

AgriMatters

AIB supporting the Irish Agricultural Industry



SPRING 2014



CAP Reform / Dairy Farming Post Quota

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Welcome to the Spring edition of Agri Matters

Michael Dowling, AIB Agri Strategy Consultant

The year just ended was a mixed one for the Agri sector – generally high product prices but also high input costs; extraordinarily difficult weather conditions in the first five months of the year but very favourable conditions thereafter. The overall result saw a modest improvement in farm income but with significant variations between sectors and even within sectors. This is reflected in our review and outlook article. Related to this, we have a note on longer term commodity price trends.

The year also saw some further signs of modest improvement in the overall economy and this is underlined in our general economic commentary.

In our last edition, we dealt at some length, with the outcome of the EU negotiations on CAP reform. Within the last month, the Minister for Agriculture, Food and the Marine, Simon Coveney, has outlined the consequential national arrangements to implement the EU decisions. We deal with this, again in some detail, in a special article in this edition. Many of the details of the rural development part of the reform have still to be fleshed out following stakeholder consultation and, furthermore, are subject to EU approval. We will come back to these in future editions as the various schemes are finalised.

This edition also includes articles on:

- Dairy farming post-quota: lessons from the New Zealand experience by Professor John Roche;
- The Irish Grassland Association's dairy summer tour by Eddie O'Donnell, IGA President;
- The factors to consider when undertaking a farm building project by Donal Whelton, one of our Agri Advisor team; and,
- The farmer share of dairy retail prices here and in the US.

We hope that within the mix you will find some items of particular interest.

Finally, and a little belatedly, we wish all our readers a happy and prosperous new year.

Michael Dowling
AIB Agri Strategy Consultant



Overall Male Champion at the 2013 National Charolais Show was 'Culla Highflyer' shown by breeders John and Paul Kingham, Culloville, Castleblayney, Co. Monaghan with Jason Monaghan, Seamus Belle and Eamonn O'Reilly, Agri Advisor AIB, class sponsor.

Economic Outlook

After a sluggish start in 2013, the Irish economy picked up momentum as the year progressed. Latest CSO data on GDP, which covers the period up to the end of the third quarter, showed the Irish economy grew by 1.5% in the quarter, following on from an increase of 1% in quarter two. This followed a decline of 1.1% in the first quarter of the year.

The latest set of National Accounts is particularly encouraging, in that it shows a broad based pick-up in domestic demand. Consumer spending rose in both quarter two and quarter three, as did Government spending in quarter three.

Construction output rose by 14.5% year-on-year in the third quarter, albeit from very low levels, even though new house building activity has yet to pick up. Meanwhile, business investment in machinery and equipment also rose by over 15% year over year.

However, on the external trade front, total export volumes were down by almost 1% to the end of September on 2012 levels, with contrasting experiences for both goods exports and service exports. Goods exports fell by 4.5%, reflecting a sharp fall-off in pharmaceutical output as a result of the expiry of patents on a number of key products manufactured here. The value of pharmaceutical exports fell by almost €4 billion, or 9%, in the first nine months of last year. Meantime, the volume of service exports, which now account for more than half of total exports, rose by almost 3% in the first three quarters of 2013.

Although GDP has picked up, it was still 0.5% lower in the first three quarters of 2013 than in the same period of 2012. The fall is largely due to the sharp decline in pharmaceutical output and exports. As a result, GDP growth for the year as a whole is now likely to be around zero.

However, GNP, which is not as badly impacted by the pharmaceutical decline, is estimated to have risen by 2.3% last year, which is probably a better reflection of the true performance of the economy.

Meanwhile, after contracting in 2012 from the strong performance of 2011, agricultural production recovered somewhat in 2013, with farm output posting a modest 0.2% increase in volume terms. On a value basis, output increased by nearly 6%, due largely to higher output prices, in particular an increase of over 20% in milk prices. However, agricultural input prices also increased, with spending on feeding stuffs and fertiliser (due to the adverse weather conditions) increasing by 10% and 17% respectively. Overall, all of these factors translated into a marginal increase for family farm income in 2013.

There was a strong recovery in the labour market in 2013. The National Household Survey showed that, by the third quarter, employment had risen for four consecutive quarters. There was a rise of 58,000 in employment, or 3.2% compared to the corresponding period (i.e. quarter three) of 2012. The jobless rate fell to 12.8% in the third quarter, from 13.6% in quarter two, and from 14.7% a year earlier. Indeed, more timely data from the monthly Live Register figures show that the unemployment rate fell to 12.3% in December.

The housing market continues to exhibit signs of improvement. Prices, on average, are up 9% from their trough, although the recovery in prices is very much a two speed recovery, with prices in Dublin leading the way, up 19% from their lows. Rents have also maintained their upward trajectory, transaction levels are also on an improving path, while building activity appears to have started to pick up, albeit from very low levels.

On the public finances front, the budget deficit has come in below target in the last four years and is on course to be below the 3% target in 2015. Ireland exited the EU/IMF programme on schedule in December 2013, without a precautionary credit line, given the large cash balances of the State and its access to sovereign debt markets.

Annual % Change Unless Otherwise Stated				
	2011	2012	2013 (e)	2014 (f)
Real GDP	2.2	0.2	0.0	2.2
Real GNP	-1.6	1.8	2.3	2.3
Consumer Spending	-1.6	-0.3	-1.0	1.0
Government Spending	-2.8	-3.7	-1.0	-1.5
Fixed Investment (ex planes)	-7.8	-3.6	9.0	6.0
Exports	5.4	1.6	-0.2	3.0
Imports	-0.4	0.0	-0.7	2.0
HICP Inflation (%)	1.1	2.0	0.5	0.8
Unemployment (%)	14.6	14.7	13.2	12.2
General Govt. Deficit (as % of GDP)	9.1	8.2	7.3	4.5

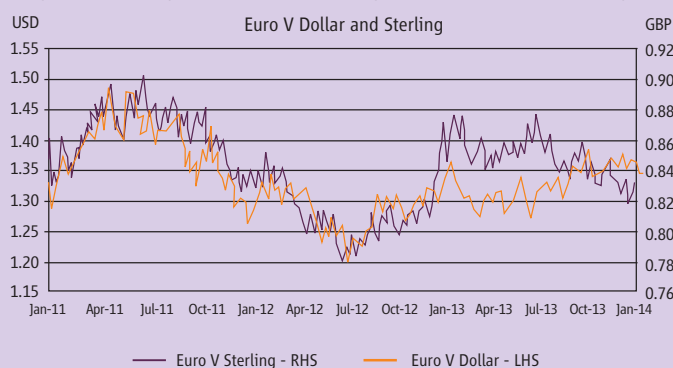
Source: CSO, AIB Economic Research Unit Forecasts

(e) = estimate, (f) = forecast

In terms of the outlook, the Irish economy is well positioned to benefit from the expected improvement in the global economy. The anticipated pick-up in exports and modest growth in the domestic economy could result in GDP expanding by over 2% in 2014 (Table 1).

On the currency markets, the euro proved to be a resilient currency last year and, indeed, was the best performing of the major currencies in 2013 (Figure 1). However, the weakness of the eurozone recovery, relative to both the US and UK, combined with the ECB's easing bias, while both the Federal Reserve and Bank of England could tighten policy in 2015, well before the ECB, could result in some downward pressure for the euro this year. The euro could move down to around \$1.30 versus the dollar. Similarly, the euro could fall towards the 80p level or below against sterling.

Figure 1: Relative performance of the Euro against the US Dollar and Sterling



Source: Thomson Datastream

Planning for Profit

AIB, in association with the Irish Farmers Journal, Teagasc and the Agricultural Consultants Association, have developed a 'Planning for Profit' resource to help farmers plan for profitable farm production. The resource outlines the initial steps of the planning process and the processes involved in preparing a business plan for your farm. A copy of the Planning for Profit resource is available at www.aib.ie/farming



Dairy farming post-quota: Skill before Scale - Lessons from New Zealand

Professor John Roche, PhD is Principal Consultant of Down to Earth Advice Ltd, a consultancy company providing strategic and technical advice to farming groups, agricultural businesses, and universities around the world. A native of Castleisland, Co. Kerry, he is Principal Scientist of Animal Science at DairyNZ and an adjunct Professor of Animal Science at Lincoln University in New Zealand.

"If you don't like change, you'll like irrelevance even less"

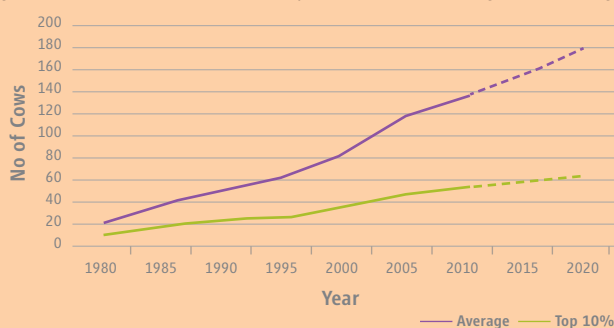
General Eric Shinseki

With the imminent abolition of milk quotas, the business environment for dairy farming is changing. Many people believe that with the 'regulatory spencil' of quotas removed, they will not only be able to increase in size, but they will, in fact, have to increase cow numbers to achieve a reasonable income and lifestyle. The rapid expansion of dairying in New Zealand is offered as an example of what is possible, with a 90% increase in cow numbers nationally and a doubling of farm size and cows/farm over the last 20 years. People must consider this path carefully; expansion brings significant costs, debt, and additional risks, and, as many of us that have been involved in large-scale dairying in different parts of the world can tell you, it does not always deliver the additional income promised.

Let's reflect

- When milk quotas were imposed in Europe, the average herd size in Ireland was 20 cows. At that point, the average dairy farmer needed to be milking 20 cows to earn the then average national wage of £7,800 (Figure 2).
- By 2010, the average national wage was €41,000. The average farmer would need to be milking 135 cows to earn this wage (with no allowance for debt servicing). Instead, the average farm size in 2010 was 60 cows. In effect, the average dairy farmer was earning less than half of the average national wage (not including the Single Farm Payment).
- To earn the average national wage predicted for 2020 (€50,000), the average dairy farmer in Ireland would need to milk 180 cows to keep pace with their urban contemporaries working a 'cushy' 40-hour week.

Figure 2: The herd size (no of cows) required to earn the average national wage



These statistics are frightening; such business growth is not feasible. However, they reflect the current state of operating efficiency in the Irish dairy industry. The comparable figures for the highest performing dairy farmers in Ireland are much more sobering. In 2010, the best farmers in the country only needed 50 cows to earn the average national wage and they would only need to milk 60 cows in 2020 to keep pace with their urban neighbours. This is the current average herd size!

Expansion or efficiency?

As we look forward to quota removal, what is the most appropriate path for

Irish dairy farmers? Nobody wants to admit that they are average. Nonetheless, the fact remains that 50% of Irish dairy farmers are performing at worse than average – that is what the metric 'average' means. The greatest opportunity for most, therefore, lies in improving current operating performance and not in expansion – expansion of a poorly-performing business could be disastrous. Once operating performance is good, expansion becomes a viable option. However, there must be 'skill before scale'.

Dairy farming businesses will need to be resilient to withstand the environment of the future. The storage and delayed selling of commodities in the EU and the US in the past created a stable milk price. With the removal of these storage vehicles, milk price has fluctuated by up to 100% over the last four years alone. In addition to this, energy price and supplement price volatility has led to large swings in the price of inputs. For example, the average price of corn in the US prior to 2006 was US\$130/t. This increased to over US\$200/t during 2007-'08 and was between US\$300-400/t in 2012. Here in Ireland, concentrate prices have increased by more than 100% over the last decade.

This level of volatility will continue in the future and the farm business must be able to weather the bad years while taking advantage of the good years. With the imminent abolition of quotas, this is an opportune time for farmers to look at their business and determine what changes should be made to ensure the farm business is sufficiently resilient to survive and prosper in the long term.

Failing to plan is planning to fail

Resilience is the ability of a system to absorb and manage change. For a dairy farm, this means:

- It should be profitable every year and not just when milk price is high;
- It should provide an enjoyable family lifestyle, with sufficient time off for all people in the business;
- It should be environmentally benign; and,
- It should create opportunities for further training, diversification, expansion, etc.

This doesn't just happen, it must be planned. Each business needs to set a five-year plan for itself on how it will develop for the future.

Lessons learned from New Zealand

New Zealand is often considered to be the mecca of successful grass-based dairy farming, with regular pilgrimages of Irish farmers to its sunny climes to understand the reasons for its success. Although a worthwhile endeavour to learn from the successes of others, it can be dangerous to emulate what others have achieved without understanding some of the differences. Although possessing a very similar climate to Ireland for grass growth, which is the reason for most of the comparisons, New Zealand had a number of advantages that facilitated the significant growth of the industry since the mid-1980s, which Ireland does not share.

For example:

- New Zealand has large tracts of land relative to its population base, with more than three times the land area of Ireland and a smaller population;
- As a relatively young country in colonial terms, there are significantly less

historical ties to the land in New Zealand. This meant that people were happy to 'sell the family farm' and move to new areas where larger, less-expensive tracts of land were available;

- There have been no hindrances to growth historically and the banking sector willingly used re-valued land as collateral for further lending; most of this lending was not amortised (i.e. debt was interest-only);
- There is no capital gains tax; this encouraged the accumulation of assets and facilitated an easier transition between farm sizes; and,
- A tradition of succession planning, through lower order share-milking to 50:50 share-milking partnerships, facilitated the smart asset accumulation of young farmers and an exit strategy for those ready for retirement.

As a result, New Zealand farm businesses thrived through periods of very low milk prices.

The picture is not all rosy however. Relatively cheap interest-only loans; large capital appreciation on land converted from beef and sheep to dairy (coupled with no capital gains tax); a large steady co-operative providing confidence in the long-term viability of the industry; relatively high milk prices; and, a competitive streak matched by very few industries, encouraged farmers to borrow heavily to expand. On average in 2011-'12, term liabilities were 40% of asset value. This is down from a high of 47% in 2009-'10. Many were fortunate that the downturn in milk price was short-lived.

In addition to the expansion in farm size or additional farm ownership, there has been a significant increase in the use of purchased supplements to increase stocking rate and milk production/cow within existing farms (i.e. expansion through intensification). National statistics (Figure 3) would suggest that this method of intensification has not always borne fruit. On average, New Zealand dairy farmers are paid approximately 12c/litre more now than they were a decade ago. However, profit has increased by only 3c/litre. This is because, on average, variable costs per litre have increased by more than 50% and fixed costs per litre have increased by 80% (total costs have increased more than 60%) during the same period. If the system remained unchanged, with inflation at 4% per year, the increase in profit should have been 8c/litre.

Although the increased costs resulted in greater milk production, this did not result in a commensurate increase in profit. For example, a farm milking 100 cows 10 years ago and producing 430,000 litres of milk expanded to milk 110 cows in 2012 and produced 550,000 litres of milk (a 28% increase in milk production). Profit increased from €18,000 to €34,000 during that time. However, if that farm had not changed its management and stayed milking 100 cows, profit in 2012 should have been €46,000, purely due to the 60% increase in milk price compared with the 30% increase in expenses. The data highlights the dangers of expansion through intensification (i.e. the purchase of feeds to increase stocking rate) when farm management is not sufficiently skilled. Again, I say there must be 'skill before scale'.

Planning for your future

The role of *strategic planning* is to position the business for the future, anticipating the opportunities and threats, while capitalising on the strengths of the business and strengthening the weak areas. All successful businesses must undertake such a plan to ensure that they are aiming for the correct targets and to ensure that their day-to-day management is leading them towards their end goal – to use a sailing cliché, 'you must trade a little speed for direction'.

For dairy farming in Ireland, such a plan must involve growing as much pasture as the land class and climate allows. This will require optimal levels of soil phosphorus, potassium and lime, the drainage of heavy soils in high rainfall zones, and sufficient tracks and appropriate fencing infrastructure to allow grazing of the entire farm without poaching.

Supplements have a place in optimising this system, but they expose the business to global commodity prices and associated volatility. Strategically, therefore, they should be limited to approximately 10% of the feed needs of the cow to ensure that the business can withstand major shifts in commodity prices. If the price of 10% of the feed requirements of a cow doubles, the business can probably withstand it. In comparison, if the price of 20-25% of the feed requirements of a cow were to double, as in higher input dairy systems, it puts the business under significant financial pressure, especially if milk price drops as well.

The farm must be optimally stocked. To do this, the amount of pasture being grown and the potential of the farm to grow pasture must be known. This requires frequent measurement of pasture covers and the identification of poorly-performing pastures for remediation (i.e. correction of soil fertility/pH, drainage, new pasture species, etc). The amount of feed purchased must also be accounted for.

The correct cow must be bred. Ireland is in the luxurious position of having a profit-focused multi-trait genetic index that takes the guesswork out of breeding. The average farm has a herd EBI of €110 and there is even considerable scope for improving this metric on the best farms.

Farmers must aim to have more than 80% of cows in calf in the first six weeks of breeding. This will ensure that pasture utilisation is optimised, the need for purchased supplements is minimised, and the average lactation length for the herd is maximised.

Through physical and financial recording and benchmarking, farmers can understand what is possible for their business. Annual financial planning, monthly cash flow budgeting and budget-variance reporting sharpen the intellect and are an essential part of business. Failing to identify impending shortfalls and manage them accordingly, often results in expensive debt and a loss of confidence by your creditors.

Tactical management

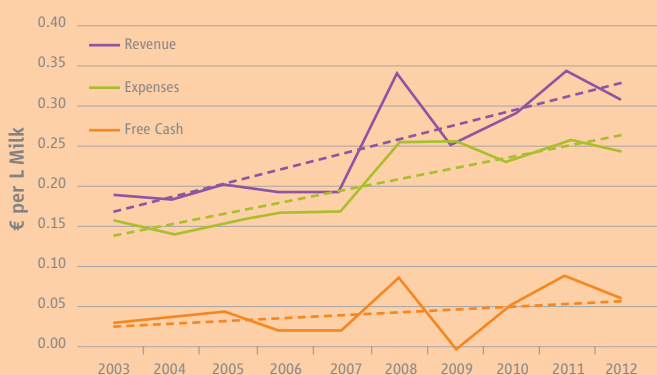
Although strategic plans are important to achieving the goals of the business, a farmer's day to day management skill is what keeps the ship afloat. It is important, therefore, that he/she recognises their strengths and weaknesses and seeks help and/or training to help manage the components of their business that they do not excel in.

Conclusion

"Change before you have to" was the mantra of Jack Welch, CEO of General Electric and one of the world's most successful businessmen. To survive the imminent changes, dairy farmers need to plan a strategy to maximise the efficiency of their business before they contemplate expansion.

For a greater insight on this subject please see our short interview with John Roche at www.aib.ie/farming

Figure 3. Trends in revenue, expenses, and free cash (€/l) on New Zealand dairy farms during the last decade.



Review and Outlook

2013 was an extraordinary agricultural year - extremely wet conditions early on as the abnormally bad weather of 2012 continued into the spring, followed by very favourable summer and autumn weather which lasted well into the winter. The former added significantly to farmer costs in the first half of the year, especially at a time when some input prices - especially feed - were at, or close to, historic highs. The changed conditions in the second half of the year helped greatly to offset those costs and the knock-on effects of booming international markets (see separate note below) significantly assisted. All in all, despite the early year gloom, the year turned out to be quite a good one, although, as is normal and as outlined below, not to an equal degree in all sectors.

Milk

This sector showed a spectacular change compared to 2012. Milk prices are estimated to have increased to an average of almost 39c/litre (actual butterfat levels) compared to about 32c/litre the previous year and, in addition, milk deliveries were some 3.5% higher. In fact, the 2013 milk price was the highest price in nominal terms ever paid in Ireland and, in real terms, the highest in the past 15 years. In real terms it was, nevertheless, still below the price when milk quotas were introduced (45c/litre at 2013 prices) but the average milk supplier delivered four times more milk last year than in 1984.

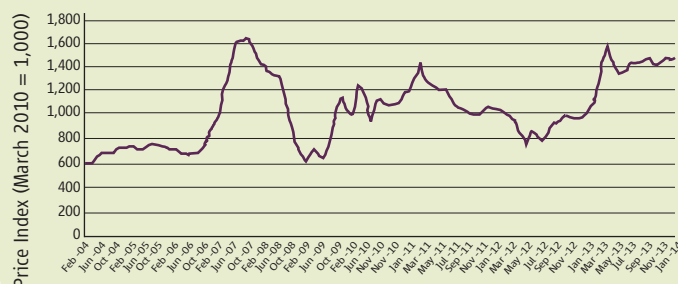
A substantial part of the benefit of the higher price and stronger deliveries was, however, offset by much higher input costs, due mainly to much greater usage, especially of feed, as a result of the appallingly wet spring. Nonetheless, average dairy farm incomes are likely to have been close to €60,000 in 2013, 18% or so up on the previous year, but still below the record figure of almost €68,000 in 2011.

Internationally, 2013 was, generally, a positive year, with continuing strong demand and a moderation in supply leading to very high world dairy commodity prices, even if prices in the US were generally a little behind 2012. The Global Dairy Trade (GDT) auction prices are a good guide to the international market and these have been on a steep upward trend since the spring of 2012 - see Figure 4. The latest auction results (mid-February) represented a slight increase on average and indicate that the trade expect strong prices to be in place until the early summer at least.

Except for whey powder, European prices too have been running well ahead of 2012, and there is no indication of any early significant weakening. While we would expect some price fall off in the second half of the year, as the consequences of increased supply kick in, it should be limited and gradual. All in all, farm gate prices in 2014 may settle in the range of 35-38c/litre. This assumes that there will be no unforeseen market disturbance and, in particular, that China will maintain its strong demand, particularly for whole milk powder.

Feed prices have begun to fall from close to peak levels and that trend should continue. Fertiliser prices are also beginning to moderate. Assuming normal weather conditions (a bit of an assumption considering our recent experiences), input usage should be well down. Combined with the likely positive price outlook, this combination of circumstances should ensure that dairy farmer incomes in 2014 should at least stay at, or close to, 2013 levels. One negative aspect - small in overall terms, but substantial for some - is that there is very likely to be a superlevy bill of over €15 million.

Figure 4: GDT Price Index



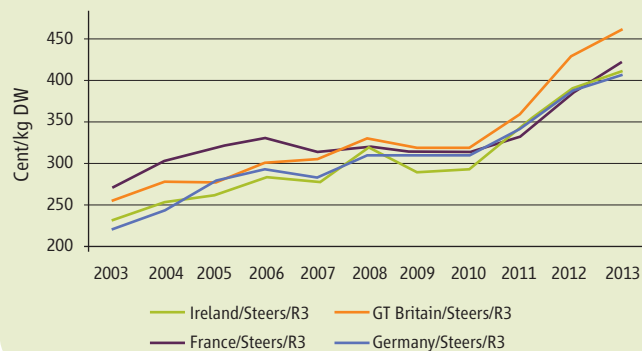
Source: Global Dairy Trade

Beef

Last year was a mixed one for the sector. On the one hand, factory prices - up 5-6% generally - were at all time record levels (but did taper off towards year end) and well up generally compared to EU price levels, although remaining below prices in Great Britain (Figure 5). Furthermore, cattle throughput increased by about 7% compared to the relatively low levels of 2012. On the other hand, weaning and calf prices were back 8% and 20% respectively and there was some evidence of the beginning of a decline in the suckler herd.

As in the dairy sector, there were substantial additional feed costs incurred due to the fodder shortage in the first half of the year. The overall result, as estimated by Teagasc, was that, despite the higher input costs, cattle finishing incomes rose marginally because of the very strong beef prices but higher costs combined with lower prices for younger cattle, led to a very substantial fall in average suckler farm incomes. It is expected that beef prices will continue to be relatively strong in 2014 and that the price of younger cattle will improve. Combined with markedly lower feed costs, this should lead to improved incomes for farmers at the different stages of the beef production chain.

Figure 5: Annual Irish and selected EU Cattle Prices



Source: Bord Bia

Sheep

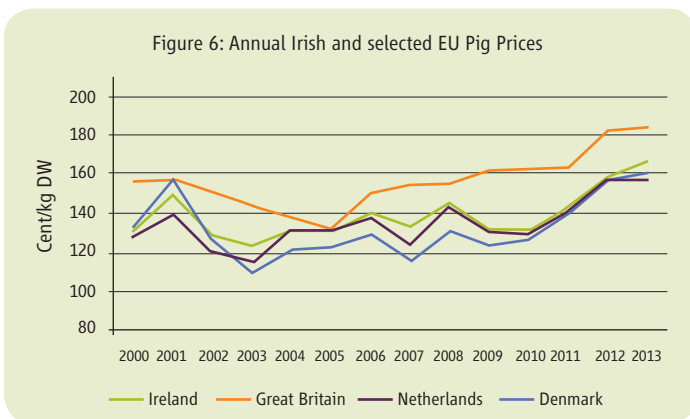
Prices were down slightly on the average of the previous two years - the highest prices recorded in over two decades. Furthermore, throughput was up over 7% and was, in fact, at a five-year high. This should have led to some increase in cash incomes on sheep farms but, in fact, the higher costs associated with the early year weather conditions is estimated to have more than offset the higher value of output. The outlook is, however, somewhat better. Prices have begun to strengthen and this trend is expected to continue. Feed costs are coming down and should remain well below 2012 prices throughout the coming year.

Together, these two factors should see incomes on sheep farms increase in 2014 to more than offset the drop in income last year.

Pigs

This was again a difficult year for the pig sector. Prices were about €1.76/kg (VAT inclusive) at the start of 2013 and dropped to about €1.70 towards year end. The higher prices coincided with a peak in feed prices, so that the margin over feed was considerably less than 50c/kg. As such, only the most efficient producers were likely to be in profit. The margin over feed rose above the 50c/kg level in September and was about 54c/kg for the fourth quarter. This would indicate a fairly general return to profitability.

Even though the sector was under some pressure for much of the year, the prices paid were relatively high by historic standards (see Figure 6) and well in line with major pig producing and exporting countries in the EU. The difficulty was the very high feed costs. These had begun to soften significantly by year end (Teagasc estimates that the composite pig feed price, which was €378/tonne in January 2013, had fallen to €326 by December). This trend is expected to intensify somewhat in 2014 which would indicate that, despite some uncertainty on the pig price, this year should be a more profitable one for the sector.



Source: Bord Bia

Cereals

Again, this was a mixed year for grain farmers. The very high prices from the 2012 harvest carried into 2013 but increased supply from the new harvest had a very significant dampening effect on the price of new season grain. Irish prices, on average, were almost 30% lower last autumn than in the preceding year. Input costs, especially fertilisers, were relatively stable and beginning to fall towards the end of the year. Yields were up very substantially – wheat, for instance, by over 12%. The result was that overall cereal farm incomes dropped by very much less than the price reduction would have indicated (Teagasc provisionally put the income decrease at 5%). The position in 2014 is likely to be relatively similar but with the final outcome likely to be a modest price increase. Global supplies should be strong but so should global demand. Fertiliser prices are likely to continue to decline and, given normal yields, margins should be somewhat better than in 2013.

Potatoes

Average prices in 2013 were probably at a modern record high. From very low levels early in 2012, prices escalated from the middle of the year (an increase of almost 200% between January and December in the year) and that surge carried into the first half of 2013. Decline then set in, to the extent that late autumn prices were about one-third down on the same period of the preceding year. That decline continued into the final quarter. Harvesting conditions were, however, quite good which will have mitigated the position somewhat for those caught by the late season price fall. It is difficult to forecast what the likely outcome will be for this sector in 2014. Input costs should be lower, but prices are likely to be no higher than in the autumn of 2013.

Input Prices

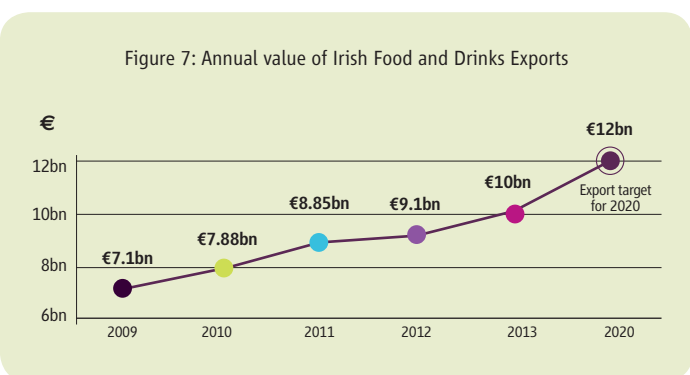
As indicated earlier, the weather, and especially the escalation it caused in input - particularly feed - usage, was the main story in terms of the practical side of agriculture in 2013. This clearly had a significantly adverse effect on farm income last year, particularly coming after 2012 which was itself a year of abnormally high weather-related feed usage. It is difficult to estimate accurately the effect all this had on 2013 incomes. Perhaps the easiest way is to compare last year with 2011, the most recent 'normal' year in terms of input usage. Compared to that year, feed and fertiliser prices were approximately 14% and 2% higher in 2013. Based on the CSO advance estimates of output, input and income in farming for last year, the value of feed and fertiliser used on Irish farms in the year was up 35% and 16% respectively compared to 2011. The difference between the two sets of yearly figures can be accounted for by extra usage. This would approximate to an extra cost of about €340 million in feed and fertiliser alone, compared to a 'normal' year, and would have the effect of reducing farm income by about 16% compared to what it would otherwise have been.

Overall

The CSO preliminary figure for 2013 is for an increase in aggregate farm income, after interest and rental costs are taken into account, of just under 4%. Extrapolating from the CSO figures would seem to indicate that there was a marginal increase in average family farm income also. The farm trading situation was, however, somewhat better. Using the CSO advance figures, it appears that farm profit, before subsidies and depreciation, was up about 25% compared to 2012. The main reason for only a very modest increase in farm income, apart from the weather related costs, was that there was a drop of €134 million in the value of mainly decoupled farm subsidies.

The Agri-Food Industry

Last year was another successful one for the industry with increases in the value of output in most sectors and, almost certainly, enhanced profitability, although margins would have remained very tight in the beef sector. Perhaps the most striking manifestation of the robust health of the industry is the strength of its export performance. Under Food Harvest 2020, exports were predicted to grow by about 50% to €12 billion compared to the 2007-2009 average. According to recent Bord Bia figures, exports grew by 9% last year to almost €10 billion, so over half of the 2020 target has already been achieved. Even though this has been greatly assisted by the surge in international commodity prices, it is still indicative of a very strong performance by the Irish agri-food industry. Figure 7 below graphically outlines the export performance since 2009. Highlights of the 2013 performance were 15% increases in both dairy and prepared foods exports and a 10% increase in beef exports. In terms of destination, 42% of food and beverage exports went to the UK, 32% to other EU countries and 26% to third country markets. Exports to third country markets included a 40% increase in exports to China, which have trebled since 2009. While still only 3% of the total, exports to this market clearly have the potential to grow rapidly.



Source: Bord Bia

CAP Reform - National Arrangements Agreed

In our last edition we outlined at some length the decisions at EU level on the CAP to apply from 2014 to 2020. We indicated that there were still a number of decisions to be taken at national level on the new direct payments scheme and that the schemes under the Rural Development Programme had still to be drawn up. The Minister for Agriculture, Food and the Marine, Simon Coveney, has recently clarified these issues.

Direct Payments

As expected, Ireland will apply the partial convergence method model for the distribution of the €1.21 billion annual allocation for the new direct payments scheme, the Basic Payments Scheme. This means that farmers with a payment per hectare less than 90% of the national average payment (estimated to be about €225, including greening but after deductions - see below) will have the gap between their current payment and the 90% level reduced by one-third by 2019. Those with payments above the national average will see their entitlement values proportionately cut, although the precise method by which the cost - about €100m - of the increase in the lower rates of entitlements is to be spread among those with higher-than-average rates has yet to be announced.

There are three further provisos:

- There will be a minimum level of payment of 60% of the national average (estimated to be about €150/ha - including greening) by 2019;
- There will be a maximum payment level of €700/ha (including greening) by 2019; and,
- No payment will be made above €150,000.

In general, it is estimated that about 19,000 farmers will benefit from the minimum payment provision – depending on the method used to reduce proportionately the entitlements of those above the national average; up to some 500 farmers could be affected by the maximum per hectare limit of €700/ha; and there are some 50 farmers currently receiving more than €150,000 in Single Farm Payment. Overall, it is estimated that about 60,000 will see some increase in their single payment; about 50,000 will get a reduced payment and close to 10,000 will see little or no change.

Active farmers who held entitlements in 2013 will automatically qualify for the new payments. Those who held no entitlements in that year but who were actively farming will also benefit, as will those who produced fruit or vegetables in 2013.

Young farmers

2% of the national allocation will be reserved for young farmer entitlements. This will provide for a 25% top-up (over €60/ha) on direct payments on up to 50 hectares for five years for trained farmers under 40 years of age who have set up their holdings within the previous five years of their first application for the direct payment scheme.

Reserve

A national reserve of 3% of the national allocation will be set up for 2015. In future years, unused entitlements will be transferred to the reserve but there will be no further transfers from the national allocation. Priority for entitlements from the reserve will be given to young farmers and other trained new entrants (i.e. those starting up in 2013 or later years who did not have any agricultural activity in their own right in the previous five years). In both cases, the recipients have to be active farmers.

Greening

To benefit from the Basic Payment Scheme farmers must implement standard greening measures and 30% of their basic payment is contingent on their doing so correctly.

There are three measures to be observed:

- Crop diversification – this relates to holdings of 10ha or more;
- Maintenance of permanent grassland; and,
- Ecological focus areas – the requirement to maintain ecological focus areas applies to arable land and only where the holding is 15 hectares or more.

Penalties

There will be no additional penalty (i.e. beyond loss of the greening payment) for failure to meet the greening criteria in the first two years. In year three the additional penalty will be 20% of the greening payment and 25% from year four.

There are a number of circumstances in which a holding is considered green by definition and no further greening obligation applies, the most significant of which are: (a) land which is organically farmed, and (b) holdings where more than 75% of the eligible area is permanent grassland or used for the production of grasses or other herbaceous forage and any remaining arable area does not exceed 30 hectares. More complete details of the greening requirements were given in our last edition.

Support for protein crops

A new support scheme for protein crops is to be introduced, the details of which have yet to be announced.

Coupled payments

The new reform provided the opportunity to introduce, at least partially, coupled payments in specific sectors. There was considerable discussion as to whether this was desirable, at least in the beef and sheep sectors, but in the end the decision, as at the time of the original introduction of the Single Farm Payment system, was not to apply coupled payments, which would, of course, have had to be taken out of the allocation available for the Basic Payment Scheme. In the Rural Development Programme there is, however, to be a targeted payment under a beef data and genomics scheme - see below.

Rural Development Programme

The new Rural Development Programme for the period 2014 to 2020 will be funded to the tune of €2.19 billion from the EU, of which €2.037 billion is to be allocated to schemes operated under the aegis of the Department of Agriculture, Food and the Marine and €153 million to the Department of the Environment, Community and Local Government for measures under LEADER. The 'agriculture' schemes will be co-funded at 46%, so the resulting €1.9 billion of national financing will bring the total rural development provision for these schemes to €3.94 billion over the seven-year period.

The new programme has to be designed in a way that is coherent with EU and national objectives. It must, for instance, foster knowledge transfer, improve competitiveness, help towards environmental protection and the response to climate change and promote social inclusion and economic development in rural areas.

What has now been announced is an indicative outline of a programme with a wide range of measures aimed at meeting these broad objectives and which, therefore, would continue to support the agri-food sector, ensure that scarce resources are managed in a sustainable manner and ensure the continued balanced development of rural areas.

The proposed measures fall into seven main headings:

1. Agri-Environment/Climate Measures

The main measure under this heading would be a new Green Low-Carbon Agri-Environment Scheme (GLAS) which would operate similarly to the old REPS scheme but in a more rigorous and targeted way. It would have different payment rates for each action but would envisage a maximum payment of €5,000 for up to 50,000 farmers and an additional payment of up to €2,000 for a limited number of farmers who undertake particularly challenging actions.

Two further measures are envisaged under this heading:

- An Organic Farming Scheme; and,
- Targeted Output Based Environment Projects which would involve the extension of the Burren Farming for Conservation Programme and a fund for similar output based conservation and agri-environment projects in other areas.

2. Areas of Natural Constraint (ANC)

The new scheme would be similar to the old Less Favoured Areas Scheme and would be expected to cost a similar amount (€195 million a year). While the new scheme would operate on the same lines as the 2007 to 2013 scheme, each Member State has until 2018 to designate its ANC areas by reference to biophysical criteria and the outcome could change the designation of areas and the structure of the scheme.

3. Targeted Agricultural Modernisation Scheme II (TAMS)

This would operate similarly to the existing TAMS model and would, effectively, be a general capital investment scheme with a 40% grant rate and a young farmers’ scheme with a 60% rate. Dairy equipment, slurry storage, animal housing, trailing shoe low emission spreading equipment and certain pig and poultry investments would be eligible for grant aid under the general scheme, which would also continue support for the Bioenergy Scheme. Initially, the young farmer scheme would apply to similar areas with the exception of pigs and poultry and the Bioenergy Scheme, but would include investment in dairy buildings as a specific heading. The cost of the TAMS scheme is estimated at €290 million.

4. Knowledge transfer measures

These measures would include:

- Improving farmer skills and enhancing competitiveness through support for knowledge transfer groups in key sectors to be facilitated by appropriate professionals;
- A targeted animal health and welfare advisory service;
- Development of the European Innovation Partnership model linking research and innovation to farm practice, especially in important areas such as environmental and climate change challenges and increased on farm efficiency based on the most recent scientific methods; and,
- A range of specifically targeted on farm training measures and support for the continued professional development of advisors.

5. Support for collaborative and quality focused measures

There are three elements to this support category:

- A grant to farmers setting up a partnership or other approved collaborative arrangement. The grant would be €2,500 per partnership for administrative/legal costs and the aim would be to achieve 400 new partnerships over the programme period;
- An artisan food cooperation scheme aimed at improving and validating production quality and at improving the awareness and marketability of local and niche quality products; and,
- Beef and Lamb Quality Scheme – the scheme would grant aid groups of beef and lamb producers to assist in the marketing of distinctive

local products and showing geographic distinctiveness through the EU geographical denomination schemes.

6. Targeted supports

The main item under this heading is to be a Beef Data and Genomics Programme which will build on the existing Beef Data Programme and the 2014 Beef Genomics Scheme. The new programme will require participants to use a tissue tag to take samples from selected animals in their herd and send them for genotyping; record animal events data for calves at appropriate stages for submission to the ICBF in order to develop a national databank; improve breed quality by selecting stock bulls and heifer replacements of high genetic merit, and dispose of persistently BVD-infected calves within a defined period. It is possible that additional animal health and welfare requirements will be added. The programme will be targeted in the first instance at suckler cow herds, and is estimated to cost €50 million a year based on a payment of €80 per calved cow for about 650,000 calved cows.

The other scheme, under this heading, will involve support for Island Farming. The details of this scheme have yet to be worked out but it will aim to promote knowledge transfer and innovation; improve farm viability and competitiveness and restore, preserve and enhance ecosystems.

7. LEADER

The strategies to be developed under the new LEADER programme will include rural economic development and job creation; rural tourism; extension of rural broadband; basic services for particularly disadvantaged communities; social inclusion, capacity building and training and a programme aimed at rural youth.

The outline of the new Rural Development Programme has been developed following consultations with stakeholders. The precise details of the different schemes will now be the subject of further consultations and the final decisions will then require EU approval. It will, therefore, be some time before the precise shape of the different elements are known. We will come back to this area in future editions as the details of the schemes are announced.

Farmers’ Share of Retail Prices

The US Department of Agriculture (USDA) recently published data on the share of the retail value of a range of foods accrued to US farmers. We thought it would be interesting to see how the situation there compared to the position here and considered that the easiest comparison would be in respect of dairy products. The table below sets out the relative current positions and the situation a decade ago.

As can be seen, the US and Irish positions are very similar on cheddar but quite different on liquid milk and somewhat different on butter. It is also noteworthy that the position has not changed dramatically in the 10-year period.

Table 2: Farmers’ Share of Retail Returns ¹				
	Ireland		US	
	2003	2013	2003	2011/2012
	(%)	(%)	(%)	(%)
Butter	60	55	36	50
Cheddar	29	31	30	31
Milk	33	33	49	55

¹The US data is from the USDA. The Irish retail prices are taken from CSO data. In the case of milk and cheddar, the comparisons are relatively straightforward. In the case of milk for butter production, its value comes from a combination of butter and skim powder. As there is no significant retail trade in the latter, we have taken the value of the fat share (about 40%) of the farm gate milk price and compared it to the retail butter price in order to get an approximate relationship.



Irish Grassland Association Dairy Summer Tour

Eddie O'Donnell, President of the Irish Grassland Association, reviews the 2013 Irish Grassland Association Dairy Summer Tour, sponsored by AIB.

Over 350 people attended the 2013 Irish Grassland Association Dairy Summer Tour in Co. Waterford. The theme of the tour was 'Growing your farm business efficiently', and delegates got the opportunity to visit two farms at contrasting stages of expansion. David and Isobel Kirwan were establishing a new dairy enterprise, while Kieran and Anne Hearne had expanded their farm successfully over recent years. Both farmers openly shared their expansion experiences and lessons learned to those in attendance.

Kirwan Farm - new entrant to dairying

David and Isobel Kirwan farm near Stradbally, Co. Waterford. In the previous 18 months, the farm moved from a split spring/autumn calving, suckler-to-beef farm (120 cows), to a dairy farm milking 70 cows. In 2011, the Kirwans assessed the long-term future of their farm, examining the best way to make the most income from their existing land base. They examined the option of converting to a dairy enterprise and, in spring 2011, David completed a farm plan and applied for the free allocation of 200,000 litres of milk quota as a new entrant to dairying. David's application was successful and he decided to set up a dairy enterprise on the farm, phasing out the beef enterprise over time. David was part of the Teagasc BETTER Beef Farm programme up until the end of 2011.

David believes that planning was, and continues to be, an essential part of the changeover from sucklers to dairying. Before entering into milk production he completed a six-year physical and financial plan with his Teagasc advisor Seamus Kearney. David feels strongly that this planning gives him confidence in what he is doing and helps him to see how he is proceeding compared to his original budget.

Fifty cows and heifers were purchased from one source in the autumn of 2011 and David commenced milking in spring 2012. Since then, David has also purchased additional milk quota through the milk quota exchange, on top of the free allocation, to bring his quota to 363,000 litres. David is increasing and improving the infrastructure on farm to cater for his new and expanding herd. He installed a 12-unit parlour and a new bulk tank and converted some of his cattle sheds to cubicles to accommodate the dairy cows. He installed further roadways on the farm over the summer and is planning on installing more cubicles over the next year. David milked 70 cows in 2013 and is planning to milk 150 cows and rear replacements on his 85 hectare-block post 2015.

The cost of conversion on the farm, following the sale of the beef stock will equate to an estimated €951/cow for the planned 150 cows when conversion is fully completed. David pointed out that the sale of the suckler cows and remaining beef stock has been a great help in funding the conversion. David was quick to point out that it has taken a lot of hard work to get to where he is, and he plans to have someone working with him in the next year or two. David told delegates that converting to dairy farming has been a steep learning curve. He feels very strongly that one of the best decisions they made during the process was to source a good core group of cows, and this has certainly helped in the conversion process. David is a good grassland manager and this was very evident on the day.

One of the main reasons behind the conversion to dairying was that David believed it offered greater potential and possibilities of generating a sufficient income to support two farm families in the future. David's estimates that his net margin per hectare will increase from €400/ha (€51/ha after own labour)

before commencing milk to a predicted €1,500/ha (€1,100 after own labour) post 2015 when the farm will be fully stocked. David believes that a simple system is essential and he feels he is getting there now.

Hearne Farm - phased expansion over time

Kieran and Anne Hearne farm near Rathgormack, Co. Waterford. They have expanded cow numbers from 40 to 160 over the past number of years and expanded milk quota from 230,000 litres to 770,000 litres. The farm is home to the CURRA herd and has an average EBI of €180 and was ranked no. 32 on the latest EBI list. The herd has excellent fertility results which really helped as the farm expanded. The herd grew from within, making expansion easier to manage from a disease perspective.

The Hearne farm is an excellently-run farm with very high milk solids per hectare being achieved from the Friesian herd at a high stocking rate. The farm currently has seven bulls in A.I. The farm is a good free draining one stocked at 3.3 cows/ha on the milking platform. The majority of winter feed and rearing of replacements is currently being carried out on out farms within a few miles of the home block. A new 18-unit milking parlour and winter accommodation has been put in place over the last number of years. It has cost €4,000/cow to complete the expansion on the farm when all extra stock, infrastructure and additional milk quota costs are included.

Kieran feels labour is a big issue on an expanding farm, and, in his opinion, he should have employed labour sooner than he did. Currently, there is full-time labour employed during the busy spring period and three days a week for the remainder of the year. Contractors carry out the majority of machinery work on the farm.

It was clear from our visit that the farm is very well run, evident in the quality of the stock and grass swards on show. Soil fertility had become an issue on the farm over the past two years and Kieran is of the opinion that he was taking a lot more out of the soil with his high stocking rate than he was putting back into it. A fertiliser plan has been put in place, utilising compound fertilisers to increase soil fertility.

One of the clear messages from the farm visit was that cash flow budgets are an essential part of any expansion process, as a lot of cash is being tied up. Replacements that would have been sold prior to expansion are being retained in the business so they are a big cash drain. Kieran feels strongly that loans should be put over a period of at least 10 years to take the pressure off in the early years of growth, but can be paid off quicker if funds allow.

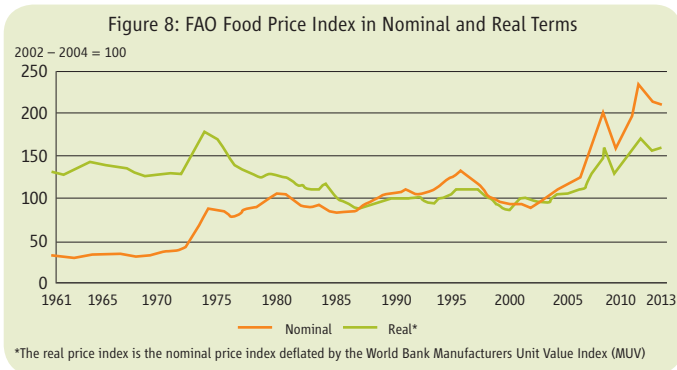
Farm profit has increased substantially since expansion commenced with net margin per hectare going from €690/ha (€145/ha after own labour) in 2005 to €1,610/ha (€1,190/ha after own labour) in 2012 when herd size was 150 cows. Kieran has a goal of selling 80,000kg milk solids from his current farm enterprise (1,600kg MS/ha) which is an excellent target for this free draining spring producing farm.

Conclusion

It was clear from both farms that neither would be where they are today without strong, rational business planning and careful financial management. Maintaining a simple, effective system and regularly monitoring performance was identified as being particularly important. Profit monitors had been completed for the past 15 years on both farms, providing the farmers with valuable information on which to base any investment decisions.

International Commodity Markets

The international market for food commodities has changed dramatically in recent years. The FAO food price index monitors the prices of cereals, dairy products, meat, sugar and vegetable oils. The graph below (Figure 8) graphically sets out movement in the composite of the prices of these commodities since the early 1960s. As is clear, except for a spike due to the consequences of the oil crises of the 1970s, prices were relatively stable - albeit with some limited volatility - up to the middle of the last decade. Since then, there has been a dramatic change with substantial increases in nominal and real price levels and much more pronounced volatility.

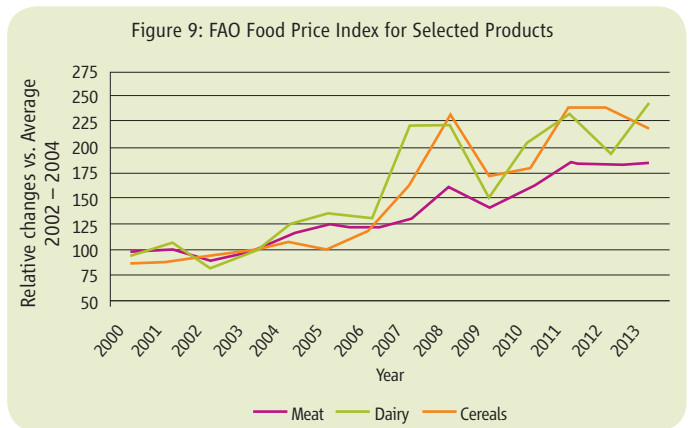


Source: Food and Agriculture Organisation

The recent trends are even more evident in the following graph (Figure 9) which charts the price movements of cereals, dairy products and meat from 2000 to the present. The trend was upwards but somewhat gradual up to the middle of the decade but then, particularly for cereals and dairy products, there was a sudden and substantial jump in 2007/2008, followed by a trough in 2009, only for prices to peak again in 2012/2013. The trend was similar but a little less pronounced in the case of meat (which covers pigmeat, poultrymeat and sheepmeat as well as beef).

In the second half of last year, prices began to slip back, especially in the case of cereals but not down to a level close to what might be considered the historic norm. Indeed, it is interesting that, even in the 2009 trough year, commodity prices were, on average, higher than in the earlier years of the decade. The question that arises is whether or not this indicates that

there has been an underlying shift in the market dynamic. It is dangerous to be dogmatic about future prospects for international markets but the balance of evidence would suggest that there has. Demand from emerging markets (especially, but by no means exclusively, China) has transformed the international scene.



Source: Food and Agriculture Organisation

And this increased demand, fuelled by an increasing population, and especially a rapidly-rising middle class, is more and more for fat and protein products. The result is that even where stock levels move back to, or above, normal levels, stock to use levels remain relatively low. Furthermore, costs of production have risen substantially, even in historically low cost systems (e.g. milk in New Zealand) and this is also tending to keep up the level of commodity prices, as are Government bio-fuel policies.

There will, undoubtedly, be continued volatility driven by factors such as the supply consequences of extreme weather events (e.g. drought in New Zealand and the US, prolonged rainfall in Europe), which apparently are becoming more frequent. But it looks as if, at least for the next decade or so, that volatility will be around a higher price plateau than has been the previous norm. Later on, other factors, for instance major technological developments affecting production techniques, could change the scene but longer term developments could just as easily work in one direction as in the other.

Recent Appointments



Eddie Downey, IFA President

Eddie Downey has recently been elected as the 14th President of the IFA. Eddie is a native of Slane, Co. Meath. He is a graduate of Warrenstown Agricultural College and farms in Slane, Co. Meath with his wife Mary and their two children. His farm enterprises include drystock, tillage and broiler breeding. Eddie was Deputy President of the Association from 2010 to 2014, Farm Business Chairman from 2004 to 2008, Meath County Chairman from 1996 to 2000, and was also Chairman of the Associations' Countryside Project Team and Direct Payments Project Team. AIB would like to congratulate Eddie on his appointment and wish him every success in the future.



Tim O'Leary, IFA Deputy President

Recently-elected IFA Deputy President Tim O'Leary is married to Katherine with four children, and has been dairy farming in Cork since 1976. His son Colm joined him on the farm in 2013. An active member of IFA since 1983, Tim has held several positions with Cork Central IFA such as Chairman, Vice Chair and PRO. He was also Chairman of the Cork Liquid Milk producers and Vice Chairman of the National Liquid Milk committee. He has been on the IFA Executive Council for over 10 years and was also a member of the National IFA Animal Health Committee. AIB would like to wish Tim every success in his role as Deputy President.



Key considerations when undertaking a farm building project

Donal Whelton, Agri Advisor, AIB examines the key factors to consider when undertaking a farm building project.

Capital expenditure on farm buildings reached record levels in 2008, driven primarily by the Farm Waste Management Scheme. While investment in farm building reduced significantly in subsequent years, over the last two years I have come across many farmers who have undertaken farm building work and many more who are planning investment for the years ahead. These farmers are planning for their futures and are putting facilities in place now, which will allow them to increase farm output in the coming years. In the dairy sector, for example, many farmers have already invested in milking parlours and increased wintering facilities in preparation for the abolition of milk quota in 2015.

Looking specifically at investment in farm buildings, investment generally can be classified into one of the following areas:

- Essential maintenance / upgrading of existing facilities to ensure that the farm remains operational;
- Improved output or cost reduction that is focussed on improved farm profitability;
- Improved labour efficiency; or,
- Availing of new opportunities (such as a start up enterprise).

I have detailed below some of the main factors to consider when undertaking capital investment in farm buildings.

1. Design

Time spent planning and seeking good advice is always time well spent. Avoid rushing into a major building project, only to discover that it lacks essential design features. Keep an open mind and look at all options. Teagasc advises that existing buildings should be used where possible, provided this does not compromise the final desired outcome. Where the total cost of the conversion amounts to 70-80% of the cost of a greenfield site option, there should be few, if any, compromises to the desired design.

Farmers should however, think ahead when choosing a design and a site, considering whether there is room for further expansion in later years, should the need or opportunity arise.

2. Planning Permission

You will generally require planning permission for any development of land or property unless the development is specifically exempt (see local planning authorities for details). Many farmers underestimate the time involved in the planning application process and this can significantly delay the start date for development work. Generally, a valid application will be dealt with by a planning authority in 8-12 weeks. This period can however, vary considerably. Again, from my experience, this process can take significantly longer if additional information is requested by the planning authority or the planning authority's decision is appealed to An Bord Pleanála.

I have come across cases where planning decisions have taken up to 30 weeks from the initial planning request. While perhaps that is not the norm, a delay of this nature can have serious consequences if, for example, a new cubicle house which is needed for winter accommodation gets delayed.

3. Costings

The two major costs on a farm building investment are labour and materials.

However, there are other associated pre-construction costs, such as the preparation of drawings, grant application preparation fee (if applicable) and the planning application fee. Some County Councils may also require a development contribution to be made.

To get a realistic idea of the potential cost of the development, it is advisable to get quotes from a number of different contractors. Be sure to enclose detailed specification of any extra work, such as extra concrete aprons or extra gates that will be required over and above the main building work. This reduces the risk of having to pay over the odds for 'extras'. It will also allow you easily compare quotes from different contractors. Teagasc has standard costings available which can be utilised to estimate the costs of construction for a variety of farm building projects.

Employing good efficient and effective trades people is very important and it may be worthwhile taking the time to visit other projects in which those you are considering were involved. Remember you want to concentrate on the daily management of your farm while ensuring the building work is completed to the required specifications. Farmers should also establish when the builder can commence the project and get a likely timeframe to completion.

4. Funding – Common Pitfalls

Once the cost of the development has been established, the cost after accounting for grants due can be calculated. There may be a period between paying for the work and when the grant is received, and, accordingly, bridging finance may be required. It is also prudent to build in a 10% contingency fund for overruns on any funding requirement. Below are some of the common pitfalls that I have come across in the funding of farm building projects:

- Overruns in capital expenditure, such as completing additional works, not included in the original plan or budget;
- Funding capital expenditure from cash flow in periods of positive cash flow. This may compromise the ability of the farm to withstand a period of low margin income; and,
- Short-term financing of long-term assets, or a farmer trying to repay a loan for capital expenditure items over too short a time frame. This can put significant pressure on farm cash flow.

Conclusion

Expenditure on farm buildings is a long-term investment and, as such, appropriate time should be spent on the planning and design phase of development. It is important to take time to visit similar projects and get an insight into the farm development experiences of other farmers. Time spent in the planning and design phase can serve to maximise future rewards and minimise preventable adjustments and expense at a later point.

Farmers should not underestimate the length of time involved in completing farm development works, from the planning process, to attaining and comparing quotations for the development work, to finally carrying out the development work itself. Farm development projects can take, on average, six months to complete, with significant variation depending on the scale of the project and the level of investment being undertaken. Good workmanship and using specified materials are essential to ensure that the development will stand the test of time.