

## **“Harvest Report”**

***Ian Pinner***

Thank you for inviting me to talk at your annual conference today. It is a pleasure for me to be here and I welcome the opportunity to present our views on the 2005 wheat crop.

Having been provided with the opportunity to wave the ADM “flag”, I am afraid I won’t apologise for presenting you with a brief introduction to ADM. I hope this will provide you with some background information on the company and offer you a little more insight into what ADM do, both in the UK and in other regions.

So, as there is no such thing as a free lunch (and I am sure you will agree we have just had a wonderful lunch) following my brief “advert”, I plan to take a look at the 2005 wheat crop with you, covering the more macro global and European matters and then focus on the UK crop size and milling quality.

So, first the advert!

ADM is the link between the farmer and the many diverse uses of the farmer’s crops. We are not in the farm inputs supply business in any substantial way although we do market seeds and fertilizer through our grain network. We don’t farm but we are the essential link in the food chain connecting the farm and the consumers of agricultural products. We add value from the receipt of crops from the farm to the first transformation of those crops into product streams, and the distribution of those products to other processors. We add value to food companies and brands through product innovation and our global supply capabilities

ADM is a global company with local businesses. Founded over one hundred years ago, we have grown over the years through both organic growth and strategic acquisition to become one of the worlds leading

processors of cereals and oilseeds. Today ADM operates over 250 processing plants and employs over 25,000 people worldwide generating sales of some \$35.9 billion or some £20.4 billion.

Our business is split into various complementary divisions:

ADM Milling is predominantly involved in wheat processing, however in some of our plants in other regions we also mill other products.

Our oilseed processing division is our largest division, processing some 89,000 metric tonnes of oilseeds a day in 93 facilities worldwide. The core finished products marketed by the oilseeds group are vegetable oils and fats as well as vegetable meal for animal feed

ADM Cocoa is a global leader in the manufacturing and marketing of industrial cocoa powder and cocoa butter, and in some regions industrial chocolate, and this group also has its own integrated raw material sourcing activity.

The corn processing group have a diverse range of finished and semi-finished products from High Fructose Corn Syrup through to bio-ethanol – a market that is growing at an enormous rate in the US.

Complementing our processing divisions we have an Animal Feed Division which uses the ADM co-products for further processing or blending to add value in this part of our supply chain. And we have various merchanting, trading and transportation businesses and networks which we utilise to provide the agricultural raw materials that our processing plants require and to transport finished goods to our customers.

ADM began its entry into Europe in earnest in the 1980's and this region has subsequently grown to be a significant asset base and sales

generation area for the global group. Our major processing businesses in Europe are Oilseeds and bio-diesel, Cocoa, and Milling. In addition to these divisions we also have various sales divisions specialising in the sales, marketing and distribution of ADM products in the UK and other countries throughout Europe.

Looking more closely at our milling business in the UK

As many of you may know, ADM entered the flour milling industry in the UK through acquisition in 1999. Following that move, our establishment in the UK, and our organic growth in the UK flour market, we acquired 6 further mills from ABF, previously operated by Allied Mills. This latter acquisition gave our UK milling business national coverage and strategically complemented the business we had already established in the UK.

Today, ADM Milling has 10 flour milling locations strategically located throughout the UK, which allows us to meet our customers' requirements on both a local and national basis.

Each location offers strength to our organisation through its computer controlled gristing and blending abilities, providing product consistency and delivering on our continued goal of achieving first class quality and food safety standards.

Working as a joined-up team, our technical and wheat groups are always monitoring crops as well as researching varieties and their baking functionality to establish a true understanding of the available wheat supply. The subsequent strategy is implemented through programmes as required at individual locations and this further supports the consistency of our flour, together with our policy to only source single-variety deliveries of wheat from the UK supply base.

As we see it, the UK flour market (our lifeblood) is made up of six sectors and this slide shows our estimated percentage split. I should emphasise

that this is our view of the *total market* and, as you are aware, a proportion of this market is not necessarily available to ADM as the “free market” because it is vertically integrated with bakeries and / or brands with milling interests or long-term supply agreements.

ADM Milling is truly independent of any bakery interests and has no vertical integration or cross-ownership relationships with our customer base. We believe this offers us strength, through having no conflict of interest with our customers’ marketplace, and it allows us to focus on the core business of providing quality food ingredients into the UK baking industry.

Servicing our customer base effectively and efficiently is a key focus for us. To assist with this we operate an extensive dedicated fleet of assets to provide our customers with the high standard of service they would expect.

I mentioned before about ADM’s ability to source the raw materials that its processing businesses require on a global scale - we also implement this strategy on a local scale in the UK through ADM Direct.

ADM direct procures quality wheat for our UK milling locations directly from UK farming businesses. By linking the supply chain from the farm to the primary processor we find mutual benefits, some of which we are able to pass on to our customers; these include improved traceability and key information on marketing patterns, market trends, variety and area planting intentions. Relevant information sourced through this channel is published in our wheat market update bulletins which you can arrange to receive from us by e-mail, if you don’t already do so.

So, to the topic, now you have all had a nap following lunch and you’re ready for a look at the wheat crop!!

Less and less of the UK flour milling raw material requirements come from the US and Canada now and most of that which does is used for more specialist or specific requirements.

The chart in this slide demonstrates that the consistent high quality of the Canadian wheat crop that we have been used to in the past has significantly changed over the past few seasons. In the 2004 season and the current season this is predominantly due to weather, which plays a big part of the farmer's life, and our wheat procurement team's life! The lack of availability of Canadian grade 1 quality wheat forced some traditional buyers of this grade to seek alternative supplies last year and so the impact this year will be a little less dramatic, but it is still having an effect on the premium and price demanded by sellers for this grade of quality.

In the US the quality this season looks to be sufficient. However, currently high premiums and prices are being charged for higher quality shipments by sellers of this wheat.

To summarise for the UK and the rest of Europe, things are back to normal. If I cast my mind back to a year ago when a large part of the UK milling wheat quality was substandard due to the high rainfall experienced during the harvest period, while the crop this year is generally "average", in comparison it is actually great, because it's providing me with a lot less sleepless nights!!

From a supply and demand point of view, on this slide I have highlighted the numbers to focus on in red.

Starting at the top with the US, you can see that the ending stocks (the balance of wheat left in store at the end of a crop season) is forecast to be some 2 million tonnes higher this year. This may have an impact on US wheat base prices, should the need arise for increased exports, which may lead to price competition in the export market.

Moving down to the EU-25 you can see that production is lower. This is predominantly due to smaller crops in Germany, France and the UK. However this reduced supply is offset in part with lower forecast export demand. The comparatively low prices of last year in France, Germany

and Eastern Europe meant that intervention (or Government-supported buying to country stores) was a better market; you can see that stocks grew by over 7 million tonnes in Europe and we expect to see that level held coming out of this season.

I mentioned that US and EU exports were reducing. However, demand from the traditional customers for this wheat has not, and this demand has more recently been supplied by the Former Soviet Union or, more specifically, Russia, Ukraine and Kazakhstan. I believe that these countries, and other Eastern European countries, will be a major influence on the flow of world wheat supply and demand in the years to come and need to be monitored closely. We are already hearing of some potential crop reduction in this region for next season and if this comes to fruition it could have an impact on next season's supply and demand flows.

Overall at the bottom of the slide you can see that from season to season the global production of wheat has reduced and this reduction in supply was offset in part with an increase in ending stocks. However, keep an eye on these numbers as demand is forecast to continue to grow and, with the level of world wheat stocks we have, it won't take much of a crop problem somewhere in the world to drive prices higher.

One of the key focuses for our industry is the supply and demand of the wheat crop in the UK and other significant wheat producing and wheat consuming regions of the world. The import and export price of various qualities of wheat in the UK, and competing regions, will determine the "base" price of our UK wheat production.

The graph shows UK wheat production for the past 6 years. Focussing on the most recent few years, we can see that the production of wheat in the UK has been fairly constant at around 15 million tonnes.

However, the production numbers are for all wheat and the amount of wheat the UK imports or exports will vary on domestic demand. UK wheat imports tend to be of more quality or milling-wheat specifications; exports

tend to be of lower quality specification and go, in the main, to Southern Europe or to other feed-wheat destinations. You can see that last year imports increased. This increase was predominantly due to the poorer quality domestic wheat crop that we had to deal with, and was of milling grade wheat.

Reverting back to my comment on the base price of wheat, this quality factor is one of the reasons why the price of feed wheat fell, however the premium demanded for quality wheat increased to such an extent that, when combined, the price delivered mill for UK milling wheat was “capped” by the ability to source European origins of full milling quality.

Because of the quality of the present crop we are forecasting imports to be lower this year.

Conversely, you can see in this chart that exports increased last year to, in part, offset the increased imported tonnage. Due to the reversal on quality this season, we expect lower exports. However, there will be continued export demand for our quality wheat and this will be at a price that the UK demand will have to compete with.

Again, when considering price and premium, the opposite picture to the imports is relevant this year as the quality is better. Subsequently base prices and premiums in the UK have a floor at a level that export demand is competitive.

However, as discussed, we do not expect exports to be that much lower due to demand. We had higher ending stocks coming into this current season as can be seen in this chart where last year ending stocks increased to their highest level for 3 years. A return to more normal levels is expected towards the end of this season, as both local demand and export demand competes.

Looking at this slide you can see that the area of wheat planted in the UK (seen in orange) can vary quite significantly. When overlaid with the production (in blue), it demonstrates that the final availability of UK wheat which we have to work with is, in part, down to good husbandry by the grower. However, a significant variable is always what “Mother Nature” throws at us to deal with in the way of weather patterns. As we have seen in the supply and demand charts, the variance in both the amount of wheat produced and the quality of the production can significantly affect prices. Until the crop is “in the barn” there is a proportion or risk taken by both the buyer and seller at all stages of our industry supply chain.

A point to note is that due to the changes in the subsidies paid to farmers in the UK and the rest of the EU, by removing subsidies away from production incentives, we expect the area of wheat sown this Autumn to reduce further, leading to less availability of domestic wheat. Trade speculation has muted as much as a 10% reduction in the area to be planted in the UK which could lead to a crop of just some 13.5 million tonnes, depending on yields! Note that both domestic and export demand for the crop is not forecast to reduce!

So, having reviewed some of the factors we have to work with that can affect the base price and premiums paid for wheat in the UK, I’d like to move onto looking at the quality of this crop, which is critical to the production and functionality of your flour.

When considering the size of the UK crop, we need to understand the true availability of the varieties and the quality of the respective varieties that we, the miller, need to produce your flour.

The lower chart on this slide shows that the trend for the farmer in the UK to reduce the planted area, and so production, of the preferred Group 1 milling wheat types is continuing. We are seeing an increase in the availability of the lower quality Group 2 type milling wheats and the Group 3 type soft wheats. However, the varieties that are beginning to dominate these groups are not necessarily preferred milling varieties, depending on the requirement of the miller and subsequently the baker. As such, these dominating varieties have been bred for higher yields and for the export

market as a “fallback” wheat for the grower and we find that they can have less functionality than some of those that are preferred for the production of flour in the UK baking industry. This could be of concern unless the trend reverses or a difference in functionality is accepted by the industry, if it is required.

Of this year’s 15 million tonne wheat crop, due to the decline in the preferred Group 1 type milling wheat plantings, we have seen a reduction of some 500,000 tonnes of available Group 1 wheat. Of this availability, we note that the percentage availability of Hereward is continuing its decline replaced, in the main, by Malacca. However, as I have mentioned, the overall trend is for the grower to plant less, and so produce less, of this quality milling wheat Group.

The availability of the lower quality Group 2 type milling wheats has increased by some 1.6 million tonnes and we can see here that the variety Einstein is becoming dominant. Einstein is one of the higher yielding varieties and so is preferred by the grower. This is because it can be planted in more “marginal” land than that deemed appropriate for achieving full specification milling wheat and *if* the quality *is* achieved then it will attract a milling premium. The subsequent base price and premium, coupled with the yield, will provide a higher revenue for the grower. So, while the incentive is there for the grower, Einstein is not necessarily a preferred variety for the miller, or rather the baker through the miller, depending, I must emphasise, on the required functionality. That said, there are other varieties such as Solstice and Cordiale which are preferred by growers in some regions of the UK and while Group 2 type wheats factor in some milling grists, it needs to be noted that they are not predominant because, to achieve the functionality required for most bread flour, Group 1 type wheats or high-quality alternatives are required.

Briefly looking at the Group 3 type soft wheats..... as I have already mentioned, a similar picture is seen as that for Group 2 type wheats in that the percentage of the overall crop is increasing. However, the functionality of the more dominant variety, Robigus, is different from that which we are used to. As Group 3 type wheats feature mostly in pastry flours or biscuit flours this trend may not have a significant affect on bread flours.

This slide shows us that the proteins this season, versus 2004, are marginally better. However, this is not a surprise when one considers the quality of the crop we had to deal with last year.

We are seeing better specific weights this season and again this can be put down to the less monsoon-like harvest conditions!

The same goes for the Hagberg results for the UK wheat crop this season.

Interestingly, while we are seeing improvement in the quality specification of the wheat this season, versus last, the way that the wheat actually mills is somewhat different. This is not necessarily a big surprise as we are likely to see some differences in milling characteristics from one season to the next. However, this season we have adverse milling characteristics against improved specifications.

This slide shows that the water absorption in this year's crop is down on the previous year and probably back to average. I guess the difficulty for the miller and baker is that, while the quality specification of the crop last year was lower, we were in fact "spoilt" to an extent with better water absorption and so we now need to adjust back to more the normal characteristics that we would expect of the UK wheat.

At our Technical Centre at Avonmouth we have a C-Cell analyser which allows us to look more objectively at the bread that the wheat varieties bake into. We mill and bake literally hundreds of samples of wheat over the harvest, and again, post the harvest, to establish the most objective view we can of the functionality of the wheat crop we are dealing with in a season.

This slide containing pictures of a Malacca bake, from our C-Cell analyser, shows that the actual bread quality of this, now predominant, UK Group 1 type wheat is unchanged to slightly improved on a year on year basis.

Thank you again for the opportunity to present to you today and I hope you found this insight both informative and useful.