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# KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM STATE NEWSLETTER

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## **Where Will 2006 Lead Us?**

Craig D. Gibson

If you find your KFBM Specialist in a “bad mood,” particularly this author, this newsletter will reveal the reason. The grain market is not cooperating and costs continue to increase. Regardless, it is refreshing to hear that some managers are already planning for 2006. Although this year’s crops are not fully harvested, it is clear that 2006 will be even more challenging than the 2005 crop year.

The purpose of this article is twofold. The first purpose is to look at sowing wheat as a viable cropping alternative for 2006. The second purpose is to stimulate producers to begin looking at the various expense categories where cost cutting measures may be required. Planning for 2006 is imperative now! Each producer must have a plan so that various tasks can begin in preparation for next year as the 2005 harvest is completed!

Are wheat and double-crop soybeans viable in 2006? The answer certainly depends upon costs and returns as compared to other cropping activities. Table 1 is provided to report the 2004 enterprise analysis summary for crops. When viewing the data results, please remember, individual producer data are likely different. Table 1 data are only averages. For those of you with individual 2004 enterprise analysis data results, Table 1 may be useful for comparison purposes.

Obviously, 2005 records have not been closed or processed. It appears at this point that the 2005 wheat and double-crop soybean yields are higher than 2004 levels. Given this, the 2004 results will not be used to analyze the feasibility of wheat and double-crop soybeans for 2006. However, 2004 price and yield results do point out one thing. No one is ever certain of the results, no matter how carefully planned. There is always risk and it must be considered. Be realistic in price and yield expectations.

Table 1. Enterprise Analysis Results for Selected Crops for 2004.

	Yellow Corn	Full Season Soybeans	Wheat	Double Crop Soybeans	White Corn	Grain Sorghum
Yield per Acre	167.0	48.0	57.0	44.0	147.0	104.0
<b>GROSS RETURNS</b>						
Production Returns	\$376.00	\$278.00	\$172.00	\$261.00	\$394.00	\$214.00
Loan Deficiency Payments	42.39	9.68	0.00	9.90	39.69	66.56
<b>TOTAL CROP REVENUE</b>	<b>\$418.39</b>	<b>\$287.68</b>	<b>\$172.00</b>	<b>\$270.90</b>	<b>\$433.69</b>	<b>\$280.56</b>
(Per Unit)	2.51	5.99	3.02	6.16	2.95	2.70
<b>NON LAND COSTS</b>						
<b>Variable Costs</b>						
Fertilizer: Dry\Starter\Lime	\$30.09	\$26.33	\$17.35	\$15.78	\$30.65	\$22.34
Nitrogen	44.00	0.00	21.93	0.00	45.40	35.56
Pesticides	36.36	27.59	15.99	23.04	36.39	26.16
Seed	35.80	29.84	22.06	28.28	35.73	12.77
Drying	7.20	1.98	1.46	1.29	7.08	5.34
Machinery Repair	22.91	18.21	15.58	13.49	27.66	15.20
Fuel & Oil	13.73	10.22	9.85	8.52	13.07	8.01
Machine Hire	<u>8.67</u>	<u>6.38</u>	<u>6.53</u>	<u>5.65</u>	<u>7.62</u>	<u>3.61</u>
Total Variable	\$198.76	\$120.55	\$110.74	\$96.03	\$203.60	\$128.99
(Returns Over Variable Costs)	(\$219.63)	(\$167.13)	(\$61.26)	(\$174.87)	(\$230.09)	(\$151.57)
<b>Other Non land Costs</b>						
Utilities	\$5.57	\$4.28	\$3.89	\$3.37	\$6.19	\$3.40
Labor - Paid	20.66	16.58	16.54	15.74	17.93	10.97
- Unpaid	15.31	15.37	11.14	10.50	15.47	14.14
Storage	1.08	1.00	.39	.85	0.11	0.06
Building Repairs	5.84	4.77	2.06	1.79	5.77	4.00
Building Depreciation	6.80	3.06	3.77	3.71	6.64	2.48
Light Vehicle Expense	.30	.22	.21	.18	0.18	.27
Machinery Depreciation	31.45	22.73	22.88	19.80	30.61	16.12
Insurance	15.21	12.35	9.81	10.13	11.94	10.71
Miscellaneous	4.46	4.81	4.03	2.93	5.74	2.32
Non land Interest	<u>30.90</u>	<u>21.44</u>	<u>17.79</u>	<u>19.25</u>	<u>28.61</u>	<u>16.40</u>
Total Other	\$137.58	\$106.64	\$92.49	\$88.25	\$129.20	\$80.88
<b>Total Non land Costs</b>	<b>\$336.34</b>	<b>\$227.18</b>	<b>\$203.23</b>	<b>\$184.28</b>	<b>\$332.80</b>	<b>\$209.87</b>
<b>LAND COSTS</b>						
Taxes	\$6.37	6.64	\$3.08	\$3.08	\$7.41	\$5.39
Adjusted Net Rent	<u>96.75</u>	<u>86.85</u>	<u>52.32</u>	<u>52.68</u>	<u>88.40</u>	<u>76.12</u>
<b>Total Land Costs</b>	<b>\$103.13</b>	<b>\$93.49</b>	<b>\$55.41</b>	<b>\$55.76</b>	<b>\$95.81</b>	<b>\$81.51</b>
<b>TOTAL - ALL COSTS</b>	<b>\$439.46</b>	<b>\$320.67</b>	<b>\$258.64</b>	<b>\$240.05</b>	<b>\$428.62</b>	<b>\$291.38</b>
<b>MANAGEMENT RETURNS</b>	<b>-\$21.07</b>	<b>-\$33.00</b>	<b>-\$86.64</b>	<b>\$30.85</b>	<b>\$5.07</b>	<b>-\$10.82</b>
Non land Costs per Bushel	\$2.01	\$4.73	\$3.57	\$4.19	\$2.26	\$2.02
All Costs per Bushel	\$2.63	\$6.68	\$4.54	\$5.46	\$2.92	\$2.80
Average 5-Year Yield	144.0	43.0	65.8	39.0	127.6	102.0
All Costs per Bushel	\$3.05	\$7.46	\$3.93	\$6.16	\$3.36	\$2.86
Average Cash Rent	\$98.18	\$98.18	\$49.09	\$49.09	\$98.18	\$98.18

Table 2 provides a basis upon which to plan for 2006 cropping activities. There are many assumptions made in its development. Yields are based on 5-year averages. Prices are based on the futures market close on September 23, 2005, and adjusted for normal harvest basis. Some cost assumptions are as follows: Nitrogen will increase 10% from 2005 levels. Dry and starter

fertilizer will be at least 5% higher. Corn and grain sorghum seed will increase 0 to 3%, dependent upon the variety. Wheat and soybean seed will increase 1%. Pesticide costs will increase about 1%. It is estimated that fuel costs will increase about 38% over 2004 levels. The balance of the remaining costs is shown to be from 3% to 8% higher.

Short-term decision models typically examine returns over variable costs. Table 2 presents these returns in parentheses. Clearly, wheat and double-crop soybeans project the highest returns (\$184.32). The activity generating the next highest returns over variable costs is full season

soybeans (\$118.05), followed by white corn (\$98.02; assuming a price premium of 40 cents per bushel) and yellow corn (\$85.20). A sensitivity model reducing gross returns for each activity by 10 percent does not change the rankings by returns over variable costs.

**Table 2. Projections for 2006 for Selected Crops.**

	Yellow Corn	Full Season Soybeans	Wheat	Double Crop Soybeans	White Corn	Grain Sorghum
Average 5-Year Yield	144.0	43.0	65.8	39.0	127.6	102.0
<b>GROSS RETURNS</b>						
Production Returns	\$331.20	\$251.55	\$227.67	\$228.15	\$344.52	\$224.40
Loan Deficiency Payments	0.00	0.00	0.00	0.00	0.00	0.00
<b>TOTAL CROP REVENUE</b>	\$331.20	\$251.55	\$227.67	\$228.15	\$344.52	\$224.40
(Per Unit)	2.30	5.85	3.46	5.85	2.70	2.20
<b>NON LAND COSTS</b>						
<b>Variable Costs</b>						
Fertilizer: Dry\Starter\Lime	\$35.00	\$29.00	\$28.00	\$28.00	\$35.00	\$26.00
Nitrogen	65.00	0.00	34.00	0.00	65.00	48.00
Pesticides	37.00	28.00	16.00	23.00	37.00	27.00
Seed	37.00	25.00	24.00	28.00	37.50	13.00
Drying	9.00	2.50	2.00	2.00	9.00	6.50
Machinery Repair	24.00	19.00	16.50	14.00	24.00	16.00
Fuel & Oil	19.00	17.00	18.00	14.00	19.00	17.00
Machine Hire	9.00	6.50	6.75	6.00	9.00	4.00
Interest on Variable Costs	11.00	6.50	6.25	5.00	11.00	7.00
Total Variable	\$246.00	\$133.50	\$151.50	\$120.00	\$246.50	\$164.50
(Returns Over Variable Costs)	(\$85.20)	(\$118.05)	(\$76.17)	(\$108.15)	(\$98.02)	(\$59.90)
<b>Other Non land Costs</b>						
Utilities	\$6.00	\$5.00	\$4.00	\$4.00	\$6.50	\$3.50
Labor - Paid	21.00	17.00	17.00	16.50	21.00	11.50
- Unpaid	16.00	16.00	11.50	10.80	16.00	14.50
Storage	1.35	1.25	.50	1.00	1.20	0.10
Building Repairs	6.00	5.00	2.50	2.00	6.00	4.50
Building Depreciation	7.00	3.50	4.00	4.00	7.00	2.50
Light Vehicle Expense	.50	.25	.25	.20	0.50	.30
Machinery Depreciation	32.00	24.00	23.00	20.00	32.00	20.00
Insurance	16.00	13.00	10.50	11.00	16.00	11.50
Miscellaneous	5.00	5.00	4.00	3.00	5.00	2.50
Non land Interest	23.00	24.00	12.75	16.00	22.00	11.00
Total Other	\$133.85	\$114.00	\$90.00	\$88.50	\$133.20	\$81.90
<b>Total Non land Costs</b>	\$379.85	\$247.50	\$241.50	\$208.50	\$379.70	\$246.40
<b>LAND COSTS</b>						
Taxes	\$6.50	6.50	\$3.25	\$3.25	\$6.50	\$6.00
Adjusted Net Rent	110.00	100.00	59.00	59.00	110.00	80.00
<b>Total Land Costs</b>	\$116.50	\$106.50	\$62.25	\$62.25	\$116.50	\$86.00
<b>TOTAL - ALL COSTS</b>	\$496.35	\$354.00	\$303.75	\$270.75	\$496.20	\$332.40
<b>MANAGEMENT RETURNS</b>	-\$165.15	-\$102.45	-\$76.08	-\$42.60	-\$151.68	-\$108.00
<b>Non land Costs per Bushel</b>	\$2.64	\$5.76	\$3.67	\$5.35	\$2.98	\$2.42
<b>All Costs per Bushel</b>	\$3.45	\$8.23	\$4.62	\$6.94	\$3.89	\$3.26

The analysis, thus far, is true for owned and cash rented land. What happens if the rental arrangement is changed under which the landlord receives 1/3 of the returns and bears no variable

input costs? The new rankings with returns over variable costs are as follows: 1) full season soybeans (\$34.20), 2) wheat and double crop soybeans (\$32.38), 3) white corn (\$-16.82), and

4) yellow corn (\$-25.20). With a 10% reduction in total returns under the assumed crop share arrangement, the rankings change to 1) full season soybeans (\$17.43), 2) wheat and double crop soybeans (\$1.99), 3) white corn (\$-39.79), and yellow corn (\$-47.28).

Another scenario to examine is the threat of Asian rust entering the U.S. during 2006. Though minor damage was found in the U.S. during 2005, consideration must be given to potential damage and/or increased costs. Assume that five year average soybean yields are attainable, but it will cost \$30 per acre to protect those yields. For owned or cash rented land, the crop activity rankings change to 1) wheat and double crop soybeans (\$154.32), 2) white corn

(\$98.02), 3) yellow corn (\$85.20), and 4) full season soybeans (\$88.05). For the crop share arrangement of 2/3-1/3, the rankings change to 1) full season soybeans (\$4.20), wheat and double crop soybeans (\$2.38), 3) white corn (\$-16.82), and 4) yellow corn (\$-25.20).

This article would be remiss if the impact of loan deficiency payments (LDPs) was not discussed. Table 3 shows the 5-year averages of LDPs. Table 2 did not include LDPs as the assumed per unit price was greater than the loan rates. However, from a historical standpoint, it does not necessarily mean that LDPs will not become available. For producers that wish to include LDPs in the current projections, please review Table 3.

**Table 3. Projected Gross Returns Including Loan Deficiency Payments Compared to Five-year Averages.**

Projections	Yellow	Full Season	Double		White	Grain
	Corn	Soybeans	Wheat	Crop Soybeans	Corn	Sorghum
Average 5-Year Yield	144.0	43.0	65.8	39.0	127.6	102.0
<b>GROSS RETURNS</b>						
Production Returns	\$331.20	\$251.55	\$227.67	\$228.15	\$344.52	\$224.40
Loan Deficiency Payments	<u>25.17</u>	<u>21.22</u>	<u>11.40</u>	<u>16.57</u>	<u>23.36</u>	<u>18.39</u>
<b>TOTAL CROP REVENUE</b>	<b>\$356.37</b>	<b>\$272.77</b>	<b>\$239.07</b>	<b>\$244.72</b>	<b>\$367.88</b>	<b>\$242.79</b>
(Per Unit)	2.47	6.34	3.63	6.27	2.88	2.38
<b>Five-year Averages</b>						
<b>GROSS RETURNS</b>						
Production Returns	\$333.20	\$244.20	\$190.80	\$222.60	\$335.40	\$216.60
Loan Deficiency Payments	<u>25.17</u>	<u>21.22</u>	<u>11.40</u>	<u>16.57</u>	<u>23.36</u>	<u>18.39</u>
<b>TOTAL CROP REVENUE</b>	<b>\$358.37</b>	<b>\$265.42</b>	<b>\$202.20</b>	<b>\$239.17</b>	<b>\$358.76</b>	<b>\$234.99</b>
(Per Unit)	2.49	6.17	3.07	6.13	2.81	2.30

A second point that should be made from the information in Table 3 is that compared with history, the projected returns to the wheat and double crop soybean activity are \$42.42 per acre larger than the 5-year history. The reason this is important is that if producers decide to sow wheat this fall, forward price contracts or some other method of establishing a price must be acted upon. The projected price used was \$3.46 per bushel in Table 2. The 5-year average selling

price is \$2.90 per bushel. The highest average price received for harvest time sales is \$3.32 per bushel during the last five years.

In addition, producers must be careful with white corn. It is recommended that white corn be grown under contract, as in more years than not, the price premium disappears by the time the crop is harvested (a 40-cent premium per bushel is assumed).

Given an understanding that wheat and double crop soybeans are a very viable consideration, especially with the 2006 price projection of wheat, cost issues must be discussed. The projections shown in Table 2 do not suggest very large profits without serious cost cutting measures. Even with some crops more closely approaching five-year average total returns, most producers have some tough work ahead of them. Let's briefly touch on some of these cost issues.

- **Soil Type:** Adjust inputs consistent with soil capability. Also, producers must consider wheat and double crop soybeans on well-drained soils.
- **Fertility:** Many producers can find a way to cut this cost. Does “starter fertilizer” pay dividends? By soil testing, discussing results with your county agricultural extension agent and even the University of Kentucky state agronomy specialists, producers may find that fertilizing by soil type can save money. In addition, pH is an important factor. A high fertilizer rate on soils with low pH is not a winner!
- **Pesticides:** This is another input that needs serious review. Timeliness is likely more important than the pesticide program itself. There is much cosmetic spraying. Discuss this with your county agricultural agent and UK state agronomist.
- **Seed:** Use variety trial information for seed selection. Save by establishing prices early for discounts. Adjust plant populations by soil types.

- **Repairs and Supplies:** It is not the time for “tinkering” or gadgets. Only purchase the necessary items. Is it justified? Think before doing! Get another party's opinion when in doubt.
- **Fuel and Oil:** Is tillage work really necessary? Yes, it can pay dividends where needed. Still, do only as required. Check for soil compaction. This is probably the only area where concern is needed.
- **Capital purchases:** Yes, some producers are financially secure enough that new purchases are affordable. However, many already have more debt payments than they will be capable of making. *Do not* use income taxes as an excuse for doing something that will be regretted or unaffordable!
- **Insurance:** Protection is important. What level is needed is the better question. For property, liability, crops, and health, reviewing policies with your agent is important. You may get an objective review from your KFBM specialist. How much can you afford to lose? Insurance coverage is not there to make money.

Producers must objectively look forward to 2006. A “team approach” is probably prudent for most. An objective team review of 2006 can help make next year a profitable one. Emotions may become a producer's biggest enemy with each decision that must be made. Producers must make a battle plan and the sooner it is made, the better!