British Dairying
December 2016
Nigel Davies

Longer term view needed to rebuild profits

The latest results from the Promar Farm Business Accounts service highlight the extent of the impact of lower milk prices and give an indication of the hurdles to rebuilding the financial position in the future.

Dairy farmers were warned it will take more than the current increases in milk prices to rebuild dairy farm finances and they need to continue to review every facet of their business.

Announcing the results of the analysis of company's Farm Business Accounts (FBA) to March 2016, Promar national consultancy manager Nigel Davies says the results show the extent of the milk downturn and the challenges that all businesses have faced, as well as how farmers have reacted and the decisions they have taken.

"The FBA results give the most in depth analysis of dairy farm profitability and financial structures," Mr Davies comments. "They are based on the aggregate results of hundreds of farms across the country with full physical and financial recording. This gives a unique insight into the financial performance of dairy farms."

Results to March 2016

Not unexpectedly, in the year to March 2016, milk price was a particularly dominant factor and many farmers sought to reduce costs wherever possible.

The physical make-up of the dairy businesses in the sample stayed relatively constant, with small increases in herd size and milk yield per cow being achieved alongside continued gains in technical efficiency with concentrate use per litre continuing to decrease.

"When we look at a matched sample of FBA farms from 2014/15 and 2015/16 it is possible to see the impact of milk prices and the farmers' reaction to them (table 1). Output has decreased significantly compared to previous years leading to reduced profits.

"Farmers have responded by looking to make economies in all cost areas and identifying efficiencies to try and drive down expenditure. Variable costs remain 49% of output so gross margins continue to be 51% of output, reflecting the level of technical efficiency. Farmers in the sample have continued to improve dairy herd performance and technical efficiency.

"Looking at overhead costs, these have reduced by around £12,000 but still remain 29% of output. The main area of economy has been in power and machinery charges.

"One area where fewer reductions have been made is in depreciation and rent and interest. Many of these costs are set for several years and reflect decisions made before the last milk year. They have increased in both financial and percentage terms.

"The combined impact is that profits have fallen from £65,647 in 2014/15 to £48,026 this year."

Mr Davies says that where farmers have made most significant and dramatic changes is in reducing their discretionary non-trading capital expenditure, with a 34% reduction in capital investment and a 10% cut in private drawings.

"Investment in machinery and in buildings both fell on average by £11,500 while £10,000 less was spent on fixtures. In the context of the expenditure in previous years and of the ongoing capital expenditure required on many dairy farms, these are very significant numbers.

"However, despite these considerable economies and responses, the average farm in the sample remains cash negative with the funds generated from trading being inadequate to cover total financial commitments. This has resulted in an increase in overall farm borrowings. It is also worth noting that this debt is increasingly being structured over a longer term.

Irrespective of this average cash deficit, the average level of new loans taken on by the farms in the sample in 2015/16 was £96,000. It has to be questionable how sustainable such a pattern is in the long term.

Future prospects

Using the 2016 accounts as a base to consider the prospects for 2017, Mr Davies says that while the milk price increases should be welcomed, they will not, on their own, lead to an immediate rebuilding of farm finances.

"Although milk prices are rising now, they are only in effect making up for lost ground compared to previous years. For the first six months of the current financial year, we have seen milk prices below the prices received in 2015/16 so it is probably only in the last six months of the milk year that prices will represent a real year on year increase."

With evidence of poorer quality forages on many farms and increasing feed prices largely as a consequence of exchange rate volatility in the light of the EU referendum result, Mr Davies says it is likely that on most farms

Continued…

dairy gross margins will probably only hold in this year. However, prospects should improve as we move into the next financial year.

"Increasing technical efficiency must remain high on the agenda and the focus on cost management has to remain a priority."

In the coming year, overhead costs are likely to be affected by increasing fuel prices and labour costs making it more challenging to implement further economies. At the same time, it's likely that wherever possible, farmers will continue to focus hard on a reduction in machinery and fixtures expenditure.

"A further impact on 2017 financial numbers will be the residual effect of historic decisions on cost structures such as loan repayments and depreciation. Capital expenditure decisions made in previous years will impact heavily on financial performance for several years to come affecting interest and loan repayments as well as depreciation. The economies made last year will take a while to work through fully to the reported financial bottom line, during which time the consequences of previous decisions will still have an impact."

Compared to last year?
(same farms - matched farm sample)

2014-15 (all £ per year)	Average	%	2015-16 (all £ per year)	Average	%
Gross Output	642,960	100	**Gross Output**	598,509	100
- Variable costs	313,767	49	- Variable costs	295,070	49
= Gross Margin	329,193	51	**= Gross Margin**	303,439	51
- Direct overheads	186,718	29	- Direct overheads	174,449	29
= Operating Profit	142,475	22	**= Operating Profit**	128,990	22
- Depreciation	39,339	6	- Depreciation	42,756	7
- Rent + interest	37,489	6	- Rent + interest	39,208	7
= PROFIT	65,647	10	**= PROFIT**	47,026	8
Less subsidies	32,069	5	Less subsidies	29,832	5
= PROFIT no subs	33,578	5.2	**= PROFIT no subs**	17,194	2.8

Mr Davies says it will be essential that farmers look further forward than the year to March 2017 when considering the rate and extent of a recovery in farm profits. "All the indicators are that the recovery will take time. Milk prices are recovering but margins this year will not surge ahead. But in 2017/18 we could see a more sustained recovery, especially if all opportunities are taken to hunt out efficiency gains to increase production and control costs.

"Overhead costs remain a concern with rising oil prices and financial uncertainty as a result of Brexit. Any increase in interest rate will be a concern.

"As the impact of reduced capital investment work their way through the system farms will see a reduction in loan repayments and depreciation, especially as the decisions of previous years run their course.

"Then we have the issue of support payments. These will be higher this year as a consequence of the improved £:€ exchange rate but beyond 2020 the prospects remain uncertain.

"The key will be to look forward at least three years as a minimum horizon when assessing future financial performance. A short-term horizon may be misleading. Farmers will need to skilfully plan and manage for both the long and short term.

"Farmers in the sample have reacted to the economic environment, continuing to pursue technical efficiency and taken tough decisions. Given the long-term nature of dairying and the ongoing residual effect of previous decisions on many components of their finances, then this twin strategy is undoubtedly an approach that they will continue to benefit from.

The best will plan ahead not just on the basis of this year's expectations, but also the years beyond and the associated twists and turns of volatility."

West Country Farmer
November 2016
Neil Adams

Dairy farmers in the Westcountry are being urged to identify and address the losses that eat away at their farm's profits

PICTURE: RICHARD AUSTIN

ADDRESS LOSSES TO IMPROVE PROFIT

Focussing on efficiency measures rather than cost-cutting should be the objective this winter, according to Neil Adams, newly-appointed Promar Regional Manager in the South and South West.

Managing the Promar consultancy business across the entire South West region, Neil says the last thing dairy farmers will want to be told is that they need to continue to focus on cost control, especially with rising prices.

Rather than focussing simply on looking for costs to cut, Neil says a more sustainable approach will be to identify and address the losses that eat away at a farm's profits. These losses are often hard to see and may include small items like silage waste, calf mortality, sub-clinical levels of disease, machinery failures and many other small items right across the farming operation. While addressing just one of these areas won't necessarily transform a business, finding marginal gains across a large number of areas will transform bottom line profitability.

"Activities that eats away at a farm's profit often cannot easily be attributed to a specific expenditure item," explained Mr Adams. "Mastitis and fertility are two obvious areas where a whole range of different costs will impact on performance.

"Cost control needs to be replaced with a philosophy of loss reduction on many dairy farms. In some instances, spending more will be more effective than spending less. For example, increasing the investment in heat detection."

He added: "In most cases poor financial performance is a symptom of underlying inefficiencies. For example high feed costs are, in most cases, symptomatic of poor forage quality.

"This winter, performance can be boosted by accurate feed analysis and balancing diets with ingredients selected on the basis of their relative feed value. However, in the long run, it is only by investing in growing and preserving high quality forage crops that performance will climb to the levels achieved by the best farms."

Mr Adams suggest the most effective way to continue to control expenditure while minimising the impact on productivity is to drill down into the areas of activity that cause losses in technical performance. Once these areas are identified and quantified, steps can be taken to bring about improvements and help reduce cost of production.

"Consider fertility," continued Mr Adams. "If reproductive performance is poor then annual milk yield will fall, culling rates will increase and all associated herd replacement costs will rise.

"Rather than cutting costs such as stopping the routine vet visit to examine cows not seen bulling and to carry out pregnancy diagnosis, it may be more cost efficient to use the vet proactively, retain the visits and reduce the net cost of poor fertility on the business."

Neil recommends following a methodical approach to identifying areas for attention, suggesting the starting point should be to ask everyone involved with managing the herd, including external advisors, for their thoughts to help build an initial picture of where losses might be occurring. He says more often than not people's hunches prove to be extraordinarily accurate.

Mr Adams said: "Then use data such as herd and fertility records, up to date costings and management accounts to quantify what is going on. You must have good records. Farms with accurate and easy to interpret records can more easily compare trends and assess how the farm is performing compared to other farms.

"When comparing performance, always benchmark yourself against the best operators, never the average. Using as many KPIs as possible will help to build a clearer picture of what could be improved."

Mr Adams stresses the importance of getting out and challenging everything that happens on a daily basis to minimise the losses that have been identified. On even the best run units there are little things that eat away at profits and drilling into these areas is what will deliver future gains. Involving everyone will improve buy-in to the loss reduction philosophy.

He said: "To improve you need to set goals and targets. Breaking improvements into manageable steps is critical to develop the habits that lead to sustained improvement. Set and communicate targets and then check and monitor progress.

"Without monitoring, it will be all too easy to slip back into old habits. Finding a clear and visual way to demonstrate the progress being made will help alert everyone to the importance of the change and allow them to see how quickly progress is being made.

"It also makes it impossible to quantify progress and acknowledge the part everyone is playing in making the improvements that have been targeted."

Farmers Guardian
2 December 2016
Neil Adams

Personality key to good farm management

PERSONALITY is key to good farm management, according to Neil Adams, agri-business consultant at Promar International.

The most profitable farm managers were also the most conscientious and the best at teamwork and collaboration.

Speaking at the Institute of Agricultural Management's (IAgrM) National Farm Management Conference in London, Mr Adams said top quarter performing farmers had a higher emotional-social intelligence (ESI) score.

"High ESI farmers tended to be friendly, engaging, welcoming and proud of their team," he said.

"They were open to influences, including from non-farmers, and much more into business planning for the long-term horizon."

Top performing farm managers were also more likely to have a better work-life balance including sport and hobbies outside of farming.

Researchers accessed 40 dairy farmers and scored them on core competences including leadership skills and developing others.

Mr Adams said farm managers were highly emotionally controlled and highly independent minded in comparison to the general management population.

Productivity

Anthony Hyde, a farm consultant, pointed to examples of productivity around the world and questioned if 'being nice' was the right way to do business.

"The Chinese business way is not a nice way. We in the UK tend to be rather nice about doing well," he said.

Mr Adams said people should not ignore cultural differences.

"The evidence is you can be a nice person and be successful."

Eddehard Herrmann, farmer and manager of large co-operative farms in Germany, also spoke about personality as a success factor.

He said research from the co-operative farms across Germany showed 'personality has a measurable influence'.

He highlighted key qualities for farm managers such as commitment and discipline.

"Apart from weather and prices, 62.2 per cent of managers agreed the most important thing is manager performance," he said.

"Most farm managers think performance is based on personality rather than wage levels or qualifications.

"Maybe we do not focus enough on personality," he said.

The most profitable farm managers were the best at teamwork and collaboration.

PICTURE: THINKSTOCK

NUFFIELD FARMING CONFERENCE

People management was discussed at the Nuffield Conference. Full report, see p130-131.

Scottish Farmer
December 2016
Nigel Davies

Cash negative dairies

TRENDS

By Patsy Hunter
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PRODUCERS will have to continue reviewing every facet of their business if they are to survive lower milk prices.

While ex-farm values are slowly improving, they will remain stubbornly low, according to Promar National consultancy manager, Nigel Davies, announcing their review of farm business accounts to March, 2016.

"Milk price was one dominant factor that hit farm profits in 2015 and many farmers sought to reduce costs wherever possible," he said, pointing out that the results provide and in-depth analysis of dairy farm profits and financial structure.

During this time, he said the physical nature of dairy businesses in the sample stayed relatively constant, with small increases in herd size and milk yield per cow being achieved alongside continued gains in technical efficiency with concentrate use per litre continuing to decrease.

NIGEL DAVIES

Output decreased compared to previous years leading to reduced profits. Both variable and overhead costs nevertheless fell at a comparable rate as a proportion of that output, so margins and profit as a percent of output remain unchanged.

Mr Davies said that where farmers made most significant strides is in reducing their discretionary non-trading capital expenditure, with a 34% reduction in capital investment and a 10% cut in private drawings.

However, despite these considerable economies and responses, the average farm in the sample remains cash negative with the funds generated from trading being inadequate to cover total financial commitments. This resulted in an increase in farm borrowings, which is increasingly being structured over a longer term.

Using the 2016 accounts as a base, Mr Davies said that while the milk price increases should be welcomed, they will not, on their own, lead to an immediate rebuilding of farm finances.

"Although milk prices are rising now, they are only in effect making up for lost ground compared to previous years.

"With evidence of poorer quality forages and increasing feed prices, dairy margins will probably only hold in this year but with prospects improving into the next financial year."

In addition, he said overhead costs are likely to be affected by increasing fuel prices and labour costs making it more challenging to implement further economies.

Furthermore, there is a residual impact on cost structures on such areas as loan repayments and depreciation, reflecting decisions made in previous years. The economies made last year will take a while to work through fully to the reported financial bottom line.

"Farmers in the sample have reacted to the economic environment, continuing to pursue technical efficiency and taken tough decisions.

"Given the long term nature of dairying and the ongoing residual effect of previous decisions on many components of their finances, then this twin strategy is undoubtedly an approach that they will continue to benefit from.

"The best will plan ahead not just on the basis of this year's expectations, but also the year's beyond and the associated twists and turns of volatility," concluded Mr Davies.

Farmers Guardian
2 December 2016
Nigel Davies

Dairy farmers take 6 per cent pay cut

DAIRY farmers have effectively taken a 6 per cent pay cut this year in response to falling profitability, according to Promar national consultancy manager Nigel Davies.

Announcing the results of the analysis of the company's farm business accounts to March 2016, Mr Davies said current milk price rises would not be enough to rebuild dairy farms' finances. He said price rises for fuel, feed and labour meant margins would not be increasing.

Private drawings reduced by £2,163 to £32,877 in the 2015/16 financial year, with farmers also spending 34 per cent less on machinery, fixtures and buildings. Mr Davies said: "Less take home pay means there is less to invest for the future."

Total commitments increased to £74,075, £9,331 more than the previous year. Mr Davies said this was a result of decisions made two to three years before.

Farmers achieved a 3.7 per cent drive in efficiency and Mr Davies encouraged dairy farmers to continue becoming more efficient when prices rise.

"Farmers in the sample have reacted to the economic environment, continuing to pursue technical efficiency and taken tough decisions," he added.

Farmers Weekly
2 December 2016
Nigel Davies

Dairy industry faces challenging short-term future

By Jack Yates

The next year will be difficult for milk producers as the cuts and efficiencies made during the dairy crisis affect technical and financial performance, according to agri-consultant Promar.

The outlook came following its release of annual farm business accounts results for the year ending March 2016, in which profits on specialist dairy farms fell 48.8% to £17,194 before drawings, tax and reinvestment.

Despite suffering the worst dairy conditions for 30 years, the UK is yet to see a mass exodus of milk producers, with numbers shrinking just 1.6% in the past 12 months.

However, the consultant said some producers could be waiting for notice periods or contracts to run out, as well as the end of the EU milk reduction scheme, before leaving the industry in 2017.

Efficiency savings, particularly lower calf numbers and retained youngstock made during the previous dairy cycle beginning in March 2014, would start to tell by the end of next year, said Promar.

Sample figures show increases to youngstock in relation to herd size slowed during the past two cycles and genetic progress may have been hindered because of a reduction in the use of AI to cut costs.

Although farmgate milk prices rose by 12.95% in the three months from June 2016, the reduction in national herd size, (down 2% between July 2015 and July 2016) and a fall in UK milk production, down 8.05% over the same period, meant producers wouldn't be able to simply turn the taps back on moving into 2017.

Large savings made to cope with the downturn could not continue indefinitely, said farm consultancy manager at Promar, Nigel Davies.

"These big cuts can be sustained for a few years, but they can't be put off forever. In the next two to three years producers will be forced to address these costs."

Mr Davies said current milk price increases would not be enough on their own to lead to a recovery in farm finances.

"With evidence of poorer-quality forages and increasing feed prices, dairy margins will probably only hold this year, with prospects improving the next financial year."

Those who weathered the recent crisis and are best equipped moving into 2017 are producers who had reacted to the economic environment, pursued technical efficiencies and taken tough decisions, said Mr Davies.

"The crisis has left us with a far more efficient dairy sector, with lots of producers making the most of forage and minimising bought-in feed," he said.

The best will plan ahead, not just on the basis of this year's expectations, but also for the year beyond and the associated twists and turns of volatility."

TIM SCRIVENER

PROMAR FARM BUSINESS ACCOUNTS DAIRY RESULTS 2015-16

- Average herd size in the sample went up 3.9% to 187 cows, but young stock increased by just 1.5% on last year's figures to 132
- Lower milk prices drove profits before subsidy down 48.8%, leaving £17,194 for family drawings, reinvestment and to meet existing commitments
- Subsidy made up 63.43% of overall average profit, a 14.58% increase on last year
- Efficiency a cow rose by 3.7%, equivalent to £54 a cow more in margin over purchased feed
- Total average debt stood at £556,000, an increase of 4.02% on the previous year
- Private drawings fell from £35,040 to £32,877 (-6.17%). Combined capital spend (machinery, fixtures and buildings) dropped from £94,393 to £62,165 (-34.14%)
- Total commitments went up 14.41% from £64,744 to £74,075
- Despite this, the majority of sample farms were looking to invest and expand and were able to attract the necessary investment
- The sample was adjusted to reflect the UK dairy industry, with correlating numbers of aligned and non-aligned producers

Farmers Guardian
2 December 2016
Emma Thompson

Marginal gains are key to improved profitability

Focusing on efficiency rather than cost-cutting should be the objective this winter, establishing what is eating away at profits, according to Emma Thompson, Promar's Midlands regional manager.

She says: "Losses may include small items, such as silage waste, calf mortality, sub-clinical levels of disease, machinery failures and many other items right across the farming operation.

"While addressing just one of these areas will not transform a business, finding marginal gains across a number of areas will impact profit.

"These activities cannot easily be attributed to specific expenditure items. Mastitis and fertility are two common areas where a whole range of different costs will affect performance.

"In some instances, spending more will be more effective than spending less. For example, increasing investment in the parlour routine.

Mrs Thompson says commonly poor financial performance is a symptom of underlying inefficiencies. She suggests high feed costs are symptomatic of poor forage quality.

Ingredients

In the short-term this winter, she advises performance can be boosted by accurate feed analysis and balancing diets with ingredients selected on the basis of their relative feed value.

However, in the long run, it is only by investing in growing and preserving high quality forage crops that performance will climb to levels achieved by the best farms.

She says the most effective way to control expenditure while minimising impact on productivity is to drill down into areas of activity which cause losses in technical performance.

Once these areas are identified and quantified, steps can be taken to implement improvements and help reduce cost of production.

She says: "If reproductive performance is poor, annual milk yield will fall, culling rates will increase and all associated herd replacement costs will rise.

"Rather than cutting costs, such as stopping the routine the vet visit, it may be cost efficient to use the vet proactively, retain visits and reduce the cost of poor fertility on a business."

Mrs Thompson advises a methodical approach to identifying areas for attention, suggesting the starting point should be to ask everyone involved with managing the herd, including external advisers, for their thoughts to help build a well-rounded picture of where losses might occur.

Promar's Emma Thompson says poor financial performance is a symptom of inefficiencies.

She says: "Use data, such as herd and fertility records, updated costings and management accounts to quantify what is going on. Farms with accurate, easily interpreted records can quickly assess how a farm is performing.

"Benchmark yourself against the best operators using as many KPIs as possible to build a clearer picture."

Mrs Thompson stresses the importance of getting out and challenging everything which happens daily to minimise identified losses.

Agri Trade News
December 2016
Promar

Staff changes at Promar

Promar International, the farm and agri-food consultancy within Genus, has added three experienced consultants to its team, each of whom has worked for the business before.

Neil Adams becomes regional consultancy manager – south with responsibility for the delivery of Promar services across the south of England through a team of consultants. Mr Adams started his career at Promar, before moving to English Food and Farming Partnerships and then the Organic Milk Suppliers Co-operative. He returned to Promar in 2012 to work in the special projects team

"Neil's depth of experience within the agricultural industry, coupled with excellent leadership skills, will be of great benefit in his new role as we look to work with farmers to develop sustainable strategies for their businesses," comments Promar managing director James Dunn.

Matt Sheehan rejoins Promar as a principal consultant in the midlands. As well as spending 1994 to 2004 with Promar, he has worked for Dairy Farmers of Britain, Dairy Crest and NSF International.

Nigel Davies was a regional consultant with Promar for five years in the late 1990s before moving to HSBC in a variety of roles from agricultural manager to commercial director. A Welsh speaker, Mr Davies is charged with growing Promar's consultancy offering in Wales, as well as with training and developing the company's supply chain contacts.

"Farmers are demanding a more strategic approach from their consultants as they develop robust businesses in a more volatile and challenging environment. These appointments will extend the breadth of experience we can draw on when working with customers," concludes Mr Dunn.