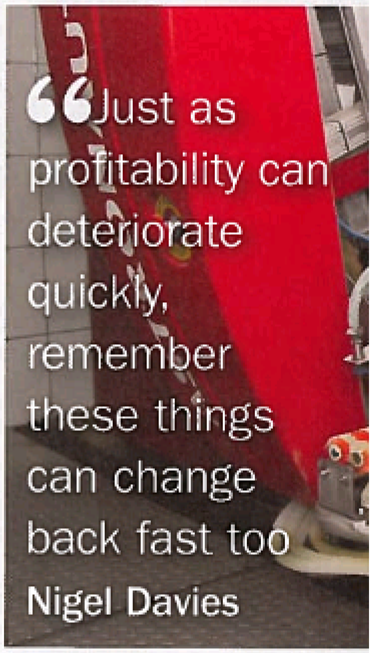
Longer term, we have the demise of the Basic Payment support. Are you factoring this in for the years ahead?

We will have to, but we haven't for the numbers we are talking about for 2019 and 2020.

We do know the sum total of this support for the average farm is 1.9ppl, and we can reasonably forecast the average won't receive that much in four to five years' time, therefore we do need to consider where those efficiencies are likely to come from. For example, they can't all come from feed reduction alone, because if the full 1.9ppl disappears, this is equivalent to 0.08kg/litre.

To what extent do you think this demise will be offset by environmental payments as Mr Gove tells us?

I think the big issue for dairy farmers is will they have a stick or carrot to encourage them to put those environmental measures in place? Will it be a legislative stick to



achieve certain criteria or a carrot? And I think some will benefit more than others. If you were to press me on what we might expect in three to four years' time, I would effectively be working on getting half of what producers get now.

So what is to be done? I know you would say increase efficiency, but doesn't that embroil you in the cycle of more capital expenditure and therefore ultimately increased debt?

It will for some and that will be the right thing for them. I think the key thing for those making expenditure is to measure its benefits in terms of efficiency – what is the effect of this investment in terms of cost of production.

For others who may be over-borrowed already, it might means some dramatic restructuring of the business to divest themselves of some non-core assets, such as land away from the main buildings, just to build a business which can withstand the downturns we are expecting in 2019 and 2020.

Some may say selling away land may be like selling the family silver and can only be done once, and therefore if we get into another decline in a few years, they won't have that to fall back on to release capital?

I can understand why selling any asset is a last step for a lot of people, but if it constructs a business with a lower cost of production, they are actually doing a positive thing. Most dairy farmers are asset rich and cash poor. You can have all the assets in the world, but unless you have cash coming in and a cash surplus – not necessary every year but maybe three out of five – then the business is not going to be sustainable. In that situation, selling those assets may then become a forced scenario, as opposed to being your choice.

Do you think there will be a decrease in the value of land as support dwindles?

It is a downward pressure, but history suggests the value of land is not just determined by the farming profits from it, but by other non-farming people wanting to own it and some very long-term views. By and large, I think land will retain a lot of its value.

I can't get away without mentioning Brexit. Have you built this in anywhere and what do you see as its impact on dairying?

Our numbers only look at 2019-2020, so we haven't fully built it in, and there could be changes in exchange rates which could be quite material in terms of input prices.

There could be an impact in terms of tariffs which, initially, given our balance of supply and demand, could be favorable for UK dairy producers if we can manufacture some of the goods we import, but Brexit certainly creates a lot of uncertainty which doesn't help. Perhaps the most immediate challenge will be around labour, both its supply and cost.

You outlined the challenge we face, but what can you say to leave us on an upbeat note?

Two positives. There are teams out there working really proficiently and I think dairy managers have a great ability to adapt and take on new ideas. One thing the numbers do teach us is little changes in management can have a big impact on the financial result.

There are many opportunities for us all to learn and grow using quality data as a base for decision-making.

Secondly, just as profitability can deteriorate quickly as we believe it is now, then remember these things can change back fast too, and I expect they will at some point.

British Dairying
December 2018
James Dunn

Preparing dairy business for challenges ahead

James Dunn, managing director of Promar International, considers some of the imminent challenges facing dairy farmers and what they can do to prepare.

There is no doubt dairy farmers are about to enter a period of considerable challenge and uncertainty which will impact significantly on their businesses.

The convergence of Brexit, increased global volatility in many prices and political pressures domestically mean dairy farming is in for an interesting time. But where there are challenges for some, there will be opportunities for others.

We know that we will leave the European Union in March but no one knows exactly what that will mean to labour supply, to tariffs and trade or to exchange rates and consequently the price of many farming inputs. The future of farm support payments is still not completely clear, and then there is the question of Ireland and what happens to the dairy trade there.

We know there is global volatility in many commodities and also that it is unlikely the growing trade war between the US and China will quieten down any time soon. Traditionally trade wars are associated with reduced economic growth which in turn hits the demand for dairy products.

Finally, we know that there is political unrest in the UK with talk of a snap election. At the same time the activities of well organised pressure groups who are not supporters of the dairy industry are growing and we are seeing shifts in dairy consumption, with the increased interest in vegan diets while the Millennial generation are moving away from dairy to vegetable alternatives.

Uncertain outlook

Faced with such an uncertain outlook, what should milk producers do? I think there are two clear messages. The first is to narrow your horizons and focus shorter term until things become clearer and better defined. The second is to concentrate on areas within your control and which you can change, not those that you can't.

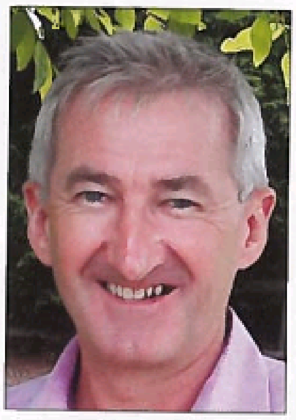
The reality is that the successful dairy farmer of tomorrow will require different management skills and a different business approach to their predecessors in the way they build profitability. They will appreciate that individual productivity is not solely measured by hours worked but by what is done in the hours worked.

They will really understand the role of data in managing their business, both technical and financial, and appreciate the value of external advice. They will seek out the best people to offer advice and embrace them as integral members of the farm team whether it is the vet, the nutritionist, the consultant or accountant.

They will take pride in managing people, developing skills and delegating responsibility, appreciating that a skilled team will deliver the incremental efficiency improvements which contribute to a sustainable business and best return on any investment.

Finally, they will understand the importance of an interdependent, responsible and sustainable supply chain as a way to build value.

These changes can't happen overnight. They are a transition but an important one. As we stand today, there are four areas which I think should be high on the list for all farmers to consider and all reflect a change in attitude.



James Dunn: "The reality is that the successful dairy farmer of tomorrow will require different management skills and a different business approach to their predecessors in the way they build profitability."

Labour supply issues

Good quality staff are a bedrock of an efficient dairy farm business, yet recruitment and retention of staff remain big concerns. A recent RABDF survey reports an 11% increase in issues with recruiting overseas workers while reportedly British workers seem reluctant to fill the gap. This means it is inevitable that more dairy farmers could find themselves starved of labour which could have severe implications for animal and farmer welfare as well as profitability.

So think carefully about your labour requirement. It is far cheaper and far less disruptive to retain existing staff than to have to recruit new ones, particularly if supply is tight. And remember, if there is a labour shortage, more people may target the recruitment of your staff.

Being a good people manager could be the difference between having someone to milk your cows or not. You can't do everything yourself so build a team of people skilled in specific tasks. What can you do to build a more effective and skilled team?

Staff management is an overlooked skill and must embrace training and development, delegation, motivation and communication of everyone in the team. Be prepared to include your staff in meetings with the vets, consultants, contractors, nutritionists so everyone is working from the same data and towards the same objectives. It is widely accepted that engaged employees are more productive, innovative and loyal.

Build effective supply chains

Can you work more closely with your customers to better deliver what they require and in so doing increase margins. Explore every relationship you have and challenge to make it more effective.

Take beef calves as an example. With the increased confidence in, and uptake of female sexed dairy semen, there will be the opportunity to increase the production of dairy cross beef calves. So how can you increase their value?

Can you agree a supply arrangement with a finisher and deliver a specific cross, or better still calves from agreed sires? It may cost a little more in semen but the return will make it worthwhile.

Can a rearing protocol be agreed which is reflected in the price. It might include vaccination and health protocols, tag and testing to confirm calves are not a BVD PI animal, a commitment not to use antibiotics or a whole host of factors.

Investing the time to work more closely with your customer could change how an enterprise is managed but secure a better price and improved margin.

Consider the environment

Environmental management is going to become increasing topical and high on the Government and public agenda. This is evidenced by the Government's recent announcement of stricter controls on livestock housing, fertiliser and slurry and manure management to help reduce ammonia emissions, bought into focus because agriculture accounts for 80% of total UK emissions.

As you are going to have to do something, it will pay to be proactive and many reductions can be achieved by adopting best practice such as the use of dribble bar applications of slurry.

It is likely that some capital investment will be required, most likely with a need to cover slurry stores, and there may be grants available. By planning ahead you will be best placed to comply with legislation and also increase the chance of qualifying for any grant funding.

Embrace and use data

There is now a wealth of data available to manage the dairy business, whether physical and technical records or financial data, yet fewer than 50% of dairy farmers benchmark performance as a way of monitoring progress or identifying areas for improvement.

In a volatile climate, the more information you have available the better placed you will be to understand where your business sits and predict the impact of any change.

Many dairy farms are going to be forced to maintain financial records digitally to comply with the Government's Make Tax Digital regulations which start in April with changes to VAT recording. This presents an excellent opportunity to make sure you are in a position to maximise the value you derive from your data to improve financial management.

The next two years will bring a period of change and uncertainty but by focussing on short-term objectives and areas within your control it will be possible to develop a business that can ride out the change and be well placed moving forward.

British Dairying
December 2018
Tryphena James

Preparation vital for VAT changes

Farmers have just four months to ensure their business is compliant with the Government's new Making Tax Digital scheme. Tryphena James, UK Farm Business Accounts manager with Promar International explains what is involved.

On April 1st, Making Tax Digital (MTD)—which has been described as the biggest change to tax management since the introduction of PAYE—is scheduled to go live.

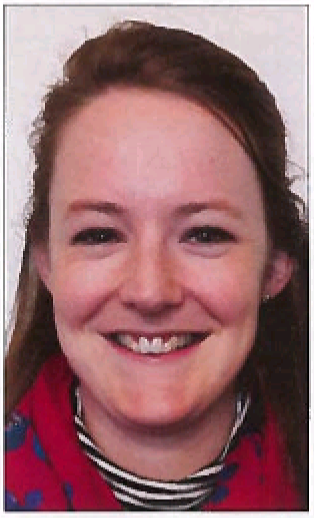
It is being described as a key part of the Government's plans to make it easier for individuals and businesses to get their tax right, claiming it will make tax administration more effective and efficient. But it is going to cause some significant and possible substantial changes to the operations in many farm offices.

"There is no hiding from the change," Ms James explains. "If you are a VAT registered business you will have to comply. The changes are quite complex and the sooner businesses start assessing what they need to do the better, avoiding rushed changes."

The first stage of the initiative is changes to the VAT system, but other taxes including Income Tax will move down a digital route in due course. MTD is a fundamental change in the way VAT records have to be kept and the way returns are submitted to HMRC.

Automated collection

"The days of manually entering your VAT using the Government Gateway will disappear as the Government believe collecting the information automatically will increase accuracy and the amount of tax collected. The new MTD rules will apply for all VAT periods starting on or after 1st April 2019.



Tryphena James.

It will no longer be possible to keep a manual cashbook and input totals on the VAT return. Equally, if you collect financial information digitally it must be on a system which is MTD compliant and enables the VAT return to be submitted automatically. The precise timing depends on whether a business is registered for monthly or quarterly VAT.

The MTD VAT rules apply to the first VAT period starting on or after 1st April 2019," she explains. "So for monthly VAT the April 2019 VAT return figures will be the first to be submitted digitally. For quarterly it is dependent on where the VAT period starts.

"So for the VAT period March to May 2019 return figures can still be entered manually and wouldn't be required to be submitted digitally because the period didn't start on or after 1st April

2019. However the VAT return for June-August return figures would be required to be completed and submitted digitally. The first quarter which will have to be entered digitally is a VAT quarter ending on 30th June.

With the vast majority of dairy farm businesses being net recoverers of VAT, Ms James stresses it is essential to make sure they comply with the new legislation to ensure cashflow is not affected. With around half of dairy farmers reporting VAT monthly rather than quarterly it will be essential to be ready from day one.

Same records kept

"On a positive note, businesses do not need to record anything differently. The financial data required is the same. It is just how it is recorded, but this could be a quantum change for many businesses who rely on well proven but manual systems as these will now no longer be acceptable as a way of holding records for VAT purposes.

"To meet the requirements of MTD, all records required for completion of the VAT return must be kept digitally on what is described as functional compatible software. This is defined as software that will automatically link with the HMRC VAT Application Programming Interface system and update the VAT return with no manual intervention and has been approved by HMRC for the purpose.

"The software must be able to keep all required records in a digital form, create a VAT return from those records and provide HMRC with that information digitally. It must also be able to receive information from HMRC about the business's compliance records.

Many software suppliers are submitting their programmes to be approved as MTD compliant. At Promar, our Farm Business Accounts (FBA) software has already been approved. However, many recording systems used on farm are still unapproved.

Two record categories

The records required to be held digitally to complete VAT fall into two broad categories. The first is business descriptive information including business name, business address, VAT registration number and details of any VAT accounting schemes used.

The second is a far larger category as it is the transaction details for both purchases and sales—the information which drives the numbers on your return. So it will include details including the time of supply (tax point), the value of the supply (net excluding VAT) and the rate of VAT charged.

Review procedures

"It is really important you start reviewing how your office procedures will need to change and to select your software as soon as possible so you have the time to get everything up and running."

Ms James suggests that if changes are required to meet the requirements of MTD then it would make sense to review the opportunity to make full use of financial data stored digitally. She says there are numerous pieces of software available that will just make sure you are VAT compliant but why not make the data work harder and get a better return on the time and cost of moving to digital financial recording.

Having a demonstrably better grip on finances may be a powerful tool when talking with the bank. You will also be in more control of your finances when Brexit hits, something that is certain to impact significantly on farm businesses.

Business management

With details of all your transactions held electronically you will now be able to look more closely at enterprise margins, to drill down into overhead costs and really benchmark performance, all of which are possible with FBA and our fully trained staff.

"You will be able to monitor cashflow and creditor/debtor balances more closely too which will be something banks are increasingly looking for. And of course if you use FBA you will be sure of meeting the VAT requirements too.

"You can't avoid MTD, but should see it as a catalyst to establish a financial records system which gives more business information to aid decision making and planning rather than as just an imposed change to meet a Government stipulation," she advises.

Dale Farm View
December 2018 / January 2019
Promar International

Another busy Winter

Dale Farm continue to have an ever-expanding presence at the Winter Fair, having taken on an additional stand this year for Dairy Herd Management and Tankcare. As usual the main stand was thronged for most of the day with producer's keen to catch up with Board Members and staff about the prospects for milk in 2019. There were a range of Dale Farm products on offer, including cheese, yoghurt, milk and custard for everyone to enjoy and members were able to get a catch up over a cup of tea and a scone.

The Fixed Price Milk contract was discussed along with the current rationalisation in the NI milk market and the ongoing turmoil created by Brexit. United Feeds were on hand to discuss winter diets with customers while they were also making customers aware of the rebranding of K&N fertiliser to Sustain (powered by Agrotain).

The Promar award for Dairy Farmer of the year was awarded to Cecil and James Brownlee from Loughgall. James and Cecil milk a high yielding herd of Holstein cows and have started to place an increasing emphasis in recent times on the disease status of their herd. A feature on the Brownlee's will be in the next edition of Dale Farm View.

Kenneth, Edward , Heather and John Johnston from Ballinderry with John Dunlop, Chairman , Dale Farm

Wyn Smyth, Ballynahinch, Zara Gabbey, Dale Farm and Elaine Sherrard, Dale Farm

William and Andrew Addison, Upper Ballinderry with Irwin Arrell, Tankcare

Andrew Graham, Tankcare , Carl and Jessica Reid, Glarryford

John McCollum, Limavady, Clarence Calderwood, United Feeds, Samantha David and baby Isla Millar from Ballymoney

James and Tynan Roulston from Bready with Zara Gabbey, Dale Farm

Fair for Dale Farm

Meanwhile on the new stand, Dairy Herd Management had a number of enquiries in relation to milk recording. PregCheck created a lot of interest with producers discussing the benefits of using the milk test as an additional pregnancy check around 80-100 days after service. The heat detection and rumination system, SenseHub, was an attraction for many, with several new enquiries. It was also encouraging to hear examples of customers who have recently installed the system and are reaping the benefits of detecting sick cows at a much earlier stage.

On the bulk tank front, Tankcare had a range of enquiries for both new and second-hand tanks as members continue to plan for expansion. The offer of three months free Tankcare for new customers also led to plenty of enquiries as customers realise the benefits and peace of mind offered by having a maintenance contract in place. For those considering their options for water heating to wash their plant and milk tank, the Flogas water heating system generated some new sales. The benefit of instantaneous hot water comes with a cost reduction with the gas option being a saving on electricity costs, therefore providing decreased running costs for years to come.

Alan and David Irwin from Benburb, Robert Bryson, Director, Dale Farm and Nasair Hussain, MD of Dale Farm GB

Samuel Roe, Jack Shanks and Steven Porte from Kilrea with Lorraine Tumelty, Dale Farm

Craig Barkley, Ballymena and Nick Whelan, Dale Farm Group Chief Executive

Mark McIntyre, John Dunlop, Chairman, Dale Farm, Christopher McKeeman, David Rowe, director, Dale Farm and Jim Thompson, from Bushmills

John and Diane Barkley, Ballymena