December 13, 2013

MANAGING IN UNCERTAIN ECONOMIC TIMES

I attended a Farmers and Ranchers College seminar at Bruning to listen to David Kohl, Ag Economics professor at Virginia Tech this past Monday. He shared some optimism but also some challenges ahead in the agricultural sector. There was also an economic update session in Omaha that Paul Hay attended. He listened to speakers from the Agricultural Economic Departments at the University of Nebraska-Lincoln and Iowa State University, combined with some private industry and Federal Reserve Bank System speakers. As always, nobody can predict the future with certainty, but there are still general trends which we should be aware of. How to structure a farm business to be flexible enough to survive when times get tougher was a parallel of the speakers Paul and I heard.

Paul listened to presentations by Michael Boehlje, Purdue University and Nathan Kauffman, Omaha Branch of Federal Reserve Bank of Kansas City. They talked about the vulnerability of current prosperity in agriculture. Data indicates production agriculture is vulnerable in the future to weak cash or working capital.

David Kohl said the same thing at the Bruning meeting. Kohl said the top one-third managers need to be positioned such that there is enough cash or total working capital to get through. Working capital examples are cash, prepaid expenses, accounts receivable and inventory. The more diversified the better to react to the unexpected.

The Omaha speakers pointed to some danger with the strong numbers in the USDA and Federal Reserve data, that most certainly include some operations carrying enough non-reported debt to equipment companies and suppliers which would be in immediate trouble in the future. The structure of debt load is a risk if terms of debt are not managed; again running out of cash is a common production ag issue.

Kohl said that top producers need a lender that is really good in asking the tough questions that need to be worked through with the farm's plan. So often the lender never has a true picture of the farm debt from seed company loans, machinery loans and off-farm expenses. How can one counsel or calculate working capital, without the total picture or ask the tough questions?

If you believe we now have land prices above or near earning potentials, it does increase risk factors if land prices would adjust. Having tighter margins and couple that with uncertain interest rates, top managers will buckle down and keep more working capital. Kohl said these operations will have working capital at 53% or slightly above.

Paul Hay summarized some excellent management suggestions tips for success: Make wise purchases of crop insurance coverage, this helps protect cash position and also protects a marketing plan which can safely lock in margins on 30-40% of future crops if available. Make sure debt is structured in a manageable way for your situation. Don't hide debt structure from your accountant, lender, partners, or yourself. Paying down some debt may help in aligning debt structure. Don't be afraid of holding cash reserves. There is always lag time in adjusting land rent,

input purchases, and family expenses to narrower margins. We need to seek out opportunities for investments in operational performance, but these need to be conservative. The bottom line of profit for every business is the production of a bushel of corn or a pound of pork. We need to produce as many as we can for the land, equipment, labor and input cost we invest. Looking for opportunities to increase productivity should not go out of style in any economic climate. Neither should the close evaluation of the investment cost and downside risk of those opportunities.

We have experienced what experts claim was a 10-year supercycle in agriculture, this has never happened before in our storied history. And finally a quote from Warren Buffett, "If the tide goes out, one discovers right away, who's been swimming naked."

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