

Veterinarians and the Dairyman's Bottomline

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Introduction

The Dairyman's Bottom Line is not just "a" measurement, it is "the" measurement of the success of a dairyman. There are additional measurements, benefits, and rewards, but they are not a substitute for the Bottom Line.

The successful dairyman is surrounded by a team of successful outside professionals. These must include a veterinarian, a banker, a CPA, and a nutritionist. The input from these professionals must be heard by the owners-managers of the dairy operation, but these people should not manage or "run the dairy". The ultimate decisions must be made by the owners because they are the ones that will receive the ultimate successes and failures, the Bottom Line. We all must be aware of the current litigious tendencies surrounding agriculture, including dairying.

Background

In the lifetimes of the people in this room, we have seen dairying progress from a sideline to the general farming operation to a true industry and profession in its own right. We have seen the industry progress from a somewhat sanitized milk can operation to a highly sanitized refrigerated steel tank industry. The production per cow has improved from 4,000 pounds to 15/20,000 pounds per annum and the number of cows reduced from over 30 million to 10 million. The average size of dairies has continued to increase from a dozen or so cows to where today dairies of several hundred or even a thousand or two cows are not uncommon. We have seen tremendous and continuous improvement in breeding, barns, and equipment.

What is the Banker's Place?

The above improvements did not come without sacrifice, expense, and capital cost. Although dairying has generally been a profitable industry, seldom have profits been so generous that new capital expenditures, barns, milking systems, land, and other equipment could be purchased from a single year's profits. This is where the banking industry entered the team of dairy experts by answering the continuous and growing need for capital expenditures. Today, most dairy communities have several banks specializing in dairy lending and provide a continuous source of short and long term funds for financing the operation of the dairy. Among the more common loan facilities available are cow loans, feed loans, equipment loans, as well as long term

real estate loans. Over time, this has been a mutually rewarding relationship—banks have received a steady stream of loan & deposit business from the dairyman & the bank has provided a dependable source of funds to the dairyman at a reasonable price.

Bank Analysis of the Bottom Line

The bank is indeed Bottom Line oriented, not only concerning the dairy industry but in all industries. The performance of the Bottom Line over time is evidence of the financial health of the dairy as well as its anticipated ability to repay debt in the future.

Analysis of the financial statements of a dairyman requires a detailed breakdown of the balance sheet and income statements prepared periodically by a CPA. The importance of accurate record keeping by the dairyman is critical to the expense and accuracy of the final product produced by the CPA. The importance of using a skilled objective CPA cannot be over emphasized. Most dairy communities have two or more CPAs experienced and specializing in dairy accounting. I urge you in your association with the dairyman to support their use of a good inhouse accounting system as well as a CPA specializing in dairy accounting.

Based upon the accounting figures supplied by the dairyman and the CPA, the banker will do a detailed analysis of the various components of the balance sheet and income statement. These figures are continuously recorded over time and produce a line graph indicating the historical performance of each major segment of a financial statement. The most critical observation sought by the banker include 1) the relationship between the major segments of the financial statements [i.e., proportion of debt to worth], 2) the trend [direction] each of the segments are taking [improving or declining], 3) and the size of net income [the Bottom Line]. Again, I must emphasize that the Bottom Line is not listed last because it is of least importance. It is last only because it is a culmination of the activities of an entire years operation. Again, the Bottom Line is the most important measurement.

Table 1 is a common format for correlating significant income and expense items to arrive at net income. This exhibit is one of many commonly distributed by CPA's specializing in the dairy industry as a method of encouraging the use of financial analysis by the dairyman and as a public relations item.

TABLE 1. Worksheet to Compare Your Dairy Operation to the June 30, 1987 California Averages.

| | Calif. Aver. | Your Amount | Diff. |
|--------------------------------|--------------|-------------|-------|
| INCOME: | | | |
| Milk | \$11.39 | | |
| Calves and heifers | 0.06 | | |
| Patronage dividend | 0.04 | | |
| Other | 0.06 | | |
| Total income | \$11.55 | | |
| EXPENSES: | | | |
| Feed: | | | |
| Hay | \$ 2.17 | | |
| Grain | 3.20 | | |
| Other | 0.67 | | |
| Less cost | (0.86) | | |
| Total feed | \$ 5.17 | | |
| Herd repl. cost: | | | |
| Depr. — dairy herd | \$ 0.83 | | |
| Loss (gain) on sale | (0.15) | | |
| Total repl. cost | \$ 0.68 | | |
| Other expenses: | | | |
| Labor | \$ 0.83 | | |
| Depr. — other | 0.31 | | |
| Milk hauling | 0.31 | | |
| St. and assn. chrg. | 0.21 | | |
| Federal assessment | 0.25 | | |
| Supplies | 0.19 | | |
| Corral Cleaning | 0.04 | | |
| Repairs | 0.26 | | |
| Utilities | 0.26 | | |
| Taxes and license | 0.13 | | |
| Insurance | 0.13 | | |
| Auto and truck | 0.08 | | |
| Legal and accounting | 0.04 | | |
| Employee benefits | 0.06 | | |
| Vet and breeding | 0.13 | | |
| Test and trim | 0.05 | | |
| Livestock hauling | 0.02 | | |
| Miscellaneous | 0.01 | | |
| Total other exp. | \$ 3.32 | | |
| Total expenses | \$ 9.17 | | |
| INCOME BEFORE FIN. | \$ 2.37 | | |
| Interest and rent | 0.93 | | |
| NET INCOME | \$ 1.44 | | |
| AVER. DAIRY STAT. DATA: | | | |
| No. of milking cows | 743 | | |
| Daily prod. per cow | 58 | | |
| Butterfat test | 3.54% | | |
| Solid-non-fat test | 8.63% | | |
| Herd turnover rate | 29.1% | | |
| Total fed % | 44.7% | | |

The graphing, testing, and comparison of the above components of the financial statements will yield ratios that the banker uses to compare a dairy operation to its historical performance as well as to the performance of its peer group in a dairy community or state. Ultimately, the banker must make a credit decision based upon 1) the present financial

status of the entity, 2) the size and significance of net income, and 3) the trends [directions]. He must estimate the probability of the dairyman repaying the proposed loan request on time.

Some of the ratios calculated from the financial statements that bankers consider most critical are; 1) current ratio (current assets above the line divided by current liabilities above the line), 2) debt to worth (all liabilities divided by the ownership equity in the company), and 3) significance of the Bottom Line (is the net income meaningful considering the amount of equity the owner has invested in the business). It is generally believed that the current ratio should be at least 1.25:1 and debt to worth no more than 1.5:1. The Bottom Line must be sufficient to provide a reasonable living for the owner and to pay his current (due in 1 year) loan payments by a margin of perhaps 150%. These three items are highly relevant to all types of operation regardless of their uniqueness i.e., rent/ownership of land, weather or state of operation.

The Challenges Ahead

It would appear that both you, the veterinarian, and me, the banker, working along side the dairyman, will certainly face some challenging times ahead. Some of these are:

Toxics—including

Drainage—Effluents per Acre per Year

Population Limitations—Cows per Acre

Neighbor Complaints

Toxics in Milk, in culls sold, etc.

Hormones—BST

Nutrition—Feeding Programs

Feed Prices & Milk Prices = **PROFITS**

Stress Management

Water—Availability & Price

Extinction of Small Dairies—Larger & Fewer Dairies

Regulations, codes, zoning

Ownership changes/trends

Management Stress—larger high tech operations

Some of these are existing problems that are likely to linger or grow. Some of these are futuristic and will force us to deal with challenges and problems with which we have little or no experience and little history to assist us. In the U.S., it is probable that we will be dealing with less cows and almost certain that we will see less dairies in the future. It is also possible that there will be less veterinarians, certainly pure veterinarians as we have known them in previous decades.

For you to find a growing, more meaningful place in the future dairy world, you will need to expand your knowledge and service further into the areas of nutrition, proactive health programs, supplements, least-cost balanced ration programs, computer analysis programs, and other futuristic services that will give "added value" to the dairyman in his incessant drive to become a low cost producer with the ultimate goal of a sustained meaningful Bottom Line.