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A Finance Guy's View on Income over Feed Cost

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I recently looked through dairy industry outlooks, milk price and supply numbers, feed prices, etc. Here's a quick recap:

Regional milk blend prices are projected to move closer to \$18.80/cwt by year end (Calvin Covington, Dixie Dairy Report, August 2021),

- cow numbers are slightly lower, but milk production per cow is up,
- national cheese, butter, and non-fat dry milk powder inventories are up so there's downward pressure on prices
- however, dairy exports are relatively strong.

Feed prices look like they're going to hold steady (Chicago Mercantile Exchange),

- corn futures prices are expected to remain above \$5.50/bu through year-end, and above \$5.15/bu through December 2022,
- similarly, soybean futures through Nov 2022 are in the \$12.50-13.50/bu range.

The changes in milk price and feed prices got me to thinking about a common financial measure for dairy farms - Income Over Feed Cost (IOFC). Like any financial measure, IOFC has its strengths and weaknesses. So, let's take a look at IOFC from the eyes of a finance guy.

IOFC measures how much of your revenue remains after you've paid your feed bill. It can be stated as an absolute dollar amount for a time period, or on a per-cow basis, or on a per-cow per-day basis. We can calculate this for the entire herd or for individual groups (early lactation, mid-lactation, etc.). And in general, the higher your IOFC, the better. Sounds easy enough, right?! What could be wrong with it? Let's take a closer look.

What revenues do we use to calculate IOFC?

After looking at several articles and listening to different presentations, it seems that most people only use milk sales as their revenues. However, I've seen examples where milk revenues AND calf sales were used. Occasionally I've seen people use total revenues for the dairy – and this includes cull revenues, crop sales, etc. Personally, I like to use milk revenues only.

What feed costs do we use to calculate IOFC?

Some people use total feed costs for the farm, including the feed for calves, heifers, and/or dry cows; some only use feed costs for the lactating herd (or group). Obviously, this can have a significant impact on IOFC. Personally, I try to use feed cost just for the lactating herd or group. There's no right or wrong answer here, just **be consistent** in your calculations and compare your IOFC to an appropriate benchmark.

But how do we determine the feed cost? It requires good recordkeeping. You need to have records of the purchased feed expense throughout the period (month, year, etc.) and of the quantity fed. To be more accurate, make sure that you are using **accrual-adjusted feed expenses**, not cash-based expenses. That means you need to keep records of the feed you have in inventory at the beginning and end of each period. This will also adjust for year-end tax moves such as prepaid feeds.

What about homegrown feeds? How do we put a value on these? The finance world tells us to use the fair market value—that is, the price could you get if you sold your feed, net of hauling costs. The problem with this method is that many times there is not a viable local market for your crops. So, let's use national or regional averages—but are they in the ballpark for your area? If you can't determine an appropriate fair market value, you can always use your cost of production for homegrown feeds. This requires a recordkeeping system that allows enterprise accounting. Another complicating factor for the cost of production of homegrown feeds is which costs to include. Obviously, we use seed,

fertilizer, fuel, etc. to produce the crop. What about the overhead costs of the equipment and storage facilities—depreciation, interest forgone, property taxes, insurance, etc. Finance guy says we need to incorporate these costs to get a true cost of production—but again, where do you come up with these costs? Records, records, records.

How about the labor, fuel, and machinery needed to mix and deliver the feed? Is this included in the feed expense aspect of IOFC? From my observations, not very often—only finance geeks like me would try to include these costs. In a perfect world we should treat the “feeding center” of the farm as a separate enterprise and include these costs in our IOFC calculation.

Does IOFC directly measure how well you are performing?

Not *directly*. Let’s assume that your milk price increases from \$18.50/cwt to \$19.50/cwt while feed costs remain constant. Your IOFC will probably increase significantly even though you didn’t do anything different. Conversely, if milk price holds constant or falls, and feed prices increase, your IOFC will drop like the last cake I tried to bake. Some changes in IOFC are due to factors outside of your control, so IOFC is not a *direct* measure of your management ability. But it is still a good management tool when used properly.

What benchmark do we use to rate our IOFC?

This is one of my biggest issues with IOFC—there really aren’t consistent, reliable benchmarks that you can use. For most farms we can use general financial benchmarks for liquidity, solvency, profitability, etc. and get a relatively good idea of the financial condition of the farm. Not with IOFC. All we can say is: 1) we want it to be positive, and 2) higher is typically better. But good managers will monitor the *relative* level of IOFC—how does it compare to the last period; how does it compare from group to group. They will also look into *why* their IOFC has changed—is it due to milk prices, feed prices, accrual adjustments, summer slump, problems with herd health, etc.

IOFC has its warts, though it can be still a valuable management tool when it is used in a consistent manner. Understand how it is being calculated. Use consistent calculation methods each period. Always be wary when comparing your IOFC to benchmarks—compare apples to apples! Finally, **focus on why your IOFC changed rather than the actual number.**

Lessons from the Jury Box

Authored by Andy Overbay, Ph.D., Sr. Extension Agent--ANR, Smyth County; aoverbay@vt.edu

Hearing an injury case as a juror in the spring made me realize just how easily a farmer could face a similar situation. To be accused of negligence and facing the loss of the home farm as a result of bad luck—and not much else—would be devastating.

With profit margins tightening over the past few decades, some farmers have looked into marketing directly to consumers. Many farmers enjoy the relationship building that accompanies this type of income strategy; however, direct marketing is not without its pitfalls and serious consideration needs to be given to exploring both the pros and cons of direct marketing.

Mr. Jim Graves of Graves Mountain Lodge in Madison County, Virginia noted one time at an Agritourism gathering that “It isn’t a question of **IF** you’ll get sued, but **WHEN** you will be sued.” A colleague once told me that it takes two to have a fight, to which I replied, “Not if one has a lawyer!” The more a farmer interacts with people outside of the family or employees of that particular farm, the more likely the farmer is to have an unfavorable experience.

The first question is “Are you insured?” Maybe a better question would be “Are you insured enough?” Several years ago, the average lawsuit in Virginia involving food illness awarded \$3.2 million to the plaintiff. Without proper insurance, you should consider the deed to your farm as your deductible!

Are you a “people” person? Most people consider themselves friendly enough but are you willing to be open-minded when a disgruntled customer becomes confrontational? Many people think about the joy they can bring to an “average” family out to enjoy a day in the country or at the local farmers market, only to be totally disenchanted by criticism from a customer or an unruly guest on their farm.

Speaking of people, who is your target audience? You can’t please everyone and if you try you are just going to be miserable. Miserable people are not good marketers! Products that are fitting for youngsters can be very different than an older demographic’s preferred product. Some considerations here would include pricing (is the

audience you're after able to pay for the service or product?), and comfort level (would you rather deal with children or adults?)

Are you a marketer or a producer? Everyone has their talents but it is rare that the same person can be both marketer and farmer. If you would rather be on the farm than out talking to people, that is fine. You might consider marketing your products with a neighbor who is good at schmoozing folks. Know your talents and limitations.

The Commonwealth of Virginia has taken steps to help protect agritourism and direct marketing operations; however, a quote from Virginia Tech Ag Economics professor and lawyer, Jesse Richardson should be noted. "You can post all the signs you want, but I'll still sue you." Ignorance of the law will not get you out of trouble if and when a person feels that a product you sold them made them ill or they were injured on your farm.

Are you inviting guests to your farm? Agritourism simply combines elements of tourism and agriculture, most commonly by attracting customers (or tourists) to farms. Agritourism enterprises may offer a wide variety of activities including everything from pumpkin patches, corn mazes, and petting zoos to on-farm bed and breakfasts, cut-your-own Christmas trees, and wineries. Issues such as parking, trash control and disposal, neighbor relations, security and customer flow are among many that need to be solved prior to opening your doors to the public.

One mistake to avoid is the thought that life will be simpler if you just go straight to your customers. Operations who have added this dimension to their farm generally find that their workload increases; however, for those who master this marketing scheme, the rewards can be very good indeed!

Upcoming Events

Regular Women in Agriculture Meetings
Every 1st Tuesday @ 7:30 pm

Day & Night Programs/One-on-One Consultations with Dr. Larry Tranel
August 30-31, 2021 & September 1, 2021

Virginia State Fair
September 23-October 3, 2021

Virginia Cooperative Extension

World Dairy Expo
September 28- October 2, 2021

Table Talk Training Virginia
October 5-6, 2021

Hokie Cow Classic
October 18, 2021

Cattle WISE for Dairy & Beef
October 29, 2021

Annie's Project
Oct/Nov TBD

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Dr. Christina Petersson-Wolfe,
Dairy Extension Coordinator &
Extension Dairy Scientist,
Milk Quality & Milking Management

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