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Webinar

Autumn 2022

UK Farming Prospects

PROSPECTS FOR UK AGRICULTURE – AUTUMN UPDATE

Please contact us there are any questions from this presentation

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Webinar recording accessible via:

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UK FARMING PROSPECTS – AUTUMN UPDATE

Richard King

September 2022

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AGENDA

- **Farm Profitability and Trade**
- **Policy Update**
- **Sector Roundup**
- **Summary and Conclusions**

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FARM PROFITABILITY AND TRADE

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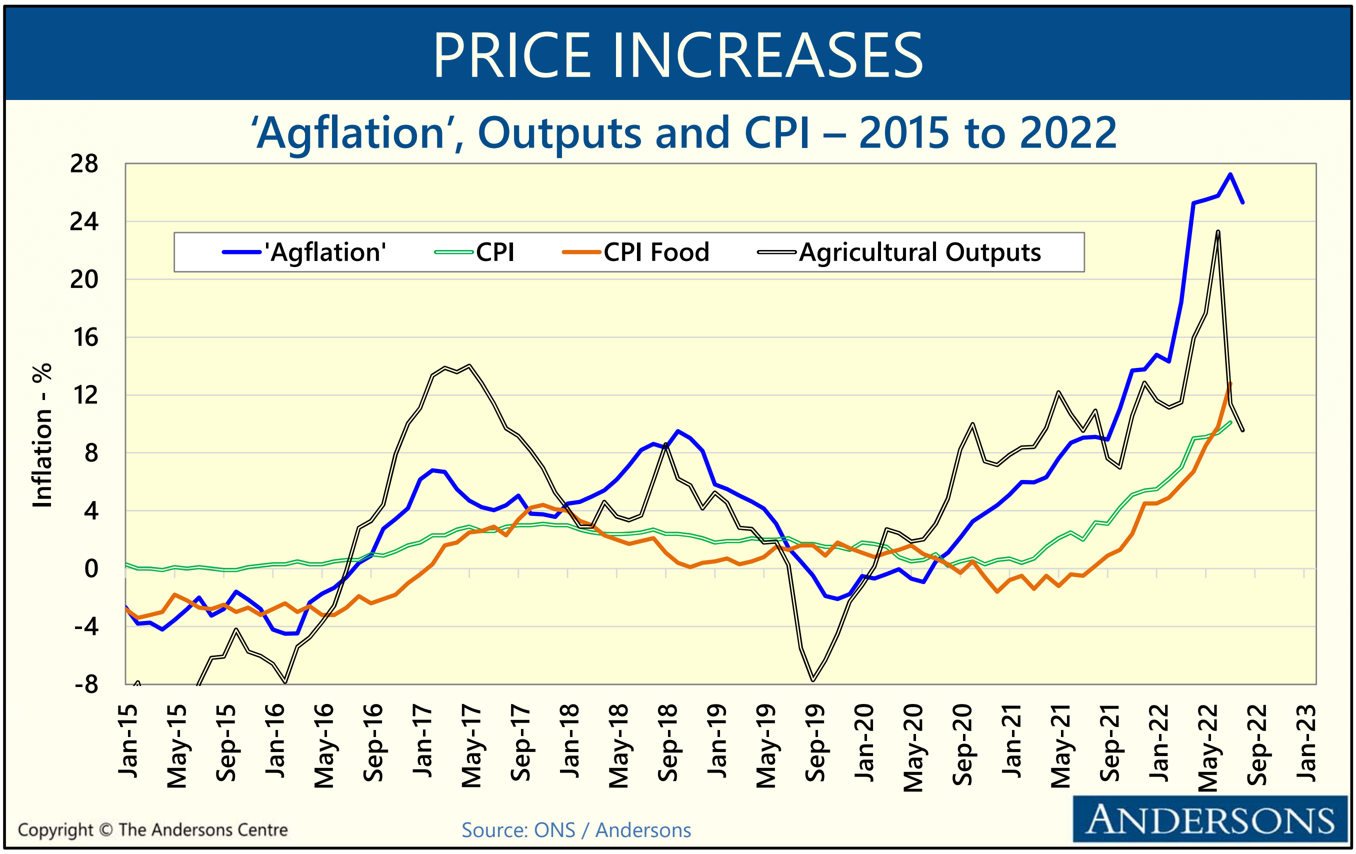
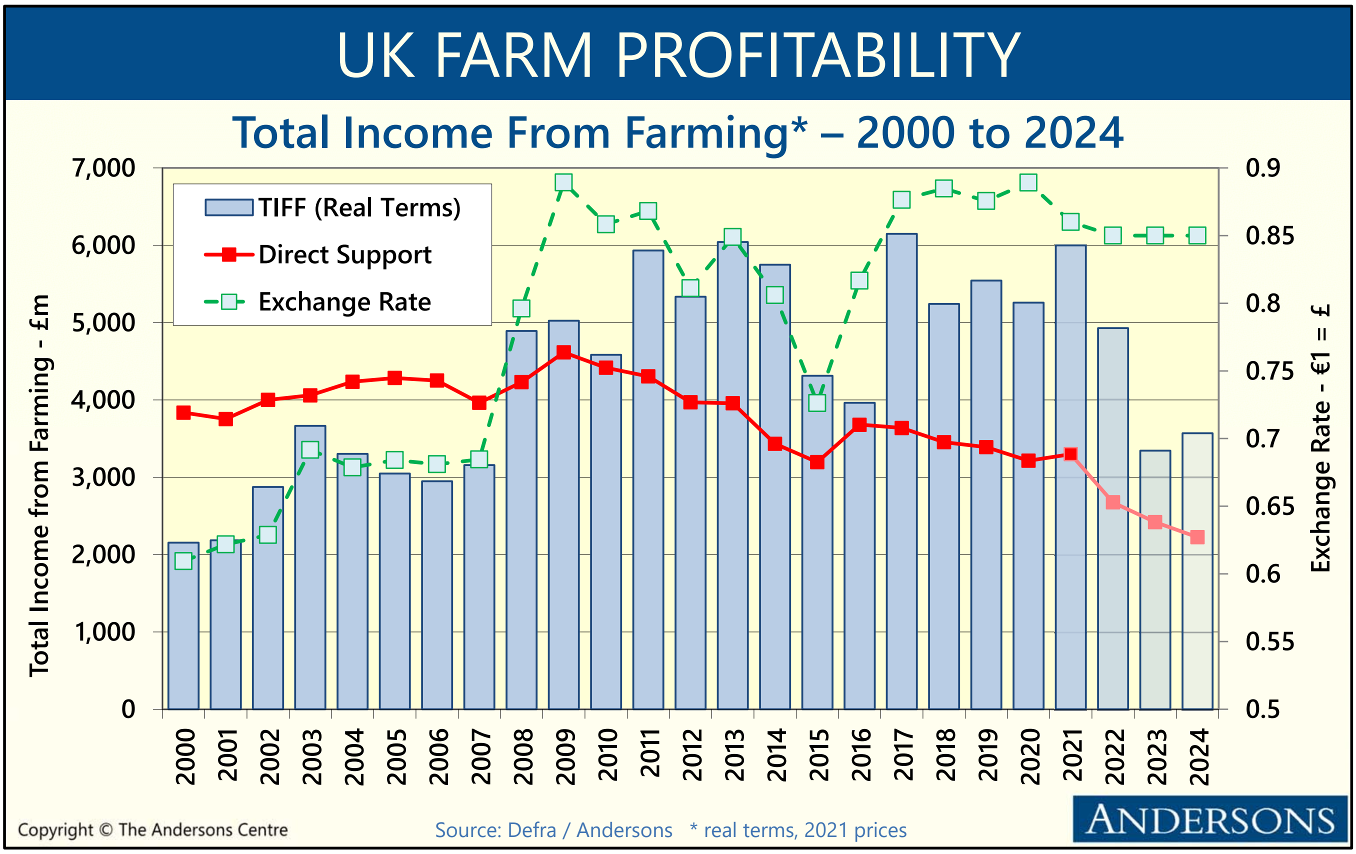
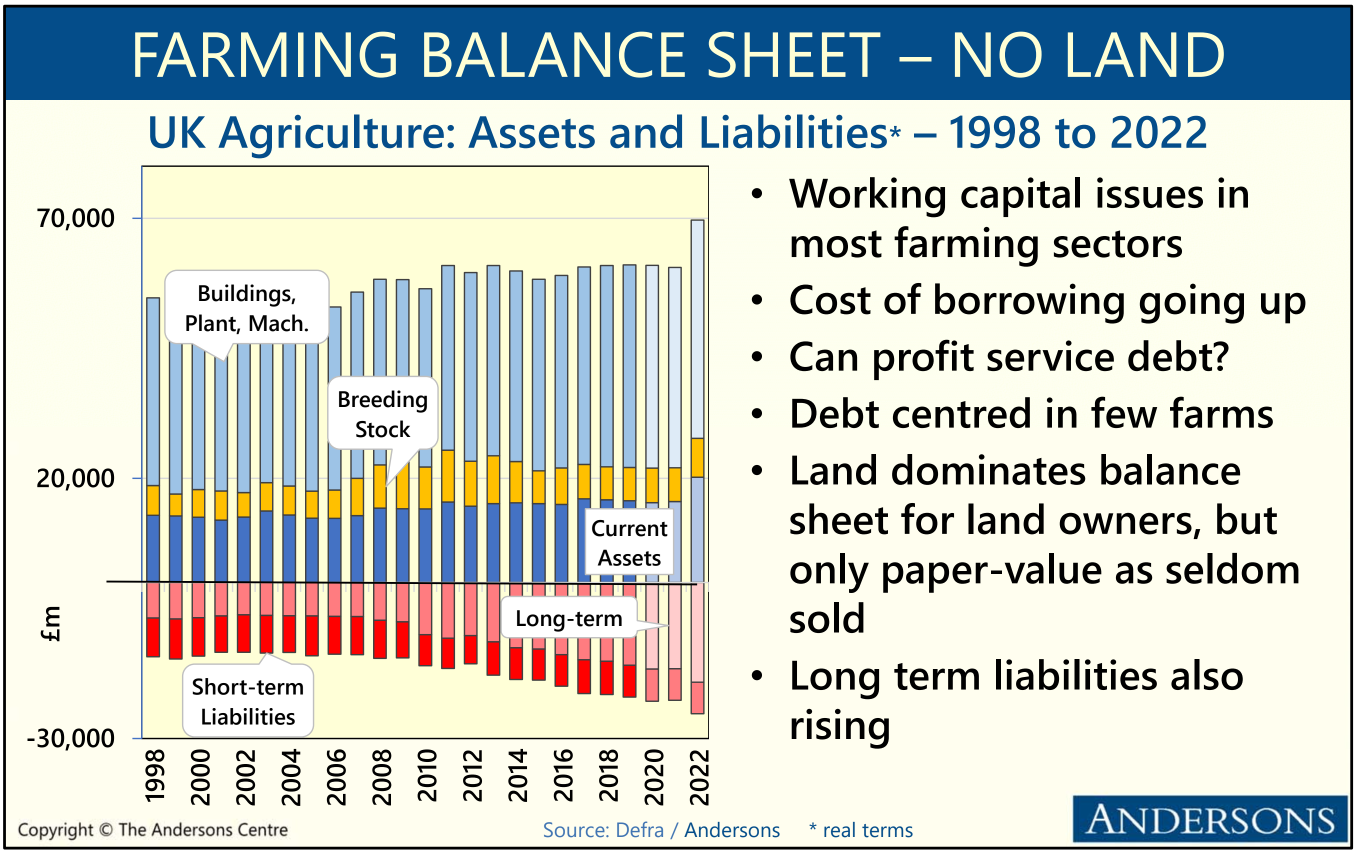


Inflation is *the* current topic in economics. This is true both in the general economy and in farming. The Government's preferred measure of inflation, CPI, has been relatively close to the Bank of England's inflation target of 2% for many years. In recent (Covid) times it has been nearer to 0%. However, prices for many goods and services rose dramatically through 2021 and into 2022. The 'agflation' figure has been calculated by Andersons. It builds upon on Defra price indices for agricultural inputs and weights each input cost (e.g., animal feed) by the overall spend by UK farmers. Andersons then provides a more up-to-date estimate of the price index for each input cost category and adds data for costs not covered by the Defra figures. Agflation is much more variable than general inflation. This is largely due to the linkages to commodity prices for such things as fuel, fertiliser and animal feed (feed is almost a quarter of the index). Agflation has been well over 20% recently (comparing prices with the same month a year previously). Agricultural output values have also surged, but it can be seen that, recently, there has been a divergence between outputs and inputs.



Defra's 'Total Income from Farming' (TIFF) measures the aggregate profit of the UK farming sector. In technical terms, TIFF shows the return to all the farmers in UK agriculture and horticulture for their management, labour and their own capital in their businesses. Defra's latest figures relate to the 2021 year and show good returns – about £6bn. In general, sale prices were high and cost increased had not yet occurred. The figures for 2022 onwards are Andersons' estimates. We calculate the profit for 2022 will be lower despite good sale prices in sectors such as combinable crops, beef and dairy. The rising cost of inputs is predicted to reduce margins – although not all of the increases will be reflected in the 2022 year. The TIFF figures are shown in real terms at 2021 prices. The high level of inflation (12% for 2022) has the effect of reducing profits too. The largest effects may be delayed until 2023. Input costs will probably be at high levels and output prices may decline as demand drops. This would put TIFF back in the range it was in the early 2000's.



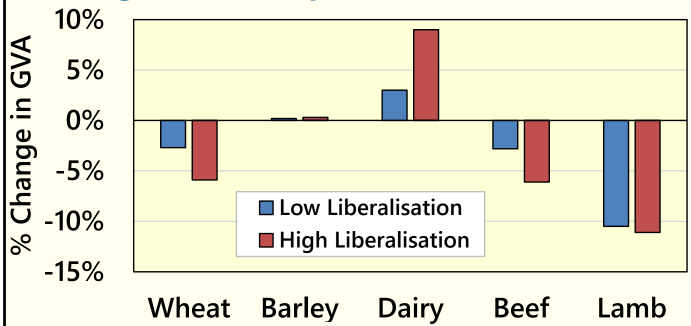
This chart presents the aggregated balance sheet for UK farming without land. The 2020 to 2022 figures are Andersons' estimates. Long-term liabilities have grown whilst short-term liabilities have decreased. This is evidence of more lending on term-loans rather than overdrafts (or trade credit etc.). Much of this long-term debt is taken on to pay for land, not shown in this graph as it dwarfs the working capital. This is the capital required to farm (owning machinery, breeding stock, and farm stores etc). In real terms, this has not changed much in 25 years but is taking a jump this year as shown on the chart. In this respect a rise in value of the farm is not an asset to the farmer, moreover, it reflects the costs required to operate the business.

TRADE OVERVIEW

Conflict Impact on Wheat Prices

Reduction in Ukraine exports	Restriction of wheat exports by Russia: 0%	-10%	-25%	-50%
0%	0%	2%	5%	11%
-25%	4%	6%	10%	16%
-50%	9%	11%	15%	21%
-100%	19%	22%	26%	34%

Long-Term Impact of Future FTAs



- **Russia-Ukraine conflict**
  - 22-23 Ukraine crop production projected 35-45% decline
  - wheat export declines greater
- **UK-EU agri-food trade close to pre-2021 levels**
  - delays to UK import controls (from EU) until late 2023
  - NI Protocol issues drag on
- **Non-EU trade deals**
  - study on impact of FTAs with Australia, NZ, Canada & GCC
  - challenges for red meat, dairy opportunities

Sources: OECD/ Aglink-Cosimo / WUR / Andersons

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The Russia-Ukraine conflict is having a substantial impact on global agri-food trade and prices, particularly grains and fertiliser. In summer 2022, Ukrainian wheat exports were estimated to be at only 20% of pre-war levels. This was before the July agreement on allowing grain shipments from Ukrainian ports. Exports from Russia have also been affected due to sanctions and logistical issues. Challenges remain for 2022-23 with further declines in Ukrainian crop output meaning continued bullish drivers. UK-EU trade has rebounded strongly and has been close to pre-2021 levels in monetary terms (albeit inflation will have boosted the value of trade). Another delay in the implementation of the UK Border Operating Model was announced in April. Controls on EU imports will not now be implemented until the end of 2023. Andersons recently led a study for the Scottish Government examining the impact of four trade deals (Australia, NZ, Canada and the Gulf Cooperation Council (GCC)) on UK output (using Gross Value Added (GVA) as a proxy) for selected commodities. Against a baseline of the UK having left the EU, the combined long-term impact of these trade deals were assessed under two scenarios. The projections signify headwinds for the grazing livestock sector, with a decline also noted for wheat. Dairy output is projected to increase by 3-9%, driven by increased exports to the GCC.

POLICY UPDATE

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SCOTLAND AND WALES POLICY 2022→

- **Current BPS to continue to at least 2024 (Scotland could be later)**
- **Scotland: LFASS to continue 2021-24 at full (2018) payment levels**
- **Gradually increase in 'conditionality' attached to direct payments**
  - GHG emissions, soils & water, biodiversity etc. – 50% by 2025
  - 'baselining' commencing in 2022 and development of new schemes
- **Consultation (autumn 2022) proposes 4-tier structure**
- **New 'Sustainable Farming Payment' will be the main Welsh farm support from 2025 onwards** – three 'layers'
  - 1. Universal – 10% woodland + 10% habitats + soils, animal health etc.
  - 2. Optional – actions to enhance environment 3. Collaborative
  - Sustainability Review required; up to 5-year contracts; payments not set
- **4-year transition from 2025; Plus advice, skills, & capital grants**

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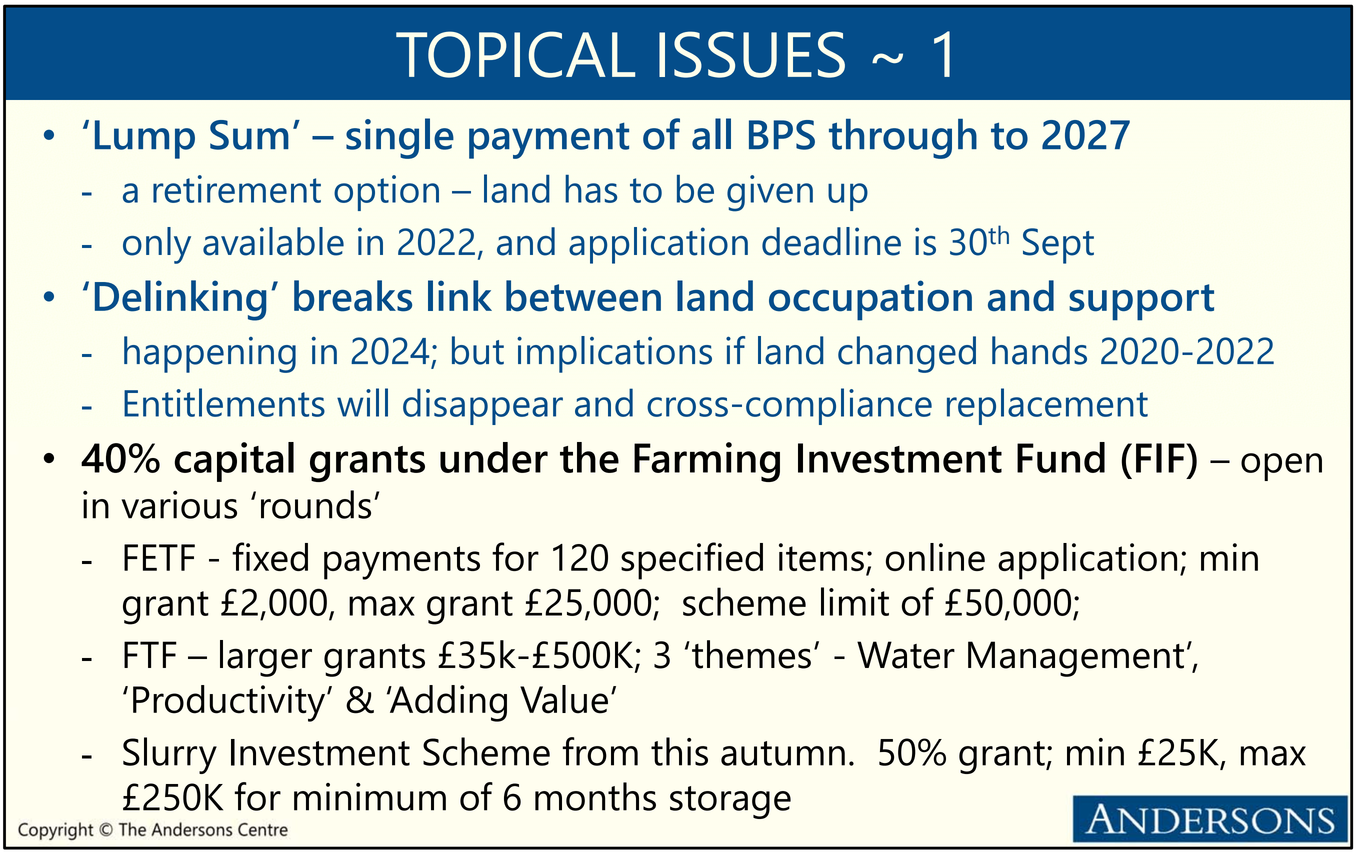
Both in Scotland and Wales existing support structures will continue until at least the 2024 year (they may go a year longer in Scotland into 2025). Thus, the BPS will remain the main source of farm support. There may be some tweaks and additions to the system to prepare for the post-2024 arrangements. In Scotland, the Less Favoured Areas Support Scheme (LFASS) will also be an important part of the arrangements. The Scottish Government had been keen to mirror the CAP as much as possible. However, there is now an acceptance that this would be a wasted opportunity and the focus is producing a farm policy that addresses climate change and biodiversity commitments. Whilst direct payments will continue, they will be made 'conditional' on farmers meeting certain criteria – 50% of payments will be subject to 'conditionality' by 2025. A four-tier structure of support is proposed after 2024. No details on any phasing is provided. In Wales, the Sustainable Farming Scheme (SFS) will replace the BPS and Glastir; a Sustainable Farming Payment (SFP) will be made. Although this will potentially be available to all farms in Wales, it will be different from the BPS as it will not be paid 'as of right' – land managers will have to provide 'public goods' to be able to access it. Again, this will have different levels. From initial proposals, Welsh farmers will be required to undertake significant environmental work – with 20% of their holdings' area being allocated to this.

ENGLISH POLICY OVERVIEW

- **Agricultural Transition underway** – no BPS by 2028 (<50% by 2024)
  - elements of ELMs slowly being launched; but limited until 2024
  - Countryside Stewardship continues; also various 'productivity' grants
- **Environment Act 2021** – statutory Biodiversity Net Gain (Nov 23); Local Nature Recovery Plans (effect on ag?); Environmental Improvement Plan
- **Other environmental issues**
  - nutrient neutrality and Nutrient Mitigation Scheme
  - carbon codes for hedges and soils being developed - boost for carbon markets?
- **Balancing competing demands for land** – new Land Use Framework
- **New Government** - assumed overall policy direction maintained
  - recession and budget for farm support (after 2024)
  - taxation regime (and regulation)

ANDERSONS

There is a lot currently going on in policy terms. England has already started the move away from the BPS with the 'Agricultural Transition'. In 2022, direct payments will be at least a fifth lower than 2020. Given that 50% of this year's BPS was paid in the summer too, the payment being received in December will be much smaller than usual. This needs to be factored-in to cashflows. The suite of Environmental Land Management (ELM) schemes to replace the BPS are appearing slowly. In the meantime, Countryside Stewardship fills the gap. Money is also being directed at 'productivity' schemes to improve the efficiency of English farming. The Environment Act has not had much direct effect on farming so far, but introduces a number of measures that will be important in the years to come. 'The environment' will continue to be a defining topic in farming – as yet, the ways of monetising this for farmers are still developing. It is assumed that a new Government is unlikely to change the policy direction seen over the past few years. The wider economic and taxation environment will be important for farm businesses.



Lump-sum payments would allow the future stream of income during the remainder of the Transition Period to be rolled-up into one single payment. Delinking of support is a key element of the Agricultural Transition. The right to future support payments would no longer be conditional on occupying agricultural land (as it is under the BPS). This frees farmers to make decisions about land occupation without affecting their future support payments. Defra is keen to improve the competitiveness and productivity of English farming. A key strand of this is capital grants for equipment and infrastructure. One new element of this coming this autumn is grants for slurry storage.

TOPICAL ISSUES ~ 2

- **Sustainable Farming Incentive (SFI) has been launched**
  - Arable Soils; Grassland Soils; Moorland and Animal Welfare 'Standards'
  - coming (early?) 2023 – Hedgerows; IPM; Soils (advanced Standards) & Nutrient Management
  - payment rates not high (arable: £22-40 per Ha; grass: £28-£58 per Ha)
  - *there is a cost to deliver option (circa 50%) – makes most sense where Standards can be accommodated with little change to systems*
  - *total sums potentially unattractive (especially on small farms) until extra Standards added*
  - *land being used for CS generally cannot also be used for SFI – makes the choice between CS and SFI complex*
- **Local Nature Recovery (next level of ELMS) – Pilots launching soon**
- **Future Farm Resilience Fund (FFRF) available from Sept**
  - free farm advice until March 2025

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The Sustainable Farming Incentive is the first part of the ELM to be launched. So far, only four 'Standards' are available – although more are promised in 2023 and extra ones will be added on new topics through to 2025. Under each Standard are three 'ambition' levels – Introductory, Intermediate and Advanced. The higher levels require farmers to do more, but provide larger payments. With a limited number of Standards available, and 'per Ha' payment rates not high, the total sums of money available are limited at present. Unlike the BPS, there is a cost in meeting SFI requirements. This reduces the margin available. The scheme makes most financial sense where the farm is already doing a lot of the scheme requirements. The figures will be different on every farm. As a result of some modelling work Andersons has done for the NFU, a rough rule-of-thumb is that half of the SFI payment tends to be taken up in compliance costs. Somewhat surprisingly, the two Soils Standards cannot be used on land already being used for Countryside Stewardship (CS). This means there is currently a complicated analysis to see which scheme is better on farm. The next few months will see the launch of pilots for the Local Nature Recovery scheme – the long-term successor to CS. A new round of free farm advice under the 'Farm Resilience' scheme will be available from October. A number of different providers are available (including Andersons under the Ricardo consortium) – each provides a different level of service, so it pays for farmers to 'shop around'.

SECTOR ROUNDUP

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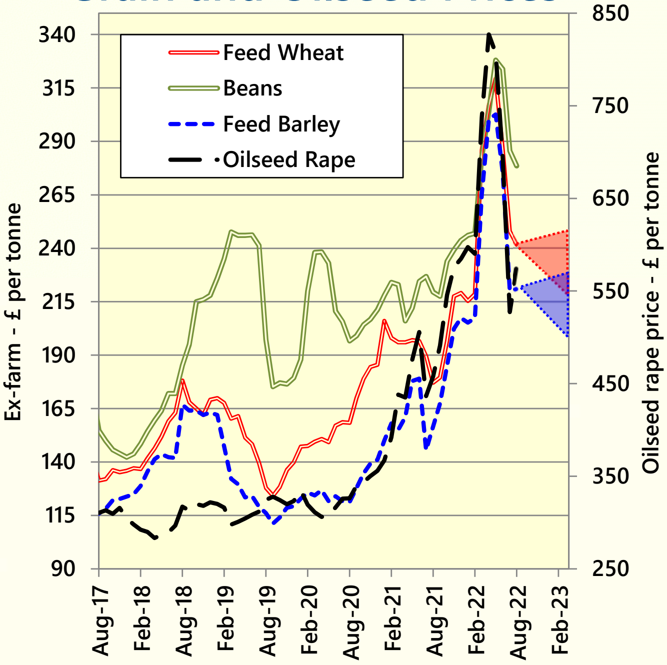
COMBINABLE CROP MARKETS

Grain and Oilseed Prices



- **High input costs, variable output prices a long-term challenge**
- **No domestic ammonia production - increased reliance on global fertiliser market**
- **Environmental pressures**
  - more volatile weather conditions impacting cropping plans
  - pressure to deliver environmental outcomes
- **Political volatility in key nations**
  - Ukraine-Russia and China
- **Changing farm support**

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This slide shows a 5-year trend of UK crop prices. For all crops we currently have historically strong values. UK ex-farm wheat prices, lead the markets for other grains. For oilseed rape, global shortages and availability uncertainty from the Ukraine war drove a surge in values which has since come back down. Bean prices have historically been volatile. This is often the case with smaller tonnage crops. Higher prices lead to higher area which in turn reduces prices. This cyclical pattern is evident at points on the graph. For 2022/23 we are not expecting a huge shift in bean acreage and as such the price may track at a similar premium to wheat as we have seen this year.

LOAM FARM MODEL

- 600 Ha of combinable crops; 240 owned, 360 FBTs
- owner plus 1 FT worker & harvest casual

£ per Ha	2020①	2021①	2022②	2023③
Output	1,165	1,523	2,133	1,956
Variable Costs	370	390	460	758
Gross Margin	795	1,133	1,672	1,199
Overheads	436	437	507	561
Rent and Finance	238	242	243	256
Drawings	75	78	80	82
Margin From Production	46	376	843	300
Basic Payment (+ SFI)	233	197	163	128+40
Business Surplus	279	573	1,006	467

 Source: Andersons ① Result ② Provisional ③ Budget

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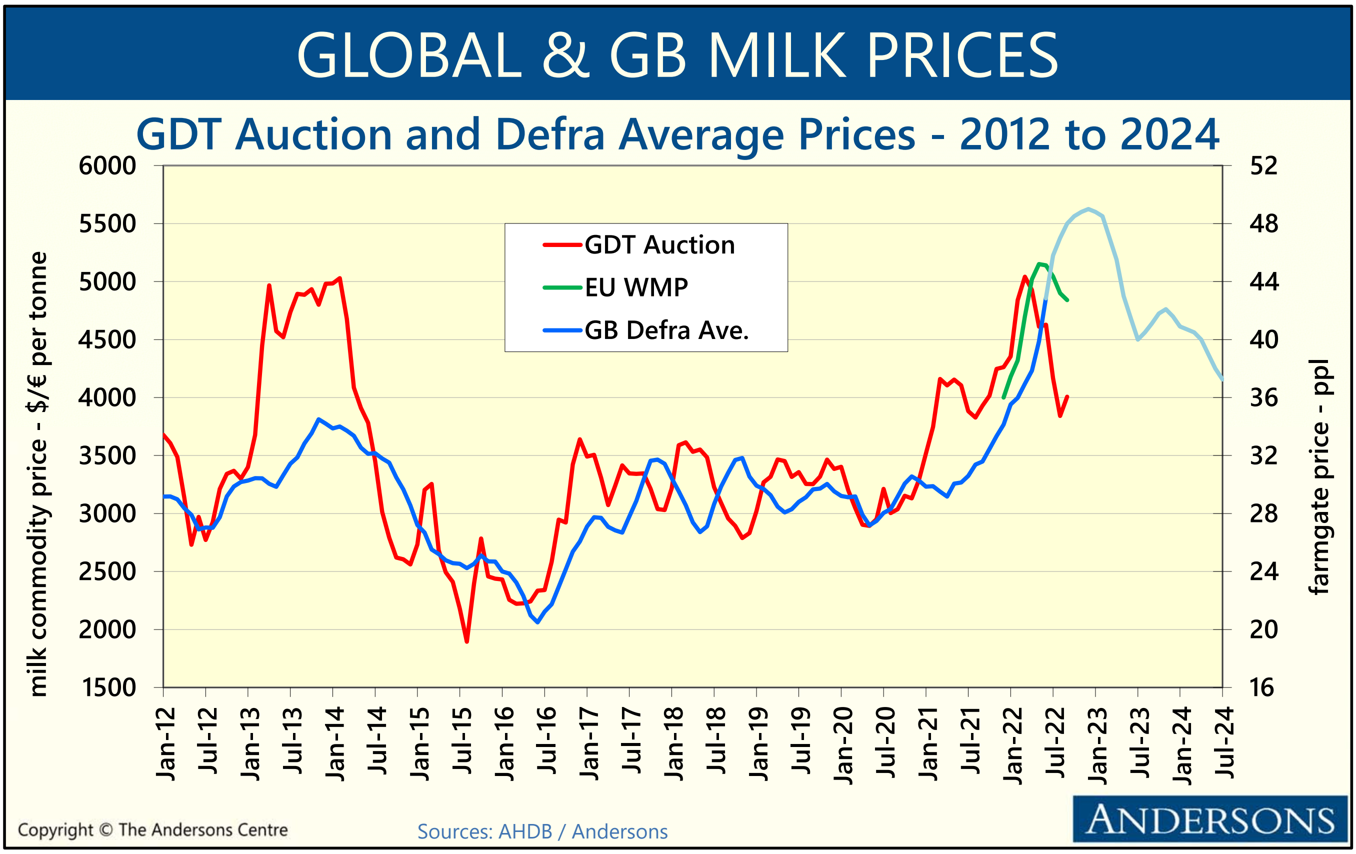
To illustrate trends in cereals farm profitability, we use our 'Loam Farm' model. This is a notional business which has been running for over 30 years and tracks the fortunes of combinable cropping farms. It has historically been a 600-hectare, simple rotation of milling wheat, oilseed rape, feed wheat and spring beans. It is based on real-life data. In 2020, Loam Farm had challenges establishing winter crops, but had lower variable costs as a result with a shift in the rotation. Whilst prices were high in 2020 Loam Farm couldn't capture all of this gain due to forward sales. In 2021, Loam Farm performed well. A change in cropping (away from oilseed rape) resulted in lower variable costs, versus pre-2020. The business surplus for 2021 was a record at the time. In 2022, there is an increase in overheads through higher machinery investment. Variable costs have also increased, but many of the inputs had been purchased earlier for the 2022 crop, so exposure to recent input rises is limited. Yields of winter crops are approximately 5% higher than average. There is still a degree of exposure to price changes for the 2022 crop, but much has already been sold. The spectacular profits can clearly be seen. For 2023, there will be significant increase in variable costs owing to the input cost inflation at present. The fall in BPS is partially mitigated by involvement in SFI (Intermediate level across the whole farm).

HIGH-VALUE CROPS

- **Access to and cost of labour a challenge (esp. seasonal)**
  - 26,400 temporary visas in year ending Q2 2022, 15,300 for Agriculture, Forestry, and Fishing
  - added bureaucracy – 9,400 of temp visas for EU, Other European, and Ukrainian nationals
- **Sector likely to remain at the forefront of a drive for innovation**
  - how achievable for businesses? And at what cost? Capital intensive…
- **Environment challenges and opportunities**
  - soils and water – potential for increases in hydroponics, indoor and vertical farming. Opportunities in urban spaces. Challenges for peatlands
  - food waste and healthy diet
- **Water abstraction issues amid volatile weather**
  - request for voluntary reductions & some abstraction licenses withdrawn
  - abstraction charges increasing significantly

ANDERSONS

Labour and the associated increased bureaucracy is a major ongoing issue for high value crops. There has been an increase in temporary Visas from 2018 (pre-covid) to 2022, with year ending quarter-two visas up 11,900. However, 35% of the temporary Visas in the year to June 2022 have been for EU nationals, and Ukrainians – staff that could have largely entered the UK Visa-free pre-Brexit. These inflate the statistics and highlight an increase in paperwork for businesses. The Environment poses both challenges and opportunities, especially given the recent drought in many parts of the UK. A number of Water Boards made requests for voluntary reductions in abstraction. Further, abstraction licenses have been withdrawn in some regions. The cost of water is also set to increase from 2022, with the minimum charge for agricultural abstraction (year-round) almost four times higher than a year ago.



The 'world price' for milk is taken to be the Global Dairy Trade (GDT) auction price (dominated by the large New Zealand co-op, Fonterra). From 2012 to 2016, the milk market was very volatile – with a large surge in prices then a sharp slump. From 2017 to 2020 there was considerably less volatility globally and nationally. Since late 2020, world prices have moved sharply upwards – following the trend of many farm commodities. The GDT has started to decline in recent months – this mainly seems to be a result of weak demand in Asia (notably China). European wholesale prices (as shown by Whole-Milk Powder (WMP) line) have remained more robust. GB prices (i.e. excluding Northern Ireland) have moved up in line with global values – but also boosted by a decline in domestic output. Andersons' forecast is for domestic farmgate prices to remain firm through the rest of the year. In the past, periods of rapid milk price increases have been followed shortly afterwards by an increase in milk production – however, high costs are currently preventing this from happening. There seems no surge in milk output that will crash prices. However, they are forecast to decline from the current highs – partly as a result of weaker consumer demand and also as output recovers next year after the drought-affected 2022.

FRIESIAN FARM MODEL

- 200+ cows plus followers on 130 Ha (part rented)
- Year-round calving, constituent contract. Owner and worker

ppl	20/21①	21/22①	22/23②	23/24③
Milk	28.5	32.5	47.0	42.0
Total Output	30.8	35.6	50.0	44.9
Variable Costs	13.3	14.4	23.6	21.2
Overheads	10.0	10.5	16.3	16.2
Rent, Fin. & Drawings	6.4	6.5	6.9	7.0
Total Costs of Production	29.7	31.3	46.9	44.4
Production Margin	1.1	4.1	3.1	0.6
Basic Payment	1.9	1.8	1.6	1.2
Business Surplus	3.0	5.9	4.7	1.8

Source: Andersons ① Result ② Estimated ③ Budget

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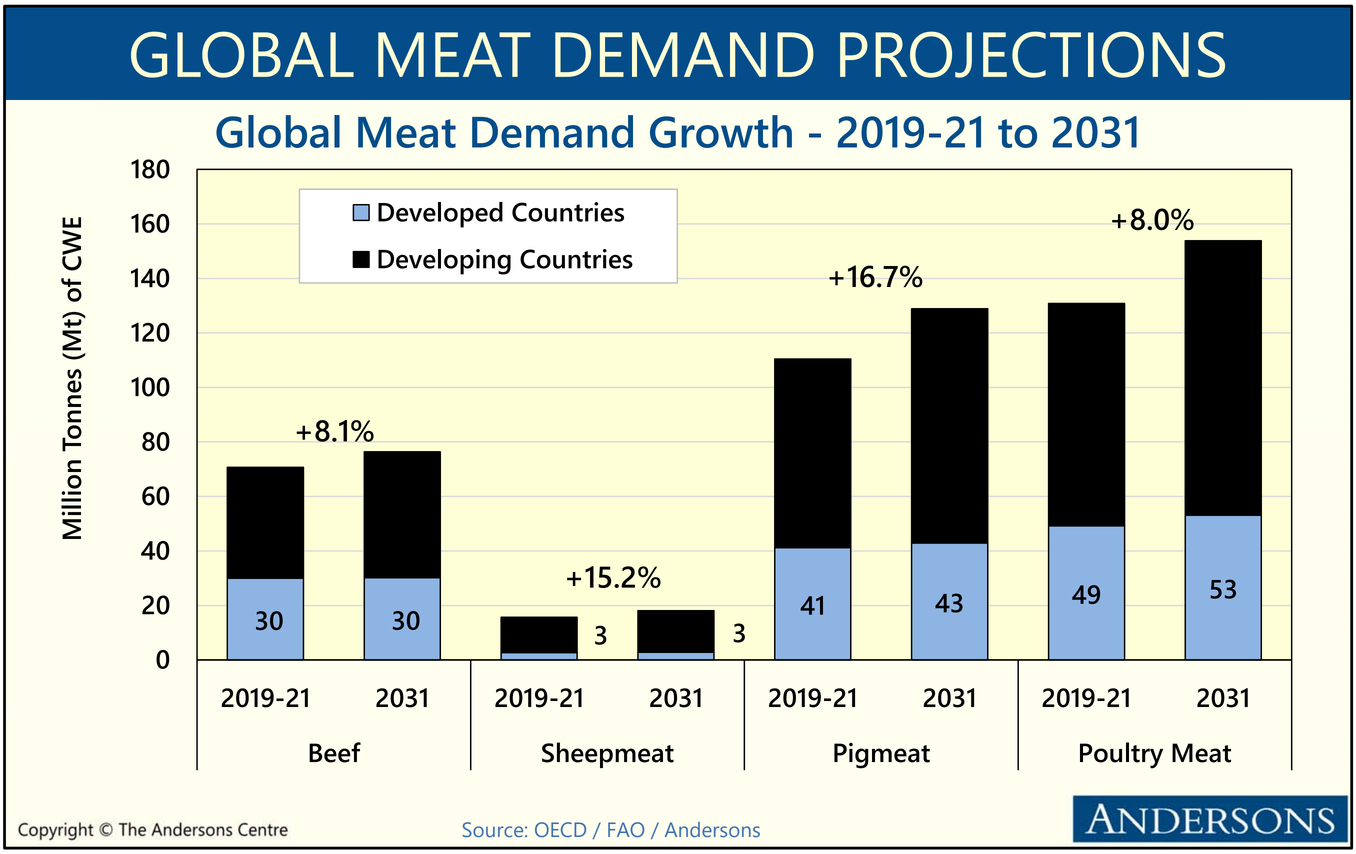
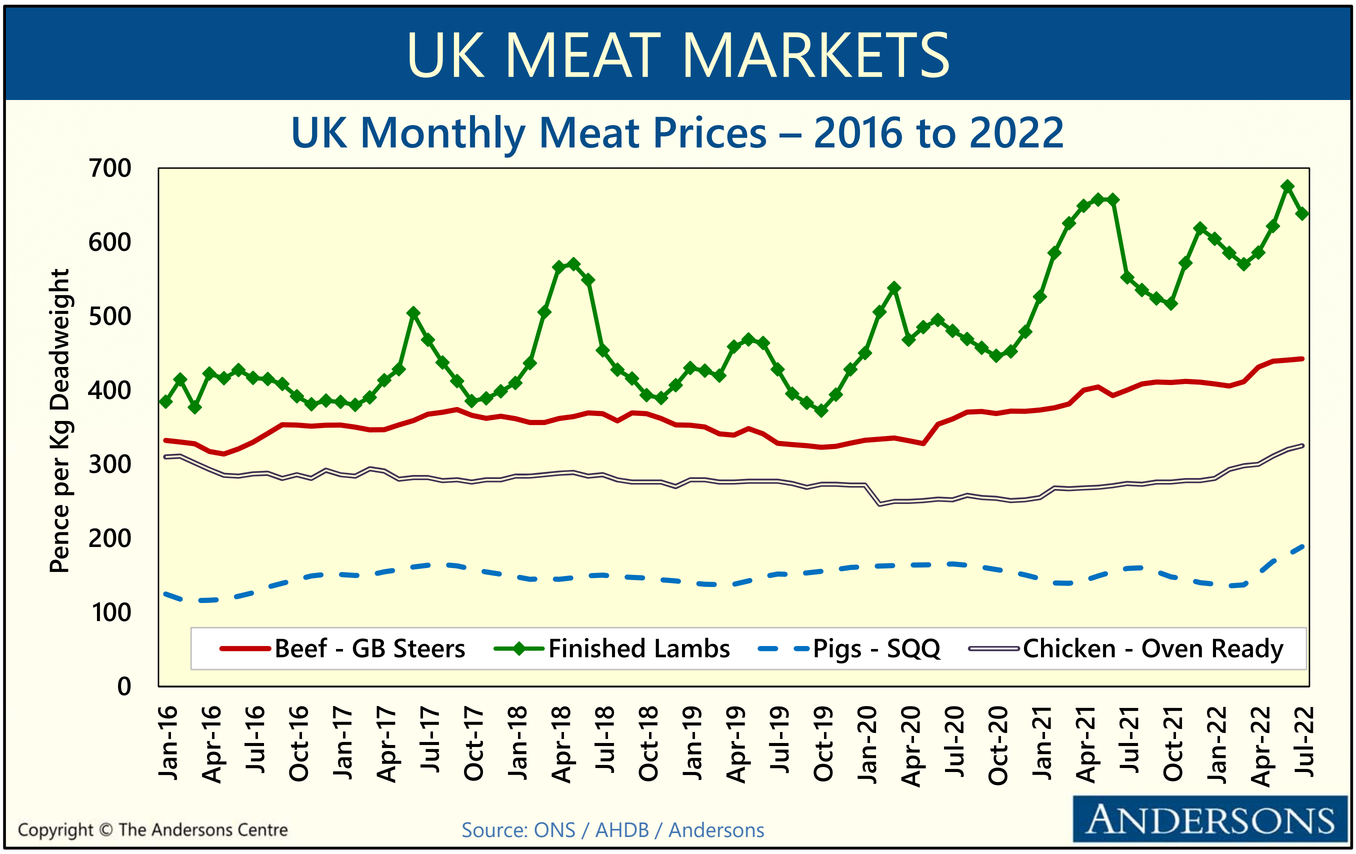
Profitability figures from our Friesian Farm model are shown. This is a notional 200+ cow business in the Midlands with a milk contract on a constituent basis. It has a year-round calving system, like much of the UK industry, but it is trying to maximise yield from forage. The figures are shown for milk years – April to March. Milk price was already rising through the 2020/21 and 2021/22 years. Whilst costs were also rising, these were out-paced by sale prices – the 21/22 year was a very profitable one for most dairy farms. The early part of the 2022/23 milk year has seen further considerable increases in prices – in some cases, exceeding 50ppl. Whilst costs have also gone up significantly, the year looks like being another one of bumper profits. Our forecast for 2023/24 is for an easing of milk prices. Costs tend to be 'sticky' on the way down and this may squeeze margins. Profitability is back below the levels of 20/21.



There has been much debate about meat consumption's impact on climate change. In developing countries, meat consumption is rising as disposable incomes increase. This is projected to continue. In percentage terms, global pigmeat consumption is forecast to rise by nearly 17% in the next decade, surpassing the growth rate of poultry (8%). It was significantly affected by the African Swine Fever (ASF) outbreak, particularly in China, thus decreasing consumption during 2019-2021. This is now bouncing back and contributing to the high growth projection to 2031. Beef consumption is also forecast to grow by around 8% this decade, but to stagnate in developed markets. Sheepmeat consumption is forecast to grow by over 15% driven by growth in developing countries. This may present some opportunities for the UK as it negotiates future trade deals.



Given the inflation the UK is facing, consumers are going to pay more attention to meat prices. This slide compares the prices for UK beef, lamb, and pig carcases as well as for oven-ready chicken. It shows pig and poultry meat prices are significantly lower than beef and lamb, with oven-ready chicken (£3.11 per kg) nearly 30% cheaper than carcase beef (£4.44 per kg). Whilst beefmince price (£3.61 per kg) is cheaper, there is a significant gap between red meat and poultry meat prices. This may impact red meat demand over the winter given the increases in the cost of living. 'Agflation' has had a severe impact on pigmeat and poultry meat profitability due to the surge in feed prices which account for the majority of production costs. There is evidence that output prices have been rising but are still insufficient to cover the production cost increases in most cases.

MEADOW FARM MODEL

- 154 Ha mixed lowland farm (114 Ha owned, 40 Ha FBT)
- Beef (suckler cows plus finishers, finished bulls, sheep and arable)
- Proprietor, 1FT family worker & casual

£ per Ha	20/21①	21/22①	22/23②	23/24③
Livestock Gross Margin	741	895	651	571
Crop Area Gross Margin	702	926	1,136	988
Total Gross Margin	732	901	752	658
Overheads	492	545	633	647
Rent, Finance & Drawings	327	328	324	332
Margin From Production	(87)	28	(205)	(322)
Basic Payment and CSS	255	241	207	172
Business Surplus	168	269	2	(150)

Source: Andersons ① Result ② Estimated ③ Budget

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'Meadow Farm' is a notional 154-hectare (380 acre) beef and sheep holding in the Midlands. It consists of grassland, with wheat and barley mainly for livestock feed. There are 60 spring-calving suckler cows with all progeny finished, a dairy bull beef enterprise and a 500-ewe breeding flock. The 21/22 year was exceptional as the farm made a margin from production for the first time in many years, driven by strong livestock and grain prices. However, 2022/23 is turning out to be more challenging as costs (both variable and overheads) have risen substantially and the farm is projected to make a loss of over £200 per Ha from production. A further cut to the BPS means the business surplus will be tiny. The proprietors are considering the new Sustainable Farming Incentive, to see if some of the 'lost' BPS can be recouped from this scheme. Due to the complications in putting arable land which is already in Countryside Stewardship into the SFI, the proprietors have opted to only consider Improved Grassland Soils Standard (Introductory Level) at this stage, which has a payment rate of £28 per Ha. Their analysis suggests that due to the costs involved with meeting the SFI Standards, the farm will receive a net income of approximately half the payment rate (i.e. £14 per hectare) for the grassland area (122 per Ha). When applied across the whole farm, this equates to just over £11 per Ha.

PIG & POULTRY ISSUES

- **Labour shortages –** processing as well as farming, pork butchery and poultry no longer eligible for Seasonal Worker visa
- **Feed Cost –** up to 75% of costs of production
- **CO_2 and other input availability** – UK ammonia manufacture stopped
- **Logistics** – live animal movements are expensive to postpone
- **Trade Deals –** large producers on our doorstep. P&P currently protected
- **Public perception** – antibiotic use, animal welfare, etc.
- **Climate Change –** emissions per kg output are tiny but per Ha are huge. Beware how they are measured. Soya considered baddie
- **Capital investment –** very high, as with all other intensive farming systems
- **Disease pressure high in enclosed high-stocking-rate systems** - ASF, Avian Flu, Anti Microbial Resistance, antibiotics…
- **Range of performance amongst producers**

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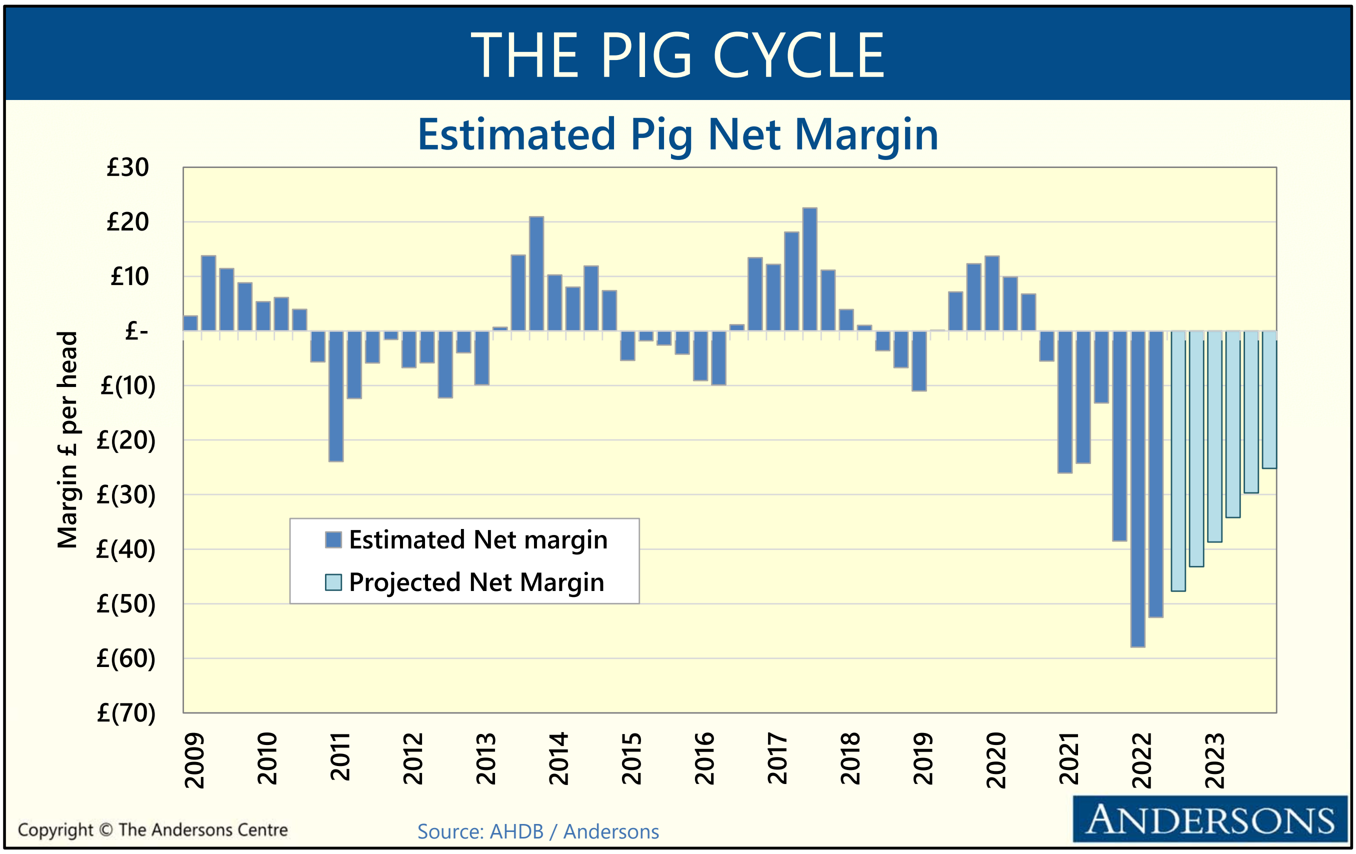
The benefits and drawbacks of farming systems are magnified when a lot of production takes place in a small space in intensive systems (mostly indoor). This multiplies the output and profits, but also the losses when they occur. Many people see them as environmental disasters as they measure emissions per shed, not per kilo of output coming from them. Compare production of say 500m^2 of broiler shed with the same area of beef-grazed grass. The emissions per m^2 of grassland will be far lower than the shed but per kg of meat sold inevitably higher. The cost of feed is always a key influencer as it accounts for so much of the profit or loss. As indoor farming is less visible to consumers, they can create more suspicion amongst the general public.



Commodity prices move in largely unpredictable cycles. These are well known in the pig meat sector. On this chart, the cycle is demonstrated not by price, but net margin per head. It is a calculated figure for an average producer using typical volumes of inputs, applying their costs and comparing them with the price per unit of pig-meat and typical weight per pig sold. The cycle is currently in an unusually low point. Finished pigs had to remain on farm for longer than usual, costing money, and going out of condition.

SUMMARY AND CONCLUSIONS

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CONCLUSIONS

- **Reasonable harvest 2022 for broadacre arable but dry summer for grassland farmers and leafy crops**
- **Farming experiencing significant political change**
  - **short term: changes to policy,** more effort for less money for farmers but long term sustainable policies
  - **long term: price pressure** from trade deals, competition from new markets. Opportunities too but arguably less than competition
- **Costs rising –** labour, construction, fertiliser, credit
- **Some outputs keeping pace,** but not all – divergence in sector fortunes
- **Changing uses for land**
  - with new policy comes an increased focus on the environment and land use change
  - pressure to minimise environmental footprint

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Most sectors will have made good returns in 2021/22, except for pigs and poultry. Currently, the 2022/23 year is much more challenging. Cost inflation is the big issue. This may well be combined with a decline in output prices from current 'spiked' levels – as consumer demand weakens and global agriculture adjusts to the Ukraine crisis. Grazing livestock, and arable to a lesser extent, have been fundamentally unprofitable with subsidy. In England, the SFI is coming in but will not displace the guaranteed income of BPS. As has been a theme for some time farming continues to go through a period of significant change. The environment is increasingly becoming a driver of agricultural land use and will continue to be so for some time to come. We have increased competition for land from diversification, woodland, peatland, and other biodiversity drivers.

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