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Agricultural Finance and Small Business Management

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Dialogue with Dr. Dave

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At the beginning of the pandemic, who could have predicted that I would be unable to conduct face-to-face programs for one whole year? Turning a lemon into lemonade has required many individuals to be adaptive and flexible, regardless of your position in life. Over the past year, my team and I have conducted over 165 online presentations using various technology platforms. The boring, informational webinar has been transformed into a more interactive presentation with polling, chat, and special guests to provide more engagement, interaction, and energy. These programs have solicited many interesting questions, some of which we will discuss in this final edition of the 2020 - 2021 Farm Management Newsletter.

The dangers of non-recurring income

An agricultural lender recently asked a question regarding the inherent danger of non-recurring revenue as a result of the run-up in grain prices and generous stimulus checks. A decade ago, agriculture was in the midst of the great commodity super cycle with a five-year window of increased profitability. Currently, agriculture is in the great *government* super cycle. As with many economic events, this cycle is a result of several converging variables. China is stockpiling a supply of commodities and is in the process of rebuilding its protein complex. Adverse weather conditions, particularly in the Southern Hemisphere, have reduced global grain production. The value of the dollar is lower, which means that U.S. exports are more favorably priced. Finally, government stimulus checks are creating non-recurring income for many producers. However, the resiliency of this cycle, particularly for the grain industry, is yet to be seen.

How producers allocate this unexpected income will be important for future success. Is it being used for debt reduction, building working capital, or increasing operational efficiency? On the other hand, are the funds being used for long-term expansion, increased family living expenses, or is it being used to lease land with higher cash rents? Often, long-term decisions made on short-term or windfall profits can be detrimental if the economy is less stellar three to five years down the road.



The cost of not doing something

An agribusiness sales team was frustrated that many of their producers were making quick decisions based on short-run cash flow and failed to consider the long-term implications. For example, cutting costs by not vaccinating animals, failing to conduct soil samples, not following a marketing and risk management program, or not completing a transition or estate plan. In each of these instances, cost-cutting can result in saving money in the short-term, but can create a costly situation down the road which can hamper business success. As one producer succinctly stated, “Not taking a scheduled vacation almost resulted in losing my family.”

Land purchase

The most common question, particularly from younger producers, has centered around the purchase of land. Land is a good long-term investment. Since 1910, farmland nationwide has appreciated in value or remained the same 79 percent of the time. When considering the period of time since World War II, this stat increases to 88 percent. With land values holding steady or increasing in many areas of the country, many young producers are being stretched thin. Let’s discuss a checklist to follow when considering a land purchase.

- How does a land purchase fit your vision and your short and long-term goals?
- What are the characteristics of the land including soil health, access to water, logistics, and proximity to the existing operations?
- After the land purchase, is your term debt to EBITDA* ratio, using a three-year average and projections, under five to one? If this ratio is above six to one, you better start tapping the brakes!
- Is your working capital more than five times your total debt service, including any proposed debt?
- Are you willing to make a financial sacrifice in your family living budget or utilize outside income to service debt for a three to seven-year period? Purchasing land can stretch your business and personal budgets, but in the long run it can be a good investment.

How to navigate the business through changing government policy

To put it simply, manage the controllable variables and manage around the uncontrollable variables. Geopolitical risk in the U.S. and abroad appears to be extremely volatile. Over the years, my observations have found that good managers focus on the controllable variables such as cost efficiencies and sweating the small stuff. They will build a financial liquidity buffer that can also be used for opportunities. Proactive managers will often develop strategies to manage around changes in trade, regulation, and consumer trends. Remember,



the decade of the 2020s will be predicated on one's ability to be adaptive, flexible, follow a process, focus on a plan, and monitor the results to evolve the business.

Transition

An individual had “hit the financial lottery” by inheriting his uncle's farm. He had been operating the farm for 15 years and needed some advice on his next steps. In another case, a father wanted to turn the reins over to his son and daughter. Both of these individuals needed some advice for the transition process.

In both cases, one of the first steps would be to complete the business IQ, a 15-question assessment discussed in a previous column. This exercise can assist in examining what areas you want to continue or what you want to improve. Next, assess the skills, responsibilities, and accountabilities of those involved. Is the younger generation more of a general manager, a doer, or a combination? What are the plans for phasing out the older generation? In the case of an inheritance, what is the spouse's role? Do not forget to ask the tough questions concerning pre or post nuptial agreements and buy-sell agreements. In either situation, a good team of advisors, which may include a lender, farm management consultant, accountant, lawyer, or another producer, could be invaluable.

The future of agriculture

The future of agriculture is very positive. The COVID-19 pandemic has heightened the importance of agriculture to the nonfarm public. Expect more “green” payments mid-decade as agriculture is perceived to be an environmental solution rather than a problem. For young people, vocational and technical education and the study of biology, economics, and communication can provide a rich future and make a difference in people's lives and society. The “DAIRY” of life will be very applicable.

- D - Discipline
- A - Attitude and accountability
- I - Initiative
- R - Reasonable and respect for others
- Y - You

Hopefully, the DAIRY of life is a measure that individuals can aspire to each and every day of their life. Have a good spring and summer. Be safe and healthy! Remember, agriculture is the foundation behind the success of the United States of America and each and every one of you play an important role.

*EBITDA is an acronym for Earnings Before Interest, Taxes, Depreciation and Amortization





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