Pathways to successful farm businesses

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Pathways to successful farm businesses

Presentation outline:

• A brief overview of the Australian dairy industry and our competitive position in the world
• Australian dairy farm profitability
• Australian production systems
• Characteristics of successful farm businesses

Distribution of Australian milk production

Source: Dairy Australia
Investment, Innovation, Opportunity

Australian Dairy Farm Investment Forum 2014

Measures of farm financial performance

Profit
• Operating profit (EBIT)
• Return on Capital (with and without capital appreciation)
• Net cash surplus
• Capital appreciation
• Equity growth

Risk
• Debt:Equity
• Cost of production (with and without the cost of capital)
• Operating profit margin

Australia’s farm sector competitive advantage

Australia does not have (by world standards) cheap:
• Labour
• Energy (electricity & oil)
• Grain
• Interest rates
• Other cost structures

Despite this (and the challenges of the past decade) we remain one of the world’s largest dairy exporters:
• Cheap land relative to its productive capacity
• Grain and fodder that is competitively priced and in plentiful supply
• Temperate (mostly) oceanic climate that allows:
  o Growth of good quality pastures suitable for grazing
  o Grazing of cows ‘every’ day of the year without the need for expensive housing infrastructure, machinery and labour inputs
Australia's farm sector competitive advantage

High performing well managed pastures combined with judicial use of supplements allows farmers to:

- Produce milk at a low cost of production
- Make efficient use of capital
- Run profitable farms across a wide range of supply curves to meet the processors needs

In addition to milk processor interaction ...

The south eastern Australian milk processing sector:

- Balanced market portfolio – domestic/export and ingredient/retail
- Caters for all types of production curves - seasonal (NZ style) to flat (US)
- Provides flexibility in terms of seasonal pricing structures
- Will buy every litre of milk – on every day of the year, from every farm
- World class food safety
- World class product quality
- Not constrained by capital

World's best dairy data

Dairy Industry Farm Monitor Project (DIFMP)

- Eight year partnership between Dairy Australia and the Victorian government (DEPI) to collect 75 full sets of farm physical and financial data from across Victoria
- Expanded this year to include 300 full sets of data from across Australia

DairyBase

- Currently in development, will initially house all DIFMP data collected to-date
- Aim to become the repository for all farm financial data sets (including consultants and accountants)
- Will provide a world's best practice farm business analysis system
Returns Australian farms are generating

- High performing farm businesses are seen in every region
- Does not include capital appreciation (2-3% adjusted for inflation)

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Source: *DIFMP data **Tasmanian Dairy business of the Year Awards data

How do Australian Production systems compare to the other key dairy regions?

Source: IFCN/Xcheque Pty Ltd
Best production system for Australian conditions

Australian dairy systems range from:

- Intensive grazing with >80% of feed as grazed pastures
- Intensive feeding with >80% of purchased supplements or conserved fodder
- More intensive feeding systems are used to extract more from the milk price schedules (flatter curves) … but increase the operating cost of production

Why do Australian dairy farmers supplement cows grazing pasture?

- More intensive feeding systems make more efficient use of capital (more saleable product sold per $ invested)
- Similar RoC are observed when grazed pasture constitutes 40-80% of the feed intake of the whole farm
- Australian seasonal conditions are more variable than New Zealand … however we have an ‘endless’ supply of locally produced concentrates, fodder and by-products
Does size make a difference?

- Yes it does ... but only for farms producing <120,000 kgMS (approximately 250 cows)
- Above this level the relationship between increasing herd size and return on capital is weak
- Larger farms require more ‘operational’ expertise
- Intensive feeding systems require more expertise

Key characteristics of the higher performing Australian farms

- High level of operational skill (with skin in the game)
- Combining a strong balance sheet with drive (usually means two generations)
- Owner operator(s) providing >30% of labour and performing most overhead tasks
- 400-800 cows (200,000-500,000 kgMS)
- 450-550 kgMS/cow
- High performing pastures and cost efficient feeding systems
- High labour efficiency
- Strong focus on cost control
- Understand their farm business and are consistent in their approach to farming

Source: Victorian dairy industry milk supply trends: Analysis of the drivers of farm profit
Investing in dairy farm businesses – pitfalls to avoid

- Timing of entry/major stakes at the wrong stage of the price cycle
- High overhead cost structures – impose corporate management structures
- Herd size too big and/or grown too quickly
- Sub optimal production systems:
  - Focussed on low cost as opposed to low cost of production
  - Focussed on production without insufficient input cost consideration – more milk is not always more profitable
- Short-term focus on returns
- Reaction when performing below expectations

How do corporate ownership structures replicate successful existing businesses?

- Replicate family farming businesses
- Partner with local management expertise and allow managers to accumulate assets
- Low overhead costs structures
- Production systems that pass the local sensibility test (i.e. are the results being achieved on similar farms?)
- Incorporate local technical expertise
- Flexible long-term view of returns – equity or flexible lease, not loans
- Not imposing onerous reporting requirements, focus on key indicators
- Start with the end point in mind e.g. exit strategies, staged management buy out
- Utilise their current in-house agribusiness support services and management structures