Don't settle for narrow margins

Small changes can make a bi g difference to dairy margins

After the euphoria of 12 months ago when milk prices increased dramatically, the honeymoon period has ground to a halt during the past six months as input costs have shot upwards. After a taste of improved margins, dairy margin forecasts are looking slimmer.

Nigel Davies: "Producers should do anything in their power to increase current margins"

Although wheat prices have fallen recently, by late summer the reality of higher input prices had set in. Winter feed and fertiliser costs are likely to be higher than they were a year ago. "The net effect is tighter margins compared to 2007," says Mr Davies, regional agriculture manager for HSBC in Wales and The Marches.

"Looking ahead, for a typical 170-cow herd, we are forecasting a margin of 1.93ppl compared with a forecast of 2.76ppl 12 months ago. At present levels of expectation, projected margins are unlikely to deliver sufficient surpluses for the average producer to make investment decisions with any confidence."

Figures published in the latest HSBC Forward Planning booklet for 2009 bases its forecasts on a 170-cow herd averaging 7,000 litres. Mr Davies admits that there are many herds with higher yields and selling a lot more milk, but he sees the same input cost and margin trends affecting all producers.

"Producers should try to do anything in their power to widen the current margins," he says. "For a committed and progressive producer the margin needs to be at least 3ppl – more if it's possible. This is the amount needed for proper re-investment and for improving the efficiency of future production.

"Many producers have worked really hard over a number of years to increase margins and the biggest potential for continued change will come from making small improvements in all areas of business activity rather than making one radical change."

For a typical 170-cow herd, the combined effect of an increase in the milk price achieved of 1ppl, a reduction in concentrate use of 0.05kg per litre, a £10 per tonne reduction in feed cost and a 10% reduction in overheads would increase the margin by 3.12ppl, equivalent to an extra annual profit of £37,000.

Skills required

"Making this all happen is inevitably down to the manager – it's the manager who will have the biggest single effect on improving margins," adds Mr Davies.

Improving the margins to the required level for a sustainable, progressive business will require good business planning. The first step is a clear knowledge of the existing efficiency of the business and this involves far more details than simple dairy herd costings.

"I would guess that only 25% of producers currently have full farm management accounts," says Mr Davies. "There are certainly not enough businesses who know how they fair after labour, depreciation and all fixed costs are accounted for. It is very difficult for these businesses to make informed decisions. More detailed accounts provide far more clarity and a far better idea of the margins that are likely."

Cash availability

More detailed costings will give producers an idea of the extra cash they will need to run their business as they account for higher inputs. "Almost all businesses will need more cash to do the same things this year that they did a year ago. Cows, feed and fertiliser are all required to operate the business and these are all more expensive than they were a year ago.

In many cases this additional cash will come from borrowed money and it's important to know if and how a loan can be serviced. HSBC projects the increase needed in the working capital – the cash – for a typical producer to increase by 23% in the 2009/10 quota year compared with 2008/09.

"Borrowing requirements for many producers will increase," adds Mr Davies. "but this isn't necessarily a bad thing if businesses are retaining more profit from higher milk prices compared with the past year.

"If, however, borrowing is increasing but net income isn't, then the situation merits concern and investigation – and this is why planning and developing a better understanding of the business is so important – producers must understand what higher input costs mean in terms of cash required."

Future profits

All farm businesses need a level of re-investment and after many years of limited re-investment, many in the dairy sector will need to look at making up lost ground in terms of efficiency.

"There's only so much you can squeeze out of the system before you need to put more in to secure future profits," adds Mr Davies. "We're not talking about the 'nice to haves', but improvements in efficiency that allow a business to move on."

Karen Wright

Five steps in planning

- Have full business costings for planning purposes.
- Know dairy margins now and the forecast for the next 12 months. Make changes to improve these.
- Know the extra cash required to operate business this year compared to last.
- Plan re-investments to progress business and improve efficiency.
- Always plan and always monitor performance. Businesses evolve and plans need to be reviewed – it's not a once-a-year chore.

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