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Agri-business Outlook 2015

Restructuring Services interviews our agri-business experts Mark Hill and Richard Crane

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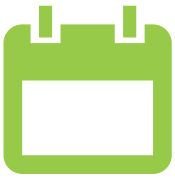
Overview from Mark Hill and Richard Crane



1. OUTLOOK FOR 2015

The fall in commodity prices has increased the pressure on producers and we would expect this to really bite in 2015. We have concerns over producers who have absorbed the pain this year, but enter the next season with a weakened balance sheet and do not have a plan to address this in 2015.

2. DAIRY FARMS

Dairy producers are in for a torrid time with ongoing reductions in milk prices. The removal of milk quotas in 2015 will exacerbate the problem and many dairy farmers will be in a worse place next year than in 2014, even allowing for the saving in feed costs.

3. EU REGULATIONS

New legislation effective for the 2015 harvest requires farms with more than 30ha arable to grow a minimum of three different types of crop. Many farms of sub 100ha would previously secure efficiency by growing a single crop. This new legislation will decrease efficiency and may also require additional investment to deal with storage of multiple crop types.

4. AGRICULTURAL EQUIPMENT

Falling incomes will mean farmers will buy less. There will be a continued squeeze on margins in 2015 which will take the confidence out of future investment and spending. We think this may lead to difficult times for machinery suppliers as there will be far less equipment bought by farmers.

5. RENEWABLE ENERGY

The industry should exercise caution around investment in Anaerobic Digestion (AD) plants that rely solely on food waste because it is going to be in short supply which may make it difficult to get the desired return from the investment. Other forms of renewables still look interesting.

Q&A

What do you see as the key factors currently impacting agri-business?

Richard: Commodity prices are half their peak level, certainly on some of the main crops e.g. wheat and barley. After five to seven years of steady price rises we have seen a dramatic fall in the last few months and they are probably still fragile, driven by global supply and an element of Russian embargo on some foods.

Most farms have had a good harvest so they have increased quantities, but overall, unless they forward sold a lot of volume early in the season, they have generated less cash than last year as prices continue to slide. Prices reached sub-£100 per tonne and if it was around £120 per tonne, the outlook would have been little brighter.

I think we are entering into a new phase of lower commodity prices over the next couple of years which brings with it squeezed margin and the corresponding impact on cash generation will take confidence out of future investment and spending. As such, I have concerns over machinery suppliers as there will be far less equipment bought by farmers.

Mark: We have got zero inflation on food prices for the consumer, partly driven by underlying commodity prices and partly driven by consumer behaviour – lower basket value but shopping more frequently and selecting the own label value range rather than branded.

There is also huge competition with the discounters Aldi and Lidl forcing margins down for the big four supermarkets. Despite their relatively small market share they have put the industry into turmoil and changed consumer behaviours and attitudes. This means there is just less margin within the supply chain to filter down to the producers.

Having said that, speaking to fresh produce producers, they often say their best relationships are with the discounters (Aldi and Lidl) as they have the most straightforward negotiations and simple specification.

> "We have got zero inflation on food prices for the consumer, partly driven by underlying commodity prices and partly driven by consumer behaviour."

Mark Hill

We have seen pressure on the dairy sector for some time now, so what is your view on the outlook?

Mark: The removal of milk quotas could have a big impact on the UK dairy sector. The UK is self sufficient for milk but in recent years the UK has not come close to reaching its c.13 billion litres quota as new entrants/ investment has not kept pace with the outgoers.

However, countries like Ireland for example, have invested heavily in dairy expansion and with no quota constraint we are expecting a huge increase in milk production, and most of that milk will find its way out into the UK market putting downward pressure on prices.

Furthermore, we also expect the natural response from farmers to the falling milk price will be to produce more to maintain income and this obviously exacerbates the downward pressure on price.

As such, dairy producers are in for a torrid time with reductions in milk prices happening as we speak. Despite lower input costs on feed, increasing supply will continue to drive prices down and many dairy farmers will be in a worse place next year than they were this year.

"The removal of milk quotas could have a big impact on the UK dairy sector."

Richard Crane

Is there any good news for dairy farmers?

Mark: Broadly, dairy consumption is pretty static in the UK and we have got a relatively static population too, so the only way we are going to increase demand is by exporting. However, we are going to be competing with a lot of the other European countries who are also expanding their production on the back of the removal of quotas.

There is big demand from China, they are big dairy producers themselves but there is a great distrust of Chinese produced food and there is a great trust of imported food. However, EU producers will be competing with Australia and New Zealand for that market.

EU Regulations: Single Farm Payments

Mark: The EU has put in a new environmental condition for the 2015 harvest on the single farm payment/basic payment scheme. This requires farmers with over 30 hectares (ha) of eligible arable land to grow at least 3 crops. Farmers with between 10ha and 30ha of eligible arable land, of which there are many in the UK, will need to grow at least two crops per farm.

It's very difficult for farmers of these smaller acreage farms to make money without economies of scale. This could be done by blocking the land with a contrator in rotation with other farm land blocks so you would be 100% wheat, 100% barley, 100% oilseed over three consecutive harvests. You are not going to be able to do that anymore as these smaller farms will need to have at least two or three crops growing at any one time.

This is obviously far less efficient as farmers will have to harvest at a number of different times in the year, which is more costly and increases the exposure to adverse weather conditions. Storage units are also likely to need modifying or building as previously farmers simply stored crops in one big heap, but now they will require different bins or sections.

So overall, overheads and economies of scale are likely to be significantly impacted as it is much more difficult to get economies of scale on three crops than one.

Richard: The other element to these new EU regulations is the introduction of "ecological focused areas", which is a small percentage of land put to one side not to be farmed, meaning overall output and revenue is likely to fall.

"Farmers with between 10ha and 30ha of eligible arable land, of which there are many in the UK, will need to grow at least two crops per farm.

It's very difficult for farmers of these smaller acreage farms to make money without economies of scale."

Mark Hill

How much will contractors feel the squeeze?

Richard: Contractors may also be in for a tough time. Contractors have been encouraged to invest into new machinery and technology which is bigger, more expensive and far more productive. However, as commodity prices drop farmers are likely to be willing to pay less and expect more.

Much of recent contractors' capital expenditure has been funded by cheap debt, and high tax allowances. However, the tax allowances are only available once and therefore the contractor can start having tax reversals on his profits in subsequent years.

So we could end up with a perfect storm if we enter a period where interest rates increase, combined with contractors making less money in a more competitive environment and they haven't got the tax break any longer because they have previously benefited from it. That having been said, we expect in the medium term that contracting will grow as fewer farmers can afford to own their own machinery.

What is the impact of renewable energy on agri-business?

Mark: there has been a surge of investment before the subsidy rate drops and landowners have capitalised on their good security rating to secure asset backed finance to develop solar or Anaerobic Digester (AD) plants. Both require a significant level of investment.

From a lender's perspective, solar is relatively easy – predictable sunshine hours and an indexed linked Feed in Tariff. For AD, security of feedstock supply is essential for finance, so those plants reliant on third party food waste find funding more difficult. We have seen a lot of our clients invest in field scale solar or AD (from own grown feedstock) which has switched a lot of land out of food and into energy production – at least for 25 years.

We have seen a complete reversal in the cost of taking food waste to feed the AD plant. We were seeing AD plant operators being paid, say £40 per tonne to take food waste off local authorities. That has now gone to zero and very soon I expect that many will have to pay for this scarce supply.

So lenders should be very cautious about funding AD plants that rely on food waste. A lender should get comfortable that there is a guaranteed supply of cropping which would mean locking in, say 20 years, of what was a 1,000 acre wheat production site to now produce maize. We are seeing an awful lot of this in Lincolnshire and East Anglia to feed AD plants with the benefit of low commodity prices being the sweetener for many farmers to enter into this sort of agreement.

> "Lenders should be very cautious about funding AD plants that rely on food waste."
>
> Mark Hill

Restructuring credentials

Corporate Advisory
Project Demeter

- Financial forecasting and stakeholder support during a refinancing of a bagged salad grower and packer.
- Short-term cash requirement.
- Increased facilities agreed and ongoing support.

Corporate Advisory
Project Castle

- Grain trader suffered a significant cash outflow from a loss making trade.
- Required new working capital facilities.
- We ran a refinancing process to help secure new working capital facilities, providing adequate headroom during peak seasonal working capital requirement periods.

Corporate Advisory
Project Stark

- Pensions covenant review of a dairy producer.
- Substantial change following the loss of a major contract.
- Assess the impact of the proposed changes on the covenant offered to the Scheme, which had a c.£14m deficit.
- Reviewed the covenant and recommended a number of actions.

Corporate Advisory
Project Turner

- Agricultural Society required a strategy review and financial performance improvement.
- Assisted the Trustees in understanding the root cause of cash outflow and key issues faced by the organisation.

Creditor Advisory
Project Bulb

- Flower grower in Lincolnshire and South West.
- Increasing exposure on existing facilities and required an estimated outcome statement and exit strategy review.

Creditor Advisory & Insolvency
Bredy Agricentre (Dorset) Ltd

- Appointed Administrators following an IBR.
- Agricultural machinery retailer failed due to poor cash management and lack of control over stocking facility.
- Bank debt c.£800k.

Creditor Advisory & Insolvency
Dent Ltd

- Appointed Administrators following initial advisory piece.
- £40m turnover outdoor reared pig producer (over 100,000 pigs across c.80 farms).

Insolvency
Bomfords Limited

- Administration appointment.
- Leading supplier in the fresh product sector supplying leading UK supermarkets.
- c.£150m turnover business operating from 6 UK locations comprising farming operations, fresh produce imports and prepared foods.
- Secured debt of c.£20m.

Insolvency
Bunting & Sons

- Administration appointment over a family owned farming and rural property business.
- The appointment followed a period where the lender had provided funding to enable a family led accelerated asset sales process, which ultimately failed.
- Secured debt was c.13m.

Author details

Agri-Business Experts

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Mark has been a partner in our Assurance and Advisory practice since 1990 and heads our UK Food and Agriculture Group. His clients are across the supply chain and include agricultural input suppliers, producer cooperatives and food processors as well as many large arable, fruit and veg, dairy, pig and poultry farms. He has a degree in Agriculture and over 20 years' experience advising agri-business in both the UK and abroad. His work has taken him to Australia, NZ, Argentina, US and Canada and Eastern Europe.

He is a Governor of Harper Adams University, the leading campus for the land based sector and sits on the BBC Rural Affairs Committee. He took part in the Elliott Review into the Integrity and Assurance of Food Supply Networks, published in summer 2014.

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Richard has been a partner in our Audit practice since 1999 and leads our Cambridge Food and Agri-group. He has a range of clients from those involved in supplying agricultural inputs (breeders, machinery supply etc), growers, as well as businesses selling agricultural produce and food processing companies.

Richard has a first class degree in Agriculture from Edinburgh University. He founded the London Global Agri-business Forum which, with the LSE, aims to bring together global Agri-business seeking to raise capital in London.

Richard is an active livery man in the Worshipful Company of Farmers and has several family farming interests.

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