

THE MANAGER

PROFIT MANAGEMENT

By Rick Hermonot

If you're a reactive profit taker, use these keys to maximize your dairy's profit. Then use those profits to proactively build your balance sheet.

Five keys to unlock the door to profit

While no one knows what next year's milk and feed prices will be, there is one sure thing: The higher and longer the price peak, the deeper and more painful the price valley will be.

This relatively new reality for dairy farmers makes it imperative for them to focus on strategic management of their dairies' profits.

Five keys to profit

Dairy industry benchmarks have taught us a valuable lesson: The dairy producers who consistently show strong profitability are balanced managers. This means they focus on all the areas of their business that drive profitability rather than overly focusing on just one area.

This fact is the power behind understanding the five keys to profit. Each of them deserves equal management attention to achieve maximum financial results on a dairy.

Here are the five keys:



1. Gross Revenue: This is a function of price X production. Since production is the more controllable of the two, dairy farmers tend to place tremendous focus on it. The industry's significant increases in production are proof of that.

We tend to consider price out of our control. However, premiums for quality, quantity, components and other more unique options offer a given dairy price opportunity of more than \$1 per cwt.



2. Production Efficiency: How effectively are you converting raw materials into finished product? Gross margin (sales - cost of goods sold) is a good measure of efficiency. It tells you how much of your milk check dollar is left after paying for materials.



3. Capacity: How effectively are you using your business' assets – cows, equipment, buildings, land? Carrying too many assets relative to the milk being produced will reduce profitability.

4. Dairy Husbandry: How well are you employing the technical skills of the dairy industry?



Internal herd growth (IHG), one measure of husbandry, should average more than 5% per year.

Factors that drive IHG include reproductive performance, cull rate, DOAs, calf and heifer mortality, and average age at first calving. Use of sexed semen also impacts IHG, but be cautious that it doesn't become a Band-aid covering up poor performance in the other areas.



5. Cost Control: Are you "tight with a buck" in ways that enhance rather than limit profit? For example, cutting costs by trimming feet less often may not effectively control costs if performance is negatively impacted.

Comparing your net cost of production per hundredweight to dairy benchmark standards can help identify how you are doing with effective cost control.

Each of these five keys deserves equal management focus. In an environment of increased milk price volatility that makes financial management more challenging, an imbalanced focus holds back a dairy's bottom line.

Table 1 presents the Top 25% vs. Bottom 25% profit groups based on the Five-Year Average (2006-2010) of Farm Credit's Northeast Dairy Farm Summary. The different areas are linked to the five profit keys.

Two things are obvious from the data:

1. There's a huge range of performance within the Northeast dairy industry.

2. Top performers do better in each of the five key areas than do the bottom performers. Because of that, top performers' net margin was \$4.82 per cwt. more than the bottom group.

FYI

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Use profits proactively

A critical part of balanced management for a dairy is to make proactive use of the profits generated. Too often people in agriculture are tempted to let the “tax tail wag the dog.” In a good year when a dairy is going to show a profit, managers are often tempted to purchase equipment to manage tax liability.

It’s critical to ask, “Will this piece of equipment pay for itself?” In other words, from an economic perspective, do we really need it?

Paying down debt to build borrowing capacity, building a rainy day fund or prepaying some expenses for the next year have never been such important strategies as they now are in this highly volatile market.

Balance sheet strength is critical to being a survivor in this kind of market. I would challenge you to set a goal for:

- Available funds on your lines of credit
- Plus amount of prepays
- Plus cash (liquid) reserves

to total \$1,000 per cow or more at year end in a good year. This ability to raise cash for the down cycle is a critical business strategy.

How are you doing? Would you consider yourself to be more of a reactive profit taker or a proactive profit maker? Most dairy managers have opportunity to be more proactive.

Table 1. Performance of Top 25% compared to Bottom 25% profit groups (Five-year average, 2006-2010)

	Top 25%		Bottom 25%	
	Per CWT.	% of Sales	Per CWT.	% of Sales
Milk sales (Keys 1 & 4)	\$17.16	100%	\$17.00	100%
Less cost of goods sold	\$8.86	52%	\$12.54	74%
Gross margin (Key 2)	\$8.30	48%	\$4.46	26%
Less overhead costs* (Key 3)	\$5.28	31%	\$6.26	37%
Net margin	\$3.02	18%	-\$1.80	-11%
Net Cost of Production (Key 5)	\$14.14	82%	\$18.80	111%
Milk Sold Per Cow (Key 1)	23,049		20,659	

Depreciation and owner’s draw are included in overhead costs.

Focus on the Five Keys and develop a plan for maximizing profitability. Then focus on using those profits to proactively build your balance sheet –liquidity – to ensure you will be a survivor. □

PRO-DAIRY adds two staff members

Tom Overton, PRO-DAIRY director, announces the addition of two staff members. **Betsey Howland** joins PRO-DAIRY as an Extension support specialist. **Julie R. Berry** becomes PRO-DAIRY’s communications manager.



Betsey Howland, PRO-DAIRY extension support specialist.

“I’m particularly excited to fill both of these positions,” Overton said. “Betsey brings solid financial skills as well as background in dairy management that will enable her to continue the Dairy Profit Monitor and Enterprise Analysis programs as a PRO-DAIRY collaboration with the New York Farm Viability Institute.

“Julie has an excellent dairy industry background along with key experiences in communications, media and journalism. We need to increase the visibility of

the great work that our PRO-DAIRY specialists do to enhance the dairy industry in New York, and Julie is the right person to help us accomplish that.”

Howland grew up on a dairy farm in Candor, N.Y. She is a 2009 Cornell University animal science graduate with a concentration in dairy and agribusiness management. After graduation she joined

Farm Credit and served as a loan officer/credit representative in the Sangerfield and Potsdam branches.

Berry has 12 years of experience as a writing and media professional. She’s worked as a reporter for the *Watertown Daily*



Julie R. Berry, PRO-DAIRY communications manager.

Times and was a columnist for *Northeast DairyBusiness*, now *Eastern DairyBusiness*. Berry also has public relations experience and led the development of the New York Animal Agriculture Coalition.

She has a B.S. with honors in animal science from Cornell University and a master’s in scientific writing from Johns Hopkins University. She lives in Adams, N.Y.

Howland’s primary focus will be farm business management, including the Dairy Profit Monitor and the Enterprise Analysis Project. She will also assist with the Dairy Profit Discussion Groups and the Junior DAIRY Leader Program.

Berry will work to increase outreach of PRO-DAIRY research and programs, including editing *The Manager* in *Eastern DairyBusiness*. □