

# IN THE FIELD

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## Tight Margins? Time to Tighten Your Belt (Again)

### How History Repeats Itself

With falling corn prices, we're back to looking at margins in farming that we haven't seen in many years. It seems like we have to find a new way of thinking, but it's really just going back to the old way. It feels like a long time since we had average negative returns per acre for corn, but really it was only back in 2005.

Table 1. Comparison of per acre costs for irrigated corn in 2005 and 2012 (our latest average data available).

Source: Nebraska Farm Business Inc.

	2005	2012
Gross Return	\$373.24	\$1,086.26
Total Listed Cash Expense	\$356.84	\$650.73
Operating, Labor & Mgt. Charge	\$23.03	\$56.42
Owned Land Equity Charge	\$24.28	\$25.37
Total Cost	\$404.15	\$732.52
Net Return Above All Costs	\$-30.91	\$353.74
Average Yield	188.74	203.44
Total Cost Per Bushel *	\$2.48	\$3.95

\* Total cost per bushel is calculated using the operator's share of the yield, not the average yield.

In just eight years the total cost to produce an acre of corn has almost doubled. A lot about that is scary, particularly as the marketing price is falling. If income goes back to where it was in 2005 (\$373.24 per acre) and expenses stay where they were in 2012 (\$732.52 per acre) the average loss becomes \$359.28 per acre. If we assume the average farm has 1,000 acres, that's a loss of \$359,280. What about the 10,000 acre farms? That's a \$3,592,800 loss in a single year. Will lending institutions be willing and/or able to stick with operations that are losing that kind of money for multiple years? (Annual income and expenses used in this article are averages from farms active in Nebraska Farm Business Inc.)

What if your farm is not average? After all, average means that half the farms are higher and half the farms are lower. What if your farm is among the high cost group or the lower yield group? You have even more work to do than the farms sitting on the other side of average.

### Minimizing Risk

How do you work on your farm to minimize the risk of losses or maybe just minimize the losses for the next few years? Net income is a factor of three things: production, marketing, and costs.



We can't do a lot about the major drop in marketing prices, which means we need to look to production and cost efficiency to minimize loss of net income. Unfortunately, increases in production often come at a steep price, making it so important to balance the cost with the increased productivity.

Consider a cost that increases your average production by 5 bushels per acre but costs you \$25 per acre. With \$7 corn, that cost still returned you \$10 per acre more than it cost ( $\$7 \times 5 \text{ bu} = \$35 - \$25$ ). With \$4 corn, the additional production only adds \$20 to your gross and

you had to spend \$25 to get that. Increasing your production may have just cost you \$5 per acre. Sometimes it is very hard to switch the thought process from having the highest gross income to the highest net income. If you focus on having the highest gross income, you will be focused solely on production and marketing. If you focus on achieving the highest net income, you must consider how the costs play into that. It's not nearly as fun, but in times of tight margins, it is of utmost importance.

### **Controlling All Costs**

Farm costs are not the only costs that have skyrocketed in the past eight years. Average family living costs have risen from \$45,469 to \$100,040. These costs don't include the almost \$35,000 increase in annual income taxes paid. In 2012, the average farm spent a combined \$143,780 on family living and taxes. If we go back to that average with a 1,000-acre farm with 2005's income and 2012's expenses and a \$359,280 loss and add the 2012 average non-farm cost, the balance sheet would have taken more than a \$500,000 hit to net worth.

Family living costs are so hard to reduce. Once the family is used to the big cell phone packages, all the movie channels, high speed internet, fancier cars, eating out, etc., it's hard to go back. The family living expense trend is a constantly increasing number. We have not seen an average family living number drop from the previous year since 2001. For about a six-year period it hovered around \$36,000. Since 2004, it has taken dramatic increases each year. How do you cut 65% of your living expenses out of the budget to get back to that level? I doubt there are too many families that are excited about that.

### **How Do We Do It?**

We will likely never get costs back to where they were in 2005 and we can hope that income doesn't go back that far either. Until crop input costs come back into line with the marketing price, it's going to be important to think about the necessity of each expense, both farm and non-farm. It may only be \$100, but a few of those \$100 expenses may be the difference between covering your costs or creating a loss.

In times of a tightening margin, it's increasingly important that you begin to manage all your costs instead of letting your costs manage you. The end of the year is too late to start doing this. By that time, your money has been spent and there's little you can do to change your cost of production.

Starting now, you need to consider the effects that each cost will have on your net income. Some costs may fall into that "have to do it anyway" column. That's okay. Other costs may fall into the "I want it" category. You may be considering a capital purchase that will make your job much easier. That's okay, but can you buy used instead of new? Is there a lower cost solution than the "ultimate dream" setup? Are you buying the tractor you think you'll need in two years? Could you get the job done with less expense?

A working cash flow is a tool that can help you manage your costs throughout the year. I'm not talking about a cash flow that you threw together for your lender and then forgot. Any cash flow is only as good as the assumptions that day and it doesn't take long for those assumptions to be proven wrong. A working cash flow should be updated to include actual costs as they become available and updated projections as the year goes on. This should also carry projected cost of production estimates which reflect any contracts you've made to get a breakeven cost for future sales.

Computer programs can help you build a spreadsheet to manage your cash flow, but if you feel you don't have the knowledge or the discipline to make yourself do it, consider hiring a consultant. Most producers don't think anything about having a crop scout or a marketing advisor. A financial consultant can be just as important if it's not your area of expertise. By managing your costs ahead of time, you can make educated decisions about whether a cost is really a good financial decision for your operation before it's too late.

Source: [cropwatch.unl.edu](http://cropwatch.unl.edu)