Finding Solutions

Economists and ranchers give insight on the increase of input prices.

by Faye Smith, editorial intern

The increase in input prices over the past year has been heavy on the rancher's mind. Although there is no magic answer, economists and producers alike continue to search for solutions to keep operations productive and profitable.

Understanding the business

The typical business model of a seedstock rancher can be simple: calving out cows, selling them as yearlings, and repeating every year.

"A fundamental of economics says that the optimal time for a person to sell an animal is when the cost to put on an additional pound of gain is equal to the price that they're going to receive when they sell it," says Elliott Dennis, assistant professor of livestock marketing and risk management at the University of Nebraska–Lincoln.

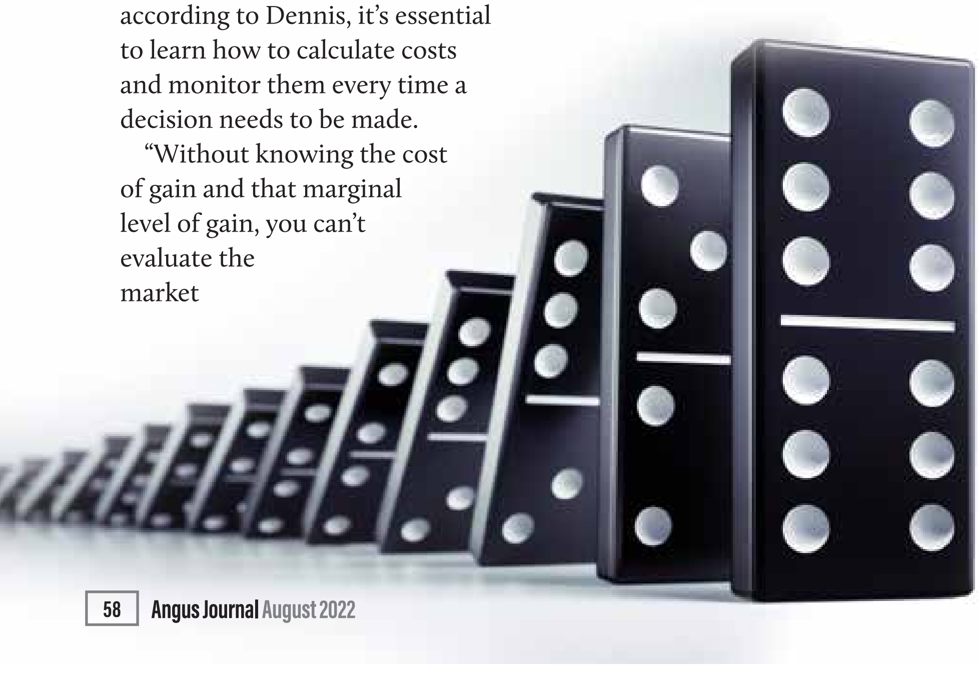
This concept might seem basic, but according to Dennis, it's essential to learn how to calculate costs and monitor them every time a decision needs to be made.

"Without knowing the cost of gain and that marginal level of gain, you can't evaluate the market price. Likewise, it's even more difficult to implement price risk management strategies to lock in profits," he says.

Ranchers typically take more risk when they price all their cattle into the cash market, especially if they sell within the same time frame. Volatility is defined by how much price changes.

Dustin Pendell, professor and director of graduate programs at Kansas State University, explains why it is hard to manage issues at the ranch when prices increase and there is high volatility.

"If input prices, such as feed, diesel fuel or calf prices, are moving around a lot, that creates a lot of volatility and a lot of uncertainty," Pendell says. "With increases in volatility, a producer wants to find a way to mitigate the volatility either on the input or output side so they can



better know their profit margin, which can help with the marketing of their calves."

Dennis reports Omaha corn prices were $8.20 per bushel (bu.) in June 2022, compared to $6.31 in June 2021 and $3.67 as an average between 2016 to 2020. Urea was also approximately $650 per ton in 2022 compared to $200 per ton in 2020.

Still, what do these components have to do with increases in input price? Eventually, the amount of available cash affects a cattleman's ability to take risks. That affects ranch-wide decisions, Dennis says.

"For a producer who has high input costs on hay prices or pasture rent, that limits their flexibility moving forward," Dennis says. "If all of that available working capital gets put into high input costs, then ranchers are generally less able to take risks in the cash market because there is less margin for error."

Pendell describes the increase in input prices as "a domino effect." He names instances like the Ukrainian-Russian conflict, pandemic supply-chain issues and drought as some of the larger driving forces; but not one is linked to a specific input. He explains there can be multiple factors that influence input prices.

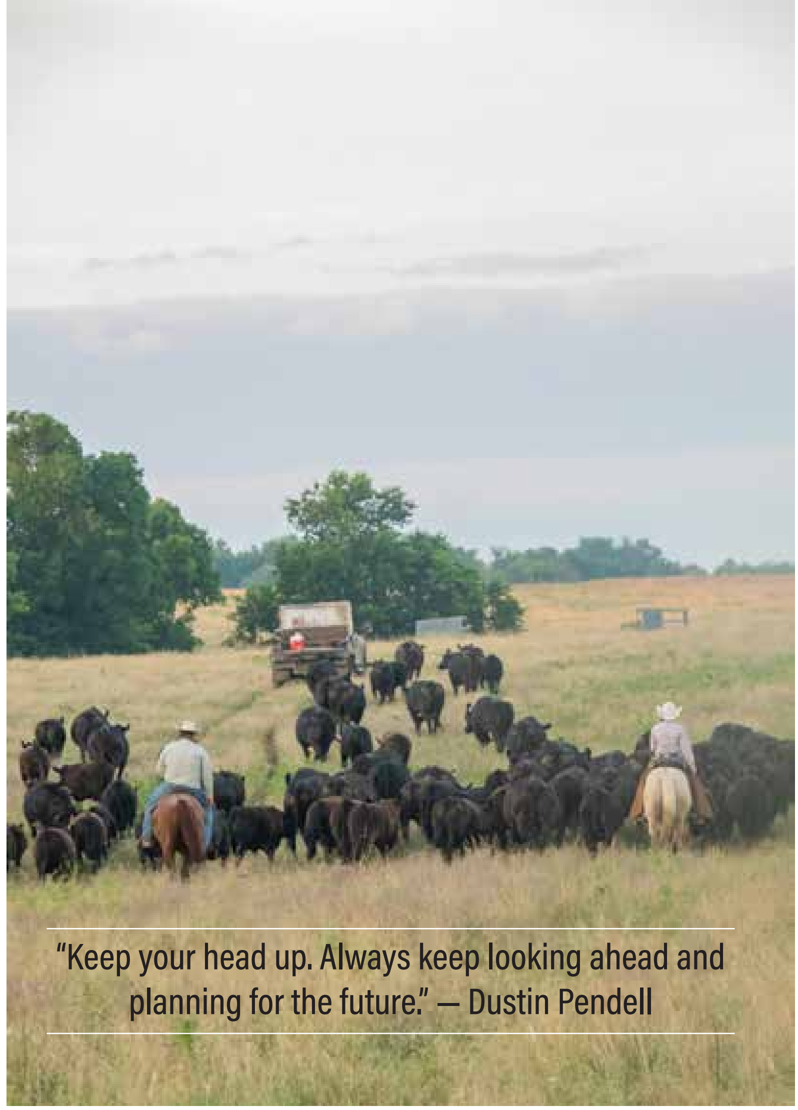
Many issues farmers experience with input prices are external determinants.

"We can't control interest rates, we can't control weather or drought; but we certainly can manage our operations in a way that allows us to mitigate some of that variation in price," Dennis says.

Economist strategies

Overall, there are many ways to integrate new strategies to navigate rising input costs. Pendell and Dennis have seen creative solutions for ranchers to research and potentially implement in their operations.

Historically, cow-calf producers do not buy into traditional Chicago Mercantile Exchange Inc. (CME) futures; CME options contracts; or USDA Risk Management Agency Livestock Risk Protection (LRP), a USDA subsidized put option, according to Dennis. He says markets have become more volatile in the last 20 years, and the practice of managing price risk across all commodities has increased.



"Keep your head up. Always keep looking ahead and planning for the future." — Dustin Pendell

PHOTO BY MEGAN SILVERIA, ASSISTANT EDITOR

Both Pendell and Dennis suggest considering these contracts if there is a need to manage an operation's price risk with selling cattle.

"At least look into and understand what it is and if it's right for your situation," Pendell says.

Pre-buying inputs is another strategy Pendell suggests. In 2020, he says Kansas grain producers pre-purchased inputs like fertilizer and fuel for their upcoming growing season. Producers were able to lock in prices and saw record-high net returns in 2021.

"I know it's easier said than done. I get that because you can't predict everything. You can't plan that far ahead, but if you can anticipate or plan six to 12 months out, lining everything up, you might be able to get better deals," Pendell says.

When it comes to land costs, Dennis suggests looking at flexible grazing leases. This is a rental rate that can flex up or down given a market parameter. It can also be layered with LRP to further mitigate the effects of downward price movements.

"For example, when feeder cattle prices are low, the operation has a low or negative net income. If the flex lease is based on the national cattle price, then ranchers would reduce pasture costs by a certain prearranged amount," Dennis says. "Conversely, when feeder cattle prices are high, the producer has more income, and it allows that rent to flex a little bit higher. It essentially lowers pasture rent when net income is low and raises pasture rent when net income is high."

University-provided extension services are there to help guide producers, as well as accounting firms or a local USDA Farm Service Agency. There are also online programs available for accounting and management.

He advises ranchers to get back to the basics of business when it comes to operating with increased input costs and calculating appropriately for them.

"If we don't understand costs, we can't make good business decisions. We can't determine whether what we're buying is going to return value to us. We can't determine if it's the right time to sell or not. And ultimately, we can't decide on certain risk management strategies," Dennis says.

Some days it's as much about bolstering morale as it is keeping the books in the black.

Pendell gives this pep talk: "Keep

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your head up. Always keep looking ahead and planning for the future."

Producer solutions

Nestled in Annandale, N.J., Howard Hoffman and his wife, Janet, own and operate Hoffman Cattle Company. The farm is located a few miles from their home, where they manage about 50 cows on their Angus-emphasized and Hereford seedstock operation.

As a rancher, farmer and business owner, Hoffman is experiencing the increase in input costs in various ways. Alongside the cattle, Hoffman farms around 900 acres of hay and grain for customers, as well as runs a small landscape construction company.

"The problem with agriculture is the margins are a little tighter than when you get into the business world," Hoffman says.

He saw his location — farming near two of the wealthiest counties in the nation — as a reason to pursue value-added products. He markets grass-fed beef and organic crops to add a premium. He bought sheep and goat herds to serve an ethnic market in nearby New York City.

Even without grain inputs, Hoffman's feeder steers grade high Choice and Prime, and the resulting premium allows Hoffman to achieve a higher profit margin.

"I think you have to do what you have to do to make the most money to sustain your operation," he says.

Throughout his years as a rancher, he says he's never seen anything like the rapid increase of input prices in today's market. Although Hoffman knows the importance of paying for increased efficiency, finding ways to cut costs for his operation is a priority.

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> — Howard Hoffman

Understanding the costs required to be in the greater agriculture industry is crucial.

Fertilizer, for example, is one of Hoffman's largest operating costs, increasing by as much as 300% in the past year. To combat this, Hoffman switched to natural organic fertilizer. It was a transition that led him to cut back on traditionally used phosphorus and potash.

"It's one of those things that I think you have to know. You have to sit down and figure out what your costs are," Hoffman says. "As an owner, you need to understand how to spend your money, whether you're on a cow-calf operation, feedlot, whatever it may be."

Once there is that understanding, it comes down to finding ways to get around spending the extra money.

Hoffman says pre-buying diesel and seed were some of the smartest decisions he made. In December he pre-purchased diesel at around $4 per gallon — $2 lower than June prices in his state. Hoffman saw the same thing with a 200% increase in seed costs after his pre-purchase.

"I saw a little bit of this increase coming. We heard about it in the fall last year, that the shortages would be coming," Hoffman says.

He advises other operations to understand "there are always ways to be more efficient."

Each year Hoffman consigns cattle to the Cow Power sale, selling some of the top stock from their herd.

"I want the next buyer that buys my genetics to be able to make money and come back to me," Hoffman says. "I don't want them to sell for crazy prices, but above the average. I want people to be able to come back to us."

Keeping an open mind to change is the best advice Hoffman says he can give to ranchers during this difficult economic period.

"I don't think you should ever limit yourself to what Grandpa did," Hoffman says. "The structure of things, the fact that we can be more innovative — we can do a lot of things differently and see the possibilities." AJ

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