

Livestock Enterprise Management: Key Financial Considerations

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Recent IRS Ruling: Capital Purchases



WVA livestock producers



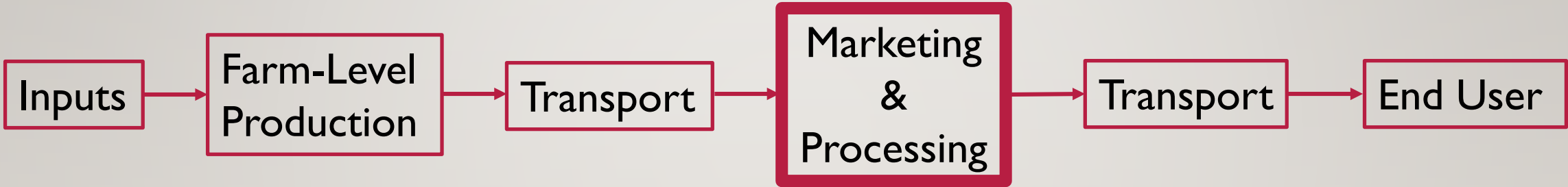
- Disclaimer: Um, no. Fake news.

What's Going On Out There?!

- Disruption in supply chain
 - Concentration in processing
 - Capacity issues (retail vs institutional....)
 - Lower demand for live cattle = lower farm-level prices
 - Lower supply of available meat = higher retail prices
 - Impact on longer-term consumer demand?
 - Reaction of the meat substitutes?

Simplified Livestock Industry “HACCP” Diagram

Regulation



Environment

Doc White's Crystal Ball (Magic Eight Ball!)

- Looking for large structural changes to the US system
 - Move away from the concentration of processing?
 - Local “breaking stations”
 - Move away from JIT inventory systems?
- Decreased efficiency may lead to higher consumer prices
 - Impact on demand?



What Else Is Going On Out There?!

- Lower expected imports (USDA)
- Record beef production expected in 2021 (USDA)
- Increased lamb/sheep production expected (USDA)

May 18, 2020 Livestock, Dairy, and Poultry Outlook, LDP-M-311, USDA ERS

So What?

- Not much upward pressure on farm-level livestock prices
 - Potential cash flow & liquidity issues
- How to prepare for the next few years?
 - Change herd size?
 - Change production (rations, etc.)?
 - New enterprises?
 - New marketing plan?



Stick to the Fundamentals

- **Revisit your goals and core values**
 - Critical to your decision making!
 - “Maximize Profit” vs “Minimize Losses” = different choices
 - “Minimize Taxes” vs “Maximize What’s Left After Taxes”
- Have a plan
 - And 2 back-up plans
- You’re already used to making decisions in uncertain times
 - Stick to your fundamentals

Fundamental Thought Process

- **“If it costs more than it’s worth, don’t do it”**
- Partial Budget
 - “Good Side”
 - Added Revenues
 - Reduced Expenses
 - “Bad Side”
 - Reduced Revenues
 - Added Expenses
- If the Good Side > Bad Side: Your profits should increase

Sell 750-lb Calves vs 550-lb Weaned Calves

- Assumptions:
 - Spring calving (Feb/Mar)
 - 550-lb calf at weaning (Oct) \$134/cwt (Sept 2020 futures, no basis)
 - 100 days to reach 750 lbs \$120/cwt (Jan 2021 futures, no basis, \$12 slide)
 - Pasture cost
 - Hay equivalent @ \$120/ton; pasture lbs DM/acre = 300 x average height (inches)
 - \$15/head “other cost”
 - Vet, grain, interest, etc.
 - 1% death loss, 2% shrink

Sell 750-lb Calves vs 550-lb Weaned Calves

Partial Budget

Good Side		Bad Side	
Added Revenue:		Reduced Revenue:	
750-lb Calf	\$873	550-lb Calf	\$737
Reduced Expenses:		Added Expenses:	
		Feed (Hay Eq)	\$93
		Other	\$15
Total Good Side	\$873	Total Bad Side	\$845
Net Change in Profits = \$28/head			
Breakeven Selling Price (adj. for death loss & shrink)		\$116/cwt	
Maximum Cost of Gain (\$/lb gain)		\$0.68/lb gain	

Financial Management Tips

- Develop an improved financial record keeping system
 - **Enterprise accounting**
 - Must know your Cost of Production (COPs)!!!
 - \$/cwt, \$/acre, \$/cow, \$/lb of gain
 - **Accrual basis or accrual-adjusted records**
 - Good COPs = based on accrual-based enterprise accounting
 - Requires BOY & EOY balance sheets
 - Bad COPs = based on cash-based Schedule F

55-70%
difference
between cash
and accrual
net income!



Cost of Production (by enterprise)


- Short-Run COP = Total Variable Costs / Output
 - Try to cover the SR COP most years
- Long-Run “Geek” COP = Total Expenses / Output
 - Includes Owner Labor, Interest Forgone....
- **MUST cover LR COP on average**
 - Otherwise, “living off depreciation”, “recreational farming”
 - Or answering this question, “Honey, why can’t we go on vacation...?”

Benefits of COPs

- Breakeven selling prices
 - Useful for hedging & contracting!
- Maximum input prices
- Buy vs produce decisions
 - Feeds, replacements, etc.
- Marketing decisions
 - Add more gain or not?



Cost of Gain

- SR Cost of Gain = Total Added Variable Costs / Total Gain
 - LR Cost of Gain = Total Added Cost / Total Gain
 - **Compare to value of added gain**, not the price/cwt
 - 600-lb calf @ \$140/cwt = \$840
 - 700-lb calf @ \$130/cwt = \$910
-  \$70/cwt value, not \$130/cwt

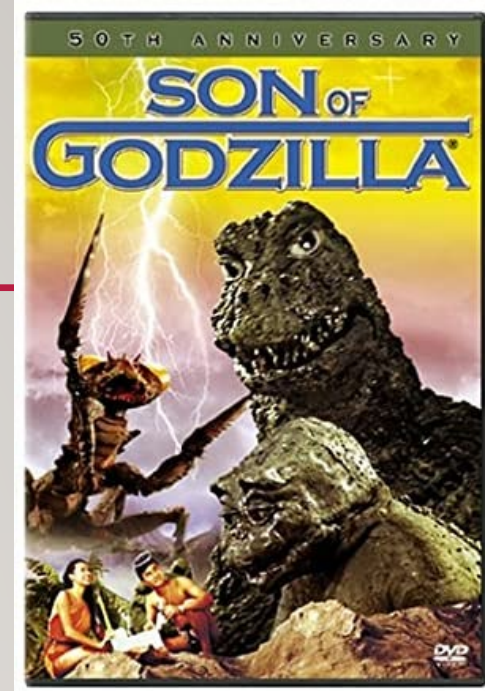
Financial Management Tips Again

- Develop a monthly cash flow statement (aka cash budget)
 - Farm and **household** cash flows
 - Helps you plan for the upcoming year
 - Identify periods of cash surplus or deficit
 - For debt prepayments, savings/liquidity, capital purchases
 - Estimate operating loan/line needs & repayment
 - Scheduling of term debt payments
 - Improve communication with your creditors



Son of Financial Management Tips

- Talk with your lender
 - **Maintain constant, open communication**
 - Discuss your operating needs – Op Loan/LOC
 - Options for repayment of operating debt this fall
 - Needs for next year if 2020 isn't a good year



Return of Financial Management Tips

- Have a tax management plan
 - Including SE Taxes and Income Taxes = ~25-35%
 - **Need to spend \$3-4 to save \$1 in taxes**
 - What if you use the other \$2-3 to build liquidity, pay down debt, etc.?
 - Prepaying expenses – need an exit plan
 - And it is an unsecured transaction
 - Carryback/carryover of losses
 - 2 years back, no time limit forward



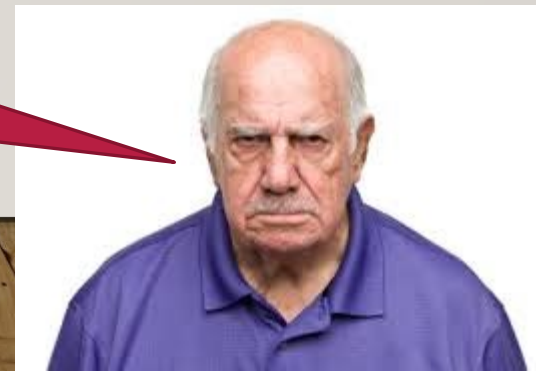
Tax Move: Prepaying Expenses

- Last year you prepaid \$50,000 for feed/fertilizer in December
 - 30% taxes (including SE)
 - Save \$15,000 in taxes
- Assume this year is a bad year (low price)
 - There's no cash or LOC available for this year's prepayment
 - Already expensed the \$50,000 last tax year
 - Nothing to offset the revenues for this tax year
 - Your taxable income will be \$50,000 **higher** in a bad year

Tax Move: Buying Assets You Don't Need

- Need to spend \$30-40,000 to save \$10,000 in taxes
 - Hurts liquidity, profitability, & financial efficiency
- Borrowing funds to make (unneeded) purchases for tax purposes
 - Hurting liquidity, solvency, repayment ability, profitability & financial efficiency
 - Guess what your lenders use to evaluate your financial condition
 - Go ahead, guess

Mmph, why give
money to the
government?
Mmph!



Same Old Same Old

- Build your emergency savings (usable liquidity) to 3-6 months
 - Working Capital/Expenses > 25%
- **Have a clear, defined marketing plan**
 - Price protection is critical!
 - Stick to your fundamentals!
- Have a risk management plan
 - Back-up markets, liability insurance, estate/transition plan