

ECONOMIC STRATEGIES FOR THE DAIRY INDUSTRY

Dairy farmers are experiencing extremely difficult economic times. Even the exceptional producers are feeling the pinch of brutal economics. Milk prices are at historic lows, corn grain and alfalfa hay were at record highs last summer when the barns and bins were filled, and the milk/feed price ratio is so low it is almost off the charts. Most dairy producers are in survival mode, attempting to hang on until the situation improves.

The extreme volatility of the market has forced some dairymen to exit the business, but that decision does not always solve the economic problem. Cows are relatively cheap today, and if a buyer can be found, cows are selling for cents on the dollar. Then, after the cows are gone, one still needs a job in order to meet the ongoing expense of family living. Where does a 40 or 50 year old dairyman go to find a job in today's economy?

With that as a background, I was most interested in a presentation by David Brown at the recent Utah Dairy Convention. Mr. Brown is Vice President of Credit Services at Western Ag Credit Bank, but he also lives and works on a successful dairy farm in Summit County. His presentation was filled with practical suggestions on how to survive during this severe down cycle.

Brown's first point was to keep accurate financial and production records. That includes a detailed balance sheet prepared at the same time each year, income and expense records with accrual adjustments, individual enterprise analysis that includes cost per unit of production, and production records similar to those provided by DHIA.

Accurate financial and production records allow producers, lenders, and consultants to precisely measure financial progress, profit or loss margins, liquidity and solvency and a host of other ratios. Accurate records are the foundation of good decisions. Decisions based on wrong assumptions can be very costly to an agricultural operation.

Second, Brown discussed the importance of a strong business relationship with a qualified agricultural lender who has a passion for the industry. Lenders can provide constructive feedback to management if there is free and honest dialogue between both parties. Since agriculture is so capital intensive, borrowers must select a lender who has a long-term commitment to agriculture. The worst thing is to avoid each other when times are difficult.

The third point of "competitive advantage" was intriguing to me. Mr. Brown explained that every dairy has some competitive advantage over other dairies. For some it may be superior genetics, others may have an exceptional workforce, some raise all their own feed and some are debt free. I know some dairies that do an exceptional job with milk quality, always taking advantage of premiums. Others are superb in raising baby calves, which allows them to expand the dairy internally or sell excess replacement heifers each year. Dairy producers were encouraged to identify their competitive advantage and then maximize it to the limits.

David also reminded producers to focus on the “big three” operating expenses. Feed, labor and replacement costs typically comprise near 70% of total operating expenses. There is no need to stew and brew over the little things until the “big three” are properly managed. Some producers, for example, drop DHIA testing in order to save a few dollars. Such a decision goes against Brown’s first point of maintaining accurate financial and production records and does very little to reduce overall operating expenses.

Other suggestions included carefully scrutinizing feed rations (with much caution), selling non-essential assets, restructuring debt, replacing marginal cows with lower priced springer heifers, and staying current on payables that carry a high rate of interest.

Mr. Brown expressed optimism that economic prosperity will return to the dairy industry. Those who have the financial resources, desire, and commitment to remain in the business will reap the benefits. The dairy producers who establish a cost structure and management program that allows them to be profitable and competitive under average market conditions will generally survive the lows and prosper during the highs.