ON-FARM STRATEGIES UNDER A LOW DAIRY PAYOUT

Dairy famers are now gearing up for their third low payout season. This article studies the focus of farmers, and how changes affect the viability and sustainability of the dairy farm.

WAIKATO RESPONSE

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When you reflect on how farmers have developed businesses over the last decade, and the recent responses we have seen heading into the third year of a challenging milk price, I suspect it presents a perfect study into rational economic behaviour.

Capital gain and budgeting

An environment that has presented tax-free capital gain opportunities means these will be chased. The shift to interest-only loans in the mid-1990s saw the previous principal payments capitalised into land value. The integration of supplementary feeding has allowed significant improvements in output per hectare and per cow and these too have been capitalised into land values.

In a similar cause and effect scenario, reasonable payouts and little accuracy in opening milk price forecasts meant that until two years ago the level of detailed on-farm financial budgeting was modest at best. Many of those budgets that were being done were often prepared by bankers with little ownership by farmers.

We have seen improvements in both the number of farmers actively budgeting and also in the accuracy of those budgets. However **Figures 1** and **2** highlight how variable the milk price is over the budgeting period. The first formal indication on expected milk price for the coming season is typically published in late May when draft budgets are being completed in March-April. **Figure 2** records the percentage change in the final milk price from the opening forecast.

These imprecise forecasts have tended to result in budgets that have been coarse in nature. Until very recently, many budgets were largely a roll-over exercise from the previous year. We are starting to see evidence of more 'blank sheet' budgeting, with increased scrutiny of every line item, although it is still not as common as might be expected.

Figure 1: Change in opening forecast and final milk price

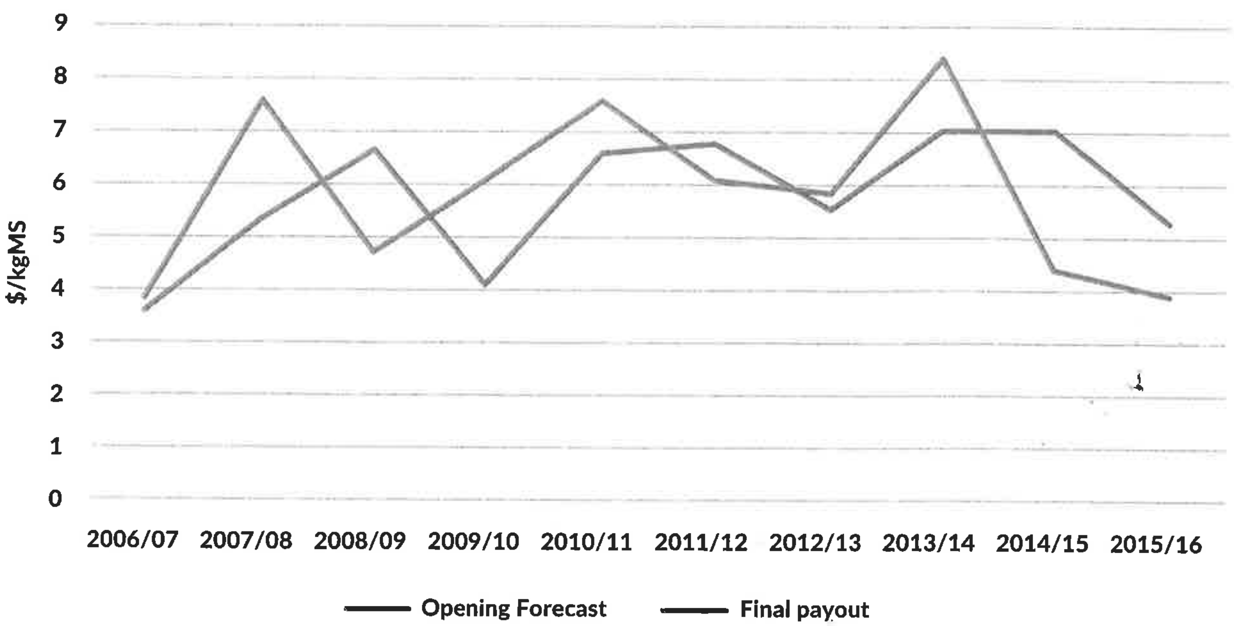

Figure 2: Percentage change in final milk price from opening forecast

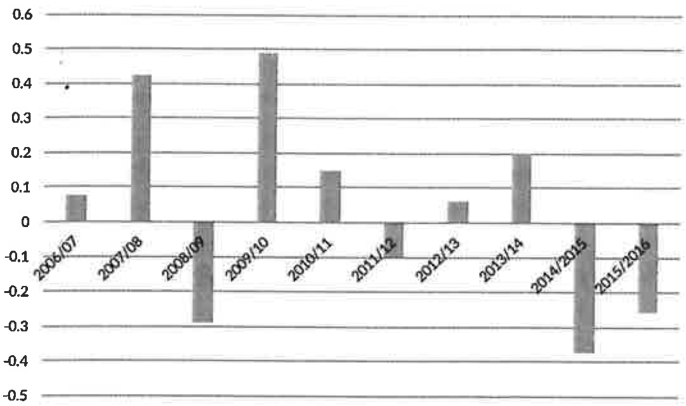

Table 1: Key variables from the AgFirst farm monitoring reports

	2013/14	2014/15	2015/16	2016/17 budget
Stocking rate	2.9	2.8	2.8	2.6
Kg MS/ha	1,023	1,060	1,020	1,010
Kg MS/cow	361	383	369	382
Net cash income $/kgMS	$7.90	$6.12	$4.09	$4.54
Expenses ($/kgMS)				
Animal health	$0.28	$0.25	$0.23	$0.22
Breeding	$0.16	$0.15	$0.13	$0.13
Feed including crops and grazing	$1.42	$1.27	$0.98	$0.98
Fertiliser	$0.43	$0.33	$0.38	$0.30
Repairs and maintenance	$0.33	$0.29	$0.24	$0.21
Overheads	$0.60	$0.41	$0.45	$0.43
Total farm working expenses	$4.54	$3.96	$3.63	$3.48
Interest	$1.04	$1.21	$1.24	$1.26
Net cash position ($/kgMS)	-0.18	-$0.10	-$1.22	-$0.56

On-farm decisions

This lack of clarity around the milk price prospects at the start of the season results in adjustments in input decisions as the season progresses, rather than a fully planned approach at the start of the season. This changing of the plans is impacting not just the dairy farmer, but a raft of suppliers to the dairy industry. Commercial growers of maize and fodder beet are increasingly gun-shy after bad experiences with cancelled orders.

The separation of farmers from direct market signals remains an issue for making finely-tuned on-farm decisions. At the time of writing, European stocks of skim milk powder (SMP) in storage were at 307,000 tonnes. The area planted in maize in the United States is the third largest planting since the 1940s and 7% up on last year. There appear to be few avenues for farmers to access interpretation of these macro influences on milk supply and demand trends as they try and make their own judgement calls on where payouts might end up.

Translation to on-farm changes

AgFirst has prepared a farm monitoring report for the Waikato/Bay of Plenty region for several years, with a Southland report prepared over the last two years as well. Participating farmers are not all AgFirst clients and the objective is to have a random sample that mirrors the Waikato average. **Table 1** details some of the key trends. Over this period term liabilities have increased from $16.20/kgMS to a forecast $21.45/kgMS in the 2016/17 season.

We did see increased spend on environmental mitigations, such as ugraded effluent systems and fencing of waterways, along with increased repairs and maintenance spending up until the 2014/15 season. This has significantly reduced over the last three years and is starting to show in the state of some farm infrastructure such as races. This maintenance can only be deferred so long before we see lifts in lameness etc.

The fertiliser spend has seen a reduced input of phosphate and an increase in nitrogen. While there was a soil fertility bank on many farms that could be exploited, it will have to be monitored carefully to ensure soil reserves are not depleted to the point where we see reduced pasture productivity.

The 2015/16 production season started with challenging spring conditions, with many farms falling below production expectations. Cash flow positions meant that despite a forecast El Nino drought, there did not appear to be any increase in on-farm cropping. As it turned out, we finished with a strong summer over much of the Waikato.

There is no doubt that stocking rates have eased back in response to reduced supplementary feed inputs. It is probable there will be a further easing as the impacts of the difficult facial eczema season become apparent post-calving.

I believe we are also seeing a firming of grazing residuals and rediscovery of what a 1,600kgDM/ha grazing residual really is. Supplements are being integrated with greater awareness of the linkage of response rate to the level of feeding.

Blank sheet budgeting is making a comeback, with a realisation that virtually all inputs have a marginal return. While there may have been a margin at $8 kgMS at current milk prices, no such assumption can be made now.

Longer term, the industry will have to accept and address the increased fixed cost in terms of interest through higher debt levels that the last three years have meant, as well as the deferred on-farm maintenance.