WEST COAST SOUTH ISLAND DAIRY

This commentary describes the collective dairy sector's perspective of dairying on the West Coast of the South Island

KEY POINTS

- Production for the model farm increased by 6 percent per cow. Coupled with an increase in cow numbers of just under 4 percent, total production for the season was almost 10 percent ahead of the 2010/11 season.
- With total payout for the 2011/12 some 15 percent behind the 2010/11 payout, total income before expenses for 2011/12 was 5 percent lower compared to 2010/11.
- The farm trading profit more than doubled compared with two years ago (2009/10), due to the improved level of returns. Farm surplus for reinvestment increased by almost $350 000 compared to 2009/10.
- Expenditure has not altered significantly, reflecting both the return to true farm operating costs following the financial hangover from the 2009/10 season, when expenditure was deferred, and currently with the softening in the market outlook.
- Good growing conditions dominated most of the season, with a long mild autumn allowing supplements to be harvested in late April. The strong autumn saw total production for Westland Milk Products (WMP) for the season finishing about 14 percent above 2010/11, with West Coast supply comprising around 10 percent of this total.
- A softening in the expectations for 2012/13 and beyond, saw some caution start to enter planning and heading into the winter as there is still some uncertainty over returns in the short to medium term.
- For the first time in a number of seasons, an increase in dairy cow numbers on the West Coast for the 2012/13 season is not anticipated.
- Contracted supply from Canterbury to WMP is budgeted to double for the 2012/13 season, with the Canterbury milk collection expected to be around 60 million litres.

FINANCIAL PERFORMANCE OF THE WEST COAST SOUTH ISLAND DAIRY FARM MODEL IN 2011/12

Despite the drop in payout, the 2011/12 season saw a consolidation of the good results achieved in the 2010/11 season. The combination of a high final payment for the 2010/11 season (130 cents per kilogram of milksolids) and the expected advance payment of $5.40 per kilogram of milksolids to June 2012 produced a within-season payout of $6.70 per kilogram of milksolids. This compares with a within-season payment of $7.75 per kilogram of milksolids in 2010/11 and $4.88 per kilogram of milksolids in 2009/10.

PAYOUT EXPECTATIONS SOFTENED THROUGHOUT SEASON

The opening projected payout for 2011/12 of $6.80 to $7.20 per kilogram of milksolids was reviewed downwards throughout the season, with a strengthening NZ dollar compounding the reduction in international product prices. The initial expectation was that the final payout would be at the lower end of the initial forecast, but the most recent forecast has been reduced to $6.00 to $6.20 per kilogram of milksolids, before any retentions were deducted. Payments will be made up to $5.80 per kilogram of milksolids in September 2012 and any further payments will be made in October.

COLOSTRUM ADVANCE PAYMENT ENDED UP TOO HIGH

In a season where market prices for colostrum changed significantly, the initial advance payments for colostrum supplied ended up being in excess of the sale price actually realised. The proposal presented to affected suppliers is that the overpayment be deducted from the October final 2011/12 season payment to those suppliers who supplied colostrum during the 2011/12 season. For 2012/13 and subsequent seasons, advance payments will be made at a lower level than those made previously, to avoid this situation being repeated.

PRODUCTION POSITIVE THROUGHOUT THE SEASON

The 2011/12 season began well, with early season production by the end of October 17 percent ahead of the 2010/11 season. The advantage eased somewhat through the second half of the season, with production holding at 14 percent ahead from December until close to the conclusion of the season. New supply from Canterbury comprised approximately 4.5 percent of this advantage, with production from West Coast suppliers being approximately 10 percent ahead of the 2010/11 season.

Good growing conditions throughout the season produced frequent periods of feed surpluses, most of which were able to be harvested at good quality levels. A short intense heavy rainfall event in late November caused an interruption to harvesting activities, but this was more than made up for by the extended period of good growth in the autumn, when further feed surpluses were able to be harvested. These good growing conditions through the late lactation period saw the majority of farms dry off with cows in adequate condition and with pasture covers at, or above, targeted levels.

COW VALUES EASE IN RESPONSE TO DECREASE IN MARKET OUTLOOK

Cow values eased during the latter part of the 2011/12 season as product returns decreased and the exchange rate strengthened. Stock sale income benefited from improved beef returns, with cull cow income at a similar level to the 2010/11 result.

WEST COAST COW NUMBERS INCREASE IN 2011/12, BUT STATIC IN 2012/13

Cow numbers in 2011/12 increased 3.6 percent (5242 cows) compared with 2010/11. Production for 2011/12 was 318 kilograms of milksolids per cow, which was up on the 2010/11 result by about 6 percent.

For the first time in a number of years, the size of the West Coast herd in 2012/13 is forecast to remain at a similar level to that milked in the 2011/12 season. There will be three new suppliers milking next season, but only one of these will be milking cows for the first time. The other two suppliers occur as a result of an additional milking shed being built on the property, with cows from the existing herds being milked through the new sheds. Over the past six years, the increase in cow numbers has averaged 3.5 percent per year.

MORE STABLE PAYOUT RESULTED IN CONSISTENT EXPENDITURE LEVELS

Following the more comfortable 2010/11 season, expenditure was held at the levels required to properly maintain and operate the business. Early season expenditure was incurred where required and as the season progressed and production held at higher levels, further expenditure on the more discretionary items was incurred. Farmers were generally willing to spend on additional higher energy feed over the shoulders of the season to hold production levels up.

The additional payments through the 2011 winter totalling almost $1.20 per kilogram of milksolids ensured that farms were well set up for the start of the 2011/12 season. There were sufficient stocks of supplement on hand and early season requirements of nitrogen and spring fertiliser and any higher energy content feeds were able to be met.

NO SIGNIFICANT PROBLEMS ENCOUNTERED WITH STOCK HEALTH

Stock health and body condition were good throughout the season and no significant animal health issues were encountered. There has been a shift in approach to calving spread, with the proportion of cows able to be induced decreasing. Overall mating periods appear to have shortened, with many farms now mating for 10–12 weeks. As a result, empty rates from the 2011 mating would be in the 8–12 percent range.

BETTER PAYOUT LED TO IMPROVED FARM PROFIT BEFORE TAX

The lift in winter payments, coupled with the healthy advance payments through the season, contributed to a similar level of farm profit before tax to that generated in the 2010/11 season. Expenditure on capital and development items was at a similar level to the previous season, though spending in these areas did diminish later in the season as payout expectations continued to decrease. With the majority of West Coast farms still in a strong financial position, consistent profit levels should see equity levels continue to improve.

FORECAST FINANCIAL PERFORMANCE OF THE WEST COAST SOUTH ISLAND DAIRY FARM MODEL IN 2012/13

Prospects for the 2012/13 are less positive than they were at the same time last season. WMP is keeping its suppliers regularly informed and is expecting the current volatility around international prices to continue in the short-term. Customer demand is still strong, albeit subject to increasing world supply and a continued strong dollar. WMP forecast a final payout for 2012/13 of $5.70 to $6.10 per kilogram of milksolids, excluding payments for colostrum and any retentions.

INITIAL ADVANCE ANNOUNCED

The initial advance payout for the 2012/13 season is $3.80 per kilogram of milksolids, with the first review scheduled for February 2013. The reduced advance, coupled with the deduction in colostrum overpayment in October, could put pressure on early season spending. However, farmers' memories of the recent lower payout years are fresh so they intend to carefully manage expenditure until returns are more certain.

Per cow production levels have been budgeted at the 2011/12 level, so with no additional cows expected to be milked on the West Coast, total West Coast production processed by WMP for the 2012/13 season is expected to remain at a similar level to that achieved in 2010/11.

GOOD WINTER PAYMENTS WILL HELP SET FARMS UP FOR SPRING

With the flow on effects of a good production season and higher final winter payments from the 2011/12 season, the majority of suppliers are confident of being able to meet full levels of expenditure on fertiliser and any additional supplementary feed for the winter and early spring period. As a result, most farms should be adequately set up for the start of the 2012/13 season. Expenditure is expected to continue at full maintenance levels, though will be carefully monitored to avoid deviation from budgeted levels.

NET RESULT FOR 2012/13 SET TO REMAIN AT A SIMILAR LEVEL

With the forecast advance payout in June 2012 indicated to be less than that for the 2010/11 season, the cash surplus for the 2011/12 season is expected to be slightly down compared to the level generated in the 2010/11 season and the typical West Coast dairy farm is expected to generate a similar level of net trading profit to that obtained in the 2010/11 season. The majority of farms are in a good financial position and should manage to sustain at least maintenance levels of expenditure.

INDUSTRY ISSUES AND DEVELOPMENTS

WESTLAND MILK PRODUCTS CONTINUING ITS CANTERBURY EXPANSION

With continued strong customer demand for high quality dairy products, WMP continues its acquisition of new supply from Canterbury. Expectations are that supply from Canterbury for the 2012/13 will be approximately double that collected in the 2011/12 season and further increases have been budgeted. WMP now has a strong Canterbury presence, with processing and staff facilities at Rolleston. WMP will still be making use of its Dairy Industry Restructuring Act (DIRA) entitlement to smooth the shoulders of the season, but the earlier Canterbury supply may alter the amount of DIRA milk actually utilised.

BANKS PREPARING FOR BELT-TIGHTENING IN THE SHORT-TERM

Financiers are anticipating that a number of farmers will require an extension to their overdraft in the short-term, to ensure farms are adequately prepared for the commencement of the 2012/13 season. With overall farm working expenses at close to $4.00 per kilogram milksolids, the initial advance of $3.80 per kilogram milksolids will strain some cashflows through the early part of the season.

AGRICULTURAL TRAINING ON WEST COAST STILL POSITIVE

The agricultural training industry on the West Coast has continued well this year, with trainee numbers just under 190 and over 80 percent of these undertaking training at Level 3 and above. Challenges still remain at achieving targeted trainee completion numbers, but with revamped qualifications now introduced, an improvement is being noted.

WEST COAST RURAL REAL ESTATE MARKET SLOWLY IMPROVING

The number of farm sales continued its slow improvement after the downturn in 2008/09. Interest occurred mainly late in the 2011/12 season, with sales and purchases coming mainly from West Coast farmers. Local rural salespersons expected more interest as a result of Canterbury properties fetching around $50 000 per hectare. Previously, when Canterbury values increased, more interest was shown in lower priced West Coast properties. West Coast properties were sold at around $25 000 to $30 000 per hectare, with the majority of interest occurring in the preferred dairying area of the West Coast.

Interest in West Coast properties is expected to continue through the 2012/13 season, with financiers adopting a more positive and supportive position to lending than was exhibited during the downturn of 2008/09. It would appear that 50/50 sharemilkers are less active in the farm purchase market, with many now preferring to enter equity farming partnerships rather than entering farm ownership.

WESTLAND MILK PRODUCTS ENVIRONMENTAL CODE OF PRACTICE LEADING TO SOME CONCERNS

The Environmental Code of Practice being rolled out on the West Coast has support from the majority of suppliers, but there is some concern being voiced over the additional capital cost required to implement some of the changes and the impact this might have on cashflows now that returns have decreased. It is hoped that some lenience might be extended to allow the necessary work to be carried out as finances allow.

WESTLAND MILK PRODUCTS CONTINUES TO START THE SEASON EARLIER

The cream plant will again be operating through the 2012 winter. As a result of this and the ability to procure winter milk through the DIRA, the opening date has now been consolidated at around 24 July.

WESTLAND MILK PRODUCTS' TIGHTER MILK QUALITY STANDARDS PROVE EFFECTIVE

WMP have recently introduced a new first grade limit on milk quality of 350 000 cells per millilitre which applies from September to April, with the current 400 000 cells per millilitre continuing to be applied in May, July and August. This has generated positive results, with the numbers of milk quality grades well down on previous seasons.

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