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Financially Successful Farms in Nebraska, What Matters?

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Market Report	Year Ago	4 Wks Ago	2-23-18
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	124.33	125.00	125.41
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	154.87	196.41	200.00
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	132.36	154.79	156.82
Choice Boxed Beef, 600-750 lb. Carcass.	194.48	206.70	216.53
Western Corn Belt Base Hog Price Carcass, Negotiated	68.06	69.27	62.74
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	80.86	81.41	78.42
Slaughter Lambs, wooled and shorn, 135-165 lb. National.	141.13	133.29	139.07
National Carcass Lamb Cutout FOB.	328.04	362.34	369.76
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	3.22	3.80	4.14
Corn, No. 2, Yellow **Columbus**, bu.	3.14	3.32	3.44
Soybeans, No. 1, Yellow **Columbus,** bu.	9.14	9.07	9.50
Grain Sorghum, No.2, Yellow Dorchester, cwt.	4.92	6.58	5.65
Oats, No. 2, Heavy Minneapolis, Mn, bu.	3.16	3.01	2.93
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	137.00	166.25	*
Alfalfa, Large Rounds, Good Platte Valley, ton.	67.50	90.00	90.00
Grass Hay, Large Rounds, Good Nebraska, ton.	65.00	82.50	*
Dried Distillers Grains, 10% Moisture Nebraska Average.	100.00	150.00	144.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	42.00	47.50	48.50

*** No Market**

The 2012 record high cash receipts for corn brought much optimism among corn farmers and associated businesses. However, more recent years have fostered feelings of concern with many reflections about other challenging times, such as those experienced in the 1980's. Among producers such feelings are usually negative, but when properly channeled can lead to positive business actions, such as cost reductions and increased efficiencies.

One of the issues faced by some agricultural producers is a lack of balance in managerial abilities. Many producers are excellent at production and resource management, but have limited technical business knowledge and acumen as it relates to their operation. While it is not necessary to have an MBA to run a profitable farm, some basic knowledge of business operations and methods can be quite valuable. For instance, basic knowledge and understanding of accounting records and bookkeeping outcomes can be advantageous in controlling costs, maintaining profitability, making business decisions consistent with individual business objectives, and measuring wealth changes over time.

Accounting in a sense is a way of keeping score in the business and like any score it is a number. Standardized accounting methods provide the means for measuring business performance over time. Consider this, how much do you care about your operation's business success score and what is the value of a play-by-play record? The larger and more complex the operation the more valuable these records become in maintaining and obtaining the objectives of the business operator. These records can and should become a central part of any plan and strategy for future business success and be used to make adjustments and corrections for the coming seasons.

There are four concepts related to accounting and financial stability with which every farm operator ought to be familiar. These are the concepts of the farm's liquidity, solvency, equity and profits. Liquidity refers to the current period and is a short term (current season) concept. In this instance, liquidity refers to the availability of assets like cash to be used in the continued operation of the business. A liquidity problem in a business relates directly to having a small proportion of liquid (cash) assets relative to the current expenses. This is commonly talked about as the working capital ratio. The working capital ratio is defined as current capital assets divided by current liabilities, or the ability of the business to pay off short-term or current expenses. Solvency is a long term concept. When all of the assets (cash, equipment, real estate, prepaid expenses, accounts receivables, etc.) of a business are less than its total liabilities (all debts, loans, accounts payable, expenses, etc.) the business is insolvent. Over time, a liquidity problem left unaddressed will become an insolvency issue.

Given the current price cost squeeze situation in corn production, some producers find themselves in a situation where costs exceed revenues creating a demand on stored resources to remain in operation. Stored resources include cash reserves and equity. If cash reserves are not available, they have a liquidity problem. Which may be solved by selling unneeded resources, i.e. equipment. Another solution is to borrow against equity, such as owned land. However these solutions are short term, stop gap in nature and don't address the real problem, which is the need for infusions of added assets, most specifically profit. When this situation goes unfixed for a number of seasons, debt eventually increases to the point where liquidity problems become solvency problems and creditors can no longer afford to lend money and the operation is forced into bankruptcy and/or closure.

In light of the recent economic environment, many agriculture production stakeholders in the Midwest have been concerned that, if unaddressed, some farm businesses may be at financial risk. With this in mind, this article discusses some of the financial differences among farms that remain consistently profitable and suggests a few areas that operators might consider in their quest for increased profitability.

Work done by Nicholas Paulson and Dale Lattz, agricultural economists at the University of Illinois, used Illinois farm financial data to create a panel of consistently profitable Illinois farms. They divided the panel into thirds. The top one third refers to the most profitable farms and the mid third to those close to average profitability. Two time periods are compared, the era of higher corn prices 2010-12 and the other with reduced corn values 2014-16. The top third of producers had more gross revenue per acre for both the higher and reduced value periods. Higher revenues were the result of both higher yields and sales value per bushel for corn and soybeans. Both yields and prices were 5-7% higher. This indicates that these managers were more effective in creating yields and in marketing their crop. Also note from Table 1, *Total Costs* are less for the top third producer group than for the mid third producer group. However *Direct Costs* (fertilizer, pesticides, seed, drying, storage and crop insurance) are not as varied. While, *Power Costs* (machinery lease/custom hire, utilities, machine repair, fuel and oil, light vehicle [pick-up etc.] and machinery depreciation) and *Overhead Costs* (hired labor building repair, rent and depreciation, other insurances and interest) were more costly in the mid third group of producers. See Table 1. The ever elusive profit is a simple mathematical formulation where *Profit is the Difference between Total Revenues Minus Total Costs*. While easy to write and understand, it is much more challenging to implement. This brief analysis of the Illinois data by Paulson and Lattz is illustrative of what producers might think about moving forward as they continue to strive for financial success.

Table 1. Illinois Farm Panel Revenue Returns and Costs per/Acre

	2010 to 2012			2014 to 2016		
	Top 1/3	**Mid 1/3**	**Difference**	**Top 1/3**	**Mid 1/3**	**Difference**
	$	**$**	**$**	**$**	**$**	**$**
Revenue	**958**	**870**	**88**	**783**	**731**	**52**
Direct Costs	248	247	1	270	276	-6
Power Costs	98	115	-17	118	128	-10
Overhead Costs	64	72	-8	67	85	-18
Total Costs	**409**	**433**	**-24**	**455**	**488**	**-33**
Returns	**549**	**437**	**112**	**328**	**242**	**85**

Below are six areas to consider when focusing on increasing profits, shoring up liquidity and avoiding solvency issues

1. **Control production costs.** Use production inputs that carry their own weight. For instance, does every 1000 seeds per acre sown return the cost associated with their planting, does every pound of fertilizer and nitrogen (N) bring back at least enough production to pay for its application. In most cases additional units added above a certain level provide limited benefits. This is true of most physical inputs, more may not be better. Use generic pesticides when possible many are available which have similar efficacy at a much lower application cost. Look for opportunities to use the buying power of neighbors to jointly buy inputs or services.
2. **Negotiate and pay affordable rent rates.** Consider land leases such as flexible lease provisions so landlords share both the benefits and risk of yields and/or price changes.
3. **Limit capital spending**. Purchases should reduce costs and help cash flow. Otherwise, why are they being made?
4. **Minimize personal expenses.** This is a very personal issue and requires some careful thought and discussion within the family unit as well as self-introspection and honesty. This action may require enlisting the help of a professional as a third and neutral party.
5. **Increase revenues**. Use the whole market, including pre-harvest and post-harvest periods. Develop a marketing system, whether that be just a plan, or professional help or a combination of things. Add new revenue streams (custom work, different crops or enterprises etc.)
6. **Increase non-farm income.** Are there opportunities off the farm to have income that would stabilize the farm business without adversely affecting productivity? Can a side business be added? Can a hobby produce income?

No one knows how long crop prices and costs will remain at the current levels. What is certain is that those farms that are able to increase or maintain profitability will certainly be better prepared for the future and more able to meet the needs and objectives of their owners and operators.

Sources

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