IS CLOVER MILKING THE DAIRY TRADE DRY?

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The R62-million bonus Clover paid its top managers in 2004 substantially benefited the recipients, particularly because the amount excluded the members' normal salaries, bonuses and benefits. Although it's impossible to prove, reports by Solidarity trade union reveal that only 11 individuals profited from the payout. Irrespective of how many people gained from it, in farming terms the payout is equivalent to:

- The average profit of R272 553 generated by 227 eastern Free State dairy farmers over the past seven years.
- The average price of R1,84 per litre received by eastern Free State farmers for 33,7 million litres of milk over the past seven years.
- The annual income of 6 582 farmworkers earning a minimum monthly wage of R785.
- The buying price of 340 balers
- (R1,2 million) at R182 500 each.
- The buying price of 12 400 in-calf heifers at R5 000 each.

To an uninformed bystander, the bonus payment creates the impression that the dairy industry is one of agriculture's most profitable sectors, but on-farm financial figures paint an entirely different picture. As people used to ask in the old days when milk suddenly ran dry "Is daar 'n likkewaan wat die koeie in die nag uitsuip?" (Is there a leguan which comes at night and drinks all the cow's milk?)

Revealing figures

Table 1 shows the financial performance of a group of Computus diary farmers whose production figures are recorded and analysed monthly.
According to this table, the profit margin of dairy cows was R2 014 per large livestock unit (LSU) in 1998, including cattle sales. After 1998 the profit margin declined slightly, peaked in 2001, but after that it started declining over a period of three years.
Production costs increased continually during that period, but dropped in 2004 due to lower feed costs.

Over the past seven years farmers attained an average profit of R1 772 per LSU. During this period, producers also had an average of 154 productive animals (cows and heifers in

calf) in their herds. Table 2 shows that on average these farmers spent R1,93 million on capital investments during the seven years.

Of this, R1,24 million was spent on machinery and R690 153 on livestock. The profit of R1 772 per LSU reflected in Table 1 still needs to service the capital investment. This profit, therefore, excludes the interest and installments needed to pay off the capital investment.

Profitability

Graph 1 shows that in 1998 this group of farmers had milk profit margins of 42c per litre. In 2001 it increased to 51c per litre and after that it started declining until it dropped to 32c per litre in 2004.

Expenditures gradually increased from 91c per litre in 1998 to R1,60 per litre in 2004 – an increase of 36%. The average milk price increased from R1,33 per litre in 1998 to R2,07 in 2003, but then fell to R1,92 per litre in 2004. The producer price in 2004 therefore increased by only 28% against the 1998 price. In nominal and real terms (excluding inflation) the dairy profit margin has decreased considerably over the past seven years.

Return on investment

A company's performance is often judged on the return earned on invested capital. A further criteria is to determine how effective the turnover was in realising a profit for the company's owners.

Graph 2 shows that the return on investment for the group of eastern Free State dairy farmers declined sharply from 29% in 1998 to 10% in 2004. Turnover effectiveness dropped from 32% to 16% during the same period. This reveals that dairy farmers' financial competitiveness has weakened steadily over the past seven years and they are now in a position where they can no longer absorb further decreases in the producer price or increases in production costs.

The reality is that, in nominal terms and against the 2004 cost structure, a producer price of R2,02 is needed for dairy farmers to match the profits they generated in 1998. However, in real terms, they are still worse off.

Price fixing

As is the case in other sectors, the dairy industry is characterised by a few buyers purchasing milk from a large number of farmers. The long agricultural production cycle involved in dairy farming also contributes to farmers generally being price takers and not price makers.

Because of this it's possible for a milk buyer to unilaterally announce a price cut of 17c per litre without the farmer having much say in the matter or any time to react to the cut. Unfortunately, this is an aspect of the free market.

But the free market is also characterised by long-term partnerships between buyers and suppliers working together to create a sustainable business environment. This applies even more in the case of a milk distributor who was initially set up as a co-op by its farmers. Figures in the tables and graphs do not include predictions for this year.

An amount of R62 million given by any agricultural organisation to its top management drains agriculture of the necessary operating capital. In the case of the dairy industry, the milk producer price has been reduced by 17c per litre, the retail price has been increased by up to 45c per litre and between 400 and 1 000 workers stand to lose their jobs because there is a shortage of operating capital. The upshot of this is that other milk processors and distributors are now pressurised to drop their producer prices as well. They are simply following the market to remain competitive. Farmers' profits, which are already extremely low, have dropped by 50%, making it impossible for them to achieve a return on their investment to keep them on their farms in the longer term.

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TABLE 1: ENTERPRISE ANALYSIS OF DAIRY COWS IN THE EATERN FREE STATE

	1998	1999	2000	2001	2002	2003	2004	Average
Total Reproducing LSU	186	151	132	156	136	160	155	154
	R/LSU	**R/LSU**	**R/LSU**	**R/LSU**	**R/LSU**	**R/LSU**	**R/LSU**	**R/LSU**
Produce sales	4203	3991	4336	6029	5039	5999	4835	4919
Stock sales	535	405	278	963	636	1313	845	711
Stock purchase	-74	-55	-97	-130	-43	-286	-84	-110
Ending stock	2333	2424	3052	3753	5286	5043	5298	3884
Starting stock	-2119	-2441	-2874	-3858	-4876	-5651	-5398	-3888
GROSS PRODUCT VALUE	**4878**	**4325**	**4695**	**6757**	**6042**	**6418**	**5496**	**5516**
Fodder purchase	158	308	167	358	468	1203	736	486
Lick & concentrates	1789	1628	1895	2414	1707	2223	1823	1926
Veterinary	135	102	129	141	119	153	142	132
AI Cost	92	69	49	70	51	46	12	56
Cleansing	37	50	50	54	73	71	63	57
Insurance	0	0	0	0	0	0	0	0
Marketing	47	42	23	450	76	93	56	112
Transport	63	86	90	94	21	31	76	66
Labour	7	29	38	33	61	32	26	32
Fuel	24	0	2	6	0	0	0	4
Repairs	85	117	93	90	64	61	57	81
Consultations	85	188	168	69	118	80	65	110
Other Expenses	76	132	166	231	174	19	22	117
DIRECT EXPENSES	**2599**	**2752**	**2870**	**4011**	**2932**	**4015**	**3076**	**3179**
Cost of farm fodder	160	164	211	260	757	392	586	362
Allotted administration	17	9	18	21	20	48	53	27
Allotted labour	48	22	24	28	251	249	244	124
Allotted repairs	39	23	40	29	88	72	79	53
ALLOTTED EXPENSES	**264**	**218**	**293**	**338**	**1115**	**761**	**962**	**565**
TOTAL EXPENSES	**2863**	**2971**	**3163**	**4348**	**4047**	**4776**	**4038**	**3744**
ENTERPRISE MARGIN	**2014**	**1354**	**1532**	**2408**	**1994**	**1642**	**1458**	**1772**

Source: Computus Bestuursburo, BK

TABLE 2: AVERAGE CAPITAL INVESTMENT OF DAIRY FARMERS IN THE EASTERN FREE STATE

	1998	1999	2000	2001	2002	2003	2004	Average
Investment in machinery	837012	688555	918508	1182788	1087102	1493442	1396912	1241202
Investment in live stock	432740	366872	403335	586839	720145	806880	822070	690135
Total investment	**1269753**	**1055427**	**1321843**	**1769627**	**1807247**	**2300322**	**2218982**	**1931337**

Source: Computus Bestuursburo, BK

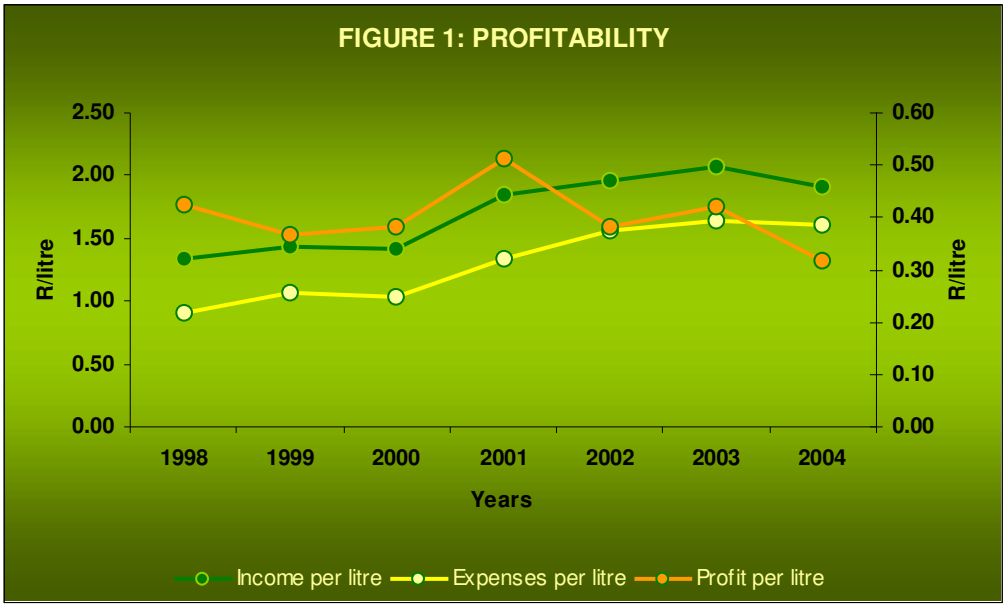
FIGURE 1: PROFITABILITY
2.50
2.00
1.50
1.00
0.50
0.00
R/litre
0.60
0.50
0.40
0.30
0.20
0.10
0.00
R/litre
1998
1999
2000
2001
2002
2003
2004
Years
Income per litre
Expenses per litre
Profit per litre

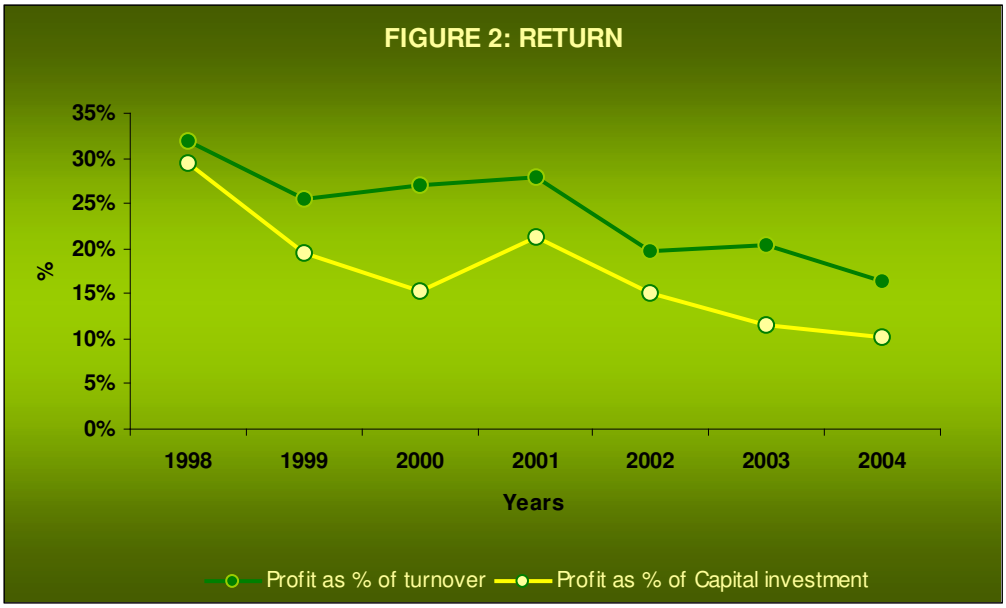
FIGURE 2: RETURN
35%
30%
25%
20%
15%
10%
5%
0%
%
1998
1999
2000
2001
2002
2003
2004
Years
Profit as % of turnover
Profit as % of Capital investment