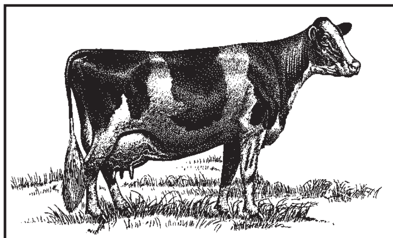

B.C. DAIRY TALK

Editor: Annette Moore

Caution Advised When Expanding Your Dairy Farm Enterprise

by
Lawrence Hurd
Business Management Specialist

Investment in high priced milk quota and land could be a good investment in the long-run provided it does not create havoc in the short-run.

With the risk and uncertainty associated with most agricultural endeavours it is important to weigh all the pros and cons of the investment prior to charging forward. That does not mean you have to become a pessimist but rather a realist about market and financial risks of the world in which we operate. Of course, their are many risks but let’s concentrate on the market and financial situation.

Interest rates are the lowest they have been in a long time and could go even lower. Those with large debts, whether it be yourself or the government benefit from low interest rates. However, if inflation should reappear and moves are made to strengthen the Canadian dollar then interest rates could rise in the future. Can your present debt load handle an increase in interest rates?

Another factor that must not be overlooked are future world trade negotiations. It is understandable why the industry wants to maintain the supply management system that now exists. Regardless of the outcome, whether it be the status quo, a change to multiple component pricing, changes to the price of milk, or added costs, you must evaluate the impact these changes will have on your business in the long-run.

To weigh all the pros and cons of an investment requires that you know your present production, financial, human resource, and market position. From your present records and financial statements it means getting in touch with your cash flow, debt equity position, level of milk production, variable and fixed costs, size of operation etc. It means making financial projections from your present situation for the next five years in the event some adverse change or opportunity does take place. For example: what if the price of milk declined $4 or $5 per hectolitre over the next five years relative to input costs. In other words, the cost price squeeze continues. Could your farm handle the present debt load?

The rule that we should get better before we get bigger will still apply to many milk producers. However, expansion may also be desirable to improve your efficiency, maintain or improve your present standard of living, and compete effectively in a North American market. Diversification of the farm business into another enterprise or value-added activity is another option but it should be analyzed carefully.

Any change to your operation requires a good business plan and some realistic estimates, based on your goals and objectives, to ensure that you do not jeopardize the viability of the whole operation. The BC Ministry of Agriculture and Food has “Preparing a Business Plan: A Guide For Dairy Producers” to assist you when making your financial projections.

Perhaps now is a good time to expand but be cautious and ensure that your business plan indicates you can withstand adverse changes in the price of milk or inputs and upward movements in the lending rates. There are several scenarios you might wish to consider:

- no change
- purchase milk quota to reduce or eliminate excess production that is attracting a world price
- sell cows to reduce production so as to stay within your “total production quota (TPQ)"
- purchase cows and quota to increase domestic milk sales while utilizing the excess capacity in your present operation
- under take a larger expansion that includes buildings, milking parlor, bulk tank etc. and perhaps the purchase of land

The following tables indicates the additional annual cash flow you might expect from the purchase of 1,000 kg of butter fat TPQ to avoid a world price of $21 per hectolitre when the skim milk price is $38.50/hl and the butter fat price is $4.25/kg. This is based on a butter fat test of 3.7 kg/hl. It is assumed the interest rate on the borrowed money is 9%.

Remember, another option is to reduce the size of the milking herd.

Impact on Annual Cash Flow

Price of Total Production Quota
$/kg butter fat

Term of Loan (years)	$30	$35	$40	$45	$50
4	-12	-1,568	-3,124	-4,681	-6,237
5	1,537	238	-1,060	-2,358	-3,656
6	2,562	1,435	308	-820	-1,947
7	3,289	2,283	1,276	270	-736

When the loan has been repaid your cash flow will increase. This analysis does not consider any income tax implications, the future value of the quota; or the future relationship of the producer's milk price, and costs of production.

BCMAF Staff	Title	Phone
Dairy Commodity Team		
Ron Barker	Dairy Specialist	604-556-3087
Regulatory Team		
Dr. Merv Wetzstein	Manager	604-556-3013
Roger Pannett	Dairy Inspector, Fraser Valley	
Debra Sand	Operations Coordinator	604-556-3014
Lynette Hare	Data Coordinator	604-556-3093