High debt drives top business model

By PETER J AUSTIN

KEY POINTS

KATE AND DION SILICH
Numurkah, Vic
DAIRY BUSINESS OF YEAR AWARD
Northern Victoria Winner
* Low cost system
* Making most of available asset
* Australia offers opportunities

DAIRYFARMERS often point to lifestyle as one of the most attractive aspects of this often demanding profession, but north Victorian dairyfarmers Kate and Dion Silich offer a more pragmatic view. They were winners of this year's northern Victoria section of the Dairy Business of the Year and say dairyfarming as a profession has much to recommend it.

"Once your milk is in the factory silo it is owned by someone else, so you don't have to worry about marketing beyond the farm gate. And importantly, you get paid every month. So all we need to focus on is the white stuff in the silo, and what it costs us to get it there," is how Mr Silich sums it up.

Originally from New Zealand and with experience in a number of industries, the Silichs moved to northern Victoria where they were able to convince their bank to back them in the purchase of a 62-hectare dairy farm near Cobram.

They had little of their own capital and that meant high debt levels, which in turn set some of the parameters that are now a feature of their business.

First and foremost, Mr Silich said they recognised that their investment was concentrated in the farm's soil, water and infrastructure, so to be successful the business had to be structured for those resources to drive the bottom line.

A starting point was to understand the real costs associated with owning those resources, and to then manage the risk to achieve a positive margin from the milk they produced.

"That helps us understand why we get out of bed every morning," Mr Silich said.

In the 2006-07 season, for which this event was judged, the Silichs milked 260 cows on the 62ha irrigation farm and produced 1320 kilograms of total milksolids a hectare (16,709 litres).

That gave an operating profit margin of 22% (a little more than $1300/ha) and a return on capital of 7.6% – an outstanding effort in a year when drought, inflated feed prices and lack of irrigation water meant many farmers in the region operated 'in the red'.

New Zealand-born Kate and Dion Silich say Australia has really been a land of opportunity, giving them the chance to buy into the dairy industry and then identify further opportunities to grow their business.

Table 1: Season 2006-07

Costs per cow	Silich	Northern Victoria Average	Top 10%
Animal health	$16	$47	$44
Purchased feed	$273	$1000	$829
Fertiliser	$110	$113	$96
Staff	$251	$401	$358
Gross cost per cow (all costs)	$1082	$2273	$1947
Core cost per cow	$189	$400	$332

Mr Silich said they looked at the option of buying in feed and essentially feedlotting their cows through the dry conditions.

But looking at their budgets they realised that to remain viable they would have to keep feed costs to less than 50% of gross farm income, which would be impossible with large quantities of bought-in feed. The alternative, and the option they chose, was to husband the water that was available and with careful use of fertiliser to grow as much of their own feed as they could.

They were able to achieve figures of 13.4 tonnes drymatter (DM) a hectare of pastures harvested and that in turn helped keep their cost of production down to 25.9 cents a litre and to get through the season with minimal grain inputs and no bought-in fodder.

Table 2: Key performance indicators for award years (2006-07)

Indicator	2006-07
Effective milking area (ha):	61.5
Cows:	260
Production (kg MS/ha):	1320
Production (kg MS/cow):	312
Return on assets:	7.5%
Operating profit margin:	17.2%
Cost/kg milk solids:	$3.28
Pasture harvest (t DM/ha):	13.4
Core per cow costs:	$189
Labour efficiency (cows per full-time staff equivalent):	176

The difficulty in relying on bought-in feed, said Mr Silich, was in controlling the purchase costs a time when heavy demand and short supply continued to inflate prices.

He said they "ran some numbers" last year on an intensive system using a feed wagon, but that showed they would have to ▶

Dion Silich believes four legs cost less than four wheels to maintain.

Maximising pasture growth is critical to the Silich business.

sell 95% of their land and retain just 3ha to 4ha and build concrete feed bunkers – not the style of farming they had in mind. "In my view, where your capital is invested is what should drive your production system," Mr Silich said.

Looking to the future, he said they aimed to only ever have two trucks visit their farm, the one that comes each day to pick up their milk and the one spreading fertiliser to boost pasture growth.

"Four legs are always going to be cheaper to maintain than four wheels, and cows have the added advantage of reproducing so they actually increase your asset base over time," Mr Silich said.

"We know that if we can harvest all of our feed from the pasture we grow then we are going to make some serious money."

Even at a much lower milk price, Mr Silich said their business would still be sustainable if they grew most of their own feed.

Cost control

Also impressive in the Silich business model is their approach to cost control, using a zero-base budget process so every outlay had to be justified anew and not just carried from one year to the next.

"What do we need to spend to produce a litre of milk? And who says that outlay is needed – a sales rep, research, your dairy company, or is it just that you have always done it that way?" he said.

One test they use for cost control was to consider each item and the likely impact for their business if they couldn't afford to buy it, an approach he said helped clarify whether spending was a necessity or just habit.

"How little can we spend without putting cow health at risk and still maintain return and margin on our assets?" he said.

Long-term the Silichs said they aimed for a target cost structure of 70% of gross farm income – 50% to cover operating costs and 20% for debt servicing.

At that rate their business model showed they could produce milk effectively and had plenty left over to pay themselves for debt reduction and further growth.

Higher milk prices in the past couple of seasons had been welcome but Mr Silich said they had to remain vigilant on cost control and not be coerced into gearing spending to current, higher income levels.

"Because milk prices will inevitably drop, and how will the business look then? These prices are no doubt saving some people at the moment but if they don't keep feed costs under control that could be short lived," he said.

In particular he pointed to what he saw as the obsession by Australian farmers to chase higher production per head, saying this could see farmers "mining their asset base" unless they were careful.

Following initial success at Cobram, the Silichs last year bought a second farm near Numurkah. While needing further development it had a better house to which the family moved earlier this year and the aim is to settle there and sell the Cobram farm.

With their second child due later this year, the Silichs said lifestyle issues would become increasingly important.

Opportunities

The Silichs said the northern irrigation region continued to be threatened by uncertainty over irrigation water supplies but still offered opportunities to build wealth, not through the returns from milk but through careful asset building.

But they had also formed an equity partnership with a friend from New Zealand to buy a large irrigation property in east Gippsland.

The land will be owned by the partnership with the Silichs owning the herd – now 500 cows but with scope to significantly increase that number.

The attraction in this farm was its scale, assured access to water for irrigation and a mild climate with high natural rainfall, all of which Mr Silich said made it a "good vehicle for our investment".

It had been a dairy farm before being converted two years ago for vegetable production, so it was relatively simple to convert back to dairy by refencing paddocks and re-installing water troughs.

Three centre-pivots draw water from deep underground and effluent from the dairy can also be spread through these units.

With managers running that farm and full-time staff at Numurkah, Mr Silich said he was now looking forward to using his Masters degree in Business Administration (MBA) in a part-time position as a specialist agribusiness adviser with National Australia Bank.

Mr and Mrs Silich said the opportunities in this country to establish a stake in the dairy industry and to try new things would simply not have been possible in New Zealand.

"We have done well here," they said.