Spring 2017

BIDWELLS

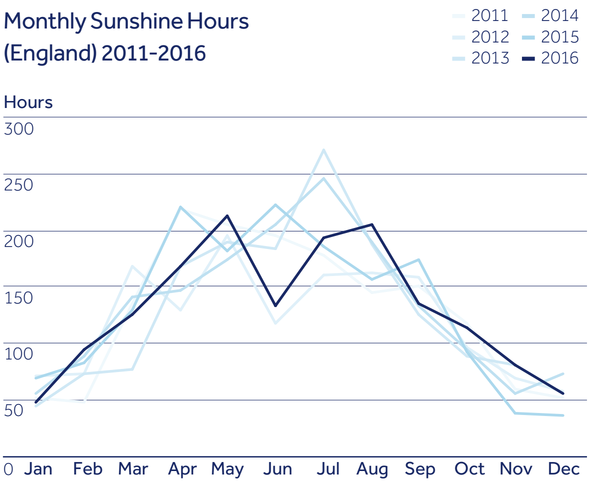
OUR VIEW ON CONTRACT FARMING RESULTS

Results from Bidwells' annual contract-farming analysis reflect the most challenging year for arable profitability in a decade. But the resilience demonstrated by the most commercial farming businesses should equip them well for the future.

40,000 acres

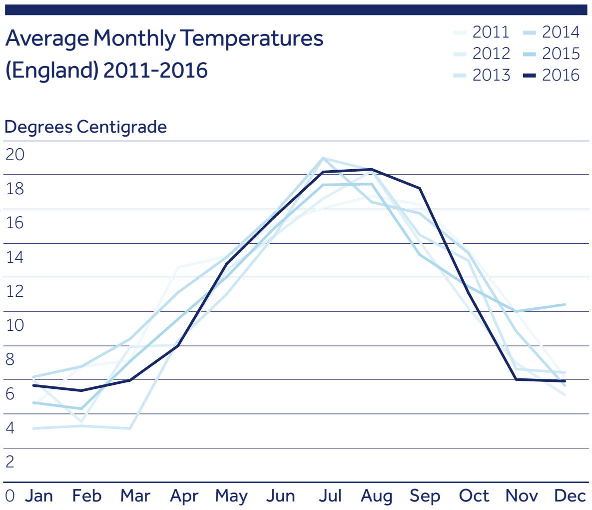
Total portfolio

Monthly Sunshine Hours (England) 2011-2016



Source: Met Office

Average Monthly Temperatures (England) 2011-2016



Source: Met Office

Each year, Bidwells publishes results from its portfolio of farms managed on contract-farming agreements. The data in our study, which spans more than a decade, is drawn from about 80 farms across England and represents the most comprehensive study of its kind. Our sample size is considerable and hides within it a range of performance levels. For the first time, we have further segmented our analysis to examine the performance of larger-scale operations, with some interesting results.

Arable farming constitutes the main enterprise on all farms, which range from relatively small units of 60 hectares to well over 1000ha. Together, the total portfolio exceeds 17,000ha (40,000 acres). More than 80% of the area grows combineable crops, with the balance made up of sugar beet, potatoes and some higher-value vegetable and salad crops.

2016 Harvest

Many farmers will remember the 2016 harvest with disappointment, particularly when compared to the year before, which saw record yields eclipsed on many farms. A relatively benign autumn which allowed decent crop establishment was followed by a cold and dull spring and early summer.

For most, earlier-maturing crops like winter barley and oilseed rape disappointed, with lower yields and critically low bushel weights hitting returns hard. Some growers, with large areas of oilseed rape in their rotations, saw yields of less than half what they had expected.

The two charts (left) demonstrate the persistently low temperatures throughout the spring growing season, and the lack of decent levels of sunshine; two main factors which robbed the 2016 harvest of much of its promise.

Even where this crop performed more in line with the average, seeds were disappointingly small. This compounded frustrations for growers struggling against cabbage stem flea beetle and slug pressure to get a viable crop at all.

A modest improvement in sunshine in late June and early July probably saved most wheat crops from similarly poor performance.

The impact of poor OSR yields and winter barley quality are directly borne out in the financial results of the portfolio. When compounded by the lowest crop prices for seven years in spring 2016, average net profit saw a sharp reduction.

Improvement in ex-farm values from harvest 2016 owed less to the fundamentals of supply and demand (the 2016 global harvest did little to deplete stocks) but much more to the fall in value of sterling against the Euro following the Brexit vote on June 23.

Analysis of results

Total income

Declines in yield and price caused total income to fall to £1093/ha – a drop of almost £100/ha on 2015. Barley income was sharply down – reflecting claims for low bushel weights as well as lower crop prices. Oilseed rape sales drew in £920/ha in total income, compared with £1052/ha a year earlier.

Income from peas and beans fell by about £60/ha, reflecting general reports of disappointing crops in many parts of the country. However, these crops, grown on larger areas since 2015, allowed farmers to meet their "greening" obligations under the Basic Payment Scheme in perhaps the easiest way. Sugar beet income fell by around £300/ha to £1474/ha.

Basic Payment Scheme

The 2016 harvest year would have been remembered as a poor one by most farmers, had not the substantial weakening in sterling contributed significantly to their total income. The fall in the value of the pound against the euro, which began on 24 June after the Brexit referendum result, and continued into the autumn, saw sterling and euro values edge closer to parity than they had since 2011.

The value of Basic Payment Scheme income grew by 16.5% on 2015; the exchange rate set on 30 September was £0.85228, significantly better than the £0.73129 a euro had been worth a year before.

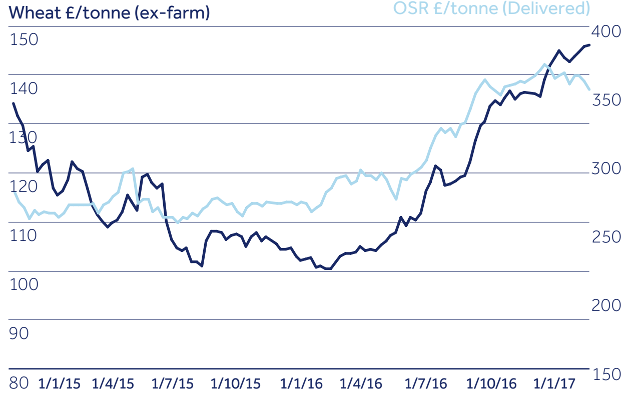
As a proportion of total income, BPS cash represented 19.3% in 2016, compared to 15.4% in 2015. Despite a general reduction in the value of direct income support over time, the significance of this source of income and many farms' dependence on it may have a significant bearing on any future, post-Brexit farming policy.

Variable costs

In general, variable costs shrank between 2015 and 2016 harvests, with fertilizer falling by about £25/ha. Pesticide costs showed a more modest fall of around £20/ha on average. However, these small gains were not enough to prevent the overall gross margin slipping from £742/ha to £690/ha in 2016.

Both seed and fertilizer costs now, to some extent, reflect a continued up-take of variable-rate technology, allowing much more precisely targeted inputs and helping to keep costs under control.

GB Feed Wheat & OSR (Erith) prices



Source: AHDB

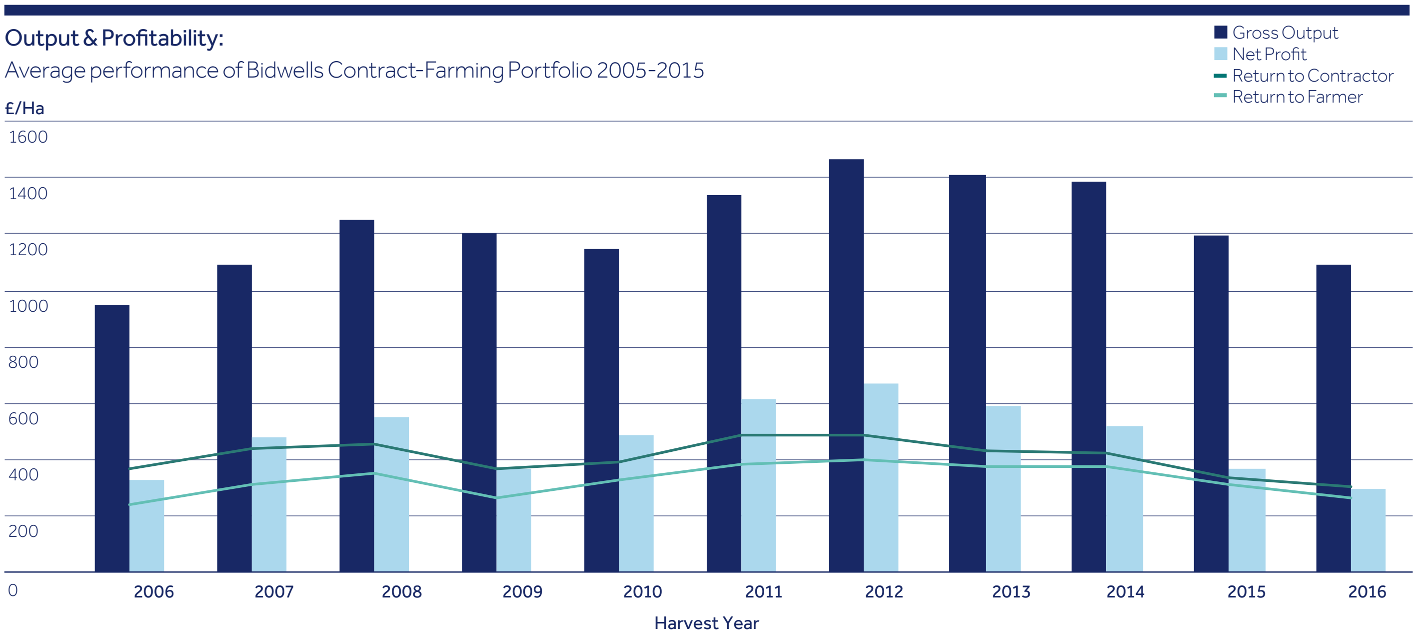
Net profit

Overall, average net profit fell to £293/ha in 2016, a sharp fall of over £70/ha. However, the decline was less than that seen between 2014 and 2015, when net profit dropped from £518/ha.

Harvest Year						
Summary of Results	**2015**		**2016**		**2016 >Avg Area in Sample (234ha)**	
	£/ha	£/acre	£/ha	£/acre	£/ha	£/acre
Total Income	1194	483	1093	442	1296	525
Total Variable Costs	452	183	424	172	445	180
Overheads (inc Contractor's Charge)	372	151	376	152	437	177
Net Profit	370	150	293	119	414	168
Total Return (Farmer)	307	125	260	105	325	132
Total Return (Contractor)	333	135	303	123	373	151

Output & Profitability:

Average performance of Bidwells Contract-Farming Portfolio 2005-2015



Prior Charges and contractors' charges

Contract-farming agreements are typically renewed on a three-year cycle. The large number of farms within Bidwells' study means that only a proportion of the agreements are renewed in any one year, and changing terms are reflected only partially in annual results. This means that trends in the way agreements are structured can take several years to feed through into farms' financial results.

The average contractor's charge, which is the basic fee for establishing, managing and harvesting crops and does not include any element of profit, fell by £40/ha (£16/acre) on the year, to a level more consistent with 2011-12 results. This perhaps indicates deals being agreed in 2013-14 when contractors expected to share in a higher proportion of profits due to higher crop prices. These basic contracting fees will be subject to negotiation in agreements being reviewed this summer and autumn.

Financial structures differ from agreement to agreement, but the relationship between the farmer's and the contractor's total return continues to edge closer together, a trend which has emerged in recent years. This suggests that, as agreements are renewed, farmers and their contractors' are agreeing a more equal division of profits; this is likely to be a more sustainable approach in times when farm profits are under immense pressure.

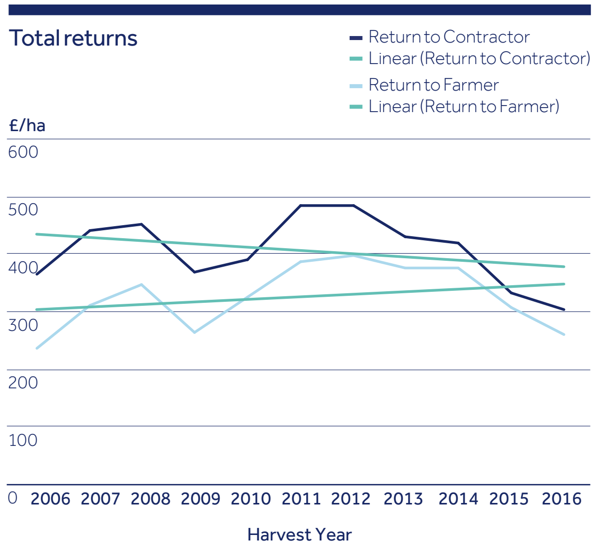
Relationship between size and commerciality

Contract-farming (as distinct from "share farming" or "crop supply") has become one of the most successful farm business structures in Britain in the last half-century. Originating with Bidwells in the 1960s, the area of land farmed under such arrangements in the UK is not precisely known, but is thought now to rival the area let under Agricultural Holdings Act or Farm Business Tenancies. The model lends itself to two particular scenarios. On a farm where economies of scale are difficult to achieve, it is an effective way to reduce fixed costs by buying-in the most costly resources from another operator – labour, machinery, fuel and oil. This helps create a more sustainable level of profit, which is usually shared with the contractor engaged.

Contract-farming also allows farmers to continue to farm when their principal activity may not be day-to-day farming. They make the key decisions; they place their working capital at risk and earn their rewards from any profits alone. In this way they can benefit from important tax reliefs on their estate. For this second reason, many of the farms in our sample are of a smaller size; although the average is between 500 and 600 acres (suggesting this is the point below which in-hand farming becomes much harder to achieve profitably without the use of unpaid family labour). These smaller farms are often inherently less commercial and have a wider range of profitability from one year to the next because of the impact of markets and production risk.

This analysis continues by looking in detail at the results from those above the average size in the sample (234ha), which appear to demonstrate a higher degree of performance and resilience.

Area farmed is, of course, an imperfect measure of commercial farming performance. But these larger units demonstrate a different trend compared to the sample as a whole. On farms above the average size in the sample, net profit was almost the same as in 2015 at £414/ha (£168/acre), with some managing a small increase. The average return to the farmer (the Prior Charge plus any share of divisible profits), was £325/ha (£132/acre), about £9/ha (£4/acre) down on the year.



£414/ha

Net profit on above average size farms, almost the same as 2015

Contractors' total returns within this sub-set actually grew to £373/ha (£150/acre), a rise of £23/ha (£9/acre). This is suggestive of many agreements achieving a level of profit which delivers the farmer's Prior Charge in full, but that the first "tier" of divisible profit ("Rateable Profit") is split in favour of the contractor. This is common in many agreements.

These total returns suggest a profile of farms which demonstrate a degree of resilience which allows them to avoid the worst impacts of poor years. These may include better crop marketing, economies of scale, or greater attention to detail rather than better soils or location alone. Several years' analysis of the Bidwells dataset reveals that the top ten performers (on financial performance alone) are consistently in the top ten.

General outlook

Outlook for 2017 Harvest
The improvement in old crop prices this season has been driven by a combination of factors; these include a UK balance sheet with an exportable surplus of higher quality than many competitors in Europe (the French 2016 wheat harvest was particularly poor). However, there is no doubt that it is our weaker currency, relative to the Euro, which has boosted business this season and led to a relatively tight supply-and-demand balance sheet as we look to the end of the crop marketing season. At the time of writing, the UK has shipped most of its cargoes for this season; but UK feed wheat is now significantly more expensive than Black Sea feed wheat and would not be competitive at current values.

As the chart (above, right) shows, the May 2018 futures contract is trading at a significant discount to old crop. This reflects a new crop valued in a very different supply-and-demand scenario to the current one.

Many growers are considering locking a proportion of their 2017 or even 2018 harvests into prices currently available, or using other management tools to avoid exposure to price risk.

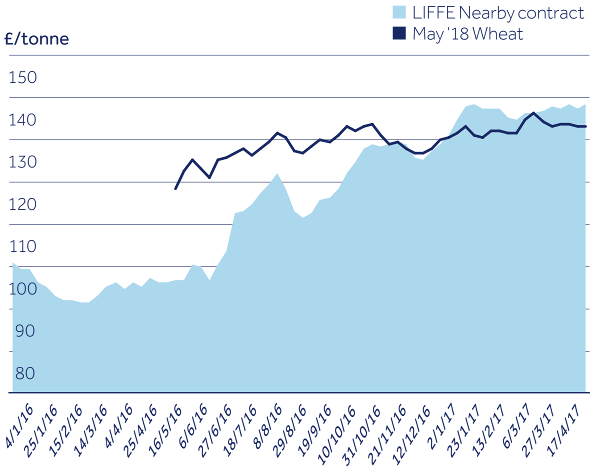
Many farmers will be focusing their efforts on issues like blackgrass control. But understanding the impacts of decisions, and their subsequent impact on crop markets and financial returns, is important too. For instance, the chart below demonstrates how crop planted areas have changed, particularly as farmers have opted for spring barley and other spring-sown crops to allow greater weed control.

Similarly, oilseed rape is now an unviable option for some farmers due to pest pressure, yet the most profitable alternative crop is not often clear.

The government has confirmed that the current direct support schemes will remain in place until at least 2019 and possibly 2020. The UK now faces a period of relative stability ahead of its departure from the EU.

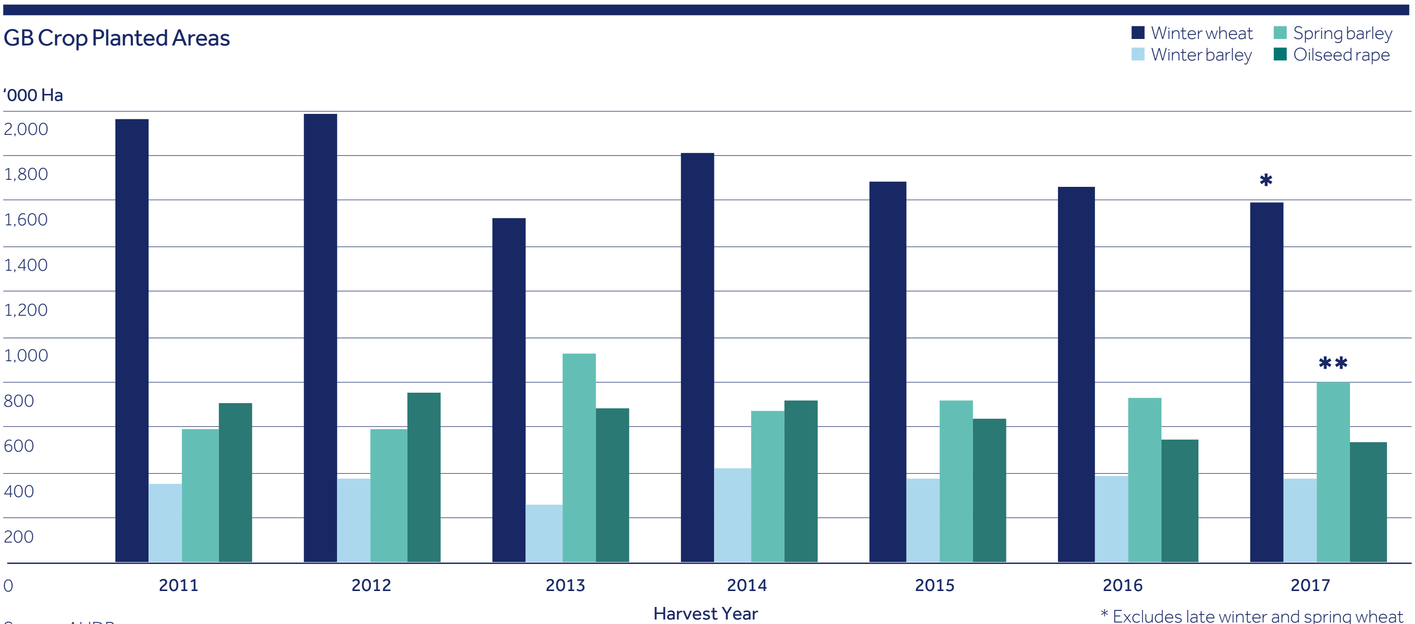
Farm businesses now have an opportunity to use this time to examine their resilience ahead of much greater exposure and uncertainty in the future. The hallmarks of businesses with real resilience include regularly calculating and, where possible, reducing costs of production, and using this information effectively in crop marketing decisions.

Futures prices - LIFFE Wheat (England) 2016-2017



Most market analysis points to a modest depletion in global grains stocks in 2017/18; there are few real problems in key exporting countries' developing crops (winter is over) and the world could be on course for another record cereals crop.

GB Crop Planted Areas



Source: AHDB

* Excludes late winter and spring wheat
** Estimate

Please contact in the first instance:
Jonathan Armitage
Partner, Head of Agribusiness
01223 559310
jonathan.armitage@bidwells.co.uk

Bidwells
Bidwell House
Trumpington Road
Cambridge
CB2 9LD

Cover photography: Tim Scrivener, agriphoto.com