Is it time to trigger Project Prudence?

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Kite Consulting looks at what recent uncertainties in the milk market and over Brexit could mean to UK dairy farmers.

UK dairy prices are affected by supply, demand, currency changes, political pressures and competitive forces within the market. Global milk production is increasing currently at about 1-1.5% and the market has been relatively balanced.

UK has grown production and is likely to hit 15 billion litres in 2020. Growing production against a background of weakening domestic demand requires options to trade across borders to access new markets and remove seasonal surpluses.

Brexit created disturbance in those trade options in March as it was uncertain what rules would be in place on 30th March. Then came the delay to Brexit and the markets went back close to normal. We now face the prospect again of Brexit on 31st October, but this time the rhetoric is even stronger in favour of a "No Deal". The political situation in Westminster is also so febrile that we may see an election this autumn as well, adding more uncertainty to the situation.

It now appears we could be heading for three possible scenarios:

- **Option 1 - A late new deal** with the EU is accepted and trading conditions beyond 31st October remain similar to now. In this scenario the pound would be very volatile up until the deal and then rally considerably, back towards 80-85p/euro.
    - The last-minute nature of any likely agreement could disrupt dairy supply chains and weaken conditions but these would return to normal in spring 2020.
- **Option 2- There is no deal.** On 1st November trade tariffs on imports could be removed but tariffs on exports to EU may be imposed. The pound would likely drop to £1 – 1 Euro for a period. The weaker pound would be good for dairy prices but the impact on the trade routes could destabilise the markets. so market prices are likely to weaken, which could impact on cash flows on some contracts. Some processors are indicating significant price falls in the case of a hard Brexit.
- **Option 3- No deal is blocked in parliament** or an election is triggered and Brexit is delayed again until at least Spring 2020, possibly following a further referendum. The scenario for dairy would be similar to Option 1 but the continued uncertainty will hold back the UK market.

Due to the short timescale there is a limit to the changes in business strategy that can be made, so it's important to avoid panic measures. The three scenarios show that if a deal is done then any disruption would be short-lived. However, the risks of a no deal appear to be increasing and, in a volatile world, a robust business should take prudent decisions to limit risk.

Actions

- In a crisis, cash is king – hold back as much as possible in the business to deal with volatility in milk prices or input costs.
- Ensure a risk management plan is in place for feeds. Fixing up to 100% of feed through to the spring of 2020 is an option to consider and taking further cover out into 2020 should mitigate some risk.
- Make sure feed stores are full on 31st October – not just bulk feed but also minerals and fats that come via EU trades.
- Have a managed system for dealing with creditors. Paying ad-hoc can be very stressful and lead to deteriorating relationships. Many supply businesses will be careful about extending credit after the experience of 2015-16 when we had the last dairy downturn.
- Suspend machinery investment until post-Christmas. Avoid new HP monthly costs until the picture is clearer.
- Hold off property repairs that will use cash until the new year.
- Spread out payments on insurance, fertiliser, seed etc. to keep maximum capacity in bank accounts.
- Keep management Information up to date and keep your bank informed. If cashflow problems arise then having good information is key to getting their support. Recognise that banks may be less willing to extend facilities because of the last dairy downturn so ensuring a good relationship with your bank will be critical to managing cash.
- Maintain any capital repayment holidays on loans until 2020.
- Be aware of foreign labour and the impact on their "take home" pay. Rules on citizens' rights are to be confirmed and short falls in income may have to be supplemented to retain staff. Ensure any overseas staff are informed and re-assured that you have a plan. This is really important since staff problems are a major cause of stress on many farms.

It's clear that the industry as a whole is operating in more volatile times, with risk management and resilience becoming increasingly more important each year. Therefore, part of our work in the longer term with clients will focus on discussing strategies to build up reserves and create "shock absorbers" in farm businesses, to ensure that farms are well-prepared for the future, whatever it may bring

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