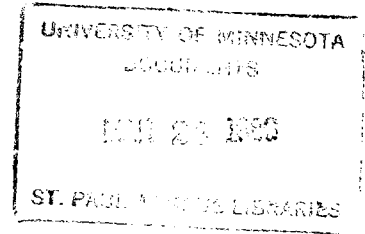


The Dairy Herd Buyout Program: How Much To Bid?
FINLRB (FINANCIAL LONG RANGE BUDGETING) APPROACH



Prepared by

Extension Economists: E. I. Fuller and P. R. Hasbargen
 Extension Animal Scientists: J. B. Conlin and R. D. Appleman
 Minnesota Extension Service, University of Minnesota, St. Paul

Features Of The Buyout Program

The dairy section of the 1985 farm bill contains a whole herd buyout provision--the milk production termination program (MPTP). The following features pertain to the bid process and MPTP operating rules.

1. Bids must be submitted to local ASCS offices during the period February 10 - March 7, 1986. Bids can be made on one, two or all three of the following herd liquidation periods: April 1 - August 31, 1986; September 1, 1986 - February 28, 1987; March 1, 1987 - August 31, 1987. Dairy stock, including heifer calves, must be certified as sold for slaughter during the specified period(s).
2. Payments can't start until all animals are disposed of. Total payments will be determined by multiplying the bid times the hundredweight of milk sold during the base period. (Base production will be the lower of July 1984 - June 1985 or calendar year 1985 sales.) Two general payment options are: Up to 80 percent in the year of liquidation (after last animals are off the farm) with equal payments in each of the following four years; no payments at liquidation, up to 85 percent a year after liquidation and equal payments in the remaining three years.

Directions For Completing The Pre-FINLRB Worksheet

Determining what is the minimum bid to insure not being any worse off under buyout conditions than by continuing to produce milk is a complex decision that can't be captured very well in a simple worksheet. Two companion publications (FM-524 and FM-525) contain the authors' attempt to capture the most important variables in partial budget formats, but some considerations--like income taxes--cannot be handled very precisely unless a total farm and family budget is used. This publication (FM 526) is for use when (a) a producer can spend the time needed to get a more refined answer (including the tax effects) and/or (b) has already done a FINLRB projection of his/her farm financial future, and would like to compare the buyout alternative to the previously selected dairy plan. Both approaches presume continued milking unless a buyout bid is accepted.

This archival publication may not reflect current scientific knowledge or recommendations.
Current information available from University of Minnesota Extension: <http://www.extension.umn.edu>.

Three steps are involved in taking the FINLRB approach:

1. Estimate the annual change (loss) in net worth due to buyout participation. This step also includes calculating the amount of after tax cash available for debt reduction or re-investment.
2. Set up or modify an existing FINLRB - FINPACK file. This step could also include doing and analyzing a new FINLRB projection of other alternatives.
3. Translate the results into the bid price which, for a given bid base milk amount, will make a producer no worse off by participating than by continuing to milk for the five years or longer, or shorter, planning span of concern.

Step 1. Complete the appropriate lines in the form below:

- A. From your FINPACK Financial Statement (lines above no. 65)
The asset value of dairy stock on inventory (A) \$ _____
- B. Net sale value of capital gains eligible dairy stock (over 2 yrs.)
\$ _____ multiply by 1.2 (a pre-tax factor) = \$ _____
Minus any remaining tax basis on purchased stock \$ _____
Equals the equivalent ordinary income tax value = \$ _____
Now add the net sale value of all youngstock \$ _____
Total the above two lines to get a pre-tax value = \$ _____
Multiply by (1 - marginal tax rate) of 0.____ = after tax dollars
(Taxes will be hard to avoid in the year of sale) = (B) \$ _____
- C. Financial Statement value of other (dairy related) machinery
and equipment to also be sold if buyout bid is accepted (C) \$ _____
- D. Net after tax sale value of machinery and equipment, if
sold now (D) \$ _____
- E. Market value of real estate if sold as a dairy farm
without buyout limits and conditions (E) \$ _____
- F. Value of real estate given buyout limits and
conditions (F) \$ _____
- G. Loss in farm real estate value (E-F=G) \$ _____
- H. Freed-up cash for debt payment or re-investment (B+D=H) \$ _____
- I. Loss in intermediate asset value due to sale now (A+C-H=I) \$ _____

FINLRB data line 351 (and 354 where appropriate) requires items H, I and G to complete the first three items of data.

Step 2. Set up and run the FINLRB projection.

- A. If a file already exists containing the proper financial statement and data banks, that process may be by-passed.
- B. Complete those lines on a FINLRB form that will need to be changed.
 - 1. Define alternative #1 as the projection of dairy operations as best defined, given the previous FINLRB projection.
 - 2. Define alternative #2 as operations without the dairy enterprise (given buyout conditions). Eliminate silage production, for instance.
 - 3. Alternative #3 can be used to examine other business opportunities.
 - 4. Use line 351, and if appropriate 354, to reflect the use of the cash freed up by liquidation of the herd. (see last page)
 - 5. Adjust the debt schedule section accordingly.
 - 6. Examine the data in the "Related Operating Expense" section carefully. Consider your planning horizon--whether it is three, five or more years. What overhead expenses could be cut - if any?
 - 7. Could "depreciation" and "annual replacement" be reduced? If a part or full time off farm job could be found, you can include it as "Non-farm income - taxable". That would reduce the required minimum bid if you use a change in net worth criteria.
 - 8. Technical note to speed data entry: If a data file already exists on disk, copy it as a new file with a different name and then modify the new file as required provided you want to retain the original data.
 - a. From the A> with the data disk in the B: drive type:
COPY B:oldname.DAT newname.DAT
 - b. Then use the newname file in FINLRB
 - c. (Data file name = oldname.) Be sure to change line 4 to indicate that this is a buyout projection.

**Step 3. Summarizing the results.**

A. Loss in farm property value (copy item G from Step 1) (A) \$ _____
 B. Loss in farm property value (copy item I from Step 1) (B) \$ _____

C. Total (A+B=C) \$ _____

D. Copy the difference in projected "net worth change per year" from the solvency projection section

Alternative #1 (with sign) \$ _____

Alternative #2 (with sign) \$ _____

Take the algebraic difference (-) (D) \$ _____

E. Multiply Line D by the appropriate discount multiplier factor for (5?) _____ years X _____ factor (see table on page 2 under line N in FM 524) Result (E) \$ _____

F. Add (C+E=F) \$ _____

G. Divide by cwt. of base milk _____ cwt.
 Result = unadjusted minimum bid = (G) \$ _____

H. Adjust by factor for payment options (from table 6 on page 2 Line H of FM-524) (Gxfactor=H) \$ _____

I. Minimum bid price (GxH=I) \$ _____

The bid adjusted for desired payment option that is shown in Line I, will result in maintaining an equivalent net worth in or out of the program.

Note that this approach compares the projected rate of change in net worth. You may also want to do a similar comparison of net cash flow (liquidity) or net farm profit (profitability).

While as of February 7, 1986 Gramm-Rudman appears to be unconstitutional, a buyout contract should be examined for a clause allowing a reduction in the amount paid under budget reduction-like circumstances. If such a clause is found it would be prudent to increase the (minimum necessary) bid accordingly unless other announcements indicate that milk price supports will also be reduced under the law--that might cause even sharper drops in future dairy earnings than in the buyout program payments.