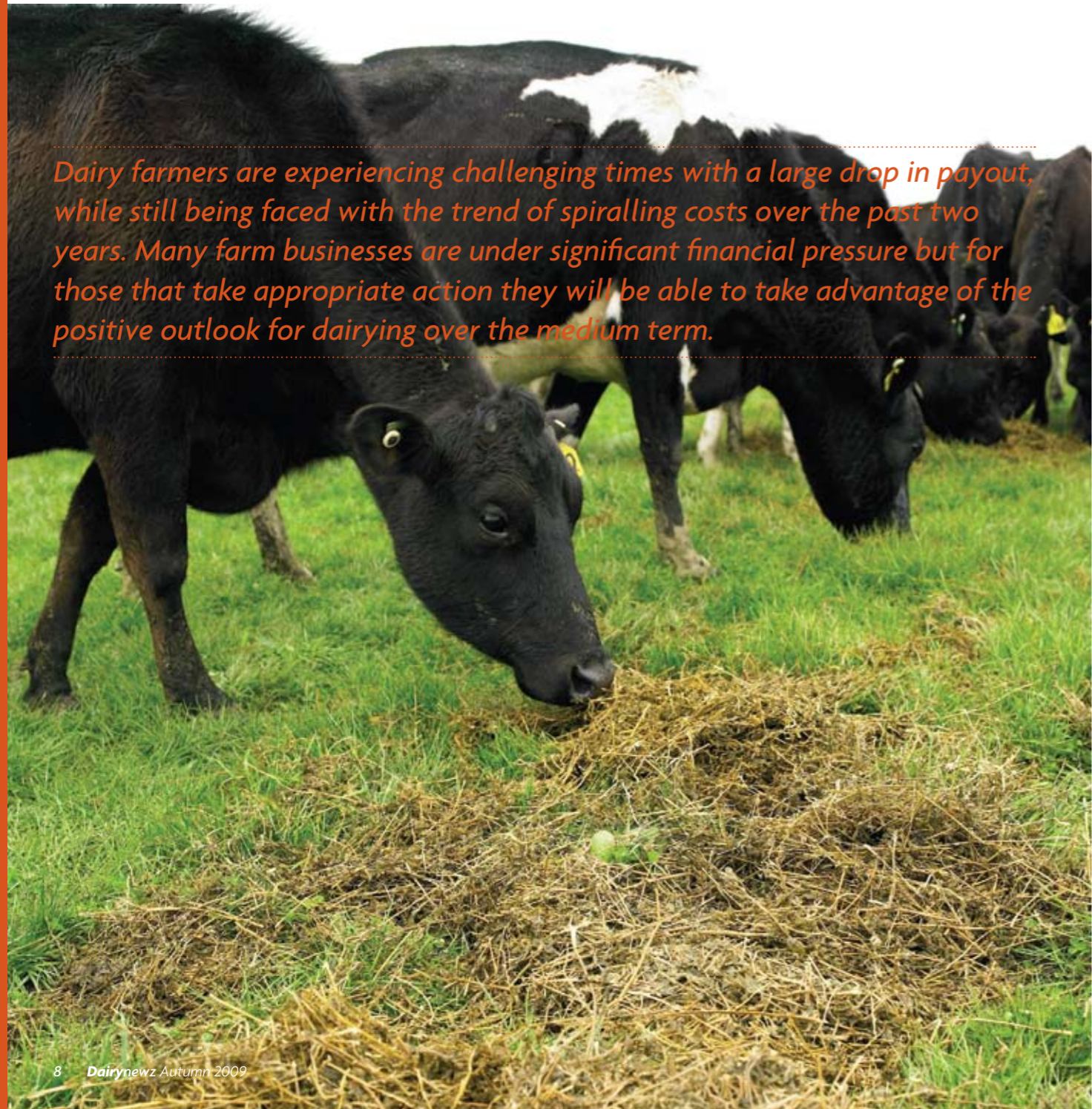


# Taking action in challenging times

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*Dairy farmers are experiencing challenging times with a large drop in payout, while still being faced with the trend of spiralling costs over the past two years. Many farm businesses are under significant financial pressure but for those that take appropriate action they will be able to take advantage of the positive outlook for dairying over the medium term.*



## Summary

- Take action now and have a plan
- Take stock of your financial situation
- Review your farm system. Can policy changes significantly increase your profit?
- Face your current reality – know your financial position and forecast budget
- Consider the implications of increased milk production on share ownership
- Zero budget – price out each item of expenditure – start with the big items of expenditure
- Talk to your bank manager about managing your debt and cash flow
- Use a team to help decide on the best course of action. Call on farmers and professionals you respect
- Remember this is only a short term blip in a longer term positive dairy market

These fluctuating cycles are common within the dairy industry, so it is opportune to look back and remember lessons we have learned before.

## Take action now and have a plan

Reassess your medium to long term goals. This is a good time to reassess where you, your family and your business are heading in the future. Farmers with clear five to ten year goals tend to take action in a decisive and timely fashion, because they know if they don't, the achievement of their goals can become impossible. Without a clear picture of what you want in your life, it is easier to just drift along, and be buffeted about by this current economic storm.

There are some farmers that will take the appropriate action, while others will be too slow to respond. This is the biggest lesson I learned following our last "high" payout of around \$5 several years ago. When payout dropped, the proactive farmers reassessed their farming systems, and dramatically reduced expenditure. However a large number of farmers kept on farming as if they were going to receive the high payout, and they were six months behind in making changes. They continued with high cost systems, even when they were going to receive a much lower payout. The proactive farmers cut their costs to match the lower payout. Taking action early gives you more options. Here are some suggested "must do" actions you might want to take at a lower payout:



*Irish dairy farmer and businessman Michael Murphy is positive about the long term future of the dairy industry.*

## Take stock of your financial situation

What cash surplus do you need to service your debt, living and tax? What farm system will generate this surplus? Once you have had a good look at your farm system, then drill down and do a zero budget to make sure this cash is delivered.

## Review your farm systems

Do you need to make some changes in strategy on your farm? Everyone will be saying that we need to cut costs. But how do we actually do this?

We can trim a few dollars off the bills here and there. This will not be enough to balance the budget. Instead you need to think strategically about the farm system you are operating.

Think about how we used to farm when cost of production was low. We ran our farms to match the pasture growth curve, and the cows worked for us. At lower payouts, which is more profitable? Farming the pasture growth curve or farming for production? If you run a medium to high input farm could you drop costs by running a lower stocking rate, resulting in less production, but lowered feed costs and lowered financing costs for buying more shares? Could you alter your system and winter more cows at home, minimising high winter grazing costs? The more pasture you utilise directly with cows, the less costs of harvesting surplus grass, and the more effectively you need to use drying off and culling to match feed supply.

Have a good think about your farm system, or get a good team of your professionals and friends around you to look at how you are operating the farm. Get back to the basics of a strong cash flow business.

#### Ensure you are up to date with your share ownership situation

Shares for any increased production this season will need to be purchased at \$5.57 and then that shareholding will reduce in value to an estimated \$4.47 per share next season. Calculate the economics if you are on track for producing more than last season. If you are producing milk economically from pasture for less than \$2/kg MS then it makes sense. But if you are spending a lot of money on supplements to produce the milk, and then also need to take the hit on dropping share values then you need to question the economics. The reduced share value is a disincentive for additional production.

#### Know your current and projected financial position

Update your budget and cash flow, and get working on that calculator. Make some revisions. Use DairyBase, your accountant or banker, to help determine the current efficiency of your farm. Some important figures you should know are:

- operating profit/ha
- operating expenses/ha
- pasture eaten/ha.

You should know your own farms figure historically and into the future, and if you are above or below average in your region.

Build your budget up from a zero basis. Price out each item of expenditure. Don't just look back at last years expenditure and copy that. Start by focusing on the big items of expenditure:

- Can you justify your current feed inputs? A handy rule of thumb is to pay a maximum of 5% of payout per kgDM for feed. At a payout of \$5.00 /kg MS, this means a maximum of 25 cents per kgDM for supplements.
- Can you renegotiate any of your existing grazing contracts – while still honouring your agreements and retaining integrity? There is a great need throughout our industry to sensibly manage costs down after a period of very high on farm cost increases.
- Is there room to trim your fertiliser application – is it in line with production, have applications been reduced on effluent areas or front sections of paddocks? Review nitrogen applications – are they giving you an economical response?
- Can your planned capital expenditure be reduced?
- Review your provisional tax payments with your accountant, given volatile payout, share values and stock prices.
- Look at your personal drawings. The average drawings for a farm owner is \$80,000 and \$65,000 for a sharemilker. If you are not achieving your financial goals this is an area that may need to be trimmed back.

- Keep in touch with your banker, and keep them informed of your financial situation and future lending requirements. They too need to plan their funding needs, and banks are less likely to have funds lying around waiting for your last minute overdraft extensions.
- Putting your cheque book away and freezing your credit card in an icecream container full of water might be useful. By the time it has defrosted, you have had time to think – do you really need this?

#### Talk to your bank manager about the structure of your debt

Maintain a good and honest relationship with your bank – underpromise and overdeliver. Banks are experiencing challenges themselves with availability of funds. For some people it is worth breaking fixed interest rate loans, to take advantage of dropping interest rates. As the banks are saying, this is on a case by case basis, so discuss your case with your bank manager. Many banks are recommending fixing interest rates some time in the first half of 2009. Other farmers will need to work with the bank on how to manage shortfalls, which may include capitalising some losses.

#### Go and visit several low cost producers

Do this by yourself or organise a small group to go and really listen to their key low cost principles. Get back in touch quickly with low cost farming, instead of arguing or justifying that you are already as low cost as you can be.

#### Autumn feed management

Are you a “demand management” or “supply management” farmer? In times of higher payout New Zealand farmers now automatically get into the habit of supply management. As feed supply gets shorter in the autumn, they add to the supply.

Instead this autumn, with lower payouts, remember demand management – cut demand rather than write a cheque to add to the feed supply. Get the culls away early, dry off the younger and thin cows, consider milking once a day. Is late autumn milk production profitable or are you better to dry off earlier? Get back to the basic great farming principles – good quality cows, farmed at an appropriate stocking rate, utilising a high proportion of pasture and turning this directly into milk. If you are using supplements, use them strategically and ensure that wastage is minimised.

#### Keep in touch with your key friends and professionals

It is useful to maintain contact with your bankers and other professionals and friends who have a good idea of what is happening all around. They can help you keep problems in perspective, help with great suggestions or be a good sounding board.

#### This too shall pass

And when it is getting really frustrating or demoralising... remember that “this too shall pass...” I recently spoke to leading Irish dairy farmer and businessman Michael Murphy, who was among the first to predict the last cycle of high payouts. Mike reminded me that this is just one of the many blips we will experience in what he believes will be a long term structural commodity bull (rising) market, extending from 2000 until perhaps 2030.

Between 1955 and 2006 prices for food commodities declined in real terms by 75%. In 2007 relatively small shortages led to strong price increases. However for the last 12 months almost all the price gains have been lost. Mike believes this is a temporary drop,

and the trend of stronger commodity prices will return within the next 3 to 5 years.

Food supply over the last 12 months responded to strong prices increases, and demand has been hit by probably the worst economic recession for 70 years. However the world will need to produce about 60% more food by 2050. Food demand is being driven upwards by increased population, increased affluence, changing eating habits and competition between food and energy for land use. This will be perhaps the greatest challenge ever faced by humankind. Inevitably this will lead to strong upward pressure on food prices overtime, which will be great news for grass-based dairy farmers, but difficulties for humankind.

Mike's advice is to manage yourself well with good sleep and exercise to mentally handle these challenging times, and to focus on developing strong business principles. “What I have noticed over the 4 or 5 cycles of up and down dairy prices over the past 25 years is that great opportunities arise out of downturns for strong solid business with a good financial base. Ensure you have a strong core business, based on superb principles of harvesting pastures through high genetic merit cows, which will turn this pasture into milk, and earning more money than you spend, therefore generating a strong cash flow and profit. With these core principles strongly established, you can be responsive to the continual changes that exist in a cyclical commodity business. This is only a short term blip, in a longer term positive market for the dairy industry.”

