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# KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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## **Bluegrass Area Update**

*David L. Heisterberg*

As of this writing the Bluegrass Farm Analysis Area is still vacant. However, an offer has been made to a candidate and we are very hopeful of filling this position in the next week or so.

I would like to thank Jennifer Rogers for helping to process the Bluegrass records this winter. Without her help I doubt that I could have completed the records, and for sure not on a timely basis. Also thanks to Linda Jones, Bluegrass secretary, for the extra effort she put in this winter.

## **Tobacco Buyout Update–5 Mistakes to Avoid**

*Brian Lacefield*

By this time everyone should have completed sign up for the Tobacco Transition Payment Program (TTPP). However, this is only the first step in the process, and several decisions and some amount of work remains. This newsletter is not attempting to discuss these issues in depth, but merely to remind you of the work yet to be done and strongly encouraging you to get competent advice from your KFBM specialist, your tax preparer, and any other financial advisors you consider appropriate.

The issue of taking a lump sum payment, or taking the payments over 10 years as scheduled, must be resolved. There has been a lot of publicity generated over this issue, and many financial institutions have a plan for providing lump sum payments. However, each quota owner and producer must determine if it is in their best interest to do so. There are two main questions that must be answered. “What will I do with the lump sum payment”, (ie what will my investment return be versus the discount charged for

the lump sum payment)? The second question is “What are the tax implications of taking the lump sum payment?”

The other job remaining for the quota owner payment is determining the income tax basis. For recent farm and/or quota purchases this may be relatively easy. For quota obtained many years ago this may be more difficult. Again please enlist the help of your KFBM specialist and/or tax preparer. This job should be completed this summer and not left until tax time next year!!

Regardless of whether you are taking an annual payment or lump sum, you are dealing with a unique cash inflow. Five mistakes you must avoid to get the most out of your buyout are:

1. **Failure to sign up**—Sign up is complete for the 2005 payment. If you have not already signed up, you have made mistake one. However, you may still sign up and receive the other nine payments scheduled to be made in 2006 through 2014. The deadline for this application is November 1, 2005.
2. **Getting in too big of a hurry**—When making a decision on whether to take your payment over 10 years or take a lump sum, many factors need careful consideration. All recipients must take the first annual payment this September. Take your time to get all the information before making an irrevocable decision. If you are considering taking a lump sum, make sure you compare discount rates and fees to make sure you are getting the best deal.
3. **Making poor investment choices**—When evaluating lump sum or annual payments, it is important to consider what you will do with the money.
  - a. During conversations I have had with buyout recipients one common statement I have heard is “I will buy land and not pay any tax.” The quota payment will qualify for a like kind exchange (1031 Exchange), the grower payment will not. This will translate to a maximum tax deferral of 15%, the current maximum long term capital gains rate. The like kind exchange only defers tax. When you sell the new property you will realize the federal tax and also Kentucky tax. The buyout payments are not

subject to Kentucky State tax. However, the proceeds from a like kind exchange will be subject to the state tax. Paying too much for your exchange property negates the tax advantage.

- b. Another option I have heard and suggested to recipients is paying down debt. This is an excellent strategy for high interest debt. Taking a lump sum with a discount rate of 5.5% and paying off debt at 8% is a good deal. Taking the lump sum at a 6% discount rate and putting it in a money market account with a 2.5% return is not a good deal.
4. **Mental Accounting**—Mental accounting is a behavioral economics term that refers to the tendency of individuals to categorize and treat money differently depending on where it comes from (Example: Spending \$20 dollars found in the parking lot with less thought than \$20 dollars from your paycheck). Use of mental accounting can affect a person’s marginal spending rate, often exceeding one. This means that a person given \$100 dollars as a gift may end up spending \$150 dollars “justifying” purchases. Be aware of this tendency and try to manage and control them. I know it is difficult. I have been studying this for 10 years and I have an ionic air freshener, bought with cash from my Grandmother, that I see every morning reminding me to watch my mental accounting.
  5. **Going it alone**—This last mistake could lead to making the previous four in addition to costing you extra in taxes. Everyone’s tax situation is unique. I cannot stress enough the importance of getting competent help with making decisions with lump sum options. There are different tax treatments for different options. What is the best option and strategy for your neighbor or brother-in-law may not be your best option. Talk with your tax practitioner, C.P.A, tax attorney, financial planner and KFBM specialist to evaluate all your options and your best strategy.

For more information, please go to the UK Ag Econ web site. There is much information there and also links to other sites with helpful information. The web address is: [www.uky.edu/Ag/TobaccoEcon/](http://www.uky.edu/Ag/TobaccoEcon/).

## Summary of 2004 Records

*David L. Heisterberg*

Net farm income for farms in the Kentucky Farm Business Management Program (KFBM) in 2004 was not quite as high as 2003. However, it was still a very profitable year for the average farm, and hog and dairy farms made a substantial improvement from 2003 due to major price improvements. Table 1 shows the net farm income per farm and management returns per operator acre for 2003 and 2004. Amounts are listed for comparison by area and also by type of farm.

Type of Farm	Income per Farm		Management Return per Acre	
	2003	2004	2003	2004
Ohio Valley	129,540	132,884	24.53	29.00
Pennyroyal	183,897	179,456	49.44	43.41
Purchase	237,939	151,237	43.03	11.65
Bluegrass	98,385	73,987	31.03	-2.35
Lincoln Trail	74,352	58,130	1.49	-22.27
All Farms	152,019	144,669	39.05	32.71
Dairy Farms	38,414	138,058	-97.20	64.08
Beef Farms	20,990	17,813	-109.20	-105.57
Hog Farms	114,687	205,844	36.88	162.56
Grain Farms	197,037	170,462	50.19	30.51

The following articles discuss some of the factors that contributed to the 2004 net income.

### Kentucky Weather - 2004

*Jennifer Rogers*

The weather in 2004 can be described as cool and wet, except for the month of September, which was dry with above average temperatures. Despite some unusual weather patterns during 2004, many producers experienced good corn, soybean, and tobacco yields. The spring was blessed with mostly good planting and growing conditions, however, many low lying areas flooded in May and then again in June. The flooded areas resulted in late planting. Cool, wet conditions of May and June led to problems controlling weeds and diseases in many crops. There were several reports of blue mold and black shank in tobacco as well as poor hay quality due to the inability to get the crop out of the field in a timely manner. Wheat yield and quality was hurt dramatically in some areas due to head scab and lodging. Abundant rain throughout the summer months along with moderate temperatures helped many crops to achieve high yields, even though they were planted late or under adverse conditions. The

warm dry conditions in September and early October resulted in quick dry down for corn as well as causing pastures to go dormant and inhibiting pod fill in late soybeans. Above average rainfall in October delayed harvest of late corn and a significant portion of the soybean harvest, affecting quality and yield. It also delayed or prevented wheat planting, and many producers did not get all the wheat planted they wanted.

### Crop Yields

*Suzy Martin*

Crop yields for the major crops grown on Kentucky Farm Business Management Program farms for 2004 were, for the most part, above the five year average. The average yellow corn yield was 166 bpa and white corn was 152 bpa. This was up from 2003 average yields of 151 bpa for yellow and 134 bpa for white. The Purchase and Pennyroyal areas enjoyed the highest yields, 173 and 171 bpa respectively, while the Ohio Valley and Central Kentucky areas had only 151 and 153 bpa.

Full season soybeans averaged 47 bpa and double crop soybeans were 43 bpa. The soybean averages were similar to the prior year but were higher than the five year averages. The Pennyroyal area had the highest bean yields at 54 bpa for full season beans and 45 bpa for double crop.

Wheat yields were down significantly during 2004. The average yield for Kentucky farms was 58 bpa. In 2003 the average yield was 69 bpa and the five year average was 66 bpa. The Pennyroyal, Purchase and Ohio Valley areas all had similar yields for wheat while the Central Kentucky area was lower at 47 bpa.

### Tobacco Production

*Brian Lacefield*

The average tobacco yields for Kentucky Farm Business Management (KFBM) cooperators in 2004 was 2579 pounds per acre. This is up from last year's average of 2553 pounds per acre, but below the 5 year State KFBM average of 2691 pounds per acre. Yield per acre decreased in the Bluegrass and Ohio Valley Areas by 126 pounds (5%) and 236 pounds (9%), respectively. Yield per acre increased in the Lincoln Trail Area by 161 pounds per acre (8.3%) and remained relatively unchanged in the Pennyroyal Area. The state average consist of all types of tobacco grown in Kentucky.

Tobacco was grown on 43% of the farms in the 2004 KFBM State averages. This was down 3% from 2003. However, the average amount produced per farm increased from 18.6 acres in 2003 to 22.2 acres in 2004. All areas except the Lincoln Trail area increased acres per farm in tobacco production.

Price received for new crop sold in 2004 averaged \$2.08 per pound, this reflected no change from the 2003 new crop price. However, 2003 crop sold in 2004 averaged \$2.10/lb. This was down \$0.05/lb. from old crop sold in 2003.

The year will remain historic in tobacco production. On October 22, 2004 President George W. Bush signed into law legislation ending the production controlled price support system. This bill established a ten year payment, paid by the tobacco company, to buy the current quota from owners and make a transition payment to active growers. Kentucky quota owners and producers will receive nearly \$2.5 billion dollars from the buyout.

New opportunities exist for tobacco producers as the quota system is eliminated. Producers will have the freedom to increase production and consolidate production that had been spread across counties and states working with available quota. Challenges still exist with the use of existing infrastructure, declining market price and increased input cost. Yield and efficiency will be the key for producers.

### **Crop Prices** *Craig Gibson*

In contrast to 2003, crop prices did not rally during the 2004 growing season. In general, crop prices rallied through late March, fell back, and then rallied one more time during late May and early June. Then prices began to falter and fell until fall harvest.

Corn prices moved to more than \$3.00 per bushel during the price rally period. In contrast to the \$2.50 per bushel beginning of the year inventory value for unpriced corn, this was a great opportunity to capture returns to storage. However, the average selling price for the 2003 crop corn sold in 2004 was \$2.61 per bushel. We inventoried unpriced soybeans at \$7.90 at the beginning of 2004. During their price rally, cash prices reached more than \$10 per bushel. That was, of course, because there were not many available! There were some sold at \$10, but very few. The average selling price of 2003 soybeans sold during 2004 was \$7.26 per bushel. Compared to the

beginning of the year inventory price and the price level reached during the rally, it is safe to say that many inventoried soybeans were contracted during 2003 and few producers had unpriced soybeans to sell!

Compared with total production, there is not much wheat stored from one production year to another. The average price of wheat produced in 2003 and sold in 2004 was \$3.60 per bushel. This compares to a January 1, 2004 cash price of \$3.60 and an average selling price of \$3.20 for "new crop" wheat sold during 2003. We can say the same for the barley crop. The average price of the barley produced in 2003 and sold in 2004 was \$1.90 per bushel. This compares to a January 1, 2004 cash price of \$2.00 and an average selling price for "new crop" barley of \$1.78 during 2003.

White corn, grain sorghum, and popcorn typically mirror yellow corn prices. Normally, white corn commands a premium and the grain sorghum price is lower. The average selling price for 2003 white corn sold during 2004 was \$2.87 per bushel, 26 cents higher than the yellow corn price. This was mainly due to the price contracts available as there was some white corn, not grown under contract, sold at the same price as yellow corn. The average selling price for grain sorghum grown in 2003 and sold in 2004 was \$2.40 per bushel, 21 cents less than the average yellow corn price. Popcorn is typically grown under contract. Because the contract prices are typically established early in the production year, producers could take advantage of higher 2003 yellow corn prices and establish relatively high popcorn selling prices. The average selling price for popcorn grown in 2003 and sold in 2004 was 14 cents per pound. This compares to 12 cents per pound received in 2003 for popcorn produced in 2002.

Because of larger U.S. production levels in 2004 than in 2003 and prices trending lower after early June, average inventory prices for unpriced "new crops" were lower in 2004 than in 2003. Year-end yellow corn inventory values fell 50 cents per bushel between December 31, 2003 and December 31, 2004 and soybean inventory values fell \$2.30 per bushel. White corn inventory values were 45 cents per bushel lower on December 31, 2004. Wheat inventory values were 60 cents lower and grain sorghum inventory values were 40 cents lower on December 31, 2004. Prices were generally low enough that some levels of LDPs were existent during harvest for corn, soybeans, and grain sorghum. There were

never any periods where LDPs were available for wheat.

Due to contracting for fall delivery completed earlier in 2004, new crop prices were relatively good and in one case higher than in 2003. The average selling prices for yellow corn, white corn, soybeans, and wheat in 2004 were \$2.38, \$2.58, \$5.98, and \$3.07 per bushel, respectively. In contrast, they were \$2.32, \$2.74, \$6.47, and \$3.20 per bushel in 2003, respectively. During the fall of 2004, yellow corn cash prices fell below \$2.00 per bushel and below \$5.40 per bushel for soybeans.

We can summarize that although price levels are never as high as desired, overall, the high yield levels achieved in 2004 more than offset the lower prices. Soybeans were an exception. Regardless, crop returns were about \$40 per acre higher in 2004 than 2003 without regard to government program payments.

### **Beef Cattle** *Rick Costin*

Net farm income for the sample of 34 beef farms in the KFBM program was \$17,813. Although the farms had positive net income, management returns continued on the “normal” negative side for beef producers of (\$37,911). The high one-third farms had a much higher net farm income of \$55,162 and a small negative management return of (\$634) per farm average.

Another figure that exhibits the ability for beef producers to generate a profit is returns above feed costs per cow (RAFC/cow). For the 43 herds that sold calves at or shortly after weaning, the RAFC/cow was \$213. The average feed costs per cow/calf unit were kept to a respectable average of \$225. To produce a hundred pounds of beef the average cow/calf producer spent \$45.50 on feed while the top one-third spent \$34.44.

For the 55 herds that sold calves after a period of backgrounding, the RAFC/cow was \$302. The average feed costs per cow/calf unit was an average of \$325. To produce a hundred pounds of beef the average cow/calf background producer spent \$45.41 on feed while the top one-third spent \$31.85.

The continued high prices for beef cattle contributed significantly to the positive net income. For calves sold off the cow weighing an average of 543 pounds,

the price received was \$100.60 per cwt. For the calves that were backgrounded, the average selling weight was 700 pounds and the price received was \$98.46 per cwt.

### **Hog Enterprises** *Ross Key*

In 2005 Kentucky hog producers saw their first real opportunity to produce a substantial profit in nearly a decade. Producers saw average prices near \$53 per CWT. This was \$13 dollars higher than prices seen in 2003. Production efficiency measures such as feed cost, pigs weaned per sow per year and death loss continue to be challenges that producers need to focus on to maintain and improve profitability into the future.

Grain prices started the year at elevated levels causing the average price paid for feed stuffs to go up slightly less than \$3 per cwt. produced from the previous year. These increased feed cost were more than offset by the increased price received at market. Producers experienced returns over feed cost \$13.26 per cwt. higher than 2003.

The higher prices received in 2004 have given producers a reason to have a positive outlook on the industry for the first time in several years. Producers should remember the lessons learned in the lean years and take this opportunity to make needed improvements and prepare for future bear markets. Producers need to look for ways to become more efficient and profitable to keep pace in a highly competitive and vertically integrated industry.

### **Dairy Cattle** *Rush Midkiff*

The 2004 year can be summarized as a highly profitable year for most dairy farmers. Milk prices averaged \$16.72 per cwt. compared to \$13.87 per cwt. in 2003. The average farm in the KFBM dairy sort of 28 farms produced 17,288 pounds of milk per cow. This is down slightly from 2003 when dairy farms in KFBM averaged 17,414 pounds per cow. Butterfat averaged 3.60% per cow. The top nine farms in the summary, the high third, averaged 18,303 pounds of milk per cow with a butterfat of 3.62%. This production level is also down from the 2003 average of 20,290 pounds per cow.

Looking at the differences between the average farm numbers and the high third group: the high third

group produced more milk per cow – 18,303 pounds vs 17,288 pounds; had a higher butterfat of 3.62% vs 3.60%, and had a higher price per cwt of milk sold – average herd at 16.72 vs high third at 16.89. The herd size was also larger for the high third group with 172.6 cows, while the average of all herds was 130.0 cows. The high third group percent cull rate was higher at 22.9% with the average herd having a cull rate of 20.2%.

Feed costs were slightly lower in 2004. This reflects grain prices moderating in 2004 for Kentucky Farm Analysis Dairy Producers. In 2003, value of feed fed ran \$7.68/cwt of milk produced. In 2004 those cost decreased to \$7.45/cwt of milk produced.

Taking all this into account, the high return group had net returns of \$10.26 per cwt over feed cost and the average herds had a net return of \$9.27 return per cwt for feed cost. So, for every million pounds of milk sold, the high return group made \$9,900.00 more net return over feed cost than the average herd.

Strong dairy prices are forecast for 2005 along with lower feed cost. It has been pointed out to dairies in the Kentucky Farm Business Analysis Program, that cost control above all else is the most determining factor in dairy operation profitability. So, watch all your cost and put some of these high milk prices in the bank. 2005 is shaping up to be another profitable year for Dairy Producers.

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David L. Heisterberg, Editor  
Extension Farm Management Specialist



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