

Red Sky Farm Performance Analysis



Red Sky Agricultural Pty Ltd

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Jim & Jill Smith

Walker St
 P.O.Box 99
 Warragul
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Dear Jim & Jill

RE: RED SKY FARM PERFORMANCE ANALYSIS FOR YEAR END 30th JUNE 2005

Summary of Results:

PROFITABILITY MEASURES	Your Farm	District Average	District Top 10%
Return on Assets	8.5 %	7.2 %	13.9 %
Operating Profit per Hectare	\$ 1,278	\$ 1,223	\$ 2,200
Return on Equity	9.5 %	8.2 %	17.5 %
Pasture DM Harvested (tDM/ha)	8.0	7.9	9.5
EFFICIENCY MEASURES			
Milk Production (litres/ha)	12,212	13,079	16,749
Milk Production (kgMS/ha)	915	988	1,244
Average Cost of Consumed Feed (/tDM)	\$ 187	\$ 195	\$ 183
Forage Cost (\$/tDM)	\$ 214	\$ 203	\$ 178
Concentrate Cost (\$/tDM)	\$ 269	\$ 282	\$ 274
Cows per Full Time Staff Equivalent	119	113	138
Management & Staff Costs per Cow	\$ 324	\$ 360	\$ 300
Core per Cow Cost	\$ 437	\$ 353	\$ 330
Core per Hectare Cost	\$ 579	\$ 604	\$ 680
RISK MEASURES			
Operating Profit Margin	29 %	26 %	37 %
Cost of Production per Litre	22.1 cents	23.3 cents	19.5 cents
Pasture as % of Diet Consumed	67 %	64 %	64 %
SOLVENCY MEASURE			
Equity %	74 %	68 %	61 %

KPI's – Profitability

<i>Return on Assets</i>	8.5%
<i>Operating Profit</i>	\$1,278/ha
<i>Return on Equity</i>	9.5%
<i>Pasture Harvest</i>	8.0 tDM/ha

Return on Assets

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

Your **Return on Assets** is similar to the Average.

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Operating Profit

Your **Operating Profit per Hectare** is slightly 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 higher 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 through 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 8.0 tDM/ha is similar to the Average and 16% below the Top 10%. 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

Milk Production	12,212 litres/ha and 915 kgMS/ha
Average Cost of Consumed Feed	\$187/tDM
Forage Cost	\$214/tDM
Concentrate Cost	\$269/tDM
Cows/Full Time staff Equivalent	119
Management & Staff Costs/cow	\$324 per cow
Core per Cow Costs	\$437 per cow
Core per Hectare Costs	\$579 per hectare

Milk Production

Your **Milk Production** per hectare is 7% below the Average. The factors contributing to this are:

- Milk production per cow of 5,858 litres (439 milksolids) that is 4% above the Average and 7% below the Top 10%; and
- Stocking rate of 2.08 cows/ha that is 11% 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.

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.

Your Average Cost of Feed Consumed of \$187 per tonne dry matter is lower than the Average (\$195/tDM). This figure is heavily influenced by the Cost of Pasture, which itself is

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strongly influenced by a) the pasture harvest, and b) the value of land, which is outside of the control of the operator.

The cost of feeds comprises 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 **Cost of Forage** is higher than the Average. The main reason for this is that a large proportion of the forage is not grown on land under your control and is purchased for a comparatively high cost.

Your **Cost of Concentrates** is lower than the Top 10%. This is one of the largest individual costs to your enterprise and is a real strength of your business.

Labour Efficiency

Labour efficiency is an area that holds significant potential for improvements in profitability in most systems 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 119 cows milked per full time staff equivalent (Cows/FTE) is above the Average but significantly below the Top 10%. This suggests there could still be a substantial 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 between the Average and 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 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.

Specific Core per Cow Costs that warrant further attention include:

- *Animal Health*: this is significantly higher than the benchmarks and should offer some potential for cost-saving.
- *Grazing/Agistment*: this appears to be due to the off-farm grazing of young stock, as opposed to having an owned or leased support area for grazing of young stock.
- *Repairs & Maintenance and Depreciation*: these are partly a "per cow" cost and partly a "per hectare" expense, however on a per cow basis they are significantly higher than the benchmarks.

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Your Core per Hectare Cost is lower than 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

Equity %	74%
Operating Profit Margin	29%
Cost of Production	22.1 cents/litre
Pasture as % Feed Consumed	67%

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 29% is a reasonable result compared to your peers for a 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 kilogram/litre 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 is 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 22.1 cents/litre 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 67% indicates a system of 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
- 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.

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Your Key Business Strengths:

- *Concentrate Costs:* these are being sourced at a competitive price.
- *Labour efficiency:* this is sound 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.

Areas for consideration and/or for further investigation:

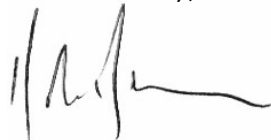
- *Milk Production:* a key component of milk production to look at when developing a strategy for improvement would be your stocking rate, which is proportionately lower than your level of per cow milk production. By increasing the stocking rate there is likely (although not guaranteed) to be an improvement 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.
- *Forages Costs:* decreasing the cost of forages offers the potential for improving profitability. This is most likely to be achieved through the cost-effective production of forages on land under your own control.
- *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.

When implementing new strategies to address these areas of comparative weakness in your business, care should be taken to ensure your areas of strength are not compromised.

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.

If you have any queries regarding your Red Sky analysis please do not hesitate to contact me.

Yours sincerely,



David Beca

Director

Red Sky Agricultural Pty Ltd