Cornell University
Charles H. Dyson School of
Applied Economics and Management

Applied Economics and Management
Warren Hall
Ithaca, New York 14853-7801
t. 607.255.2191
f. 607.255.9984

MANAGING DURING LOW MILK PRICES

Dairy Farm Business Summary, New York, 2016

Author: Richard Kimmich

With another year of low milk prices forecasted for 2016, dairy owners and managers have to take a closer look at their businesses to determine how they will meet the cash flow needs of the farm. During down price years, cash flow becomes very important in order to survive the low period and to then be able to improve profits once positive margins return. This article will look at different ways to manage cash flow during the down cycle and how to identify your business' operation cost to produce milk.

Operating Costs to Produce a Hundred Weight

The first step to take to determine the best strategy to survive a low price cycle is to consider or think about the long term goals of the business. For the dairy industry, this is usually determining if the farm end-goal is to continue operation beyond the current owners or the short term (for example be transferred to the next generation or junior partners or longer than the next five years), or is the farm set to cease operation under the current owners through asset liquidation for retirement, which is expected to occur in the short term. This question should be considered in order to determine what strategy is best for the farm. For the purposes of this article, the assumption will be made that the farm looks to continue past the short term.

To determine the business's operating cost of production, you need to take the accrual expenses excluding depreciation, unpaid family labor, interest on equity capital and the value of operator's labor and management. From this total, you subtract all the farm revenue that was

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received from non-milk sources or revenue. Once you have the operating costs to produce milk, you then add in family living expenses and principal payments, as these are additional items that need to be covered by cash flow. Preliminary data for 2015 (collected from 110 farms) reflect an operation cost to produce milk of $15.67 per hundred weight (cwt), with a value of $1.28/cwt for family living and $2.09/cwt for principal payments (the interest portion of payments is considered within the operation cost), resulting in a total cash cost of $19.04 for 2015. This number reflects the gross milk price required to cover cash needs on the farm. Now that you know this number you can start to work on management decision for the business.

Based on data from the USDA, the net milk price or mailbox price for February 2016 was $15.58/cwt. We had just figured out the cash operating cost for the farm to be $19.04 but since we are comparing to the mailbox price, we must reduce that number by $0.96/cwt, otherwise we will be double counting the milk check deductions. This adjustment gives us a cost of $18.08/cwt needed to cover the cash needs for the business. Since the cash operating cost is higher than the net milk price, the farm is in a situation where it cannot cover total cash commitments through cash flow. This is when you need to take a look a different options to help meet the cash flow needs.

Managing Cash Flow

This first area to address when looking at cash flow are your expenses. Is there an area of expense that you may be able to make a reduction without damaging revenue? With 2016 looking much like 2015 in terms of the low margins, many farms do not have much room to make additional changes in expense, as most areas of waste were trimmed during the previous year. This leads us to look at different options to improve cash flow and minimize losses.

The main options to consider when you are not able to cash flow from operation are, selling non-productive assets, improving the business, refinancing, restructuring debt, interest only payments, borrowing, and contributing non-farm equity. Some of these options will involve working with advisors and vendors outside of the farm business, so first we will look at what you can do on farm.

Although not the only options, the two options that we will look at on farm are the sale of non-productive assets and improving the business. The sale of assets is fairly straight forward, sell non-productive assets such as machinery or cattle that no longer contribute to the revenue of the business. Culling low producing cows is a good way to generate short term cash flow while also improving the business by focusing resources, such as feed, on the higher margin animals. This practice is very short term but can improve both feed efficiency and herd average. Sale of timber from wooded lands is also a good way to add an influx of cash to the business. The sale of land not essential to the business is also an option but be sure to consult your tax preparer to discuss the tax liabilities of a sale. Labor efficiency is also an on-farm area to consider. This will vary farm to farm depending on milk systems, barns and business model but it is a good time to work with your employees to ensure that there is no needless time or supply waste as well as making sure that protocols are maintained.

The other options that were mentioned above will require working with advisors, lenders and even vendors as you work to improve cash flow. Depending on your debt structure, you may be able to refinance current debt in order to free up some monthly cash flow. Other options to consider with your lender as a short term way to increase cash flow is moving to interest only payments for a short period of time. Although this will lengthen your debt term it will free up cash resources in order to help cover operating costs.

Using equity to cover short term operating cash flow issues is also an options and will require more thought, as equity is important to your business in the longer term, especially when investing in new technology or expansion. Using the farm's equity to cover operational cash flow issues is most commonly done by borrowing to cover the short falls. Although this can improve your situation in the short term, (i.e., cover your cash flow needs); it can have adverse effects if not used sparingly and from a strong position.

These are just some options to consider while surviving the down-cycle in milk price. While making decisions always keep in mind the long term goals of the business and to consider how the short term cash flow fix may affect any future plans. Be sure to work with financial consultants throughout the year, even during strong price years, in order to maintain a strong respective on the financial health of your business. The Dairy Farm Business Summary and Analysis program is offered by Cornell Cooperative Extension and is a free service that will work with you to take a look at and interpret your financial information in order to assist you in making solid management decisions for you farm. Also, the NY FarmNet program provides services to help with financial as well as personal issues on farms. All NY FarmNet consultants are familiar with helping farmers develop strategies to manage through cyclical milk prices, and many have decades of agricultural lending experience. NY FarmNet consultants have assisted numerous farms in making cash flow projections and helped farmers develop cash flow plans to meet planned cash commitments.

For more information on participating in the Dairy Farm Business Summary please contact your local Cornell Cooperative Extension agent. You can find information about your local extension at www.cce.cornell.edu or send an inquire email to dfbs@cornell.edu or visit dfbs.aem.cornell.edu. For more information on New York FarmNet you can visit www.nyfarmnet.org, email an inquiry to NYFarmNet@cornell.edu or call 1-800-547-FARM (3276).

The DFBS program has been in existence over 50 years. The author is an Extension Specialist in the Dyson School of Applied Economics and Management, College of Agriculture and Life Sciences at Cornell University.