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Organic milk production: financial performance

Market prospects

The organic milk sector has altered course from one where demand could not keep pace with the four-fold increase in organic milk supply as seen in 2001/02 to one where increasing organic liquid milk sales are leading to a supply shortage as seen in 2005/06. This is resulting in a better business outlook for the organic dairy sector which in the past has been forced to sell a proportion of organic milk on the conventional market. Now with the main milk buying co-operatives expressing concern that increased supplies are required to meet continued rising demand in the future, farm gate prices are reaching 26-28ppl for organic milk.

The increased demand for organic milk can be attributed to promotional work by Calon Wen and the Organic Milk Suppliers Cooperative Wales, and by the multiples, to build the retail market, which is predicted to grow at 25% annually. Other market growth factors include research work relating to the higher Omega 3, vitamin and antioxidant content of organic milk as well as on-going media coverage of animal welfare and food quality aspects of intensive farming systems.

Despite positive market signals for the organic milk sector, producers looking to convert to organic production should seek advice from any of the organic milk co-operatives and ensure that they secure organic supply contracts prior to conversion. This is essential to avoid tipping the balance from planned expansion to meet demand to a recurrent oversupply situation.

Dairy enterprise performance

The gross margin performance for dairy herds recorded in Wales by the Farm Business Survey is lower under organic production at the recorded price levels in 2004/05 than for conventional production. The effect of selling organic milk at conventional prices is worse still under organic management, mainly due to the high price of organic feed. Another main difference in performance between the systems is in stocking rates. This is partly due to reductions in forage yield with reduced fertilizer use, but mainly due to the need to produce more forage on the farm rather than relying on bought-in feed inputs. These differences explain the need for a price premium and resulted in lower returns per ha on a gross margin basis for organic farms than conventional farms. At current (2006) price of 26ppl, organic herds perform better.

Gross margins for organic and conventional dairy herds, 2003/04 - 2004/05

	2003/04		2004/05	
	Organic	*Conv*	*Organic*	*Conv*
Sample No.	9	81	9	65
Milk yield (litres/cow)	5,233	6,431	5,326	6,188
Milk price (ppl)	19.55	18.05	19.14	18.15
Values (£/cow)				
Financial output	1,028	1,160	1,058	1,165
Purchased feed	207	241	200	231
Other costs	95	122	155	155
Total variable costs	302	363	354	386
Gross margin	**726**	**797**	**703**	**780**
at conventional prices	648	-	613	-
at 2006 org price (26ppl)	1,064	-	1068	-
Forage costs	68	96	75	89
GM inc forage (£/cow)	**659**	**701**	**628**	**691**
Assumed stocking rate*	1.6	2.2	1.6	2.2
GM inc forage (£/ha)	**1,054**	**1,541**	**1,005**	**1,520**
at 2006 org price (26ppl)	1,702	-	1,709	-

Source: Institute of Rural Sciences, UWA

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Whole farm profitability

Survey data for 2004/05 for the dairy sector in Wales show net farm incomes for all farm sizes averaged £295/ha (Welsh Farm Business Survey data, 2004). Organic farms extracted from this survey data found net farm income was lower at £212/ha compared to conventional farms. Similarly for 2003/04, the organic survey farm data indicated lower net farm incomes for organic dairy farms at £215/ha compared with conventional farms at £334/ha. For these organic samples, an additional 4 ppl would have added £214 and £286 to net farm income in 2003/04 and 2004/05 respectively, resulting in higher incomes than the conventional group.

Net farm incomes on organic and conventional dairy farms, 2003/04 - 2004/05

	2003/04		2004/05	
Values (£/ha)	*Organic*	*Conv*	*Organic*	*Conv*
Milk yield (l/cow)	5,233	6,445	5,326	6,190
Milk price (ppl)	19.55	18.22	19.14	18.13
Size (ha)	93	102	114	94
Dairy output	1,098	1,674	1,400	1,609
Other output	339	448	383	450
Total outputs	1,436	2,122	1,783	2,059
Feeds	305	478	381	441
Other livestock costs	111	182	170	193
Crop costs	31	138	61	123
Whole farm margin	**990**	**1,324**	**1,171**	**1,301**
Labour	259	328	328	320
Machinery	164	213	199	211
Other fixed costs	352	450	431	474
Total inputs	1,222	1,788	1,571	1,763
Net Farm Income	**215**	**334**	**212**	**295**

Source: Institute of Rural Sciences, UWA

Cost of milk production

In 2003/04, the cost to produce a litre of milk averaged 15.46 ppl according to the latest organic financial data from UWA. The Farm Business Survey in Wales found that the cost of production was 15.62 ppl in 2004/05 for their organic farms surveyed. These data do not cover the hidden costs of production including unpaid labour costs (2.55 ppl), imputed rent (1.34 ppl) and interest on tenant's capital (1.57 ppl). This equates to an average "true" cost of production figure of 20.92 ppl in 2003/04. The same survey farms received 20.84 ppl for their milk for this financial period.

Summary

Organic milk production is an alternative for dairy producers, depending on the price that can be obtained and whether costs can be kept under control. A premium is required to match conventional incomes and producers should be looking to secure a milk price that will at least cover costs of production. Previous studies have indicated that a premium of ca. 5 ppl is needed for organic farmers to achieve similar results to conventional, although market conditions at present indicate better price premiums. This is a significant step forward from previous years when organic producers were only obtaining 19-21 ppl, and those selling on conventional markets alone only 18-19 ppl, which was below the cost of production for many producers. A key message for farmers considering conversion is to obtain an organic supply contract prior to conversion to ensure a price premium; otherwise the economics of conversion to organic farming can be poor.

Overall, the organic route should be seen as a way for viable holdings to produce milk with significant advantages for the environment and enhanced animal welfare. In addition, specialist marketing and added-value processing activities can contribute to business profitability and rural development.

Further reading – Soil Association Organic Market Report 2006
- Organic Farm Management Handbook (2007 edition), UWA
- Organic Farm Incomes in England and Wales (2001/02 – 2004/05), UWA

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