Dollars & Sense

by Vern Pierce, beef economist, University of Missouri-Columbia

Rightsizing your operation

The cattle cycle has mystified many for a long time, yet our outlook forecasters have been good at telling us what is around the corner in terms of prices and profits. The opportunity comes when an individual producer can look at those forecasts and plan farm operations around a fairly predictable cycle.

The Food & Agricultural Policy Research Institute (FAPRI) at Iowa State University and the University of Missouri suggested in its February baseline forecast that U.S. cattle inventories were expected to decline until 2002, when we will level off at about 95.3 million head, finishing the liquidation phase that began in 1997. An expansion phase then will ensue, bringing national cattle numbers to 98.3 million by 2007.

What does that mean for prices? FAPRI predicts the price of Oklahoma 600- to 650-pound (lb.) feeder steers will continue to rise until 2003, peaking at nearly $94/hundredweight (cwt.) before beginning their descent. Fed prices will peak at more than $76/cwt. that same year if the projections hold. Cow-calf profitability is expected to be positive each year, peaking in 2003 at $32.45/cow when the feeder-to-fed-steer price ratio drops below 1.2.

Using the information

Now, what do you do for your farm with this information? This is where you need to stop looking at national averages and start looking at why your operation is organized the way it is. The average return projected by FAPRI for cow-calf operators for the 2000-2009 period is about an $8/head loss, and I expect for a national average that will be right on target. The net returns you receive will be a function of your cost-control and marketing efforts.

Let's assume the trend for cattle prices will be the same as the predictions I mentioned. Here are some scenarios for you to consider as we enter this phase of the cycle.

Understanding how to calculate, interpret and manage cost of production is likely to separate farm managers who will step up the ladder of success from those who won't. Managing a cow-calf operation without this guide upon which to make business, marketing and production decisions likely will use equity rather than profits to help the farm stay in business. If you don't know your cost of production, and if it mirrors the national average trend, the likely result will be nothing less than an erosion of equity.

A different economy

Your operation has weathered the cattle cycle before this, so the answer is to tighten up the bootstraps and tough it out, right?

The problem with this philosophy is that the economy has changed since the last time you "made it through" the low end of the cattle cycle. Capital providers are no longer seeking cattle loans. In fact, many rural banks don't even have a loan officer with an agricultural background.

The opportunities that we have in the cattle business come from the changes that are happening.

Restructuring in the lending business has resulted in lenders' turning to loan portfolios with greater liquidity and resale value, like cars and family homes. In fact, the agencies that sell money to banks to lend are sending a clear signal that agricultural loans are not coveted like they once were. If you get a loan to help you through the tough times, your lender likely will be more aggressive in monitoring your repayment and will be far less forgiving than in the past.

If you are thinking of expanding your operation now or in the near future, here is something to grasp: If you had a difficult time making it through the last valley of cattle prices in the mid-1990s, then what is different about your operation that will make this trip easier to weather?

If your cost of production puts you at or near the national average and your marketing efforts yield calf prices with the same trend, then decisions you make this year to hold back more heifers or even to buy more cows will give you a calf crop that will see higher prices for the next three falls (2001-2003) and give you an average return per cow of $32/year during that time. Let's say you increase your herd size from 100 to 150 cows during that period. Your net income, using the FAPRI guidelines, for the entire three-year period will be about $13,000. When 2004 arrives and returns start to fall, those 150 cows will eat up that $13,000 by 2007; by 2009, you'll be another $16,000 in the hole — a net drop of nearly $20,000.

Rightsizing

Have you thought about "rightsizing" your operation? Why do you have the number of cows that you do? Is it based on the carrying capacity of your land or perhaps on the number you always have had? What if that farm size dooms you to equity erosion through the next cattle cycle?

The opportunities that we have in the cattle business come from the changes that are happening. The world economy is changing the rules of the agribusiness food chain with such velocity that you can no longer simply ride the market and expect to thrive. You must consider redesigning your production and marketing systems to be ready. That process starts with a strategic plan, and planning starts with knowing your cost of production.

Did you hear about the producer who was losing money on his calf crop each year, so he decided to expand and make up for the loss with volume?

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