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This is one of a series of articles written by Dr. David Kohl for the Minnesota State Farm Business Management Education Program.
Vol. #82

Renewal Season on the Brink

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As another year is drawing to a close, commodity prices have remained stable and costs have continued to inflate. Next year will represent seven years of the economic reset. This elongated downturn is stressing financial liquidity and, in many cases, draining equity from the balance sheet. Some agricultural producers are facing the emotional stress of operating in a business environment where there appears to be no light at the end of the tunnel. Many producers are now in the process of renewing operating lines of credit for next year. How can one proactively position this request, given the tightening of credit from lenders and regulators?

The first step is to provide your lender with an updated balance sheet between January 1 and January 15. Include machinery and livestock inventory schedules. Do not plug in numbers from last year because this will be a red flag to your lender. Adjust values to truly represent your business. Make sure you list all of your liabilities including accounts payable and capital leases on machinery and equipment.

Next, you will be required to provide three years of tax records. An increasing amount of fraud is occurring with financial documentation, so expect to provide original forms or those that are signed with an IRS release.

To provide a more accurate picture of your business, develop an accrual adjusted income statement instead of only a cash version. This analysis will provide the business owners, managers, and lenders a more accurate depiction of the changes in inventories, receivables, payables, prepaid expenses, and accrued expenses. The better managers are finding that this step provides valuable information not only for the lender, but also for decision making.

Some producers have operated the past several years at a loss. It is very important to calculate your burn rate by dividing these losses into working capital. Working capital is a measure of liquidity calculated using current assets minus current liabilities. The burn rate will determine how many years it will take you to deplete your working capital if no improvement of the financials is expected. If your business has no working capital, the next step would be to calculate the burn rate on core equity or excess reserves in land. For example, let's assume that your land is valued at $1 million and your lender will advance up to 70 percent of the value. If you have no debt against your real estate, then your excess reserve would be $700,000. If your losses are $100,000, divide that number into $700,000. In this instance, the burn rate would be seven years before you would deplete your equity. This approach is very straightforward, objective, and provides a method to examine the preservation of wealth.

Next, develop a monthly projected cash flow, which will delight your agricultural lender. This basic exercise will help you and your lender determine the credit availability needed throughout the year. A basic cash flow allows managers to think through production, marketing, and operating plans on paper.

The next step would be to conduct sensitivity analysis by financially shock testing production, price, cost, and interest rates, especially given the environment of possible rate increases. Using a spreadsheet, one can quickly project how lines of credit can vary, which shows the parameters of business financial operations.

An important step in renewal season is for the business owner to come to the table with written, articulated goals. The goals should be further defined by their term of completion. Short-term goals are to be achieved within one year and long-term goals have a three to five-year timeframe. Goal setting is an important practice that can be valuable in the communication process with lenders, partners, and stakeholders of the business.

Another important variable in renewal season is to be proactive and not procrastinate. Often, your loan officer will gather the data and then a credit analyst will examine the financials. Up to three to five years of trend analysis will be conducted. In some cases, the information will be sent to a loan committee for decision-making. This process can take some time and it is important to start early and provide all the necessary information up front.

One final thought for renewal season is to develop a family living budget. Many lenders are reporting that their customers' cash flow problems can be traced back to the personal or family aspect of financial management. For many families, the budget buster is healthcare costs. In other cases, the culprit can be too many individuals living out of the business. A family living budget allows you to document the family living expense line item on financial statements and use it to help calculate the cost of production.

Yes, this is truly a renewal season on the brink for some businesses. Refinancing requests to term out operating loan losses will be closely examined. Lenders will look for cash flows with sound marketing plans that are executed with crop insurance to provide some assurance of income.

While the aforementioned set of steps may sound excessive to some, this process can be invaluable in monitoring and improving the management of the business. This is truly a renewal season that will test the resolve of producers, agribusinesses, and agricultural lenders. Transparency and clarity of the financials will be essential.