Dairy Sense: Facing Financial Angst

A good record keeping system and chart of accounts goes a long way to empower producers to take the first step in learning their breakeven cost of production.

Image by Arek Socha from Pixabay

Production perspective:

Farming is a business and to succeed in today's market an operation needs to track income and expenses. This sounds like a simple process but anyone who has done cash flow planning, filling in balance sheets and income statements knows it is very complex. Add in the animal and crop production aspects and the result is information overload. For some, just thinking about all the details required to determine cost of production is enough to send them running in the opposite direction. Much of this anxiety could be eliminated with a good record keeping system and chart of accounts. This would go a long way to empowering more producers to take the first step in learning their breakeven cost of production.

The Extension Dairy Business Management Team has worked with hundreds of producers over the past decade on their cash flow plans. Many were apprehensive at first when going through the process of determining their cost of production. However, after the initial collection of both financial and production related data, the vast majority continued working with Extension on an annual basis to evaluate their plans against their actual income and expenses for the year. Tools have been developed to help simplify the process and to make it less painful. The easiest first step is evaluating the whole farm system. This considers not only the milk income, but other farm income. An operation can still know their breakeven number for their business, the missing part is knowing the cost of production for the dairy and cropping enterprises. This is the part requiring extra effort to segregate data, especially expenses, to the correct categories.

A question being asked by many producers "Is it worth continuing dairying if the other income streams are subsidizing the dairy?" After evaluating many break-evens for the whole farm and the dairy enterprise, this is a legitimate question. The past few years have been extremely tough, and a lot of operations have depended on alternative sources of income to survive. This is another reason why knowing the cost of production for the dairy enterprise is so important.

From the financial side, the most difficult numbers to gather are loan payments, line of credit, and credit card debt. Most of the other expenses for dairy and overheads are usually well organized. The other part that can get complicated is doing cash flows on an accrual basis. This means tracking payables owed to vendors. This number has increased steadily over the past few years due to unsustainable milk income.

Feed costs are the top or second highest expense on a dairy. Assessing the rations for all animal groups, tracking inventory and costs can be a time-consuming exercise when developing a cash flow plan. However, it is the single more significant component of the process. It is the costs related to home raised feeds and purchased feed that can tip the scale for a positive or negative cash flow plan. This would include itemizing direct crop costs for each home-raised forage or grain to examine how each enterprise is performing.

Most producers farm because they love working with animals, equipment and crops. It is understandable why the financial side is not attractive and why farmers are not standing in line to participate in cash flow planning workshops. However, data compiled from Penn State's programs show that producers who know their breakeven cost of production, develop a yearly plan, and use that number to make decisions, have experienced lower and lower costs of production over the years. The financial side of the business may be intimidating but it shouldn't be the excuse for not knowing the cost of production.

Action plan for evaluating the whole farm system

Goal – Complete a cash flow plan for the whole farm

Step 1: Using Penn State Extension's Excel spreadsheet, complete a year end analysis for 2019 on both a cash and accrual basis.

Step 2: Compile income for the dairy and other sources including crop sales or other farm income (custom work, hogs, birds etc.).

Step 3: Compile expenses for the dairy, crops, feed, overheads, family living, and loan payments including principal and interest.

Step 4: Include accounts payable. The usual areas are feed, seed, fertilizer, and vet expenses.

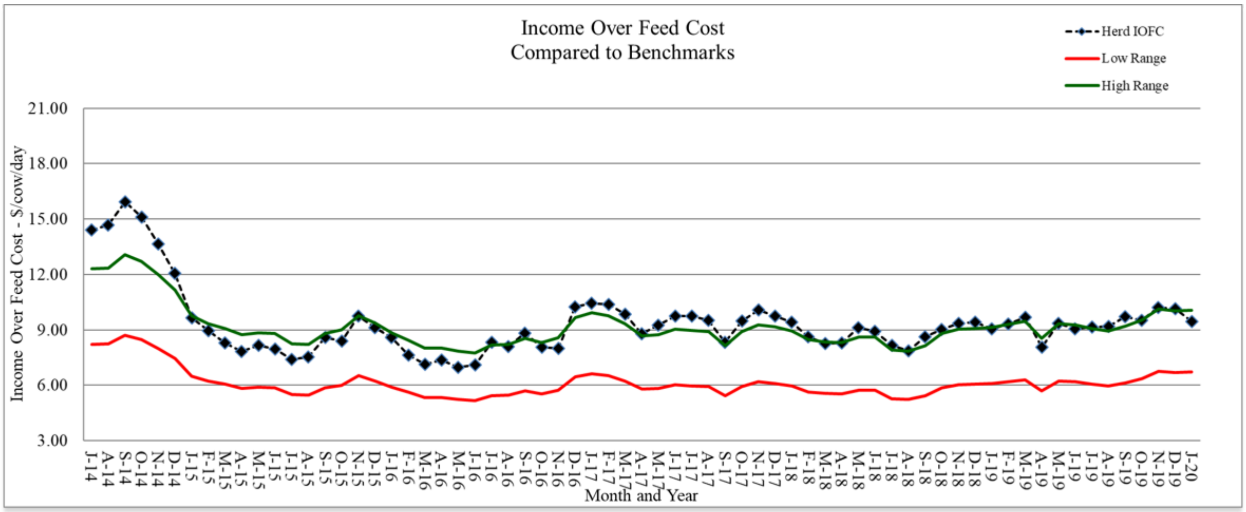
Step 5: Work with the appropriate consultants to discuss the farm's cost of production and the possibility of breaking out the dairy and crop enterprises.

Economic perspective:

Monitoring must include an economic component to determine if a management strategy is working or not. For the lactating cows, income over feed cost is a good way to check that feed costs are in line for the level of milk production. Starting with July 2014's milk price, income over feed cost was calculated using average intake and production for the last six years from the Penn State dairy herd. The ration contained 63% forage consisting of corn silage, haylage and hay. The concentrate portion included corn grain, candy meal, sugar, canola meal, roasted soybeans, Optigen and a mineral vitamin mix. All market prices were used.

Also included are the feed costs for dry cows, springing heifers, pregnant heifers and growing heifers. The rations reflect what has been fed to these animal groups at the Penn State dairy herd. All market prices were used.

Income over feed cost using standardized rations and production data from the Penn State dairy herd.



Note: January's Penn State milk price: $19.73/cwt; feed cost/cow: $7.33; average milk production: 85 lbs.

Feed cost/non-lactating animal/day.