AgriProfit$

Newsletter for Alberta Cattlemen

Economics Unit

Editor's Corner

The first few issues of the AgriProfit$ newsletter set a broad focus on the economics of the cow/calf business. In this issue's feature, I draw the thoughts of the previous three issues together to addres the cost control issue.

From here, we'll move on to focus on information, technology, management skills and management strategies to improve economic and financial performance.

In the *"So What ...?"* column, Ted Darling and Jeff Millang provide an update of what's happening with the CowProfit$ software and a lead in on some of the activities planned for this fall.

In upcoming issues we'll turn to some key management performance criteria, and the impact they can have on your bottom line.

Dale A. Kaliel,
Editor

Are You a "Low Cost" or "High Cost" Producer?

Dale A. Kaliel
Sr. Economist: Production Economics

What can you do to build, and then maintain, your "competitive edge" in the face of increasingly competitive global beef production systems and markets? Re-visiting a quote from Dr. Michael Boelhje (Purdue University):

> *"Family farmers of the future will be defined by their management of labour, production and marketing opportunities and less by their own labour and land holdings."*

Success hinges on effective use of information, both on-farm and external, in making knowledgeable management decisions.

This article draws together themes from the first three newsletters, and then examines the question, "does it really matter if you're a high cost or low cost producer?" The main points from the previous articles are re-capped below.

In "***Why Do We Keep Cows***?", key elements were:

- recognize your objectives for raising cattle ... profit, diversification, using idle resources, the way of life, or some combination. Defining your operation's profit potential helps quantify what you "forego" to attain the other objectives.
- over the long haul, there is profit in the cow/calf business.
- proactive management, using your own "on-farm" information and controlling costs, is the key to profitability.

"***Benchmark Your Cow/Calf Operation***" covered why it's important to know your own production costs (per lb. weaned), emphasizing:

- good information as the key to sound business analysis and management decisions.
- comparing your (current and projected) performance against your performance in the past ... measuring how effective you've been in managing your operation (relative to your goals and objectives for your cow herd and your farm).
- comparing your performance against external benchmarks (peers and competitors) ... reveals opportunities for improvement or fine tuning in your operation, plus "sets the mark" in terms of how good you have to be to stay competitive.
- comparing yourself to the "average" guarantees that you'll be average ... and puts you at the back of the pack of the folks who are leading the industry. Set your sights on the "top performance" group.

- benchmarking is the first step in the "monitor - analyze - decide - implement - evaluate" cycle. Constant attention to performance in all aspects of production, marketing, economics and finance, is vital.

The column, "***So What ... Is a Profit Center?***", highlighted:

- the importance of breaking out the analysis, planning and decision making of your farming operation into separate enterprises producing, for instance, weaned calves, harvested forages, grazing, feeder cattle, and so on.
- over the long haul, each profit center has to pull its weight, contributing to overall farm profitability. This requires valuing all production inputs (both purchased and home grown) and products "at market".

"***Cattle Market Fundamentals and Outlook***" brought into play the markets side of the equation, closing the circle of production - marketing - cost management. This article emphasized:

- a working knowledge of the time concepts of seasonality, trends and cycles builds an understanding of market fundamentals and is a valuable component of your "manager's tool box".
- use economic signals to guide your decisions regarding:
  ... in the short term, when and how you sell your calves,
  ... in the long term, what kind of calves you want to produce, what kind of cows you need to deliver these calves, and how you go about replacing your breeding stock.
- integrate your production, marketing and cost management to effectively manage your cow/calf enterprise and farm level risk.

Are "Low Cost" and "High Cost" Different?

Intuitively, there is little difference, as long as net returns (to all inputs and assets) are on par with your competitors. In other words, if you take the high cost route, you also have to ensure that your long term returns, on a per lb. weaned basis, more than compensate you for the added costs.

However, historical comparisons of these two distinct strategies have shown that low cost producers are:

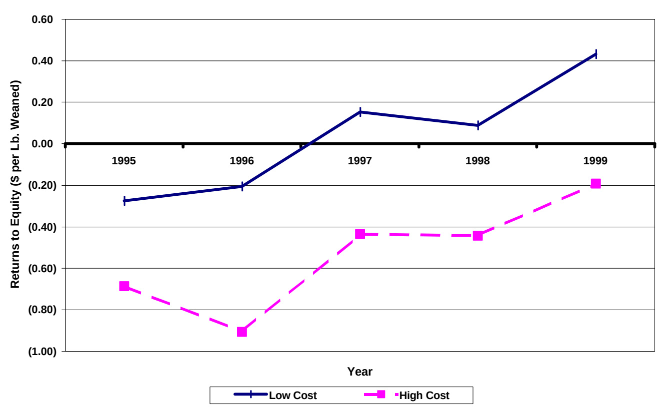
- more likely to show sustained profit over the long run (with more stable net farm incomes),
- more capable of surviving cattle cycles, and
- more in tune with the global longer term trend towards cost control and minimizing unit production costs.

Profiles of low cost vs. high cost producers from our AgriProfit$ research program bear this out.

What Do the Numbers Say?

AgriProfit$ participants were ranked by total production costs per lb. of calf weaned. Then the low cost and high cost thirds were drawn out for this analysis. The results, covering five years of research data, were very sobering. Figure 1 shows the Returns to Equity, or "bottom line" for each group.

Fig. 1: Returns to Equity - Low & High Cost Cow/Calf Enterprises



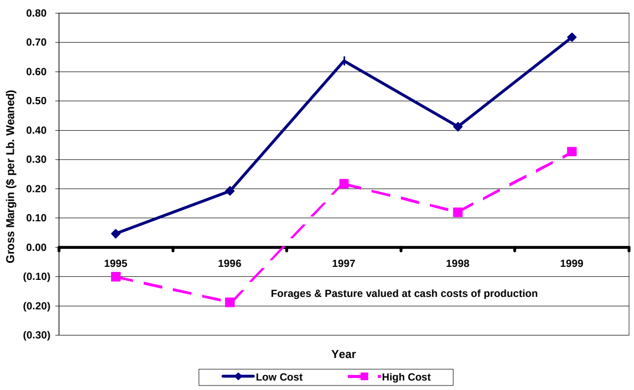
Key observations we can draw from this chart are:

- the high cost group were never profitable, even in the recent years of decent prices.
- the annual gap between these groups ranged from \$0.41 to \$0.70 / lb. of calf weaned ... or roughly \$193 to \$325 / cow wintered.
- the high cost group defies economic logic in terms of "carrying" an enterprise with little likelihood of providing a positive return to inputs used and assets employed.

The last observation, in particular, raises the issue of "why (and how) do these producers remain in business?" and brings us back to the first topic of "Why Do We Keep Cows?".

In an effort to explain the behavior of the high cost group, adjustments were made to cost elements and a different bottom line was chosen. Forages and grazing were costed into the cow/calf enterprise at their cash costs of production as opposed to market value. Non-cash costs (value of operator labour, depreciation) for the forage, grazing and cow/calf enterprises were ignored. The resulting margin, called "Gross Margin", for the same two groups is shown in Figure 2.

Fig. 2: Gross Margins - Low & High Cost Cow/Calf Enterprises



Key observations we can draw from this chart are:

< the picture for both groups is more positive, with gross margins for the low cost group always in the black, and on the plus side in three of five years for the high cost group.
< the annual gap between these groups ranged from $0.15 to $0.42 / lb. of calf weaned ... or roughly $76 to $250 / cow wintered.
< the gross margin estimates display "logical behavior" on the part of both groups.

Digging Deeper

The interpretation of these charts and observations gives valuable insight into:

< managing the cow herd as a profit center, and
< managing the cow/calf profit center as a contributor at the farm level.

This distinction is important.

For the low cost group, gross margins were consistently positive. Cash commitments were covered and there was excess left to cover operator labour and depreciation plus provide a rate of return on investment. This excess could also be directed to cover shortfalls in other enterprises.

With the high cost group, at times the cow/calf enterprise didn't cover its own cash costs and was essentially a financial drain on the rest of the farm.

Home Stretch

When we boil it all down, we have to realize that each cow/calf producer's cost profile is unique ... to their location, environment, financial circumstance, and so on. There is no one "best way" that all producers should use in their choice of cattle, feeding systems, land use, etc.

Herein lies the challenge with the cow/calf business. Dr. Boelhje's comment on the significance of "management" is key. Resources provide us with "upper limits" to productivity and profitability ... management skills let us reach the maximum potential the resources can give.

The cost control - low cost strategy we've laid out is a product of:

< analyzing what profitable producers do and how they perform, and
< observing the direction that beef production systems have taken over time, and are expected to take in the future.

The information is on the table ... how does it relate to your operation?

If you fill your "manager's tool kit" with:

< a clear statement of "Why Do I Keep Cows?",
< historical, current (and projected) benchmarks for your own operation,
< relevant peer and/or competitor benchmarks,
< knowledge about market fundamentals and marketing options, and
< skills in applying economic and business analysis techniques,

you will be well positioned to:

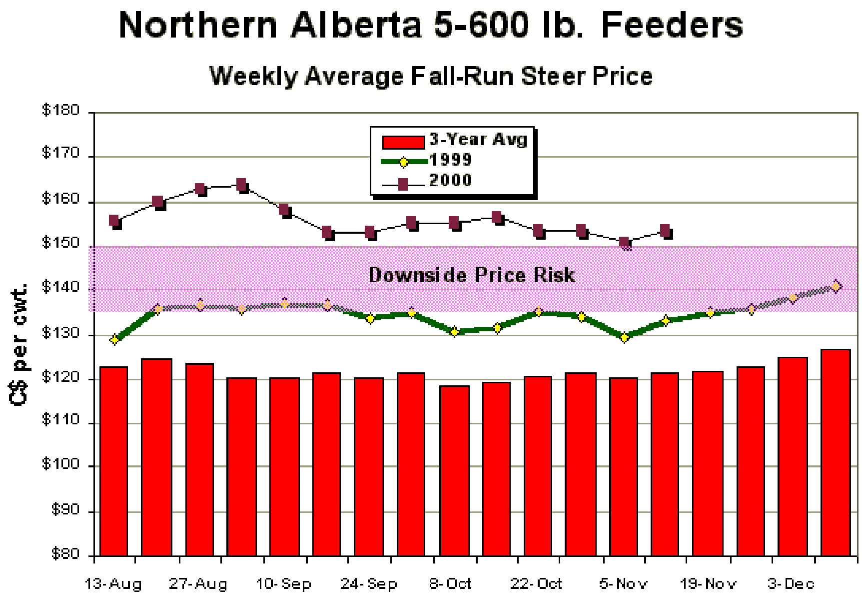
< determine if you are, can and should be a low cost producer,
< analyze and incorporate production technologies and business options as they arise, and
< define your own strategy for managing costs.

You can direct your own economic future.

Dale A. Kaliel

Sr. Economist: Production Economics
Phone: (780) 427-5390 Fax: (780) 427-5220
dale.kaliel@gov.ab.ca

Market Watch



Source: Canfax; Economics & Competitiveness Division, AAFRD

Another season of early calf marketings – this time from southern Alberta – appears to have evened out feeder supplies somewhat. Prices have remained above the $1.50 per pound mark, even with the big jump in US feeder cattle imports (up 57% to the end of October), and appear to be steadying, with some upside heading into the winter months.

There are still lots of questions about where all the heifers will end up – on feed or on grass? If feedlot placements and herd re-building take a big enough bite, the market for grass-type cattle this spring could test some of the summer calf price peaks.

We'd like your comments and questions about the articles featured in this newsletter. Suggestions for future issues are also welcome. Please contact me at:

E-Mail: dale.kaliel@gov.ab.ca Phone: (780) 427-5390
or, by mail, to: 302, 7000-113 Street, Edmonton, Alberta T6H 5T6

AgriProfit$ If you'd like to learn more about and/or participate in our research program, please contact me, as well, at the above.

CowProfit$ If you're interested in the CowProfit$ software, training or seminars, contact:
Ted Darling at (403) 948-8524 (ted.darling@gov.ab.ca), or Jeff Millang at (403) 556-4220 (jeff.millang@gov.ab.ca)

So What's .. Going on With CowProfit$?

Times are good in the cow-calf industry! But as surely as fall turns to winter, we know that calf prices will peak and eventually head the other way; we just don't know when.

Cattle cycles are difficult to predict with any accuracy, but becoming a "low-cost producer" can help you prosper during the high prices and at least hold your ground during the lows. At a recent conference I attended, Topper Thorpe, an ex-CEO of Cattle-Fax, showed us that over the past 20 years, American cow-calf producers just broke even. Of course there have been good years and bad years, but when you average it all out, income has equaled expenses and there has been no profit.

However, when Mr. Thorpe considered low-cost and high-cost producers separately, he found that there was a $100 per head difference. He also showed that this difference was consistent through good years and bad. Low-cost producers were profitable through all but the lowest prices while their high-cost cousins consistently suffered losses. Alberta results show the same pattern, with low-cost producers becoming profitable in 1997 while high-cost producers were still in a loss position in 1999.

Before you can become a low-cost producer, you have to figure out your current cost of production, and the CowProfit$ software helps you do just that. It's designed to work from your financial and production records to calculate your costs per cow wintered and per pound of calf produced. It analyzes your cow-calf enterprise as well as those enterprises that play a supporting role, like forage and pasture. The end result is a new and clearer financial picture of your whole farm operation.

Once you've calculated your own costs, the next step is figuring out how to drive them down. Cost of production benchmarks are available from AAFRD's Economics Unit. They're readily available on the Internet at: http://www.agric.gov.ab.ca/navigation/economics/production/index.html. Reports generated from the CowProfit$ software follow the same format as the benchmark data, making direct comparisons easy. Measuring your costs over several years and studying the trends, can lead to even better cost-cutting information. What better time to start the process of becoming a low-cost producer, so that when the cycle turns you'll be able to stay profitable longer?

The CowProfit$ software was released last summer. AAFRD's Beef, Forage and Farm Management Specialists are familiar with it and would be happy to discuss how it might work in your operation. As well, we're planning information sessions and hands-on workshops in most regions of the province. They'll start in November and continue through the winter. Contact your nearest AAFRD district office for information about sessions in your area. If you'd like more information about the software itself, try downloading the free demo on Ropin' the Web at: http://www.agric.gov.ab.ca/ruraldev/homestdy/cowprofit$.html. A full working version costs $150 plus GST.

For more information contact:
Jeff Millang
Beef Specialist
Olds, AB
(403) 556-4220
jeff.millang@gov.ab.ca

Ted Darling
Farm Management Specialist
Airdrie, AB
(403)948-8524
ted.darling@gov.ab.ca