Master Cattleman Quarterly

Oklahoma State University

Proactive Economic Planning

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The cattle industry, along with many sectors of the economy, faces critical challenges in the months ahead. It is easy to become rather fatalistic about our situation when markets are weak and volatile, especially when many of the causes are external to the industry and broad-based across the economy. We have a tendency to feel that economics is just what happens to us and there is nothing we can do about it.

It is certainly true that we probably cannot avoid or completely mitigate current adverse economic impacts. However, changing economic conditions imply that every producer needs to think about adjusting to endure hard times in the short run and prosper longer term. Here are three levels of consideration for your 2009 business and management plan: survive, optimize and thrive.

Business Survival: Assess the extent to which the current situation threatens the very survival of your business. If the threat is large, adopt a defensive posture and think about significant and necessarily unpleasant adjustments that must be made. The one thing for sure is that waiting and doing nothing will be worse than whatever you decide to do now. An operation facing serious threat of failure must consider debt restructuring, liquidation of some assets and significant adjustments to family living expenses, among others. The current economic climate may well mean that producers should consider an expanded risk management program to reduce the threat of a failure in the midst of volatile markets.

Reoptimize Your Operation: Changing values of products and resources means that it is necessary to adjust input and output levels to maintain profitability or in the worst case, minimize losses in the short run. Changing values of feed, fertilizer, fuel and other inputs means that you may need to use less of some inputs, more of others and perhaps stop using some altogether. Consider not only the level of use of various inputs, but also adjustments in timing, intensity and targeting of input use. Changing values for alternative products likely means that you need to reduce production of some things, expand production of others and possibly reduce overall production levels. In any event, doing the same things you have always done or making across-the-board cost reductions or production adjustments will be worse than carefully evaluated and targeted adjustments to production enterprises.

Look for New Opportunities: A dynamic and volatile economy shakes up the status quo and causes many negative impacts but also results in new opportunities. It is the nature of markets that someone's reduced sale value is someone else's buying opportunity. Look for and prepare to take advantage of opportunities for new investment, upgrading assets or repositioning the business as the economy works through a wide range of adjustments and revaluation of resources. Opportunities may be rather short lived and producers must have the vision and courage to act quickly to take advantage of them.

There are no universal or simple recommendations for dealing with the current situation, but there are things that every producer can do to reduce the negative impacts. Producers and their lenders should take a hard look at what they do and how they do it. The tendency is to hunker down and try to ride it out. However, hunkering down when you are on foot in the middle of a busy street will not help…you must have a plan to get out of traffic before you can figure out how to get on down the street...

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Fine-Tuning the Beef Business

Damona Doye, Extension Economist

As Derrell points out in the preceding article, often it is only when circumstances force us to reexamine our daily routines and plans that we do so. Periods of relatively high profitability often do not provide an incentive to change. But, changing circumstances provide motivation for a business audit and fine-tuning. The ability to change depends on the business financial position, its historical performance, and its stage in the business life cycle (start -up, growing, or mature) as well as the financial demands placed on the farm by the family. What follows is more food for thought on how you can better position your business to survive and thrive. We'll take a quick look at farm costs, asset ownership, income levels, enterprise mix, insurance protection, and family issues that impact the farm business.

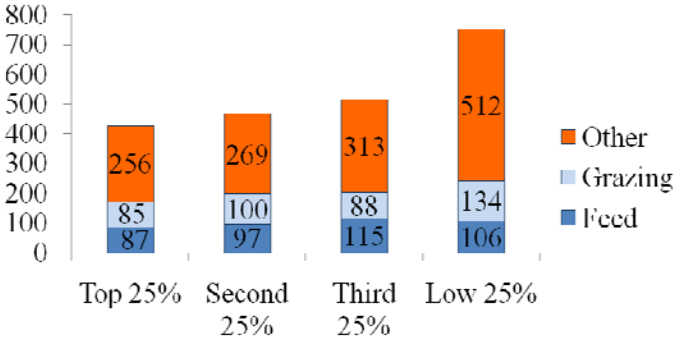

Figure 1. Cost of Production ($ per Cow) by Net Income Quartile

Farm costs

Study after study shows that controlling cost of production is the most important thing that the business manager can do to ensure long-run survival. Sure, it may be fun to brag about snagging a top price for calves or scoring a great rate of gain for calves, but sometimes it is the more mundane chore of taking care of business that really helps the bottom line, increasing farm net worth. Taking an objective view of your farm's finances can be revealing. Lay out three years of tax returns side by side. What are the high-cost categories? Are resources (land, labor, machinery, equipment, money and management) being used efficiently, effectively and profitably? Study farm records to ensure that inputs are being purchased as cheaply as possible and are being fully utilized. Look especially closely at high-cost items, such as interest, machinery costs, rent, feed, fertilizer and labor. Where are costs high relative to other producers who are profitable? Cow/ Calf Standardized Performance Analysis (SPA) data for Texas, Oklahoma and New Mexico, 2002-2007 point out some differences between low and high profit producers (Figure 1).

Some costs may be relatively fixed, some may be variable, and still others may be negotiable. To lower variable costs, consider substituting comparable but less expensive inputs, for instance, adjusting feed rations to utilize relatively low price grains. Shop around for the best prices on all big ticket items. Assess whether inputs could be used more efficiently, such as feeding hay in rings to minimize waste. High repair costs on machinery or equipment may signal the need for additional investment in new equipment or preventative maintenance. Before hiring labor, be sure that it can be fully employed, with minimal time spent on make-work jobs.

If rental rates are out of line with the market, talk to the landlord and see if a new rate can be negotiated. Renegotiating a cash lease to lower the payment will reduce current expenses. Also, changing a cash lease to a share lease will reduce cash outlays and improve liquidity, particularly in poor yield and low price years. Flexible leases can be used to share production and price risk between the tenant and landowner, for instance, by combining features of cash and share leases. In lease agreements, the payment amount, number of payments, timing of payment, and end date are variables to evaluate.

Schedule loan repayments at times when crop and/or livestock sales are expected. Negotiate for lower rates if you have a good record keeping system and can provide financial statements for the lender. Check your depreciation schedule on your tax returns to make sure that it is accurate.

Asset ownership

While producers may feel that they must own land to be farmers or ranchers, some enterprises will not generate the cash necessary to make principal and interest payments, even though potential land price appreciation makes ownership appealing. Fixed asset utilization and management are particularly critical to success and cost containment. Once you've bought land or machinery, equipment, vehicles, breeding livestock or similar capital assets, ownership costs are relatively fixed. Owning assets means higher fixed costs, including depreciation, interest on investment, insurance, property taxes and possibly housing or storage costs. SPA data show that the least profitable producers have significantly higher in-

Opportunities for Change (cont)

vestment cost per cow compared to other producers (Figure 2). While high fixed costs are only a part of the story, it is a significant burden on the road to profitability.

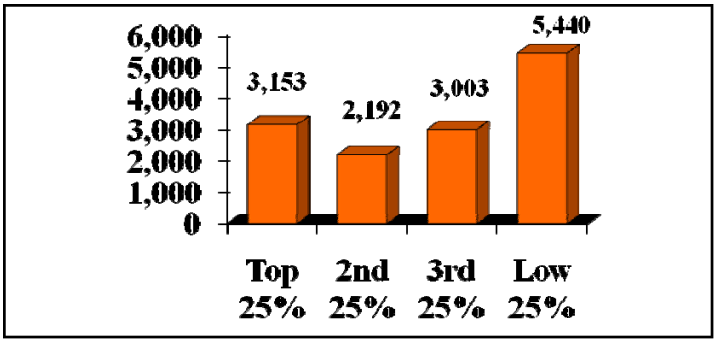

Figure 2. Capital Investment, Cost Basis (dollars per cow) by Net Income Quartile

Real estate (land and buildings) can be controlled by owning, leasing with a multiyear arrangement or renting on an annual or short-term basis. Breeding stock can also be leased or owned. Rental markets may be better developed in some areas than others. Renting or leasing an asset reduces the ownership costs (depreciation, taxes, insurance, interest on investment) while increasing the cash flow and possibly the operating capital needed.

Producers should also evaluate whether vehicles, machinery and equipment are earning their keep, particularly on small operations. Leasing or custom hiring can be a reasonable alternative when equipment is expensive and used infrequently. Machinery availability may be a risk for the farmer with short-term or seasonal operating leases. A financial lease using a long-term contract may alleviate the problem. The long-term agreement is similar to ownership in providing exclusive rights to use the asset over its useful life. Under a financial lease, the producer pays all repair, maintenance and operating costs. With custom hire, ownership costs are avoided and the ranch might gain the benefit from the experience of skilled operators. Jobs may be completed faster and machine use can be readily adjusted to changes in crop mix and market conditions. However, service may not be available at the best time, reliability of custom operators may be a concern and rates are variable. An advantage is that the ranch owner's capital and labor can be channeled to other uses.

Older equipment that is fully paid for and depreciated will not contribute to cash flow or profitability problems unless repair costs and associated down time are very large. However, new vehicle, machinery and equipment purchases can contribute to cash flow and profitability problems if the assets are held for a relatively short period of time and used on small operations. Selling underutilized assets generates cash, but may also trigger recapture of depreciation and increase income tax. Delaying farm capital purchases or postponing improvements may help with short-run financial problems, but place a greater demand on farm income in future years.

Income levels

Ranch profitability can be improved not only by containing costs but also implementing changes that increase volume or price per unit. Thus, improving either production or marketing practices or both can increase ranch returns. Having a deliberate marketing plan, producing at the level at which costs will increase more than returns if the crop or livestock yield increases, and utilizing all assets that have income potential are keys to maximizing profits.

Increasing returns per acre or per head means increasing the yield or reducing production losses or both. Are you managing livestock so pregnancy percentages are high and death losses are minimal? Having the highest average weaning weight may give you bragging rights at the coffee shop, but it doesn't guarantee a profit. Producing more is not always better--the increases in the value of higher production levels must exceed the additional costs incurred to generate those higher yields.

Identify both resources and assets that may not be fully utilized at present but have income potential. If range, brush or timberland is not currently being used, could hunting leases be sold?

Learning new production or marketing skills may require an investment in terms of time and money. Join a marketing club to "practice" using new tools, then go slowly in implementing them on the farm. Absolutely do not expect to get rich quick and do not bet the farm through risky trading schemes. Rather, use marketing tools to manage risk.

Insurance protection

To protect against losses that might cripple or ruin the business, consider insurance. Financially stressed farms often cannot afford a loss which might lead to delinquent loans or more borrowing. Federally subsidized crop insurance (and forage insurance in some areas) is an alternative for many producers. Insurance helps minimize the losses associated with adverse events outside the pro-

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Opportunities for Change (cont)

ducer's control. Known costs (annual premiums) are substituted for unpredictable and irregular losses. Insurance can stabilize the farm's cash flow and improve financial liquidity. Liability, property and life insurance also help protect farm assets. All insurance policies should be reviewed both from protection and cost standpoints. If your vehicles are aged, you may not need the same level of insurance that you did when they were new. Don't forget to include health care and long term care insurance in your review as they are increasingly important risk management tools on farms.

See Chapter 33 in the OSU Beef Manual and the USDA Risk Management Agency website, http://www2.rma.usda.gov/, for more information on livestock and forage insurance. A bulletin by the Oklahoma Insurance Commission on long term care insurance is posted at http://agecon.okstate.edu/farmtransitions/files/LTC_11-08-08.pdf

Enterprise mix

A whole farm financial plan, complete with enterprise budgets, is a useful means of identifying farm cost and profit centers. Knowing the relative contributions of different crop and livestock enterprises allows producers to redirect resources, for instance, labor or land, to profitable enterprises and away from less profitable enterprises. Producers may want to consider a new, promising enterprise if it fits with the rest of the farming operation and farm and family goals. A particularly profitable enterprise might be expanded to use a greater proportion of the farm's resources. For profitable enterprises, additional land could be rented instead of purchased to allow production on a larger scale. An enterprise which has been unprofitable could be dropped in favor of a new enterprise.

One way of determining the appropriate enterprise combination is to analyze the relationship between land and labor in the business. If land is scarce relative to labor, then labor-intensive enterprises (for instance, fruit or vegetable production) may increase returns. If labor is scarce relative to land, more land-extensive enterprises (for example, beef production) or capital intensive operations may be more suitable.

Often people investigate alternative enterprises thinking they will provide higher profits with less effort. Wouldn't everyone like to stumble on a get-rich-quick opportunity? What they often find is that new enterprises are more demanding when it comes to management and also require new and different skills. Before adding a new enterprise, think about how it fits in with the rest of the farming operation. Does it complement, supplement or compete with present activities? A complementary enterprise will not negatively affect existing enterprises. A supplementary enterprise will generate new income and, at the same time, enhance profits in an existing enterprise. A new enterprise which competes with existing enterprises for resources may lower the profitability of the existing enterprise. Are the expected returns to the new enterprise enough to compensate for potential losses? The impact of a change on business cash flow depends on changes in the levels of production of existing enterprises, whether capital assets are sold or purchased, and the added cash flow demands of any new enterprises.

Family Issues that Impact the Ranch Business

Family withdrawals

Ranch families should be sure that their expectations with respect to the business' ability to generate income are realistic. Family living expenses typically rise as the family expands until the children are self-sufficient. If plans include bringing them back into the operation as adults, additional careful planning must be done. If financial stress is an issue, curbing family living expenses frees up cash for other uses. Developing a budget, living within it, and minimizing nonessential spending may allow producers to pay down high interest loans and credit card debts, reducing future cash obligations for loan repayment. At the same time, postponing major expenditures or purchases, such as a new vehicle or other similar item, may increase future demands on ranch income.

Supplemental income

The number of families who earn income solely from the farm/ranch has dramatically decreased over time. Off-farm income helps provide an income safety net and diversifies the financial risks that families face. Farm income can be supplemented through income from an off-farm job, a home-based business or from custom work done for other producers. Deciding if anyone, and who, should take an off-farm job may depend on the skills of family members, age and the need for their expertise on-farm. Diverting hours from the farm may result in a labor shortage at critical times, reducing productivity. Job opportunities may be limited in rural areas.

Opportunities for Change (cont)

Summary

Opportunities often arise to take advantage of changing economic circumstances. Sometimes the forces are positive such as an increase in demand for the farm product, leading to higher prices. At other times, natural disasters or fluctuating commodity prices lead to financial stress. Adjustments may be needed in the farm plan or family spending to deal with either positive or negative stressors. While changes in the environment often provide the incentives to reevaluate farm plans, the payoff from introspection may be higher returns, lower costs, or greater satisfaction with business operations.

Areas for analysis include family and farm withdrawals, capital purchases, cost control, enterprise returns, asset ownership and/or control agreements, and use of supplemental income. Changes in the enterprise mix as well as production and financial management may be prompted. Financially stressed operations may need to investigate debt rescheduling, debt restructuring, investment by outsiders or even partial liquidation (see OSU AGEC-208 on http://pods.dasnr.okstate.edu/docushare/ for more information).

The appropriate strategy or combination of strategies for a farm depends on both family and business factors. While the business financial position and historical performance are very important, the willingness and ability to change, the tolerance for risk both personally and financially, market conditions, potential tax liabilities, and farm and family goals must also be considered. Once goals and priorities have been reassessed, financial repercussions should be anticipated: How will the change affect the business' ability to pay bills in a timely fashion? Will additional borrowing be needed to finance the change? Will the change generate positive net returns in the long run?

Evaluating changes should include long-range budgeting, The Oklahoma Cooperative Extension Service offers free, confidential business planning assistance to Oklahoma farmers and ranchers through the IFMAPS program (agecon.okstate.edu/ifmaps or 1-800-522-3755 for more information).

In the budgeting and evaluation process, risk assessment is also critical. Will a lender go along with the change, or can financing be obtained if needed to make the change? If new skills are required, is there sufficient time to learn them? If change is needed quickly, is there time to make any needed investments associated with the change and implement a new plan? While planning and budgeting may seem like a great deal of work, analyzing the potential impact of a change should enhance the likelihood of success. Any evaluation should include a review of impacts on farm profitability, cash flow and solvency as well as tax obligations. Be objective in your evaluation, improve your record-keeping system if you find it comes up short and seek the best outside information available.

Choices Magazine

Choices is an online, quarterly magazine for readers interested in the economic and policy issues which impact agriculture, the food industry, natural resources, rural communities, and the environment. *Choices* is available free online at www.ChoicesMagazine.org. In the latest issue, leading economists analyze what can be done to improve public policy decisions that impact land use changes. Land use policy directly affects some of the most critical issues to be addressed in meeting growing demand for food, feed, and fuels. *Choices* investigates this topic in five articles, which cover a broad range of issues in land use policy, including the economic, social, and environmental impacts of land use change; farmland preservation policy; improving policy decisions using estimated amenity values of agricultural land; and using market-based approaches to dealing with water quality. Also discussed in this issue of *Choices* is the implementation of mandatory country of origin labeling (COOL) and the challenges of making a locally-owned ethanol plant a driver of rural community development. *Choices* is published by the Agricultural & Applied Economics Association (AAEA).

Farm Transitions Conferences

Are you anticipating retiring or transferring some farm assets and management? Upcoming conferences will help you understand the potential tax and legal issues, become familiar with business entity options plus estimate your financial needs, financial position, and identify productive ways of resolving conflicts. Workshops will be held in three locations in different formats: **Alva**, March 27 - 28, plus April 24 - 25; **Altus**, April 3 - 4, plus April 17 - 18; **Lawton,** April 7, 19, 21 and 28. More information is available through your local Extension Office or online at agecon.okstate.edu/farm transitions.

New OSU Specialists with Beef Interests

Doug McKinney is the new value-added beef specialist with statewide responsibilities, working on campus with Animal Science and Agricultural Economics faculty to support a variety of educational efforts. Doug was raised in northeastern Oklahoma in the small town of Porter on a cattle ranch where they produced both commercial and registered Angus cattle plus wheat, soybeans, oats, hay, and alfalfa. In high school, he was actively involved in agriculture through the FFA program and exhibited steers, heifers, and swine. Doug was also very successful in leadership activities, receiving the State FFA Degree in 1991 and the National FFA Degree in 1992.

After High School, Doug attended Connors State College for two years before transferring to Oklahoma State University where he received a B.S. Degree in Animal Science in 1995. He earned a M.S. Degree in Agriculture Development from Stephen F. Austin State University in 2002. After working two years in private industry, he served as an Agriculture Extension Agent in East Texas for eleven years.

As a county agent, Doug experienced success developing value-added programs for producers in East Texas, including special sales, preconditioning programs, source and age verification programs, quality sources, and marketing cooperatives. Producer participation and knowledge increased every year in the East Texas area. His leadership accomplishments and success as a county agent were recognized by peers and private organizations on the state and national level.

Doug met his wife, Mandy, shortly after graduation from OSU and they have one son, Logan.

Eric DeVuyst joined the Department of Agricultural Economics in July as an associate professor and extension economist. Eric research and extension responsibilities are in farm management and production systems. His current projects include developing software tools to assist producers in determining the value of poultry litter and animal manure as fertilizer, the economic value of genetic testing of cattle, and developing budgeting software for wheat stockers.

Prior to joining OSU, Eric held faculty positions at the University of Illinois and North Dakota State University. He has degrees from Michigan State University (BS, MS) and Purdue University (PhD). Eric grew up on a hog and cash crop farm in central Michigan. He has continued to be involved with production agriculture throughout his academic career by owning and operating a small farm in each of the states in which he has lived.

Eric's wife, Cheryl, is also new to OSU. Cheryl is the new associate dean for academic programs in the College of Agricultural Sciences and Natural Resources. They and their daughter Megan live north of Morrison.

Rodney Jones is the new Extension Agricultural Economist in Northwest Oklahoma, working out of the Area Office in Enid. For the past 15 years with Kansas State University, he had a combination of Extension, teaching, and applied research duties, and brings experience working with all segments of the beef cattle industry as well as a production agriculture background to address these interesting and challenging times. The increases in grain and other commodity prices over the past few years have put upward pressure on costs of production for beef producers. On the other side of the economic equation, the recent world financial market upheaval and economic slowdown has certainly impacted beef demand prospects and pulled cattle prices at all levels down significantly. These broad economic forces create an environment of financial risk that the industry has not experience in recent memory.

Dr. Jones looks forward to helping Oklahoma cattle producers respond to these and other challenges and opportunities. He is ready to assist with risk management, overall production system management and cost control, and the development of improved management information systems. He is also looking forward to helping with decisions regarding implementation of the provisions of the new farm bill. These provisions include COOL (country of origin labeling) requirements, LIP (the livestock indemnity program which provides compensation to livestock producers for abnormally high mortality due to adverse weather), and LFP (the livestock forage disaster program) which may provide financial assistance to help cover grazing losses due to drought.

New software tool available to analyze the value of poultry litter as fertilizer

A new Excel based tool is available to compare the value of poultry litter to commercial fertilizer. Data requirements are minimal, but fertility recommendations from a soil test are required to accurately determine the value of litter to a specific producer. The file can be downloaded free at http://agecon.okstate.edu/budgets/index.asp?type=publications

A fact sheet/user's manual is also available at http://pods.dasnr.okstate.edu/docushare/dsweb/View/Collection-237

Recent OSU Publications of Interest to Beef Producers

OSU Fact Sheets are accessible at:
http://pods.dasnr.okstate.edu.
A picture of the screen is shown below. At the search prompt, type in the Fact Sheet Number, key words or the author's name. No login is required. New publications include:

AGEC-614, Update on Beef Industry Alliances. C. Ward and K.Raper. January 2009.

AGEC-615, Extent of Alternative Marketing Arrangements for Fed Cattle and Hogs. C. Ward. February 2009.

AGEC-616, Price Comparison of Alternative Marketing Arrangements for Fed Cattle. C. Ward. February 2009.

AGEC-617, Price Comparison of Alternative Marketing Arrangements for Hogs. C. Ward. February 2009.

AGEC-618, Upgraded Packer-Feeder Market Simulator. C. Ward, D. Peel, and K.Raper. February 2009.

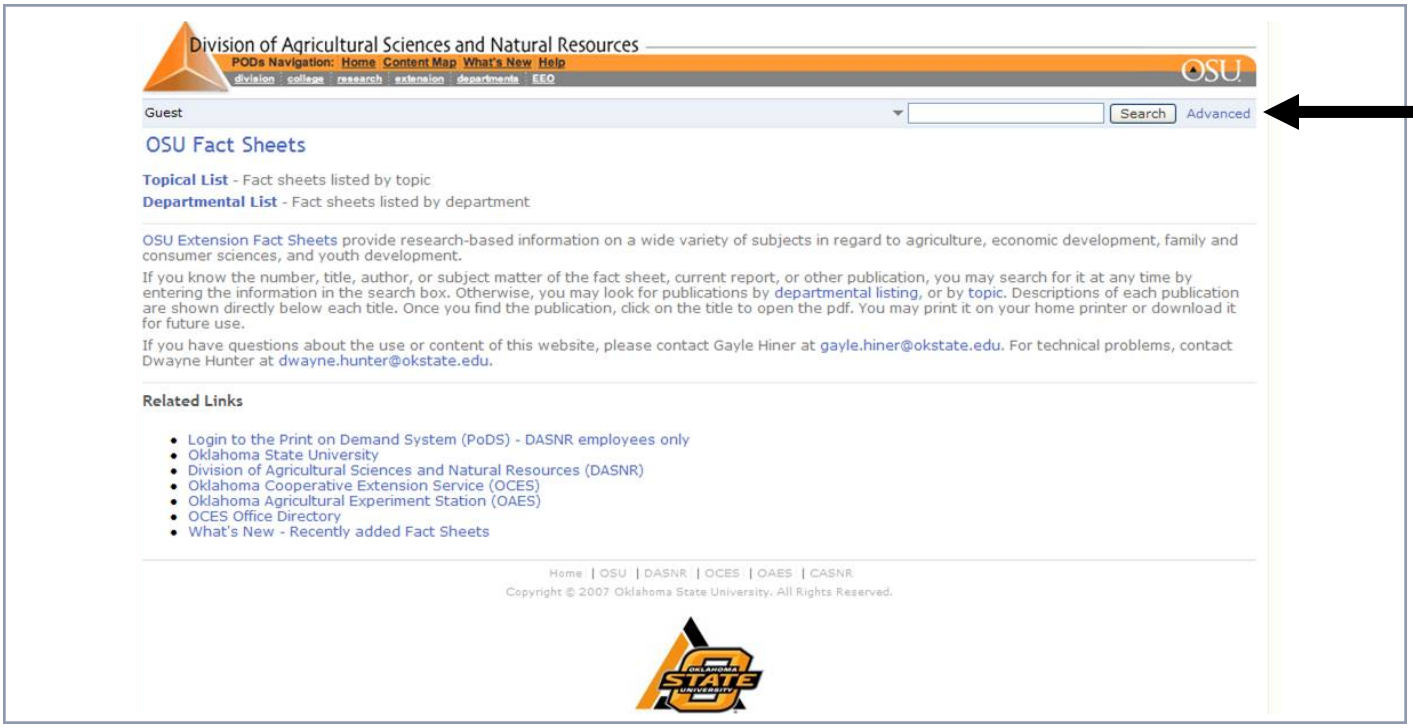
ANSI-3035, Managing Bermudagrass Pasture to Reduce Winter Hay Feeding in Beef Cattle Operations. D. Lalman, B. Woods, K. Barnes, D. Redfearn, K. Coffey. Jan. 2009

AGEC-250, The Environment for Oklahoma Agricultural Land Values, Past and Present." P. Guiling, W. Brorsen and D. Doye. October 2008.

AGEC-251, Farm and Non-Farm Influences on Oklahoma Agricultural Land Values. P. Guiling, W. Brorsen and D. Doye. October 2008.

AGEC-252, Urban Influences on Oklahoma Agricultural Land Values. P. Guiling, W. Brorsen and D. Doye. October 2008.

AGEC-253, Oklahoma Agricultural Crop versus Pasture Land Values. P. Guiling, D. Doye and W. Brorsen. October 2008.



Save the Dates!

Master Cattleman Summit

The popular Master Cattleman Summit will be held on the OSU campus Aug. 13-14, 2009. "Hands on" activities at the Animal Science Building and at OSU's Range Cow Research Center will focus on forage production and availability, determining appropriate stocking rates, forage management, risk management and minimizing input costs. Chip Ramsey, AgReserves, Inc. will be a featured speaker, discussing keys to profitability on the extensive cow/calf operations that he manages. Dr. Todd Thrift will also be a featured speaker on the topic of simple crossbreeding systems to maximize profitability of commercial beef cow enterprises. You will also have the opportunity to choose among interesting concurrent sessions to help you make better management decisions. Please mark your calendars now as Master Cattleman participants will have the first opportunity to register for this program before registration is offered to the general public.

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