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Wisdom and Perspectives for 2020

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This article concludes our newsletter series. Wow! The black swan event that has been developing over the last thirty days has been humbling at best. The new decade is well underway and many of you are itching to get into the fields, continue caring for your livestock, or launch a new business enterprise. Some producers may be scaling back or phasing out. Whatever direction you aspire, the following are some points, perspectives, and wisdom to ponder over during the spring and summer. This will be particularly true given the black swan event that is evolving.

Equity on the balance sheet does not pay the bills

Many agriculture producers are walking the line of whether to use equity in land as a buffer for a debt restructure or to discontinue the business. Solicit assistance from a third party such as your farm management instructor, a consultant, or your agricultural lender to assist in these difficult decisions. In some situations, scaling back and reducing debt is the optimal solution. In other cases, a debt restructure can provide time to adjust business practices to improve your revenue, reduce costs, and ultimately increase your EBITDA*. Your plan should be in writing with a projected cash flow so that you can closely monitor the business results and make the necessary adjustments throughout the year. In summary, there is much credence to the old saying that, “The deeper the hole you dig, the more opportunity to bury yourself alive, both financially and emotionally.”

Working capital and cash are queen

When a business experiences financial issues and challenges, the first area on the balance sheet affected will often be working capital. It is critical to examine the current assets that can quickly be turned into cash without disrupting normal operations. Your business is full of moves and options, just like a game of chess. The most important player on the chessboard is the queen. If the queen is in a safe position, analogous to having working capital and cash, then you are in a position to be more proactive than reactive in strategic decisions. Working capital and cash allow producers the flexibility to negotiate cash discounts on fertilizer, feed, and other inputs at optimal times. Liquidity is a difference maker in an environment of low margins and high volatility.



These small, incremental successes or “base hits” can get you around the bases for the score. With that being said, the triple play of financial philosophy will be invoked in the future. Profits and cash flow are your kingdom to operate in. Working capital and cash are the lubricants that make the business flow. Earned net worth is the king of long-term business sustainability.

Mental hygiene is becoming just as important as physical hygiene

After reading this article, ponder on this statement while on the tractor, in the combine, or while you are working livestock. One critical skill for both adults and youth is to be undistractable. You are either in control of your time or others will control it for you. Learn to say no and be in the moment. Are you mindful or is your mind filled!

A new buzzword is trashercise, which means to mentally or physically clean while exercising. This new trend is impacting productive people who are finding time to enjoy solitude, quiet, and immerse themselves in natural scenery for healing and stress reduction. In my case, a full moon shining across a snow-covered Midwest Road, a sunrise, or a sunset can be the fuel that energizes me after a mentally draining day or situation. In a sign of the times, more businesses are encouraging meditation and training. Teaching workers how to make eye contact and shake hands is very important. Remember, up to 70 percent of communication is nonverbal. Those of you who have worked with animals have an idea of how important nonverbal communications can be.

Develop a financial dashboard

One observation among successful agriculture businesses is that they develop a financial dashboard. It is suggested to include no more than five to seven factors to monitor. What are some of my favorites?

If you borrow money with debt service obligations, the debt service coverage ratio can give you breakeven metrics. In other words, this ratio can show you what has to be accomplished in terms of price, costs, net income, taxes, and family living withdrawals to service debt in a timely manner. Maintain a cushion of 25 to 50 percent, even during stellar economic times.

As discussed before, working capital is critical. Working capital to expenses, including normal depreciation, should be 20 to 25 percent. Current assets that are cash or can be quickly converted to cash should be 10 to 20 percent of total working capital.

One of my favorite ratios is calculated using operating expenses minus interest and depreciation expenses divided into total revenue. If this ratio is below 75 percent, then you may be in a position to grow the business. Use a three to five-year average and keep in mind that in any given year, your results could be reflective of items beyond your control.



Next, a new financial metric is the term debt divided by EBITDA*. When nonoperating debt is divided by EBITDA, a ratio under 3.5 is solid. If the ratio increases above 6:1, then the business could be in a position to drown in debt service, particularly during adverse times.

To round out my top five ratios for a financial dashboard, I recommend the classic debt to asset ratio. When the debt to asset ratio exceeds 50 percent, you must step up your management game plan. This includes production efficiency, modest family living, having good marketing and risk management plans, and access to nonfarm income can provide an additional buffer.

Tidbits

Many of you that have heard me speak or read my articles know I spend some time north of the border in Canada. Canada is often an agricultural trendsetter because it is a melting pot of many immigrants from around the world. Along with Europe, analyze Canada to stay ahead of the trends here in the U.S. About 25 percent of Canadian farmers are females. Sixteen percent of young farmers now live and farm in urban areas or cities. One of the fastest-growing trends in Canada is large-scale indoor, vertical growing systems. These systems have local appeal, reduced transportation costs, and boast edible barcodes on the product to identify the source.

Similar trends are occurring in the U.S. I often challenge farm groups and those attending educational classes to visit these operations to see how they are organized and aligning with their consumers. Observing those operating outside the box is very important.

From the locker room

To recharge my mental energy, I enjoy engaging with Division I and Division III basketball teams. This experience takes me full circle from playing the sport to coaching. One philosophy the coaches like to bestow is that your self-worth and financial net worth is equal to your network of people or who you connect with. You will note that self-worth is listed before net worth in establishing life's priorities.

I hope you have a safe, healthy, and productive spring and summer. Make plans in the coming year to develop a side-by-side relationship with your advisory team. This can be a big step in the journey of life, particularly for the decade of the 2020s.

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

P.S. This article was developed two months ago, so I have added a special report for you to read on the black swan event that is now occurring.





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