FIRESIDE CHAT
MANAGING DURING A MILK PRICE FALL

(1) We have had dramatic milk price declines many times in recent dairy history. The decline of the mid-1980's, in the early 1990's and 2009 being the most serious in memory. Some dairy farmers will experience real pain and there could also be some big winners. I am going to focus on the pain component of the price decline.

(2) Significantly lower milk prices and therefore dairy farm profits, combined with lower asset values, translating into reduced borrowing capacity, pose a serious threat to the survival of many dairy farms. This current situation is different from the past in that the total economy is in difficulty. As a result, we may be facing a more prolonged period of low prices.

(3) What should a dairy farmer consider and what actions should be taken in times of very low milk prices? Let's apply our proven management principles and economic theory to this situation. Economic theory tells us that we need to look at the individual farm situation using both profit and cash flow analysis.

PROFIT

NOW: If cash receipts cover cash expenses, then continue to operate the dairy as long as there is some contribution to overhead. Cash expenses include items such as hired labor, veterinary fees and medicine, utilities, interest, and purchased feed. Farm produced feed/forage is now, in my opinion, a fixed or sunk cost and should not be included as a cost in the ***NOW*** analysis.

If cash receipts do not cover cash costs, then cutting all costs possible without deteriorating the net profit margin, selling unprofitable cows or making other changes to the cost and revenue stream must be implemented. There is no time to lose to make changes to the business.

PLANTING TIME: We must now include crop production costs as a cash cost in our analysis. To continue in production, the expected milk price over the next year should be such that it will cover all cash costs and generate some contribution to fixed costs. If that is not the result, then the ***NOW*** strategies previously discussed, as well as some longer term changes, should be adopted if they can be expected to reverse this scenario.

NEXT TWO OR THREE YEARS: To continue in production, the expected milk price will need to cover the cost of production, including the value of operator labor and management. Remember, profitability is the key to long run business survival.

CASH FLOW

NOW: Consider these options if you are covering cash costs, but cannot cash flow from operating. Refinancing, making interest only payments, selling non-productive assets, borrowing, improving the business, etc. should all be considered. But, only consider improving cash flow if you can expect to have a profitable business after planting time. If you are not covering cash costs, and cannot make changes to correct that situation, then liquidation or eating equity are your options. Eat equity only if there is a promise of significantly better days ahead. Remember, cash flow is the key to short run business survival. Note: eating equity simply means that the net worth or equity of your business goes down as a result of continuing to operate the business.

PLANTING TIME: If you can project to cover cash costs, including those associated with growing crops, then refinancing, making interest only payments, selling non-productive assets, borrowing, etc. should be considered. But, only consider improving cash flow if you can expect to have a profitable business after planting time and be able to cover scheduled debt payments and provide for family living. If you are not covering cash costs, and cannot make changes to correct that situation, then liquidation or eating equity are the options. Keep in mind that full or partial liquidation and eating equity can have serious long term consequences on your business.

NEXT TWO OR THREE YEARS: A business must be profitable to be sustainable in the long run. If you cannot project profits over the next years, then you likely will be eating equity. The only exception is if asset values increase dramatically and your strategy is to wait to sell assets later at higher prices. However you then become a speculator, not a business manager.

This crisis will also pass, as have other before. However, this current crisis will be very painful for many farmers. These trying times will severely stretch and test the management skills of all dairy farmers. We should not react out of fear, nor not react at all. Rather, we should do a careful analysis of where our business is and where we want it to go. Then do an analysis of the expected impacts of possible changes on both profit and cash flow before taking action. While difficult, we should also view this as a time to employ our financial management skills. Many professionals are available to help. Cooperative Extension, FarmNet consultants as well as others can give assistance, identify alternatives and provide an objective outside view of available options.

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