LMC Quarterly
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# LMC PUBLISH REGIONAL PRICE DIFFERENTIAL RESEARCH

Regional Price Disparities in Deadweight Cattle: Understanding the NI / GB Price Differential

December 2013

OXFORD ECONOMICS  LMC Livestock & Meat Commission

LAST month, LMC launched its research into the price differential between Northern Ireland and Great Britain in a report titled Regional Price Disparities in Deadweight Cattle: Understanding the GB / NI Price Differential.

The purpose of the research was to examine the causes of the price differential and examine whether any action could be taken to redress the situation. This issue of LMC Quarterly provides a synopsis of the main findings of the research and reproduces large sections of the introduction and executive summary.

The full report report is available on the LMC website or alternatively, for a hard copy contact LMC by phone on 02892 633 000 or email: bulletin@lmcni.com

# BACKGROUND TO THE RESEARCH

SINCE 2009, when over a decade of price stagnation gave way to more fluid market conditions, farmgate beef prices have increased sharply across the UK. By mid-November 2013, Northern Ireland farmgate prices were second only to Great Britain in terms of the global beef trade.

However, despite the strong global performance of Northern Ireland beef prices, the price gap between NI and GB continues to frustrate producers. The market forces behind this differential are worth examining, not least because debate on the issue has typically been hindered by lack of information and conjecture which in turn contributes to tension; but also because a better understanding of the issue may facilitate action to help redress the differential, giving potential to add real value to the supply chain.

In 2012, LMC appointed Oxford Economics to examine the nature and cause of the price differential. In conjunction with a project steering group, the brief was to explore reasons for the price differential through consultations with stakeholders and to find evidence to explain why prime cattle prices in GB were higher.

The approach to the research was in two stages:

- Qualitative research – which involved discussion with industry stakeholders to establish the factors perceived to be influencing to the differential; and
- Quantitative research – which involved a detailed statistical analysis of each of the factors identified in the first stage.

Official data from a wide range of sources was used including LMC, Agriculture and Horticulture Development Board (AHDB), British Cattle Movement Service (BCMS), the Department for Agriculture and Rural Development (DARD) and Bord Bia. This data has been supplemented by confidential commercial data kindly provided to us by a number of individual companies.

The research delivered on the key objectives by identifying the relative influence of each factor driving the price differential. The causes have been evaluated in terms of their relative importance and are ranked as having a major, medium or minor influence. In the process, the research has uncovered many important findings that are useful in their own right, in explaining how the cattle trade operates in the UK.

The report provides an objective analysis of those factors which determine that the NI market returns lower prime cattle prices than GB. The price differential is clearly a complex phenomenon which is constantly evolving and the report finds that many of the drivers are interconnected. Because of this we encourage stakeholders to read the entire report and resist temptation to focus in on specific issues.

The report findings (pages 2-3) provide encouragement that action can be taken to influence the differential and add significant value to the red meat supply chain in NI.

It is important to understand that to overturn the differential will require sustained and determined effort in a number of key areas, combined with the confluence of some external factors (such as exchange rates and supply elsewhere) that are beyond the control of the Northern Ireland industry. This report therefore identifies priority areas for action and LMC, in conjunction with the steering group, has outlined recommendations to help redress the price differential (Page 4).

# REGIONAL PRICE DIFFERENTIAL

## EXTENT OF THE PRICE DIFFERENTIAL

THE research concluded that there has been a significant differential between prices paid for prime cattle in Northern Ireland and Great Britain throughout the 2009-2012 reference period.

Between January 2009 and December 2012, the average weekly difference between Northern Ireland R3 steer prices and equivalent prices in Great Britain as a whole was 14.2p/kg, which was found to be statistically significant. The GB price was consistently higher throughout the period but the differential widened significantly during the last 5 months of 2012.

The research also found that the differential varied by grade of cattle. The average price differential for R4 steers was 21.3p over the four year period and the average price paid for an average prime animal was higher in Great Britain than in Northern Ireland. On the contrary, the price paid for P2 cows has been on average 9.2p/kg lower in GB than equivalent Northern Ireland prices during the same period. These average variances are all statistically significant.

The differential has also varied by GB regions with the differential for prime cattle generally much greater between Northern Ireland and Scotland than between Northern Ireland and other reporting GB regions.

For example, the average price differential with Scotland for R3 steers over the 2009-2012 period was 22.5p/kg, while the differential with Southern England was much narrower at 5.8p/kg. It should also be noted that Northern Ireland prices are generally higher than those reported in the Republic of Ireland where prices paid for R3 steers were on average 8p/kg lower than in Northern Ireland between 2009-2012.

A number of stakeholders queried the validity of these comparisons because of potential differences in the way in which prices are reported. This was considered in the research exercise and it was noted that price reporting systems are regulated and audited by the European Commission. It was concluded that the prices collected provide a sufficient basis for valid comparisons to be made. However, we would recommend that there should be continuing regular liaison between price reporting agencies across the UK and Ireland in order to monitor issues that may impact upon the prices reported.

Table 1: Average price differential by selected grade, NI vs GB, 2009 – 2012

| Grade / Category | Average Difference p/kg | Percent |
|---|---|---|
| R3 Steer | -14.2p | -5% |
| R3 Heifer | -9.6p | -3% |
| R3 Young Bull | -11.2p | -4% |
| R4 Steer | -21.3p | -7% |
| R4 Heifer | -16.7p | -6% |
| O3 Young Bull | -16.7p | -9% |
| P2 Cow | +9.2p | +3% |

## FACTORS CONTRIBUTING TO THE DIFFERENTIAL

AS a result of the consultations with the industry, a long list of factors was identified which potentially explain and contribute to the persistent differential in the price paid for prime cattle in Northern Ireland relative to the price paid in Great Britain. A detailed statistical analysis of each of these factors was undertaken to establish the degree to which they may or may not contribute to the differential, using econometric analysis and tests of statistical significance where appropriate.

Based on this analysis it was concluded that the factors can be grouped under three headings – Major, Medium and Minor - reflecting the broad order of the significance of their impact on the differential. The assessment of whether a factor is major, medium or minor is based on the researcher's consideration taking into account the following:

- The economic potential of the factor to impact on the price differential;
- The explanatory power and consistency of the analysis, including the statistical significance of the relationship where this is available; and
- The reliability of the available evidence.

The headings can therefore be described as follows:

- Major factors – are those which demonstrate positively all three of the above characteristics – there is a clear economic rationale, the statistical analysis is strong and consistent and the evidence is reliable;
- Medium factors – are those for which there is a clear economic rationale but where the statistical analysis may not be strong or the evidence not wholly reliable ; and
- Minor factors – are those for which the economic rationale may be less convincing and/or where the statistical evidence is not strong or is less reliable.

Using these headings, and in no particular order, the factors contributing to the price differential are set out on page 3 together with a brief summary of the key evidence that has been used to arrive at our judgement.

## DEVELOPMENTS IN 2013

THE scope of the research was limited to 2009 – 2012, but developments in the beef trade in 2013 have given cause for reflection on the evolving findings. Two such findings were that barriers to the GB live export trade and the influence of the ROI trade were major drivers of the price differential. Exceptional circumstances, including the horsemeat crisis, gave rise to some interesting trends in these areas in 2013. For example, the renewed focus of UK retailers on local (British) sourcing emphasised the distinction between NI and ROI supplies. It is in this context that a wider differential emerged between NI and ROI prime cattle prices in 2013, with seemingly reduced capacity of the ROI trade to act as a drag on NI prime cattle prices. This emphasis on British sourced product has also resonated through the live cattle trade. Tight supplies in GB and the primacy of UK origin product has meant that some GB-based processors have become more active in procurement in NI and exports for direct slaughter to GB have doubled in the last year. The combination of these and other drivers has led to a narrowing of the differential in the autumn of 2013 relative to previous years. In this regard the events of 2013 go some way to underlining several of the key findings within this report.

# RESEARCH: REPORT FINDINGS

| MAJOR DRIVING FACTORS | |
|---|---|
| Additional costs and barriers to trade for Northern Ireland into GB markets for both the sale of live cattle and the trade in beef | The additional cost of transport of live cattle to GB processors (over and above intra-NI transport costs) is of the order of 10-12p/kg when measured as a carcass weight equivalent (CWE). Similarly, the additional cost of transporting beef to GB is estimated to be between 3-6p/kg CWE. These factors add additional costs for the NI beef industry in servicing its main market. TB incidence – both actual status and a fear of future TB incidence – and the restrictions on movement arising from this, both real and perceived, is also a barrier to the sale of live cattle from Northern Ireland to GB. A range of other factors such as the complexity of building cross-industry relationships are also issues affecting trade between NI and GB. |
| The impact of Republic of Ireland trade | There is an extensive trade in both live cattle and beef between North and South. NI beef and Irish beef are partial substitutes and the availability of a cheaper supply in the Republic of Ireland tends to constrain Northern Ireland prices relative to GB. |
| The relative supply and more seasonal nature of cattle production in Northern Ireland | The more seasonal nature of cattle supply in Northern Ireland, with on average 27.4% of cattle slaughtered in the autumn, due to grass based production methods, is linked to lower prices in Northern Ireland during this period. This also has an impact on processor costs as a result of excess capacity at other times of the year. There is also a relationship between the relative supply of cattle in NI and GB on the differential, but this was found to be both within and less prominent than seasonality. |

| MEDIUM DRIVING FACTORS | |
|---|---|
| Differences in the structure of the production and processing industries in Northern Ireland compared with Great Britain | The average size of finishing herd, which accounts for the majority of cattle supply, is smaller in Northern Ireland than in GB – 24% of cattle slaughtered were presented by herds finishing over 500 head compared with 29% in GB. This combined with the potential for more intense competition for cattle in GB, partly driven by the presence of a large number of small independent operators, may exert some upward pressure on GB prices relative to Northern Ireland due to the bargaining power of producers |
| Adherence to specification between GB and NI in terms of the typical criteria set by factories | A detailed comparison of the proportions of cattle presented to plants in Northern Ireland and GB by weight, age and grade, shows that a higher proportion of cattle in GB price reporting plants meet a typical retailer specification. There also may be a tendency in GB for smaller abattoirs to buy up cattle that do not meet specification. This has an impact on the markets served by processors and the price paid for cattle. |
| Higher costs of production experienced by Northern Ireland processors relative to those facing GB processors | Processing plants in Northern Ireland face higher costs for energy and rendering (in addition to transport costs mentioned above) compared with plants in GB with average processing costs estimated at 3-5p/kg higher in Northern Ireland. In a low margin industry this puts some downward pressure on prices paid for cattle. |
| Variations in the end markets for beef processors in Northern Ireland and GB | While almost all Northern Ireland prime cattle are eligible for the GB multiple retail market, end markets for beef vary on a plant by plant basis. Distance from the larger more lucrative GB markets and sourcing policy (driven primarily by transport costs) means that Northern Ireland plants have a smaller share of those markets than GB counterparts, relying more heavily on alternative wholesale or foodservice markets which return lower prices. The NI industry is also more dependent on European export markets which have been less profitable particularly in the latter part of the study period. |

| MINOR DRIVING FACTORS | |
|---|---|
| Differences in herd mix between Northern Ireland and GB | There are only small differences in the proportion of premium breeds in Northern Ireland and GB. This has a very limited impact on the price differential with GB, although it would have a more significant impact on the price differential between Scotland and the rest of the UK. |
| The impact of movements in the £stg/€EUR exchange rate | Variations in exchange rates will affect the relative price of Northern Ireland and Irish beef on the UK market. However the exchange rate has been very stable over the 2009-2012 period and has had limited impact on the price differential, although the actual exchange rate has a bearing on the substitutability of Irish beef for NI beef in some British markets. At the same time it is recognised that a significant and prolonged change in the £/€ exchange rate could lead to it having a more pronounced impact. |
| Differences in the price discovery mechanism | In Northern Ireland, processor deadweight price quotations are published in contrast to the GB situation. In GB there are a higher percentage of finished cattle sold through live auction markets than in Northern Ireland. Despite these differences, the evidence shows that this has a negligible impact on the price differential. |
| The price spread across different types of cattle and the impact of higher prices for cows in N Ireland | The pricing model varies across regions reflecting local specialisms but there is no evidence to suggest that cross subsidisation takes place between the price paid for prime cattle and cows. |

# REPORT RECOMMENDATIONS

A number of the factors identified as contributing to the price differential are more easily addressed than others and this is reflected in the recommendations. The analysis presented in this report and subsequent conclusions suggests that there are a number of areas where action might be taken to address the issues raised.

The Project Steering Group has identified a number of specific recommendations (opportunities) pertaining to each of the key areas for action identified by Oxford Economics.

The action areas and corresponding recommendations are set out in the table below:

| Action Area | Recommendations |
|---|---|
| **Increasing the proportion of cattle within customer specifications**<br><br>Based on a like-for-like comparison, a smaller proportion of NI cattle are meeting retail specifications compared with GB. A greater degree of uniformity will reduce processing costs and ensure more NI beef is fit for premium markets. The benefits will accrue to both producers and processors. A better coordinated supply base has potential benefits by improving producers' bargaining power, improving communication in the supply chain and delivering processors consistent volumes of in-spec cattle. | That industry and government prioritise the integration of data and software systems for the genetic evaluation of cattle breeds. The aim being the development of breeding programmes that use genomics to facilitate the profitable production of cattle to commercial specifications.<br><br>To deliver joined up use of the BOVIS, APHIS, LMC Data and AFBI / CAFRE Knowledge and Technology Transfer services, for producers and processors to encourage and promote adherence to specification.<br><br>To encourage smaller scale beef producers to consider if greater use of live markets to sell cattle as forward stores brings a better return than finishing. As well as potentially improving specification (by increasing the volume of beef from specialist finishers), this has the potential to improve producer bargaining power.<br><br>Industry should consider opportunities afforded by the Rural Development Programme 2014-2020 to support the creation of producer organisations to better organise the supply of cattle to market requirements. With the sufficient level of co-operation and appropriate incentives such an initiative could provide processors with greater certainty over the supply of raw material and focus on delivery to specification, whether niche or otherwise. |
| **Differentiating NI Beef**<br><br>In its key markets, NI beef is, at best, regarded as equivalent to GB product. In other markets NI and ROI beef are seen as substitutes. Yet NI beef has a number of unique selling points, that can be packaged and promoted to potentially make it even more attractive to retail and foodservice customers.<br><br>Stronger differentiation at a business-to-business level could deliver a premium for the NI industry. | The development of a NI Business-to-Business Beef Brand / Campaign would allow the NI industry to differentiate itself from ROI and GB beef. The NI beef industry has several unique selling points that set it apart from the other UK regions and ROI: A traceability system that is arguably the most sophisticated in Europe; One of the longest established and most robust quality assurance schemes in the world; A bovine information system (BOVIS) that has the potential to facilitate benchmarking, genetic evaluation and carbon footprint measurement at farm and wider industry level; A world leading feed materials assurance scheme; and an integrated veterinary surveillance and support service focused on protecting and enhancing animal health and welfare.<br><br>Collectively, these tools underpin the marketing efforts of the industry by providing reassurance on the provenance, quality, health and environmental credentials of NI beef. While these systems are in some ways too complicated to be promoted at a consumer level, they provide essential reassurance to retail and foodservice customers. Combined with the strong reputation of our farmers, processors and products, these systems potentially provide the basis for a strong NI business-to-business brand which could be developed to positively differentiate NI beef from its competitors. Finally, the NI industry should explore a business-to-business or consumer branding approach in export markets. |
| **Reducing barriers to live export trade with GB**<br><br>To some extent at least, the live export trade from NI to GB has been under-utilised from 2009 - 2012. This has been due to a combination of factors including TB restrictions, associated regulations and misconceptions about those regulations. Resolution of these issues where possible will support the live export trade which in turn could help redress the differential, particularly at times of strong NI supplies and when the differential exceeds transport costs. This is usually in the autumn when seasonality is a major factor. | Government should review the regulations around the movement of cattle from certain categories of restricted herds in NI for direct slaughter in GB.<br><br>As part of government commitments to reduce Bovine TB, DARD should consider the importance of the identification of genetic traits associated with TB / TB resistance. In conjunction with breeding programmes and use of genomics, such work has the potential to reduce and eventually eradicate the disease.<br><br>To deliver a relevant market information seminar, involving producers, hauliers, agents and government. This would include clarifying regulations around live exports to GB. |
| **Ongoing monitoring Deadweight Beef Prices and the GB/NI/ROI differential** | It is important to continue monitoring the deadweight beef prices in the respective countries partly to build on the existing knowledge as to why the differentials exist. Ongoing liaison is required between price reporting agencies to ensure that the growing complications of breed premiums and other incentives are monitored and communicated where possible. |

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# SUCKLER BEEF COST OF PRODUCTION 2012/13

The Farm Business Survey for the 2012/13 accounting year shows that the cost of producing beef from the NI suckler herd was £4.14/kg. This was 8 per cent higher than previous year levels (see Table 1 below).

Last year, variable costs associated with suckler to beef production increased by 33p/kg, reflecting the very difficult production environment throughout the year. Fixed costs were slightly lower with a three per cent decline in depreciation costs (associated with current and historic investment).

### Increased feed costs in 2012/13

The higher production costs in 2012/13 were mainly driven by increasing feeding costs, which was in turn caused by the difficult weather conditions. The cost of concentrates increased by 34 per cent (23p/kg). This was due to a combination of higher prices per unit and more usage of concentrates during the year. Likewise, forage costs increased by 11 per cent (8p/kg).

Figure 1 below illustrates the unusually high rainfall of the summer of 2012. In June 2012 rainfall was more than double the monthly average of 1998-2010. The higher than average rainfall continued right through until autumn 2012 and this weather was the underlying driver of increased costs for beef farmers over the course of the year.

The heavy rain and colder weather meant that grass growth was poor and this in turn led to a very light silage crop which in many cases was also lacking in quality.

In addition to this, very poor ground conditions meant that cattle were housed as early as July meaning that producers became even more reliant on conserved fodder and concentrates. With cattle struggling to reach target weights due to the poor weather and perhaps also due to the quality of feed, producers were often compelled to spend more again on concentrates to supplement diets. For producers, this meant spending more on bought-in silage, straw and concentrates at higher than normal prices. In the 2012/13 financial year, NI sales of beef cattle compounds and coarse mixes and blends were up by 20 per cent year-on-year (there was a four per cent increase in the cattle kill).

In the quarter ending December 2012, silage prices were 52 per cent higher than in the same period in 2011. Straw (large bales) prices were up 12 per cent on the year. Wheat prices were up by 34 per cent, with barley prices up by 25 per cent (*Source: DARD NI Quarterly Market Report*).

The resultant impact of the weather conditions and subsequent developments in the animal feed market is therefore within reflected in the Farm Business Survey. With forage feed and concentrate prices up by a combined 30p/kg. This means that feed costs accounted for 40 per cent of total costs in 2012/13 compared to 35 per cent in the previous year.

### Other variable costs increase

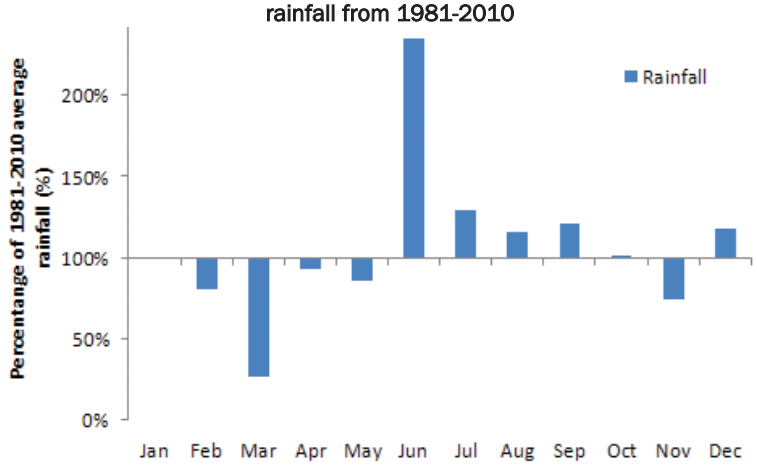
The difficult weather conditions were also responsible for increased costs in other respects. Veterinary and medicine bills were up by six per cent during the year, possibly reflecting the increased requirement for medicines because of the difficult production conditions. Mortality was known to be a bigger issue, particularly in the latter half of the year, and this is probably reflected in the increase in the cost of sundries in the survey.

**Table 1. Fixed and Variable Costs for Suckler Beef Producers Excludes Land, Labour and Working Capital (£/KG DW)**

| Costs / Year | 06/07 | 07/08 | 08/09 | 09/10 | 10/11 | 11/12 | 12/13 |
|---|---|---|---|---|---|---|---|
| Variable | £1.19 | £1.27 | £1.48 | £1.61 | £1.61 | £1.72 | £2.05 |
| Fixed (Excl Depreciation) | £0.95 | £0.96 | £1.01 | £1.14 | £1.15 | £1.25 | £1.26 |
| **Sub-Total** | **£2.13** | **£2.22** | **£2.49** | **£2.74** | **£2.77** | **£2.97** | **£3.31** |
| Depreciation | £0.66 | £0.67 | £0.69 | £0.81 | £0.86 | £0.85 | £0.83 |
| **Total** | **£2.80** | **£2.89** | **£3.18** | **£3.55** | **£3.62** | **£3.82** | **£4.14** |

Figures may not add due to rounding

**Figure 1. NI Rainfall in 2012 expressed as a percentage of monthly average rainfall from 1981-2010**




## WHAT COSTS ARE INCLUDED?

The figures used to calculate the cost of suckler beef production in NI are from farm enterprises that rear and/or finish suckler calves. These costs are for a combination of steer, heifer and young bull production including suckler cow maintenance costs.

### Hidden Costs

**These costs include:**
- Costs of purchased inputs
- Depreciation costs
- Bank interest and rent
- Herd replacement costs

**These costs exclude:**
- Unwaged family labour
- Opportunity cost of:
  - Own Land
  - Working Capital

With no provision for hidden costs in these figures, producers therefore need to consider that the enterprise must also cover the cost of their own labour, land and working capital.

### Depreciation

Depreciation, which is associated with current and historical investment in capital, contributes significantly to overall farm costs. It is important to note however, that this type of capital investment is not entirely funded by the suckler enterprise with other revenue streams such as the Single Farm Payment, LFACA, Farm Nutrient Management Scheme and Farm Modernisation Scheme important factors in driving investment. Care should therefore be taken when interpreting these figures given that these grants and subsidies are important factors in the investment decision.

### Mixed Farms

On any farm business there may be a number of different enterprises. For example, a suckler producer may also be involved in lamb production alongside a broiler breeder operation. Care is taken in the Farm Business Survey to ensure that costs for each enterprise are allocated correctly and proportionately.

# SUCKLER BEEF COST OF PRODUCTION 2012/13

### Fixed costs stable

Fixed costs associated with the suckler beef sector have remained stable in the last year. There was a nine per cent increase in conacre costs which probably reflects an ongoing increase in the cost of conacre over the course of recent years. Farmers spent 13 per cent more on building repairs over the course of the year. This may reflect the length of time cattle were housed over the course of the year. It may also be a reflection of the impact of the weather on yards and laneways. The cost of hired labour on farms fell by 1p/kg to 6p/kg in 2012/13 and this may well be a reflection of the reported cashflow problems on farms with some producers perhaps opting to reduce expenditure on casual labour with feed costs on the rise.

Depreciation costs were slightly lower in 2012/13 but remain a significant overhead accounting for about 20 per cent of overall suckler-to-beef costs. These costs stem from current or historical investment in fixed assets or machinery. The cost of the initial investment is accounted for in the form of depreciation in the farm accounts for the following 10 years. For example, between 2007-2009, under the Farm Nutrient Management Scheme (FNMS) many beef producers invested in new housing and slurry stores with the support of grant-aid. These depreciation expenses will appear on the accounts of these farms until 2017-2019. The Single Farm Payment (SFP) has been another important source of finance for machinery purchases on many farms in recent years, with tax incentives further encouraging such investments. Clearly income sources like the FMNS and SFP must be taken into accout when considering how the enterprise covers these depreciation costs.

### Comparison with costs

Figure 4 shows a comparison between suckler beef production costs and farmgate prices paid for suckler origin cattle. The red line shows the average farmgate price paid for prime suckler-origin beef (*source: Price Reporting*). The green bar shows costs, excluding depreciation, while the pale blue bar shows depreciation costs. These costs do not include a return on farmers' own land, labour and working capital.

The figures show that the average suckler beef price (prime cattle were £3.30/kg) just about covered costs excluding depreciation (£3.31/kg).

With prices not sufficient to cover depreciation, it shows that there is no room in the farmgate price to fund investment in the average suckler farm and that remains an ongoing concern, particularly in light of the impending CAP reforms.

It is important to consider that these figures are average costs calcualted from the accounts of a wide range of beef farms participating in the Farm Business Survey. Some of these farms will be more efficient, with lower costs of production, while other farms will be less efficient with higher costs of production.

This may mean that some beef farms are not even covering their cash costs. On the other hand, some suckler beef enterprises will be covering these costs and in addition, will be making a contribution towards depreciation costs or towards the farmers' own labour, land and working capital.

With this in mind, producers must maintain a strong focus on managing costs, particularly given the very difficult weather conditions of 2012/13. The CAFRE benchmarking programme is an excellent source of support for producers who want to improve their efficiency. The programme allows producers to guage their own progress by comparing their farms with other similar enterprises to identify improvement measures. This is a very worthwhile exercise, particularly considering these figures.

Contact CAFRE Benchmarking on 028 9442 6771 or visit the website at ruralni.gov.uk.

Figure 2. Suckler Beef Production
Index of Variable Costs - 2006-2013

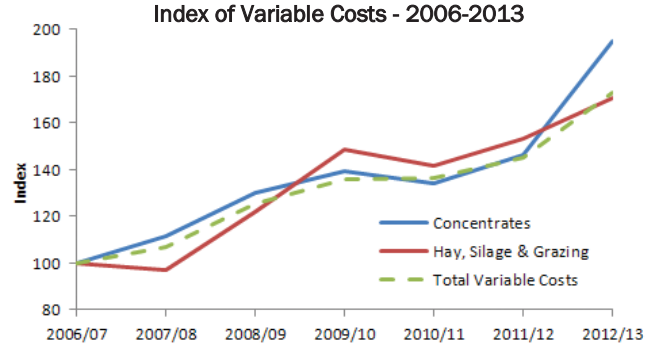



Figure 3. Suckler Beef Production
Index of Fixed Costs - 2006-2013

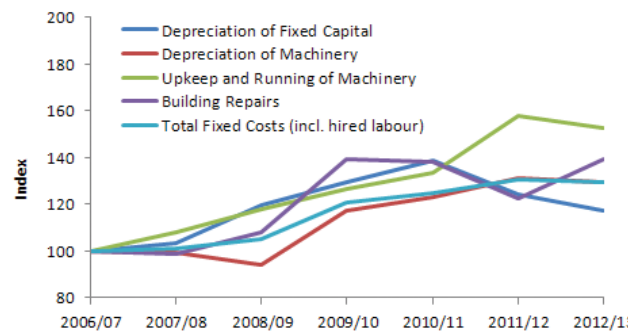



Figure 4. Suckler Beef Production 2009-13
Average Costs v Average Farmgate Price Paid for Suckler Origin Beef

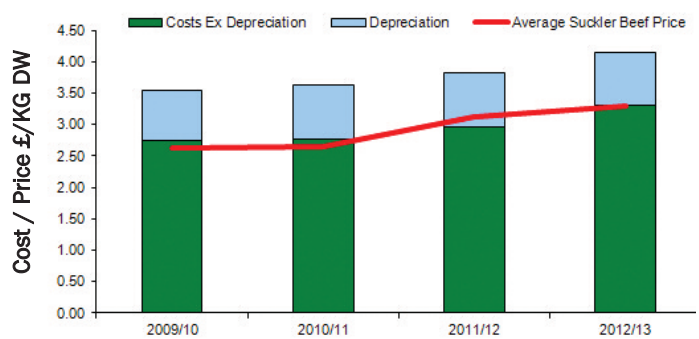



Figure 5. Suckler Beef Production
Breakdown by Cost Centre - 2012/2013