OUTLOOK

AIB's Series of Sectoral Research Reports

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DAIRY

in association with

IFA

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SUPPORTING THE DEVELOPMENT OF THE IRISH DAIRY SECTOR

Welcome to the third in our series of SME sector reports covering key sectors within the Irish economy.

The third report focuses on the Irish Dairy Sector examining the opportunities and challenges facing the sector. The aim of this report series is to analyse key sectors of the Irish economic landscape providing expert opinion, guidance and an outlook from some of the stakeholders within each sector. We are pleased to partner with the Irish Farmers' Association on this key report in our series.

An important component of this report is specially commissioned research which has been undertaken by Broadmore Research and Amàrach Research and includes both a farmer survey and expert interviews. The findings provide interesting insights into the opportunities and challenges facing the sector.

The agri-food sector has always been a cornerstone of the Irish economy in general and is the real foundation of the rural economy. The sector accounts for almost 8% of National Gross Value Added and exports from the sector reached €9 billion in 2012 with dairy accounting for almost 30%. Milk alone accounts for 25% of gross agricultural output.

The Irish dairy sector produces 5.2 billion litres of milk annually from 18,000 farmers. While modest by international standards, the Irish dairy sector enjoys a strong global presence. Ireland is a major player in the global infant food market and is home to leaders in both ingredients and cheese manufacture.

The outlook for the sector is positive with growing demand for dairy products from developing economies. The industry here is preparing to take advantage of the market opportunity and fully realise its potential when quota is removed in 2015. Realising this opportunity requires some careful planning to ensure that the farm is developed from an efficient base and that expansion does not in any way undermine an already strong business.

MINISTER FOR AGRICULTURE, FOOD AND THE MARINE, SIMON COVENEY T.D. AND AIB'S HEAD OF BUSINESS BANKING, KEN BURKE PICTURED AT THE LAUNCH OF THE AIB OUTLOOK REPORT ON THE DAIRY SECTOR.

There will be many challenges ahead which need to be planned for and managed. Volatility will challenge all dairy farms to manage competitive businesses through a variable income cycle. The research reflects that this is a very significant consideration for farmers. There is a real need for farmers to examine management strategies to support them through the cycle.

The sector has shown a very strong performance over many years in which resilient businesses have been developed. As we move forward, we all have a responsibility to ensure the sector grows to meet its potential in a planned and balanced way, ensuring the viability of the farm families at its very core.

AIB has a very strong presence in the sector with dedicated teams in corporate banking at Industry level and in Branches and Business Centres at supplier and farmer level. AIB has invested significantly in our capability which is a key focus in our SME activity. Our national network of Agri Advisors work to support customer needs in branches and business centres and partner locally with industry stakeholders on key issues and initiatives.

As Ireland's leading bank for the dairy sector, AIB believes that the prospects for the sector are very strong. We have partnered the dairy sector through its development over many years and we are committed to playing our part in helping it realise its enormous potential in a planned and balanced way.

I hope you find this report interesting and useful.

KEN BURKE
HEAD OF BUSINESS BANKING

THE ROAD AHEAD

Irish dairy farmers are looking towards the removal of milk quotas with a sense of optimism and opportunity despite the challenges faced by them over the past year with the adverse weather conditions. This is one of the key findings from research commissioned by AIB, in association with the Irish Farmers' Association and carried out by Amárach Research and Broadmore Research. The research was conducted by way of a survey of 200 dairy farmers and interviews with key executives in the dairy industry.

Dairy farmers have been focused for a number of years on 2015 and the removal of milk quotas. The move towards quota removal has not been smooth as farmers attempt to best position themselves for profitability and/or expansion post 2015. Farmers who considered expanding in advance of 2015 were restricted by the tight milk quota situations in 2010/11 and 2011/12, and the possibility of super-levy penalties. The over-riding influence in 2012 and early 2013 has been the adverse weather conditions and the severe fodder shortages, mediated to some degree by the above average milk prices.

Despite the challenges of the past 12 months, dairy farmers are optimistic for improvement in the dairy sector overall. Almost six in ten (57%) expect improvement within the next 5 years. There was a higher level of confidence regarding their own dairy business relative to the broader dairy and indeed national economies, with 57% believing that the situation will improve for themselves within 3 years. This positivity may reflect the fact that farmers believe the situation must improve following the weather-related pressures in 2012 and early 2013. Nonetheless, it is encouraging to see that the fodder crisis has not severely dented enthusiasm. The confidence in dairying is endorsed by the fact that two-thirds of farmers invested in their dairy enterprise over the past 3 years and half intend to invest over the next 3 years.

The abolition of milk quotas is seen as the most important opportunity for dairying over the next 5 years. Over half intend to increase milk output between 2015 and 2020. However, farmers see challenges ahead in rising input costs and milk price volatility. While farmers expect volatility in prices, they may not be fully prepared for the challenges posed by volatility but they recognise that reducing costs is important in dealing with price fluctuations. The challenge identified by the greatest number of farmers was that posed by the weather (reflecting the experiences over the past 12 months). Managing the costs of expansion is considered to be the most critical issue for farmers considering business expansion.

Some of the other key findings from the research include:

- One fifth of farmers surveyed intend to over supply milk quota in the current year, while the same proportion expect to under-supply their quota;
- 52% believe that it will be at least 5 years before the overall economy improves;
- 60% experienced a drop in income between 2011 and 2012; however 23% experienced an increased income in 2012 – driven mainly by increased output;
- 50% of farmers identify net margin per litre/hectare as the most important measure of performance;
- Of those who invested in the dairy business, the main areas of investment were in winter housing/slurry storage (40%), milking facilities (38%) and equipment (30%) and farm infrastructure (20%);
- Over half (54%) of those planning investment in the next 3 years expect to get a bank loan - for an average of 65% of total investment;
- The main areas of future investment were similar to past trends, winter housing/slurry storage (28%), milking facilities (26%), milking equipment (21%) and increasing herd size (21%);
- The main reasons for planned investment are to improve cashflow/profits (39%) and to increase production (24%);
- 42% of farmers intend to improve their grassland management practices over the next 12 months; and
- Other farmers and family are a key source of information and advice on management decisions (78%), with 72% gaining information from the farming publications.

RESEARCH SURVEY: AMÁRACH AND BROADMORE RESEARCH

DAIRY FARMERS LOOK TO THE FUTURE

WHILE IT HAS BEEN A DIFFICULT YEAR FOR IRISH DAIRY FARMERS, RESEARCH CARRIED OUT BY AMÁRACH RESEARCH AND BROADMORE RESEARCH, HIGHLIGHT THAT THERE IS A RENEWED SENSE OF OPTIMISM AMONGST THE DAIRY FARMING COMMUNITY WITH THE MAJORITY OF DAIRY FARMERS FORECASTING THAT THE INDUSTRY WILL IMPROVE WITHIN THE NEXT FIVE YEARS, WRITES **DR PAT BOGUE** OF BROADMORE RESEARCH

Since the downturn in the general economy, considerable focus has turned to the agriculture and food industry as a source of growth and as a key contributor to driving the recovery in the overall economy. Within farming, dairying has traditionally been one of the strongest performing enterprises. The Food Harvest 2020 Report set ambitious targets for increased output and value for the agriculture and food sector including a 50% increase in milk output by 2020, taking advantage of the removal of milk quotas in 2015. The current situation in dairy farming is one of significant contrasts which are best summed up by the headlines in the farming press in recent weeks which have simultaneously highlighted the severe financial and personal burdens of the bad weather and fodder crisis and the fact that milk prices have reached record levels. Therefore, the experiences on the ground among dairy farmers can be very mixed and impacted on not only by their past decisions and management practices but the vagrancies of climatic conditions and the opportunities presented in the market place. It is against this backdrop that this research survey was undertaken with dairy farmers.

The research findings provide an insight into the business decisions, long term plans and opinions on the overall economy.

Methodology

AIB, partnering with the Irish Farmers' Association, commissioned Amárach Research and Broadmore Research to undertake a research report examining the outlook, opportunities and challenges for the Irish dairy industry. The primary research, completed in May 2013, involved a telephone survey with Irish dairy farmers. A total of 200 dairy farmers from across the country were interviewed for this confidential survey. We would like to thank all those who gave their time to share the details of their farm business, their views and plans for the future with us. We acknowledge that this was a particularly challenging period for many of those interviewed.

PROFILE OF FARMERS

A broad cross section of dairy farmers were interviewed. A significant proportion are located in Munster which reflects the relative strength of dairying in that area. Of those interviewed, 13% hold a liquid milk contract. Over three-quarters (76.5%) of the farmers are the sole manager/decision maker while 23.5% are jointly responsible for business decisions on the farm. Some 64.5% are involved in specialist dairy operations while 35.5% operate a mixed farm enterprise (mainly beef). The younger farmers (under 44 years) are more likely to be involved in specialist dairying than the older farmers (over 55 years).

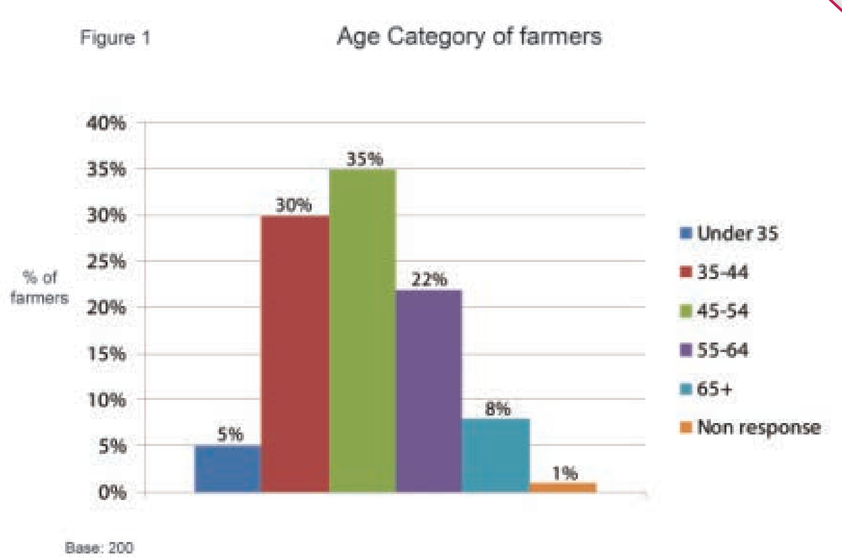
Just over one third (35%) of farmers are aged under 45 years, the same proportion between 45 and 54 years, while 8% are aged over 65 years[1] (Figure 1). Dairy farming has a younger age profile than the general farming population.

For those aged over 50 years, 60% expect the farm to be taken over by a family member when they can no longer farm themselves while 19% are undecided. Only 3% state that they would sell the farm. The expectation of having a family successor increased with quota size from 42% for the smallest quota holders to 76% for the larger quota holders. These figures indicate the ongoing strong attachment to the land, the reluctance to consider selling it and the expectation of a family member continuing the farming tradition. For those who intended a family member to take over the farm, 54% of those successors are currently involved in the decision making on the farm.

The average area farmed (owned and rented) is 66 hectares[2] with an average of 52 hectares devoted to dairying.

The average milk quota size is 374,000 litres[3], an average milk yield per cow of 5,600 litres and average milk solids for 2012 were 3.77% butterfat and 3.39% protein. Higher average milk yields per cow were found on the larger farms with the bigger milk quotas. In general the younger farmers, involved in specialist dairy operations on larger farms are achieving the higher levels of milk solids. Farmers who are in a farm investment/development mode (past and future) are also more likely to be producing a higher level of milk solids.

Over half (57%) of farmers intend to supply their volume of milk quota in the 2013/14 milk quota year, while one fifth expect to supply in excess of their quota and a similar proportion intend to supply less than their actual milk quota. Farmers who had invested in the dairy business over the past 3 years are more likely to intend to oversupply their quota (27%) than those who had not invested (10%). It is evident that a quarter of farmers are willing to risk a super levy bill for additional profit and/or scaling up in advance of 2015.



BUSINESS SENTIMENT

The majority of dairy farmers (52%) perceive that it will be at least 5 years before Ireland's overall economic situation will be better, with less than one fifth (18%) believing that the situation will improve within the next 3 years. However, there is greater confidence >>

1. *For the purposes of analysis in the report: younger farmers refers to farmers younger than 45 years, while older farmers refer to those, 55 years and above.*
2. *For the purposes of analysis in the report: small farm size refers to less than 50 ha; medium between 50 and 80 ha; and large, 80 ha and above.*
3. *For the purposes of analysis in the report: small milk quota size refers to up to 250,000 litres; medium between 250,001 - 400,000 litres; and large, over 400,000 litres.*

of improvement in the dairy industry with 57% of farmers believing that the situation will be better within the next 5 years. Farmers in Connaught/Ulster are most pessimistic about the dairy industry overall, with 51% believing that it will not improve for more than 3 years compared to 29% in the Leinster region. Those who are most positive about the dairy sector are more likely to be planning investment on their farms. Some 57% of farmers believe that the situation for their own dairy business will be better within 3 years. This shows significant confidence in their dairy farm business and the wider dairy industry which may be reflecting the current strength in milk prices.

MILK PRICE VOLATILITY

While milk prices are currently strong, two thirds of farmers expect price volatility to be a feature of the dairy sector between now and 2015, while 88% expect it to be a feature of the dairy sector between 2016 and 2020. In the event of milk price increasing significantly over the next 3 years, one quarter of farmers would do nothing different (older farmers are more likely to do nothing), while 22% would save or invest surplus income for a rainy day (Figure 2). Specialist dairy farmers, larger quota holders and farmers aged less than 45 years are most likely to save or invest for a rainy day (29%) and farmers aged over 55 years least likely (15%). Some 13% would spend the surplus income on farm improvements while 12% would save or invest surplus income for future farm improvements. Other strategies included: clearing debts/loans (9%) (larger farmers and specialist dairy farmers most likely to do so); increase herd size (9%); and increased output (9%). Farmers who are planning to produce in excess of their current milk quota are most likely to intend to save or invest surplus income for a rainy day and to clear debts.

In the event of milk price decreasing significantly over the next 3 years (Figure 3), 43% of farmers would seek to reduce overheads or costs, while 12% would get out of farming and 10% would reduce herd size. Interestingly, 23% of farmers would do nothing different. Younger, larger and those farmers who are planning to over-supply their milk quota are most likely to reduce costs if milk price decreases. Smaller farmers and those in Connaught/Ulster are most likely to consider getting out of farming/selling the farm if price decreases.

Figure 2

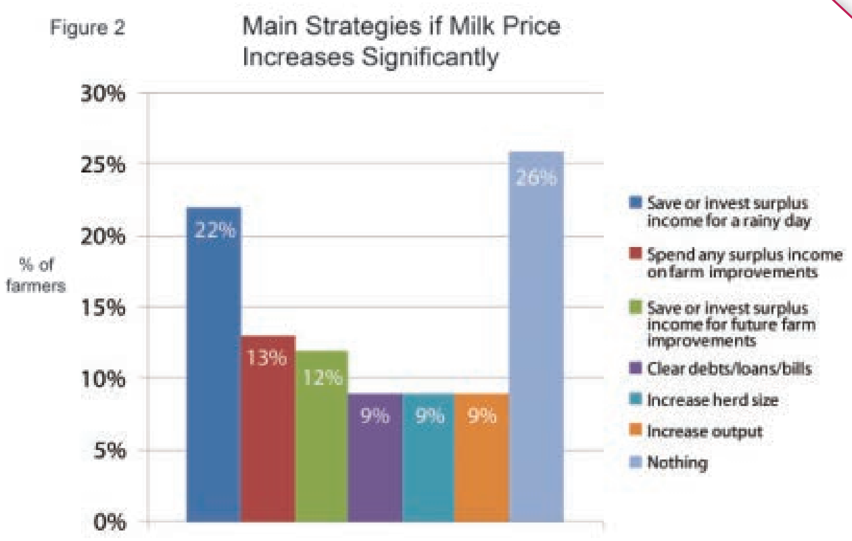


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Figure 3

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TRADING PERFORMANCE

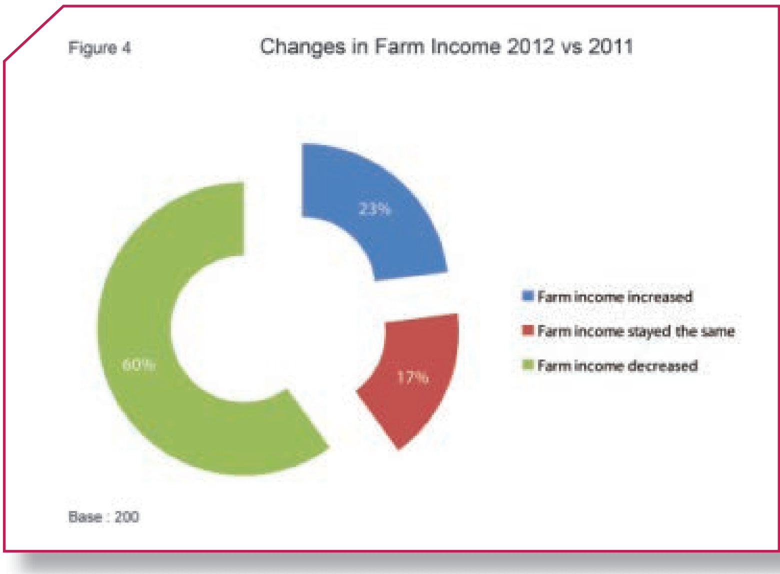
Three out of every five dairy farmers experienced a drop in income from 2011 to 2012 which in part reflects the challenging weather conditions during 2012 (Figure 4).

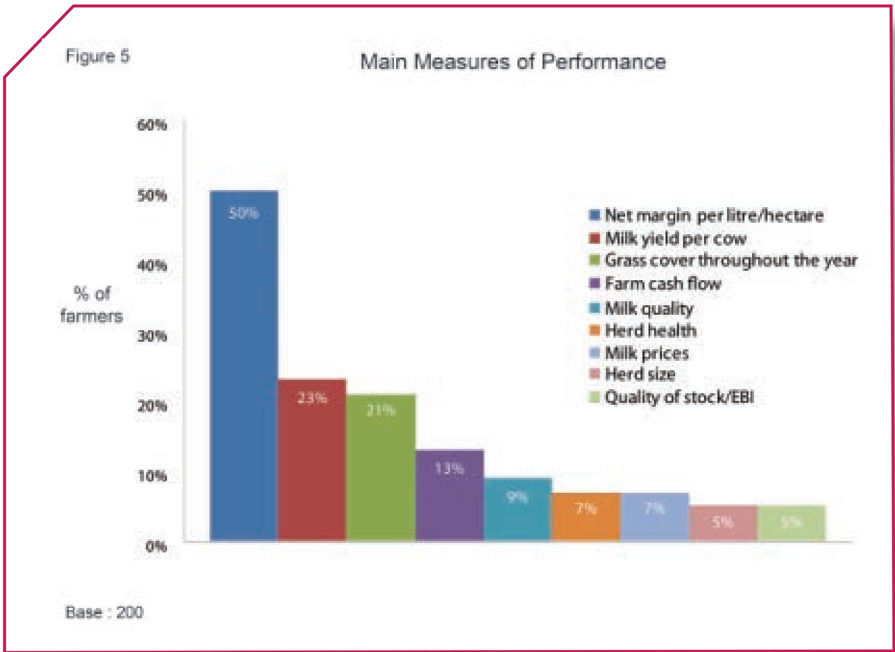
The scale of reduction in income between 2011 and 2012 was significant with 26% experiencing a reduction of over 20% and a further 34% a reduction of between 10% and 20%. The reduced income has imposed a significant burden on these farms which has dented the confidence and ability to invest in the future, with much lower planned investment levels for this group of farmers. The poor grass growth and unfavourable weather conditions this spring may have exerted additional pressure on many of these farms. Despite the difficult year, almost one quarter (23%) of farmers increased their income in 2012, while there was no change in income for 17% of dairy farmers. Evidence suggests that increased output drove the increased income on many of these farms (average milk yield per cow was highest on those farms which had increased income).

MEASURING PERFORMANCE

Dairy farming has traditionally been one of the most profitable farm enterprises, however the profitability not only reflects the price received for milk alone but also the level of management and efficiency on-farm. The strive for efficiency can be attributed to many things but the lack of expansion opportunities under the milk quota regime encouraged farmers to produce their quota as efficiently as possible. In addition, increased proportions of farmers are participtating in discussion groups and advisory programmes which promote best management practices and adoption of technology. In terms of measuring the performance of their dairy business, net margin per litre/hectare is the key measure used by dairy farmers (50%) (Figure 5). Milk yield per cow is used as a measure of performance by 23%.

Interestingly grass cover is considered as a measure of performance by one in every five dairy farmers. While grass cover does not directly generate income for dairy farmers, it is the single most important input into the business and the more grass that can be grown on the farm and the more efficiently it can be utilised, the more profitable the business. Improved grassland management and utilisation is one of the key improvements in the dairy industry over the past 2 decades. In the past, herd size would have featured more prominently as a measure of performance, but it is evident that farmers are focused on efficiency irrespective of the scale of enterprise. >>

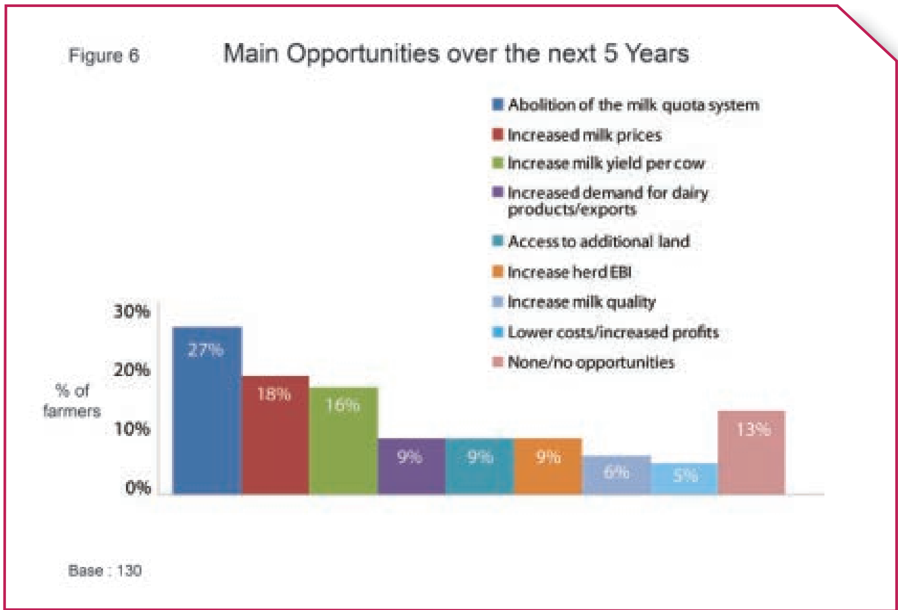


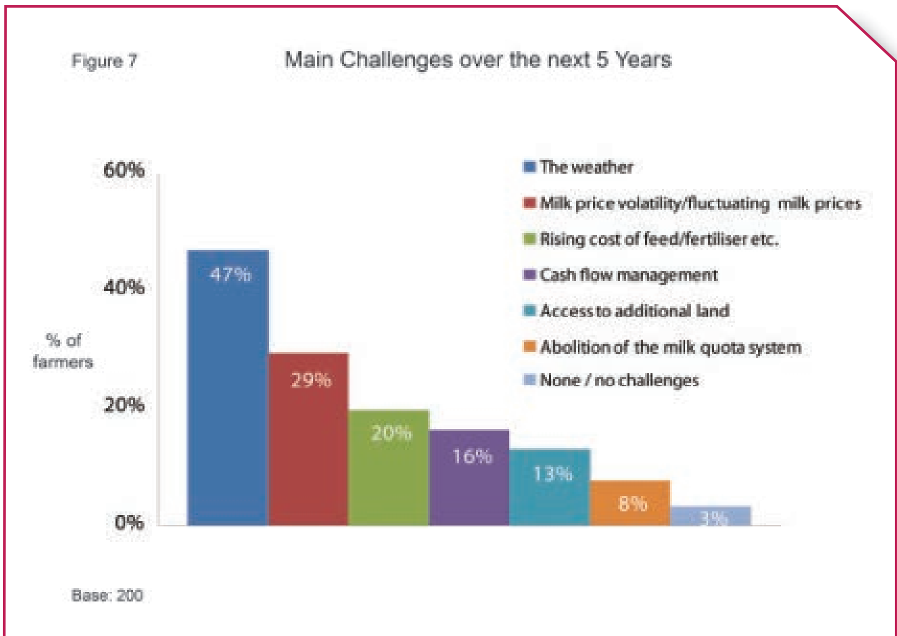


RESEARCH SURVEY: AMÁRACH AND BROADMORE RESEARCH

Farmers in Leinster place more emphasis on net margin (63%) than those in Connaught/ Ulster (42%). Similarly those with quotas in excess of 400,000 litres are more focused on net margin per litre/hectare as a measure of performance than those with a quota of less than this (64% compared to 44%). The larger milk quota holders are also more focused on farm cash flow. Milk yield per cow and grass cover are considered more important in Munster than the rest of the country. Net margin is considered more worthwhile as a measure on larger farms than on smaller, while smaller farms place more emphasis on

milk yield per cow than larger farms. While farmers who intend to over-supply their milk quota may be considered to be taking a risk, they are focused on net margin. Almost three in four (73%) of those intending to over supply their current quota consider net margin as a measure of their performance, compared to only 31% of those who are expecting to under-supply their milk quota.





INCREASED OUTPUT AND SUPER LEVY

Some 59% of farmers indicated that they had increased their milk output over the past 3 years (28% by more than 10%), while 38% had made no change. The larger milk quota holders were most likely to have increased output. Over half (56%) of farmers took no action in recent years to avoid over-production and the possibility of a super levy fine (as they were not at risk of over production). Some 11% leased/purchased additional milk quota and the same proportion sold dairy cows, while 11% fed more milk to calves.

OPPORTUNITIES OVER THE NEXT 5 YEARS

The proposed abolition of the milk quota system in 2015 is considered to be the main opportunity for dairy farmers in the next 5 years (Figure 6). Over one quarter (27%) of

farmers view it as an opportunity – this could involve increased herd size and/or increased yield per cow. Some 18% see opportunities with increased milk prices and 16% consider that there is an opportunity presented by increasing milk yield per cow. Thirteen per cent see no opportunities for their dairy business in the next 5 years.
Larger farmers and those in Munster see the greatest opportunities presented by the abolition of milk quotas and those in Connaught/Ulster the least opportunities, which may reflect greater scope on the larger farms and better land areas to capitalise on the removal of milk quotas.

CHALLENGES OVER THE NEXT 5 YEARS

Reflecting the difficult year that farmers have just experienced, it is not surprising that almost half (47%) identify the weather as a major challenge for the next 5 years (Figure 7). The weather is of most concern to farmers in Connaught/Ulster (55%) and of least concern to those in Leinster (33%). Those whose income decreased between 2011 and 2012 are also most likely to consider weather as a challenge (52%). Milk price volatility is perceived as a challenge over the next 5 years by 29% of dairy farmers, while the rising cost of inputs (mainly feed and fertiliser) is a challenge for 20% and cash flow management is a challenge for 16%. One third of farmers in Munster are concerned about milk price volatility in contrast to only half this proportion in Connaught/Ulster. Those farming less than 50 hectares are less concerned about milk price volatility than those farming larger areas. Some 13% of farmers consider access to additional land as a challenge and 8% view the abolition of milk quotas as a challenge. The rising cost of inputs is a greater concern for those involved in mixed enterprises (27%) than specialist dairy farmers (16%).

BUSINESS INVESTMENT AND DEVELOPMENT

Two thirds (65%) of dairy farmers invested in, or developed their dairy business over the past 3 years. Seven out of ten (71%) specialist dairy farmers had invested in their dairy business in the past 3 years, which compares to 55% of mixed dairy farmers. The level of past investment decreased with age. Almost eight in ten (79%) farmers aged less than 45 years had invested while only 54% of those aged over 55 years had done so. Investment increased as farm and milk quota size increased (53% of those farming less than 50 ha compared to 78% of those farming over 80 ha; while 39% of those with milk quotas of up to 250,000 litres had invested; the proportion was 85% of those with over 450,000 litres in quota). Seven out of ten farmers in Munster had invested in the past 3 years in contrast to half in Connaught/Ulster. Some 83% of farmers who intend to over supply their milk quota had invested in the past 3 years (twice the proportion who expected to under-supply their milk quota) and the trend is similar for those who had increased their output. For farmers aged over 50 years, those with a family successor identified are twice as likely to have invested as those without a successor (66% compared to 32%).

Figure 8 Main Areas of Investment in the Past 3 Years

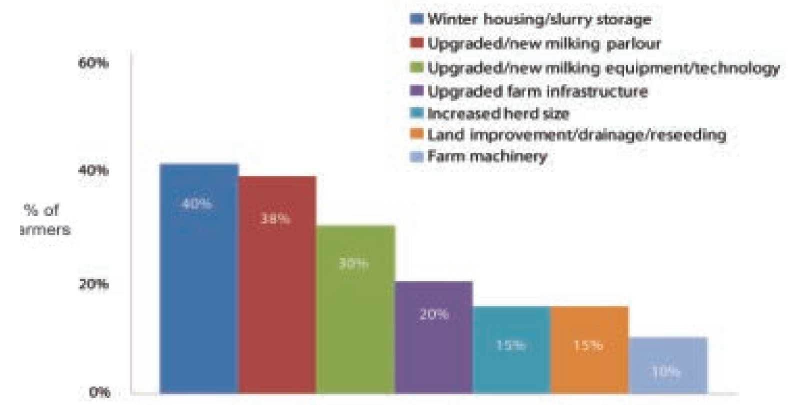


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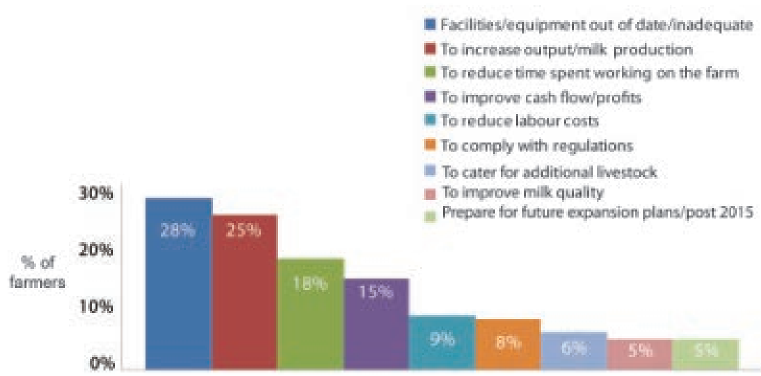
Figure 9 Main Reasons for Investment in the Past 3 Years



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Of those who invested, 40% of farmers invested in winter housing or slurry storage (greatest proportion in Connaught/Ulster and on larger farms). Some 38% upgraded or built a new milking parlour (highest among Leinster farmers and those farming over 80 ha) while 30% had installed new milking equipment or upgraded existing equipment (Figure 8). One fifth of dairy farmers invested in farm roadways, paddocks or water systems (29% for Leinster farmers). Over one in seven farmers (15%) increased the size of the dairy herd (highest for those farming less than 50 ha). Larger quota holders were over 4 times more likely to have invested in winter housing/ slurry storage than smaller quota holders (54% compared to 12%).

The main reason for investing in the dairy business over the past 3 years was that existing facilities/equipment were out of date or inadequate (28%) (Figure 9). One quarter of farmers invested in order to increase output/milk production (farmers aged over 55 years were least likely to cite increasing production as their reason for investment), while one fifth did so to improve their own >>

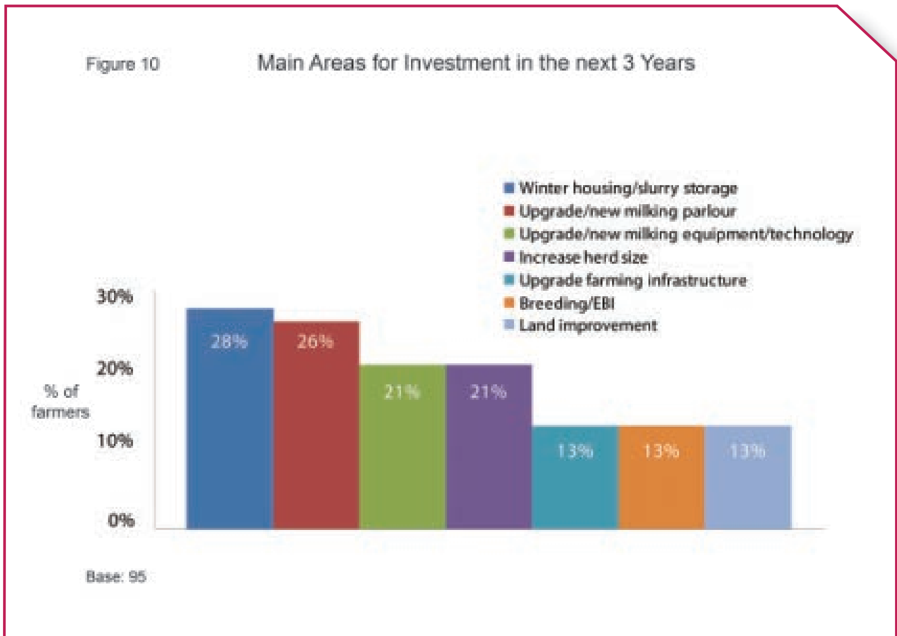
labour efficiency (a further 9% invested in order to reduce labour costs) and 15% did so to improve cashflow/profits.

FUNDING FOR INVESTMENT

Three out of every five farmers (60%) funded their on-farm investments from a bank loan, while almost half (48%) utilised profits from the farm but only 8% received an investment grant (reflecting the fact that the main farm grant schemes have ceased). Farmers who are planning to supply in excess of their milk quota are most likely to have invested the profits from the business (73%) in contrast to only 31% of those who expect to under supply. Some 68% of specialist dairy farmers funded investment through a bank loan while only 41% of mixed dairy farmers did so, which may reflect either confidence in the enterprise or the greater ability of the dairy enterprise to meet repayments.

DEVELOPMENT, EXPANSION AND GROWTH

The achievement of the Food Harvest 2020 targets in dairying will only be attained if dairy farmers continue to develop and expand their enterprises.

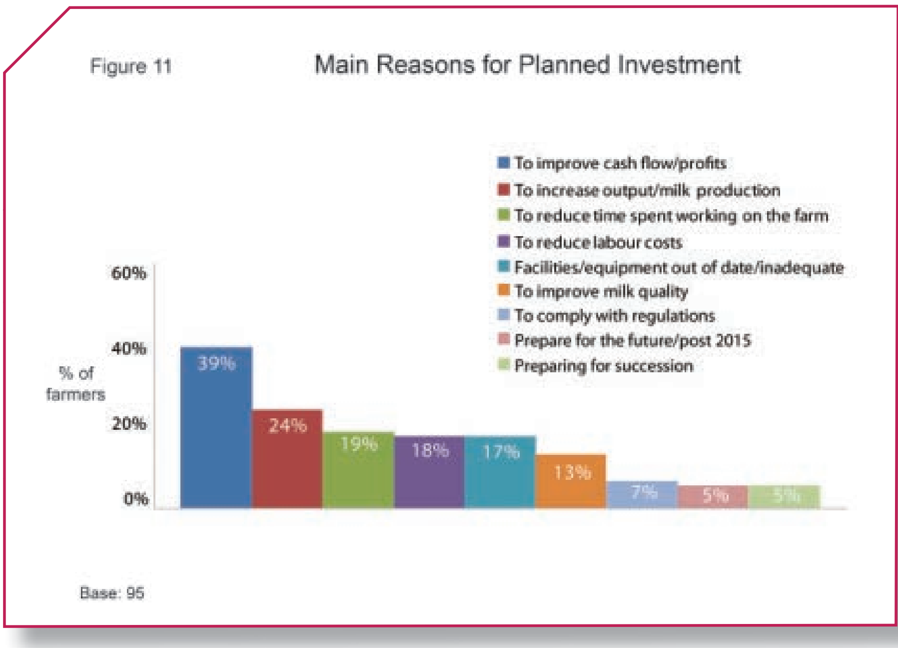


PLANNED INVESTMENT IN THE DAIRY BUSINESS

Almost half (48%) of dairy farmers plan to invest in or develop their dairy business over the next 3 years. Farmers in Leinster are most favourable towards investment (56%) and those in Connaught/Ulster least favourable (36%). Twice as many farmers aged under 55 years plan to invest than older farmers. Creamery milk suppliers are more likely to be considering investing than liquid milk suppliers (51% versus 27%). Farmers with the smallest milk quotas are most likely to be planning investment in winter housing and milking facilities.

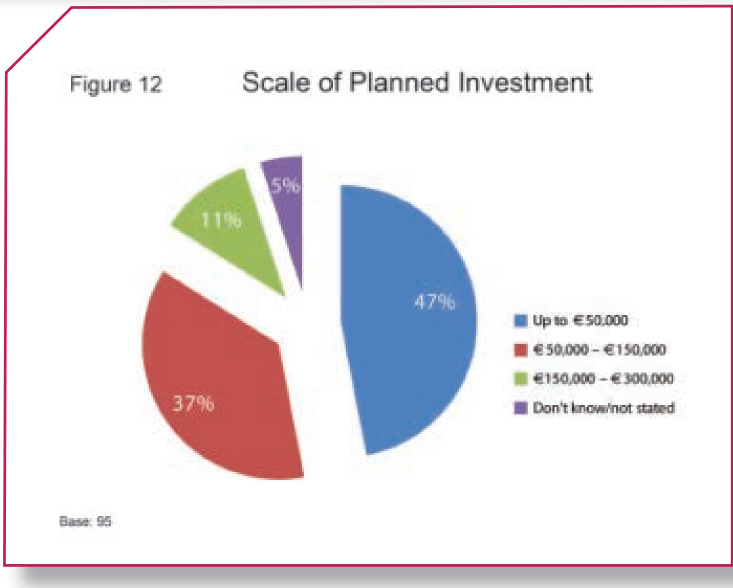
Confidence in the improvement in their own dairy situation is obviously related to investment plans. Almost six in ten (58%) farmers who believe that the situation on their own farm will improve within 3 years are planning investment compared to 34% of those who think that improvement in their own dairy situation is more than 3 years away. Those whose incomes improved between 2011 and 2012 are more likely to be planning to invest than those whose incomes decreased (70% vs 38% respectively). Over half of those who invested in the past three years are planning further investment compared to 37% of those who had not invested. Half of the farmers aged over 50 years with family successors plan to invest compared to only one in ten (11%) of those without family successors. Of those who plan to invest in the dairy business, 28% intend to invest in winter housing/slurry storage while 26% plan to invest in a new or upgraded milking parlour (Figure 10). In addition, 21% intend to invest in milking equipment/technology and the same proportion intend to increase herd size.

The primary reason identified by farmers for investing in their dairy business in the next 3 years was to improve farm cash flow or profits. Two out of five (39%) farmers plan to invest in order to improve cash flow/profits and 24% to increase milk production (Figure 11). Some 19% plan to make investments in order to reduce the time spent working on the farm, while 18% want to reduce labour costs. Farmers in Munster and those aged over 55 years are most likely to invest to reduce labour costs.



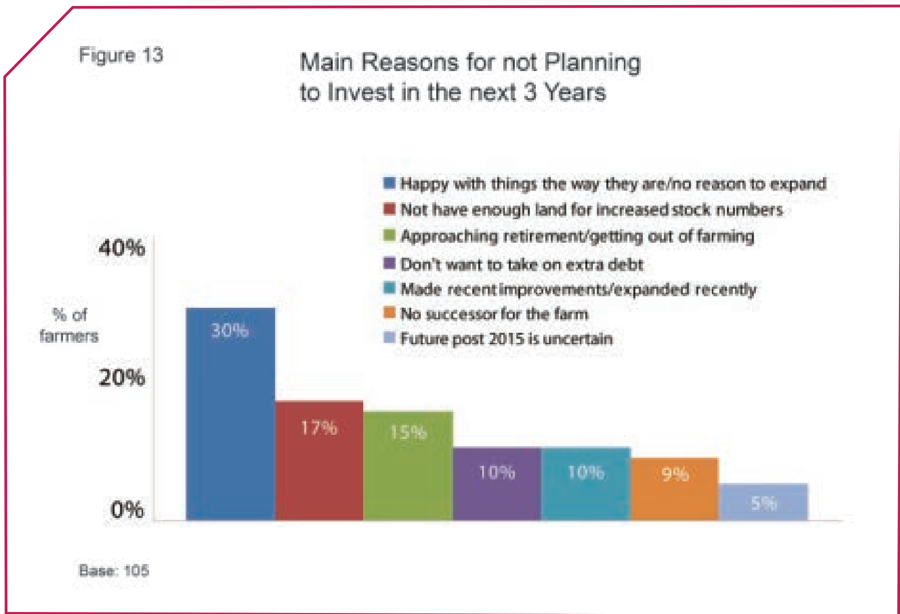
Among those planning to invest in their dairy business in the next 3 years, over half (54%) intend to get a bank loan to fund the investment, while 44% will reinvest farm profits and 20% will utilise general cash flow. In terms of planned expenditure, almost half (47%) intend to invest less than €50,000 in the dairy business over the next 3 years while 37% intend to invest between €50,000 -150,000 (Figure 12).

On average 65% of future investment is planned to be funded from bank loans. Almost three in ten (31%) farmers intend to source in excess of 75% of their investment from bank loans while a further 27% intend to source in excess of 50% from borrowings.



REASONS FOR NOT PLANNING TO INVEST IN THE DAIRY BUSINESS

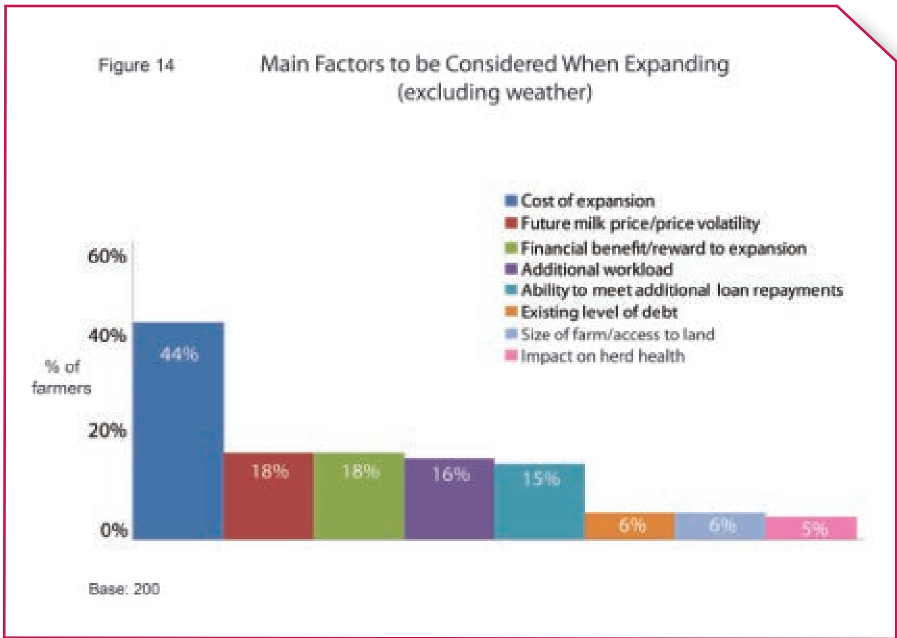
For the 52% of farmers who do not plan to invest in their dairy business over the next 3 years, 30% of them state that they are happy with things the way they are and have no reason to expand (Figure 13). Larger farmers and those in Munster are more likely to identify the former. Almost one in five (17%) farmers not planning to invest in their dairy business in the next 3 years do not have enough land to carry increased stock numbers (highest in Munster 24%). For 15% of farmers the lack of planned investment is because they are approaching retirement age, while for 9% it is due to the fact that they have no successor. >>

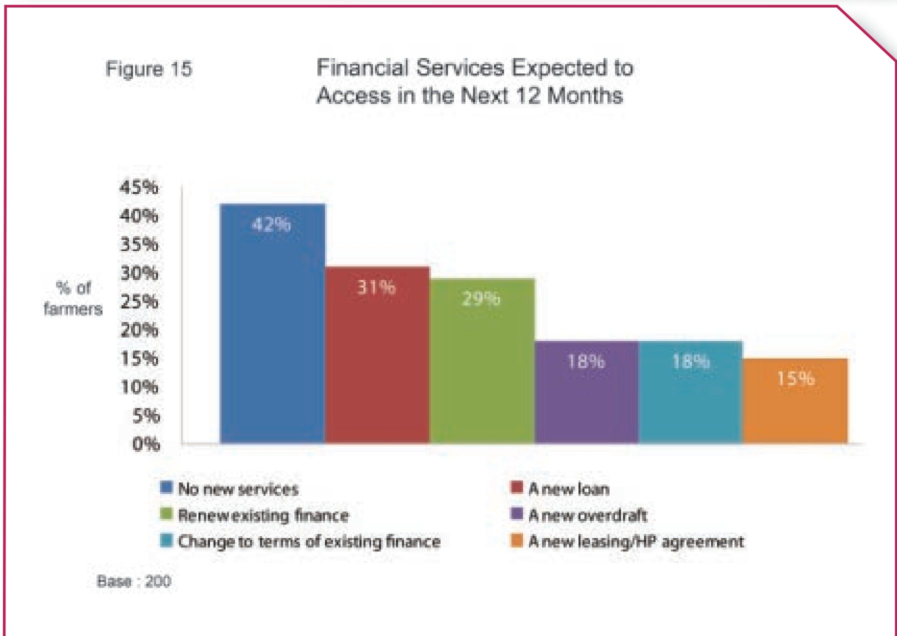


INCREASED OUTPUT/MILK PRODUCTION

Two out of every five farmers intend to increase production between now and 2015. Some 57% of farmers aged less than 45 years plan to increase by 2015 in contrast to 31% of those aged over 55 years. Those who intend to over-supply their milk quota in the current year and those who have recently increased production are most likely to plan to increase production further by 2015. Similarly, those who are investing (past and/or present) are more likely to have plans to increase production by 2015. As could be expected, almost half of those farmers aged over 50 years with family successors are planning to increase output while only 21% of those without family successors plan to do so.

Over half of farmers intend to increase output between 2016 and 2020. Three-quarters of farmers aged between 45 and 54 years intend to increase production between 2016 and 2020 compared to half of older farmers. Similarly larger farmers are more likely to plan to increase output than smaller farmers. Three quarters (74%) of those farmers aged over 50 years with family successors were planning to increase output between 2016 and 2020 while only 42% of those without family successors plan to do so.





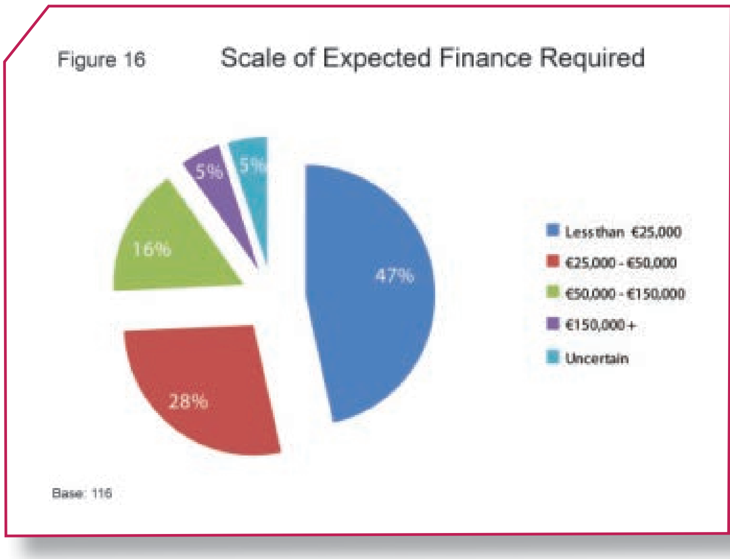
FACTORS TO BE CONSIDERED IN EXPANSION

The cost of expansion is the main factor (44%) identified by farmers which needs to be considered when expanding (most important for those who intend to over-supply milk quota). Other factors include: future milk price/volatility (18%); financial benefit/reward to expansion (18%); additional workload (16%) (most likely to be identified by younger farmers and those over supplying milk quota); and ability to meet additional loan repayments (15%) (Figure 14).

ACCESSING FINANCE

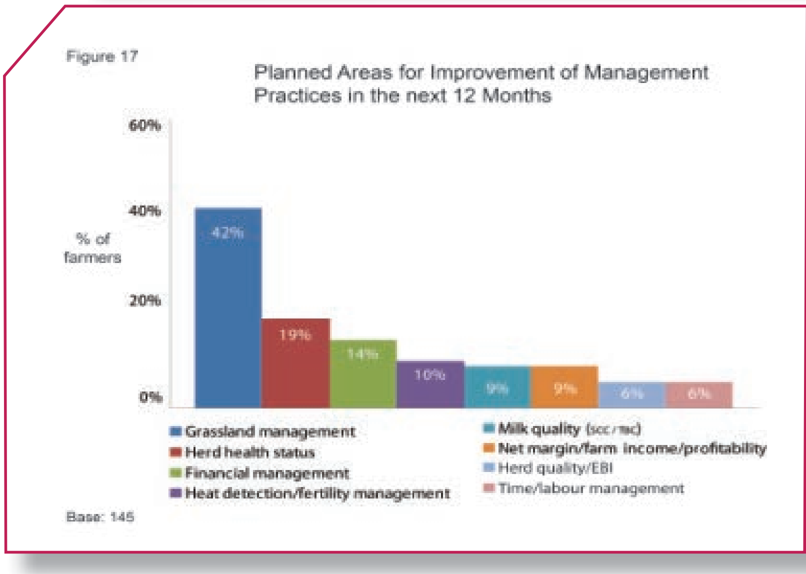
Some 31% of farmers expect to seek a new loan within the next 12 months and 29% intend to renew their existing financial arrangements (Figure 15). Twice as many farmers aged between 45 and 54 years expect to seek a new loan compared to 39% of those aged over 55 years. Some 18% intend to renew their overdraft and the same proportion expect to seek a change in existing finance. However, two out of five (42%) farmers expect to make no demand for new services.

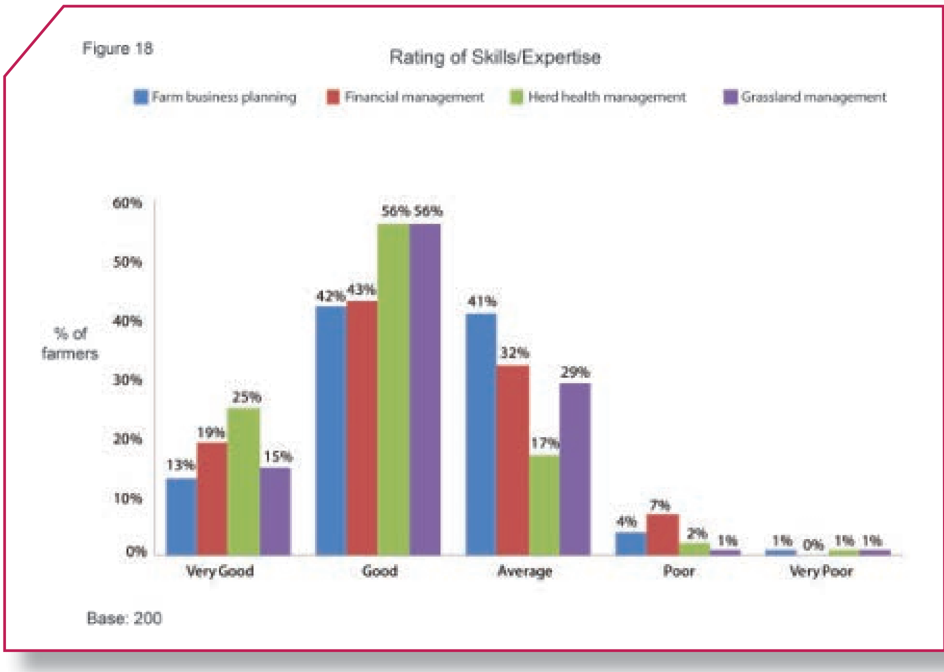
For those seeking finance over the next 12 months, almost half (47%) intend to seek less than €25,000, while a further 28% intend to seek between €25,000 - 50,000 (Figure 16). For those who intend to seek finance, 70% of those aged over 55 years intend to seek less than €25,000 compared to 36% of those aged less than 45 years (younger farmers are more likely to seek in excess of €50,000). Similarly smaller farms and those with mixed enterprise are most likely to seek less than €25,000.



FARM MANAGEMENT PRACTICES

Almost three-quarters (73%) of farmers intend to improve their management practices over the next 12 months (Figure 17), ranging from 66% of those farming less than 50 ha to 80% of those farming in excess of 80 ha. Three quarters of farmers aged over 50 years with a family successor intend to improve management practices in contrast to less than half of those with no family successor. Of those who intend to improve their management practices, 42% intend to improve their grassland management. One fifth of farmers intend to improve their herd health and 14% their financial management. >>

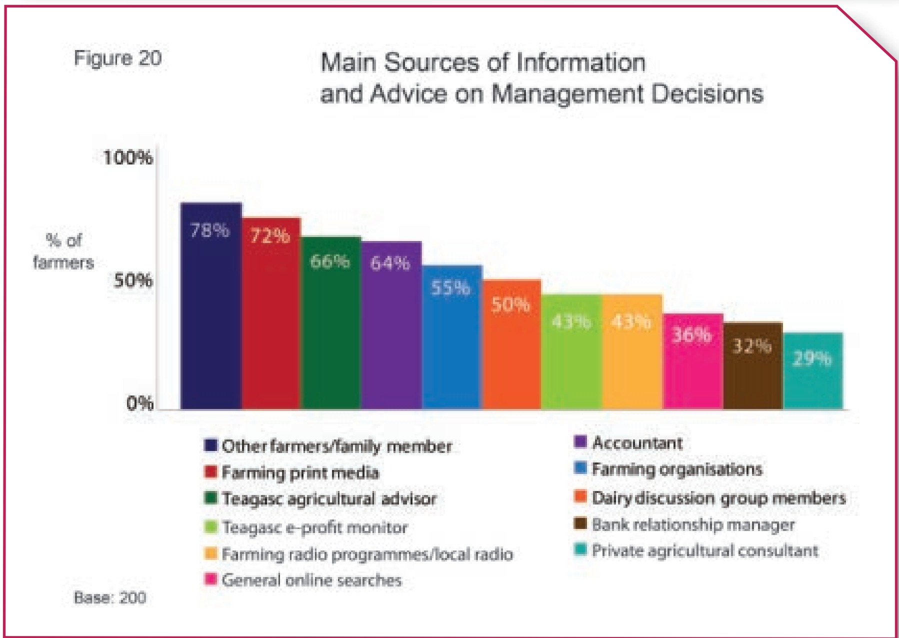




FARMING SKILLS

Some 55% of farmers rate their farm business planning skills as either good or very good, while 62% rate their financial management skills as such (Figure 18). Four out of every five farmers consider their herd health management skills to be good/very good and 71% consider their grassland management skills as such.

Over half of farmers are interested in training (over the next 12 months) in the areas of: farm business planning (57%); herd health management (56%); grassland management (56%); and information technology (51%) (Figure 19).



INFORMATION AND ADVICE ON MANAGEMENT DECISIONS

Almost four out of every five farmers (78%) consult with other farmers or family members when making farm management decisions (Figure 20). The farming print media play a valuable role in information provision for farmers (72% consult newspapers for management information). Two-thirds (66%) of farmers consult with a Teagasc advisor and 29% get advice from private agricultural consultants. Accountants are also important in decision making (64% consult them). One third of dairy farmers consult with their bank relationship manager. Farmers aged between 45 and 54 years are mostly likely to consult with their bank relationship manager indicating that it may take time to build up the relationship.

SUSTAINABLE GROWTH AHEAD

ALTHOUGH THERE WILL BE CHALLENGES AND HURDLES TO OVERCOME, THE LONG-TERM OUTLOOK FOR THE IRISH DAIRY INDUSTRY IS VERY ENCOURAGING ACCORDING TO SOME OF IRELAND'S LEADING DAIRY EXPERTS.

AARON FORDE
AURIVO CO-OPERATIVE SOCIETY

The general outlook for the Irish dairy industry is very positive not only due to the opportunities presented by the removal of milk quotas but due to growth in population, incomes and overall consumption. However, the growth will not be linear or gradual so the route is undoubtedly going to be challenging with bumps along the way. The opportunities will exist for farmers to significantly increase their supply but it is likely that demand will still exceed supply in 2020.

The biggest threat over the next few years will be price volatility as a result of market prices, weather, currency and short term changes in demand. The challenge for the industry is to manage volatility at all levels and to learn how to cope with it. Some processors have commenced work on fixed pricing and others will need to develop their models in this area. Generally in Ireland, we are not used to market management tools to any great extent. It is also a concern for Co-ops on how to advise farmers about dealing with volatility as they need guidance in this area. Some are preparing for volatility, but others are not and many are keeping their 'heads in the sand', hoping that it will go away while the reality is that in any cycle of a number of years, there will be highs and lows in milk

AARON FORDE

price. Now is the time to prepare collectively (market, farmers and processors) for dealing with volatility.

The processors are looking at the issue of volatility by addressing it with consumers/customers and with the Irish Dairy Board. Price fluctuations are not good for the customers either, while obviously the challenges for producers and customers will be at opposite times. Therefore, farmers must accept that they need to 'give a little' in good times and customers must 'give a little' when prices are low.

Optimising Supply

Optimising our seasonal supply presents an ongoing challenge to milk processors as we move towards a quota-free regime. We need to smooth the production curve by increasing milk supply at the shoulders without losing our grass-based competitive edge. This can be achieved by way of incentivising improved calving pattern and an improved utilisation of grass. If production is focused on the peak, it will increase the level of capital investment required by the processors which will ultimately be a cost to farmers and the industry.

It is evident that many farmers are eager to grow production while others are happy to stay as they are. Those who are ready to grow have planned for expansion and are well prepared for it, they have put their facilities in place and the stock numbers to facilitate this and it will be the first time that they will have the opportunity to freely grow milk production.

The milk processors are reasonably well prepared for milk quota removal, some processors have their development plans in place and others are putting their plans and structures in place. Key to the preparations is optimising the investment for best return. However, managing the increased supply as it occurs will pose a challenge.

In dealing with the transition to a quota-free regime, it is important to ensure that farmers and processors do not over-expose themselves in terms of capital investment, it must be kept manageable so that the fluctuations in prices and margins can be endured. Debt and access to finance will be a challenge but this should ease up somewhat as circumstances in the banking sector improve.

The increased milk production will require access to new and expanding markets. While milk quotas will be removed across Europe, not all countries will grow milk production at the same rate but we need to look beyond the EU markets as an outlet for our produce. In particular we need to look at (and indeed the Irish Dairy Board are looking at) growing markets for products, growing markets with growing populations. The mix of products that we produce is suited to the fact that the majority of our dairy products are exported. The dried and powdered products suit the growing markets in Africa and Asia and therefore these products will facilitate us to capitalise on the opportunities in these markets and utilise our increased production.

Clean and Green

The clean and green Irish image is in the marketplace but it is like selling a dream, because we do not have a lot to back it up in terms of hard facts on our claims. EU competitors are moving into our space in the market and they have the proof for their claims. We need evidence and proof of our sustainable production, our carbon footprint and quality claims, with hard facts we can convince the customers in the market place that the Irish image is a reality and we have the proof. Brand Ireland will be critically important once we have the evidence but the brand will have to be promoted in every market place and with every customer, our image is not going to sell itself.

The new scenario post milk quota regime will require closer cooperation between milk processors and with the Irish Dairy Board. A maturing >>

sector will be best placed to work together to explore the opportunities ahead and the exploitation of new and expanding markets. The Irish Dairy Board also needs to communicate to farmers what they are doing in the market place and how their actions are benefitting them in terms of improving or indeed a more stable milk price. In this regard the Irish Dairy Board has a role to play in helping to deal with milk price volatility.

Looking to the future, a successful Irish dairy industry will be: paying a good price to farmers (benchmarked against EU counterparts); selling into growing markets (opportunities for ongoing steady increases in production); better prepared and protected from milk price volatility (in terms of being able to cope with it); and profitable at farmer and processor level.

JIM WOULFE
DAIRYGOLD CO-OPERATIVE SOCIETY

The international market for dairy products is currently very buoyant with demand running ahead of increasing supply. A

JIM WOULFE

positive outlook in dairy demand is being driven by world population growth, increased urbanisation and a general westernisation of the diet (in favour of dairy products) in developing countries. However, the balance between supply and demand is a fine line and undoubtedly there will be fluctuations in dairy product prices and consequently milk prices when supply/demand shifts.

The current market buoyancy has seen a lift in milk prices in the region of 20% during the first five months of 2013. This has been created by a number of factors including drought in New Zealand and Australia, high grain prices in the US and a long harsh winter in Europe. As a result, world milk supply has been curtailed and accordingly the market has responded with higher prices.

Milk Price Volatility

It can be difficult for dairy farmers to adjust to milk price volatility as they have come through long periods of relative stability in milk prices. During 2009, very low milk prices were very challenging for dairy farmers but it did create awareness across the industry of the impact of fluctuating prices. Farmers need to consider how to cope with price volatility when making long term plans. Even more difficult is the fact that the price cycles tend to be short so adjustment has to be prompt. While not yet fully embracing the idea, dairy farmers are now receptive to exploring the concept of fixed pricing as a possible mechanism to hedge against volatility.

Many milk processors are currently exploring options and encouraging more milk producers to engage with the fixed price model. This is a definite way of helping dairy farmers to plan for and cope with volatility. It's important to remember that fixed pricing provides income security to dairy farmers and protects them from making rash decisions on the strength of high (but possibly unsustainable) milk prices.

Farm Level Impacts

While the removal of milk quotas will bring significant opportunities, it will also bring challenges at farm and processor level. Availability of land for expansion of the milking platform will limit expansion for some farmers. In general farm debt levels are manageable and much lower than some EU competitors and should not pose a problem once borrowings are

"Dairy farmers are now receptive to exploring the concept of fixed pricing as a possible mechanism to hedge against volatility."

carefully planned and managed. However, managing finances in an expansion mode and in a volatile market will be a challenge for all farmers. The financial acumen of dairy farmers needs to be further developed particularly the ability to manage cash flow during expansion. Farmers who may be competent in managing cash flow in a static environment will face challenges when doing so in situations of rapid growth. Education and training will be required to develop these skills in order to manage growth in an organised, structured and more sustainable manner.

Processing Efficiency
Similarly at processing level, planned and careful investment is required. Milk processors are currently preparing to maximise the utilisation of plant and equipment across a range of products. There has been considerable debate about where investment is required and it is important that investment is focused on the areas which generate the best returns on investment. Processors are collaborating and we will need to collaborate further in the future. Smart and modular investment in processing is essential but determining the most efficient route to market is equally important as we will have to export every extra kilo of product. The future should see a more aligned processing and marketing model in pursuit of the most efficient route to market.

The efficiency and cost of production on Irish dairy farms (even if a significant number of dairy farmers do not have a sufficient knowledge of them) is generally quite good. In a world market context, the anticipated increase in Irish production is not going to create a significant upheaval.

Seasonality of milk production is obviously linked to the Irish grass based system. Going forward dairy farmers need to maximise production from a 300 day lactation and produce more milk earlier and later in the season. Processors will have to explore the incentives which encourage farmers to extend the production season.

As output grows, processors constantly need to exploit the areas in which there is a competitive advantage but also the areas such as the infant formula market where there is both strong growth and added value potential. Irish processors need to exploit the potential in the areas of current strength in advance of exploring totally new products. We must capitalise on what we are good at.

Quality Assurance
Quality assurance and sustainability are key issues for customers and consumers. All producers seek to portray themselves as being quality assured and sustainable.

The Irish dairy industry has high standards but it is generally slow to embrace the measurement and monitoring of quality standards. In this regard, Ireland needs to demonstrate and maximise the potential of the high standards which are in place.

Therefore, Irish producers and processors need to work with Bord Bia, IDB and others to fully embrace the procedures and gain competitive advantage in the market place. The image of Ireland is of a clean, green and fresh countryside where high quality natural products are produced. We need to better exploit Ireland's green and environmentally clean image and maximise its potential as competitors are fast gaining ground. In this regard, Origin Green is a very positive development.

Beyond 2015
The Irish dairy industry has a firm focus on 2015 because of the obvious opportunity presented by the removal of milk quotas. However, 2015 is only the start of the opportunity and it is important that the industry looks at continued growth beyond this date. The potential for on-going growth will remain and must be planned for.

A key measure of success in the development of the Irish dairy industry over the next six years will be the achievement of the projected 50% growth in dairy output anticipated by the Department of Agriculture's recent Food Harvest 2020 report.

Benefits to farmers will come not only from expansion but also from increased efficiency. To maximise the benefits to be achieved will require a greater level of collaboration and cooperation at different levels within the industry. Businesses within the industry both in farming and in processing will become more efficient.

A key focus/business measure at farm level will be the kilos of milk solids produced per hectare thus capitalising on the increased output to dilute the investment in fixed costs. In order to have successful expansion our industry needs to be sensibly ambitious regarding growth, be aware of costs and closely monitor changes and reacting and adapting as they occur. >>

JIM BERGIN

JIM BERGIN
GLANBIA INGREDIENTS IRELAND

The general outlook for the Irish dairy industry is positive in the context that dairy in Ireland has a bulk commodity element and sensitivity with good opportunities to add value. The main challenge for the future is to optimise the return from the increased volume of milk planned and to create sustainable customer relationships with a high degree of common learning in them. A potential threat is the possible drop in GDP growth in developing regions where dairy consumption is growing.

A key challenge for the industry is milk price volatility, which is the fear of each person in the chain as it affects viability, affordability and availability of a consumer food product. In terms of dealing with price fluctuations, Glanbia has introduced its own volatility scheme which it is hoped will be expanded for customers and suppliers over the coming years. Europe needs to catch up quickly with other countries, in particular the US, who have considerable risk management tools already in place.

Seasonality is an issue in Ireland but it provides grass as a low cost input for milk production. However, Ireland is set up for manufacture of products with medium to long shelf life even in very challenging climatic conditions. There is considerable growth in demand for these products.

> "One should not be blind to the fact that we are playing in an international market with great opportunities for international co-operation and collaboration"

Opportunities Post 2015
The removal of milk quotas in itself poses no challenge only opportunity for Irish dairy farmers. However, there is a high risk of superlevy fines in 2013/2014 which could inflict short term pain on farmers. Capacity expansion plans are well advanced both at farm and processor level. As farmers increase output after being capped for 30 years, they will face growing pains in areas such as financial planning, managing increasing herd size and increasing productivity. Access to finance at farm level appears to be very limited and this could pose a challenge to farmers (in Glanbia, milk suppliers received their share of the €220m spin out earlier this year). The level of farmer indebtedness up to this spring was relatively low but working capital requirements have increased at least temporarily.

The Irish dairy industry is fragmented with organisations with global scale and spread alongside smaller organisations. The industry is more complex than it would appear in other strong dairy nations. Ultimately this slows the pace of development and the innovation/ marketing engines are sub-optimal. At farm level, milk suppliers are well prepared for the removal of milk quotas. A Glanbia survey in 2011 portrayed a very solid platform for growth at farm level. Farmers are focused on development of their business and how to make things even better which is very encouraging. In Glanbia 70% of the milk suppliers have a successor and a high percentage of those who don't are under 45 years of age. The Agricultural colleges are currently oversubscribed, showing considerable interest in farming as a career. Dairying presents a sustainable living and way of life for young people in Ireland.

A Quality Story
Ireland has a very strong sustainability and quality story. The current Infant Formula manufacturers are proof positive of Irelands standing in world dairy production. The National Quality and Sustainability Scheme launched by Minister Coveney was well timed to add substance and auditability to our excellent dairy platform. We can deliver sustainability with distinct advantages over more intensive milk producing methods.

Farmers are well positioned to benefit from the opportunities ahead so long as we clarify the

sustainability and environmental factors and plan for them accordingly. Processors have been focused on international markets by necessity since the 1970's. A considerable knowledge base in logistics and supply chain is in place. However, with a couple of exceptions other dairy export nations are further along the maturity track than the collective dairy industry is in Ireland. Big international 'plays' are happening while we remain fragmented.

However, there is a high degree of collaboration at processing level, but less at marketing and innovation level. One should not be blind to the fact that we are playing in an international market with great opportunities for international co-operation and collaboration 'in market'.

New markets in developing regions provide the opportunities for volume growth. Developing market sectors such as clinical nutririon, performance nutrition and health and wellness provide the opportunities in developed regions where dairy markets tend to have low growth levels be static overall. Routes to market and value optimisation remain as an ongoing development area for processors. Ireland with such growth potential is strategically interesting now to global buyers who are planning to rebalance their portfolios between Oceania, US and Europe post quota. Value can be created from these positives in addition to innovation platforms which have been developed over recent years.

The Irish Brand
Brand Ireland is very important in the markets where Irish producers are known, however, that's not everywhere yet and further efforts need to be undertaken. The Irish Dairy Board has some considerable strengths and the industry needs to optimise them.

The future success of the dairy industry, should be measured on:

- Growth and financial health happening in tandem at farmer and processor level;
- Considerable inroads in managing volatility for both supplier and customer;
- Managed growth in the context of leading sustainable practices and a structured approach to the environmental factor; and
- Ireland recognised as a leader in hi-value/hi-tech dairy products.

"Irish farmers have shown the ability and resilience to produce a consistent supply of milk even under difficult weather conditions."

MICHAEL HANLEY
LAKELAND DAIRIES GROUP

The future for the Irish dairy industry is optimistic as current demand for dairy products remains strong. Global consumption is growing year on year and Ireland is well placed to produce additional milk post-2015 to capitalise on the increasing market demand. However, the removal of quotas and resultant increase in supply could present short to medium term fluctuations in market returns as farmers, processors and customers respond to increased output.

MICHAEL HANLEY

Post 2015 Ireland will be somewhat more exposed to price volatility that is the nature of the world market. However, the duration of extreme lows in the future should be relatively short as overall demand continues to grow. Producers will need to be prepared for changing prices as a market reality. Extremely high prices will not be maintained indefinitely in the same way that extreme lows will not endure either.

Addressing the future supply and demand curves in the marketplace, the dairy industry must pursue long term sustainability for producers and processors working co-operatively together.

Milk Price Volatility
Dairy processing co-operatives such as Lakeland Dairies are pledged to paying the highest milk prices that market conditions will allow. This must be underpinned by lean and efficient operations, a maximum throughput of milk and most importantly, the marketing of value-added products.

From the producer's perspective, processors are also addressing milk price volatility in a number of ways. Currently, small amounts of milk are supplied under fixed prices but this will need to change in order to provide more security to farmers when prices are low. Milk price volatility will be addressed by developing fixed price contracts with producers; engaging in forward selling; and engaging in longer term contracts with customers. This approach to long term sustainability will be very important for the future.

Capitalising on the removal of milk quotas will obviously require significant investment by farmers and processors. At farm level, the evidence from the Greenfield farms initiative has shown that >>

the costs of large scale expansion are significant and the process challenging. Given the scale of investment required, it is likely that the majority of the increased output will come from existing dairy farms.

Funding Available
While there will be new entrants into dairy farming, the proportion overall will be modest. Established dairy farms will be better positioned to access the required finance for investment and be in a better position to meet repayments. The financial sector would appear to be open to providing funding for investment in dairy expansion and development.

As the opportunity approaches to expand, it will be important for producers to consider the various options that they have to achieve this. Increasing yields from the current herd using existing resources, land and buildings will be a first step; whereas for others, investment in bigger herds and greater scale will be an option. Producers will need to make prudent decisions so as to ensure that they have an appropriate cost base and can maximise their returns from increased output.

Dairy processors will face similar challenges as farmers in funding investment in productive capacity and facilities. Developing the right economies of scale will be crucial. Access to additional working capital will also be critical to fund investments; provide credit to new and expanding customers; and to cover the cost of ongoing research and innovation.

Grass based production
Ireland's green island reputation and the sustainability of natural, grass based production will be a critical element in our success. Customers require continuity of supply and the Irish grass-based system is somewhat prohibitive to this. In particular, value-added dairy products require a longer production period. The Irish competitive advantage is in grass-based production and with changes in calving (supplying more milk in February and March) and greater production in the later part of the year (October/November), more balance could be achieved.

Ireland is in a fantastic position to capitalise on the opportunities presented by the removal of milk quotas. Ireland has built a strong reputation with international customers and those customers are focused on sustainability of production and supply.
Irish farmers have shown the ability and resilience to produce a consistent supply of milk even under difficult weather conditions. Ireland is therefore viewed as a reputable supplier with the ability to honour contracts without major weather shocks.

Demographics
The age profile of Irish farmers remains an issue for the industry, however, it has not hindered the production of the national milk supply to date. It is important that policy incentives are in place which support and encourage the establishment of young farmers. There is a need for a proactive approach to encourage earlier access to farm assets. Land mobility and the freeing up of land movement between farmers needs encouragement. The linking of EU payments to land has slowed down movement because landowners are keen to maintain their EU payments and as a result, continue farming even at a low intensity.

Origin Green
The Origin Green initiative is very worthwhile and beneficial to the Irish food industry. Quality and sustainability are critically important for international customers and they are looking at the rules and regulations under which Irish farmers produce. Bord Bia and the Irish Dairy Board are working hard across the globe to promote the Irish image. Brand Ireland and the Irish image are recognised but significant effort will be required to retain that image and our position in the market. Quality assurance needs to be continually improved and monitored and our capability to improve those standards further developed. Ireland has many competitors abroad.

Seasonality of production impacts on the product mix and the opportunity to add value to dairy products. To maintain markets, Irish producers need to be able to meet the customers' demands year round. The ability to service markets year round is particularly important for value–added products and not to do so would see the return to more commodity products.

While increased output may require changes in the Irish dairy product mix, a key to developing markets for increased output is to work with existing customers to develop their product requirements further and to innovate within the various product categories.

Supply and Demand
On average, demand for dairy products will exceed supply in the years ahead and there are continuing opportunities for processors to co-operate with each other to meet this excess demand. There is currently co-operation between processors and this can be further enhanced for the benefit of the entire industry. Generally Irish processors are not in direct competition with each other as there are long established customer relationships in place. The benefits of further co-operation will be seen in addressing new market demand post-quota as the consumption of dairy products continues to grow worldwide.

In summary, the future success of Lakeland Dairies and the Irish dairy industry will be measured on:

- The ability to achieve a strong return from the market for dairy products and to deliver a strong and sustainable milk price to farmers, consistent with real market conditions.
- The ability of farmers to produce extra milk over a longer season.
- A dairy processing sector maintaining an efficient processing cost for products (accepting that value added products will have higher costs).
- A broadened portfolio of products - including high volume commodity products and lower volume but higher value added products.
- The ability of processors to develop and market new high value products.
- Successful marketing of Ireland's green island reputation and its capacity to deliver products of a distinctively high quality.
- Overall sustainable growth and development on a long term basis.

ANNE RANDLES & MARK FAHERTY
IRISH DAIRY BOARD

The removal of milk quotas in 2015 will bring about momentous changes in the dairy sector, like no other that we have experienced in recent times. Milk quotas were introduced at a time of development and growth within the Irish dairy industry and their imposition in 1983 stifled the sector's ability to maximise that growth potential. The abolition of the quota regime presents significant opportunities for Irish farmers, but the critical factor for farmers and the dairy industry is the management of change in terms of the level and rate of expansion.

The change will impact on dairy farmers across the EU, but our production model presents more opportunities for Ireland relative to others as it will enable us to maximise our grass based production system.

Managing Growth
Managing growth in milk production and coping with milk price volatility will be critical to the future of dairying. Managing the transition from a volume regulated regime to a deregulated supply environment will pose challenges for the entire industry. There will be particular challenges in anticipating the pace of supply growth, especially in the first years after 2015. We know supply will increase but the level of increase in production immediately following quota removal is difficult to predict with certainty.

Milk price volatility will be an inevitable feature of dairy markets and the industry will have to learn how to manage both price peaks and troughs. This may require an assessment of the suitability of the current milk price-setting process in this more volatile environment. It will not be possible to eliminate volatility, but we will have to look at ways of minimising its impact on margins and mitigating its risks. The Irish Dairy Board and its members will also have a role to play in reducing the impact of volatility by strengthening brand image further and by reducing product substitutability, developing longer term supply relationships and by making use of financial tools such as hedging to reduce risk.

Seasonality of production is unlikely to change significantly in the next number of years but there are opportunities to grow output at the shoulders of the production curve and to extend the season, making the supply peak less pronounced.

Post 2015
Farmers are gearing up already for increased production post 2015. Cow numbers have increased and most farmers are clear in their own minds as to their output plans to 2020. The Irish Dairy Board is implementing

ANNE RANDLES

MARK FAHERTY

its strategic plan in advance of 2015 and has plans in place to market the extra dairy output. At processing level, Glanbia and Dairygold have announced their investment plans, while the other processors either have expansion plans in place or have sufficient capacity available to handle the anticipated increase in milk flows. The big challenge for processors will be the pace and extent of the surge in production post 2015, at least in the initial post-quota years. The pace of growth should however settle relatively quickly.

The extent of the benefit to farmers of the removal of milk quotas will depend on how increased EU production will be absorbed by the world market and equally on how competing milk-producing regions will react. The fundamentals underpinning the dairy market are positive, with demand growth expected to exceed supply over the longer term. If, however, an initial surge in EU production coincided with a weakening price trend in the market place, then the increased output could temporarily dampen market returns.

Consumer Engagement
In the marketplace, customers are focused on sustainability in terms of quality assurance, food safety and security, environmental impact, farming practices and animal welfare. As consumers become more informed, the provenance of food is growing in importance. Consumers want to engage with the supplier (and producer) to find out more about the product; how it was made, where the milk was produced and so on.

Kerrygold has been enormously successful as a brand in conveying the core attributes of Irish dairy products to consumers; identifying the product as being tasty, natural and of high quality. This has been achieved through significant investment over several decades. Less well known are other attributes such as the uniqueness of Irish dairying in a global context, our extensive grazing system and our ideal environment for producing milk. We must verify and prove our credentials in these areas to the well informed consumer and demanding customer seeking his/her own sustainable supply chain.

The key areas to measure long term progress for the Irish dairy industry include:

- Market return: ability to deliver a long term sustainable return to farmers from the market place.
- Irish image and reputation: enhanced and better understood with a unique selling point for Irish dairying and the capacity to stand over and verify those qualities.
- Consistent growth: successful capitalisation on the removal of milk quotas should result in consistent stable growth in dairy production (post initial surge).
- Age profile of farmers: opportunities for ongoing growth and development in the industry should lead to a reduction in the age profile of farmers as the industry becomes more attractive to younger farmers/new entrants.
- Managing seasonality: by way of maximising our low cost production system at the shoulders (while maintaining quality) rather than altering the overall pattern of production and supply.

EXCITING TIMES AHEAD

KEVIN KIERSEY AND **JOHN BRYAN** OF THE IRISH FARMERS' ASSOCIATION SAY THE IRISH DAIRY SECTOR CAN LOOK FORWARD TO CHANGED BUT EXCITING TIMES IN THE FUTURE.

The IFA is pleased to be involved in this study of Irish dairy farmers' development plans with less than two years to go before the end of milk quotas.

REAL MARKET OPPORTUNITIES

The growth in world population and particularly the emergence of middle class consumers in developing countries are underpinning strong growth in food demand, especially for Western style dairy products. This trend is set to stay.

As an exporting dairy producer with strong sustainability credentials, Ireland is uniquely placed to capitalise on this important commercial opportunity to grow our dairy sector and capture new markets.

RESISTING RESTRICTIONS POST QUOTA

Since 2008, IFA has fought hard in Brussels to bring about the abolition of milk quotas. As we approach the abolition date in March 2015, we have been strongly resisting moves by the EU Parliament to

KEVIN KIERSEY – IFA NATIONAL DAIRY CHAIRMAN

restrict milk output increases after 2015 through their CAP Reform proposals.

IFA has built strategic alliances with like-minded farm organisations around Europe, and joined in a European cross-industry initiative involving processors and traders on this issue. We will continue to fight and resist any moves to implement quotas by the back door.

CAP PAYMENTS CRUCIAL FOR PRODUCTIVE AGRICULTURE

IFA has campaigned to minimise the redistribution of CAP direct payments away from productive farmers, as this would reduce farmers' ability to make investments and grow production.
IFA has also pushed hard for strong and well-funded market supports to help counter market volatility and its negative impact on farmers' incomes.

INDUSTRY: FARMER CONTROL AND CO-OPERATION

IFA has also campaigned strongly in favour of greater farmer control of the dairy industry, and significant progress has been made among the larger processors.

There is still an urgent requirement for real efficiencies and extended co-operation. Also, the smaller players must come forward with their plans to secure the long term future of their suppliers.

FIT FOR PURPOSE BANKING FACILITIES

Bank borrowing is the main source of funding for dairy farmers' investments, and IFA has been in constant contact with banks to demand that they be genuinely supportive of the sector.

IFA estimates that farmers will have to spend up to €1.5bn on farm to grow production by 50%, and that is before any financial contributions towards their co-ops' development plans.

Farmers will need long term finance to fund investment, but also ready access to short term funding such as overdrafts or other facilities. Events such as the 2012/13 fodder crisis, margin volatility or even the simple seasonal nature of dairy farmers' incomes and input purchasing needs must be taken on board by the banks.

TAX SOLUTIONS TO SUPPORT DAIRY GROWTH

At national economic level, the agri-food industry makes a major contribution to

JOHN BRYAN – IFA PRESIDENT

economic growth, with food and drink exports in 2012 exceeding €9 billion for the first time, and growth continuing in 2013. IFA has made a number of proposals in its pre-budget submissions to ensure a pro-growth, pro-business approach to farm taxation.

The proposals, developed by the dairy industry working group led by IFA, would reduce the cost to farmers of contributing to their co-ops' investment plans, and must be progressed by Government.

It is also critical that farmers are allowed purchase co-op shares tax efficiently, as in most co-ops this will become a normal production expense rather than an investment with expectation of return.

OPTIMISTIC, BUT PRUDENT ON-FARM PLANNING THE WAY FORWARD

In planning for growth, it is crucial that the farmers who intend to expand their business do so cautiously. They need to match their funding needs with the appropriate financial product, and build in realistic repayment schedules.

Prudent, gradual growth is essential if Irish farmers are to avoid the pitfalls encountered in some countries where excessive debt levels were taken on by ill-prepared farmers, at great financial and human cost.

It is also vital that advisory services such as Teagasc make available to farmers short courses or other forms of training to equip them with essential business and financial management skills.

AN EXCITING ROAD AHEAD

The Irish dairy sector is poised for its first opportunity for real growth and development in over a generation. IFA has calculated that the potential rewards for the industry, for farmers and for the economy as a whole are huge: 9,500 additional jobs, €1.3bn extra annual export revenue and a total of €300m overall extra tax take and social welfare savings are achievable by 2020.

IFA is pleased that this study shows that farmers are ambitious for growth, but are conservative and prudent in their investment and borrowing plans for expansion.

IFA will continue to campaign to maximise wealth creation by the dairy sector, by seeking the best possible conditions for the sector to help dairy farmers deliver to their fullest potential.

> "The agri-food industry makes a major contribution to economic growth, with food and drink exports in 2012 exceeding €9 billion for the first time, and growth continuing in 2013."

THE AIB VIEW

OUR COMPETITIVE ADVANTAGE

WHILE THE IRISH DAIRY SECTOR DOES FACE SOME CHALLENGES, AIB BELIEVES THAT THE FUTURE OF THE SECTOR IS BRIGHT, WRITES **ANNE FINNEGAN** AND **MICHAEL DOWLING,** AIB'S AGRI SECTOR EXPERTS.

The dairy sector in Ireland is one of the real success stories of the Irish economy over the past thirty years. For most of that time, output from the sector has been constrained by quota however significant change has given way to a progressive dairy processing and farm sector. There are few indigenous Irish business sectors that have built a global footprint similar to that of the dairy sector from a stagnant domestic production base. Indeed, the sector was challenged to adjust to a static output after a decade that was extremely expansionist prior to the introduction of milk quotas in 1984.

Unlike other sectors of the economy, dairying and farming in general is not burdened with the debt levels, both business or personal related, that are a feature of so many other business sectors. As evidenced by the research results, dairy farmers are more optimistic about their own farm business and the dairy sector in general than they are about the prospects for the wider economy.

While dairying is one of the most capital intensive of the productive farming sectors, its long term profitability and cashflow performance has supported ongoing investment at farm level. From AIB's perspective, the sector has shown a strong performance over time, both at farmer and processor level, and has always been a key area of focus of the bank. In comparison to both European and International competitors, the sector remains relatively lowly geared which is a significant competitive advantage that should be retained.

The medium term outlook for the sector remains positive, underpinned by growth in consumption of dairy products predominantly in developing economies with rapidly growing middle classes. While undoubtedly growth in production into the future will come, in the main from developing economies, growth in demand is likely to outstrip any foreseeable increase in production for some time to come.

The competitive advantage offered by the grass based production system will strengthen as a significant proportion of the growth in dairy in developing economies comes from feed based production systems where land and water will be significant constraints to development and sustainability. Ireland's mild climate influenced by gulf stream, stable rainfall patterns on average, and good soils all combine to provide a key strength in dairy production and a sustainable base from which to capitalise on the opportunities at hand. It is on this basis that AIB maintains a strong positive outlook for the sector and is committed to supporting the ongoing development at both farm and processor level.

We also recognise the many challenges ahead. In recent years, the dynamic within the sector has shifted from a relatively stable and predictable annual cashflow performance to one that has seen significant income volatility – spectacular highs to unforgettable lows. Commodity prices, while high by historic standards, are also highly volatile. The result, income volatility, is one of the main challenges confronting the sector in Ireland and all of those, including AIB, that support the sector in one way or another. There is certainly a greater need for farmers to examine risk management strategies and buffer measures on farm which is borne out by the survey findings.

It is clear, therefore, from the survey findings that dairy farmers see volatility, arising from weather, milk price and input prices, as the greatest challenge for their business in the next five years. It's no surprise that cashflow management is also seen as a significant challenge by dairy farmers, particularly given the year just past. The need for increasing efficiency levels, increased grass utilisation and cost management, at both times of high and low milk prices, has never been more acute. In addition, forecasting annual cash

flow and subsequently arranging adequate working capital facilities are essential to ensuring the financial stability of the farm business.

The natural response to a significant milk price drop is to reduce overheads and cost. This is borne out by the survey findings. However, it is worth examining the cost structure of individual dairy businesses at a range of milk prices, from very low to very high, to stress test what the business can withstand and to plan accordingly. This is a must for anyone considering further investment but it would inform all dairy farmers on what level of volatility their business can withstand.

In reality, we have already seen dramatic swings in price which will almost certainly recur in the years ahead. While the cost structure of Irish dairying can sustain low milk prices better than some of our competitors, there is no doubt that the impact

on business and family finances as experienced in 2009 is severe.

The forthcoming removal of milk quotas provides the first real opportunity to expand milk production since quotas were introduced. It is clear from the survey results that dairy farmers identify quota removal as one of the primary opportunities ahead. At AIB we are already seeing a strong demand for credit from farmers who are gearing up to expand production.

It is reassuring that the survey respondents cited improved cashflow / profit as the principal reason for investing in their business in the next three years. Increased profitability must be the key driver of any expansion plan. Expansion can only be successful when undertaken from an efficient base which already maximises pasture based milk production. Otherwise, the result will be a multiplication of inefficiencies which will either result in no or low increased profits.

> "The sector has shown a strong performance over time, both at farmer and processor level, and has always been a key focus of the bank."

While the cost of expansion was identified by farmers as a key consideration for those considering expansion, the financial benefit or reward from expansion was cited by a much lower proportion of farmers. Cost and reward should be of at least equal considerations when thinking about business expansion. Any business investment involves risk and without an adequate return there is really no point to it. We strongly advise that any farmer planning to invest for expansion determine at the outset what the proposed investment will be worth to their business's bottom line when complete.

In AIB, we have a long standing association with the Irish dairy sector and believe that the prospects for the sector are very strong. There will be many challenges ahead and we are committed to playing our part in the development of the sector, working with all stakeholders. We are committed to supporting this indigenous sector, both at processor, marketing and farm family level to realise its full potential.

Anne Finnegan is Agri Sector Expert with AIB. With a Degree in Agricultural Science from UCD, she undertook PhD research into farm health and safety in Ireland. She has undertaken consultancy work for the European Bank for Reconstruction and Development into farm credit in Georgia.

Michael Dowling is Agri Sector Expert, AIB Bank. He is a Director of Kerry Group, plc and of the Agricultural Trust and a former Secretary General of the Department of Agriculture and Food. He is visiting professor in the Food Business Department associated with the School of Science, Engineering and Food Science at National University of Ireland, Cork.

DEALING WITH THE BANK

AIB AGRI ADVISORS ILLUSTRATE SOME OF THE KEY BANKING CONSIDERATIONS WHEN APPLYING FOR FINANCE USING FOUR CONSTRUCTED CASE STUDIES TYPICAL OF CREDIT REQUESTS THEY RECEIVE ON A DAY-TO-DAY BASIS.

A LAND PURCHASE PROPOSAL

Andrew (45), an existing AIB customer, approached AIB seeking €250,000 to purchase 25 acres joining his milking platform, €17,500 for land development works and €100,000 to upgrade existing winter housing facilities to accommodate an additional 100 dairy cows and followers. He is currently milking 120 cows and filling a 620,000 litre quota, on his 240 acres, consisting of three separate holdings. The 125 acre grazing platform, included a 16 unit milking parlour, farm buildings and slurry storage for approximately 150 cows. The second holding, an 80 acre block, separated in part by the land Andrew was seeking to purchase, was being used for tillage production, mainly spring barley, while the third holding, a 35 acre holding of moderate quality some 20kms from the main farm, was used to rear his dairy replacements.

It quickly became clear that Andrew was a progressive operator with clear farm business goals. He approached his local branch with a detailed and comprehensive business plan, which outlined the financial merits of a range of expansion scenarios. Andrew was clear why he was expanding, the benefit of expanding, and what factors were essential to its success. Income and cash flow projections were provided, with contingencies in place, particularly regarding milk price volatility and the potential impact of expansion on farm cash flow.

Purchasing the 25 acres created a potential grazing platform of 230 acres for Andrew. His intentions were to reduce the tillage operation and expand the milking enterprise on a phased basis from own-herd replacements, with fields furthest from the parlour utilised for tillage / silage production. The new parcel of land required some reclamation work, fencing, roadways, reseeding and Andrew had budgeted a cost of €700/acre.

AIB have a dedicated team of regional Agri Advisors with in-depth farming knowledge and experience, who support branch and Business Centre staff in delivering a service to farmers.


DONAL WHELTON, AIB BANDON


EAMONN O'REILLY, AIB TULLAMORE


TADHG BUCKLEY, AIB MALLOW


LIAM PHELAN, AIB ENNISCORTHY


PATRICK BUTTERLY, AIB DROGHEDA


PATRICK O'MEARA, AIB NENAGH

From the subsequent farm visit, and review of the farm financials it was clear that the farm was well managed. Repayment capacity was tight, due largely to outstanding capital expenditure debt and the fact that the farm was going through its growth phase. When the projected income and increased farm profitability from utilising existing tillage land within the grazing platform was factored into repayment capacity analysis, it became evident that the farm was capable of carrying additional debt. The farm had a proven track record. Utilising AI and high EBI sires, profitability per hectare and per cow was consistently above the national average for the last number of years, with strong grass utilisation, minimising the overall cost of production. Milk price volatility and the potential of a super-levy fine were however key considerations in this proposal.

As repayment capacity was evident on the proposed expansion plans and the customer had a positive track record with regard to existing loans, the requested loan facilities were provided to the customer. The level of security held by the bank was sufficient for existing facilities with a legal charge taken over the 30 acres purchased.

A FARM DEVELOPMENT PROPOSAL

Tom (62) and his son Brian, (34), approached AIB in 2011 seeking a loan of €390,000 to build a new 20 unit milking parlour and additional slatted cubicle accommodation on their farm to facilitate putting in place more labour efficient farm facilities that provided the capacity to increase milk production on the farm in the future.

Tom and Brian operate a liquid milk production system, from a herd of pedigree Holstein cows. They operate a high input / high output system (intensively fed, high yielding pedigree cows) and receive a winter liquid milk bonus which helped to offset the higher production costs on their farm.

From the farm visit it became very clear that the farm operation was well managed. Tom had also developed a positive track record during his time as farm manager and of his farm finances with the Bank. He had commenced milking in the early 1970's and had expanded the farm, producing 550,000 litres of milk from 80 cows. Tom and Brian had acquired 180,000 litres of milk quota and were planning to increase milk production to 730,000 litres in the following quota year. The longer term plan for the farm was to provide facilities to make a labour efficient unit for Brian, (who was working on the farm and was the farm successor) with the capacity to increase milk production up to 1.3 million litres. Tom and Brian had plans to supply 900,000 litres of milk within three years. Access to quota was not deemed a constraint.

Tom had been the driving force on the farm in recent years, however, his son was now very involved in the management of the farm, and was responsible for the computerised record keeping that was maintained on the farm. The dairy profit monitor, and the fertility and milk production figures were the responsibility of Brian and a copy of all were provided to the Bank, as evidence of the farm management. Although meal usage was high, there was a focus on grass budgeting on the farm in an effort to increase grass utilisation and reduce costs. Both father and son were participants in a farm discussion group.

Tom and Brian provided income projections based on production from 730,000 litres. The farm accounts were reflective of a 550,000 litres system and therefore did not reflect the projected earning capacity from the farm. Income projections were based on a milk price of 30 c/litre which incorporated the milk price premium they were receiving as liquid milk producers.

The bank was satisfied that repayment capacity was evident and additional comfort was also available as Tom had built up savings of €150,000 and a pension fund of €100,000 for retirement, of which €60,000 was being invested in the proposal. As a result and coupled with their strong track record to date ensured loan facilities of €390,000 were provided to the customers.

A PROPOSAL THAT DID NOT SUCCEED

George (31) approached AIB in 2011 seeking finance which did not come to fruition. He had recently taken over the family farm which he had been farming with his father since loosing his job three years ago and had applied to the New Entrants to Dairying Scheme for 200,000 litres of milk quota.

George, was looking to invest €120,000 in a new milking parlour (second hand machine) and convert existing sheds to cubicles. He was seeking a farm loan of €100,000 over 15 years >>

to assist with this – with the remainder funded from beef stock sales. In addition George sought an overdraft facility of €50,000 (up from his existing €20,000 facility). He had planning permission to hand although he was not able to furnish a set of trading accounts for the farm. There was adequate farm machinery to manage a dairy farm.

George was running a spring calving suckler herd consisting of 75 cows and finishing all animals on the farm. The farm consisted of 150 acres (owned) of moderate quality land in one block and winter accommodation for 200 cattle. He had a Single Farm Payment of €30,000. The farm had existing debt of €150,000 which related to winter accommodation and a silage slab built in 2008. He had a continuous high level of debt on his existing farm overdraft, and €40,000 feed and fertiliser bills with his local merchant outstanding.

When on the farm in late May, a considerable number of the cows were still indoors and had not yet calved. The fields surrounding the farm were poorly fenced and grass utilisation appeared low. George had no structured breeding policy, mortality rates were above average and a number of additional inefficiencies became apparent.

From our discussions it became apparent that George was now only starting to take control of the farm as management decisions had in the past all been made by his father. It became evident from our discussion that the farm was not generating sufficient cash to support the new proposal and required living expenses. We examined the future potential of a dairy operation on the farm and discussed a range of possible options as to how George might achieve his long-term goals, including the preparation of a detailed five year plan for the farm and cash flow forecasts.

As it turned out George was unsuccessful in obtaining milk quota through the New Entrants to Dairying Scheme. He has since decided to gain some dairy experience with a local dairy farmer and concentrate on improving his breeding programme, stock management and grassland management all of which will leave him in a better position if subsequent applications prove successful or in any eventuality if he commences milk production post 2015.

A NEW ENTRANT TO DAIRYING PROPOSAL

Denis (40) approached AIB in late 2010 after being successful in obtaining 200,000 litres of milk quota under the New Entrants to Dairying Scheme. Denis was an existing AIB customer farming a substantial spring calving suckler cow herd, selling his stock as weanlings. His farm consisted of 55 adjusted hectares, with a potential milking platform of 80 hectares including land rented. The existing farm facilities included slatted accommodation for the suckler cows, calving pens, silo and machinery shed. From the initial farm visit it was evident that the client was an excellent stock person, had a substantial milking platform, had good equity in his existing beef livestock and that the existing buildings could be converted to dairy accommodation with little extra investment. In addition the farm was laid out with paddocks, roadways and water facilities in place.

Denis had a 5 year farm plan which involved investment in a new milking parlour and expansion plans to supply over 450,000 litres of milk from April 2011 onwards. Denis' farm plan highlighted a long term borrowing requirement for a new milking parlour and dairy. He had projected to fund the cost of the dairy stock from his own input (sale of suckler cows). The 5 year farm plan outlined a strong repayment capacity position and strong cash flow; however a major cause of concern was the possibility of incurring a super levy fine.

Once Denis realised the implications of incurring a super levy fine, he decided to re-look at the farm plan and the implications of producing 200,000 litres of milk initially and phasing down the suckler cow operation over 3-to-4 years. Given that Denis was seeking 15 year money for the milking parlour; we asked him to stress test his plans with a milk price of 0.28c/l, rather than the 0.32c/l he had factored in at first. The new farm plan, required more finance from AIB as there was less stock being sold up front, but the concern AIB had in relation to super levy was now satisfied.

Denis constructed an 8 unit milking parlour with room to expand to a 16 unit parlour in the future. He produced 270,000 litres of milk in 2011/2012 and while he was over quota, he did not incur a super levy fine. In addition, as Denis was purchasing a smaller amount of dairy stock, he was able to source all stock from the same holding, reducing any disease implications from buying from several different holdings.

Post 2015, Denis is looking at completing his expansion to 120 dairy cows. AIB are supporting him with his plans, confident that Denis is expanding now off a profitable dairy base, having milked 50 cows for 2 years, before expanding further.

OUTLOOK

Outlook is a series of AIB reports, that over the coming months, will examine and analyse the key issues affecting particular sectors within the Irish economy.

To download the reports and view videos with industry experts visit **www.aib.ie/business**

Our next report (Issue 4) will focus on the Pub Sector.

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