

How resilient is my business?

By Duncan Coull, Rural Business Solutions

Given the current milk price environment farmers are asking the question “How resilient is my business?” In essence how well prepared are we to deal with volatility?

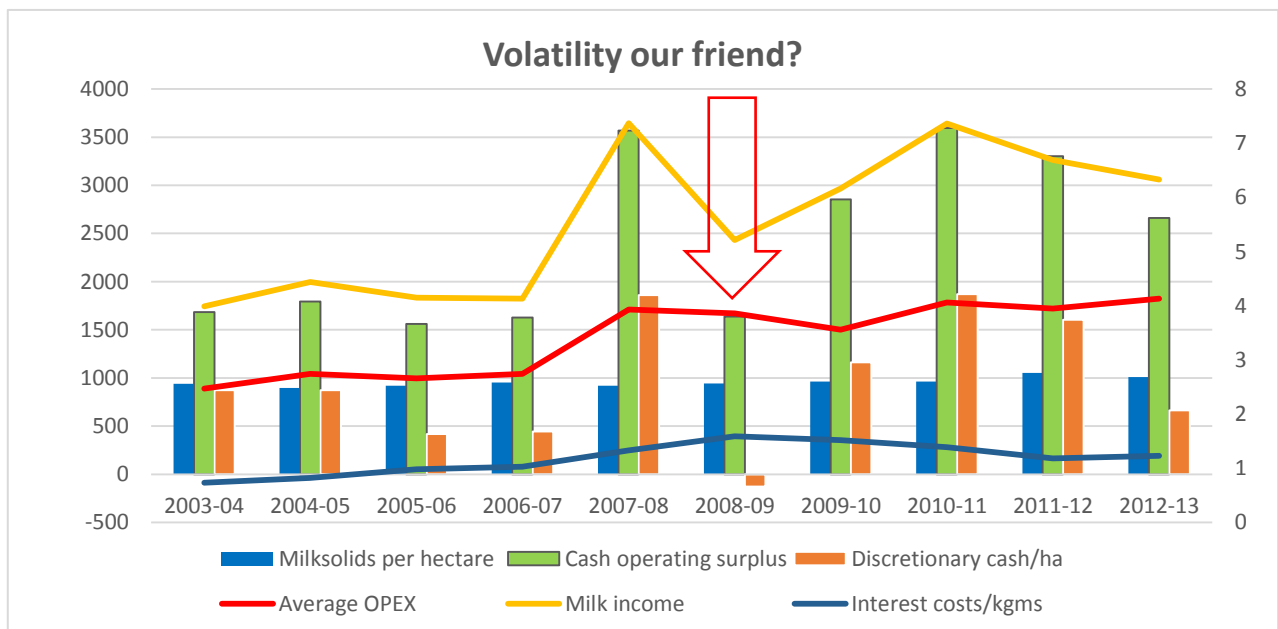
To answer this we must:

- Look back at trends over time.
- Understand our business drivers.
- Business fundamentals.
- Look at practical steps to deal with the now.

Looking Back

As can be seen from the table below volatility has been with us most recently from 2007-08. Of note:

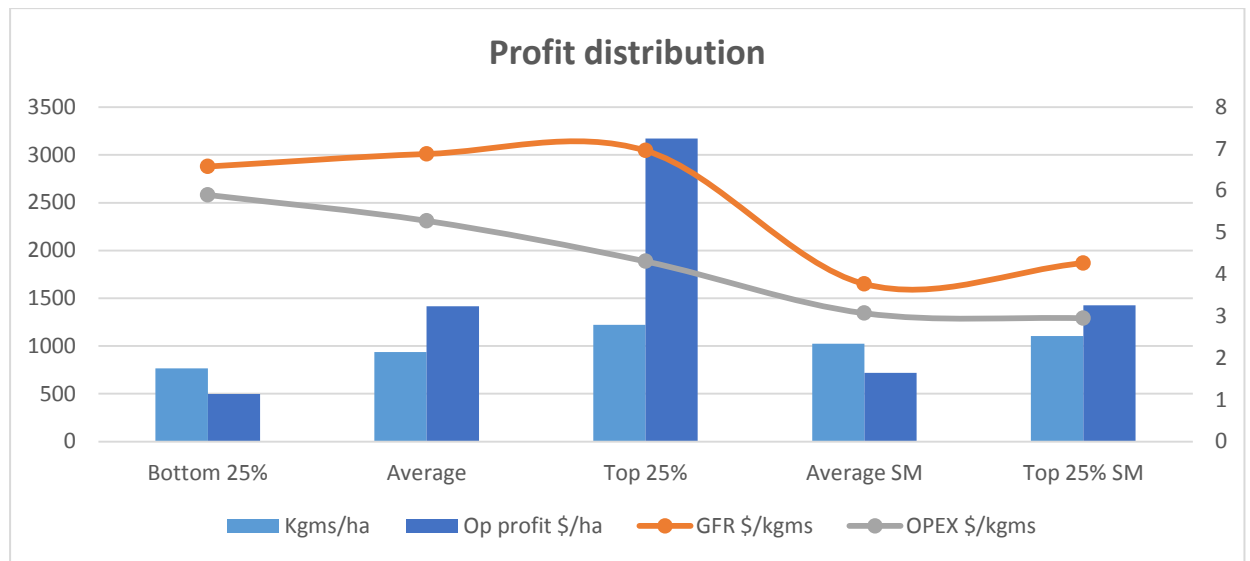
- Over this period milk production per ha has only increased 5%.
- Milk income has increased 59%.
- Feed costs have increased 142%.
- Farm working expenses have increased (Opex) 67%.
- Interest costs 68%. Debt per kgMS has doubled from \$11.00 to \$22.00.
- Cash operating surplus has increased 58%.
- Discretionary cash (post interest, drawings etc.) has only increased 10%.



Source – Dairy NZ dairy economic survey.

Add three droughts to the mix and we get a feeling of how volatile our operating environment has been over the past 7-8 years. That said have we managed volatility well? The numbers above would suggest not. We are in danger of transferring variable costs (used to manage volatility) into fixed costs which will erode profitability, or head room, in lower

milk price environments. The 2008-09 season reflects this with the average farmer making a cash loss. **Do we understand what's driving our business?**



Source – Dairy NZ dairy economic survey.

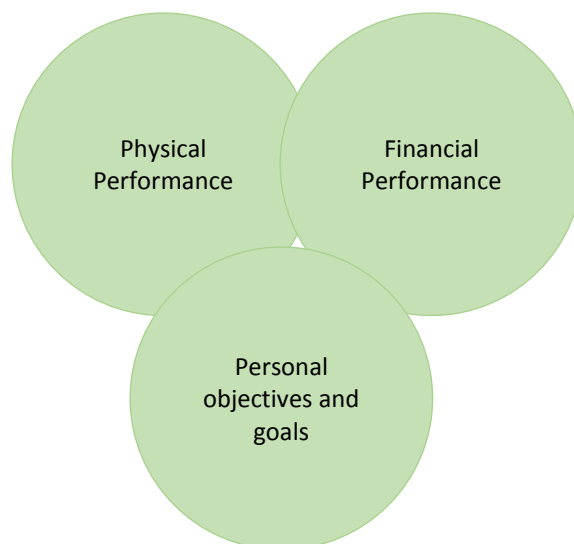
The graph above shows profit distribution amongst the quartiles for owner operators and compares the average against top quartile for 50% sharemilkers.

- Pasture grown and harvested is the biggest profit driver as it lowers operating cost/kgMS.
- Interesting that the top quartile of 50% sharemilkers have a higher operating profit than owner operators on half the income.

Business Drivers

More often than not our business drivers tend to get out of sync! There are three components to a farm business and alignment is a necessary function of a happy, healthy and profitable business.

- Farm system needs to align with personal objectives. Need to have satisfaction in what we are doing.
- Personal objectives drive farm objectives and required financial outcomes. **All too often this is the last consideration if consideration is made at all.**
- Financial outcomes need to align with farm system employed. i.e. if I am growing 10t DM then can only expect production of 750kgMS off pasture which will drive a \$2250 operating surplus at \$4.00 farm working expenses.
- **Farm system by design not default!**



Business Fundamentals

Planning

- We can't monitor what we don't measure. Cashflow forecasting and monitoring is as important as the weekly pasture walk or weighing young stock!
- Plenty of good cash management tools in the market, Cash Manager, Bank Link, Xero etc.
- Hands on farmers need to be hands on with cash management.
- Hindsight is helpful (looking back at historical performance) but foresight through planning is empowering for a business.
- Involve your wider professional team. Banker, accountant and farm advisor.

Do

- Having spent the time planning you now have the confidence to action the plan.
- Timeliness is a big profit driver. Procrastination isn't!
- Having a plan gives clarity to decision making.

Review and reward

- Important that we take time out of the business to work on the business.
- This component together with planning acts as the governance component of the business. Monitoring and measuring our business strategy.
- Use this time to measure progress against budget.
- What if scenarios?
- Involve your wider team.
- Most important that we reward for achieving goals. As simple as time out with family or fish and chips at the beach.

Adjusting to milk price volatility

- Need to understand what the "base parameters" look like.
- Currently banks using status quo figures of \$6.25 for milk price and 7.5% for interest rates.
- Need to separate fixed and variable costs. Fixed = function of farm's system to deliver output. Variable = some flexibility without affecting output.

- Discretionary spending needs close scrutiny. Separate into needs, wants and nice to have.
- Once base system is set we then understand sensitivities around milk price etc. on overall profitability.

Current situation

- Understand how the drop in forecast milk price affects you. Will be different for everyone depending on production spread, balance date, milk growth etc.
- For farmers who have a balance date of 31st May, rolling average milk price for current financial year will be circa \$6.00/kgMS.
- How does this compare with my base model?
- What is the gap if any?
- For most farmers the current milk price will have most effect heading into next winter.

What to do and where to look?

- Every line in the budget needs to be looked at.
- Not just about being defensive and trimming costs.
- Opportunity to increase productivity and or efficiency also? The current beef schedule should deliver another \$.10c to stock sales this financial year. What is the cost of herd wastage in my business?
- Line by line ask the question as to whether this is a fixed or variable cost and what effect will not having this input and incurring this cost have on my business in the short and medium term?
- The most obvious categories are:
 - Feed – fixed or variable? What response could I expect? Can I grow feed on farm and use fertility bank in effluent field? Based on this what could I afford to pay? Do I want to make a margin over cost of feed? **Answer should be yes as other fixed costs associated with feeding out supplements. Need to be targeting feed under 23c/kgDM.**
 - Fertiliser – what is my current soil fertility status? Where will I get best bang for my buck? Target elements that are below optimal first. Better to be more directed than blanket approach at half the rate. i.e if phosphate levels are in the 40s yet K levels are on 4 then best to direct all fertiliser spend on the K to promote pasture growth.
 - Grazing – Given comments around herd wastage, is my replacement rate fit for purpose? Have I been happy with my calves out grazing? Is it an option to cull early and keep calves at home till May?
 - Repairs and maintenance – given high milk price last year most farms should be up to speed with R & M.
 - Interest costs – farmers are priced on risk. Do you understand your risk profile and what could be done to reduce the margin you pay on your term debt? Discuss with your banker. Having a plan will give them confidence and could lower your overall margin.

Other options

- OAD milking
 - 200 cows on OAD will save approximately 0.5kgDM/day in intake (energy). Over 150 days this equates to 15tDM.
 - If buying in maize this could save \$5250 at .35c/kgDM.
- Early culling
 - Culling early February to take advantage of high schedule and apportion feed to balance of herd given demand exceeds supply over summer period.
 - Feed saved on a 200 cow herd if 30 cows culled = 15kgDM x 90 days = 40tDM
 - 40t DM x .35c = \$14,000 or at .25c = \$10,000.
 - If feed converted to milksolids at 100g milksolids response/kgDM fed = 4000kgMS x \$4.70 = \$18,800.

Summary

- Understand the drivers in your business and take control.
- Plan, do, review and reward. All about confidence and sense of control.
- Understanding your business will help develop strategies to manage volatility.
- Communicate with all stakeholders and don't be afraid to ask for help. We are all in this together.
- Fundamentals for dairy are still strong.
- Remain positive!