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Costs of production

Steve Malakowsky, Financial Services Executive
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At AgStar we have the opportunity to review the cost of production from operations and systems ranging in size from 1000 to 100,000 or more sows. We have a relationship with approximately 60% or the largest 40 producers listed in *Successful Farming*. These operations are farrow-to-finish, farrow-to-wean, and wean-to-finish units. They are independently owned, owned by investors, and owned by shareholders who purchase weaned pigs from isowean units.

Benchmarking production costs

As you can tell by the diverse group of individuals and companies we work with, we also see various reporting methods. Very few of these operations have the same reporting and allocation of costs at the various stages of growth in their operations. This has made benchmarking the cost of production extremely difficult. However, with the vast amount of information we do receive, we are able to put together benchmark costs for farrowing, nursery, and finish operations. The benchmarking categories we have used cover the majority of the cost within most producers' operations. **Tables 1-4** show typical cost structures we see for the abovementioned operations.

Not all producers have the lowest wean pig, nursery, and finisher costs. The driver for higher breakevens for 2004 has been feed costs. With higher feed costs during the first three quarters of 2004, average production costs have been \$123 per head or \$47 per cwt. This compares to a \$106 per head cost for 2003. Some of the obstacles to

Table 1: Typical cost of production for farrowing operations.

Item	Average	Range
Feed	\$9.00	\$8.00-11.00
Breeding	\$2.00	\$1.75-3.00
Vet med	\$2.00	\$1.50-3.00
Ins, supp, util	\$3.00	\$2.50-5.00
Labor	\$6.50	\$5.25-9.00
Repairs, taxes	\$1.50	\$1.00-2.50
Replacement	\$1.50	\$2.50-5.00
P&I	\$6.50	\$5.50-8.50
Management	\$1.00	\$1.00-2.25
Total	\$33.00	\$29.00-48.75

getting to lower breakevens are PRRS and other diseases, environmental concerns, labor, inflation (costs continue to rise), and not everything always goes as planned. As we learned during this year, it is imperative that producers know their breakeven costs so they can implement a marketing strategy that provides adequate margins by protecting against higher input costs.

Benchmarking pitfalls

When benchmarking costs, the most important factor to keep in mind is the production performance of an operation. For example, a 3000 sow isowean unit that produces

Table 2: Typical cost of production for nursery operations (10-50 lb).

Item	Average	Range
Contract fee	\$5.00	\$4.50-7.00
Death loss	\$1.00	\$0.50-1.75
Feed cost ^A	\$9.20	\$8.00-10.00
Vet med	\$0.75	\$0.50-2.00
Trucking	\$1.00	\$0.75-1.50
Total	\$17.95	\$14.25-22.25

ACorn at \$2.80; meal at \$300/ton.

Table 3: Typical cost of production for finish operations (50-260 lb).

Item	Average	Range
Contract finish	\$13.33	\$12.75-15.00
Feed ^A	\$48.30	\$44.00-????
Vet med	\$2.00	\$1.50-5.00
Death loss	\$1.40	\$1.25-3.00
Trucking	\$2.00	\$1.50-5.00
Interest	\$1.75	\$1.50-2.50
Gen admin	\$3.00	\$2.50-5.00
Total	\$71.78	\$65.00-80.00

ACorn \$2.80; meal at \$300/ton

Table 4: Summary of the cost ranges we see on a per head basis to 260 lb.

	2003	2004
Farrowing	\$27.00-46.75	\$29.00-48.75
Nursery	\$11.75-20.25	\$14.25-22.25
Finishing	\$53.50-75.40	\$65.00-80.00

22.33 pigs weaned per sow with a \$31 cost per pig could be considered competitive. If production falls by approximately 10% or to 20 P/S/Y, the breakeven of the operations would increase to \$34.62 with all costs remaining unchanged. This typically does not hold true when reduced production is the result of health problems; in such cases you will most likely see increased veterinary and medical costs for the operation.

This will also apply to nursery/finish operations when death loss is excessive. Typically, decreased performance will have a detrimental impact on the cost of production through lower throughput and increased costs of an operation. This is the primary reason why producers should know all costs of their operation, with detailed enterprise analysis completed on the farrowing, nursery, and finish aspects of their operation. To continue to be competitive in the future, producers will need to know these costs so they know where they are proficient and where they need improvement.

Another common mistake of benchmarking made by producers is not accounting for all costs of operations. When producers complete their cost analysis on their operation, they need to include any family living or other draws from the company, replacement of fixed assets to keep the operation in good condition, interest costs, and any other overhead not accounted for.

Informed decision making

By doing enterprise analysis on their operations, producers will know exactly what their cost of production is and where they need to improve. This also gives the producer the information necessary to make informed decisions on their operation and allows them to benchmark the operations against other producers. To be cost competitive in the future, producers should strive for the following:

- Have good liquidity positions. (Cash is king.)
- Target \$300 per sow working capital with owing fixed assets.
- Have above-average management teams.
- Maximize throughputs.
- Utilize and have in place adequate risk-mitigation methods.
- Strive to decrease leverage.
- Have very controlled growth plans (preferably through acquisition, not new sows).
- Have a systems approach.

Producers today have all types of agreements with packers that allow them shackle space, matrix or widow contracts, or other forms of contracts. In order to negotiate

contracts in the future, it will be vital for producers to know their cost of production. Adding to uncertainty are future environmental concerns, the political environment, activist groups, and other external factors. It is imperative that producers start benchmarking so they know where they stand within the industry.

