



**NORTH EAST SCOTLAND AGRICULTURE ADVISORY GROUP
BULLETIN – 23 SEPTEMBER 2020**

DAIRY SECTOR UPDATE

1 Recommendation

1.1 It is recommended that the Group notes this report

2 Discussion

- 2.1 At the last meeting of NESAAAG on 19 November 2019, a bulletin was presented to update members on the latest dairy sector developments at that time; most notably that earlier that month (on 1 November), Muller Milk and Ingredients, the main wholesale outlet for locally produced liquid milk, had advised 14 dairy farms north and west of Aberdeen that their supply contracts would be terminated on 30 November 2020, giving them twelve months to find an alternative outlet. Five of the fourteen were on 'aligned' contracts. There has been no lack of endeavour since then by NE Milk Producers Association, the body set up by local farmers to represent their interests, but an alternative option has failed to materialise. It is understood that all but three former Muller suppliers in north and west Aberdeenshire will now cease production in the coming weeks, sell off their dairy cattle and equipment, and part company with staff, many of whom are long-serving.
- 2.2 The coronavirus (CV-19) pandemic put paid in April 2020 to the last remaining prospect of establishing a local milk processing facility, under which an investor with a large scale dairy operation in the North of England was actively considering a joint venture with a local food business. However the damage caused to the foodservice supply chain by CV-19 – to which the investor was heavily exposed – severely undermined the financial and management capability required by both parties to develop, create and fund the new facility. Scottish Government had previously signalled a willingness to find public sector match funding in support of the venture via the Food Processing, Marketing and Cooperation Scheme (FPMC), while the council and its partners, chiefly ONE and SAOS, stood ready to extend further help to the Association.
- 2.3 It is understood that one of the fourteen has very recently been awarded a contract to supply organic milk to an alternative outlet. Two others plan to continue, subject to the costs of transporting milk to an alternative outlet and/or while an alternative dairy business model is developed. The number of farm staff being made redundant is understood to be around 25. Dairy cattle will be sold off by private sale and via the mart at Carlisle. It should be noted that a handful of non-Muller dairy farms in north and west Aberdeenshire will continue to supply Grahams, Organic Milk Scotland (OMSCO) or their own food manufacturing operations.
- 2.4 Given the concerted efforts of all involved, the outcome is profoundly disappointing and represents the loss to Aberdeenshire of yet another primary production food sector, following on the heels of the termination by The 2

Sisters Food Group in 2014 of broiler poultry supply contracts. Like many of the poultry producers, most of the dairy farms about to close are highly efficient and very well invested in robotic milking systems. The factors which contributed to the ending of large-scale dairy production in Aberdeenshire include:

- Increasing commoditisation of food production and consolidation of retail supply chains
- High risk associated with the creation and operation of a new processing plant
- The lack of a Scottish outlet for low-value skimmed milk/products
- Farmers' reluctance to invest off-farm and embrace a cooperative business model, exacerbated by the division arising from aligned/non-aligned contracts
- Limited support, engagement and encouragement from dairy ingredient buyers
- Shrinking production volumes fell quickly below the critical mass required to sustain a plant (c.40M litres pa)
- Inadequate market signalling by processors to producers, resulting in overproduction. Muller reported in November 2019 that it was obliged to transport 180M litres per annum to England for processing. Analysis in July 2020 by the NE Milk Producers Association revealed that over the last 10 years, 283 herds had been lost in Scotland; but that Scottish dairy cow numbers were up by 13,645; that the four main dairying areas in SW Scotland had increased by 21,280 cows; while Aberdeenshire had lost the largest number of cows by region (2,765).

Remarkably, the UK is the world's second largest importer of dairy products (after China). The value of imported cheese, butter, cream, yoghurt and butter oil in 2019 was c.£3.3Bn, up from £2.8Bn in 2018. That UK liquid milk producers continue to operate on extremely thin margins while the value of dairy product imports soared by £500M in 12 months represents a strategic failure.

Background

- 2.5 Muller UK & Ireland (incorporating Wiseman Dairies) announced the closure on 31 May 2016 of its processing plants in East Kilbride and Aberdeen, resulting in the loss of 255 jobs and adversely affecting dairy farms in NE Scotland supplying the Aberdeen (Tullos) factory. At that time, 43 dairy farms supplied c.74M litres of milk per annum to the company. The Tullos factory closed in July 2016 and locally produced milk was then tankered to the Muller site in Bellshill near Glasgow at a cost to local farmers of 1.75p per litre. While dairy farmers on 'aligned' contracts with Tesco did not pay the charge, the majority of producers were liable, putting them at a serious commercial disadvantage. As a result the number of farms in the local milk field halved in three years.
- 2.6 In June 2016 at the request of local dairy producers, Aberdeenshire Council and ONE funded a major study to assess the impact of the additional costs on producers and to evaluate alternative dairy processing options to sustain large-scale dairy production in NE Scotland. A detailed Options Appraisal Study was carried out by a team of 2 specialist advisers (HRA and SAOS) with the consultancy costs shared by ONE and the council (which administered the contract). The study objectives were as follows:

- Identify market options & describe market, production economics and range of producer returns
- Prepare an analysis of current & latent NE milk and milk product demand, including retail products & food manufacturing ingredients.
- Investigate the feasibility of an appropriately scaled dairy plant in Aberdeenshire/ Angus.
- Establish the economics, production efficiency and intentions of the local dairy farms.
- Present the results to a meeting of all local milk producers.

The study concluded that local dairy farmers were well-invested, efficient, market facing and progressive. A technical and economic overview was undertaken of dairy fractions (fats and skimmed milk products), potential processing options and markets/outlets and costings, including capital. The minimum entry level for a processing facility was determined to be 40M litres of liquid milk. Anything less would be uneconomic. Technical requirements for prospective sites were considered and options proposed. Discussions took place with representatives from the local food manufacturing industry interested in home-produced dairy products/ingredients. The study advised that the bulk liquid milk market was not considered to be an economically feasible option for local producers in the long term.

- 2.7 In early 2017 and with assistance from SAOS, local dairy farmers formed NE Milk Producers Association and met with Scottish Government to explore the potential for grant aid (Food Processing, Marketing and Cooperation). Capital and financial projections were developed and revealed the extent of the risks associated with the processing plant project. These included difficulties in securing commitments from food manufacturers to buy dairy ingredients, the challenge in marketing high volumes of low value skimmed milk co-product, and the reluctance of producers on aligned contracts to switch allegiance, thereby surrendering the security of relatively profitable 12 month supply contracts in exchange for an unknown quantity ('aligned' milk was required to generate critical mass). Ultimately, and only after a very considerable body of work had been undertaken, the Association concluded in late 2017 that the risks at the time were too large and the financial margins too small, and subject to volatile externalities (international markets and exchange rates).
- 2.8 Aberdeenshire Council, ONE and SAOS continued to work closely with the NE Milk Producers Association to identify and evaluate options. In August 2018 financial support was provided for a visit to Orkney by a small deputation from NE Milk Producers Association to learn about the Orkney Cheese business model, a partnership comprising local dairy farmers, Orkney Islands Council and Lactalis, an international dairy product marketing company.

3 Scheme of Governance

- 3.1 The Head of Finance and Monitoring Officer within Business Services have been consulted in the preparation of this report and are satisfied that the report complies with the Scheme of Governance and relevant legislation.
- 3.2 NESAG is able to consider this item in terms of its remit to provide a NE Scotland focus to enable issues and concerns across the agricultural and related sectors to be addressed. This includes strengthening economic development links across the wider land-based sector and food industry,

contributing to regional and local priorities, improving links between industry, the environment and biodiversity and contributing to policy development and consultations.

4 Council Priorities, Implications and Risk

4.1 The table below sets out whether risks and implications apply if the recommendations are agreed.

Subject	Yes	No	N/A
Financial		x	
Staffing		x	
Equalities		x	
Fairer Scotland Duty		x	
Town Centre First		x	
Sustainability		x	
Children and Young People's Rights and Wellbeing		x	

5.3 An equality impact assessment is not required because the recommended actions do not have a differential impact upon people with protected characteristics.

5.4 No risks have been identified at Corporate or Strategic level.

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