DID DAIRY FARMERS ACTUALLY MAKE A BIG PROFIT IN 2022?

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As the 2022 financial year comes to a close for Dairy Farmers, the record high milk payout forecast from all dairy companies is a positive to celebrate. But the question needs to be asked, has the high payout resulted in more cash in the pocket?

Also of concern, what are the tax implications? Was it in fact a good year for our dairy farmers and what will future cashflows look like for the 2023 year.

High demand for our products and good returns overseas along with excellent grass growth in the spring and early good production levels made for much positivity in the sector. The hype of a high payout for 2022 continued to grow through the season when Fonterra forecast it's highest ever of $9.60 midpoint per kilogram. However, many farmers did not get too excited as they had clear memories of the previous high in 2014 of $8.40, which was quickly followed by a drop to $4.40 and subsequently $3.90 the following year.

Also, for many farmers, the autumn drought has been the worst they have seen. Intermittent skiffs of rain gave hope of more to come. Greater quantities of supplements were fed to push out the drying off date but was mostly all in vain. The 2022 forecast also took a small downward turn on the back of decreasing world demand for product despite a favourable exchange rate for exporters, currently under $US 0.65.

Meanwhile an inflation rate of 6.9% has been announced for the March quarter. That is bad enough. However, farm inflation is running much higher and has created a lot of nervousness. For example, the palm kernel price has increased by up to $200 per tonne. Fertilizer has increased and fuel prices continue to soar. The 2022 Federated Farmers and Rabobank remuneration survey shows an increase of approximately 15% in employee's gross income since the previous survey two years ago largely due to a shortage in the labour market due to problems with immigration, and as everyone is aware, bank interest rates continue to increase with the Official Cash Rate (OCR) now at 2.00%, the highest since 2016.

These increases in expenses all counteract the positive of the increased milk price.

Many farmers will feel cash is tight after repaying bulk debt, and potentially having purchased the long awaited new tractor. Using cash on capital items does not mean less profit, but simply less cash in the pot left to pay the tax bills. Therefore, it is important to quantify the effect on the bottom line.

To analyze the effective payout in the 2022 tax year, we need to consider the 2022 advance rate and the previous year's deferred rate, using a Fonterra farmer as an example.

In the 2022 tax year the advance rate was $7.70 plus deferred milk from 2021 at $1.49 plus 30c dividend which gives an effective payout of $9.49.

The 2021 final payout was $7.54, but when adjusting for the tax year, an advance rate of $6.05 plus deferred milk from 2020 year at $1.34 plus a 10c dividend, gave an effective payout for tax purposes of $7.49. This is $2.00 per kilo more for 2022 compared with 2021. This is effectively extra income of $300,000 for a dairy farmer producing 150,000 kg of milk solids - but how much of this is profit?

The majority of dairy farmers have a May balance date, so with their next provisional tax payment due at IRD on 28 June, this is a good time to review the financial year profits. In addition, as the 2023 budgets are currently being completed, it is important to accurately forecast the tax payments which will be due.

No one likes to think about tax, but it is a cost which we at CooperAitken can help to plan for. If funds are short, it is not a good idea to simply not pay the tax that IRD are expecting. Better options include agreeing to an installment arrangement with IRD before the due date. Alternatively, tax pooling is an excellent mechanism to lock in lower interest rates than what the IRD will charge and is simpler than increasing the bank overdraft limit. The use of Income equalization can be another option.

It's a great idea to get your accountant to prepare an estimate of the 2022 profit before provisional tax is due on 28 June. This will help with the 2023 budget, show where the funds are required and give peace of mind. If any of the specialist rural team at CooperAitken can help, please contact us.