

## *RANCHING FOR PROFIT*

### **THE LAND BUSINESS v. THE LIVESTOCK BUSINESS**

A few months ago a Kansas rancher told me he was thinking about buying a section of land adjacent to his ranch. The price was \$300/acre. He figured the carrying capacity was about 10 acres/cow. He asked me if I thought he should buy it.

“That all depends.” I said. Are you in the land business, or the livestock business?” There’s an important distinction.

Some people own vast tracts of “ranch” land but run no livestock themselves. You could say they are in the land business, but not in the livestock business. Some ranchers run hundreds or thousands of cattle on leased ground, but own virtually no land. They are in the livestock business, but not in the land business. Those who own livestock and the land on which they graze are in both the livestock and the land business.

We don’t usually think of our businesses this way, but if this last category describes your situation, you would be well served to think of your operation as the “xxx land & livestock Co.”

#### ***Asset Rich & Cash Poor***

The majority of ranchers earn a very low rate of return on their equity. At the *Ranching for Profit School* and in our *Executive Link* program we challenge our clients to achieve a 10% return or higher on their equity (ROE). There are two ways to achieve a greater return. The approach most have taken is to try to increase the return. We have succeeded. Our cows are more productive than ever, weaning more and bigger calves all the time. However, the increase in production and income has been outpaced by increases in costs. As a result, increasing production has actually decreased profit.

The other, and most often overlooked way of increasing the return on your investment, is to reduce the amount you have invested.

The bulk of most ranchers’ money is tied up in the land they own. Ranch land produces lots of values. The wind that blows over it, the water that flows through it, the wildlife that live on it, and the minerals underneath it all have value. Yet the majority of land-owning ranchers harvest only one of the values the land produces: the grass.

A highly successful client recently asked me if he thought the name “Ranching for Profit” was misleading. He said, he’d learned to make a 10% return on his investment on livestock (after paying rent). But when he added the value of his investment in land, the total return dropped to about 4% (that’s still about 400%

better than the industry average). The answer lies in either developing other revenue streams from the other values the land produces, or reducing the amount invested in the property (e.g. selling the development rights, mineral rights, selling the ranch and leasing it back, etc.).

### ***How Much Is The Grass Worth?***

A long time ago, Stan Parsons told me that the rule of thumb he uses is that grass is worth the value of the animal that it supports. For example, it would take about 10 acres of that land in Kansas to support a cow. If that cow is worth \$800, then the productive value of the land for grazing would be about \$80/acre for grazing (\$800 cow/10 acres = \$80/acre purchase price).

When I worked this out with that Kansas grazier, he shook his head and grumbled that the land was over-priced. I disagreed. If someone will pay \$300/acre, then by definition, that is what the land is worth...to that buyer. The other \$220 of value must come from values other than the ability to support a cow. If he's willing to build his business to capture some of those values, it might make a lot of sense to buy that land. If he's not willing to harvest the other values, buying the land is probably not a good business decision (although it might be a good lifestyle choice).

Of course there may be reasons other than the immediate economic return for buying this land. Perhaps it helps consolidate his holdings, allows him to simplify his operation or provides security, protecting the rest of his property. These are all good reasons to consider the purchase, but lets not kid ourselves. He can't expect the cows to buy that section if he's really Ranching for Profit.

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