Managing Risk in Today’s Agricultural Environment

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Thinking about Risk

• Risk can be difficult to discuss
  – Overconfidence in forecasts and ability to influence events
  – Challenging to assess range of possible outcomes
• Important to
  – Recognize sources of vulnerability
  – Ways to manage risk
    • Agriculture is in the midst of unprecedented volatility
    • Higher income and increased wealth to protect
    • Lower margins and prices to contend with

Types of Risk

- Business Risk
- Financial Risk
- Strategic Risk
Business Risk

- Production
- Human
- Price/Market
- Technology
- Legal/Regulatory
- Casualty
- Relationship

Financial Risk

- Debt Use and Leverage
- Working Capital and Liquidity
- Capital Lease Commitments
- Incomplete budgeting or investment analysis
- Interest Rates (Fixed or Variable)

Strategic Positioning Risk

- Accurate Assessment of External Forces and Internal Resources/Capabilities
- Proper Alignment of Resources and Capabilities to External Forces
- Proper Implementation of Strategy
- Realigning Strategy to Changing External Forces and Internal Resources/Capabilities

External Forces

- Business/Economic Climate
- Competitor Actions
- Customer Preferences

Internal Resources & Capabilities

- Physical
- Financial
- Customer
- Employee/Supplier
- Organizational

Potential Loss Exposures

- Financial Income Loss Exposure
- Relationship Loss Exposure
- Resource Loss Exposure
- Social Psychological Loss Exposure
The Paradox of Uncertainty

• Uncertainty Creates Risk (Loss Exposures)

BUT

• Uncertainty Creates Opportunities

The Fundamental Challenge

• Minimize the Downside

• Capture the Upside

Vulnerabilities to Continued Prosperity

- Margin Compression
- Weak Working Capital Positions
- Excess and/or Poorly Structured Debt
- Asset Value Declines
- Availability of Credit
- Increased Tax Burdens/Reduced Preferences

Strategies To Use In This Environment

- Be a Low-cost Producer
- Protect Working Capital
- Lock in Margins
- Buy Crop Insurance
- Consider Fixing some Interest Rates
- De-leverage – Pay Down Debt
Strategies To Use In This Environment (cont'd)

- Hold Financial Reserves
- Increase Asset Utilization
- Conservative Bidding & Buying
- Slow Growth & Fund with Equity
- Make Investments in Operational Excellence

Changing Business Climate in Agriculture

- Crop agriculture continuing to transition out of an extraordinarily profitable era
- Long-run future in crop agriculture is still bright, but the next several years will test managerial skills
- Aggressively manage all input costs
- Look for both cash rents and land prices to adjust downward the next several years
- Livestock sector facing extremely tight margins

How many acres do you anticipate planting in 2016?

- 4,000 or greater
- 3,000 – 3,999
- 2,000 – 2,999
- 1,000 – 1,999
- 1 – 999
- None

What is your total cost of production for corn on a per bushel basis? (Include all costs not just variable costs)

- More than $4.50
- $4.00 - $4.49
- $3.50 - $3.99
- $3.00 - $3.49
- Less than $3.00
- Don’t know
What is working capital?

Working Capital =

Current Assets – Current Liabilities

To make it scale neutral, it’s best examined as a ratio

Working Capital/Gross Revenue

How much working capital do you have as a percentage of gross revenue?

- 100% or greater
- 75 – 99%
- 50 – 74%
- 25 – 49%
- Less than 25%
- Don’t know
Today’s Scenario

- 3,600 acres corn/soybean operation
- Cash rent 1,800 acres at $175/acre average
- Purchased 100 acres at $2,400/acre in 2012
  - 50% financed with debt
- Total Assets = $2.5 million
- Total Liabilities = $0.5 million
- Taxable Income in 2015 = $50,000
- Recently updated machinery lineup

Additional Information

- Debt to Asset Ratio = 0.2
- Working Capital = $750,000
- Working Capital to Gross Revenue = 0.7

- Anticipate losing $100/acre this year
  - $360,000
- Burn rate = 2.08 years

Wait! How Do I Calculate my Burn Rate?

Working Capital = Current Assets – Current Liabilities
Burn Rate = Working Capital/Net Income Loss

Example: Working Capital = $500,000 & Net Income Loss = $200,000

Burn Rate = $500,000/$200,000 = 2.5 years

Why should I worry about “burn rate”?

- Working capital is a buffer to absorb short-run losses
- Burn rate helps us visualize how much “buffer capacity” we have
- Burn rate tells us how long we can continue at our current pace before our working capital is exhausted
- Increasing working capital buys time to make improvements
For more information, please contact me at eyeager@ksu.edu or 785-532-4935

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• Can explore business changes such as alternative enterprises, debt restructure, farm transitions, etc.
• Will show projected impact on Net Farm Income and Cash Flow
• Assistance when working with creditors
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