Difficult times ahead...

The potential impact of milk price cuts, feed price increases and adverse weather, on dairy farm cash flow in the current milk year

A discussion document prepared by Kite Consulting

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The potential impact of milk price cuts, feed price increases and adverse weather, on dairy farm cash flow in the current milk year

Notes:

1) This document has been produced by Chris Flint and Edward Lott of Kite Consulting to illustrate the cash flow effects for a 1.4m litre per year dairy farmer of recent milk price cuts and feed price rises, when combined with the effect of recent adverse weather conditions. Farm size has been chosen because it is the typical size of a producer who supplies into the liquid market in the Midlands.

2) The document is entirely devoid of any emotional arguments related to milk prices. The document is being put into the public domain for discussion. Email comments are welcome and should be sent to enquiries@kiteconsulting.com

3) The costs used to influence this analysis are from Kite's costings service. This assesses the average performance and production costs of hundreds of different dairy farmers across the UK. The document primarily covers farmers supplying into the liquid milk market who are not on 'cost of production' contracts.

4) Our provisional data for farm businesses as at April 2012 showed a milk price of approximately 28.8ppl with costs at that time at a breakeven cash position on the average farm. Indications from the DairyCo intentions survey showed that confidence to invest was also at a higher level in April. This document looks at the dramatic change in conditions for dairy farm businesses that have occurred since then.

5) The scenario illustrated is taking the current worse-case scenario in terms of milk price reductions and our estimate of the effect of rapidly rising feed prices on the average producer. Some producers could face even higher cost rises due to reliance on particular feeds, such as soya. For others the rises could be lower if they were lucky enough to lock into lower prices last spring. The scenario also takes into account the effect of the appalling weather seen across the country this summer. Even if it were to improve in the coming days, the effects are now locked in, with winter feed quality reduced, and higher costs from housing stock through much of the normal grazing season. The effect will also be seen through lower productivity this winter, concentrating the fixed costs of the business over fewer litres of milk produced.

6) The scenario produced for discussion is based upon:

- A 4ppl cut in milk price by August 2012
- A rise in feed cost of 1.5ppl
- A rise in general costs of 1ppl

Changes in milk price and costs and impact on cashflow in pence per litre (ppl)
Discussion points...

- As at April 2012 the ‘average’ farmer was just breaking even.

- Currently (as at mid July, prior to August price cuts), with weather conditions already impacting on costs, and feed price rises coming through, the average producer is already £3,600 per month worse off in cash flow terms than they were in April.

- If August’s price cuts are imposed the cash flow deficit for the average farmer will increase initially to £6,500 per month and further to more than £7,500 per month as anticipated feed cost rises continue. At the time of writing, common feeds like soya, rape and wheat are £130, £100 and £50 per tonne more expensive respectively than they were in April 2012.

- Net costs of production could increase to over 31ppl, with feed price rises and poor weather factored in, and with no allowances for investment.

- There are scenarios where some farmers are not facing such large drops in milk price but all farmers will have been affected to some degree by the weather conditions, and feed price rises will impact upon the majority of farms. There will always be some degree of range in each producer group or locality but the figures here illustrate the potential impact.

- Losses could accrue to more than 6.5ppl for the average producer.

- On-farm investment in most, if not all, cases will stop. Additional bank support will be required to cover the negative cashflows. But will this be forthcoming, especially to tenant farmers?

- Exit rates will increase. Kite predicts that on the back of these figures the exit rate for those farmers who are subjected to the lowest price cuts and the best dairying conditions will be between 3 and 5 per cent because of low confidence and cash flow problems. A 1.5ppl feed price increase could easily double this exit rate. The desperation of those farmers facing the worst milk price cuts and who have seen the worst of the weather is such that their exit rates could easily be 10 per cent, with their milk output dropping by the same degree, or more. Once the 1.5ppl feed price increase takes effect then exit rates could easily be at record levels – perhaps in the mid teens.

- The implications for milk output are obvious. Unless the situation changes, 2012–2013 is likely to be the lowest milk production year on record.

- The longer this situation persists then the deeper the fall in output and the harder it will be to reverse the decline.
Comments

Comments on this document are welcome. Please email them to enquiries@kiteconsulting.com