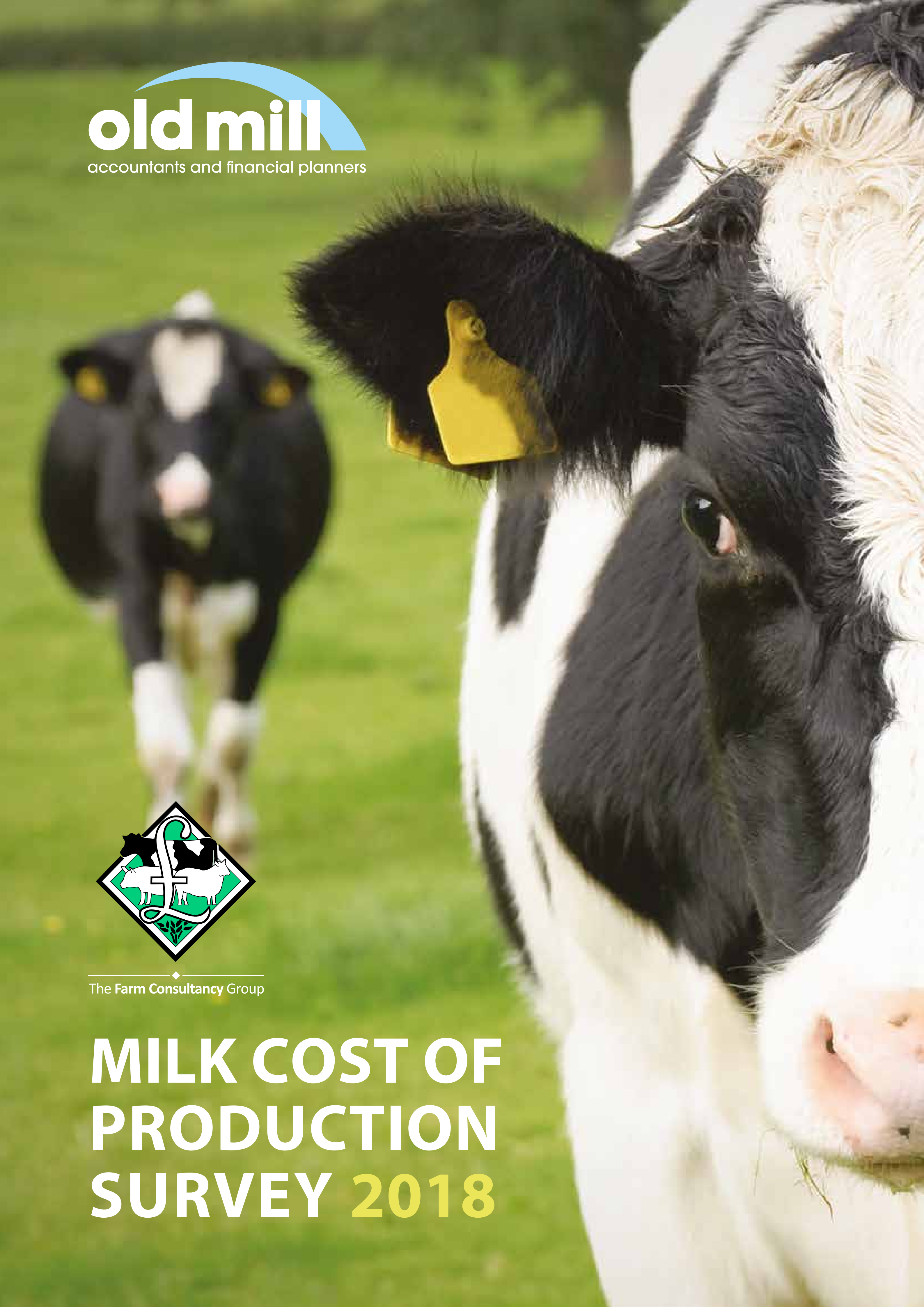

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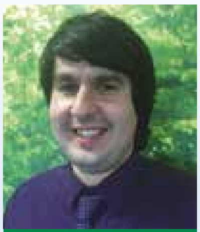
MILK COST OF PRODUCTION SURVEY 2018


Mike Butler


Dan Heal

That light at the end of the tunnel is turning out to be a train

Compared with 2016/17, any year was going to have to be an improvement if dairy farmers were going to survive. As it turned out, the 2017/18 survey results shows a much needed return to profits for the majority of farms participating in the survey.

What is clear is that there remains a number of businesses who are still unable to generate a profit, despite the noticeably higher milk price achieved in that year. For those businesses it will be extremely important to understand how they are going to deal with that and if they are going to survive when the pendulum starts to swing back the other way.

That being said, the pendulum has already started to swing and whilst 2018/19 predicts the potential for some marginal milk price increases, what is noticeable is that costs continue to rise. Consequently, margins and profits are coming under pressure.

Our survey predicts a decrease in profitability for 2018/19 with the combination of inflation increases (and in some cases above inflation increases), being compounded with additional costs incurred as a result of dealing with challenging climatic conditions from this summer.

The full effect of the cost of this year's wet spring and then extremely dry summer will not be known until we get well into 2019. Only then will we know how tight winter fodder volumes are by how much supplementary feed is needed and how well milk producers can maintain their output under these challenging conditions.

What is certainly clear is that there has never been a more important time to forward plan for these challenges and uncertainties. Anyone entering into this winter without an honest and firm assessment of where they stand will find that they could end up in an unexpected and difficult position. Planning ahead can not only identify pinch points but it can also help to inform the best solutions to the problems. It can also take an element of emotional stress out of already difficult trading conditions. Speaking to the bank early is also a fundamental part of coping with the challenges we have seen for 2018.

Phil Cooper

Whilst milk prices for the year 2018-19 have risen, this is set to be a difficult year due to the weather. Spring saw wet conditions and snow followed by drought, which is still impacting on grass growth in the South West. The result was milk output falling and increased pressure on feed stocks. Cereal prices have also risen, leading to concentrate costs increasing as we go into the winter.

The forecast figures for 2018-19 overall still show a profit, but this is expected to fall by around 40% due to:

Output

- Milk yield per cow is expected to fall due to heat stress in the summer and poorer quality forages being fed through the winter, the better quality forage having already been fed to mitigate the lack of grazing during the drought.
- Cow numbers are expected to be lower this year as businesses have had to reduce their number of cows more than ever to ease pressure on feed stocks. Purchases are expected to be down for the same reason.
- These have resulted in costs, particularly overheads, having to be spread over fewer cows/litres, increasing the cost per litre or cow.
- Stock sales are expected to increase as a result of heavily reducing cow numbers, but as stock is not being replaced there is likely to be a drop in valuations at the end of the year.

Costs

- Feed costs are expected to increase by 10% to 20% due to higher prices, increased usage (particularly in spring calving herds), and the need to replace forage that hasn't been made due to the drought.
- Bedding costs will increase due to the high straw prices, which in turn have led to sawdust, sand and other bedding material prices increasing for this winter.
- Fertiliser costs have seen an increase due to higher prices as the new season opened in July. Less may have been used on farm due to the drought so there should be some in stock, which could lower the overall cost next year.
- Seed costs are likely to be higher this year as firstly the drought has led to lower yields in the grass seed crops creating a shortage, and secondly more reseeding is likely to be carried out this autumn to repair the damage to leys caused by the drought.
- Fuel costs are up due to rising prices.
- Contractor costs see a fall under silage making as fewer cuts have been taken, but slurry spreading costs will increase due to cows being housed for longer periods in the summer to reduce the impact of heat stress and to feed forage to replace the lack of grazing. Reseeding costs are also expected to increase as more is completed this year.
- Depreciation costs are expected to drop as less investment is likely to take place this year due to higher input costs.

Overall whilst costs are likely to increase by 5%-10% for the current year, dairy farming can still show a profit across all systems providing costs are controlled. The concern is that whilst this year still shows a profit, it is with a milk price of 32 ppl. The average milk price over the last 10 years has been 27 ppl. This year's costs equate to 32.7 ppl, which clearly shows there is still plenty of work to be done on reducing costs in order to have a viable business at a milk price of 27 ppl.

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Key findings

- The average total comparable cost of milk production in the year to 31 March 2018 was £2,186/cow compared to average milk income received of 2,272/cow.
- The average total comparable cost of milk production in the year to 31 March 2019 is projected to be £2,307/cow against an average milk income received of £2,256/cow.
- 2017/18 has been a comparatively high milk price year, with an average milk price of 30.62p/litre, with all types of farming system able to produce milk profitably on a £/cow basis.
- Milk income has risen £126/cow higher than projected, as a result yields have been increased and cows have been pushed harder, leading to feed costs being £148/cow higher than projected.
- Whilst the milk price is projected to be higher on a ppl basis in 2019, this is projected to be offset by reduced yields causing milk income per cow to decrease by £16.
- The main change in the cost of milk production for 2019 is projected to be feed increasing by £66/cow. An increase is expected as a result of the summer drought affecting crop quality and yields, and also an increase in grain prices quoted for the winter, leading to higher feed costs.
- Variable costs are also expected to increase in cost by £37/cow. The variable cost increase is anticpated due to increased prices for bedding and fertiliser, along with a higher level of reseeding due to drought stressed leys.
- Overall the comparable farm profit is projected to decrease from £383/cow in 2018 to £240/cow in 2019.
- For 2018/2019, cost of production is projected to increase, combined with a projected decrease in milk income of £16/cow seeing comparable farm profit reduce by £143/cow.
- The total comparable cost of milk production for the top 10% of producers was £1,944/cow compared with £2,765/cow for the bottom 10%, a difference of £821/cow.

The basis

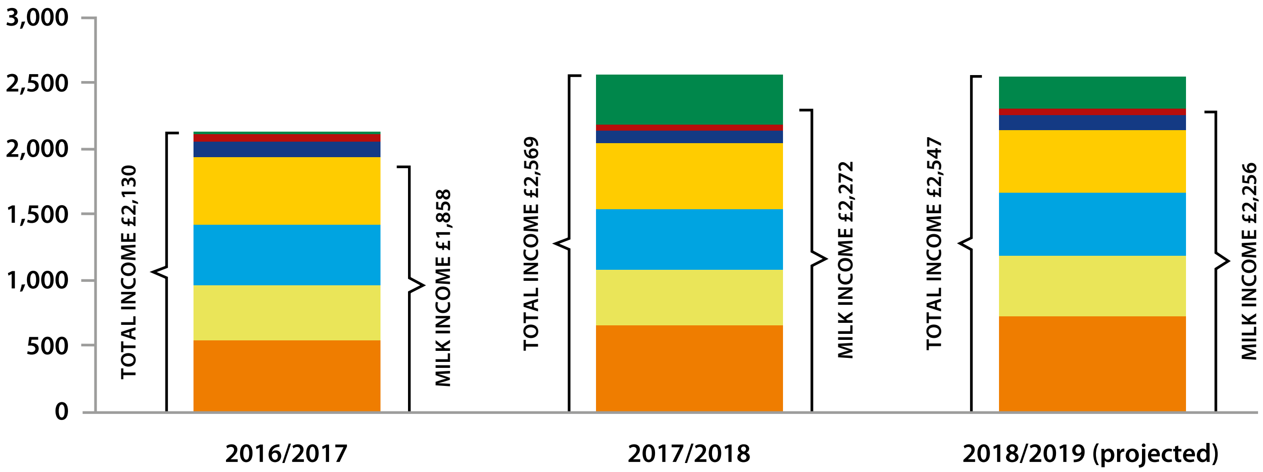
In order to understand and interpret the results of the survey, it is important to set out the basis upon which these figures have been produced, specifically:

- The sample consists of Old Mill and Farm Consultancy Group clients who derive their income mainly or solely from milk sales, across a variety of farming systems.
- All farms have a 31st March year end.
- In order to make the businesses comparable, rents, interest payments, drawings, tax and capital expenditure have been excluded from the figures and a labour charge of £30,000 has been included per full time partner/director. Basic payment scheme has also been excluded from the income. It should be noted that depreciation has been included in these figures.
- The projection for 2019 has been calculated by looking at actual costs incurred for this financial year to date along with national trends.
- The sample data within the pool data of dairy farmers for the survey varies year on year due to data availability.

Results for 2017 and 2018 vs projected results for 2019

	2016/2017	2017/2018	2018/2019 (projected)	Difference
Herd size	277	283	275	(8)
Yield per cow (litres)	7,227	7,421	7,050	(371)
	£/cow	£/cow	£/cow	£/cow
Milk income	1,858	2,272	2,256	(16)
Non milk income	272	297	291	(6)
Total income	**2,130**	**2,569**	**2,547**	**(22)**
Purchased feed	547	662	728	66
Variable costs	410	422	459	37
Labour (paid + unpaid)	463	463	483	20
Power & machinery	518	490	477	(13)
Administration	116	100	109	9
Property repairs	57	49	51	2
Cost of production	2,111	2,186	2,307	121
Comparable farm profit	**19**	**383**	**240**	**(143)**

Actual results for 2017 and 2018 vs projected results for 2019



Key

- Comparable farm profit
- Property repairs
- Administration
- Power & machinery
- Labour (paid + unpaid)
- Variable costs
- Purchased feed

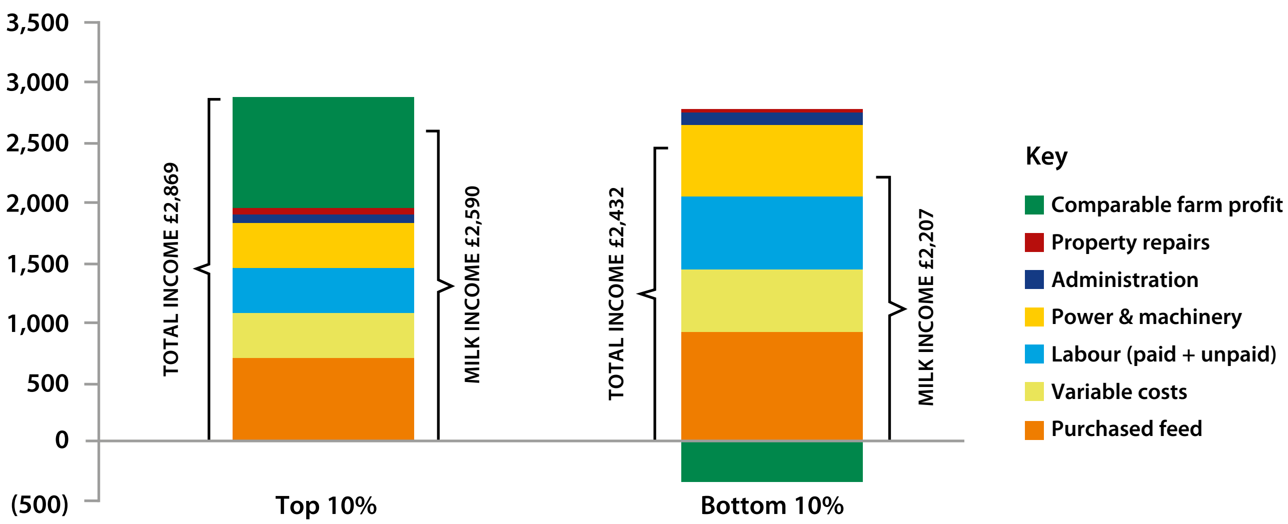
Key points

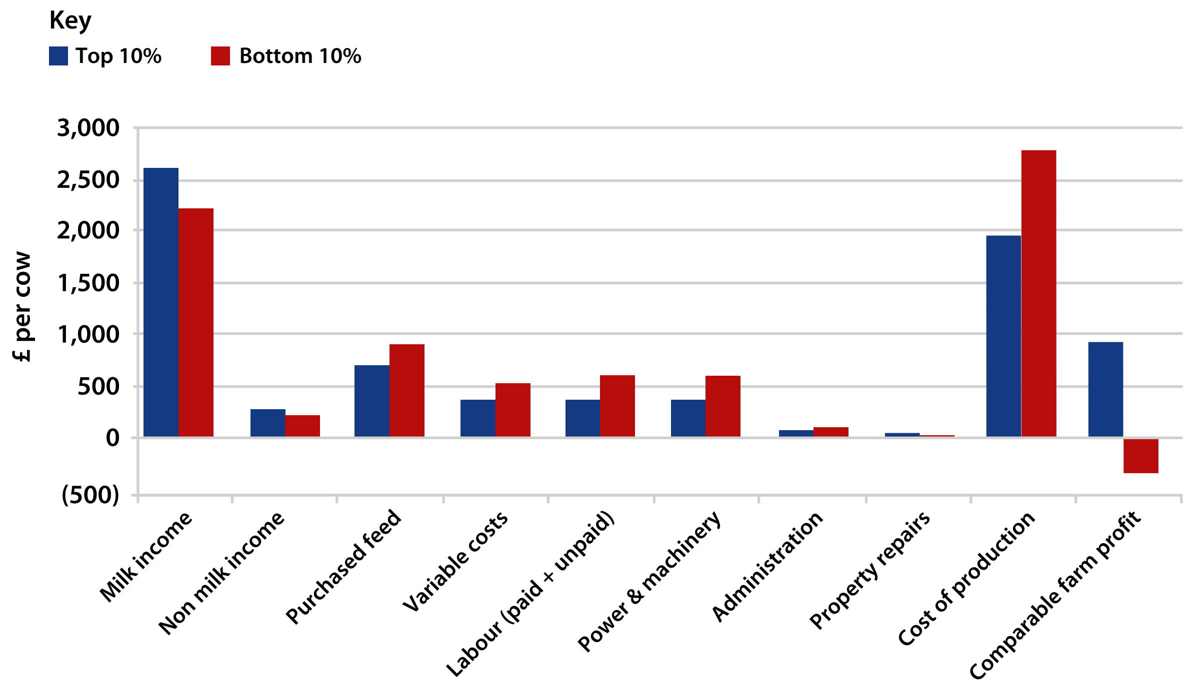
- Herd size is expected to decrease slightly due to farmers managing their cow numbers, in light of forage shortages.
- The comparable farm profit for 2018/19 is projected to be around 37% lower than in 2017/2018.
- The bottom 10% of producers received £437/cow less income than the top 10%.
- The cost of production is expected to increase by £121/cow, or 3.36p/litre.

Top 10% vs bottom 10% by retained profit for 2018

	Top 10%	Bottom 10%	Difference
Herd size	288	330	42
Yield per cow (litres)	8,324	7,582	(742)
	£/cow	£/cow	£/cow
Milk income	2,590	2,207	(383)
Non milk income	279	225	(54)
Total income	**2,869**	**2,432**	**(437)**
Purchased feed	696	907	(211)
Variable costs	375	523	(148)
Labour (paid + unpaid)	368	606	(238)
Power & machinery	372	599	(227)
Administration	78	103	(25)
Property repairs	55	27	28
Cost of production	1,944	2,765	(821)
Comparable farm profit	**925**	**(333)**	**(1,258)**

Actual results for top 10% vs bottom 10%





Key points

- The top 10% received £383 per cow more for their milk, maximising their milk price by producing to milk buyers requirements.
- There was a difference of £821/cow in the costs of production between the top 10% and the bottom 10%, with the top 10% producing more milk for a lower cost.
- All of the key cost categories are significantly higher for the bottom 10%.
- The average comparable farm profit for the top 10% was 11.11p/litre compared with -4.39p/litre for the bottom 10%.
- The top 10% has a slightly larger non milk income than the bottom 10%, at £279/cow compared to £225/cow.
- The average yield per cow is 742 litres lower in the bottom 10% than the top 10%, reflecting the top 10% maximising their income.
- The top 10% has a herd on average 42 head smaller than the bottom 10%.
- There are a variety of systems and calving patterns in the top 10%, showing all can be profitable if done well with a keen eye on costs.
- The bottom 10% of herds all calve all year round.

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Old Mill offer specialist farming accountancy, tax and financial planning services.

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