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Financial issues for the dairy farm in a drought

NSW Department of Primary Industries

Livestock Officers (Dairy)

Carefully assess the financial implications of a drought and any changes you plan to make to your business. A wrong decision may place the business into a position from which it cannot recover, so it is essential that you seek professional advice from your accountant, bank manager, and/ or farm advisers. Accurate assessment of your financial position will have a major bearing on what are the most appropriate management decisions to make.

Cost of feed is the main variable cost that increases during a drought. In an average\ year dairy feed costs should be less than 16c per litre of milk produced, and less than 45% of total farm income. In a drought these figures can exceed to 35c per litre, and exceed total income. This situation is not sustainable.

Because feed cost is the major cost, particularly during periods of drought, it is important to monitor the margin between price received per litre of milk and cost of feed per litre of milk. To provide an overall perspective this positive or negative margin needs to be calculated over milk production and length of feeding.

To calculate the margin ($):

> (total milk income over the expected days of feeding)
> minus
> [(feed costs in c/L divided by 100) x (daily milk produced) x (expected feeding days)]

Note: Other variable and fixed costs, debt servicing and personal drawings also have to be deducted from this margin.

Two financial assessments of your business need to be made:

1. **Develop a cashflow report** for the next 12 months after reviewing your current financial position. Use current and predicted prices for purchased feeds and milk sales, and assume that the drought and its effects will last for 12 months. Ask yourself the following questions:

- Can your business meet its financial commitments (debt servicing, overhead costs, personal commitments etc.)?
- Can you access credit or make alternate arrangements to get you through the negative cashflow periods?
- How long before you have to make some hard decisions?
- Will the short-term cost of managing the drought be greater than the long-term business losses?

2. **Develop partial budgets** to investigate the viability of adopting alternate management plans, such as those listed in Primefact 540 *Dairy herd management strategies in a drought*.

Partial budgets are a quick and simple method to assess proposed farm changes. They require minimal information and are designed to only look at the net effect of a change. They compare extra costs plus income forgone, to costs saved plus extra income gained if a new proposal is adopted. The following template can be used to analyse any proposed change.

Partial Budget Template

Losses		Gains	
Extra costs	$	Costs saved	$
Income forgone	$	Extra income	$
Total Losses	$	Total Gains	$

- **Step 1**. Calculate the extra costs incurred by the proposed change.
- **Step 2**. Calculate the income forgone.
- **Step 3**. Add “extra costs” and “income forgone” to give “Total Losses”
- **Step 4**. Calculate costs saved as a result of the proposed change

- **Step 5**. Calculate extra income generated by the proposed change
- **Step 6**. Add "costs saved" and "extra income" to give "Total Gains"
- **Step 7**. Calculate Net Gain = Total Gains minus Total Losses
- **Step 8**. Determine if there are any non-financial benefits that may influence your decision.

Tax implications of forced sales

The tax implications of any change to your business need to be considered. Contact your accountant or the Australian Taxation Office for advice. If you are obliged to sell livestock because of the destruction of pastures or fodder through fire, drought or flood, you can spread the profit on the livestock sale over five years. This means that one-fifth of the profit would be included in your gross income for the year of the sale of the livestock, and one-fifth would be included in the gross income for each of the following four years.

To take advantage of this concession, you must declare that the sale followed the loss or destruction of pastures or fodder because of fire, drought or flood. In addition, you must show that the main part of the proceeds of the sale will be used to purchase replacement livestock, or will be used in the maintenance of breeding stock for restocking.

Alternatively, you may elect to have the profit on a forced livestock sale excluded from your assessable income for the year in which it was derived. The profit is then applied to reduce the cost of stock acquired during that year – or any of the five subsequent years – to replace the stock disposed of.

Where replacement stock are bred instead of purchased, you may elect to include in your assessable income, over the same period, appropriate installments of the profit on the forced sale (as described above).

At the end of the fifth year after the year in which the forced sale occurred, any part of the profit on the disposal that has not been applied in reducing the cost of new stock purchased, or has not otherwise been included in assessable income, will be included in your assessable income for that fifth year.

Monitoring your financial position

There are a number of computer programs available through NSW DPI that can assist you in monitoring the financial implications of the feeding regime that has been adopted to survive the drought:

- **RationCheck** will calculate the margin over feed costs as well as determining if the ration fed to the milking cows, dry cows or the replacements, is balanced for energy, protein, fibre and minerals.
- **FeedBiz** calculates the feeding efficiency and financial implications of both the home-grown and purchased feeds used on the farm over a 12 month period. These indicators are then compared to pre-determined targets set by the farmer.
- **Milk Biz** does a complete financial analysis of the business and compares both financial and physical key performance indicators to pre-determined targets set by the farmer.
- **Mini Milk Biz** is a quick and simple method of calculating the financial implications that changing feed prices, feed quality and quantity and milk prices have on the business cash flow on a daily, monthly or annual basis.

Financial assistance

There may be some financial assistance available in the form of transport subsidies on fodder, water and stock movements, low interest carry-on finance and low interest loans for certain farm improvements. There may also be some Centrelink benefits available for farmers without an income. Do not assume that you will or will not be eligible for any assistance. Contact the appropriate authorities for details.

Further information

- NSW DPI website www.dpi.nsw.gov.au
- Dairy CHECK Farm Business Management,
- Australian Taxation Office,
- Centrelink,
- Rural Assistance Authority,
- Rural Lands Protection Board,
- Advancing Agriculture Australia,
- Rural Financial Counselling Services,
- Accountants, bank managers and financial advisors.

Acknowledgement

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