Switching factories can boost farm profits

By CARLENE DOWIE

DAIRYFARMERS needed to assess different factories' milk payment schemes to maximise their profitability, accountant Colin Wright told the Dairy Business of the Year conference. Mr Wright, a director of Sale, Victoria, based accounting and financial planning firm, Phillipsons, said dairyfarmers could be costing their businesses thousands of dollars by sticking with one milk factory over another.

Income generated from milk sales usually made up 90% or more of farm revenue on most dairy farms. "If your company can't pay you more than another factory, change your factory," he said.

If a farm could obtain $85,000 more in revenue by switching factories, that was money straight in the bank, as the costs for producing the milk were not going to change, he said.

Other factors also played a part – though the money was the most critical.

KEY POINTS

MILK PRICES

- ✓ Compare prices between factories
- ✓ Significant differences exist
- ✓ Take into account other factors

These other factors included:

• Security of payment. It was important to consider the soundness of the factory/company. For example, people who switched to the Pyramid Building Society before it collapsed were chasing the promised higher returns but that had a significant risk.

• Method of payment. Some factories paid monthly, while others paid weekly, which could make cash-flow management easier.

• Incentives and milk quality penalties. It was important to base comparisons of factories on what was currently being produced on the farm. "Don't chase rainbows," Mr Wright said. For example, if a switch was made to a factory based on changing production to meet seasonal incentives, that change might not be successful and ultimately it might not bring the expected increased revenue.

• Farming systems. "It is important to match milk payment to your farming system, not the other way around," Mr Wright said.

• Risk management. Farmers also needed to take into account the different risk factors associated with different systems, for example, a fixed price for the season versus a base price and step ups. Depending on the stage of development of the property, some might like to know exactly what they will get for the season, while others might prefer budgeting on the base price and then using the step-up payments, when and if they came, for investment elsewhere.

• Factory shares. Shares could be viewed as forced saving for future benefit but the ▶

◀ cash from them could also be used to reduce debt or for off-farm investments.

• Emotional issues. These play a part, particularly the co-op versus public company versus private company debate. For others, fear of change could be a factor in the decision.

• Support services. Factories offered different levels of support services such as field services people, trading stores, support in hard times and finance options. An assessment needed to be made on what these were worth to the farm business.

• Flexibility to change. It was also important to consider the impact of locked-in contracts – do they allow enough flexibility for future planning?

• Processor management. Farmers should keep abreast of changes in the milk company and its personnel, as these could influence its future performance.

• Will they have me back? Many farmers feared changing factories because they believed or had been told they would not be taken back if they changed their mind, Mr Wright said. But he said in times of milk supply shortage, as at the moment, most factories were seeking more suppliers and would take milk from wherever they could get it.

Mr Wright said to compare factories firstly farmers needed to collect data from each of the factories taking into account when their farm's milk was produced and the grade applied.

They needed to then adjust these so that they ensured they were "comparing apples with apples". For example, different factories had different quality cut-off levels. They then could assess the net gap between factories in dollars.

Once they had that information, they could apply their personal views to the data taking into account the other factors.

Farmers who were good with spreadsheets could do this themselves, while others could get help from farm advisers, bank managers or accountants to make the comparison.

Mr Wright said farmers could then make the decision that was best for their business.

He recommended farmers on fixed-term contracts do an assessment just before their contracts expired, while those on a year-to-year contract, do the assessment annually. D