AGRICULTURAL FINANCIAL AND TAX PLANNING
Are You Operating an Insane Ranch?

By Thomas J. Bryant, CPA and Ryan Beasley, CPA

Cattle prices continue to look weak for the remainder of the year. What are your plans for the survival of your ranch operation? Have you reviewed last year's operations and compared them to the first quarter of this year? Have changes been made to increase the efficiency of operations by increasing revenue, reducing cost and/or freeing up capital? Did you review your key production indicators (KPI's) and identify areas for improvement.

Albert Einstein said the definition of insanity is "doing the same thing over and over again and expecting different results". In a depressed market there is no margin for insanity in a ranch operation. In these trying times managers must identify opportunities and implement changes to maximize the potential for long term profits. If an analytical review of your ranch operations has not been done to identify improvement opportunities, than you are operating an "Insane Ranch" according to Albert Einstein. The balance of this article will focus on ways to restore some sanity to a ranch operation.

Gather and use Data relevant to your operation

Robert Saik, in his book <u>The Agriculture Manifesto,</u> states that **Data** "is the biggest opportunity in agriculture …because agriculture data is growing at an exponential rate." Data, combined with technology, will provide opportunities for greater profitability. A manager should be gathering data about their operations in order to establish key production indicators (KPI's) and other data points to measure the efficiency of the ranch. Make the most of your financial advisers in helping you set up and maintain a good data collection system. Your advisor should also be helpful in the analysis of the data once collected to help identify profit improvement opportunities.

Cut cost

Review the data that you currently have to identify variable cost that might have the least impact on the overall performance of the herd. Are you spending more on your bulls than they deserve? If they require extensive care, do you really want them to pass that trait to your calves? Did you over develop your heifers? New data indicates that first breeding at 55% of mature cow weight is adequate as opposed to the traditional 65% required weight. Is the size of your cows giving you a maximum return per acre? Studies are showing that a smaller cow provides a better return per acre because of a higher pregnancy rate and lower maintenance cost (feed) per pound of beef produced. Consider grazing vs. making hay and buying additional hay as needed. Do you know your true cost of producing hay? If you do produce hay, should a third party harvester be hired instead of using your equipment and labor? A small operation that owns its equipment could have cost that exceeds $200 per ton. It should be noted that the cost of purchased hay may be less than one may think when you recognize the value of the added nutrients provided to pastures. Remember that 90% of what goes in a cow is expelled at the rear. This organic matter is a net add of minerals to your pasture since it was imported. Your other input cost such as feed supplement and minerals is another area were cost savings of up to 25% can be realized. The convenience of tub supplements over the liquid form carries a significant cost that could be eliminated. Research your sources and benefits of your feed and supplements to carve out cost. Many more areas for cost improvements may be identified like: vehicle usage, overhead items, pasture maintenance and equipment cost.

Improve your herd's performance

Consider using technology in your operations such as "Artificial Insemination along with Synchronization" (AI) to improve the herd performance. Cliff Lamb, professor and associate director of animal science at University of Florida, stated that pregnancy has the greatest economic impact over any other production trait. It can be up to 4 times greater than any other. In a case study at the UF North Florida Research and Education Center, AI produced an increase of 6% in weaning rate and a 38 pound increase in weaning weight. Conclusion was that the AI cost benefit may be worth the time and effort. In addition, with the lower prices of heifers it may be a good time to improve the herd by culling the underperforming and adding prime new heifers.

Free Up Capital

There is a good saying that if an item rusts, rots or depreciates, it should be avoided where possible. Review your equipment on the ranch for any items that have not been fully utilized in the past two years. It seems all ranches have idle equipment and that is working capital that is not working. An analysis of equipment as a function of acreage is one way to review your equipment needs. A rent/lease verses owning analysis may provide an added opportunity to free-up capital. Your financial advisor should be able to help with that analysis. In addition to tying up working capital, excess equipment incurs hidden cost such as storage cost, insurance cost and property taxes.

Find other source of revenue from your ranch land

The manager should be striving for a total return per ranch acre instead of per cow. Explore other sources of income for the acreage. Consider other crops that might be used for grazing after it is harvested. Consider hunting leases, timber, sod, palm trees, special events like (agri-tourism) such as dude ranch activities corn maze, cookouts or even possible storage areas for boats or motor homes. During low cattle prices cash is king and all sources must be considered.

Oh and that tax thing of documentation for audits

In a February 27, 2017, internal memorandum, the IRS issued guidance with respect to a pilot program for auditing Schedule F expenses. Good news for now, the pilot is only being worked currently in IRS's Brookhaven, NY campus. The memorandum addressed year end large expenditures, mainly supplies, the personal use of fuel, hobby losses and the proper reporting of custom hire, leased equipment and employee wages. This is being noted because the IRS is actively looking at ranching activities. Accordingly, proper records should be kept to defend against potential IRS audits especially hobby losses. This subject of hobby loss audit defense was discussed back in our January article.

Summary

Due to the current economic conditions it is time to make sure you are not running an “Insane Ranch”. Review recent operations and make changes that will provide an opportunity to maximize your profit potential in the future. Do not continue to do the same thing and expect different results. Data and technology in agriculture are growing exponentially. Focus on collecting data relevant to your operations and review the available new technologies in order to survive. Your financial advisor should be able to help with the collection and analysis of the data. As always, prepare proper documentation to defend against an IRS assertion of your operation being a hobby.

For more information on this topic and other tax planning for agricultural operations, please contact me at my cell (863) 640-2008 or Tom@beasleybryantcpa.com and/or Ryan Beasley at (863) 646-1373 or Ryan@beasleybryantcpa.com . Please visit our website at www.beasleybryantcpa.com for information on other relevant topics.
We at Beasley, Bryant & Company, CPA's, P. A. are experienced in agricultural business problems, tax issues or concerns, and are here to help you.
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