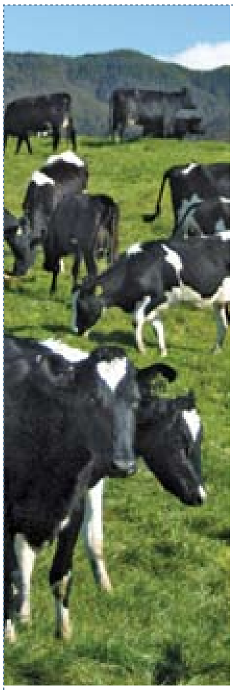


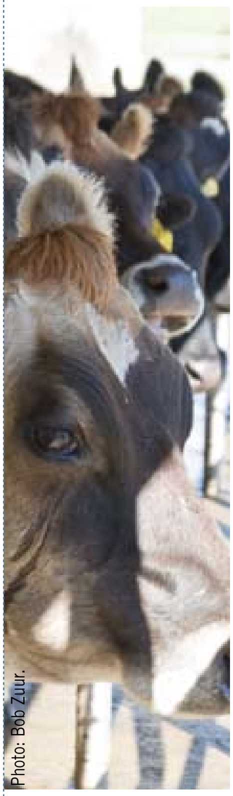
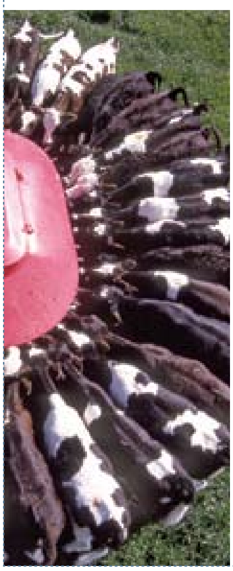


Photo: Bob Zuur.



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

- At the beginning of the 2008/09 season, expectations were for a similar payout to the previous season, but that rapidly dissolved in November 2008.
- With production down and payout levels almost 50 percent less than last season, gross farm income and net cash positions were significantly down on 2007/08 figures.
- A wet and cool start to the season meant feed surpluses and high energy supplements were used to maintain production and improve cow condition prior to mating. Peak production was slightly later in 2008/09 than for previous seasons, due to the wet and cool weather, and total production was just under 1 percent ahead of the 2007/08 result.
- With expectations high after the excellent payout results in 2007/08, the 2008/09 season has been marked by a sense of uncertainty regarding the outlook for 2009/10 and beyond.
- Dairy cow numbers on the West Coast are expected to increase by a further 8000 (6.1 percent) in the 2009/10 season.
- Increased input costs over the past few years have put significant pressure on budgets already under pressure from declining product returns.
- There is a sense that as a result of the current economic downturn and its associated difficulties, the industry and individuals within it will be more resilient and in a better position to move forward.

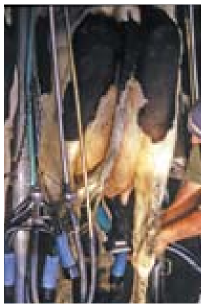
FINANCIAL PERFORMANCE OF THE WEST COAST SOUTH ISLAND DAIRY FARM IN 2008/09

After a high initial advance payout of $4.95 per kilogram of milksolids, there was a period of recovery which amounted to an "over-advance, then a reduced advance" of $4.05 per kilogram of milksolids through the last half of the season.

From early winter 2008, suppliers were notified that the initial advance payout would be set at $4.95 per kilogram of milksolids, with an expectation that the final payout would be between $6.85 and $6.95 per kilogram of milk solids. At Westland Milk Producers' annual general meeting in late November, suppliers were informed that commodity prices were decreasing and the overall tone of the market was quite negative. Following this in late December 2008, suppliers were informed that the advance payout was being reduced to $4.05 per kilograms of milksolids and that 45 cents per kilograms of milksolids was to be recovered from advances paid in January and February 2009. In late May, Westland Milk Products sent a letter to suppliers announcing a revised payout of $4.50 per kilogram of milksolids, and that three payments of 15 cents per kilogram of milksolids would be made in June, July and August 2009.

PRODUCTION VARIES OVER SEASON

The 2008/09 season started off on a positive note, with production in early November more than 8 percent ahead of the previous season. However, production stalled during late November and December due to wet and cool weather, but was still up 4 percent on the December to February period last season. From



March, daily production started to decline, though total production ended the year slightly higher, up 1 percent compared with 2007/08. A 6 percent increase in cow numbers (4000 cows) over the supply area resulted in average production levels of 342 kilograms of milksolids per cow and 752 kilograms of milksolids per hectare.

Favourable weather conditions at calving saw the season get off to a good start. November and December proved more difficult to manage with many suppliers moving to alternative milking intervals. Once-daily or 16-hour milkings are now commonplace on the West Coast and are used to ensure cow condition does not decline over the mating period and to manage periods of feed shortage. Pasture growth rates slowed and pasture utilisation levels decreased as efforts were made to avoid pasture and soil damage. Feed surpluses were smaller than usual and slow to develop, while weather conditions made harvesting difficult and resulted in many crops being quite mature and of lower quality at harvest. Higher priced and high energy supplements were purchased to hold production levels in the first half of the season while the advance payout and farmer expectations were high.

Good growing conditions over the mid-summer period continued through until mid-autumn. With the reduced payout, there was increased pressure to maximise the amount of supplement made on-farm, rather than purchasing the balance of supplementary feed requirements. As a result, significant amounts of supplement were harvested through April and May. However, as weather conditions deteriorated in late April, a lot of pressure was put on pasture cover heading into winter. Drying off occurred earlier than usual due to below average stocks of supplement and pasture covers. This resulted in supply to Westland Milk Products ceasing in the last week of May.

EXPENDITURE FALLS AS PAYOUT DROPS

On the back of the initial advance payout of $4.95 per kilogram of milksolids, suppliers to Westland Milk Products continued to be optimistic with their spending however, when they were notified of the reduced advance payment and final payout expectations in December, optimism began to decline. Farm expenditure was at full maintenance levels and purchases of higher-priced feeds was still common. When notice of the reduced payout was received, development and conversion projects either slowed or were put on hold altogether.

The timing of the payout announcement made significant expenditure savings difficult, with many of the "big ticket" expenditure items already purchased through the early to mid milking period. As a result most farms are in a well-maintained state and their equipment is either reasonably new or in good condition. This means that it may be possible for many farms to function for a period at a bare minimum level of expenditure.

There were cases of employees being made redundant, either immediately or at the conclusion of the season, and expenditure on fertiliser through the remainder of the season was either cancelled, or reduced. In order to drive production up fertiliser is likely to be kept at full maintenance levels and farmers believe that the asset base of their business should not be undermined. There was some easing in fertiliser and fuel costs, but the overall farm expenses increased.

When the advance payout reduced and accounts arrived for items already purchased, overdrafts increased rapidly which increased term debt in many cases. Banks moved quickly to support their clients, by extending overdrafts, while they reviewed and restructured debt for many clients. There is a sense that debt levels will continue to rise further as necessary expenditure sets farms up for the new milking season. As a result, cashflow budgets and regular financial updates are becoming mandatory in order to address any deviations from the budget. However, indications from financiers are that numbers in their "at risk" category are similar to usual.

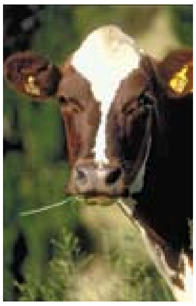
Nitrogen usage is still an important component of pasture production on the West Coast. However, there will be more focus on the timing of applications and the overall stocking rates are expected to ease to take some pressure off feed supply.

Stock health and condition remained good throughout the season, despite the reduced payout. Reported submission rates were good, but empty rates were variable ranging from 5 to 15 percent with little information available to explain the difference.

NET RESULT REDUCES DRAMATICALLY

Expectations of a similar financial result to last season has not eventuated in 2008/09. Income almost halved but expenditure is at similar levels to 2007/08. This will result in the majority of farms incurring cash losses for 2008/09. Overdrafts will be added to term debt and most farm businesses' debt will be reviewed and restructured. Equity levels will have moved backwards, but the majority of farms are still in a strong position financially.

BUDGET FINANCIAL PERFORMANCE OF THE WEST COAST SOUTH ISLAND DAIRY FARM IN 2009/10



Uncertainty still surrounds the prospects for the 2009/10 season. In late May 2009, suppliers were informed that the forecast payout for the season would be $4.50 to $4.90 per kilogram of milksolids. However, the initial advance payout has been set at $3.00 per kilogram of milksolids. The consequence of this lower advance is that additional borrowings or overdraft facilities could be needed throughout the winter and into the early milking period to ensure all necessary inputs can be purchased.

The lower overall payout for the season, together with the higher cost structure, could put a lot of pressure on budgets already finding it difficult to avoid a deficit. Industry commentators and farmers believe that the long-term prospects for dairying and indeed agriculture in general are positive. However, carefully managing expenditure will be vital to avoid further significant losses accruing.

PRODUCTION INCREASES AS COW NUMBERS RISE

The size of the West Coast herd continues to increase, with a forecast increase of 8000 cows (6.1 percent) over 2009/10. It is expected that a further seven farms will be supplying Westland Milk Products for the 2009/10 season. Westland Milk Products' budgeted production for the 2009/10 season is 4 percent above 2008/09, at 45.3 million kilograms of milksolids.

The effects of the reduced payout in 2008/09 will flow through into the 2009/10 season. While expenditure will be close to maintenance levels, it will require careful management to ensure it is kept to the bare minimum. Leading farmers have adopted low cost feed systems to achieve this.

Tax payments have been reviewed to take account of the reduced income levels and to minimise the tax payments required. Full levels of maintenance expenditure will be budgeted for, as will an allowance for increased tax payments. Any capital purchase requirements have been put on hold until future prospects are clearer. In many cases, the higher payouts in previous seasons have seen plant and machinery either replaced or maintained to a high level. This will serve to keep maintenance costs on this equipment at a lower level in the interim.

NET RESULT FOR 2009/10

Constant review of income and expenditure, both at farm and company level, will be a frequent occurrence in order to minimise any further deficits on-farm. Under the current scenario, given the low levels of final payments through the 2009 winter, it will be hard to avoid a significant deficit for the 2009/10 season.

PUBLISHER

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Email: policy.publications@maf.govt.nz

Web: www.maf.govt.nz

ISBN 978-0-478-35150-7 (Online)

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