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DAIRY PIPELINE

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Financial Moves For Tough Financial Times: Start With "The Three Cs"

—Alex White, Dairy Farm/Business Management; axwhite@vt.edu

"Now that cash is tight it is much more important to use it wisely."

Financial advisors always say, "Use the good times to prepare for the bad times." However, no one really says what to do during the bad times. There are a lot of possible actions, but let's keep it simple by focusing on "The Three Cs".

Communicate with your creditors – When cash is tight no one wants to talk about loans and accounts payable. A common reaction is to avoid your creditors. Frankly, that is one of the worst mistakes you can make. Open and honest communication with your creditors will be critical to your future success. Think of your creditors as being your business partners; keep them up-to-date on your situation and your plans. After all, they were nice enough to lend you money in the first place! You'll find that your creditors will be much more willing to work with you during tough times if you communicate regularly.

Cash Flow Statement – One of the most useful tools available to farmers and ranchers is a cash flow statement (aka, cash budget). It shows your cash inflows and outflows by category (ex. feed, vet, labor) and when these cash flows are occurring. This information will help you determine your need for operating capital (how much you need and when you will be able to pay it back). It helps you identify your largest cash outflows (how much & when needed) and potentially methods of reducing those outflows. It helps you see how you might be able to move expenses from one month to another to smooth your cash flow. And it helps you look for ways to improve your debt repayment plans. You can start to build a cash flow statement by using your Schedule F as the main source of information, but don't include depreciation because that isn't a cash expense. Be sure to include non-farm cash flows such as non-farm income and family living expenses. Email me (axwhite@vt.edu) if you would like an Excel spreadsheet version of a cash flow statement.

Cost of Production (COP)– Every farmer and rancher should know their COP for each of their primary enterprises. Unfortunately, most farmers do not have a good handle on their COPs. What does it cost you (feed, labor, repairs, etc.) to produce your milk ($/cwt)? You need to have a good enterprise accounting system to come up with an accurate estimate of COP. Or, you can use your Schedule F as a starting point for building enterprise budgets for your farm – but realize that all those tax moves you make are skewing your actual COP – that's why you need to make some simple cash-to-accrual adjustments to your Schedule F. *And, you should strongly consider participating in the Dairy Management Institute so that you can compare your COP to statewide benchmarks!* This will provide you with valuable management information, and it will improve your communication with your creditors. Once you know your COP by enterprise you can readily develop strategies to reduce your expenses without hurting your milk production.

Now that cash is tight it is much more important to use it wisely. Look for methods of reducing your cash outflows such as restructuring your debts by Communicating with your creditors. Use management tools such as a Cash Flow Statement and your Cost of Production to explore methods of rearranging your cash flows and/or improving your profitability. Cash management is critically important – remember the old saying, "If your outflows exceed your inflows, your upkeep will be your downfall."

Upcoming Events

See VTDairy for details.

April 9-June 1, 2018
MPP Sign-up period

June 9, 2018
Franklin County Livestock Show

June 9-10, 2018
Show like a Pro Workshop
Rockingham County

June 16, 2018
Virginia State Dairy Judging Contest

June 28, 2018
Franklin County DHIA Banquet

July 2018—Date TBD
Hoof Care Management
Franklin County

July 8-13, 2018
Southeast Youth Dairy Retreat, GA

July 23-24, 2018
MQ-IQ "The Teaching Parlor" Workshops—
July 23: Rocky Mt, VA
July 24: Harrisonburg, VA

Additional workshops are being scheduled for TN, KY, and NC.

If you are a person with a disability and require any auxiliary aids, services or other accommodations for any Extension event, please discuss your accommodation needs with the Extension staff at your local Extension office at least 1 week prior to the event.

A different perspective of the *"safety net"*?

—Gonzalo Ferreira, Extension Dairy Scientist, Management, gonf@vt.edu

Recently there has been a lot of news about the updated Margin Protection Program (MPP) for Dairy. Some good news is that the premiums are substantially less expensive than before. For example, farmers that used to pay $5,381/year for covering 3,240,000 lb of their production at $7.00/cwt now would be paying $2,141/year. This 60% reduction in premiums will substantially help farmers managing their risk. Having said that, when speaking with farmers or extension educators about MPP, I typically stress that this is a protection tool against poor margins and not a tool to increase farm revenues. As the Farm Service Agency (www.fsa.usda.gov) clearly states, this program intends to provide a *"strong(est) safety net."* So, what exactly is the meaning of a safety net?

One important concept to understand is that farmers should not look forward to claiming a payment from the MPP. As an analogy, expecting an (erroneously called) *return* from MPP is like a tightrope walker looking forward to a fall onto the safety net. Despite the presence or absence of a safety net, falling implies a failure. In the dairy context it is similar. The chronic low milk price scenario dairy farmers are suffering is like falling from the tightrope. Having protection with MPP is like having a safety net that may attenuate the consequences of the fall, but it will not avoid the fall. Obviously, higher milk prices are desperately needed to avoid the fall, independent of the presence or lack of the safety net.

On another matter, farmers should clearly understand that the definition of margin for MPP is not the same as the economic definition of margin. For MPP, margin is the difference between the all milk price and average feed cost. For those involved in dairy nutrition, this definition is analogous to what is known as *income over feed costs*. Alternatively, margin can be defined by economists as the difference between a product's selling price and its cost of production. Those involved in dairy management might well know that the cost of production includes much more than just the feeding costs (e.g., labor, replacement expenses, veterinary supplies and services, and equipment repairs, among many others). Therefore, the economic margin will always be less than the margin under the scope of MPP. Maybe this discrepancy is one reason why farmers have been so frustrated with MPP. Simply, a positive margin under MPP does not necessarily mean that the dairy business will have a positive economic margin. Again, as they are a major component of the cost of production, feeding costs can substantially affect the economic margin, but feeding costs do not determine the economic margin alone.

"…the economic margin will always be less than the margin under the scope of MPP."

In conclusion, MPP is a protection tool against reduced income over feed costs and, as such, should not be considered an investment from which economic returns might be obtained. Also, MPP can provide protection against reduced income over feed costs but cannot protect farmers against reduced or negative economic margins. In addition to securing protection through MPP, tightly monitoring operative expenses (i.e., beyond feeding costs) is still of paramount importance to face these chronic periods of very low milk prices and minimal or negative economic margins.

For more information on Dairy Extension or to learn about current programs, visit us at VT Dairy—Home of the Dairy Extension Program on the web at: www.vtdairy.dasc.vt.edu.

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