How to Cut Costs & Return to Profitability

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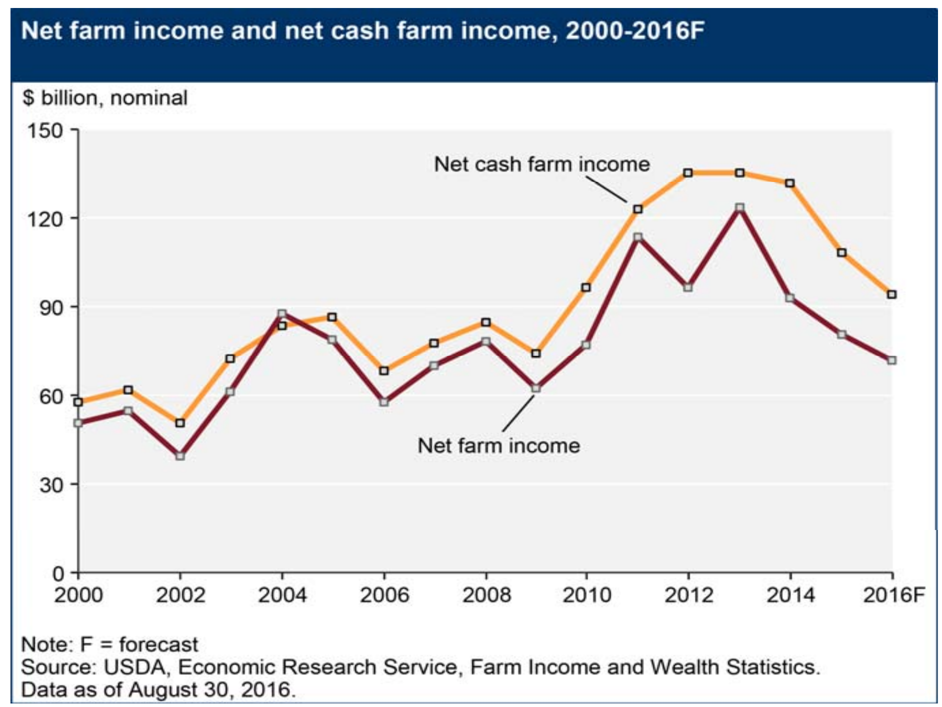
2016 Crop Insurance Meetings
Brush, CO – Grand Island, NE – Salina, KS – Enid, OK

General Observations

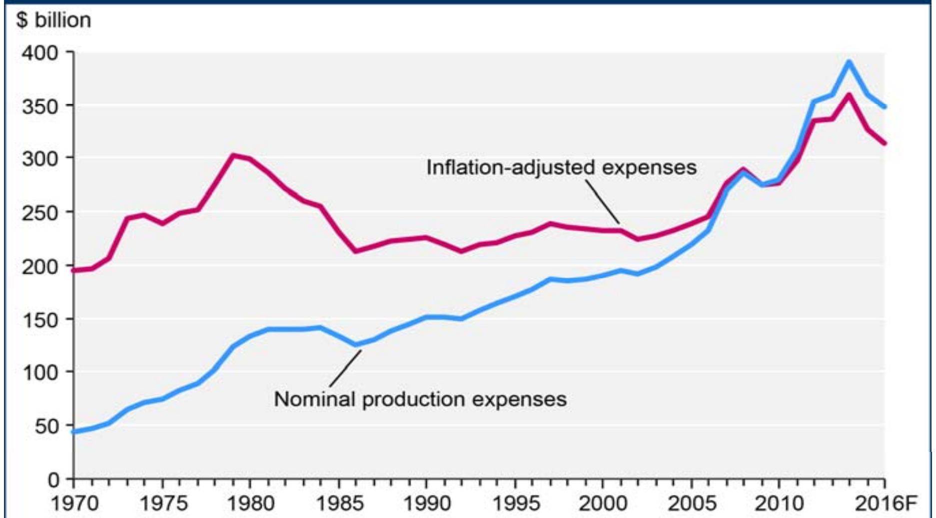
- Costs of production for corn have increased more than 50% since 2002.
  - Seed = 182%
  - Fertilizer = 300%
  - Machinery costs = 92%
- Cash rents increased 100-200% between 2010 & 2013

General Observations

- Average corn yields = doubled since 1975.
- Interest rate = declined and remain low.
- Fuel (especially diesel) = declined.
- Land values (since 2010) = increased significantly.
  - CO, KS, and NE = 20%+ per year (2011 – 2014)
- Land values (2015-2016) = declined 10-40%
- Machinery values = declined as much as 50% (particularly combines)



Nominal and inflation-adjusted farm production expenses, 1970-2016F



Note: F = forecast. Values are adjusted for inflation using the chain-type GDP deflator, 2009=100.
Source: USDA, Economic Research Service, Farm Income and Wealth Statistics.
Data as of August 30, 2016.

Change in farm cash receipts, 2015-2016F, by component of change

Note: F = forecast. Other changes include price/quantity changes in "all other crops" (excluding sugarcane and sugarbeets), proso millet, and miscellaneous animals/products for which data are not available.
Source: USDA, Economic Research Service, Farm Income and Wealth Statistics.
Data as of August 30, 2016.

Where are we headed?

- Continued lower commodity prices
  - crops and livestock
- Current breakeven values showing losses
  - In spite of record yields (winter wheat, corn, other grains)
- Land sales declining
  - Sellers not willing to sell at lower values
  - Buyers waiting for further declines
  - 80% of recent sales due to estate settlements or dissolution of partnerships/corporations (one land broker)
- Need weather events or increased demand/exports
  - Weaker dollar

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Brief Return to Costs of Production

- Fixed Costs
- Variable (operating) Costs
- Total Costs (fixed + variable)

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Brief Return to Costs of Production

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- Difference between Total Cost curve and Total Variable Cost curve is Total Fixed Cost curve

- Why look at this economic concept?
  - Determines if a business is profitable or incurring a loss.
  - Farms/ranches can absorb a short term loss (1-2 years)
  - Farms/ranches cannot absorb long term losses

Brief Return to Costs of Production

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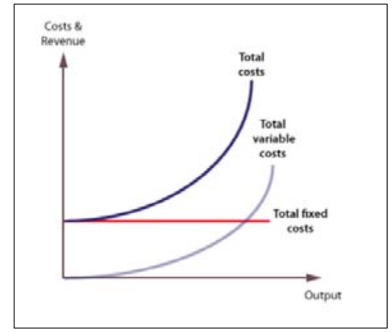
Total Cost curve
- Total Variable Cost curve
= Total Fixed Cost



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Cost Curves

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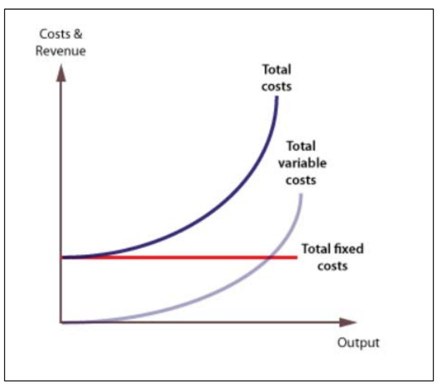

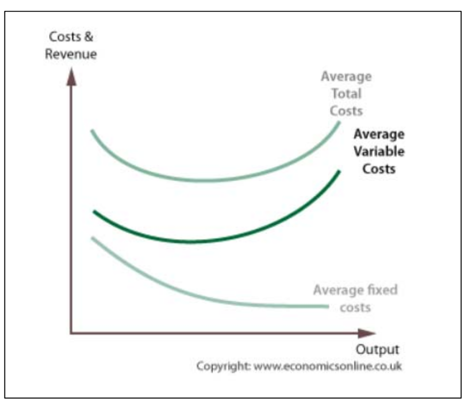

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What do most people do in the short run (current production period)?

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1. Reduce or eliminate variable costs.
   - May reduce production needed to breakeven or generate a profit.
   - 2015 ISU study recommended corn/soybean producers reduce operating costs by $100+ per acre in 2016.

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What do most people do in the short run (current production period)?

1. Reduce or eliminate variable costs.

2. What do we recommend for 2017?
   - Reduce variable costs even further?
   - What about reducing fixed costs?

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What do most people do in the short run (current production period)?

1. Reduce or eliminate variable costs.
2. What do we recommend for 2017?

3. Address fixed cost structure of business(es)
   - Machinery payments
   - Family living withdrawals
   - Other (full-time labor, land payments, cash rents, insurance, real estate taxes)

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A Return to the 1980s?

- Many producers and business leaders are questioning if this is a repeat of the 1980s.

- Not quite, but will depend on the next few years.

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What To Do?

- "The horse is already out of the barn" for some producers.

- Can fixed costs be reduced or eliminated?

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What To Do?

1. Cash reserves?
2. Liquidate assets without changing the operation?
3. Working capital in the form of stored crops or marketable livestock?
4. Credit reserve?
5. Use equity in long term assets (land or machinery) to refinance excess current liabilities?
6. Lengthen repayment periods on machinery and breeding livestock?

What To Do?

7. Defer capital purchases?
   - Repair rather than replace
   - Reduce culling rate rather than purchase replacement heifers
8. FSA guaranteed loans
   - Reduce credit risk
   - Lower repayment requirements
9. Increase off-farm income?
10. Decrease non-farm expenses (family living, overhead)?
11. Cancel or re-negotiate leases? (tenant farmers most at risk)

What To Do?

12. Trade use of equipment and labor with someone you can work well with?
    - Joint ownership of equipment
    - Lease equipment/machinery (short term needs)
13. Change the enterprise mix?
14. Alternative marketing strategies?
15. Assess available resources (land, machinery, credit, markets, and people
    - Improve use of existing resources
    - Look for outside resources

Conclusions

- Limited upward movement in next 2 years in the commodity markets.
- Farmers/ranchers are resilient and must be aware of what they have control over.
- Producers need to be proactive and flexible.
- No two operations are the same – different strategies/alternatives must be addressed.