


ACCOUNTING FOR PROFIT

By Bob Matlick & Leland Kootstra

Evaluating your operation to measure profitability

Milk income remains one of the dairy industry's greatest drivers of profitability, often leading to the common question among dairy producers, "How many cows should I milk?" Unfortunately, the answer provided, without much thought, has been, "However many you have available today." The answer is not as simple as it seems and I think the real question is, "What business model is right for this dairy?" The number of cows is a major part of every dairy's business model, but it is not the only part.

The dairy industry has faced volatility as one of the biggest issues in recent years. Volatility can wreak havoc on even the most well-thought-out operations. Volatility not only occurs in milk price, but also in cow numbers available to milk, climate and its effects on crops, cows and feed availability. Managing this volatility can be the factor that decides which operations will thrive in the next few years. Due to high milk prices in the last year, checking accounts have been bolstered and producers are looking for the right way to use their money. In the past, dairymen have used similar situations to expand facilities, purchase land and increase herd size. However, with memories of 2009 and 2012 still fresh in their minds, many producers are being much more conservative this time around. Instead of expanding, many producers have decreased their debt to limit exposure should we see another industry down-turn.

While hesitant to borrow more money, many producers are left evaluating their current herd, facilities, land and finances to maximize efficiency. We will focus on these four aspects of the operation. While each operation may have individual nuances that may lead to other factors, these four aspects are usually strong drivers in the decision-making process.

Herd

Herd flow volatility is a silent killer. On many of the dairies our firm works with, breeding issues have big financial implications, especially when milk production and herd size decrease at the same time. Some dairies we have worked with have a 12-17% variance in milking cow numbers due to various contributors. Instead of expanding outright, dairymen may find it more beneficial to look at their current herd and evaluate for ebbs and flows in the breeding cycle and heifer inventory, filling in low months by purchasing additional animals and selling in excess periods. This practice will result in less herd number swings, which equates to less volatility in income. Investing in reproduction, heat abatement and overall herd health can have huge returns.

Facilities

When determining the right business model, understanding facilities is key. What was the facility designed to support? There are very few facilities that were built without a strategy in place, but over time have morphed into something other than the original strategy. How many cows was the parlor built to milk in a day? Does it make sense to go 3X or will the cows be on their feet too long? Can parlor efficiency be increased to milk an additional 100 cows? Is there space for transition cows without overcrowding? The facilities need to be evaluated as a whole in order to maximize the returns on investment.

Land

Does the dairy have farming operations associated with it? Are the farming operations sufficient for the dairy's needs? What is the dairy permitted for? For many dairy producers, self-raised crops play an important part in the dairy's profitability, as well as expense structure. Raising forages limits exposure to difficult markets, feed price fluctuations, freight charges and neighbors with deeper pockets.

With volatility prevalent in the industry, limiting the reliance on outside forages protects a dairy operation substantially. However, it is important to make sure that one's farming operations fits well with the dairy's needs. Growing too much feed and stockpiling can be a drain on cash flow, especially during harvest time. Working with your nutritionist to feed the forages or to identify excess crops that can be sold at market maximizes return on investment and can be another strong income stream. If self-raised forages can cover the herd's needs at a reasonable cost, a dairy is protected against outside market forces. Reliance on outside forages can cause big issues if the feed markets take off, permanent plantings are put in, a neighbor sells his crops elsewhere, etc.

Finances

Finances are greatly affected by volatility. While the past year has been great for many producers' checkbooks, the near future may tell a different story. Sufficient consideration should be given to paying down debt, purchasing animals to fill holes in the heifer program, risk management on both milk and feed, and maximizing resources.

Choosing the right business model for your dairy is not an easy task. There are many variables that go into the decision and those variables need to be explored and included in the evaluation. While this may seem like a daunting task, the benefit of developing the right model for your dairy is huge and should be an ongoing process. ✱

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