

## Red Sky Farm Performance Analysis

**DAIRY BUSINESS**  
OF THE YEAR 

**Red Sky Agricultural Pty Ltd**

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22<sup>nd</sup> September 2007

**Jim & Jill Smith**

Walker Rd  
P.O.Box 99  
Masterton



Dear Jim & Jill

**RE: RED SKY FARM PERFORMANCE ANALYSIS FOR YEAR END 31<sup>st</sup> MAY 2006**

Thank you for allowing us to undertake this review of your dairy business. We have appreciated the opportunity to detail some of the options available to you for ongoing business development, and we hope that this information can assist you in realising your personal goals.

**Summary of Results:**

<b>PROFITABILITY MEASURES</b>	<b>Your Farm</b>	<b>District Average</b>	<b>District Top 10%</b>
Return on Assets	3.5 %	3.0 %	6.5 %
Operating Profit per Hectare	\$ 967	\$ 871	\$ 1,957
Return on Equity	-0.3 %	-1.3 %	5.8 %
Pasture DM Harvested (tDM/ha)	10.6	11.1	12.9
<b>EFFICIENCY MEASURES</b>			
Milk Production (kgMS/ha)	949	1,004	1,297
Average Cost of Consumed Feed (/tDM)	\$ 220	\$ 221	\$ 194
Forage Cost (\$/tDM)	\$ 313	\$ 315	\$ 272
Concentrate Cost (\$/tDM)	\$ 447	\$ 402	\$ 334
Cows per Full Time Staff Equivalent	131	112	147
Management & Staff Costs per Cow	\$ 308	\$ 354	\$ 290
Core per Cow Cost	\$ 442	\$ 418	\$ 374
Core per Hectare Cost	\$ 844	\$ 882	\$ 881
<b>RISK MEASURES</b>			
Operating Profit Margin	22 %	18 %	31 %
Cost of Production per kg Milksolids	\$ 3.10	\$ 3.48	\$ 2.84
Pasture as % of Diet Consumed	83 %	81 %	76 %
<b>SOLVENCY MEASURE</b>			
Equity %	56 %	56 %	54 %

**KPI's – Profitability**

<b><i>Return on Assets</i></b>	3.5%
<b><i>Operating Profit</i></b>	\$967/ha
<b><i>Return on Equity</i></b>	-0.3%
<b><i>Pasture Harvest</i></b>	10.6 tDM/ha

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### Return on Assets

The most important measure of profitability is **Return on Assets**. This is calculated by dividing your Operating Profit by the total value of all assets owned by you. The lease costs associated with any leased assets are deducted from your Operating Profit.

Your **Return on Assets** is higher than the Average, though significantly lower than the Top 10%.

### Operating Profit

Your **Operating Profit per Hectare** is also higher than the Average. This is not as sound a measure of profitability as Return on Assets given it is highly influenced by the quality of the land being farmed.

### Return on Equity

Return on Equity is the most important indicator of **net wealth growth** – but it cannot be used for comparison with other farmers as it includes debt servicing, and is therefore influenced by each individual's level of debt.

Your **Return on Equity** (excluding capital gain) is lower than your Return on Assets. It would be beneficial if your Return on Assets was consistently above your cost of funds (nett financing costs) as this would result in your Return on Equity being factored up on each dollar you have borrowed. In general your Return on Equity can be improved by:

- Increasing operating profit; and/or
- Decreasing finance costs (i.e. borrowing at a lower rate)

When the Return on Equity is less than the Return on Assets then it generally means that the percentage cost of finance is greater than the percentage operating return being made on your total assets.

### Pasture Harvest

**Pasture harvest** is a key indicator of profit. In general it is improved by an increased stocking rate and/or better pasture management. An increase in pasture harvest has the effect of reducing the cost of pasture and hence the overall cost of production.

Your pasture harvest result of 10.6 tDM/ha is slightly below the Average. There is likely to be a number of possible reasons for this, but your low stocking rate is likely to be inhibiting your ability to increase your pasture harvest.

### KPI's – Efficiency

<b>Milk Production</b>	949 kgMS/ha
<b>Average Cost of Consumed Feed</b>	\$220/tDM
<b>Forage Cost</b>	\$313/tDM
<b>Concentrate Cost</b>	\$447/tDM
<b>Cows/Full Time staff Equivalent</b>	131
<b>Management &amp; Staff Costs/cow</b>	\$308 per cow
<b>Core per Cow Costs</b>	\$442 per cow
<b>Core per Hectare Costs</b>	\$844 per hectare

### Milk Production

Your **Milk Production** per hectare is 5% below the Average. The factors contributing to this are:

- Milk production per cow of 361 kgsMS that is 5% above the Average and 9% below the Top 10%; and
- Stocking rate of 2.63 cows/ha that is 19% below the Average.

In this situation stocking rate is the most significant limiting component of the "per hectare" equation and should be addressed first when looking to increase total production, with consideration taken to maintaining per cow performance.

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### Cost of Consumed Feed

The **Average Cost of Feed Consumed** is a weighted average of the cost of pasture, forage and concentrates. In almost any system, feed costs are one of the two highest costs, along with labour (imputed & paid). It is one area that has significant potential for improvement in profitability due to the scale of the expense.

The cost of feed has three components:

1. Direct (or purchase) costs.
2. Variable costs – a proportion of some farm working expenses that should be attributed to the particular feed type e.g. labour, repairs & maintenance, and vehicle expenses.
3. Capital costs – costs attributed to owning capital items required for feeding e.g. the land for growing pasture, feed pads for forage, silage wagons, in-shed feeding systems, etc.

Your Average Cost of Feed Consumed of \$220 per tonne dry matter is similar to the Average. This figure is heavily influenced by the Cost of Pasture, which itself is strongly influenced by a) the pasture harvest, and b) the value of land, which is outside of the control of the operator.

Your **Cost of Pasture** is being negatively influenced by your lower than average pasture harvest.

Your **Cost of Forage** is similar to the Average. This is due to your use of a mix of home-grown and purchased forages, with both sources being at a cost similar to your peers.

Your **Cost of Concentrates** is significantly higher than the Average. This is worthy of further analysis for cost saving strategies.

### Labour Efficiency

Labour efficiency is an area that holds significant potential for improvements in profitability as it is a highly 'elastic' cost, and one of the largest expenses on the farm. These ratios include an allowance for the owner's time as well as an allowance for other people who are completing work but not drawing a monthly wage. As a result improvements in these ratios can lead to either cost savings or for more time to be available to pursue other interests.

Your **Labour Efficiency** of 131 cows milked per full time staff equivalent (Cows/FTE) is significantly above the Average but below the Top 10%. This suggests there could still be an opportunity to improve this ratio, which should lead to improvements in profitability as well as the freeing up of time.

Your **Management & Staff Cost per Cow** (including imputed or "unpaid" labour) is also lower than the Average but higher than the Top 10%. This is a potential area for further profitability gains.

### Core Costs

Pasture-based dairying has a high proportion of variable costs. In businesses such as this there are not significant opportunities to increase revenue (i.e. milk production) to "water down" the impact of high costs. Effectively businesses with a high proportion of variable costs have no alternative but to **control these variable costs** if they are to improve profitability.

**Core per Cow Cost** is calculated from (Animal Health + Breeding + Dairy Shed Expenses + Electricity + Grazing + Freight + Other Expenses + 50% Repairs & Maintenance + 30% Standing Charges + 70% Vehicle Expenses + 50% Depreciation) divided by Peak Milking Cow Numbers.

**Core per Hectare Cost** is calculated from (Administration + Cropping [green feed] + Phosphate & All Other Fertiliser + Pasture Maintenance & Renovation + 50% Repairs & Maintenance + 70% Standing Charges + 30% Vehicle Expenses + Weed & Pest + 50% Depreciation) divided by Effective Milking Area.

Your Core per Cow Cost is higher than the Average, which does not provide a good base from which to increase production and profitability.

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Specific Core per Cow Costs that warrant further attention include:

- *Animal Health*: this is higher than the benchmarks and should offer some potential for cost-saving.
- *Repairs & Maintenance and Vehicles and Depreciation*: these are partly a "per cow" cost and partly a "per hectare" expense, however on a per cow basis they are higher than the benchmarks. *Repairs & Maintenance* in particular could be worth closer scrutiny.

Your Core per Hectare Cost is similar to the benchmarks although you will see that the Top 10% benchmark is higher than the Average. This indicates that this ratio does not have a positive correlation with high performance so it should only be addressed if the costs are much higher than the benchmarks.

### **KPI's – Risk & Solvency**

<b>Equity %</b>	56%
<b>Operating Profit Margin</b>	22%
<b>Cost of Production</b>	\$3.10/kgMS
<b>Pasture as % Feed Consumed</b>	83%

#### Equity

Your **Equity %** is sound and indicates a comfortable position with regards to the long-term risk to your business.

#### Operating Profit Margin

The **Operating Profit Margin** represents the percentage of gross revenue retained as profit (for interest payments, principal repayments, tax and true 'profit'). The higher the figure, the more secure the system. Target levels are related to the farm system being operated, with high feed-input systems targeting lower operating profit margins than low feed-input systems.

Your Operating Profit Margin of 22% is a reasonable result compared to your peers for a low-moderate supplement operation. This represents a sound margin available for debt servicing or to absorb changes in milk or feed prices.

#### Cost of Production

**Cost of Production (COP)** represents the nett cost of producing one litre/kilogram of milk. If gearing is high (e.g. high levels of debt) then there should be a significant gap between Cost of Production and the milk payout to ensure there are sufficient funds for debt servicing and tax payments.

Cost of Production can also be compared across years for your enterprise and against other farmers at varying milk prices as it is not influenced by milk revenue.

Your Cost of Production of \$3.10/kgMS is a reasonable result compared to your peers, and lower than the Average. This leaves a satisfactory margin for debt servicing or to absorb changes in milk or feed prices.

#### Pasture as % of Feed consumed

Your **Pasture as % of Feed Consumed** of 83% indicates a system of low-moderate supplementation. Systems with higher levels of supplementary feeding inherently carry higher levels of risk.

In general your risk/solvency measures are indicating a moderate level of risk, and a business that is in a sound position to withstand unfavourable conditions/events.

### **SUMMARY**

The main profit drivers of any farm system are:

- Milk production
- Pasture production
- Labour efficiency

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- Supplement feed costs
- Core costs

*How do you measure up for the 5 Key Profit Drivers?*

The attached "dot" assessment report graphically outlines your performance in each of these areas.

Your Key Business Strengths:

- *Labour efficiency:* this is good although there potentially remains scope for improvement. The range in performance across farm businesses is immense, and provides opportunities for further cost savings or for you to free up more time to pursue other interests.
- *Core per Hectare Costs:* overall your per hectare costs are sound.

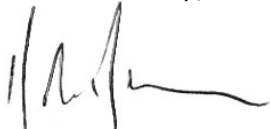
Areas for consideration and/or for further investigation:

- *Milk Production:* a key component of milk production to look at when developing a strategy for improvement would be your stocking rate, which is proportionately lower than your level of per cow milk production. By increasing the stocking rate there is likely (although not guaranteed) to be an improvement in pasture production.
- *Pasture Production:* a number of strategies could be looked at to increase pasture production and pasture harvest. One of the key issues here is your low stocking rate. Methods for increasing pasture production, such as regrassing, increased nitrogen fertiliser use and grazing management could also be implemented, providing the stocking rate is adjusted accordingly to harvest the extra production. Through improving pasture production, there is likely to be a corresponding increase in milk production.
- *Concentrates Costs:* decreasing the cost of concentrates offers potential for improving profitability.
- *Core per Cow Costs:* a number of the "per cow" costs are higher than the benchmarks. These should be reviewed for potential cost-saving strategies. Tight cost control on a per cow basis is a key component of highly profitable dairy businesses.

There are a number of opportunities identified here to improve the profitability of your system. Some may or may not be appropriate due to circumstance not obvious from a financial viewpoint. These opportunities should be discussed with your farm consultant or accountant, and then you should be in a position to select one or two key areas to focus on in the coming year.

We have appreciated the opportunity to analyse your dairy business with Red Sky. If you have any queries regarding your analysis please do not hesitate to contact me. Now that we have your historical performance recorded in Red Sky it is a straightforward exercise to examine various scenarios and detail the likely financial gains from these options. We look forward to being of further assistance to you in the future.

Yours sincerely,



David Beca

Director

**Red Sky Agricultural Pty Ltd**