AN "OLD" ARTICLE WRITTEN FOR THE AUSTRALIAN DAIRYFARMER MAGAZINE IN OCTOBER 2004 !!! IT STILL SEEMS FAIRLY RELEVANT.

IT'S TIME FOR A REALITY CHECK!!

By John Mulvany

It hasn't taken long for the dairy industry hype to start again! After several extremely tough years, the increase in milk price is a real boost for farmers and they are of course keen to take advantage of this, looking for the best way to maximise their profits and ensure their continued viability in the industry.

Unfortunately, several articles have appeared recently in the industry press, implying that "one approach suits all" and the answer is "produce your way to profitability". These articles have implied that if you are not increasing production via increased cow numbers or per cow production then your business is under threat and may not be viable or sustainable. In the last edition of the *Dairy Farmer*, Rod Banks made the comment " A low input dairying system can be profitable but is unsustainable in the medium to long term" and that there is no "halfway" between the low input and the sustainable input system.

While I agree that a dairy business cannot "stand still", it is essential that all the implications of the increased production to the dairy business are fully understood. My observation of clients and discussion groups is that most dairy farmers are not silly. If it was simply a matter of "taking on a good advisor" and following the "seven point" recipe to success, as suggested by Rod, then why on earth haven't the vast majority done it? The answer is quite simple - they understand the principles of marginal milk production. **The margin for all standard litres or kilograms of milk solids is not the same**. A similar simplistic approach is to assume that maximum pasture consumption will always achieve maximum profit - it is not necessarily the case if the last tonne of pasture cost 5 times more than the previous 10 tonnes!

There has also been a great deal written about "diluting the overheads of your farm with increased production". These overhead costs include debt, living, rates etc., which must be paid regardless of how much milk is produced. Again, the theory is fine. The more milk from more cows will spread these overhead costs. **<u>But</u>** what these articles have failed to highlight is that this will only occur if the increased production is in itself profitable, and, in many cases, the risk involved if it doesn't work is not adequately highlighted.

Let's consider the example in the last edition of the *Dairy Farmer*, where the shift from 4500 litre cows in an "unstainable system" to the "sustainable input" 8000 litre cows was recommended to dilute our core costs. The costs per cow increased from $985 to $1750 an increase of $765 per cow. At 30 cents per litre, a production increase of 2550 litres to 7050 litres is required to simply break even. When the level of risk in the project is considered, most people would want a 20 percent return on the investment, so we now need 7560 litres at 30 cents per litre. If we get it about 75% correct (which wasn't a bad effort when I went to school) then don't be too concerned

- we've only gone backwards $191 per cow or $57,300 for a 300 cow herd. There's no room for error on marginal milk.

I do not wish to come across as negative, just realistic. It can work and it does work for some people but there are risks, and changes to the system and risk profile of the business must be considered.

The dairy farmers who have grown assets over the years have considered all options, evaluated the risks involved and built a business profile that suited their business and personal objectives. Consider the following dryland dairy farm profiles from 2003/2004 client data:

	"Secures"	**"Crackers"**
Stocking Rate	2.1	2.9
Solids per cow	429	557
Litres per cow	5593	7293
Grain fed per cow (tonnes)	0.88	1.80
% energy imported	25%	42%
Pasture consumed T/ha	7.6	11.0
Operating Surplus/cow*	$808	$1123
Operating Surplus/milking ha*	$1697	$3256
Earnings before interest and tax/cow	$450	$502
Earnings before interest and tax/ha	$945	$1456
Percentage of income on production costs	50%	51%
Cash costs per cow	802	1150
Equity %	55%	39%

*Operating Surplus = Milk and stock income less production costs (herd, shed, feed, overheads, labour) but not debt, personals, tax, or capital.

These two farms highlight that there is no "wrong or right" system; it's about people, skills, farms, facilities, and finances. Both farms are high performing **sustainable, viable,** dairyfarms with quite different risk profiles. The "Secures" are not prepared to risk higher expenses to possibly generate higher profits - hence their costs per cow are lower. The "Crackers" business has a higher risk profile in relation to low equity, higher dependence on imported feed, and higher cash costs per cow. The "Crackers" risk an additional $348 per cow of expenses but in their case it generates extra income of $663 per cow resulting in an additional surplus per cow of $315 per cow. Debt has been a great motivator for the "Crackers". They know that the extra production must be done profitably; otherwise they will be under even more financial pressure. The "Crackers" don't have huge cows or huge heifers and their cows don't calve over score 5!

Another observation is that I have never seen anyone be successful in a "Cracker" position until they have successfully done a few years as "Secures". You can't swim in the Olympics until you've done the work locally! In fact, one of the causes of the financial pain in the dairy industry is that too many people have "purchased" the Crackers' production but with no increase in profit or operating surplus. For example, a farmer decides that "we are going to crank the production up" and take some cows producing 400 kg solids (because it's solids you actually get paid for!) to a higher production level. This will be done by using more nitrogen, pasture renovation, lead

feeding, extra grain and hay at a total additional expense of $371 per cow. The farmer **must** get an extra 96 kg of milk solids per cow at a milk price of $3.85 per kg just to hold margin!

All this sounds obvious, but when the changes are gradual the risks being taken are not apparent until the total impact of the changes is appreciated, such as when milk price declines. The profitability of the extra milk depends critically on the milk price and supplement price ratios. The year it's extremely profitable, then the profit can probably fund the son and daughter-in-law returning to work on the farm - as long as we know what to do in the years when it's not so profitable! It's the reality in the Dairy Industry that it's a high risk industry and the level of risk increases as you try to maximise return on assets or business profit by increasing stocking rate or level of inputs. This is fine if you are fully aware of this but a rude awakening if you are not.

It is interesting to note the recent ABARE Dairy Farm Performance Study commissioned by Dairy Australia across 300 Australian farms. The results indicated that milk production per hectare was a significant factor with the most profitable farms milking more cows per hectare and producing more milk per cow. It was particularly interesting that the top 25% of seasonal herds had an average production per cow of 5600 litres and fed 1.410 tonne per cow. In all year round calving herds the figures were 6100 litres and 1.86 tonne per cow. So top **milk production per cow certainly does not ensure top profit.**

I would argue that all dairy businesses should know the following, but the higher the level of inputs and number of cows milked on the farm, then the more critical it is to know:

- The operating surplus per cow or per hectare last year.
- The proportion of feed being imported of total feed consumed.
- Debt servicing per cow or per hectare and as percentage of income.
- What percentage of your business you own - your equity

This information combines the physical and financial profile of your business and the level of risk when the external environment moves against you! These will be discussed more in the next edition of the *Dairy Farmer*.

John Mulvany
Director, ONFARM Consulting Victoria.