

Profitable farming - a farmer's perspective.

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Introduction

Together with my wife Rachel we farm in Mid-Canterbury and North Otago where we milk 3100 cows across 5 dairies and associated support blocks, some of which are via equity partnerships. We are also involved in other dairy operations elsewhere in NZ and in the US.

Our aim in farming is to operate an efficient, repeatable and sustainable pasture based dairy business that focuses on generating free cash and delivering a total compounding return on equity of $\geq 15\%$.

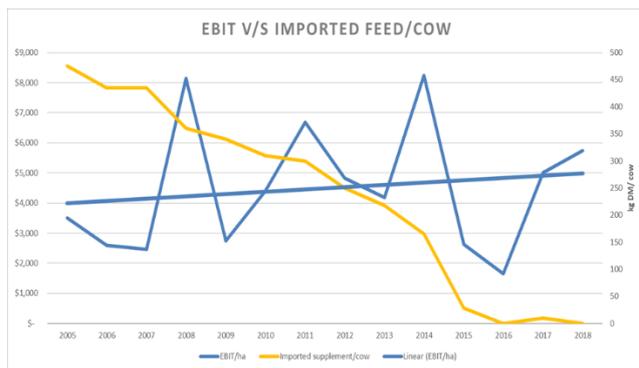
Whilst both Rachel and I thoroughly love farming and the lifestyle that it allows, our view is that we are farming as a business and the assets that we control need to deliver a competitive return, furthermore that additional capital should only be allocated to assets that achieve that.

Understanding what our competitive advantage as dairy farmers in NZ is and focus on maintaining the “moat” around this advantage is front of mind.

Farming system as a driver of profit.

Over time our farming system has evolved and distilled to focus on driving profit through a decrease in complexity, increased pasture harvested and on driving down cost.

The ability to scale up a farming business and get repeatable results requires a focus on simple and repeatable systems and a reduction in the number of decision points that have the potential to impact profit. To achieve this, we have moved to a grass only farming system which suits that focus. This change has had a positive impact on both per ha profit and system simplicity.



Through out the day farm managers and their team make a lot of decisions, for most of which the outcome is not immediately obvious as to how it impacts business performance. By reducing the number of these critical decisions, it allows higher quality decisions and a focus on the areas that have maximum impact e.g. pasture management, pasture quality etc.

Our day to day and week to week discussions with the management team 9/10 times are around pasture management i.e. pre-graze covers, residuals, round length and feed quality. Repetition of this type of discussion imbeds the farm system and gives constant upskilling and improvement.

Understanding what drives profit on farm

Measurement to allow control

Having robust systems in place for data capture and monitoring for the key information on farm is important for our system. We will only capture and record that which generates opportunity for benchmarking, analysis and productivity improvement.

We focus heavily on pasture management KPI's but will avoid production-based data as we find no strong linkage between absolute milk production and profit.

Financial planning, monitoring and benchmarking has played an important role over time to understand the key drivers of profit on farm. An extensive historical data base has allowed analysis of the factors that impact on farm profit and an understanding the correlation between on farm factors and profit.

The key message that we find consistently is that, after Milk Price, lowering cost and maximising pasture harvested have the two single biggest impacts on profit. Gross output e.g. Milk Solids per cow or per ha have a much smaller impact on profit.

Maximising pasture harvested

As pasture harvested is a key driver of profit for the business developing a culture on the farms of trusting grass has been the key success factor. To master pasture management simply takes practice and repetition of simple concepts.

We utilise simple and easy to understand rules, key numbers and tools that all team members can understand. Understanding what the key non-negotiable numbers on the farm are e.g. dry off covers, round lengths etc and understanding that they are fully under our control is an important concept.

Cost control

Our focus has been to attempt to avoid cost inflation through relentlessly revisiting every line of input on farm. Using innovation to beat inflation.

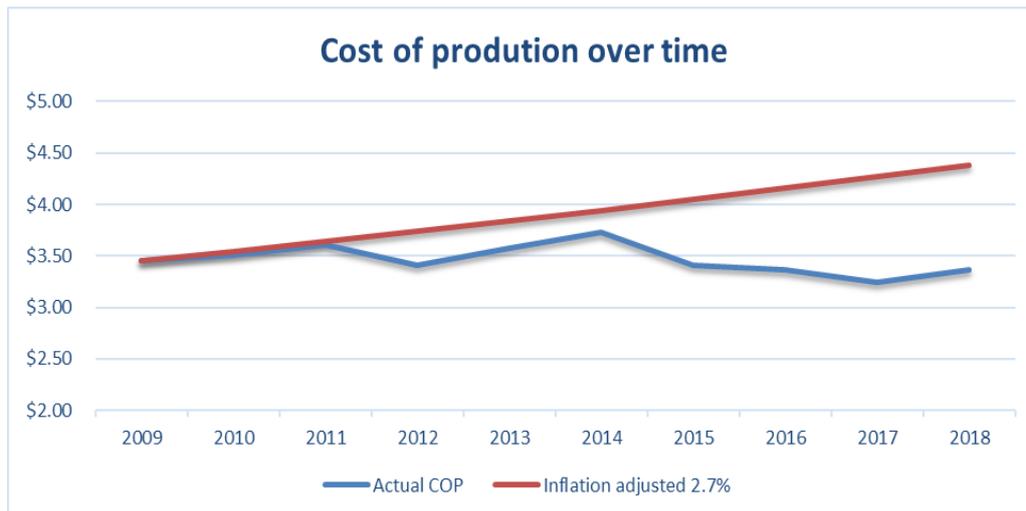
At a high level we try to target of farm working expenses being 50% of Gross Farm income effectively means that we need to double every \$ spent. This is not always achievable with extremes of milk price. Any expenditure that doesn't achieve a doubling requires the next \$ to achieve more. This approach really creates a tension to challenge on farm expenditure.

Making many small savings at a 1-5% level year accumulate in to improvements in return. Continually challenging all inputs and looking clinically at their effectiveness rather than what the marketing may advise or on what you have historically done is critical. Most cost control is unsexy, difficult and tedious however for our business it is a key driver.

We will avoid at all cost simply carrying out activities on farm that are a repetition of what we have "always done" and are happy to tinker with any input to find the most appropriate level.

Understanding the concept of diminishing marginal return for inputs and operating on the steepest part of the return curve has the most likelihood of delivering profit.

We try to create a culture on farm that embraces high profitability through driving productivity while trying to avoid the on farm feeling of simply cost cutting. The difference is subtle but important around job satisfaction and staff retention.



Future proofing the business

NZ farming is facing challenges currently and will continue to do so over time. The type of farming system can give a degree of protection and business sustainability. Environmental regulation and Milk price volatility are two current pressure points.

Profitability for business resilience and future flexibility

Focusing on return on equity as a key performance indicator and using it as a hurdle rate for investment is a key mechanism to generate resilience for our farming business.

With a clear on achieving a compounding return on our equity in excess of 15% year on year allows us to harness the power of compounding return.

A 15% compounding return results in a doubling of equity inside 5 years.

Environmental challenges

With a farm system that focuses on productivity rather than absolute production and by ensuring that farm inputs are at a level on the steepest part of the marginal return curve it is likely that there is less opportunity for wastage. This principle applies as well to nutrients as to any other farm input i.e. any nutrient or energy leaving the farm in a form that is not generating revenue is an opportunity lost. Farm systems that closely match pasture supply to animal demand, maximise pasture harvested, and use fertiliser strategically and sparingly are more likely to have a reduced environmental foot print.

Price volatility

As a producer of largely a commodity product there is risk of price volatility. The temptation in a pasture system is to lift the level of supplement in good pay-out years to capitalise on the apparent opportunity. Something that we avoid are changes to our farm system in years of higher milk price. We keep the focus on just maximising the margin on each kg that we send by keeping unit production cost low to maximise profit rather than try to lift gross revenue. Whilst this approach at times may have a slight compromise on total profit opportunity our view is that the distraction and change of focus for our farming team would outweigh any small opportunity that may sit in changing tact. This approach bears real dividend in years of lower milk price when there are not major changes required to remain profitable.