Contract milker

Description

A contractual arrangement where the farmer managing the property is paid on a set price per kgMS produced.

Background

A contract milker (CM) typically provides the labour, and pays for shed costs, electricity, transport and sometimes a share of feed and nitrogen costs.

There has been a significant shift towards CM agreements in recent years. CM agreements are lower risk to a CM than variable order sharemilker agreements given the payment is a fixed rate that is not related to milk payout. CM contracts offer some income security to milkers in a low milk price, but do not offer the same profit opportunities in high milk price years as VOSM contracts.

On the larger scale farms, contract milking businesses can be very successful at allowing progressing farmers to generate enough surplus for further dairy industry investment. At the smaller end of the farming scale however <150,000 kgMS/yr, the profit margins for the contract milker are sometimes not sufficient to allow them to build equity and progress through the dairy industry.

Advantages and considerations

Advantages

Contract milker

- Given milk production is relatively stable compared to milk price, the Contract milker agreement reduces the financial risk for the Contract milker.
- Contract milker agreements are common and relatively simple to understand and administer.
- Minimal equity is required
- Having 'skin in the game' brings a vested interest in increasing productivity.

Farm owner

- Can take a more hands off approach with the farm
- A set income for the contract milker e.g. $1.20 per kgMS makes budgeting simpler for farm owner

Considerations

Contract milker

- Not affected by a decline in milk price, but neither do they benefit from a lift in the milk price.
- At the smaller end of the farming scale <150,000 kgMS, profit margins for a contract milker are sometimes not sufficient to allow them to build equity and progress.

Farm owner

- Budget wisely, if the payout drops significantly the farm owners' income suffers
- Responsible for ensuring farm infrastructure etc. is maintained
- A fair and reasonable contract rate is agreed to ensure a viable business for the contract milker, which will help with success and longevity of the relationship.

- Consider the drivers of contract milking (predominantly production-driven) and decide if that aligns with your farming philosophy.
- Instilling good reporting mechanisms that satisfy your need to show how the business is tracking will allow a more hands off approach.
- If a farm owner is closely monitoring and directing the day-to-day activities of the contract milker then the relationship may be closer to that of an employee. Click here for more information.

Keys to success

- Good budgeting is essential to understand the costs and profitability of the CM business prior to agreeing a rate and signing the contract.
- Shared farm philosophies between parties and understanding will aid in the success of the relationship.
- The farm owners and the CM should agree in principle a basic annual farm plan including expected fertiliser, nitrogen and supplement feeding inputs. This will ensure both parties understand what inputs can be expected throughout the season and have confidence in the milk production target.

Financial

Drivers

The main drivers for this option are cash returns driven by the negotiated contract rate and milk production.

Equity required

A contract milker requires minimal equity. They will typically provide farm bikes, tools and enough working capital to pay for staff, fuel and shed costs for the first three months until milk income starts coming in.

Financial returns

Will vary depending on contract rate. It is important both parties understand the CM budget to set a fair contract rate:

Example

The below budget is an example from a 300 cow, position in the Waikato with 22-aside herringbone with an agreed price of $1.20KgMS. Make sure you do your own budget for your situation.

Income	
135,000 kgMS x $1.2/kgMS	$162,000

Expenses	
Permanent Labour	$35,000
Relief staff	$4,000
Running bike costs (quad and two wheeler)	$5,500
Fuel	$2,800
Cleaning materials and costs	$1,000
Rubberwear, milk filters etc.	$3,000
Tools	$500
Safety clothing	$500
Electricity	$13,000
ACC	$3,200
Insurance	$1,800
Accountant	$2,200
Communication	$1,800
Total Costs	**$74,300**

Cash surplus for CM pre tax= $87,700

Total package including accommodation valued at $14,000 = $101,700

Notes

- Depreciation on farm bikes should be considered. If a quad bike is purchased for $12,000 and worth $2,000 after four years, this has cost the CM $2,500/yr in depreciation.
- Make sure there is sufficient cashflow in the business to cover the first three months of expenses as there may be no income over this time.
- Always have some cash spare in the budget for contingencies like bike breakdown.

Skills required

The contract milker will need:

- farm management skills
- financial management/budgeting skills
- people management
- Health & Safety knowledge
- Environmental compliance and regulations for region

How easy is it to enter/exit agreements?

Contract milker agreements are simple and easy to enter and exit and are often on a one year rolling contract for this reason.