Managing a Successful Growing Dairy Business

Dairy Expansion
Financial & Management Planning

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First Become a Business Manager

We probably can sum up those characteristics of being successful simply, that some farmers are "Business Managers" but most would rather not be.

A business manager is well focused, driven to achieve, and has daily goals that are tied to a long-term philosophy of knowing where one's going.

The question to ask yourselves is how you as a farmer can become a business manager. Some say you can't. You are either born with it or not! My grandfather said it depended on the shape of your head.

In my humble opinion of helping farmers over the past 28 years, it takes a lot of change in philosophy and discipline. There are a few things you can do:

- **First**, you need to light a fire in yourself. The sooner you start, the better.
- **Second**, you should associate with those who are. Find someone who functions like a businessperson and learn.
- **Third**, make managing (planning, organizing, staffing, directing, and controlling) fun to do and learn.
- **Fourth**, set up practical helping devices. But most importantly is to install financial discipline into the business. This part of managing requires a lot more than one realizes. Here are a few key points.

Know Principles of Financial Management

1) Start with a foundation of facts. Every business needs to track where it has been and where it is going.

Where the Farm has been

- Develop your own financial statements on net worth and earnings. Track earned net worth.

Where the Farm is going

- Develop your own financial projections with a capital investment priority plan.

2) Know the standards (benchmarks) of your industry.

- Compare to others, especially the good ones!
- Know the boundaries of solid financial RISK management.
- Know what technology and practices have a fast payback.

3) Instill a decision making process into the business that is:

1st Economically driven - will it make me money?
2nd Tested by an outside unbiased advisor.
3rd Carried through successfully by an action plan.

4) Someone has to be in charge of saying "no" - every business that has profit has a good, talented, dedicated *Chief Financial Officer*, i.e. **controller**.

5) Most farmers plan in their minds, business owners plan on paper. Successful owners plan with their management team (spouse, next generation, lender, consultant).

Observe the Dairy Finance Rules

Basic Guidelines on the use of capital

1) Total debt/cow
 < \$2,000 before expansion
 < \$3,000 after expansion (perhaps \$3,500/cow under certain situations)

2) Net Worth > 70% before
 > 40% after

3) Debt Structure:
 \$1,000/cow for 5-7 years for 40% of the total debt
 \$2,000/cow for 15-25 years for 60% of the total debt

4) Short term security 2:1 ratio For every \$ borrowed you'll need \$2 in short term assets as security.

5) Asset values stay in balance:

cattle	$1,200 - $1,600/cow
equipment	$1,000 - $1,200/cow
real estate	$3,000 - $4,000/cow

6) Working capital is critical. You must have enough funds available to take advantage of opportunities.

Illustration of a Typical Expansion for a 300 Cow Dairy to Increase to 500 Cows.

Total assets @ $6,000/cow =	$1,800,000
Total debt	-540,000
Net worth	$1,260,000 = 70%
Debt/cow	$1,800/cow

New Capital Investment Maximum of $1 million

400 cow free stall barn	$400,000
New milking facility with bulk tank	200,000
Facilities	$600,000
Manure handling	40,000
Expand bunker silo	50,000
Heifer additional capacity needed	30,000
Additional equipment	30,000
Cows and youngstock	200,000
Misc. and overrides	50,000
	$1,000,000

Change in New Worth after Expansion

Assets were	$1,800,000
Add 50% of facility	337,500 *
Add Cattle	200,000
Add 50% of Equipment	15,000 *
	$2,352,500
Debt was	-540,000
New debt	-1,000,000
Net worth	$812,500 = 35%
	Debt/cow $3,080/cow

* Lost capital

Practice Risk Management - Stay Financially Flexible

1. Have excess earnings of $100 - $200/cow after all payments are made. This is a cushion for emergencies, downcycle, tough luck, replace equipment, and facilities.
2. Protection from catastrophes. Death, divorce, injury, discontent, and/or lawsuits.
3. Capital debt payments less than 20-25% of the milk check. Need to have enough funds for working capital.
4. Double herd size - quadruple the risk in all areas - Must have a strong financial cushion.

Avoid Financial Problems with Capital Investments

1. Difficult to grow into new facilities. It is financial suicide if you don't fill the barn with cows right away! Growing into a new facility usually takes 3 years, meanwhile there is not enough earnings to handle debt.
2. Trying to do it all on short term.
   $1,000 per cow short term debt goal.
   Leasing is also like short term financing.
3. Investments that look good on paper, but never produce the profits.
   Labor saving changes require someone to either leave the business or do something more productive.
4. Commit to building and then look for financing.
5. Room for over-runs. Most expansions don't include everything. Have enough to absorb 10-40% more capital.

Important Issues to Study Regarding Dairy Farmers Looking to Expand

1. Management Depth and Intensity
   Especially going forward in expansion.
   ✓ Is owner alone? Can he manage labor?
   ✓ Is owner a good delegator?
   ✓ Talented 2nd line staff?
   ✓ Management succession plan?
   ✓ Assess the strengths and weaknesses of the manager/management team?
2. Financial Flexibility
   Can the business afford to expand? Does it have the financial strength to do so? Can the business handle expansion capital needs and still have a cushion for the unexpected?
3. Environmental Concerns
   What are the environmental concerns? Is a DEC approval plan needed?
   Is the farm and owner liable for scrutiny by neighbors and regulators regarding practices?

4. Balance of Resources
What is required for expansion? More buildings, land, cattle, equipment. What are the missing resources. What should be the plan of resource acquisition over time?

5. Herd Production
Ability to make milk cost effective. What is lacking? Cow Care!

6. Replacements Program
What is their cost effective approach, raise, boarding, buying.

7. Controlling the Business
What does the owner do to monitor the operation? - Financial, labor and production records. Are any changes or upgrades in monitoring systems needed?

8. Long Range Implications for this Operation
Do they have a plan?
How big can or should they get?
Who will buy this farm?

Dairy Expansion Planning Process

Study, observe, and analyze
- Budget with limits.
- Visit farms in detail.

Know fundamental rules
- 3 years profitable - expansion doesn't cure poor management.
- First calf heifers raised well and lots of them.
- Overload system - temporarily crowd facilities.
- Build 3-6 months of extra silage.
- Develop confidence in ability to manage.
- Use the phase-in approach - grow in long stairs.
- Know how to make 3x's a day work.
- Water: have plenty of it with back-up plan.
- Must do monthly cash flows - less working capital as you build the business.

Put a plan together on paper.

What will your lender require?

1. A good track record.
   - 3 years of profits.
   - Paying debt down ahead of schedule.

2. Strong financial position
   - Don't borrow your last dollar situation.

3. A written business arrangement
   - Multi-family operation requires a management and ownership plan with a formal business entity.

4. Monthly financial records

5. A written plan for expansion
   - Capital requirements - list of investments with detail bids.
   - Farmstead site plan.
   - Environmental approvals.
   - Two - three years of cash flow projections.

6. NO SURPRISES!!!

In summary

For those who like the challenge of managing a growing dairy business.

1. Learn the "art of managing" - every successful dairy owner has a chief financial officer. He most often performs the role himself because he realizes that the daily physical activity (likes to do) and management (referred to by some as "office work") need to be kept in balance.

2. Have a vision with economic sense.

3. Never stop questioning how to do it better.

4. Only investing in fast payback investments and technology, but more than just this: Monitor changes, if they don't meet expectation, find out why! Pronto!

5. Invest in young people. Might even have to spend time on recruiting and training as well as bringing them into the operating part of your business.

6. Practice risk management. The best way is to pay debt down faster than scheduled!

7. Be stewards of the environment. Be leaders in nutrient management.

8. Excellent quality roughage still is the secret formula, if there is any. Cows will make money every time with good roughage including intensive grazing. Besides they are always healthier. Makes cow care easier.

9. Must accept the consequences that pushing heifers and cow production will result in a whole new set of challenges.

10. Need to find and train specialists. Successful large dairy farms have a dedicated feeder, a milking supervisor, shop foreman, herdsperson, equipment operator, and a calf manager.

Remember....
In dairy farming - there are many ways to make a profit, but not without being a business manager first!!!

Dairy Farm Benchmarks

Cost of Producing Milk Accrual Basis	TOP 25% 1993 Agrifax Farms Dollars per CWT		Your Farm
Herd Size	140	247	
EXPENSES			
Feed (Purchased)	3.80	3.63	
Labor +(WC, HI, FICA)	1.70	1.82	
Interest	.70	.73	
Dairy (1)	1.05	1.12	
Repairs (Bldg. & Eq't)	.96	.79	
Crop (seed, fert, lime, chem. fuel)	1.41	1.12	
Taxes, insurance, utilities	1.13	.94	
Marketing (hauling & advertising)	.73	.47	
Other	.89	.53	
Adjusted Cash Operating Expenses (2)	12.37	11.15	
+Depreciation (3)	+1.28	+1.41	
+Family Living & Income Tax	+1.13	+.65	
TOTAL COSTS	14.78	13.21	
-Nonmilk Income (4)	-2.41	-1.25	
Net cost of Production	12.37	11.96	
Gross milk price	13.17	13.04	
Margin/CWT	.80	1.08	

(1) Includes: DHIA, bedding, supplies, breeding, vet and med., hooftrimming.
(2) Adjusted means expenses increased or decreased due to a change in prepaids and open accounts.
(3) Depreciation is standardized by taking 10% of the equipment and buildings' fair Market value estimate.
(4) Nonmilk Income includes: cattle sales, crop sale, nonfarm income, other farm income, and capital sales.

*Don R. Rogers * Farm Business Consultant * Farm Credit Bank of Springfield * March 1994*

Evaluation Factors

Scope of Operations	Benchmark		Your Farm
Number of Cows	140	247	
Number of Youngstock	121	197	
Pounds of Milk Sold	2,760,802	5,055,346	
Gross Milk Price/CWT	13.17	13.04	
Tillable Acres	458	620	
Worker Equivalent (incl. owner)	3.9	5.3	
Total Cash Wages & Payroll Expenses(1)	$46,934	$92,007	

Efficiency Factors	Benchmark		Your Farm
Cows/Worker	36	47	
Pounds of Milk sold/worker	702,918	961,397	
Crop acres/cow	3.3	2.5	
Labor Costs(1) as % of Total Receipts	11%	13%	

Productivity Factors	Benchmark		Your Farm
Milk Sold/Cow	19,780	20,484	
Youngstock as % of cows	87%	80%	
Purchased feed costs/cow	751	744	
Purchased feed as % of milkcheck	29%	28%	
Debt/cow	$2,202	$2,087	
Cash Net Farm Income(2)	$633	$643	

(1) Labor does not include family living for one operator farms
(2) Gross receipts less farm expenses includes interest, but no depreciation or family living.

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