



2. BUSINESS



Good financial management provides more control and more choice.

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Five features of profitable and successful farming businesses

A successful business has:

1. an effective business structure, a business plan and strategy to achieve goals
2. a cash management system, well-maintained budgets, benchmarked performance
3. routines, practices, policies and procedures that enable the business to meet regulatory requirements and obligations
4. good record keeping and a productive office space
5. a good support team.

Know the important numbers

Monitoring a small number of financial key performance indicators (KPIs) helps steer the farm business in the right direction. Cash, profitability, risk and wealth creation are important to consider when analysing your business.

The following series of KPIs help form a financial picture of your business.

- Breakeven milk price
- Operating profit
- Operating profit margin
- Debt to asset ratio
- Operating Return on Dairy Assets
- Equity growth %

Breakeven milk price

This important KPI calculates any cash surplus and helps you focus on costs for all aspects of the business. Maximising the cash surplus allows you to grow your business, invest in other opportunities, reduce debt, and achieve family or business goals.

The breakeven milk price shows how much income from milk is required to pay farm working expenses, interest, rent, tax and drawings in any given season.

Calculate cash surplus: Subtract breakeven milk price from the current milk price to determine your surplus, e.g. milk price = \$6.00 the cash surplus is \$0.25.

To improve the cash surplus and reduce the break-even milk price requires a focus on all aspects of the business, from increasing milksolids at minimum cost to reducing farm costs and controlling personal expenditure.

CALCULATION EXAMPLE:

Cashflow per kg milksolids sold	Example \$/KgMS
Farm working expense	\$4.00
interest and rent	\$1.35
tax	\$0.25
drawing	\$0.65
Total cash expense	\$6.25
Less net stock sales + other dairy cash income	\$0.50
Breakeven milk price	\$5.75

Note: This does not include principal repayments nor capital expenditure

Operating profit

Operating profit is defined as gross farm revenue less operating expenses. It is a measure of farm profitability but does not include interest and therefore takes no account of how the business is funded.

Operating profit can be broken down using the following equation:

$$\text{Operating profit \$} = \text{gross farm revenue} - \text{operating expenses}$$

Operating profit is derived by adjusting the net cash income and farm working expenses with five non-cash adjustments that impact either income or expenses.

1. Non cash adjustments
2. Value of change in dairy livestock
3. Labour adjustment (unpaid family labour)
4. Feed inventory adjustment
5. Owned support block adjustment
6. Depreciation

CASH	\$/KG MS	\$	NON CASH ADJUSTMENTS	\$	CASH + NON CASH	\$
DAIRY SALES			DAIRY GFR			
Net milk	4.05	1,221,625			Net milk	1,221,625
Net livestock	0.41	124,994	+ value of change in dairy livestock	40,009	Net livestock	165,005
Other dairy	0.00	0			Other dairy	0
NET CASH INCOME	4.47	1,346,621				1,386,630
CASH FWE			NON CASH ADJUSTMENTS		OPERATING EXPENSES	
Wages	0.48	145,287	+ labour adjust	125,348	Labour expenses	270,635
Stock expenses	0.71	213,979			Stock expenses	213,979
Supplementary feed	0.97	292,029	-feed inventory adj	0	Total supplement expenses	292,029
Grazing and support block	0.27	80,495	+ owned supp block6	63,000	Total grazing and support block	143,495
Other working expenses	0.63	188,487			Other working expenses	188,487
Overheads	0.22	67,144	depreciation	91,097	Total overheads	158,241
FARM WORKING EXPENSES	3.27	987,421				1,266,866
CASH OPERATING SURPLUS	1.19	359,200	NET ADJUSTMENTS	-239,436	DAIRY OPERATING PROFIT (EFS)	119,764

Operating profit can be expressed as \$/kgMS, \$/ha, \$/cow enabling comparisons to be made with other farms.

A key driver of operating profit/ha is operating expenses/kgMS i.e. farms with low operating expenses/kgMS tend to have a higher operating profit/ha regardless of farm system, herd size, farm size or region. Operating profit can be increased by:

- reducing expenses if any resulting reduction in revenue is less than the reduction in expenses.
- increasing revenue (milk and stock) if any resulting increase in expenses is less than the increased revenue.

See the latest Economic Survey to learn more about profitability for owner operators and sharemilkers dairynz.co.nz/economicsurvey.

Operating profit margin

This KPI is a measure of efficiency and is defined as operating profit as a percentage of gross farm revenue. Operating profit margin is a measurement of what proportion of a farms revenue is left over after paying for variable costs of production such as wages, grazing, R&M, depreciation, etc.

$$\text{Operating margin \%} = \frac{\text{operating profit \$}}{\text{gross farm revenue \$}} \times 100$$

This indicates dairy operating profit as a percentage of dairy gross farm revenue – the higher the margin, the better. This KPI is a risk measure and a large margin helps cope with fluctuations in milk prices, milk production and input prices.

Farmfact for operating profit is available at dairynz.co.nz. If you are a member of DairyBase the operating profit margin is calculated for you on the main KPI page.

Debt to asset ratio

This measures the proportion of the asset value that is borrowed by the business. It is not a measure of performance but can be used to assess an important area of risk in the business.

$$\text{Debt to asset ratio \%} = \frac{\text{closing total liabilities \$}}{\text{closing total assets \$}} \times 100$$

Farmers who operate profitably and have high return on assets can withstand higher debt levels and continue to grow their business. For farmers with moderate or poor profitability be cautious about increasing debt, even with high equity levels.

Operating return on dairy assets (RoDA)

This measures how much profit the business is generating and is often compared to the return on money 'in the bank'.

$$\text{Return on dairy assets \%} = \frac{\text{Dairy operating profit \$ + support block adjustment - rent \$}}{\text{Operating dairy assets \$}} \times 100$$

This KPI does not include capital gain or loss. As a rule of thumb, if the RoDA is lower than bank interest, risk levels rise and without capital gain, equity will reduce over time.

Equity growth %

This is the ultimate financial KPI for a business and measures growth in equity as a percentage of opening equity.

$$\text{Growth in equity \%} = \frac{\text{Closing equity \$} - \text{opening equity \$}}{\text{Opening equity \$}} \times 100$$

A high level of wealth creation or equity growth over time comes from:

- investing in productive assets
- not paying too much for them
- operating them efficiently
- investing the resulting profits wisely
- capital gain.



Key resources

Business resources

For planning tools, budgeting templates, break even milk price calculators, and tips for developing KPIs for your business and monitoring your finances visit dairynz.co.nz/business

Benchmarking

DairyBase analyses resources and farm performance allowing you to track your business over time and benchmark against other dairy farms.

Visit dairynz.co.nz/dairybase

Budgeting

For templates for annual and monthly cashflow budgets

visit dairynz.co.nz/budgets

Industry information

For historical trends and analysis use the Economic Survey for financial data and the Dairy Statistics for physical data (by district and region in many cases).

dairynz.co.nz/economicsurvey
dairynz.co.nz/dairystatistics