

STRAIGHT TALK, STRAIGHT ACTIONS: MANAGING YOUR FARM THROUGH A CHANGING ECONOMY

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Macro Clinic Video Blog: <http://agstar.com/edge/>

Road Warrior of Agriculture: www.cornandsoybeandigest.com

Ag Globe Trotter: www.northwestfcs.com

Dave's GPS & Dashboard Indicators: www.farmermac.com

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Ten Compelling Reasons to Be Optimistic in Agriculture 1

- 50/70/70 Rule
- 1995-2013- Top 20% livestock/crop producers had 10% returns
- one size does not fit all
- young people, women, and minorities are the “new energy”
- innovation and technology
 - bio, engineering & information



Ten Compelling Reasons to Be Optimistic in Agriculture 2

- talent wars in agriculture and rural America
- 1 in 6 jobs in U.S. are directly or indirectly connected to agriculture
- retail, entrepreneurial segments
- emerging nations, BRICS & KIMT, think globally but act locally
- raising a family- value systems/living expenses



Commodity Super Cycle Burnout

- slowing of emerging nations' economies
- ethanol & biofuel mandate softening
- central bank stimulus
- inefficient infrastructure in emerging nations
- weather – northern southern hemisphere



Grain Industry- “Margin Flipping”

- easy money has been made
- top flight managers still earn profit
- high overhead/fixed cost structure
- game of chicken with land rents
- duration of cycle
- four strategic factors



Managing Thru the Cycles

| <u>Cycle Duration</u> | <u>Credit Issues</u> |
|---------------------------------|---|
| One Year Cycle | Repayment Ability |
| Two to Three Year Cycle | Repayment Ability/Liquidity |
| Three to Five Year Cycle | Repayment Ability/Liquidity/Equity |

Livestock Industry “Margin Flipping”

- strategic resource changes over past decade
- 50 to 65 year olds will not return
- price, early cycle margins
- cost, late cycle margins
- young people migration
- mistakes made in the best of times
- duration of the cycle



Global Economy Update

| <u>Country</u> | <u>Code</u> |
|----------------|-------------|
| Europe | Red |
| China | Yellow |
| Russia | Red |
| Japan | Red |
| Middle East | Red |
| Argentina | Red |
| Brazil | Red |
| Portugal | Red |
| U.S. | Green |

Risk Ranking

- Geopolitical
- Trade tensions
- Natural resource
- Economic reform

Global Economics: Europe

- Germany & France
- Southern Europe
- central bank stimulus
- China – largest customer
- code red
- Ukraine – wild card



Global Economics: China

- bifurcated economy
- natural resource issues
 - water, land, air
- trade negotiations
- China exceeds U.S. in purchasing power parity
- shadow banking – wild card



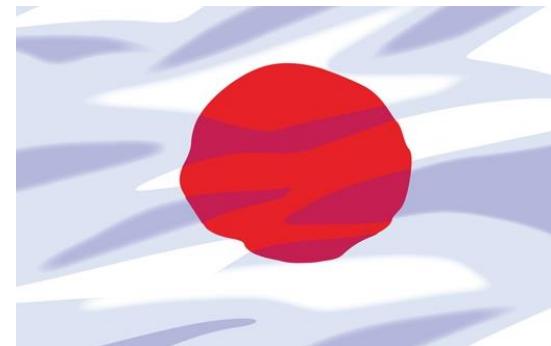
Global Economics: Other

- Russia
 - oil
 - Mr. Putin
- Brazil
 - slow economic growth
 - socialist agenda
- Argentina
 - leadership issues
 - agricultural infrastructure



Global Economics: Japan

- third largest economy in the world
- demographic issues
- debt issues
- central bank stimulus
- deflation



U.S. & Global Economy on Steroids

| Indicator | Status |
|-------------------------------------|--|
| Wealth Effect | <ul style="list-style-type: none">• Stock market• Real estate |
| Dow Jones Average | <ul style="list-style-type: none">• 2009- 6400• 2014- 17,823 |
| Japan's Stock Market | <ul style="list-style-type: none">• 2009- 8500• 2014- 17,450 |
| Real Estate: | <ul style="list-style-type: none">• Florida, Georgia, Arizona, Nevada, & Rural America |
| One Dollar Increase In Stock Market | <ul style="list-style-type: none">• Spend \$0.04 more |
| One Dollar Increase In Real Estate | <ul style="list-style-type: none">• Spend \$0.09 more |

Federal Reserve's Interest Rate Barometer

| Indicator | Possible Change | Definite Change | Current Status |
|--------------------|-----------------|-----------------|----------------|
| Unemployment | 7.0% | 6.5% | 5.6% |
| GDP Growth | 2.0% | 2.5% | 5.0% |
| Core Inflation | 2.0% | 2.5% | 1.7% |
| Headline Inflation | 4.0% | 5.0% | 1.3% |

Watch List:

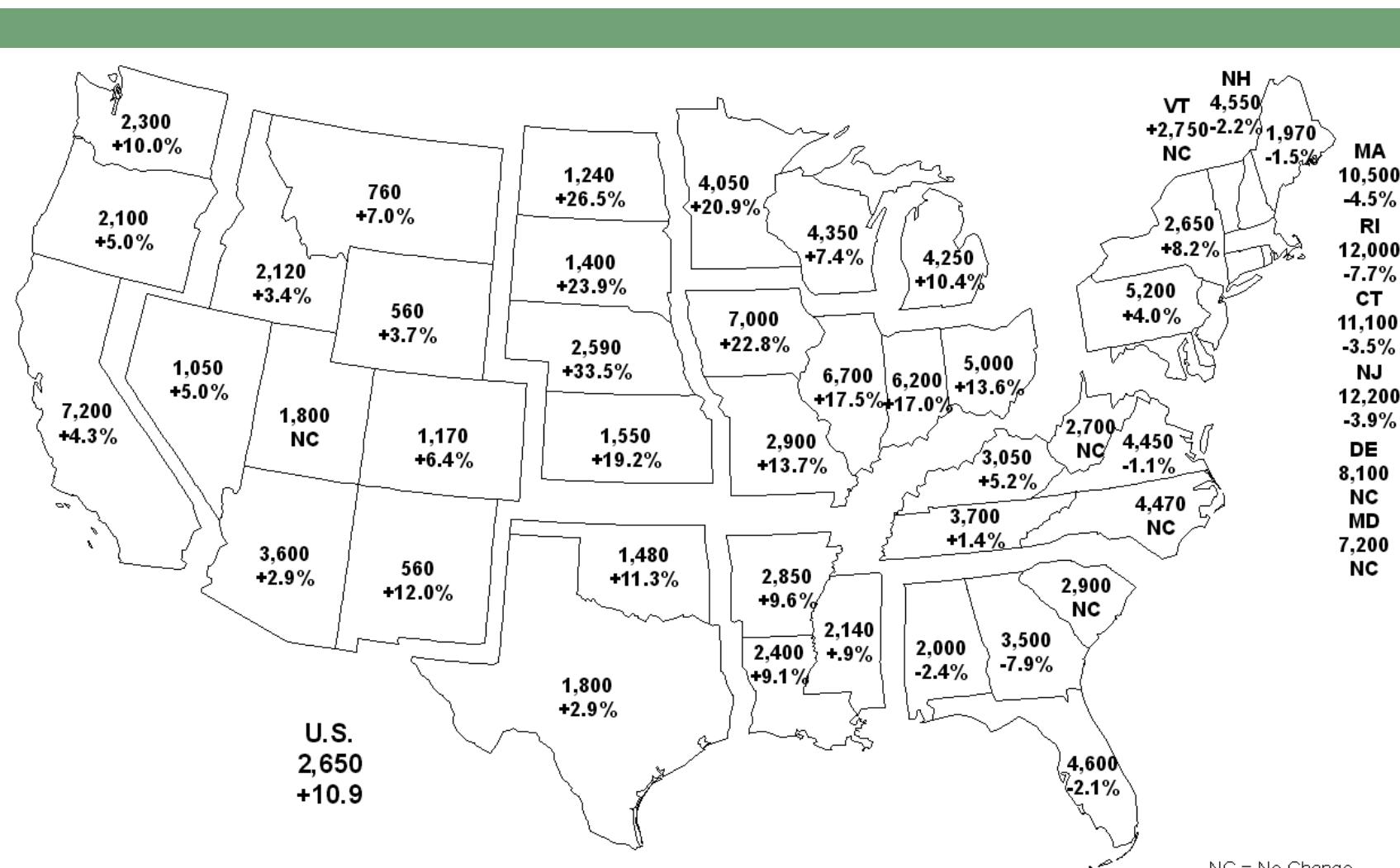
- Dr. Yellen
- FOMC voting
- FOMC minutes
- Rail traffic
- Shoe shiners
- Copper prices
- Overland trucking
- Baltic Sea index

U.S. Economy Update

| <u>Indicator</u> | <u>Code</u> |
|--|-------------|
| Employment <ul style="list-style-type: none">• Numbers• Wages• Participation | Yellow/Red |
| Factory Utilization | Green |
| Housing | Yellow |
| Oil/Interest Rates | Yellow |
| LEI & PMI | Green |

2012 Farm Real Estate Value By State

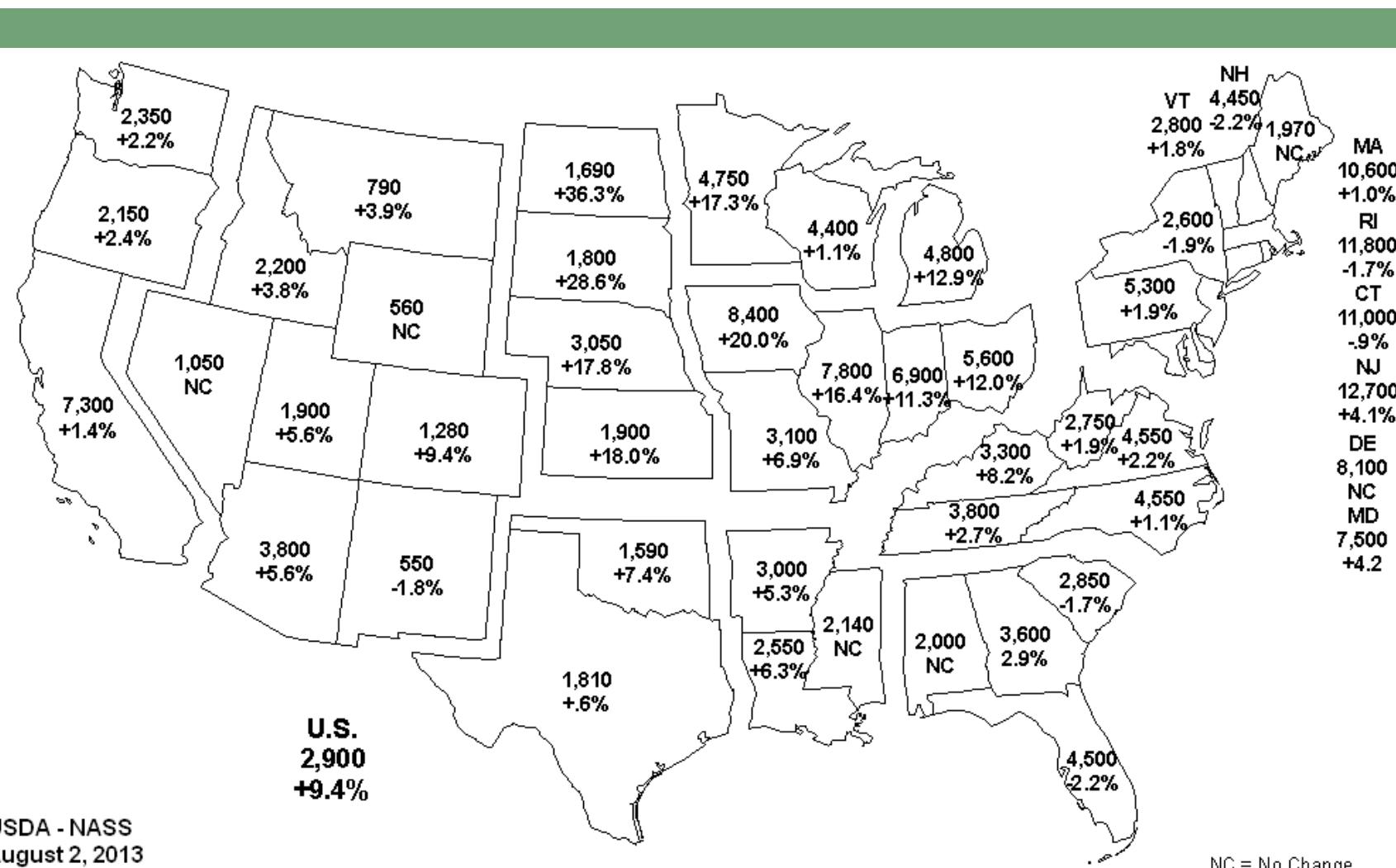
Dollars per Acre and Percent Change from 2011



NC = No Change

2013 Farm Real Estate Value By State

Dollars per Acre and Percent Change from 2012

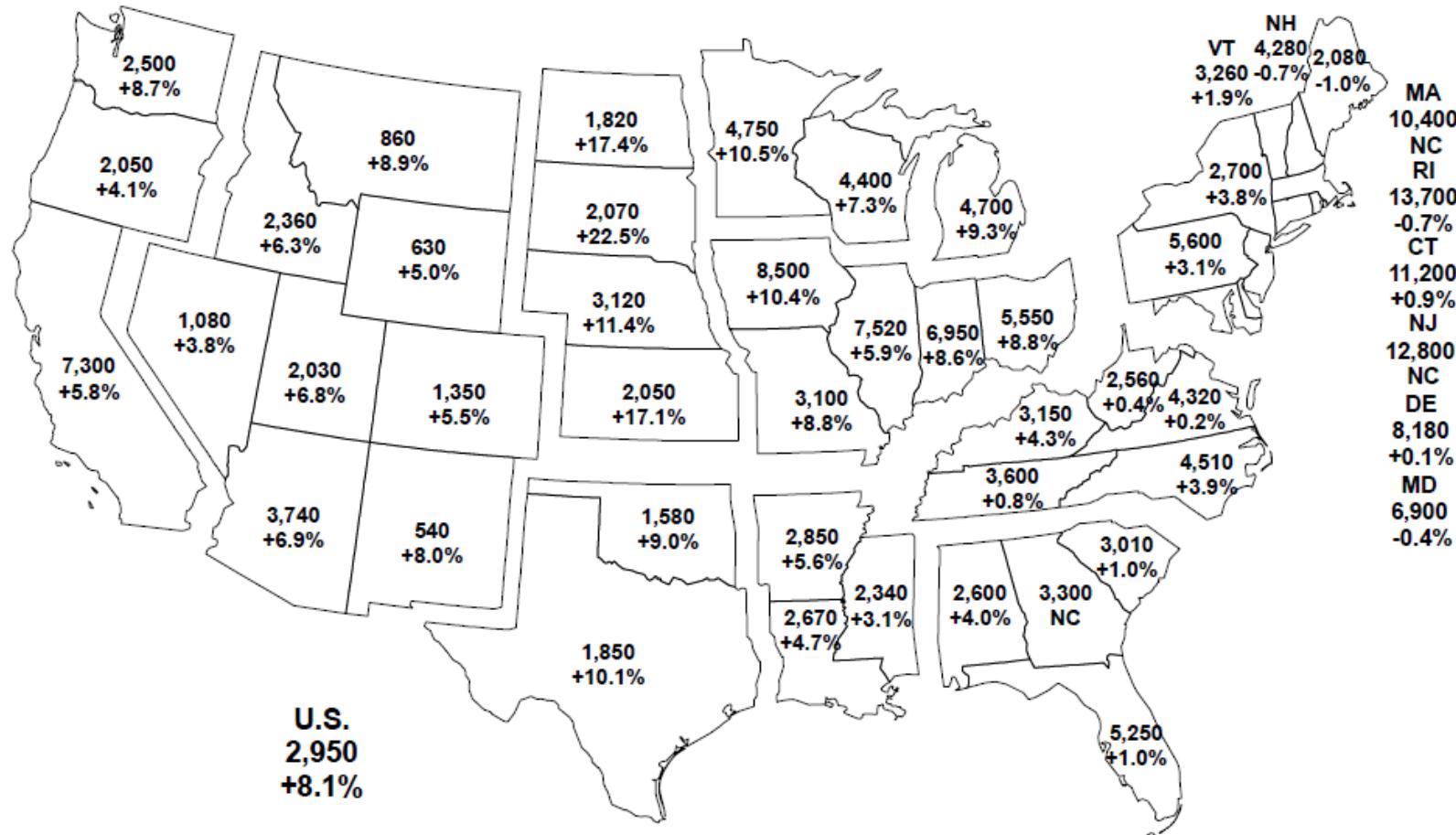


USDA - NASS
August 2, 2013

NC = No Change

2014 Farm Real Estate Value By State

Dollars per Acre and Percent Change from 2013



USDA - NASS
August 1, 2014

Source: http://www.nass.usda.gov/Charts_and_Maps/graphics/farm_value_map.pdf

Producer Views from the Road

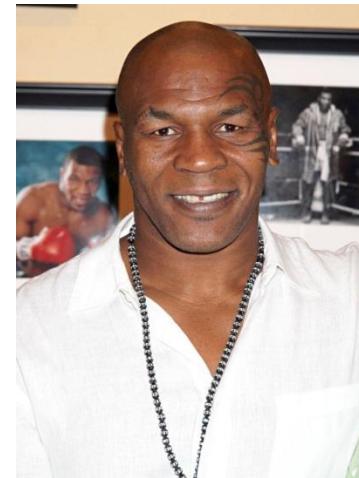
How measurements are used in decision making:



| View | Percentage |
|---|------------|
| • Obsessive about measures; used in planning & decision making | 28% |
| • Measure many things, but do not use to improve farm or in decision making | 54% |
| • Track just enough to get by, mainly for taxes & crop yields | 18% |
| Total | 100% |

Taking the Economic Punch

Everyone has a plan 'till they get punched in the mouth. -- Mike Tyson



Taking the Economic Punch

- Has the producer been profitable?
- economic cycle vs. management
- demonstrated ability to build working capital
- modest living expenses & non farm capital expenses
- burn rate of working capital 2.5 years
- ability to shed marginal assets- land, livestock, machinery, human
- consolidate vs. split lines of credit
- shed “victims” & “know it all’s”
- HUT principle
- communications



Producers That Will Thrive

- strong, productive asset base
- records that talk to the business
- modest living expenses- \$60,000 difference rule
- modest non-farm capital expenses
- working capital- 33% of revenue
- burn rate of working capital above 3.5 years
- know cost of production via enterprise
- strategy/alternatives
- history of handling adversity

Burn Rate - Working Capital

| | |
|---------------------|-------------------|
| Current Assets | \$1,000,000 |
| Current Liabilities | <u>\$ 500,000</u> |
| Net Working Capital | \$ 500,000 |
| Total Revenue | \$2,000,000 |
| Net Income Loss | \$200,000 |

Net working capital \$500,000 = 2.5 years burn rate
Net Income Loss \$200,000

Ten Questions of “True Liquidity” (1)

- concentration of assets- current
- hollow grain bin- verify & confirm
- forward pricing- marketing/risk, contract, quality
- attitude on risk
- accounts receivable
 - concentration
 - collectable
 - timing
- crops growing in field & livestock in pens
 - insurance/level
 - timing
 - quality

Ten Questions of “True Liquidity”

(2)

- prepaid expenses
 - cash conversion cycle
 - how secure?
 - line of credit
- accounts payable/line of credit
 - less than inventory
 - timing
 - <5% revenue vs. >25% revenue
- cash
 - amount debt service
 - amount compared to major expenses
- deferred tax consequences

Dashboard Monitor

Alpha Pup Example

| | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>2015</u> |
|--|----------------|----------------|----------------|----------------|----------------|---------------|
| Business Revenue (thousands) | \$1,000 | \$1,200 | \$1,400 | \$1,200 | \$1,100 | \$900 |
| + Non-Business Revenue | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Subtotal | \$1,000 | \$1,200 | \$1,400 | \$1,200 | \$1,100 | \$900 |
| - Business Expense | \$800 | \$900 | \$1,000 | \$1,000 | \$1,000 | \$1,000 |
| = Net Income | \$200 | \$300 | \$400 | \$200 | \$100 | -\$100 |
| + Depreciation & Interest Paid | \$100 | \$200 | \$200 | \$150 | \$100 | \$100 |
| Subtotal | \$300 | \$500 | \$600 | \$350 | \$200 | \$0 |
| - Family Living & Income Taxes | \$100 | \$100 | \$150 | \$150 | \$100 | \$100 |
| Repayment Capacity | \$200 | \$400 | \$450 | \$200 | \$100 | -\$100 |
| -Debt Service | \$100 | \$200 | \$150 | \$100 | \$100 | \$100 |
| Margin | \$100 | \$200 | \$300 | \$100 | \$0 | -\$200 |
| Coverage Ratio | 200% | 200% | 300% | 200% | 100% | -100% |
| Working Capital | \$200 | \$300 | \$400 | \$450 | \$450 | \$250 |
| Revenue | \$1,000 | \$1,200 | \$1,400 | \$1,200 | \$1,100 | \$900 |
| WC/Revenue Ratio | 20% | 25% | 29% | 38% | 41% | 28% |
| Working Capital | \$200 | \$300 | \$400 | \$450 | \$450 | \$250 |
| Debt Service or (Debt + Loss) | \$100 | \$200 | \$150 | \$100 | \$100 | \$200 |
| Working Capital Burn Rate (Years) | 2.0 | 1.5 | 2.7 | 4.5 | 4.5 | 1.3 |

Five Step Process to Positive Margins

1. ↑ business revenue
2. ↑ non-business revenue
3. ↓ expenses
4. ↓ family living & taxes
5. debt service restructure



| | <u>2015</u> |
|-------------------------------------|--------------------|
| Business Revenue (thousands) | \$900 (1) |
| + Non-Business Revenue | \$0 (2) |
| Subtotal | \$900 |
| - Business Expense | \$1,000 (3) |
| = Net Income | -\$100 |
| + Deprec. & Int. Paid | \$100 |
| Subtotal | \$0 |
| - Family Living & Income Taxes | \$100 (4) |
| Repayment Capacity | -\$100 |
| -Debt Service | \$100 (5) |
| Margin | -\$200 |
| Coverage Ratio | -100% |

Big Data, Small Data & Useful Information

Starting Five Dashboards

| <u>Balance Sheet</u> | <u>Income Statement</u> | <u>Cash Flow</u> |
|---------------------------|-------------------------|----------------------------------|
| Assets 3M | Business Revenue 2M | Cash Income 2.1M |
| Liabilities 1M | Variable Expenses 1M | Non Farm Income 1T |
| Net Worth 2M | Fixed Expenses 6T | Business/Living Expenses 1.6T |
| Current Assets 5T | Net Income 4T | Debt Service 4T |
| Current Liabilities 2T | Income Margin 20% | Net Cash Flow 2T |

Dashboard Key Financial Ratios

| <u>Ratio</u> | <u>Percent</u> |
|-------------------------|----------------|
| Percent Equity | 66% |
| Working Capital/Revenue | 15% |
| Profit Margin | 20% |
| ROA | 13% |
| Coverage | 150% |
| Total Debt/EBITDA | 1.25 to 1 |

Business Planning Resiliency

- professional records system
 - “talk to the business””
- working capital
 - 33% of revenue
- working capital – burn rate
 - 3.5 years
- family living budget
 - high/low difference of \$60,000
- credit score/report
 - 700 rule
 - steps to improve

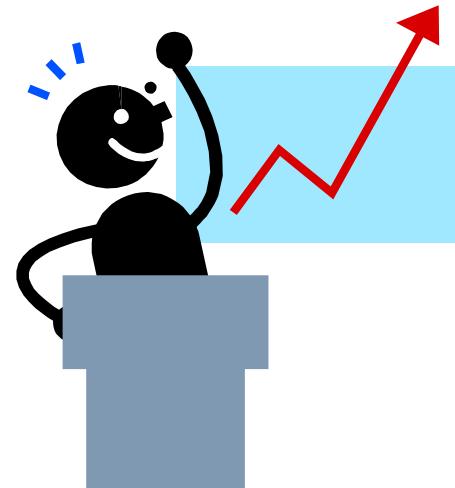
Business Planning Agility

- goal setting
 - family, business, & personal
- people plan
 - six steps
- profitable
 - interest rate
 - inflation rate
- team of advisors
 - lenders, mentors, & peers
- education
 - 3-5 venues
 - networking

Business Equation for Success

$$P=O+C+L+M^2$$

- P=people, profits, & plans
- O=overhead cost control
- C=costs- know thy cost
- L=liquidity-cash is king
- M²=marketing & management = margin



Dave's Top Ten Questions & Advice From the Road

- one piece of advice for a young business person
- tip for both generations in transition
- What is the best business turnaround tool?
- 40-20-40 Rule of people
- What is the top business tool that the Creamery uses?
- Why do you recommend certain levels of cash in a business?
- What is the 96-4-50 rule?
- agriculture is a good field of study
- What should young people study?
- What are the best reads?