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Prepared by Mark Mapstone, CAC

Farm Credit East

Managing under Base Excess Programs

Base programs come in 3 types:

- Agri-Mark Style: Over Base Penalties on 2-5% below your daily production level when base was established but very steep discount on what is produced over current base limit (**big bite)**
- DFA Style: Penalties currently start at 10% below your daily production level when base was established and less of a discount for over current base limit milk **(medium bite)**
- Upstate or Land O'Lakes style: Base restriction only put into action as needed. Base is relatively close to your farms production level at time of establishment. Relatively low penalty for over base milk. **(little or no bite)**

****The type of Base restriction your farm has makes a big difference in an overall farm's strategy**

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Managing under Base Excess Programs

Being under any Base restrictions requires a manager to think differently about how they manage their operation:

Focus on maximizing solids in milk, rather than just volume.

Over base milk is just a fraction of milk produced- therefore there is dilution effect on milk price as you produce more over base milk.

Some processors have market adjustment expenses on top of potential over base penalties

Not growing the top line of a business can result in financial problems down the road

Needs to include how a manager thinks about **income and expenses** in the operation

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Traditional Way of Looking at Farm Income and Expenses

Income

- Milk
- Other Income

-Expenses

- Labor
- Feed
- Crop
- Livestock
- Marketing
- Insurance
- Taxes
- Repairs
- Professional
- Other

=Bottom Line

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Different Way of Looking at Farm Income and Expenses

Income

Milk

Other income

- Variable Expenses

Expenses that go directly into milk and crop production

(These expenses tend to change with every additional cow , crop acre or employee hired)

=Gross Margin (Profit generated from producing milk and crops)

- Overhead Expenses

Expenses that are related to owning or renting assets (land, buildings and equipment)
Owner draws and living expenses are included here
(These expenses tend to only change if we invest, rent additional assets or add an owner)

= Net Margin (Bottom Line)

Different Way of Looking at Farm Income and Expenses

Variable Expenses

- Labor
- Purchased Feed
- Crop Inputs (seed, fertilizer, spray, tractor and vehicle fuel)
- Custom Hire
- Livestock Expenses (bedding, vet, supplies, testing, hoof trimming)
- Heifer Board
- Milk Marketing

Different Way of Looking at Farm Income and Expenses

Overhead Expenses

- Owners Labor
- Depreciation
- Lease Expense
- Interest
- Repairs
- Taxes
- Insurance
- Utilities
- Professional Fees

Different Way of Looking at Farm Income and Expenses

Income	**$600,000**
- Variable Expenses	-$300,000
=Gross Margin	**$300,000**
- Overhead Expenses	-$200,000
= Net Margin (Bottom Line)	**$ 100,000**

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Key Understanding from Gross Margin, Net Margin View:

Base excess program or not, Overhead is a fixed expense:

- Overhead expense doesn't change if you milk 20 less or 20 more cows
- Overhead expense doesn't change if you make more or less milk per cow

<u>Farms under Base excess programs need to focus on what's happening with Gross Margin</u>

Key Understanding from Gross Margin, Net Margin View:

Since a cow producing milk in early or mid lactation is difficult to restart if you purposely slow down her production, I suggest a farm look at the over base penalty on a yearly average

Look at Base Penalty from an Annual Average

DFA Over Base Penalty Tracker		
	Calendar year 2021	Calendar year 2022
Production Month	Over base Penalty/cwt	Over base Penalty/cwt
December (January's check)	10.19	8.37
January	6.60	3.80
February	1.37	0.37
March	1.25	4.28
April	5.76	5.38
May	8.21	
June	13.33	
July	9.23	
Aug	3.86	
Sept	1.06	
Oct	0.67	
November	3.67	
Total Penalty YTD/Cwt	$ 5.43	$ 4.44

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Key Understanding from Gross Margin, Net Margin View:

On Over Base Milk, does the gross milk price minus the over base penalty still cover variable costs and result in additional gross margin?

Concept: You can be diluting your average milk price as you produce over base milk and still be increasing the annual gross margin dollars in the operation.

Key Understanding from Gross Margin, Net Margin View:

	2021	2021 DFA OB	2022 (Projected)	2022 OB
Milk Price	$19.00	$13.50	$25.00	$19.50
Variable Expenses	$12.50	$12.50	$15.50	$15.50
Gross margin	$6.50	$1.00	$10.00	$4.00
Overhead	$5.00		$5.00	
Net margin	$1.50		$5.00	

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Key Understanding from Gross Margin, Net Margin View:

On Over Base Milk, does the gross milk price minus the over base penalty still cover variable costs and result in additional gross margin?

Agri-Mark: (Red light) No. No reason to produce any over base milk ever

DFA: 2021 (Yellow Light) Yes, Milk price minus Base penalty covered variable expenses on most farms. 2022 (green light) Milk price – Base penalty covers variable expenses plus some.

Upstate and Land O lakes: (Green Light) Little or no Base penalty

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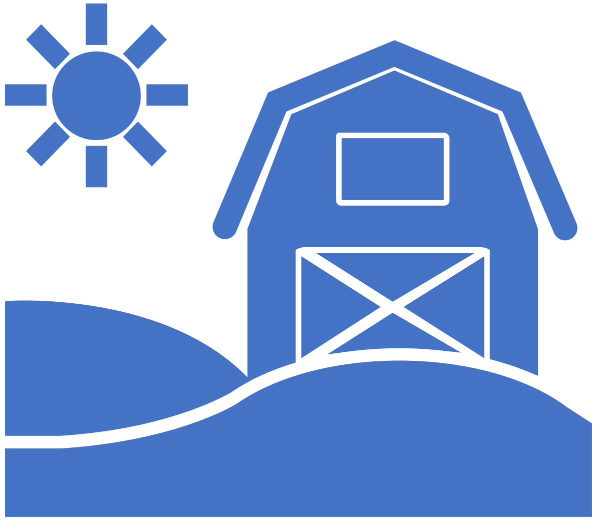

Key Understanding from Gross Margin, Net Margin View:

For 2022:

- **I'm expecting a sweet spot on most farms bottom line when they are at 10-20% above their base (point where the over base penalty starts)**

- **Farms that cut back under base (had no penalties) generally did poorer on their bottom line. Its hard to cut back expenses enough to recover the lost milk revenue.**