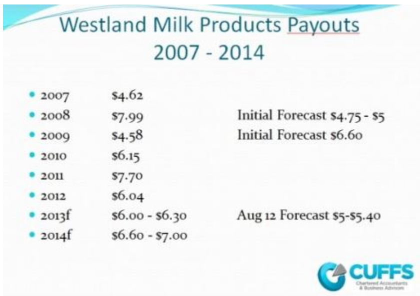
Strategies for Managing a Fluctuating Payout

Over recent years we have seen significant fluctuations in the dairy payout both between and within seasons. The table opposite shows the fluctuations from 2007 to the forecast for 2014.



Westland Milk Products Payouts
2007 - 2014

2007	$4.62	
2008	$7.99	Initial Forecast $4.75 - $5
2009	$4.58	Initial Forecast $6.60
2010	$6.15	
2011	$7.70	
2012	$6.04	
2013f	$6.00 - $6.30	Aug 12 Forecast $5-$5.40
2014f	$6.60 - $7.00	

Establishing strategies to manage cashflow resulting from variable payouts can assist in many ways. Managing tax, reducing stress, proactive rather than reactive planning and the ability to improve your rating with the bank and achieve reduced margins are some examples.

Firstly, some tips for a low payout year.

- Defer non-essential maintenance on buildings, fences, drains and other farm assets.
- Your accountant can defer fertiliser claims.
- Bring back any IRD Income Equalisation Deposits. This evens out the tax rate and payments made.

In a high payout year the reverse applies.

- Undertake deferred maintenance.
- Buy consumables, for example, fencing materials, drench, fuel, detergents, AI (semen cost) and feed prior to balance date. From a tax perspective you can retain up to $58,000 of consumables on hand.
- Accelerate certain expenditure e.g. prepay rental of land and buildings. You are not allowed to exceed $23,000 and 6 months payment in advance.
- Prepay services, for example, AI servicing, accounting and farm advisors. For this type of expenditure you cannot exceed $12,000 and 6 months in advance is allowed.
- Consider also forward payment of rates and insurance up to a year in advance and buy up mileage for diesel vehicles.
- Put money into Farm Equalisation Deposits.
- Undertake farm development work like weed and pest eradication, fencing and land clearing in a good year. This will also help with increased productivity in a bad year.

Purchasing assets like tractors is not recommended. There is only a minimal tax saving on the depreciation claims which are also based on the number of months you have owned it in the year.

Other strategies can include buying assets on HP in low years (as they are only affordable if you can afford the payments in a low payout year) and paying cash for assets in high years to avoid the burden of repayments in difficult years. Lump sum repayment of debt in good years can also be a worthwhile strategy.

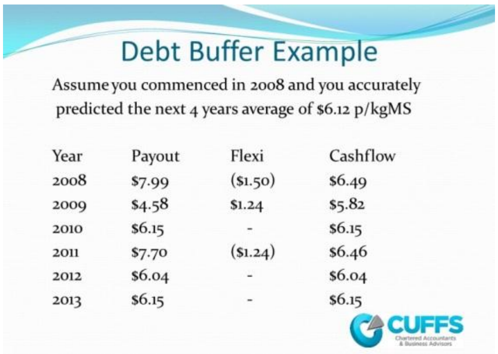
Another way of managing it is to establish a Debt Buffer. So what is a debt buffer?

This is a separate flexi loan. I have suggested it be approximately $1.50p/kg MS. Use this to manage the highs and lows yourself rather than going to the bank for overdrafts.

To set this up firstly calculate what you believe the average future payout is going to be. Then set yourself a variation band around this payout at which you won't take any action with your debt buffer. I have suggested 30c up or down. When the payout is then 30c over your average payout estimate, pay any surplus above this off the flexi. When the payout is 30c less than your estimate, bring any deficit back from the flexi loan.

In the table opposite, I have shown how this would work if you had set an average payout of $6.12 in 2008 (which was the average for 2008 and the next 4 years).

So in 2008 when the payout was $7.99 you would have paid $1.50 off the flexi to bring it down to zero. Then in 2009 with the payout of $4.58 you would have brought $1.24 back giving you $5.82 in your cashflow. In 2010 you would have done nothing as the payout is within the band and in 2011 you would have again paid $1.24 off the flexi. 2012 & 2013 will be within the band so you would do nothing.


Debt Buffer Example

Assume you commenced in 2008 and you accurately predicted the next 4 years average of $6.12 p/kgMS

Year	Payout	Flexi	Cashflow
2008	$7.99	($1.50)	$6.49
2009	$4.58	$1.24	$5.82
2010	$6.15	-	$6.15
2011	$7.70	($1.24)	$6.46
2012	$6.04	-	$6.04
2013	$6.15	-	$6.15

What you get as a result is a much smoother inflow of funds into the cashflow of your trading account. See the cashflow column of the table above.

This strategy should be set up in an above average payout year – like 2013/14 is expected to be! Alternatively you could pay a lump sum off your debt in a good year, but this is not so easy to get back in a bad year. <u>With a flexi loan you control it yourself.</u>

Following the advice above will mean you spend the money when you have it (the high payout year) and you will spend less when you don't.

If you would like to know more about these strategies, view the video in the farm accounting section of www.cuffs.co.nz or contact me at the office.

Happy farming.

Peter Cuff
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Level 2, Como House, 51 Tancred Street, Hokitika 7810
• PO Box 325, Hokitika 7842
• **Phone** 03 755 8866 • **Fax** 03 755 8910
• **Email** team@cuffs.co.nz • **Web** www.cuffs.co.nz

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