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ASSET MANAGEMENT: ALTERNATIVES TO EQUIPMENT OWNERSHIP

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Abstract

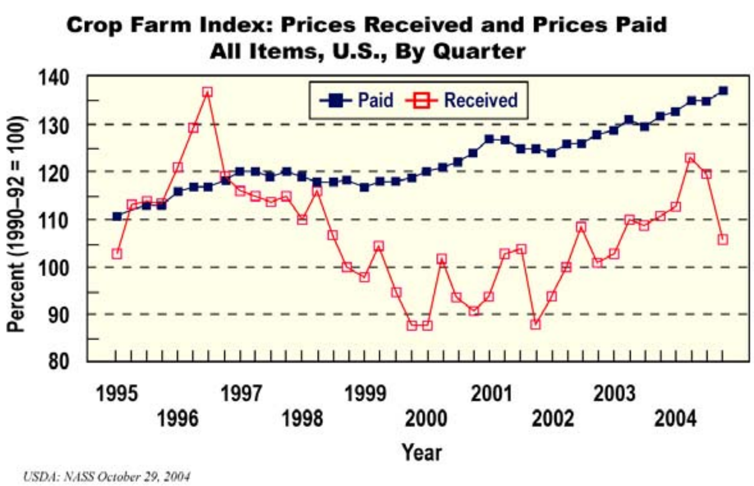
With current economic pressure on cotton and grain producers to maintain or improve operational profitability and productivity, more farm managers and producers are looking at ways to reduce production costs. This includes evaluating their unique financial situations and operations for opportunities to move traditional farm expenses off the balance sheet, resulting in reduced production costs, manpower savings and other benefits.

One often overlooked but very important part of the balance sheet is the utilization and real costs of owning farm equipment, especially seasonal equipment such as cotton harvesters and combines. The costs associated with owning, maintaining, servicing, repairing, storing and insuring equipment, as well as the time and labor involved, all factor into the cost of equipment ownership.

For profitable producers, managing equipment assets is as important part of maximizing return on equity and return on assets while reducing financial risks of the operation. Today, there are several alternatives to owning equipment, such as the Innovation™ Leasing Program from MachineryLink, Inc., that reduce per acre costs of production, increase productivity and efficiency, and result in increased profitability for the cotton and grain producer.

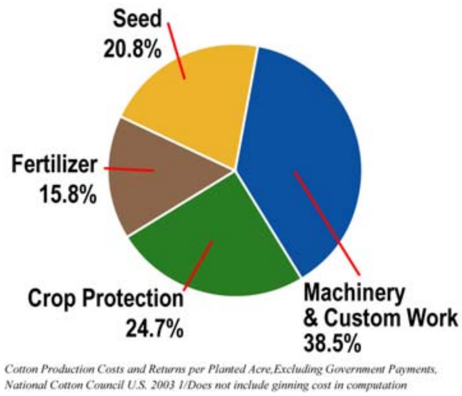
Economic Trends Drive Asset Management

In the last 10 years, according to the United States Department of Agriculture, indexed production costs for all farm commodities have continued to trend significantly upward while prices received for these same farm commodities have remained flat to declining.

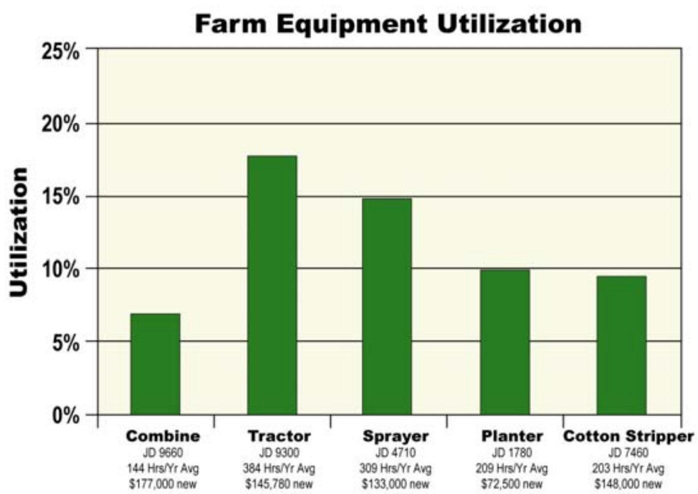


One of the largest annual expenses for cotton and grain producers, excluding land costs, is the cost of machinery and custom fieldwork expenses. According to the National Cotton Council 2003 data, machinery and custom work accounted for nearly 39 percent of annual cotton production costs, significantly more than crop protection costs (25 percent) and seed costs (21 percent).

Annual Cotton Production Costs



Coupled with the high costs for seasonal farm equipment is the low utilization level of this machinery. While even tractors and sprayers have relatively high utilization compared to cotton strippers and combines, overall farm equipment utilization is low considering its cost, number of hours used and the amount of capital tied up in iron, as well as related costs for maintenance, repairs, storage, insurance and depreciation. The level of equipment utilization is a critical factor in the management of these assets and in subsequent decisions on the replacement of existing equipment with new or used equipment or the addition of new or used equipment to the fleet.



Alternatives to Equipment Ownership

There are a number of alternatives to ownership of seasonal equipment available to producers that can significantly impact their overall cost of production, profitability and productivity / operational efficiency. These alternatives include the use of custom fieldwork and harvesting services, short-term rental, leasing and equipment sharing programs, to name a few. Each program comes with its own benefits and disadvantages and may be a more profitable option, depending on each producer's operation size, financial situation and equipment needs.

In addition to the aforementioned economic considerations, these options impact the amount of capital required, balance sheet health, machinery availability and timing needs, access to current or more efficient technologies, operation efficiency and labor, as well as overall personal comfort level and "hassle factor" involved with the alternatives.

One option to equipment ownership that has met with success by grain producers across the country since 2001 and that is being introduced in the stripper cotton market involves leasing equipment for just the time needed.

MachineryLink, Inc., of Kansas City, Mo., offers an equipment leasing option under its Innovation™ Equipment Program that make cotton strippers, as well as combines and tractors, available for producers to use during scheduled time periods at low hourly use rates. Depending on the size and financial considerations of the operation, this type of program provides a number of advantages, including:

- Fixed and predictable hourly cost with no capital outlay
- Straight tax write-off as business expense
- No ownership or reselling risks
- Elimination of maintenance and repair costs
- No storage costs
- Crop loss and equipment breakdown protection

In addition, these types of programs often provide other non-economic benefits that may be equally or more important to producers. These include:

- Access to newer, larger technology and equipment features
- Guaranteed, flexible scheduled delivery and use period
- Fractional use by farmers throughout the country and supported by transportation / logistics and service network

Cotton Producer Examples

Following are economic scenarios for purchasing versus renting a John Deere 7460 cotton stripper based on a hypothetical Texas producer with 1,500 acres of cotton yielding 1,100 lbs./acre and doing 750 acres of custom harvesting work. He owns one stripper and has one rented stripper. Below are the cost considerations for purchasing a second stripper or renting a second stripper:

New Machine Purchase Option		
Purchase Price of New Machine (JD 7460)		$155,000.00
Interest Rate		7.00%
Number of Years Financed		6.00
Annual Payment		$32,518.35
Depreciation		$19,633.33
Insurance		$1,000.00
Storage		$500.00
Preventative Maintenance ($4.00/Sep Hr)		$600.00
Repairs ($6.00/sep hr)		$900.00
Winter Maintenance		$2,000.00
Total Estimated Cost Per Year		$37,518.35
Cost Per Acre (**750** Acres)		$50.02
Cost Per Pound (1,100 Lb / Acre)		$ 0.045

Estimated cost for renting a John Deere 7460:

Machine Rental Option		
Purchase Price of New Machine (JD 7460)		$0
Interest Rate		0%
Number of Years Financed		0
Annual Rental Payment (150 Hr Contract)		$12,750
Depreciation		$0
Insurance		$150
Storage		$0
Preventative Maintenance ($4.00/Sep Hr)		$0
Repairs ($6.00/sep hr)		$0
Winter Maintenance		$0
Total Estimated Cost Per Year		$12,900
Approx. Cost Per Acre (**750** Acres)		$17.20
Approx. Cost Per Pound (1,100 Lb / Acre)		$ 0.016
Approx. Savings with Rental Machine (Per Year)		$24,618.35
Approx. Savings with Rental Machine (Per Acre)		$32.82

(The costs used in the charts are estimates used to illustrate the economic scenarios only; actual costs may vary.)

Conclusion

Depending on a producer's situation, renting a stripper provides significant cost savings and improvement in profitability for the operation. In addition, producers may have access to newer or larger harvesting equipment than they could otherwise afford, in addition to other time-savings, labor-savings and fuel-savings benefits.

Alternatives to equipment ownership may provide for more cost-effective management of machinery, improve return on equity and return on assets and the overall health of the balance sheet while reducing financial risks and hassles associated with ownership of under-utilized seasonal equipment.