Herd owning sharemilking agreement (50/50 Sharemilking)

Description

The sharemilker supplies the herd and operates the farm on behalf of the farm owner, the sharemilker receives 50% of milk income and all money from the sale of livestock.

Under a herd owning sharemilking agreement, the sharemilker traditionally received 50% of payout. Herd owning arrangements can range between 40 and 60% of milk price and the dividend may or may not be included in the sharing of income.

How it works

Agreements between farm owners and sharemilkers are governed by the Sharemilking Agreements Act 1937 or Sharemilking Orders made under that Act.

A herd owning agreement typically agrees:

- The farm owner provides land, infrastructure, fertiliser
- Sharemilker provides cows, labour, machinery, fuel, power
- Shared costs can include: grazing, nitrogen, supplements, feed, water
- Sharemilker carries out all farm work or employs labour at their cost to do so
- There is a contract between two parties and details can be altered by mutual consent

Background

Herd owning sharemilkers have historically made a greater return on equity invested than farm owners, albeit while accepting more risk. Between 2013 and 2015, HOSMs achieved average returns of 12.3% compared to 3.2% for a farm owner with HOSM. This higher return reflects the greater risk HOSMs carry with a higher proportion of farm working costs to revenue, less capital as security and significant shifts in asset value from year to year.

It is important to note that no two HOSM positions are equal. Some farms have excellent infrastructure, good contour and productive pasture resulting in a much lower cost of production for the sharemilker. Other farms can be more challenging with a higher labour demand and greater supplement use resulting in higher farm working costs for the sharemilker.

The standard Federated Farmers herd owning sharemilker (HOSM) agreement allows for the percentage share of the milk income to be negotiated.

Advantages and considerations

Advantages

- Can increase the financial returns for a well set-up and productive dairy farm owner.
- Potential for high earning for the sharemilker
- Allows farm owner to step back
- More 'skin in the game' for the sharemilker as they own the cows
- Ability for sharemilker to increase stock numbers
- Experienced operator in charge of farm operation.

Considerations

- It is very important that a detailed budget is completed by both parties to understand the viability before making a decision
- Farm owners must understand that not all farms are equal
- Higher equity required (than for land) from the sharemilker and bigger swings in profit volatility
- Need clear agreement on who will cover what costs, especially bought-in feed and maintain soil fertility etc.
- An HOSM is an independent contractor and not an employee with protections under employment law if disputes occur.
- When going through the contract it is critical you are very clear about what you are responsible for and under what circumstances.
- Volatility in milk payments, production shortfalls, and cost blowouts will impact on the profitability of each party.

Keys to success

- Each party knowing their obligations and responsibilities will enable the relationship to run as smoothly as possible.
- Given the importance of budgeting in negotiating a viable contract for both parties, getting professional advice on this is recommended.
- Following a process of due diligence before signing agreements will help improve likelihood of success for both parties.
- A thriving business relationship between two parties is likely to be one where goals and values have been shared and are fairly well aligned.

Financial

Drivers

The key drivers for the herd owning sharemilker are the cash returns from their business, and the ability to build equity through herd ownership.

Equity required

Equity requirements for purchasing livestock are higher than those for farm land. Livestock assets averaged $814,000 between 2011 and 2016 for an average NZ HOSM. Equity of a minimum of $500,000 is likely.

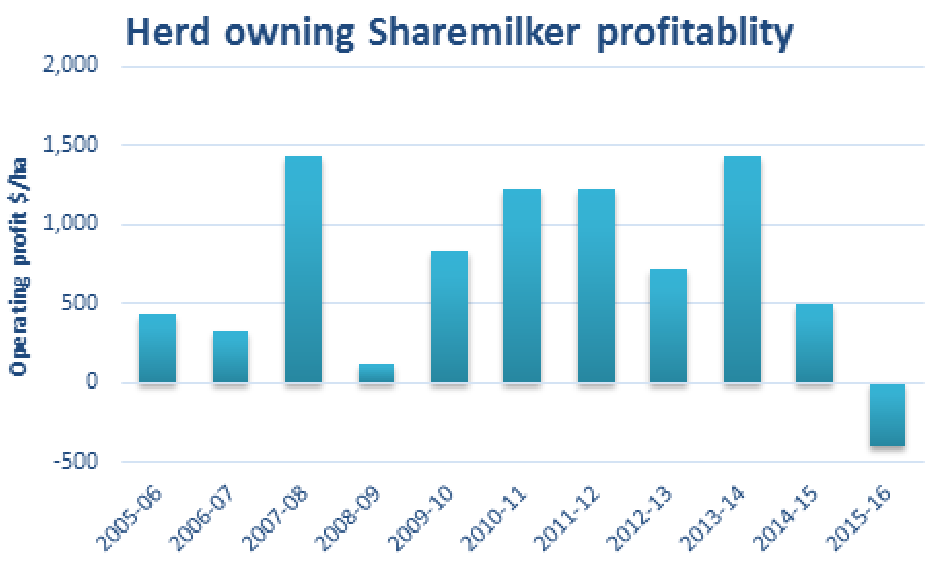
Financial returns

Profitability of HOSM roles varies depending on livestock values. Below are examples of cash surplus for an HOSM and Farm Owner with a $6 milk price and a snapshot of profitability per hectare from the Economic Survey.

Example	
Production	150,000 kgMS
Milk price	$6/kgMS
Milk income	$900,000
Stock income	$80,000

50:50	
Sharemilker receives	$530,000
Farm working expenses	$330,000 ($2.20/kgMS)
Cash operating surplus	**$200,000**

Farm owner receives	$450,000
Farm working expenses	$270,000 ($1.80/kgMS)
Cash operating surplus	**$180,000**



How easy is it to enter/exit agreements

- Contracts are for a given term with a simple and proven entry and exit process.
- Timing of entry and exit is critical for HOSM due to fluctuating livestock values. This can seriously erode equity for the HOSM.