

Direct Marketing Profit\$

Agdex FS450/821-3

... business performance tools in an Alberta cheese production & marketing enterprise

Business Summary

This factsheet provides specialized economic information on establishing and operating a start up cheese production and marketing enterprise. This information was generated by a group of cheese processors who arrived at a consensus of opinion on investment, production, marketing requirements, costs and revenues associated with developing a viable cheese enterprise.

This information is intended as a business planning tool. Managers will have to assess all the key production and financial variables that would influence the success of their enterprise.

Production Basics

The enterprise would be a one-person operation with a 1,200 litre vat producing Farmers cheese. It would process 120,000 litres of milk per year at two vats per week, 50 weeks of the year. With this production capacity, 11,500 kilograms of cheese would be produced. Allowing for 1% loss for shrink, spoilage and home consumption, 10,350 kilograms of marketable cheese would be available.

Production/Market Mix Targets

Package sizes	Mild	Medium	Old
	Prices (\$/kilogram)		
300 grams	\$12.50	\$14.50	\$16.50
500 grams	\$12.00	\$14.00	\$16.50
750 grams	\$11.75	\$13.75	\$16.50
1,000 grams +	\$11.50	\$13.50	\$15.50

Financial Benchmarks

	Start up	Expansion	
		Established Market	Wholesale Market
Gross operating profit ¹	\$15,534	\$ 67,394	\$151,873
Return to management ²	\$ 1,414	\$ 53,274	\$117,152

Capital Investment

This investment reflects a start up operation. Building costs reflect a completed building with power, heating and plumbing installed. Individuals can reduce the investment cost by doing their own construction. Processors may also want to consider a large raw milk storage tank with suitable access if they are bringing in milk for processing.

	Investment
Land (3 acres)	\$ 9,000
Improvements	
Utilities (50% share)	\$ 7,500
Facilities	
Building (1200 sq. ft.)	\$ 72,000
Equipment	
Vat (1,200 litres)	\$ 10,000
Cooler	\$ 3,000
Press	\$ 5,000
Molds	\$ 7,000
Shelving	\$ 5,000
Small tools	\$ 5,000
Vacuum packer	\$ 5,000
Pumps	\$ 2,500
Tables	\$ 200
Brine vat	\$ 2,000
Total equipment	\$ 44,700
Vehicles	
Delivery van/truck (50% share)	\$ 5,000
Other Capital	
Office equipment	\$ 5,000
Market development	\$ 5,000
Total other capital	\$ 10,000
Total Capital Investment	\$143,700

Market Basics

Marketing activities should build a reputation as a reliable supplier of a good quality product. Managers must know both the buyers and sellers that make up the industry.

Marketing activities should include:

- Developing sample labels
- Promotional activities
- Printing brochures and business cards
- Providing sample cheese products to potential buyers

Development Strategies

Direct Market Cheese Enterprise

A key challenge in developing a new cheese plant is finding a balance between developing production capabilities, developing a market and gaining regulatory approval. A common strategy for developing a cheese enterprise is to stage into the industry over time which would allow individuals time to develop both their production capabilities and their markets.

In this development process a key decision will be what size of new (initial) facility to build. This decision reflects the challenge of balancing the production/marketing mix in a developing enterprise. Factors to be considered in making this decision include risk exposure, viability of the operation and market potential.

A critical future decision is scaling up from a start-up operation to one that attains desired economic performance through the production and marketing of larger quantities of cheese. One expansion strategy is to increase production and sales in existing markets utilizing the same equipment. Processing would take place four times per week, processing 240,000 litres of milk and producing 22,248 kilograms of cheese.

An alternative expansion strategy is to focus on producing for wholesale markets which would require more equipment and more storage capacity. Approximately 750,000 litres of milk would be processed, producing 71,280 kilograms of cheese for these markets.

Additional Capital Investment for Expanded Operation in Wholesale Markets

	Total Cost
Vat (5,000 litres)	\$ 25,000
Addition to building	\$ 96,000
Plate pasteurizer	\$ 85,000
Total Additional Investment	\$206,000

Projected Revenue and Expenses - Expanded Operation in Different Markets

	Established Markets	Wholesale Markets
Projected Revenues		
Cheese sales	\$271,245	\$724,784
Projected Direct Costs		
Production costs	\$169,720	\$518,870
Marketing costs	\$ 27,000	\$ 34,000
Interest on operating	\$ 7,131	\$ 20,042
Total Projected Direct Costs	\$203,851	\$572,912
Projected Indirect Costs		
Depreciation	\$ 6,235	\$ 16,535
Total Projected Direct & Indirect Costs	\$210,086	\$589,447
Gross Operating Profit	\$ 61,159	\$135,337
Interest on Investment	\$ 7,885	\$ 18,185
Total Projected Economic Costs	\$217,971	\$607,632
Return to Management	\$ 53,274	\$117,152

Projected Revenue and Expenses

Direct Market Cheese Start-Up Enterprise

Projected Revenues				Revenues	Your Snapshot
Cheese sales	Mild	Medium	Old		
300 grams	\$15,525	\$18,009	\$10,247	\$ 43,781	_____
500 grams	\$14,904	\$17,388	\$10,247	\$ 42,539	_____
750 grams	\$16,418	\$19,212	\$ 5,123	\$ 40,753	_____
1,000 grams +	\$ 5,356	\$ 6,288	\$ 1,604	\$ 13,248	_____
Total cheese sales				\$140,320	_____
Less: wholesale adjustment (40%)				(\$ 14,032)	_____
Total Projected Revenues				\$126,288	_____
Projected Direct Costs		Litres	\$/litre		
Milk purchases		120,000	\$0.565	\$ 67,800	_____
Ingredients		120,000	\$0.05	\$ 6,000	_____
Cleaning supplies		120,000	\$0.02	\$ 2,400	_____
Whey management		120,000	\$0.02	\$ 2,400	_____
Power				\$ 2,400	_____
Building repair & maintenance				\$ 720	_____
Building insurance				\$ 2,000	_____
Equipment repairs				\$ 2,500	_____
Telephone				\$ 1,200	_____
Heating costs				\$ 1,200	_____
Professional fees				\$ 500	_____
Vehicle insurance				\$ 1,000	_____
Vehicle operating				\$ 1,000	_____
Marketing costs					
Vehicle operating				\$ 4,000	_____
Label & packaging costs				\$ 3,260	_____
Market stall rental				\$ 2,500	_____
Advertising & promotions				\$ 1,000	_____
Trade shows & meetings				\$ 1,000	_____
Casual labour				\$ 4,000	_____
Interest on operating ³				\$ 3,874	_____
Total Projected Direct Costs				\$ 110,754	_____
Projected Indirect Costs					
Depreciation ⁴ of facilities & improvements				\$ 3,475	_____
Depreciation of equipment & vehicles				\$ 2,485	_____
Depreciation of other capital				\$ 525	_____
Total Projected Indirect Costs				\$ 6,235	_____
Total Projected Direct & Indirect Costs				\$116,989	_____
Gross Operating Profit				\$ 9,299	_____
Interest on Investment ⁵					
Facilities & improvements				\$ 4,475	_____
Equipment & vehicles				\$ 2,485	_____
Other capital				\$ 275	_____
Land				\$ 900	_____
Total Interest on Investment				\$ 7,885	_____
Total Projected Economic Costs				\$124,874	_____
Return To Management ⁶				\$ 1,414	_____

Sensitivity Analysis

The profitability of a direct market cheese enterprise will be strongly influenced by the price per kilogram received for different package sizes and cheese types.

The table below shows the effect on return to management of the changes in prices (across the board) for cheese products.

Enterprise	Percent increase in prices		
	10%	15%	20%
Start up	\$ 14,043	\$ 20,357	\$ 26,672
Expansion			
Established market	\$ 80,398	\$ 93,961	\$107,523
Wholesale market	\$189,631	\$225,870	\$262,109

Capabilities

Personal Capabilities Required for Developing a Cheese Enterprise

- People skills
- Marketing skills
- Capacity to put in long hours
- Capacity to be flexible with time
- Have a passion for cheese making
- Developed style or techniques
- Pay attention to details
- Patience and perseverance
- Practical experience (one year)
- Formal or informal training

Key Marketing Activities/Capabilities for Developing a Direct Market Poultry Enterprise

- Finding a unique target (niche) market
- Knowing competitors in the market
- Making market contacts
- Determine quantities required by target market
- Determine the distribution system required by the target market
- Determine marketing activities required to access market

Definitions

¹Gross operating profit: The amount remaining after direct and indirect expenses have been paid.

²Return to management: An amount left of compensate the owner-operator for risk and management.

³Interest on operating: The interest on an operating loan, calculated at 7.25% for 6 months.

⁴Depreciation: The reduction in the value of an assets over its lifetime.

⁵Interest on Investment: The cost of investing in capital assets rather than in a financial investment. Valued at 10% on all asset categories.

Management Strategies

Key management strategies that will contribute to the production and economic performance of the enterprise:

- Developing a niche market.
- Choosing a product that is unique rather than competing with imported products.
- Be fully aware of the significant level of market development required to become established.
- Responding to customer needs by making the type of cheese requested.
- When considering expansion, expanding the product line is a strong option along with expanding production capabilities. Opportunities for different types of cheeses should be thoroughly investigated.
- Communicate with other producers.

Regulatory Considerations

The regulatory requirements for developing a cheese production and marketing enterprise are significant. If the product will be marketed outside of the province, the plant must be federally licenced and inspected. This will require the submission of blueprints for the facility, a business plan with five years of projections and inspection by Canadian Food Inspection Agency (CFIA) inspector.

If all the product will be marketed in Alberta, a provincial inspector with the Food Safety Division of Alberta Agriculture, Food and Rural Development (AAFRD) would inspect the facility and recommend that the Alberta Dairy Board grant a licence.

Processors will also have to be licenced by the Alberta Dairy Board for their supply of raw milk. A licence will be granted upon inspection of the facility by either the CFIA or the Food Safety Division of AAFRD.

At time of printing, legislation was introduced to change the Alberta Dairy Board to a producer run organization to be called Alberta Milk.

For more information, contact:

Alberta Agriculture, Food and Rural Development
Production, Marketing, Economics, Business Planning & Development - Contact the Alberta Ag-Info Centre at 1-866-882-7677 or visit our website at <http://www.agric.gov.ab.ca>

Regulatory Issues - Contact the Alberta Dairy Board at (780) 361-1231 or Prevention/Investigation Unit, Regulatory Services Branch at (403) 340-7172.

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