

Beef talk 758: Is Return on Assets Large Enough to Expand the Cow Business?

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Some events in one's life become stories because they have an impact on the future. These stories are used to teach and add wisdom to current conversations. Sometimes the discussion may stray, but if the facts are true, the story continues to add wisdom.

As I was starting my Extension career, a fellow Extension specialist from Iowa State University was sharing some thoughts on various programs. One was the expansion of the Iowa swine industry. Doing what all Extension specialists do, there was a desire to develop a program that would encourage people to invest in the swine industry.

Actually, all through the Midwest, there were various programs to grow the swine industry and animal agriculture in general. The point of the presentations, as developed by Extension specialists, was the tremendous production opportunities to produce pork. Pounds of pork per swine unit were on the rise. The costs were manageable and the income was positive.

Obviously, full bore ahead was the mandate. The presentations went well because the producers were interested in the details for improving swine production. Production technology was certainly fine-tuned, if not even a bit futuristic.

Because these presentations were very popular, a potential investor from Chicago expressed an interest in investing in the swine industry. After all, with all this excitement and reasonably educated specialists fully engaged, the investment opportunity seemed very probable.

Administration certainly was excited and did what seems natural: invite the potential investor to a swine seminar. As the meeting drew near, the discussion was good, the planning extensive and the coffee black.

As the meeting started, the production opportunities were well laid out and seemed to be going well. All of sudden, the investor stopped the meeting and asked: What would be my return on the assets I invest? The room fell quiet until someone ventured a response: Maybe a return of 2 percent. The investor thanked them for their time and hospitality and left, so the meeting was adjourned.

The moral of the story is, if the rate of return is inadequate for the one investing the assets into a business endeavor, there is no business. Granted, the production seminars continued and the swine industry still exists. However, let's repeat the moral of the story: If the rate of return is inadequate for the one investing the assets into a business endeavor, there is no business.

The story easily could be told utilizing the current beef industry. The industry is excited because the pounds of beef per producing cow unit are great, the costs are manageable and the income is positive.

Those thoughts come from databases that mean well. However, is the cattle industry ready to expand? Most of the excitement centers on increased gross margins that are outpacing expenses. Cattle prices are high and producers like the feeling.

However, there still is the complicated question of the day: Will the cow business expand? Of course, is the obvious answer from many, but the answer is not that simple.

A visit with James McGrann, professor and Extension specialist emeritus at Texas A&M University, reminded me of the full equation. The bottom line is that the investment in the beef industry must meet the investor's targeted

return on total assets (ROA), including land and improvements. If the industry cannot offer an adequate ROA, the industry will not grow.

Jim and I first met when the National Cattlemen's Beef Association was developing a process called Standardized Performance Analysis (SPA). The process was completed and is available today at <http://www.beefusa.org/spacalculationsworksheet.aspx>.

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The real answer to the question rests with the ability to complete the SPA process. Unfortunately, production seminars are more popular and the challenge to do a full financial analysis of a beef operation is time-consuming.

However, let me paraphrase Jim to seek the answer, as individual producers must understand their "cow-calf operating and total unit cost and return on ROA, including land and improvements. It's valuable to review the economics of expanding the cow herd if added debt is required for land purchases and breeding cattle investments. Even at historical highs, calf prices in the cow-calf sector are characterized as a large investment with a low ROA."

Will the cow-calf industry expand? Will calf prices be high enough to achieve a target ROA? As Jim says, "Make your numbers do the talking." However, keep the ear tags.

May you find all your ear tags.

Your comments are always welcome at <http://www.BeefTalk.com>.

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