AHDB

Back to basics on risk management - buying in feed

Feed and forage costs account, on average, for over 30% of the total cost of production (taken from MilkBench+ analysis 2014).

Whether your feed is purchased or home-grown, its cost to your business and the effectiveness of its use to produce milk is critical to profitability.

Ensuring you are managing this vital area of your business in the best way possible is key and this factsheet looks at ways to manage the buying of feed, and is applicable to other inputs too.

Be proactive in managing your input costs. Develop a strategy that can help manage volatility of your input prices.

Purchasing feed

Increased volatility in world grain markets create uncertainty in feed purchase decisions. Grain price variation is driven not only by factors affecting supply and demand (such as extreme weather) but also movements in the exchange rates.

These can cause large and unforeseen changes in the price of feed, which can have an almost immediate impact on dairy producers.

Think about your:

- **Attitude to risk**
- **Exposure to market forces**
- **Storage facilities**
- **Level of flexibility to respond to the unforeseen**
- **Time you can devote to monitoring the market**
- **Cash flow requirements during the year**

There is no 'one size fits all' strategy and any plan you adopt should reflect your own appetite for risk, the nature of that risk and the potential impact to your business should it not work out as planned while meeting your own needs and business objectives.

First, know how much you need to buy; to do this understand your livestock's requirements in the best and the worst conditions (production/weather). You also need to think about any waste that may be occurring during storage of feeds and waste left by cows after feeding.

Feeding+ Section 3, **Planning your feeding** and Section 6, **Managing your non-forage feeds** look at requirements, feed budgets and reducing areas of potential waste

PLAN BEYOND THE CURRENT YEAR AND PRODUCTION CYCLE

Futures markets allow for grains to be traded almost three years in advance. You can use this price as an indicator for purchases or use futures to lock in a price for your purchases.

DO NOTHING / BUY ON SPOT

Should be part of the plan; not waiting for the market price to move in your favour. Often referred to as buying on the 'spot market', it's commonly used. It offers the greatest potential returns (should the market price fall), however, it leaves you completely exposed to market movements giving no protection (should the market price increase). As such, it presents the greatest risks.

BUYING GROUP

A buying group can allow benefits from economies of scale, as well as possible access to specialised marketing and professional expertise. Allocating the responsibility of sourcing requirements to a 3rd party can help with time management, allowing focus on other aspects of business management but reduces the control you have on your purchases and the price paid.

FORWARD CONTRACTS

A private contract with suppliers to purchase a specific amount of feed to a certain specification for delivery on agreed dates at a set price. Buying some or all of your requirements in front of demand, can allow you to lock in a price, providing greater price certainty and allowing costs of production to be budgeted in advance. It does, however, limit opportunities to benefit from any fall in the market.

FUTURES

Futures contracts provide the same ability to lock into a price as Forward Contsacts do but they have standardised contracts. They are also traded through clearing houses that guarantee the transactions, removing the risk of either party defaulting, as can occur in a Forward Contract.

AVERAGING

Buying a proportion of your feed requirements forward (with Forward Contracts or Futures) at regular intervals. This reduces exposure to volatility in the market by taking the average price over the period. It removes the uncertainty in knowing when to react to price movements and is relatively time efficient. It can help better manage cash flow, as it spreads purchases over the year, as opposed to buying all your requirements at any one time.

OPTIONS

Options act as a form of price insurance for your Forward Contracts or Futures purchases, providing price certainty while leaving the opportunity to benefit if the market price falls. They do come at a cost though, meaning they are better value in a more volatile market.