

Profits in 2014 mask dairy industry's deep financial problems

LAST year was an extraordinary one for dairy producers. Record dairy exports, record milk prices, falling feed costs, and high cull cow values made 2014 one of the most profitable years in history.

Unfortunately, a leading dairy accountant says that not only have equity levels not recovered from losses suffered during the Great Recession, last year's profitability masks a deep and alarming decay of producers' financial well-being that has been going on for 15 years.

As seen in the summary table below, the highest total income levels in history resulted in outstanding profitability by the firm's clients in 2014, averaging about \$3.58 per hundredweight. In 2013 the average was about \$1.17 per hundredweight.

But Gary Genske, managing partner of Genske, Mulder and Company, the nation's largest dairy

accounting firm, warns that all is not well.

"It was an exceptional year, probably one of the best ever," he admits. "It brought back part of what was lost in 2009 and 2010, but not all.

"What it also did was extend farmers' slow death sentence. It gave them another reprieve in what has been a long trend of too-low milk prices that keep them alive, but force them to take on new debt just to stay even with where they are."

Genske, who is also a partner in a New Mexico dairy, cites four key items in the summary that support his deep concern. The first is total cost of production, which in 2014 averaged \$20.12 per hundredweight for the firm's entire client base. Had milk prices not shattered all-time high records, he says it would have been impossible for producers to survive that cost.



More importantly, it is a figure that sounds loud alarm bells about what producers face in coming years, even if it declines by multiple dollars.

Items two and three are not as obvious, but Genske points to them as symptoms of producers' overall poor financial health: interest and rent, and the large "current portion of long-term debt" debt repayment requirements.

He explains that average producer interest and rent costs (mostly interest) continue to be stubbornly high even after seven consecutive years of

2014 Dairy income and expenses

INCOME	Arizona		California		Colorado		Idaho		New Mexico	
	Total	Per cwt.	Total	Per cwt.	Total	Per cwt.	Total	Per cwt.	Total	Per cwt.
Milk	\$10,820,102	\$23.19	\$11,572,169	\$22.39	\$14,245,855	\$23.93	\$13,093	\$23.23	\$12,246,030	\$21.78
Co-op inventory loss allocation	(\$71,819)	(\$0.15)	(\$43,123)	(\$0.08)	\$0	\$0	(\$16,193)	(\$0.03)	\$0	\$0
Milk futures	(\$67,532)	(\$0.14)	(\$35,633)	(\$0.07)	(\$70,733)	(\$0.12)	\$96,615	\$0.17	(\$242,375)	(\$0.43)
Calves & heifers	\$388,468	\$0.83	\$265,707	\$0.51	\$394,009	\$0.66	\$226,293	\$0.40	\$429,806	\$0.76
Patronage dividend	\$27,272	\$0.05	\$111,499	\$0.22	\$29,899	\$0.05	\$27,994	\$0.05	\$75,480	\$0.13
Other	\$22,299	\$0.05	\$70,869	\$0.14	\$27,599	\$0.05	\$19,435	\$0.04	\$28,019	\$0.06
Total income:	\$11,118,790	\$23.83	\$11,941,488	\$23.11	\$14,626,629	\$24.57	\$13,447,177	\$23.86	\$12,536,960	\$22.30
EXPENSES										
Hay, silage & farming	\$3,451,541	\$7.40	\$3,051,732	\$5.90	\$3,394,422	\$5.70	\$3,883,605	\$6.89	\$3,651,532	\$6.50
Grain	\$3,188,129	\$6.83	\$4,147,233	\$8.02	\$4,353,888	\$7.31	\$4,121,322	\$7.31	\$4,167,337	\$7.41
Less cost of feeding heifers	(\$1,124,212)	(\$2.41)	(\$1,272,488)	(\$2.46)	(\$1,536,117)	(\$2.58)	(\$1,334,096)	(\$2.36)	(\$1,290,793)	(\$2.30)
Total feed cost:	\$5,515,458	\$11.82	\$5,926,477	\$11.45	\$6,212,193	\$10.43	\$6,670,831	\$11.84	\$6,528,076	\$11.61
Herd replacement costs										
Depreciation - cows	\$477,396	\$1.02	\$565,384	\$1.09	\$596,050	\$1.00	\$520,365	\$0.92	\$558,151	\$0.99
Loss on sale of cows	(\$64,427)	(\$0.14)	(\$67,258)	(\$0.13)	(\$65,596)	(\$0.11)	\$49,952	\$0.09	(\$8,947)	(\$0.01)
Total replacement cost:	\$412,969	\$0.88	\$498,126	\$0.96	\$530,454	\$0.89	\$570,317	\$1.01	\$549,204	\$0.98
Other expenses										
Interest and rent	\$482,932	\$1.04	\$376,848	\$0.73	\$553,351	\$0.93	\$302,602	\$0.54	\$334,370	\$0.59
Current debt repay & owner draw	\$573,317	\$1.23	\$935,671	\$1.81	\$691,743	\$1.16	\$1,368,117	\$2.43	\$567,911	\$1.01
Equipment lease	\$0	\$0	\$2,194	\$0.00	\$11,968	\$0.02	\$9,265	\$0.02	\$3,335	\$0.01
Labor	\$718,698	\$1.54	\$661,403	\$1.28	\$1,149,895	\$1.93	\$675,946	\$1.20	\$912,045	\$1.63
Depreciation - other	\$147,917	\$0.32	\$231,665	\$0.45	\$613,070	\$1.03	\$360,894	\$0.64	\$261,002	\$0.47
Milk hauling	\$230,214	\$0.49	\$184,438	\$0.36	\$242,023	\$0.41	\$160,602	\$0.28	\$193,179	\$0.34
Industry assessments	\$255,618	\$0.55	\$104,698	\$0.20	\$204,189	\$0.34	\$109,996	\$0.19	\$113,283	\$0.20
Supplies	\$315,740	\$0.68	\$317,256	\$0.61	\$485,821	\$0.82	\$414,487	\$0.73	\$340,579	\$0.61
rBST	\$2,583	\$0.00	\$42,242	\$0.08	\$200,999	\$0.34	\$27,146	\$0.05	\$0	\$0
Manure mgmt. & environmental	\$7,685	\$0.02	\$36,177	\$0.07	\$17,753	\$0.03	\$11,142	\$0.02	\$37,509	\$0.07
Repairs & maintenance	\$290,594	\$0.62	\$289,503	\$0.56	\$417,435	\$0.70	\$336,605	\$0.60	\$264,573	\$0.47
Utilities	\$188,453	\$0.40	\$169,723	\$0.33	\$260,778	\$0.44	\$157,726	\$0.28	\$171,066	\$0.30
Taxes & licenses	\$77,380	\$0.17	\$105,610	\$0.20	\$133,188	\$0.22	\$88,173	\$0.16	\$132,380	\$0.24
Insurance	\$65,663	\$0.14	\$90,548	\$0.18	\$139,470	\$0.23	\$55,764	\$0.10	\$82,429	\$0.15
Fuel & oil	\$127,018	\$0.27	\$105,210	\$0.20	\$228,947	\$0.38	\$160,593	\$0.28	\$154,003	\$0.27
Professional services	\$23,524	\$0.05	\$30,308	\$0.06	\$43,664	\$0.07	\$19,843	\$0.03	\$33,826	\$0.06
Employee benefits	\$10,277	\$0.02	\$56,737	\$0.11	\$30,015	\$0.05	\$23,739	\$0.04	\$35,776	\$0.06
Veterinary & breeding	\$83,188	\$0.18	\$132,679	\$0.26	\$361,994	\$0.61	\$221,212	\$0.39	\$189,814	\$0.34
Testing & trimming	\$34,157	\$0.07	\$45,867	\$0.09	\$52,693	\$0.09	\$44,172	\$0.08	\$35,013	\$0.06
Livestock hauling	\$5,116	\$0.01	\$8,205	\$0.02	\$16,648	\$0.03	\$9,163	\$0.02	\$18,987	\$0.03
Miscellaneous	\$3,104	\$0.01	\$12,936	\$0.03	\$17,625	\$0.03	\$9,573	\$0.02	\$7,337	\$0.01
Less cost of raising heifers	(\$100,825)	(\$0.22)	(\$227,218)	(\$0.44)	(\$301,725)	(\$0.50)	(\$95,889)	(\$0.17)	(\$242,006)	(\$0.43)
Total other expenses:	\$3,542,353	\$7.60	\$3,712,700	\$7.19	\$5,571,544	\$9.36	\$4,470,871	\$7.93	\$3,646,411	\$6.49
Total cost of production:	\$9,470,780	\$20.30	\$10,137,303	\$19.61	\$12,314,191	\$20.68	\$11,712,019	\$20.78	\$10,723,691	\$19.08
TOTAL NET INCOME (loss):	\$1,648,010	\$3.53	\$1,804,185	\$3.50	\$2,312,438	\$3.89	\$1,735,158	\$3.08	\$1,813,269	\$3.22
Net income (loss) per cow:	\$796		\$808		\$909		\$735		\$708	
Average milking herd size	1,800		1,927		2,179		2,038		2,134	
Average lbs. milk/cow/day	71		74		75		76		72	
Average butterfat test	3.47%		3.68%		3.63%		3.69%		3.46%	
Average protein (or SNF) test	3.08%		3.08%		3.15%		3.10%		3.06%	
Herd turnover rate	32.9%		41.9%		33.5%		37.1%		34.6%	
Net mailbox price	\$22.15		\$21.83		\$23.18		\$22.76		\$21.24	

All data provided by Genske, Mulder & Co., LLP Certified Public Accountants

the lowest prime interest rate in 60 years.

"Despite last year, we are at record-high debt levels today because dairies had to borrow so much against their equity in order to survive 2008, 2009 and 2010," he explains.

Another side of that problem is current debt repayment. It increased on the 2014 summary because of not only the regular portion of long-term debt that became due that year, but also the portions that had been deferred in previous years when producers couldn't pay them.

"Banks expect to be repaid each year according to your loan agreement," says Genske. "If you can't do it they can do one of two things: They can give you a loan covenant violation waiver, or they can say, 'We're not going to finance you anymore because you are not credit worthy enough to make payments going forward.' Revolving lines of credit are renewable every year, so you have to prove yourself worthy and refinance them every year.

"In past years, banks recognized that dairies weren't going to make money and gave some of them a repayment 'pass,'" he adds. "But they aren't

doing that much any more; we are seeing fewer loan covenant violation waivers every year."

Genske emphasizes that dairies are no longer able to invest in major new equipment and technology out of cash flow, and without the likelihood of reasonably profitable years in the future, more and more bankers are backing away from financing dairy producers altogether.

Symptom four is repairs and maintenance costs, which were much higher on the 2014 summary than in previous years. Once again, Genske says it is because dairy producers could finally afford to catch up with delayed needs.

"Last year was about catching up for everyone," he says. "When you're not making money you can't do any capital improvement projects. You have to use baling wire to keep your place going. You pay for improvements and repairs or you pay for the feed bill, but you don't have money to do both.

"Before 2009, producers pretty much got used to entering into projects when they felt like it. But they aren't doing that anymore. They can't because they haven't been paid a consistently sustainable

milk price," he continues.

"The infrastructure of dairies is gradually declining to a point where if we don't have sustainable milk prices for several years in a row, dairies are going to start losing productivity because producers don't have the money to keep up older facilities. There are all kinds of new, better and more efficient ways of doing things today, but few people have the ability to do them because of unsustainable milk prices."

Genske agrees that this gradual decline is like what happens when a herd is poorly fed. "It's the same thing as underfeeding cows. You can get away with it for a while, but eventually they lose body weight, production drops, and health declines."

There is actually a fifth item that backs up Genske's serious concern about the eroding financial health of dairy operations.

"From 2000 forward, all of our clients averaged a net income of \$17.54 per hundredweight," he explains. "Cost of operation, including payment of current debt and owner draw, averaged \$17.80. So they have been upside down by 26 cents per hundredweight for 15 years, or \$99,200 per year. Those losses – nearly \$1.5 million – have accrued in the form of more debt and interest to be repaid.

"When you average out those 15 years, the average dairy has not met its obligations, let alone had extra money to repair or improve things. This all points to an unsustainable producer sector of the dairy industry. If milk producers would produce only the milk that can be profitably sold, producer pay prices would permanently remain at sustainable levels," he concludes. **WEST**

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Texas		Washington		Upper Plains states		Lower Plains states	
Total	Per cwt.	Total	Per cwt.	Total	Per cwt.	Total	Per cwt.
\$12,945,555	\$24.09	\$14,928,293	\$21.20	\$13,322,914	\$25.25	\$12,746,467	\$23.74
(\$16,221)	(\$0.03)	(\$305,135)	(\$0.43)	\$0	\$0	\$0	\$0
(\$6,974)	(\$0.01)	(\$135,218)	(\$0.19)	(\$465,985)	(\$0.88)	(\$81,985)	(\$0.15)
\$360,834	\$0.67	\$369,546	\$0.52	\$257,809	\$0.49	\$366,269	\$0.68
\$19,589	\$0.04	\$61,141	\$0.09	\$66,514	\$0.12	\$22,698	\$0.04
\$47,580	\$0.09	\$83,797	\$0.11	\$74,539	\$0.14	\$27,251	\$0.05
\$13,350,363	\$24.85	\$15,002,424	\$21.30	\$13,255,791	\$25.11	\$13,080,700	\$24.36
\$2,639,197	\$4.91	\$4,455,563	\$6.33	\$2,742,403	\$5.20	\$3,011,459	\$5.61
\$4,023,698	\$7.49	\$4,469,950	\$6.35	\$3,576,806	\$6.78	\$3,556,502	\$6.62
(\$1,054,132)	(\$1.96)	(\$1,785,574)	(\$2.54)	(\$1,013,634)	(\$1.92)	(\$671,860)	(\$1.25)
\$5,608,763	\$10.44	\$7,139,939	\$10.14	\$5,305,575	\$10.06	\$5,896,101	\$10.98
\$592,969	\$1.10	\$573,295	\$0.81	\$550,841	\$1.04	\$545,430	\$1.02
(\$76,711)	(\$0.14)	\$203,551	\$0.29	(\$944)	\$0.00	(\$52,315)	(\$0.10)
\$516,258	\$0.96	\$776,846	\$1.10	\$549,897	\$1.04	\$493,115	\$0.92
\$298,607	\$0.56	\$541,980	\$0.77	\$390,794	\$0.74	\$468,251	\$0.87
\$592,803	\$1.10	\$928,868	\$1.32	\$826,464	\$1.56	\$744,070	\$1.38
\$6,328	\$0.01	\$16,651	\$0.02	\$31,406	\$0.06	\$6,177	\$0.01
\$796,310	\$1.48	\$1,035,922	\$1.47	\$1,140,399	\$2.16	\$1,012,121	\$1.89
\$366,372	\$0.68	\$465,452	\$0.66	\$501,621	\$0.95	\$439,097	\$0.82
\$689,958	\$1.28	\$489,979	\$0.70	\$217,156	\$0.41	\$437,006	\$0.81
\$135,861	\$0.25	\$229,348	\$0.33	\$103,427	\$0.19	\$155,926	\$0.29
\$332,670	\$0.62	\$507,609	\$0.72	\$493,685	\$0.94	\$371,506	\$0.69
\$0	\$0	\$0	\$0	\$139,976	\$0.27	\$70,621	\$0.13
\$33,147	\$0.06	\$46,725	\$0.07	\$134,743	\$0.26	\$40,609	\$0.08
\$313,576	\$0.58	\$700,865	\$1.00	\$415,824	\$0.79	\$325,140	\$0.61
\$159,736	\$0.30	\$175,222	\$0.25	\$205,393	\$0.39	\$199,842	\$0.37
\$106,261	\$0.20	\$112,358	\$0.16	\$127,718	\$0.24	\$116,206	\$0.22
\$70,126	\$0.13	\$100,420	\$0.14	\$100,899	\$0.19	\$99,007	\$0.18
\$157,494	\$0.29	\$249,903	\$0.35	\$218,213	\$0.41	\$164,916	\$0.31
\$32,490	\$0.06	\$44,624	\$0.06	\$48,357	\$0.09	\$48,137	\$0.09
\$21,388	\$0.04	\$29,997	\$0.04	\$24,644	\$0.05	\$20,129	\$0.04
\$229,776	\$0.43	\$245,018	\$0.35	\$261,913	\$0.50	\$312,902	\$0.58
\$50,622	\$0.09	\$76,961	\$0.11	\$60,649	\$0.11	\$49,272	\$0.09
\$10,081	\$0.02	\$10,485	\$0.01	\$18,524	\$0.04	\$13,626	\$0.03
\$10,685	\$0.02	\$5,109	\$0.01	\$23,530	\$0.04	\$13,542	\$0.03
(\$235,226)	(\$0.44)	(\$366,412)	(\$0.52)	(\$166,009)	(\$0.31)	(\$220,151)	(\$0.41)
\$4,179,065	\$7.76	\$5,647,084	\$8.02	\$5,319,326	\$10.08	\$4,887,952	\$9.11
\$10,304,086	\$19.16	\$13,563,869	\$19.26	\$11,174,798	\$21.18	\$11,277,168	\$21.01
\$3,046,277	\$5.69	\$1,438,555	\$2.04	\$2,080,993	\$3.93	\$1,803,532	\$3.35
\$1,256		\$503		\$936		\$787	
2,094		2,471		1,905		1,951	
70		78		76		75	
3.68%		3.65%		3.80%		3.58%	
3.14%		3.16%		3.17%		3.14%	
36.5%		39.2%		39.1%		36.5%	
\$22.56		\$20.17		\$24.64		\$22.64	



Jerseys did better than average again

It was an excellent year for dairy cow profitability in general, but Jerseys once again did better than average in 2014.

Income and cost data for the relatively few Jersey dairy clients of Genske, Mulder & Company show they made \$66 per head more profit compared to the summary for all client herds.

Jersey herds' profit advantage in 2013 was \$122 per head.

Lower production, higher feed costs and higher herd replacement costs helped push total cost of production per hundredweight 12 percent higher for Jersey dairies. But tremendously higher butterfat and protein tests made their average total income 17 percent higher. **WEST**

Average milk production	2,094	2,471	1,905	1,951
Average yield/bu/cwt/yr	74	81	76	75
Average butterfat test	3.68%	3.65%	3.80%	3.58%
Average protein test	3.14%	3.16%	3.17%	3.14%
Average herd turnover	36.5%	39.2%	39.1%	36.5%
Average cost/cwt	\$22.56	\$20.17	\$24.64	\$22.64
Total income/yr/cwt	\$11,277,168	\$13,563,869	\$11,174,798	\$11,277,168
Total cost/yr/cwt	\$4,887,952	\$5,647,084	\$5,319,326	\$4,887,952
Profit/yr/cwt	\$6,389,216	\$7,916,785	\$5,855,472	\$6,389,216