



Herd Management

The Key
 To Progress

Tuesday
 November 6, 2007

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 Desert Wind Winery
 Prosser, Washington

Profit Outlook for 2008

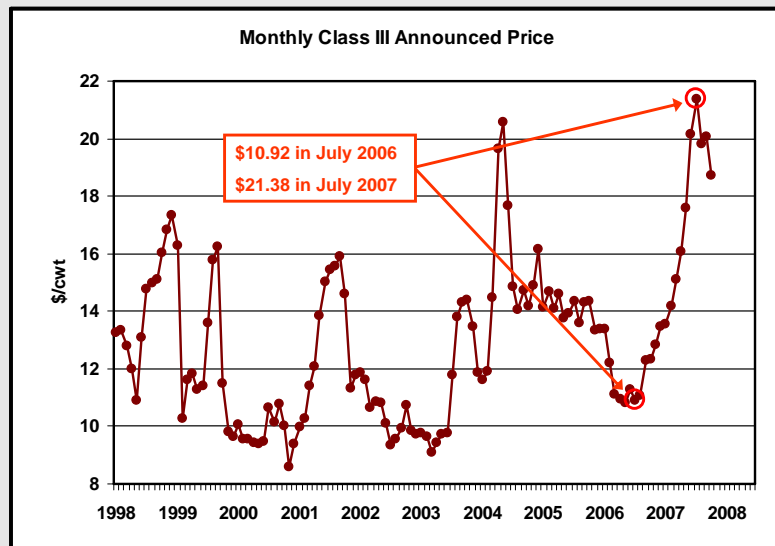
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 Department of Agricultural Economics
 Kansas State University, Manhattan, KS



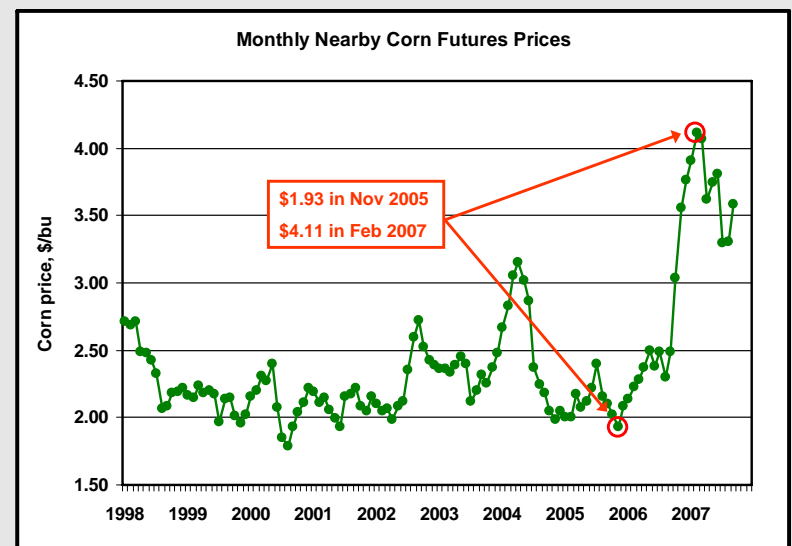
A look back before looking forward...

- Milk market
- Feed prices
- Ethanol situation

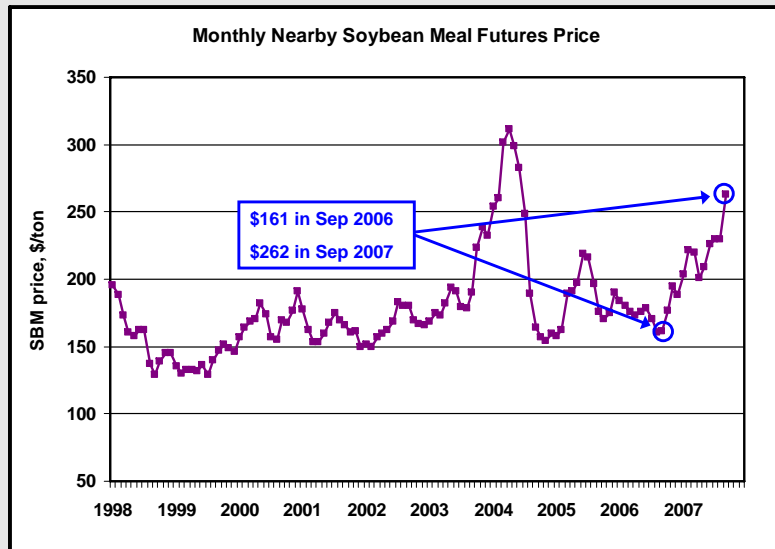
Milk market has been on a wild ride...



Corn prices on the same wild ride...

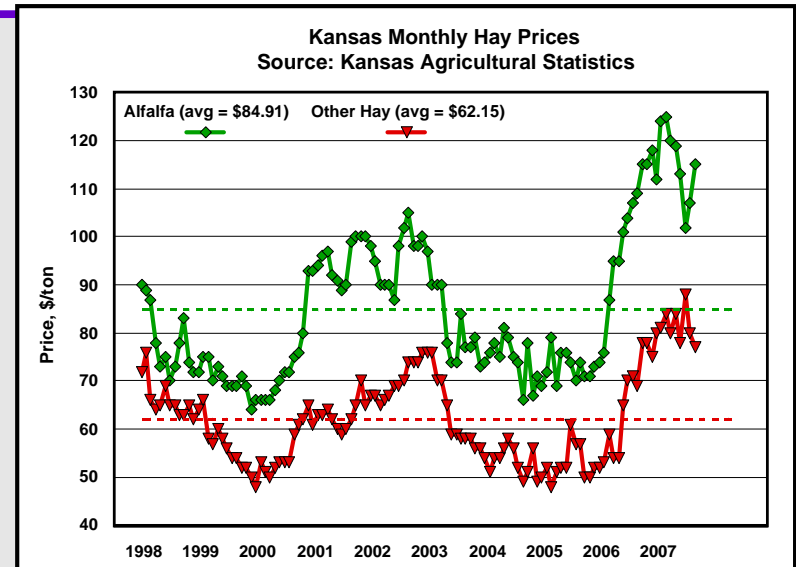


SBM prices also increased sharply...



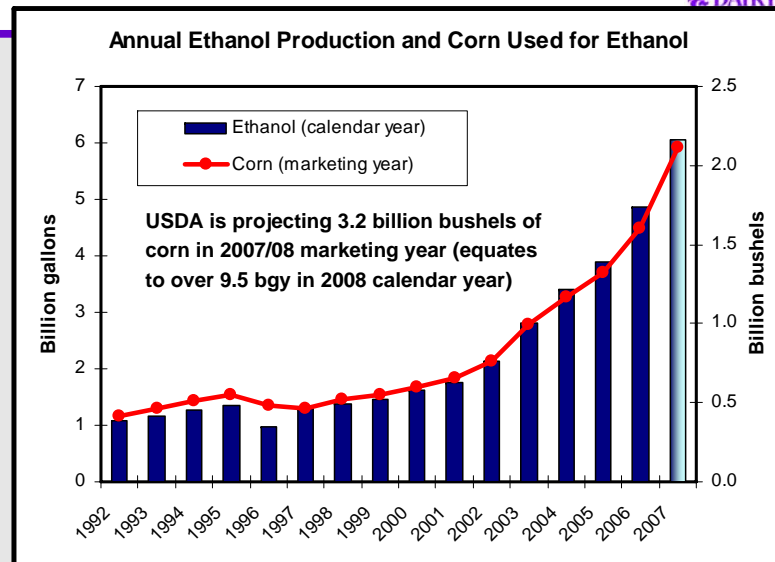
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It's not just grain prices...



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Ethanol has increased the demand for corn...

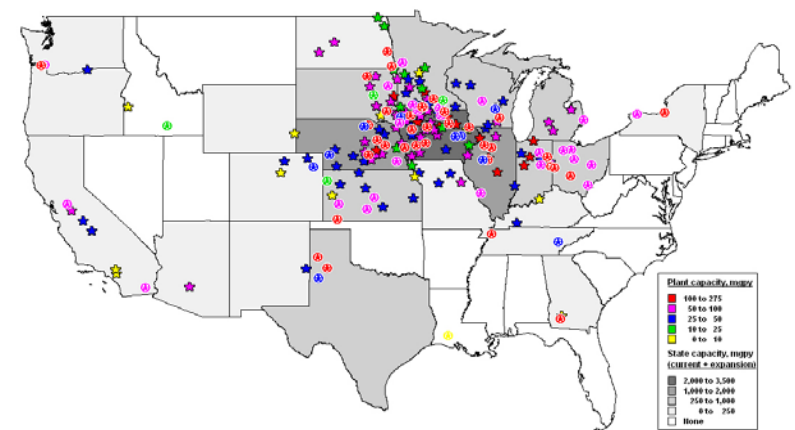


Source: Energy Information Administration (EIA), USDA NASS, and KSU

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Existing and new ethanol plants

Source: Renewable Fuels Association (RFA)



10/9/07 – 202 plants / capacity of 13.45 bgy

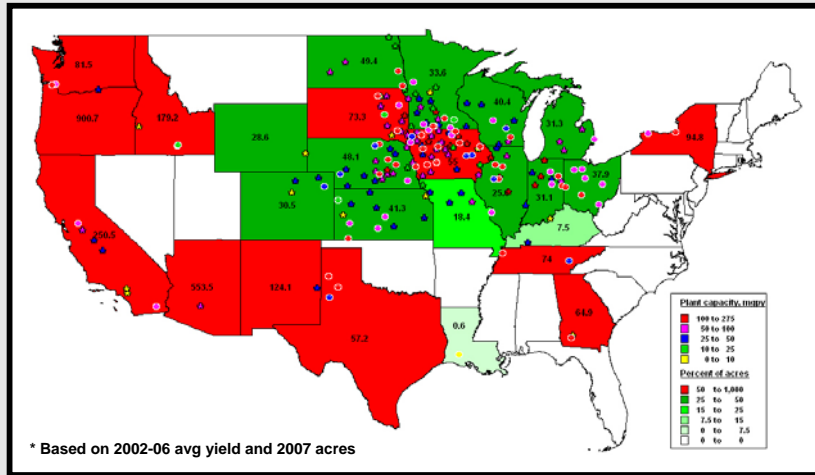
Current ethanol plant capacity: 132 plants, 6.93 billion gallons/year

Expansion and new construction plant capacity, 80 plants, 6.48 billion gallons/year

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% of Acres Needed for Ethanol Production*

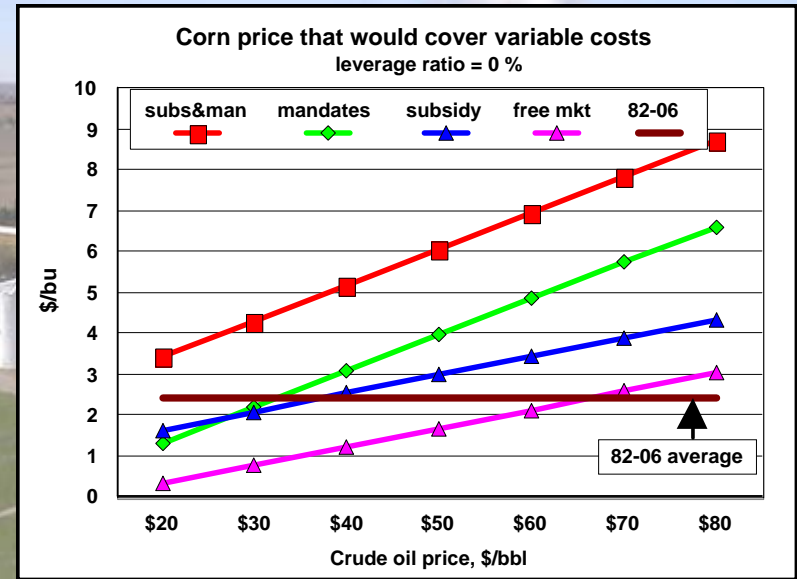
Source: USDA NASS and KSU



* Based on 2002-06 avg yield and 2007 acres

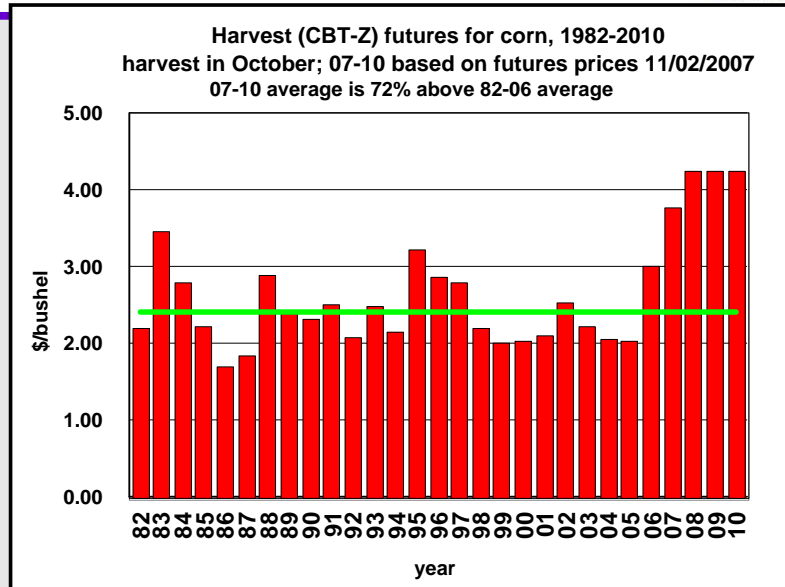
Ethanol expansion is going to create some interesting dynamics...

Ethanol Profitability...

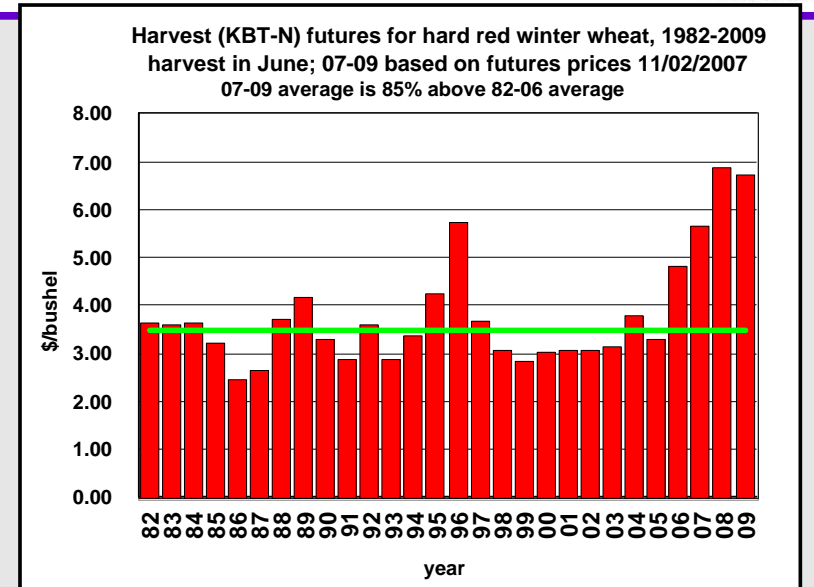


If mothballing costs are high, effective breakeven prices are higher

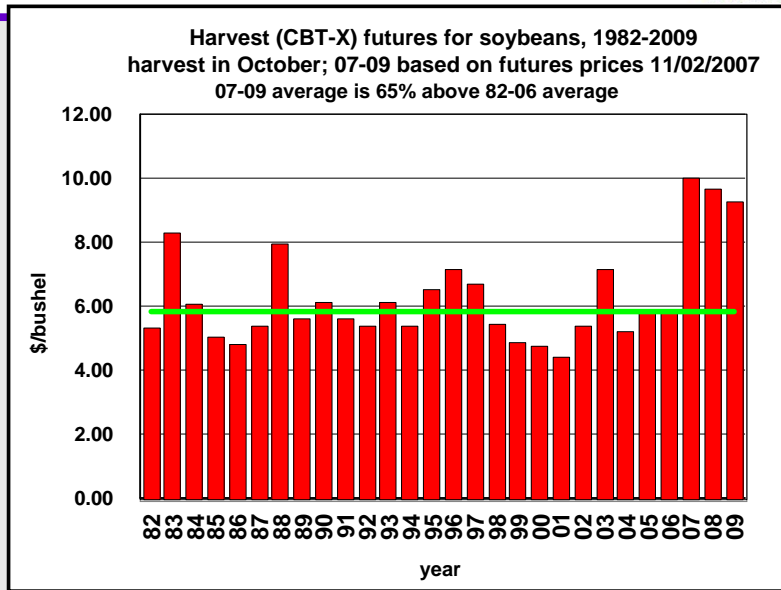
Feed prices will be high for awhile...



Feed prices will be high for awhile...

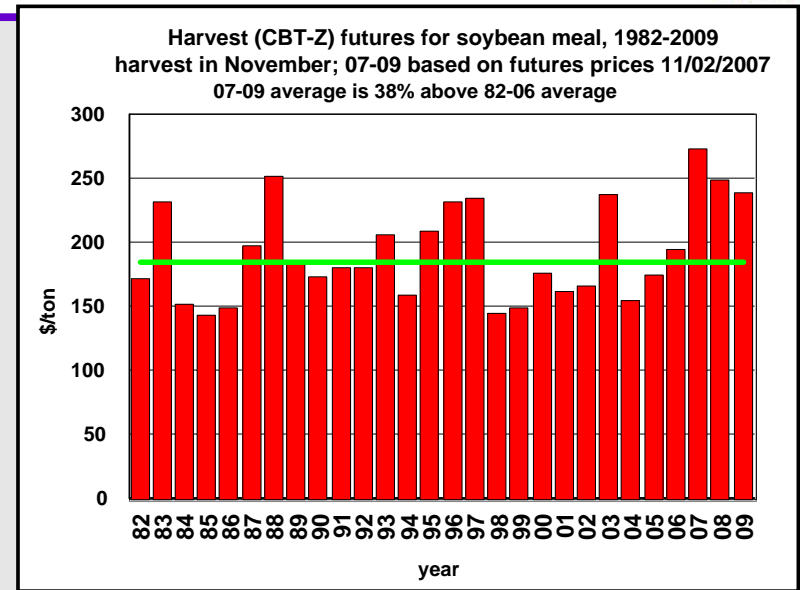


Feed prices will be high for awhile...



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Feed prices will be high for awhile...



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Outlook for 2008 assumptions...

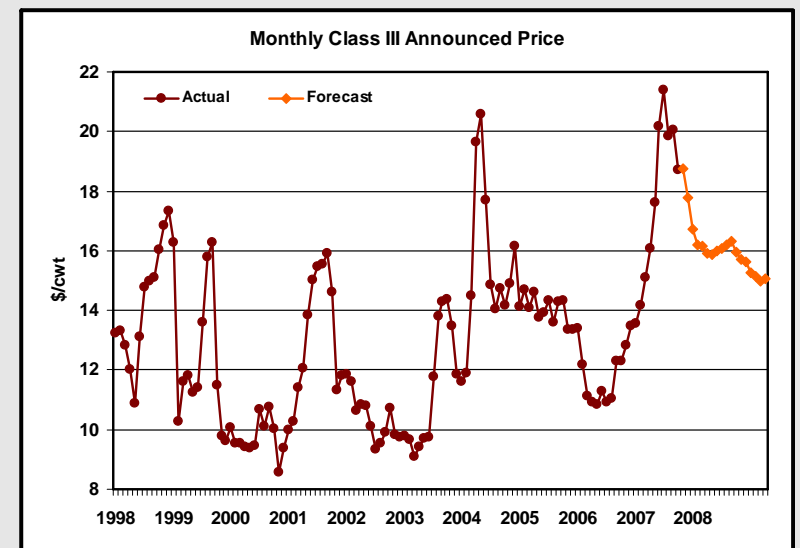


- Milk prices based on futures market adjusted for basis (plus assumed a premium of ~\$0.50/cwt)
- Feed prices based on corn and SBM futures adjusted for basis
- Costs based on KSU budgets and adjusted where appropriate (based on economic costs not cash flow)
- Production based on 2006 average for WA of 23,270 pounds and 2008 projected value of 23,770
- Interest rate of 8.25%, 50% equity (total investment in buildings and equipment of \$3,750/lactating cow)

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Milk prices expected to soften...

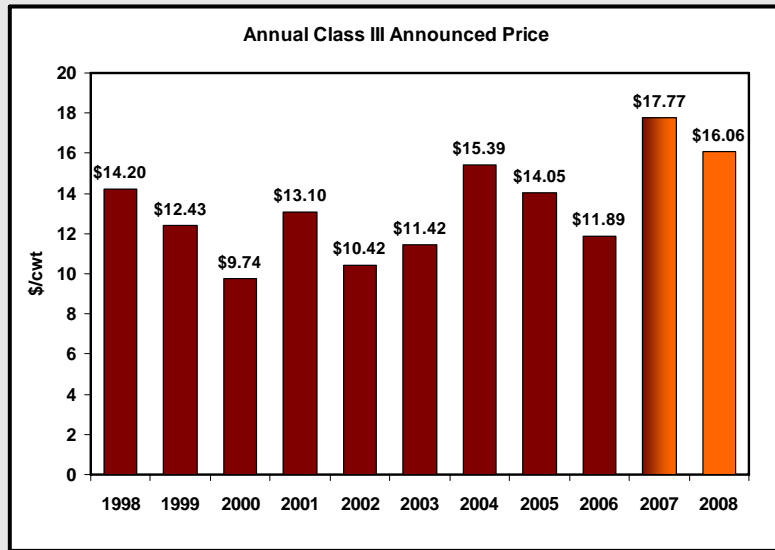
Forecast is 11/02/07 closing futures prices



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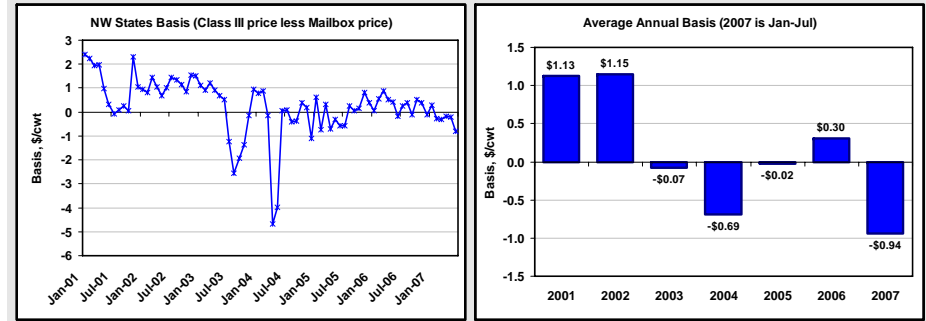
Milk prices still strong historically...

Forecast is 11/02/07 closing futures prices



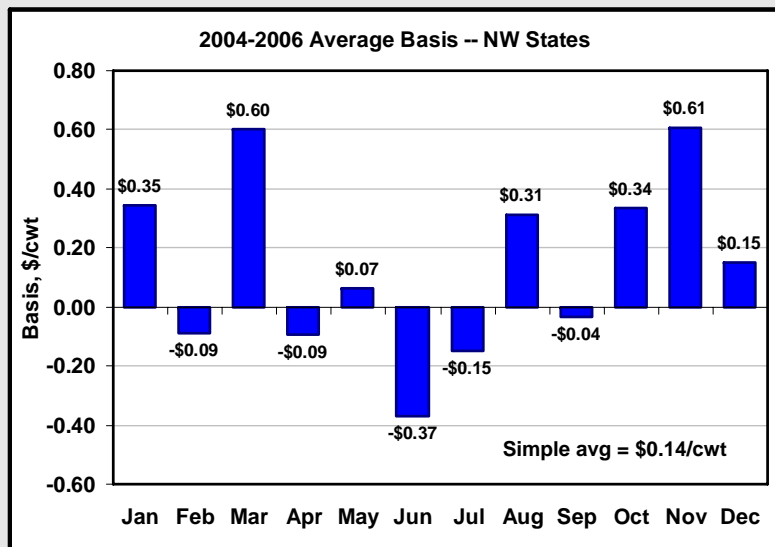
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Historical basis is highly variable...



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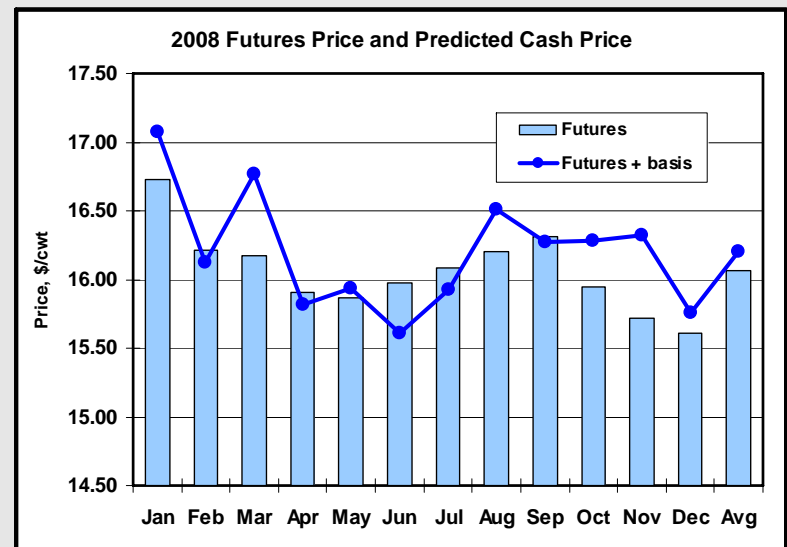
Basis forecast using 3-year average...



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Forecasted cash price for NW States...

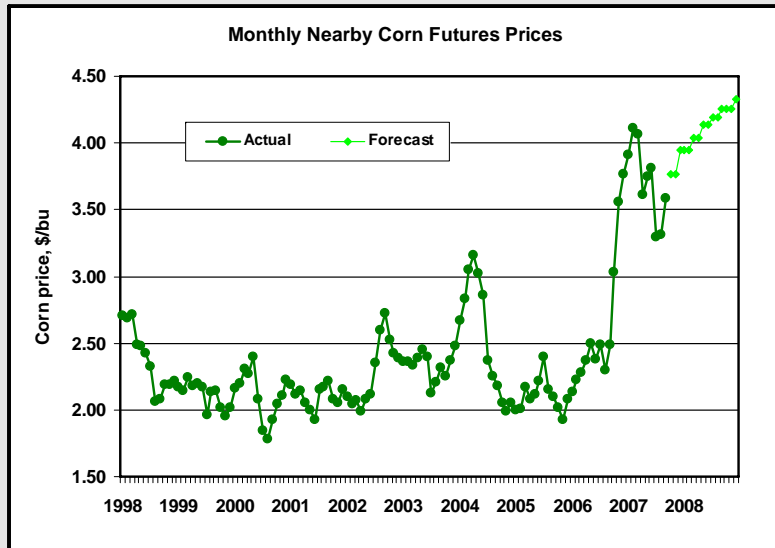
Futures is 11/02/07 closing futures prices



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Feed prices not backing down...

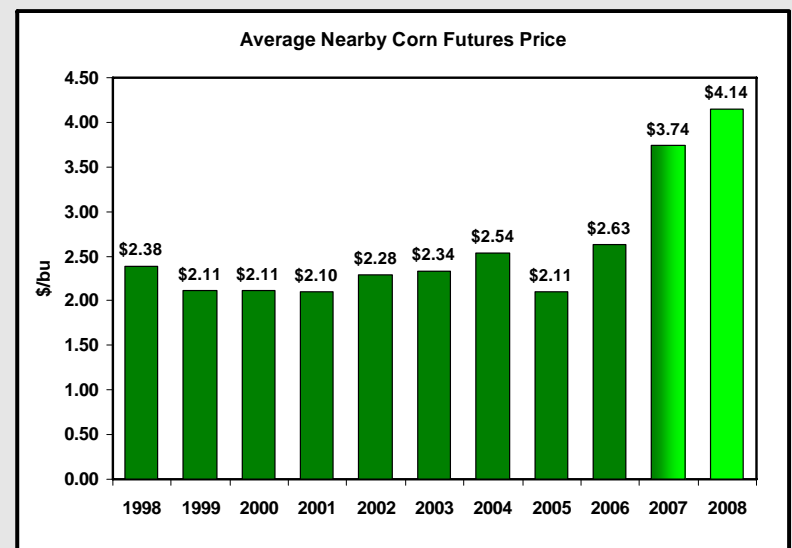
Forecast is 11/02/07 closing futures prices



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Corn prices expected to strengthen...

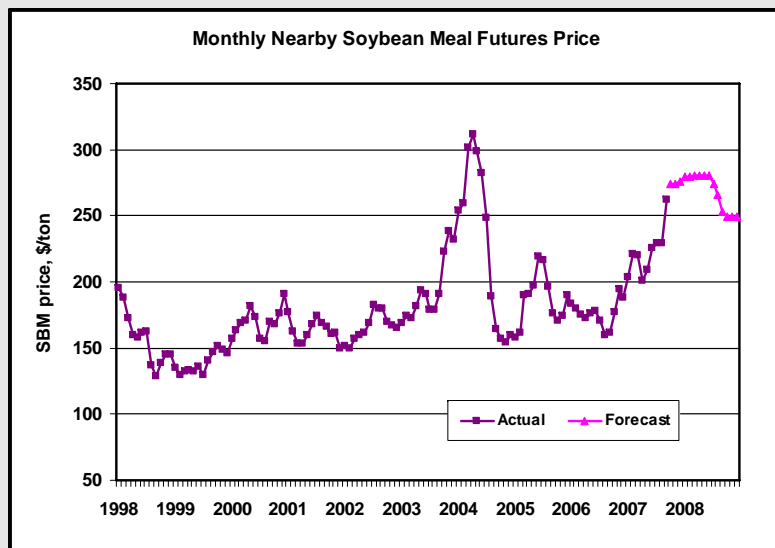
Forecast is 11/02/07 closing futures prices



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Feed prices not backing down...

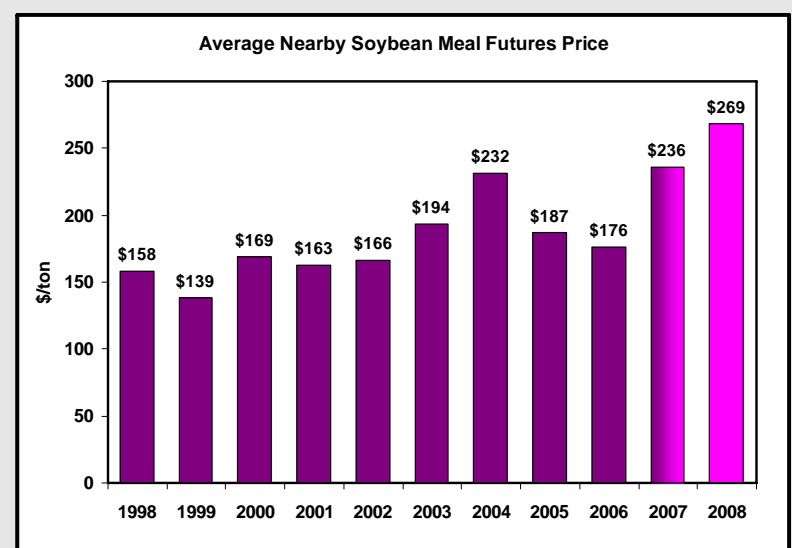
Forecast is 11/02/07 closing futures prices



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SBM prices expected to strengthen...

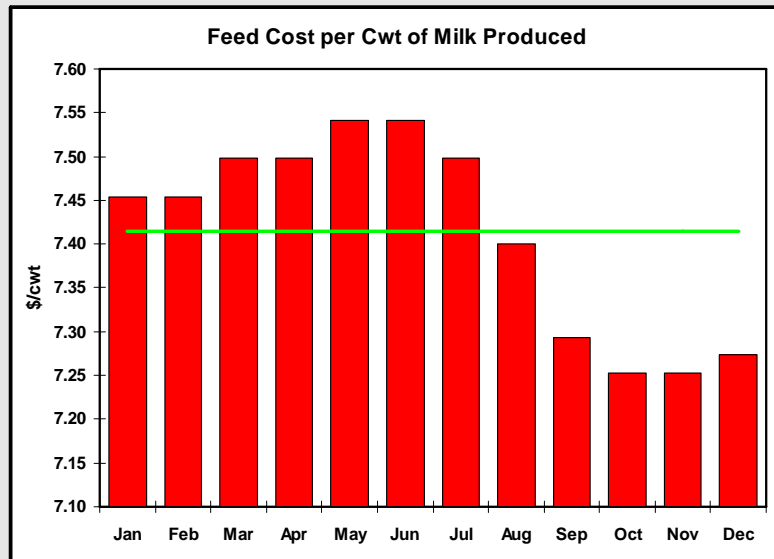
Forecast is 11/02/07 closing futures prices



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Feed costs per cwt of milk...

Based on 11/02/07 closing futures prices for corn and SBM and adjusting for basis



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In spite of high feed costs, 2008 has potential...



Projected Costs and Returns for WA Dairy in 2008				
PRODUCTION LEVEL				
Total pounds milk sold/cow/year	2006	2008	2006	2008
	23,270	23,770	23,270	23,770
Daily milk production, lbs.	74.5	76.1	74.5	76.1
RETURNS				
	\$ Per Cow		\$ Per Cwt	
Milk Sales	\$3,889	\$3,972	\$16.71	\$16.71
Other Income	498	498	\$2.14	\$2.09
A. GROSS RETURNS	\$4,386	\$4,470	\$18.85	\$18.80
VARIABLE COSTS				
Feed	\$1,726	\$1,749	\$7.42	\$7.36
Other operating	907	914	3.90	3.84
Labor	318	318	1.37	1.34
Replacements and breeding charge	989	989	4.25	4.16
Facilities and equipment	380	380	1.63	1.60
TOTAL COSTS	\$4,321	\$4,351	\$18.57	\$18.30
RETURNS OVER TOTAL COSTS				
	\$65	\$119	\$0.28	\$0.50
BREAKEVEN MILK PRICE, \$/cwt	\$16.43	\$16.21	\$16.43	\$16.21
ASSET TURNOVER	80.0%	81.5%	80.0%	81.5%
NET RETURN ON ASSETS	9.15%	10.15%	9.15%	10.15%
RETURN ON EQUITY	10.33%	12.32%	10.33%	12.32%

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2008 has potential, but...



- Margins are positive, but they are relatively tight so it is important to recognize where your major risks are
- Risk of market prices is always important
 - Milk price
 - Feed costs
- Production risk

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Production and milk price risk...



Figure 1. Sensitivity of Return on Assets to Milk Production & Milk Price

Region/year => ID/WA (2008)							
Milk production	Average Milk Price, \$/cwt						
	\$14.70	\$15.20	\$15.70	\$16.20	\$16.70	\$17.20	\$17.70
68.6	-0.42%	1.53%	3.49%	5.44%	7.40%	9.35%	11.30%
71.1	0.94%	2.96%	4.99%	7.01%	9.04%	11.06%	13.08%
73.6	2.29%	4.39%	6.48%	8.58%	10.68%	12.77%	14.87%
76.1	3.65%	5.82%	7.98%	10.15%	12.32%	14.48%	16.65%
78.6	5.01%	7.24%	9.48%	11.72%	13.96%	16.20%	18.43%
81.1	6.36%	8.67%	10.98%	13.29%	15.60%	17.91%	20.22%
83.6	7.72%	10.10%	12.48%	14.86%	17.24%	19.62%	22.00%

ROA is positive almost everywhere, but anytime it is below the interest rate this could lead to cashflow concerns (depending on equity position).

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Production and milk price risk...

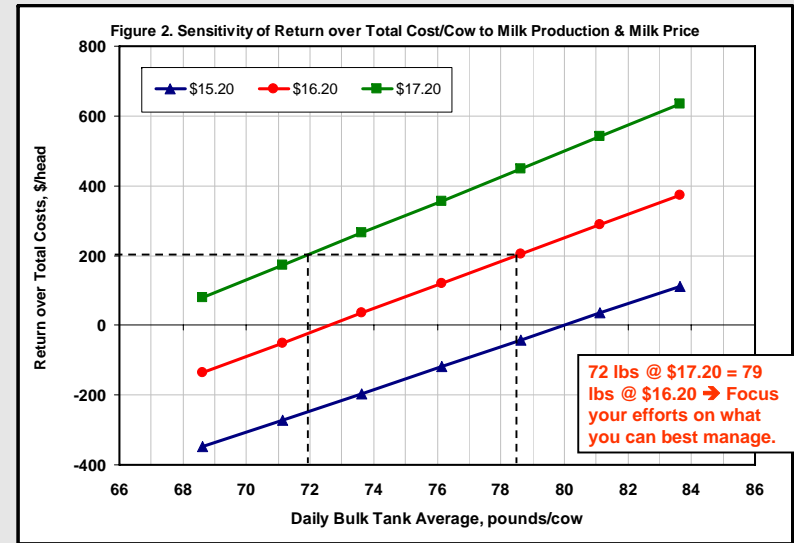


Figure 2. Sensitivity of Return over Total Cost/Cow to Milk Production & Milk Price

Region/year => ID/WA (2008)							
Milk production	Average Milk Price, \$/cwt						
	\$14.70	\$15.20	\$15.70	\$16.20	\$16.70	\$17.20	\$17.70
68.6	-\$456.22	-\$349.08	-\$241.94	-\$134.80	-\$27.66	\$79.48	\$186.62
71.1	-\$383.33	-\$272.28	-\$161.24	-\$50.19	\$60.85	\$171.90	\$282.94
73.6	-\$310.43	-\$195.48	-\$80.53	\$34.41	\$149.36	\$264.31	\$379.26
76.1	-\$237.53	-\$118.68	\$0.17	\$119.02	\$237.87	\$356.72	\$475.57
78.6	-\$164.63	-\$41.88	\$80.88	\$203.63	\$326.38	\$449.14	\$571.89
81.1	-\$91.73	\$34.93	\$161.58	\$288.24	\$414.89	\$541.55	\$668.21
83.6	-\$18.83	\$111.73	\$242.29	\$372.85	\$503.40	\$633.96	\$764.52

Returns per cow start going negative with fairly small drops in prices, or as production declines.

Production and milk price risk...



Production and feed cost risk...



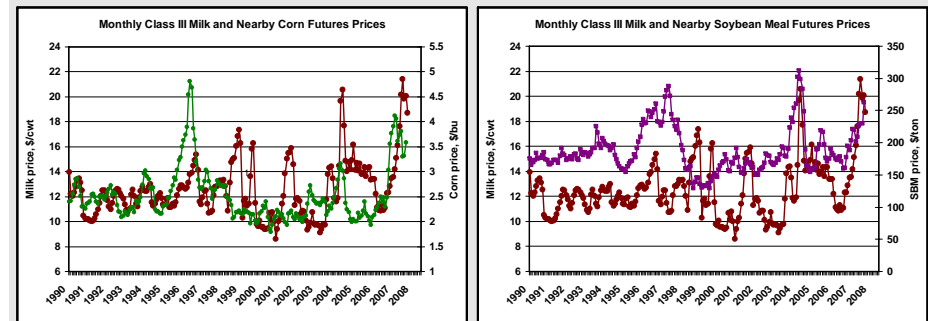
Figure 3. Sensitivity of Return over Total Cost/Cow to Milk Production & Feed Price

Region/year => ID/WA (2008)							
Milk production	Average Lactating Cow Feed Price, \$/cwt*						
	\$9.56	\$9.81	\$10.06	\$10.31	\$10.56	\$10.81	\$11.06
68.6	-\$10.42	-\$51.88	-\$93.34	-\$134.80	-\$176.26	-\$217.72	-\$259.18
71.1	\$76.90	\$34.53	-\$7.83	-\$50.19	-\$92.56	-\$134.92	-\$177.28
73.6	\$164.21	\$120.95	\$77.68	\$34.41	-\$8.85	-\$52.12	-\$95.38
76.1	\$251.53	\$207.36	\$163.19	\$119.02	\$74.85	\$30.68	-\$13.49
78.6	\$338.85	\$293.78	\$248.70	\$203.63	\$158.56	\$113.49	\$68.41
81.1	\$426.16	\$380.19	\$334.21	\$288.24	\$242.26	\$196.29	\$150.31
83.6	\$513.48	\$466.60	\$419.72	\$372.85	\$325.97	\$279.09	\$232.21

* Feed prices for dry cow diets and heifer pre-calving diets change proportionately.

Higher feed prices are not devastating so long as production remains high.

Input and output price relationships...

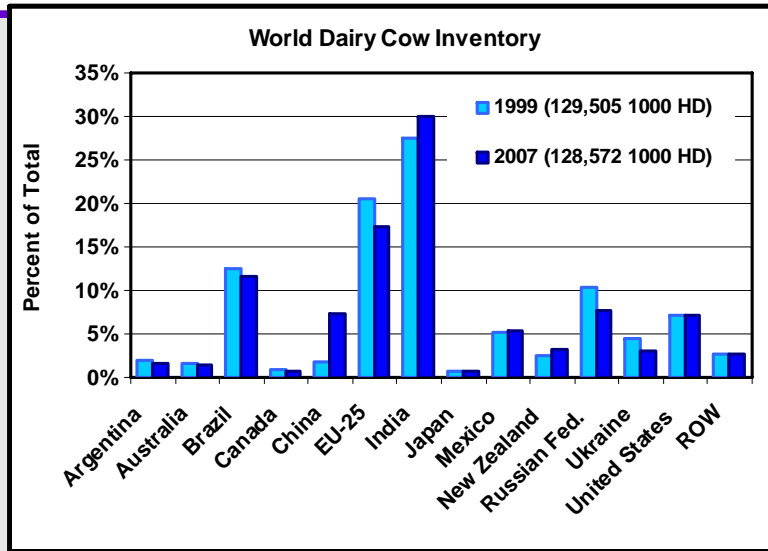


Correlation between:

Corn & milk prices = 0.317; SBM & milk prices = 0.317; Corn & SBM prices = 0.622

While these relationships are positive (i.e., prices tend to move in the same direction), it is not a particularly strong relationship. Thus, be careful locking in one price and not the other...

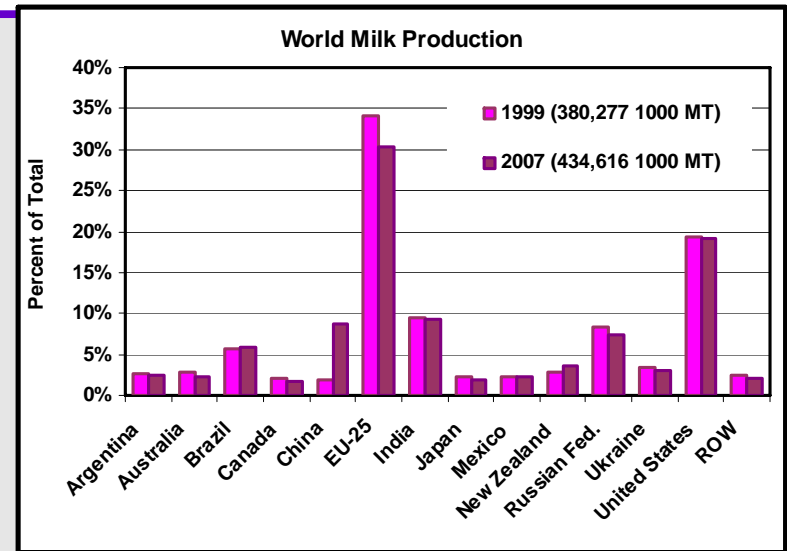
Location of world's dairy cows...



Source: USDA Foreign Agricultural Service (FSA)

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Location of world's milk production...



Source: USDA Foreign Agricultural Service (FSA)

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Feedstuffs, October 22, 2007

EU dairy producers lay out sector reforms

By IAN ELLIOTT

ORGANIZATIONS representing the bulk of the European Union's milk producers and cooperatives laid out their portrait for what they need to see when the 27-nation bloc reforms its dairy regime.

The European Commission will start that reform process next month by laying out what it proposes to do to reform the bloc's Common Agricultural Policy (CAP) as part of the 2008-2013 multi-annual CAP. CAP will face a major overhaul around 2013.

EU Agriculture Commissioner Mariann Fischer Boel said recently that she is thinking of proposing a major increase in dairy production quotas as part of November's health check. The increase production could be in place as soon as next April. The European Commission wants to end all quotas by March 31, 2015.

On Oct. 8, the EU's Committee of Professional Agricultural Organizations (COPA) and General Confederation of Agricultural Cooperatives (COGECA) skirted the question of ending quotas in their first look at a dairy reform package. However, they were direct on the underlying structure needed in any package, insisting that it must allow dairy producers "to have a fair income and be profitable."

"European dairy farmers and cooperatives have, in the past, enjoyed a situation of relative market balance," said Pekka Pesonen, secretary general of COPA/COGECA. "Major market fluctuations were avoided, and this contributed to stable milk prices for consumers and producers alike."

"The European dairy sector as well as rural areas in general have benefited substantially from a balanced geographical distribution of milk production and processing across all EU member states," Pesonen added. "COPA and COGECA strongly wish that these essential traits of the (European) Community dairy policy will be maintained in the future for the benefit of European society."

Stable, balanced, predictable

Any reform package, COPA and COGECA said, needs to be premised on three principles: "stability, balance and a high degree of predictability."

"The existing regime has led to stability and predictability in the dairy sector. Quotas, introduced in 1984, have been a major contributing factor in this stability while at the same time maintaining a balanced geographical distribution of milk production and dairy processing," the groups said.

They stressed that any new reform package needs to meet five policy objectives:

- (1) "A secure and reliable supply of high-quality and fully traceable milk and dairy products."
- (2) "Protection and improvement of dairy producers' incomes and profitability."
- (3) "Maintenance and promotion of competitive dairy farms and processing industries."
- (4) "Encouragement of young people to enter the dairy sector."
- (5) "Ensuring that dairy production and processing are carried out throughout the entire EU."

"Any new policies agreed need to be funded within the EU's budget. The groups made it clear that they are not particularly interested in any reform package that simply takes money from dairy farmers' pockets and distributes it to processors and retailers."

Competition regulators in Britain recently charged major grocers and dairy processors with price collusion.

"The long-term competitiveness of dairy producers will first and foremost come from fair milk prices," the groups said. "Competitiveness must not be achieved through low dairy prices that would compromise producers' livelihoods. Instead, a specific political framework for milk should seek to raise milk prices to a level that fully reflects the increasing costs of milk production."

In order to improve dairy producers' income, any reform package needs to "reduce imbalances in the food chain," improve marketing structures, curb price volatility, keep track of long-term production trends — watching particularly for overproduction — review other EU policies impeding competitiveness and "stay firm and EU-oriented in trade negotiations," COPA and COGECA said.

Finally, EU legislators need to do something about production quota values.

"Throughout the EU, milk quotas have often been purchased as an investment. In many cases, the value of the quota serves as a security for bank loans. Dramatically destroying this value is likely to have serious economic consequences on many people's livelihoods," they said.

EU Agriculture Commissioner Mariann Fischer Boel said recently that she is thinking of proposing a major increase in dairy production quotas as part of November's health check. The increase production could be in place as soon as next April. The European Commission wants to end all quotas by March 31, 2015.

Summary...



- Based on current futures market prices
 - Milk prices in 2008 will be lower than last year
 - Feed prices in 2008 will be higher than last year
- Profit outlook is positive assuming you are getting average or better production and capturing economies of size regarding overhead costs
- Price risk will likely be a major factor in 2008, especially on the feed price side

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2007 Insurance Workshop
November 8, 2007
Marriott City Center
Lincoln, Kansas

2007 Kansas Income Tax Institute
Click here for 2007 locations

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Site Updates

Grain Outlook Radio Program
November 2, 2007 by Mike Woolverton

Kansas Grain Price Differentials
November 1, 2007 by Daniel O'Brien

Updated Crop Basis Tool
November 1, 2007 by Kevin Dhuyvetter

In The Cattle Markets
October 29, 2007 by Jim MinterLLMIC

Livestock Outlook Radio Program
October 29, 2007 by Jim MinterLLMIC

KFMA Monthly Newsletter
October 26, 2007 by KFMA NE Economists (Althausser, Simons & Hennigan)

Current Grain Outlook Newsletter
October 26, 2007 by Mike Woolverton

Livestock and Hay Charts
October 19, 2007 by Jim Minter

Crop Basis Maps
October 18, 2007 by Kevin Dhuyvetter

KSU-Vegetative Buffer Excel Tool
October 15, 2007 by Craig Smith and Jeff Williams

KSU-Streambank Stabilization Excel Tool
October 15, 2007 by Craig Smith and Jeff Williams

KSU-Tillage Excel Tool
October 15, 2007 by Craig Smith, Kevin Dhuyvetter and Jeff Williams

World Grain Supply and Demand Estimates (WASDE)
October 12, 2007 by Jim Minter and Mike Woolverton

Seasonal Grain and Cattle Price Spreadsheets (Excel)
October 3, 2007 by Kevin Dhuyvetter

Futures-Based Price Forecasts for Diesel Fuel
October 2, 2007 by Kevin Dhuyvetter

Water Quality Indices and Net Returns for Crop

Done Internet 100%

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