Business Update - Risk Mitigation: What is the gain from forward buying feed?

Information correct as at 10:00am on 28.08.2020

- Forward buying feed gives you a reliable fixed price that you can budget against and reduces the risk of exposure to prices increases.
- When fixing feed purchases it is important to relate the feed price to your likely milk price to ensure you are locking into a good margin.
- Focus on buying proportions of your requirements early when the price is affordable, rather than thinking you are aiming to get the lowest price as that can risk missing out on a good price. This can be achieved by pound cost averaging.

In an industry of commodity products, where both milk price and input costs are volatile, forward buying feed reduces exposure to unpredictable market prices. The difference between current and future prices is market dependent and difficult to predict, but forward buying gives you a reliable, fixed price that you can budget your production against to ensure it is profitable on your farm. It is unlikely you will always pay the lowest price for your feed, whatever you do, but it is more likely you can avoid paying the most with a good buying strategy.

Different farms take different approaches to forward buying, the method you use will depend on volumes, convenience and your attitude to risk:

1. Order your whole requirement in one order when you think the price is good, those who are prepared to take a higher risk will often try to wait for the best price. This method can achieve the best prices one year, but in another it can leave you stuck needing to buy when prices are unfavourable, so it is a riskier strategy than it may feel.
2. Decide on a price that your business can afford at your current milk price and feed rates, then when prices are below that order a certain percentage of feed requirements. This may not be the best price, but it is an affordable price and leaves a proportion of feed left to order should prices come down and if prices increase you are only paying the higher price on some of your feed requirement.
3. Spend a set amount each month on feed. This is called pound cost averaging and is explained below. This method ensures the price per tonne you pay will always be below the market average.

Pound Cost Averaging:

The example below uses nearby wheat prices, but you can apply this method to any feed on either nearby or future prices. The more prices fluctuate and change, the less you will pay per tonne compared to the average market price.

	January 2020	Feb 2020	March 2020	April 2020	May 2020	June 2020	Total
Spend	10,000	10,000	10,000	10,000	10,000	10,000	60,000
Wheat Price	150.21	149.98	152.97	154.69	156.04	160.25	
Tonnes Bought	66.57	66.68	65.37	65.65	64.09	62.40	390.76
AHDB: UK ICE Feed Wheat Prices (2020)			Average Market Price £/tonne			£154.02	
			Average Price Paid £/tonne			£153.55	

Using this strategy, you buy more feed in the months where price is lower and if you stick to this method consistently you will always end up paying less per tonne than the average market price.

This will not always result in the lowest price but will give you a consistently good price. We use this method in our Kite feed buying groups.

It takes time and an interest to follow the feed markets and track prices, our feed team in Kite does this for you and keeps your consultant up to date with the current situation.

For further discussion or to help with any questions that you may have, please contact Consultant Support on consultantsupport@kiteconsulting.com or 01902 851007 / 07542 403225