

## LIVING WITH VOLATILE MILK PRICES

**In December, British Dairying reported the views of Jean-Francois Verdenal, president of European Dairy Farmers on prospects for dairy farmers. Here, Derek Gardner, national dairy consultant with Promar International takes a closer look at the UK situation.**

When Jean-Francois Verdenal was asked for his view on the prospects for EU milk producers two things stuck out. The first was that the short term forecast was fairly gloomy, while the second was a general view that wherever they farmed, farmers felt the grass was always greener on the other side.

The dominant concern was that milk prices would be more variable, and what can be done about them. As Mr Verdenal pointed out, there is a strong correlation between costs and profits and at any level of milk price some farmers make a profit while others do not.

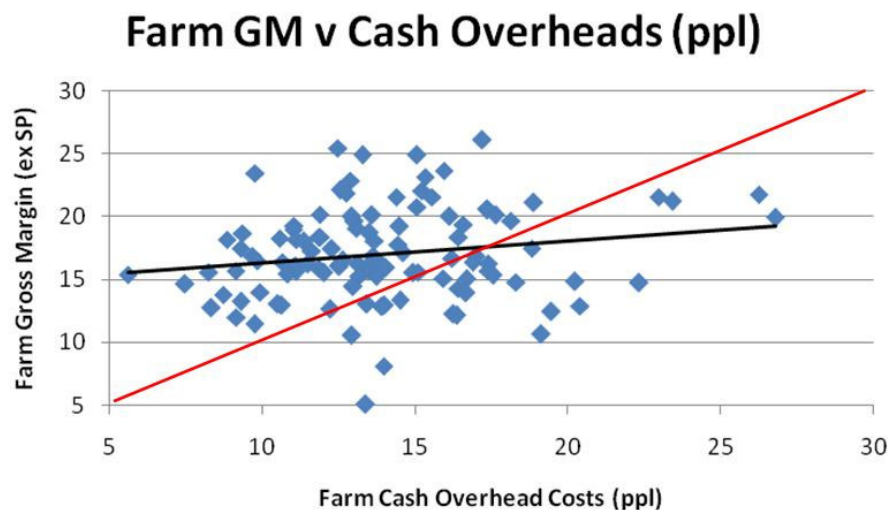
But what about the UK? There is still a considerable range in milk prices available and volatility has become a fact of life, so what are the pointers for profitability.

Using data collected by the Promar Farm Business Accounts service, it is possible to get behind the headline numbers and start to pull out some trends and relationships which might give pointers for the future. The data is for over 100 specialist dairy farms with the same financial year end of March 31<sup>st</sup> 2009 (though none of these herds is involved in the Promar Cost Tracker scheme for Tesco).

The most significant conclusion is the huge range in results. However you analyse the data there are people doing better than others, and as a core principle, everyone should be asking what do I have to do to achieve the top level performance?

It is not just about milk price, or milk yield, or scale. All these factors may play a part, but inevitably the general reason is management skill and attitude – determining the way to get the best from your system and then achieving it. The expected milk price will be a key consideration in this process, but not the only one.

It is useful to start by looking at the relationship between gross margin and overheads costs on a pence per litre basis (graph 1). This graph compares whole farm gross margin excluding single farm payment with the level of cash overheads i.e. excluding depreciation.



**Graph 1**

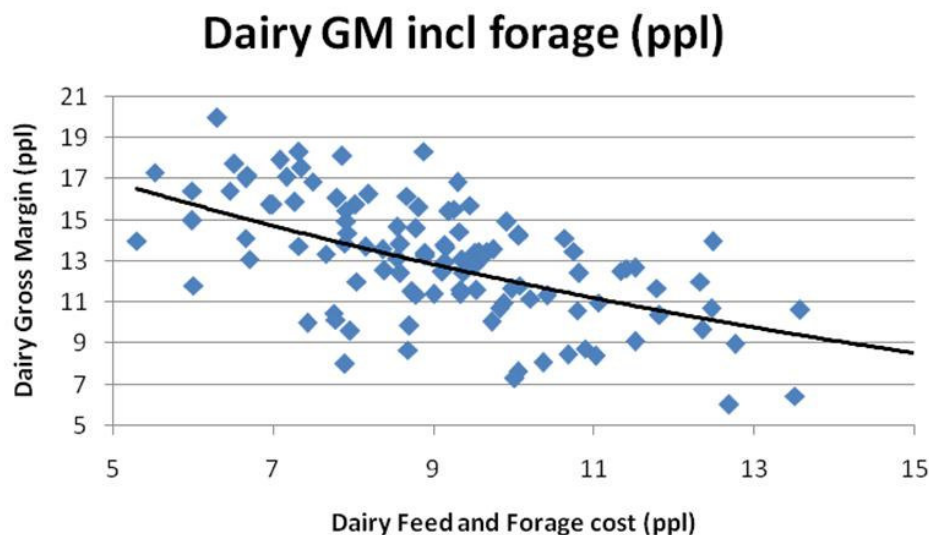
The red line is the breakeven line where farm gross margin equals overheads so the aim must be to be above this line and by as much as possible. The black line is the average of the data.

It is no surprise that higher gross margins lead to higher profit but look at the range. The whole farm gross margin per litre varies from 5ppl to over 25ppl while overheads range from 6ppl to close to 27ppl.

As overheads go up, so gross margin must increase to cover them, but the graph shows that for the same level of overheads there is a huge range in gross margin. For example, at an overhead cost level of 15ppl the range in gross margin is from 15ppl (breakeven) to 25ppl.

Farmers need to understand where their farm data sits on this graph and then decide what they can do about it. For their level of overheads how can they improve gross margin, as usually it is easier to improve gross margin than reduce overheads.

Graph 2 compares dairy herd gross margin with the feed and forage costs per litre. This shows that dairy herd margin (ppl) is directly related to feed and forage costs and as these costs increase so gross margin declines. This shouldn't be a surprise as feed is the biggest single cost of dairy farming, accounting for 48% of the cash costs of dairying including rearing heifers.



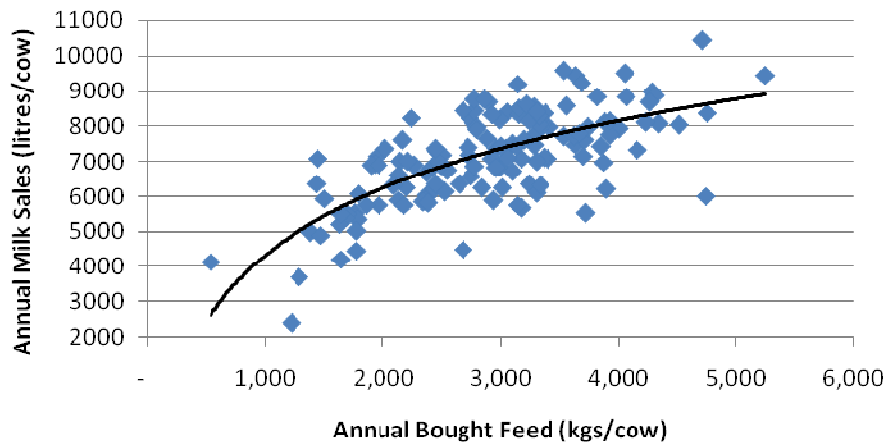
## Graph 2

So it makes sense to look at this in a bit more detail. What can be done to address feed and forage costs to help improve gross margin?

Graph 3 looks at the relationship in the sample between annual milk sales and annual purchased feed use. As you would expect yield increases as more purchased feed is used, but two very clear points emerge. The first is that it is not a straight line response but a curve.

At low levels of feed use the response is about 0.4kg feed/extra litre of milk. However, at high levels of purchased feed use it can take on average 1.6kg to produce the extra litre. At high levels the extra concentrate tends to substitute for rather than supplement the base diet. Pushing more feed in at these levels is unlikely to pay, especially at lower milk prices.

## Milk Yield v Feed Use



**Graph 3**

This has become more pronounced as people have chased yields as the impact of quotas has diminished. Over the last decade the average feed rate per litre has risen from 0.32kg to 0.37kg/l, and it is questionable how profitable this has been.

The second significant point is the staggering range in yield at any given level of purchased feed. For example, many farmers are feeding around 3,000kg per cow but are getting vastly different results, with average milk sales per cow ranging from under 6,000 litres to over 9,000 litres.

Clearly someone producing 9,000 litres will be generating a higher gross margin and be able to cover a higher level of overheads compared to someone producing 6,000 litres from the same feed input, irrespective of milk price.

So why the difference? In general it comes down to 'management'. At any level of feed usage, the farmers achieving higher yields will be getting cows in calf quicker, will have lower levels of mastitis and lameness and will probably have better cows. They will be producing higher quality forage and more of it, which is vital as forage is about 70% of the annual diet.

They will pay particular attention to accuracy of feeding ensuring the diet is balanced, that cows have plenty of access to feed and that it goes to the right cows. TMR feeding may explain some of the increase in feed rate. No-one overfeeds high yielders, but the consequence is often that low yielders are overfed.

The other fact that becomes clear is that unless all aspects of management are fine tuned, it does not pay to throw more feed at cows in the hope that yields will improve. There is a strong correlation between feed cost per litre (ppl) and feed use (kg/l). Usage is the major driver of cost per litre, not price. In most cases, it will be more productive to look at ways to improve efficiency of feed use to reduce costs per litre, rather than haggling to reduce price per tonne.

The question every farmer needs to ask is "how can I increase production from the current level of purchased feed, or reduce feed rate without losing yield to increase overall gross margin." This in turn will allow them to be better placed to ride out volatility in milk prices, as lower costs per litre make it possible to cope with a period of low milk prices.

Overall, the UK is better placed than much of the EU to produce milk profitably, and while there will be volatility in milk prices, there are opportunities. The crucial thing is for all dairy farmers to really understand the implications of their own cost structures and how they compare to the best farmers. Only then can they take actions to improve business performance using independent and realistic benchmarks.