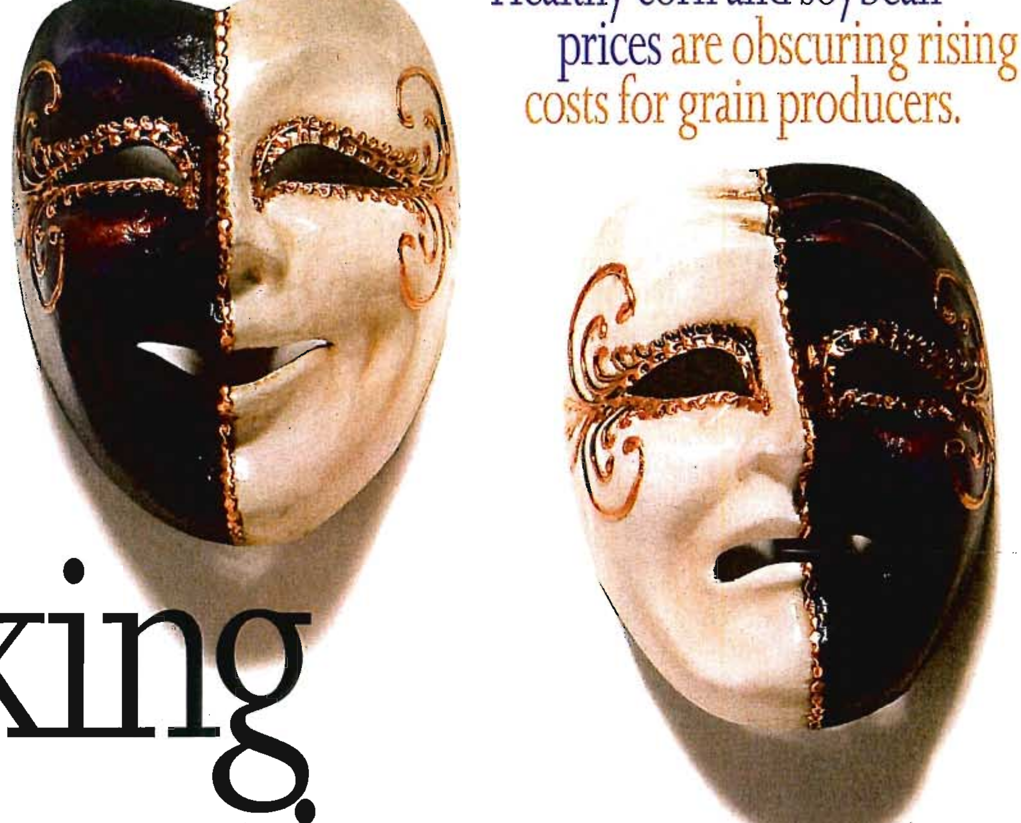
business point

Healthy corn and soybean prices are obscuring rising costs for grain producers.



Masking production costs

In agriculture, it sometimes seems that every silver cloud has a dark lining. This may be the case for crop growers now. While corn and soybean prices are jockeying between wildly lucrative and highly profitable, the picture on the flip side isn't quite as rosy.

Production costs are rising, eating away at the profit margin for many U.S. corn and soybean growers. Producers with sharp pencils already have a pretty good idea of this trend, but unless you really do the math, the magnitude of this move may surprise you.

Growers can benefit from reviewing their production costs and understanding the impact on the breakeven prices. For farmers who participate in cooperative farm management associations in a dozen or more states, this starts in early winter. Members of these associations close out their records in the last few days of December or in early January.

Analyzing production records

As winter settles in, they "check in" their completed record books and/or computer-generated accounts with a trained farm management specialist or consultant. Both crop and livestock production records, as well as financial data, are critical to farm business analysis. The farm management specialist, therefore, inspects the grower's records for completeness and accuracy.

The specialist then supervises the preparation of financial and management reports. These include current income statements, balance sheets, statements of cash flow and enterprise analysis reports, to name a few. Also a valuable part of the mix for most of these reports is a five-year trend for selected factors.

Farmers use their individual reports to finalize their financial plans and prepare cash-flow projections for the new year. This information also is an excellent source to document credit files as the operation secures new lines of credit and other financing.

Corn input costs, dollars per acre
"Key" production figures

	2006[1]		2005		2004		2003		2002	
	IA	IL	IA	IL	IA	IL	IA	IL	IA	IL
Soil Fertility	70	80	56	77	55	66	49	56	45	54
Pesticides	28	39	29	42	30	38	32	35	33	33
Seed	47	46	44	43	39	39	37	36	35	34
Drying & Storage	12	17	10	15	14	15	8	17	3	13
Machinery Repair, Fuel & Hire	45	42	45	39	39	37	35	32	28	32
Economic Machinery Depreciation[2]	27	21	26	20	24	19	23	18	18	29
Total economic cost[3]	451	488	419	458	404	425	381	395	317	401
Average yield	167	174	175	150	187	184	161	174	142	145
Costs per bushel	2.70	2.80	2.39	3.05	2.16	2.31	2.37	2.27	2.23	2.77

The 30,000-foot view

After gathering information from the majority of their members, the farm management associations compile comparative analysis standards, or benchmarks, so the members can learn even more about their operations.

The standards provide an overview of the total business and financial situation. Just as important, however, they help farmers learn what their strong points are and what they need to change to become more profitable. The farm management consultant is available to help analyze the business records and provide clients with a sounding board for ideas.

Seeing healthy incomes

A number of participants in the Iowa/Illinois FBFM Association program are looking at some of the best financial results they have ever experienced. Corn yields were within 5 to 10 bushels of their best-ever yield on a total farm basis. Soybean yields also were good, with the farm average running about 55 bushels per acre. The increased net incomes came about because of the run-up in the price of corn at year end. Many producers had inventory to sell and take advantage of historically high grain prices.

But a closer look reveals a threat. Crop growers are justifiably concerned about the rapid escalation of their production costs. Even with incredibly high yields, the average cost of producing a bushel of corn has risen from approximately $2.20 per bushel to between $2.75 and $3.00 per bushel. And these costs don't reflect the drastic increase in cash rents in some parts of Illinois over the winter. The costs would include an interest charge on equity capital and an unpaid labor charge for sole proprietors.

No relief from livestock

Livestock returns in Illinois in 2006 did very little to improve overall results. Hog farms were the only livestock farms on which 2006 earnings exceeded the five-year average.

The earnings on both dairy and beef cattle feeding farms were lower than the five-year average (2002-06). Most farmers bring a renewed optimism to their business that is present every spring, thinking the current economic situation offers good opportunities for business growth.

We reviewed input costs per acre for corn and soybeans for several key production items from Illinois and Iowa Farm business members. As of April 1, we saw slightly different costs for these two states, but the review confirms producer concerns about the rapidly escalating costs. (See attached tables.)

For example, the percentage increase in corn production costs over the past five years is significant. For this period, soil fertility costs are up about 50 percent; seed costs are 35 percent higher; machinery repairs, fuel and hire as much as 60 percent; and economic depreciation as much as 50 percent.

Producers are keenly aware of the increase in the price of machinery, and depreciation costs would be even higher if you look at tax depreciation including expense-election amounts.

Producing grain costs more

The total economic costs show a 20 percent to 40 percent increase in the two states, with some difference in land values or leasing charges being a part of this. Individual members in the two programs, working with their own farm management specialist, focus on their own unique situation, which might vary all the way from substantial owned land, to primarily crop-share leases to a significant percentage of cash-rented ground.

Also, this winter's run-up in grain prices has precipitated proposals for significant cash rent increases. The unfortunate part is that many of these are not tied to flexible leases that will adjust if grain prices drop.

The bottom line: Increased production costs are cutting into grower profits even with high-priced grain. The trend indicates these higher costs of production may challenge grower profitability if and when grain prices fall back to "normal" levels. ■

***Editor's note:** Kent Vickre and Chuck Cagley author a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Cagley is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

FBFM
IOWA FARM BUSINESS ASSOCIATION

Soybean input costs, dollars per acre
"Key" production figures

	2006[4]		2005		2004		2003		2002	
	IA	IL	IA	IL	IA	IL	IA	IL	IA	IL
Pesticides	19	25	23	31	19	28	24	32	21	30
Seed	29	33	29	29	24	27	23	25	23	24
Drying & Storage	3	6	1	5	1	6	1	7	1	4
Machinery Repair, Fuel & Hire	42	37	42	34	37	32	32	28	28	28
Economic Machinery Depreciation[5]	26	18	25	17	23	17	22	16	18	25
Total economic cost[6]	338	375	332	353	308	333	293	320	242	326
Average yield	54	53	54	52	50	54	35	38	46	48
Costs per bushel	6.26	7.08	6.15	6.79	6.16	6.17	8.37	8.42	5.26	6.79

[1] 2006 "projected" data is as of April 1, 2007. Final 2006 comparative data available at: www.iowafarmbusiness.org and www.fbfm.org.
[2] Iowa Economic depreciation is calculated at 10 percent/year with 10 percent salvage. Illinois changed to economic depreciation in 2003, with most machinery calculated at 10 years, 125 percent declining balance. 2002 was tax depreciation.
[3] Total cost includes non-cash "average" equity charge on asset values and "average" unpaid labor and management charge.
[4] 2006 "projected" data is as of April 1, 2007. Final 2006 comparative data available at: www.iowafarmbusiness.org and www.fbfm.org.
[5] Economic depreciation is calculated at 10 percent/year with 10 percent salvage. Illinois changed to economic depreciation in 2003, with most machinery calculated at 10 years, 125 percent declining balance. 2002 was tax depreciation.
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