2011 Southern Peanut Farmers Conference

Farm Planning and Financing

Marshall Lamb
USDA/ARS National Peanut Research Laboratory
Dawson, GA

"The vast majority of men die poor, not because their intentions were not right, but because their plans were not right"
Anonymous

Whole farm planning is a comprehensive approach to farm decision-making. It brings the entire farm and all its resources into the thought process. The purpose is to help farmers achieve their **goals**.

The concept is that a farmer can make better decisions if he or she has all relevant information about available resources, alternative solutions, and potential impacts.

A farm plan is not just a document, but instead is a dynamic, time driven process. It is a pathway to your goals.

Farm and Financial Planning is something that farmers do NOT like to do! It is boring and tedious.

But, it’s just as important as planting seed in the ground.

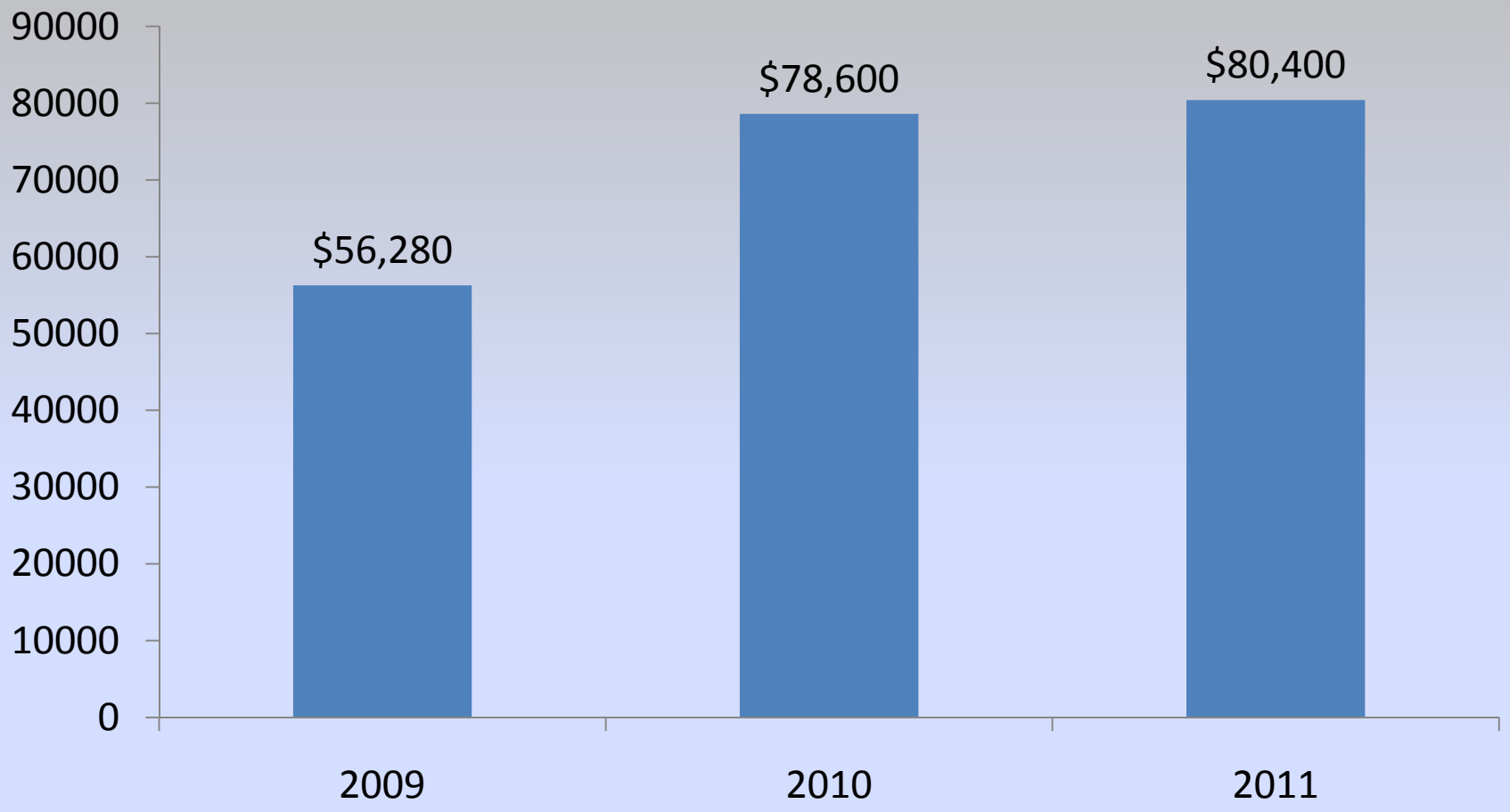
If you have goals in life (and in business) you have to have a plan on how to reach them and to know when you’ve reached them.

Goals must be measurable.

Briefly (here are some goals that I've heard over the year):

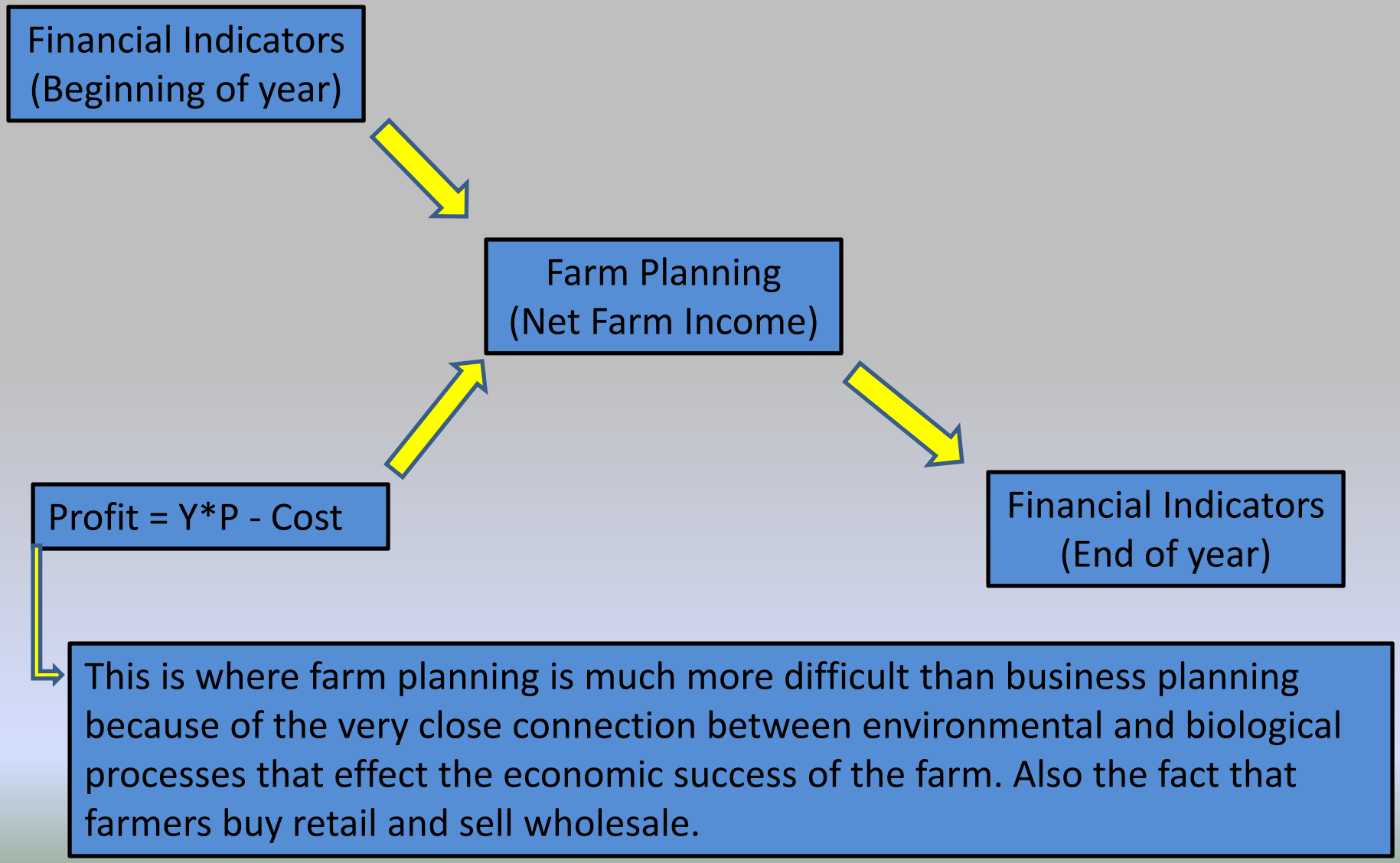
X - Get financed
X - To start farming so I can be my own boss
? - Become a full time farmer (took 3 yrs but he did it)
?/+ - To become more secure financially
+ - To diversify/become less dependent on farming to survive
+ - To downsize the farm (starting toward estate planning)
+ - To be able to live on my land rent when I retire
+ - To increase my net worth by %% each year

US Average Net Cash Farm Income



2011 is forecasted

Today, let's focus on the interaction of farm planning and financial planning including elements of risk(s). (What to look for and what to avoid)



Success means that you accept and manage risks associated with farming.

Land earns rent
Labor earns wages
Management earns a salary
Capital earns interest, and
Assuming risk earns a profit.

Without risk in agriculture there would be no chance of profit.

What to look for and what to avoid

Profit = Y*P - Cost

Yields for all US commodities have been trending upward. This is due primarily to improved genetics. The is also true in peanuts when we consider the yields in 2008, 2009, and 2010.

Be conservative with yields in farm plans. Be honest with yourself. Use average yields and then +/- 15% variations to see the effect on income and cash flow.

We do have better genetics, but yield is still primarily determined by weather (Baldwin – “If it don’t rain, it don’t matter”)

What to look for and what to avoid

Profit = Y*P - Cost

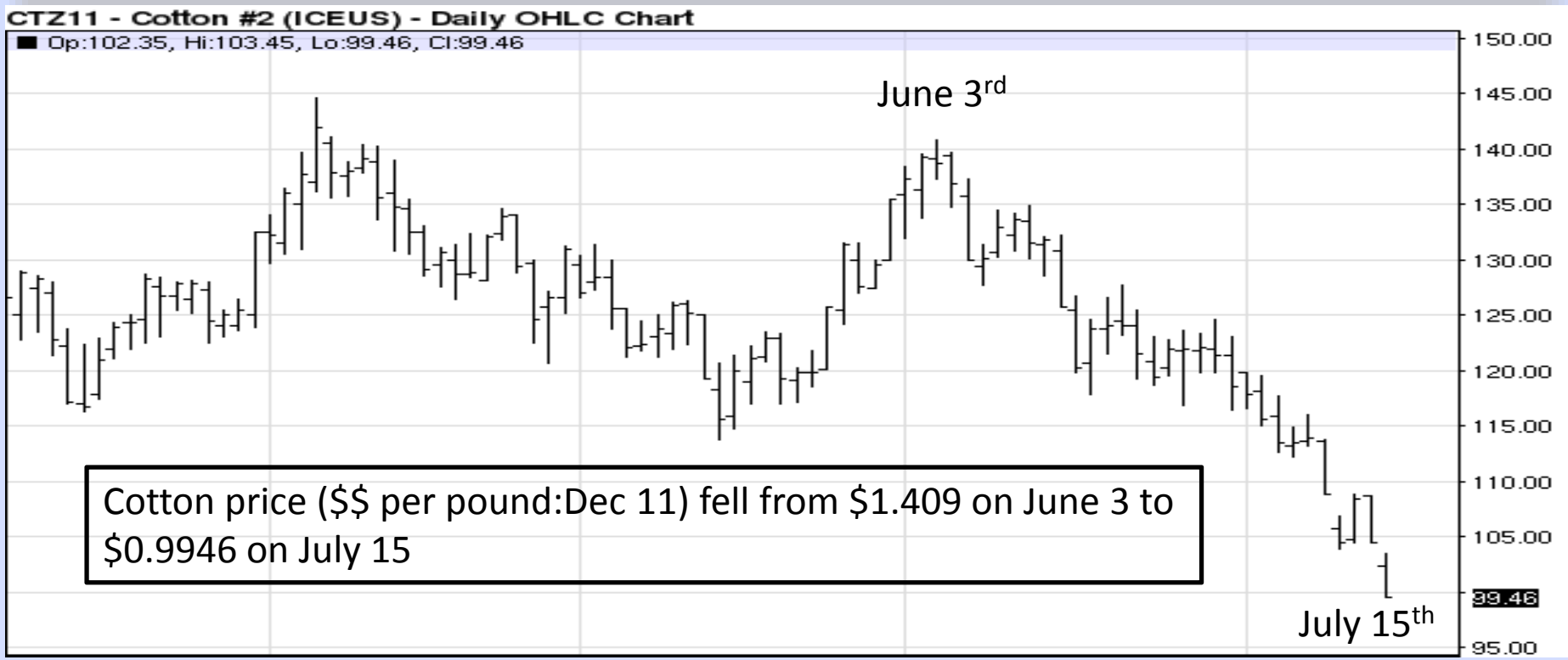
Price - volatility is at its all time highest point. We've seen unprecedented volatility in the range of daily price movements.

Data from the CBOT volatility index (day-to-day price movements converted to an annual basis) show the following percent volatility:

	Historical	2006/2007	2008-2010
Wheat	19.7	28.8	73.0
Corn	22.2	31.4	49.1
Soybeans	23.0	33.5	54
Cotton	17.0	24.0	42.6

What to look for and what to avoid

Profit = Y*P - Cost



Cotton price ($$ per pound:Dec 11) fell from $1.409 on June 3 to $0.9946 on July 15

Peanut prices for the 2010 crop: $500 per ton contract and now $800 per ton on un-contracted loan peanuts

What to look for and what to avoid

Profit = Y*P - Cost

Factors behind high prices and high price volatility (Schnepf):

- Widespread weather-related crop shortfalls (Australia, Russia, EU, others)
- Economic growth in developing countries (increasing world population along with more purchasing power (especially in India and China))
- Gov't Biofuel Policies (US, Brazil, EU, others) (Appr. 35% of the US corn crop will be used to produce ethanol)

What to look for and what to avoid

Profit = Y*P - Cost

Factors behind high prices and high price volatility (Schnepf): (CONTINUED):

-Weak US Dollar (since 2002, the US dollar has lost 47% of its value against the euro and 37% against the Canadian dollar)

AND FINALLY

What to look for and what to avoid

Profit = Y*P - Cost

AND FINALLY

- Declining Investment in Agricultural Productivity (years of under-investment in ag research and ag sectors in developing countries has caused stagnant yield growth. Population driven demand growth is outpacing crop yields).

-If the cuts in funding ag research in the US continue (state and federal), we could change our status from a developed country to a developing country. Are we willing to let this happen?

What to look for and what to avoid

Profit = Y*P - Cost

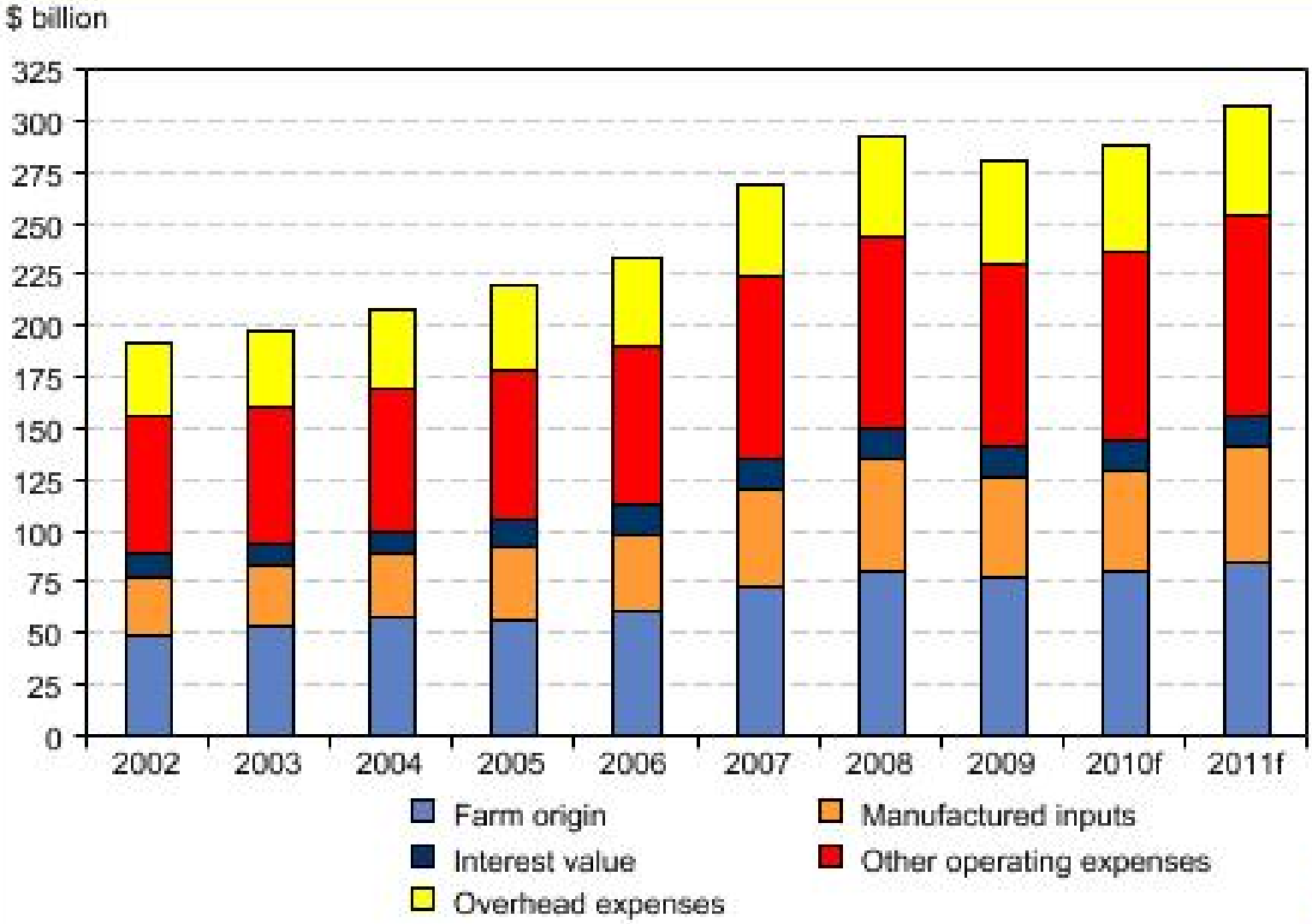
Production cost are going to increase in 2011:

-Fuels 16%
-Fertilizer 14%
-Pesticides 7%
-Seed 5%.

-Total US farm expenses are forecasted to exceed $300 billion for the 1st in our history.

-For peanuts, production cost in UGA budgets was $879.03 in 2010 and up to $939.46 in 2011. (7.2% increase)

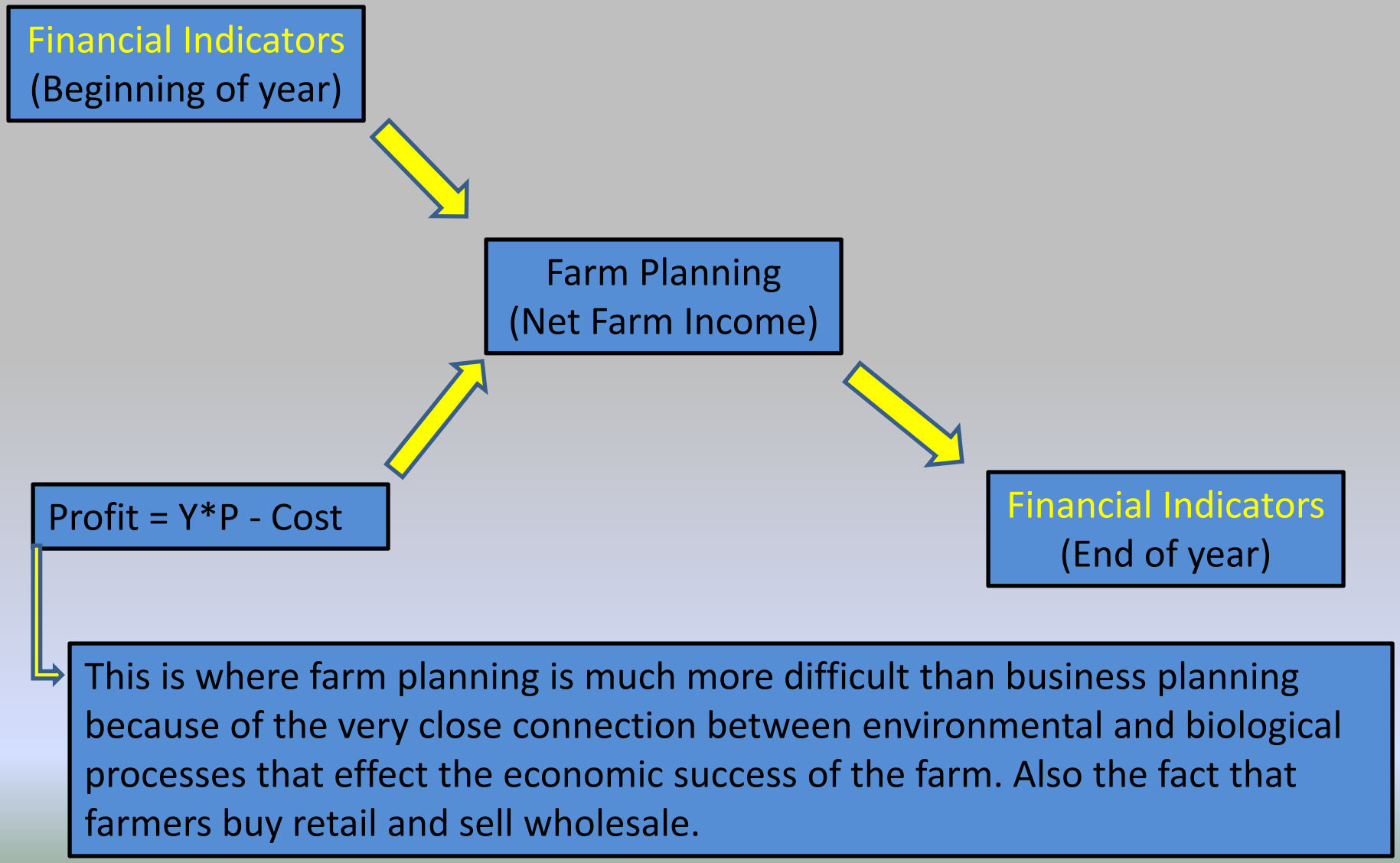
Production expenses are forecast to rise above $300 billion for first time in 2011



Source: Economic Research Service, USDA.

ERS

Today, let's focus on the interaction of farm planning and financial planning including elements of risk(s). (What to look for and what to avoid)



Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

	Description
Liquidity	Measure the ability of the farm to meet financial obligations as the come due
Solvency	Measure the amount of debt and other expenses used in the farm relative to the amount of owner equity in the farm
Profitability	Measure the extent in which the farm makes a profit
Financial Efficiency	Measure the intensity of asset usage to generate value in farm production
Repayment Capacity	Measure the ability of a farm to cover principal and interest payments

Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

Liquidity (2 measures)	**Description (From the Balance Sheet)**
Current ratio	Current Farm Assets/Current Farm Liabilities "Extent to which current farm assets would pay for current liabilities" 
Working Capital	Operating capital available in the short term from within the farm business

Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

Solvency (3 measures)	**<u>Description</u> (From the Balance Sheet)**
Debt To Asset Ratio	Total Farm Liabilities/Total Farm Assets (the banks share) "Higher ratio indicates greater financial risk and lower borrowing capacity" 
Equity to Asset Ratio	Farm Net Worth/Total Farm Assets (aka, your share) "If you add the (D to A) and (E to A) it will add to 100%"
Debt to Equity Ratio	Total Farm Liabilities/Farm Net Worth

Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

Profitability (4 measures)	**Description (From the Income Statement)**
Net Farm Income	"Represents return to Your Labor, Your Management, and Your Equity"
RoR on Farm Assets	"Represent the average interest rate being earned on all investments (yours and the banks) in the farm
RoR on Farm Equity	"Represent the average interest rate being earned by your investment in the farm
Operating Profit Margin	"Shows the operating efficiency of the business. The brings into clear account commodity prices, operating expenses, production efficiency"

Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

Financial Efficiency (5 measures)	**Description (From all Statements)**
Asset-turnover rate	Value of farm production/Average farm assets "Represents efficiency in using capital"
Operating-expense ratio	"Represents the portion of farm income used to pay operating expenses"
Depreciation-expense ratio	"Represents how fast the business wears out capital"
Interest-expense rate	"Shows how much gross farm income in used to pay interest on capital"
Net farm income ratio	"Compares profit to gross farm income"

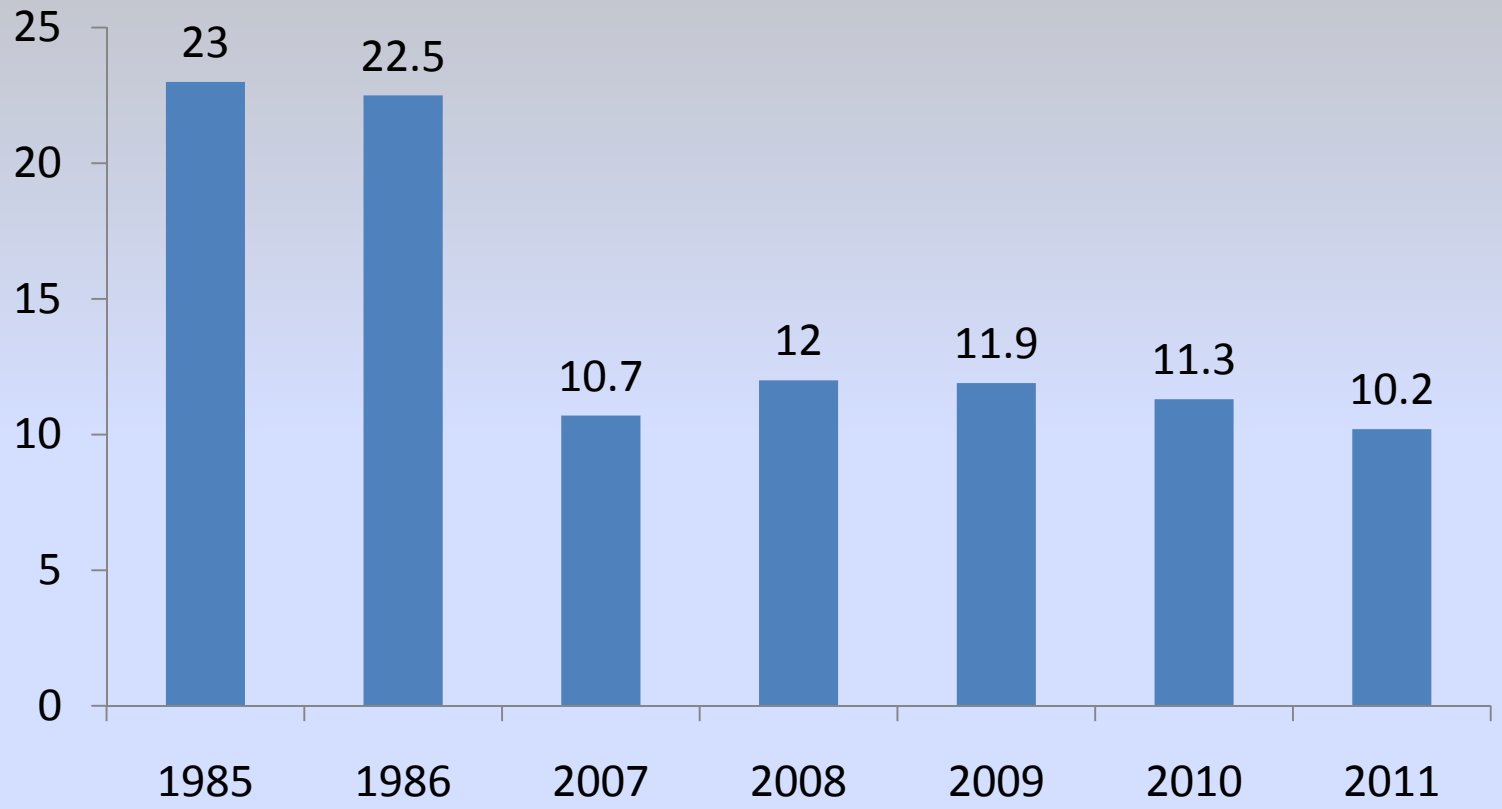
Financial Indicators for Farmers

-There are many ratios that indicate the farms financial progress and risk bearing ability that are generally grouped into 5 categories:

Repayment Capacity (2 measures)	**Description (From the Cash Flow Statement)**
Term-debt coverage ratio	"Did the business produce enough cash to cover all debt payments" Problems with this ratio will be reflected in other indicators
Capital-replacement margin	"Money left after paying bills to buy equipment, land, or livestock"

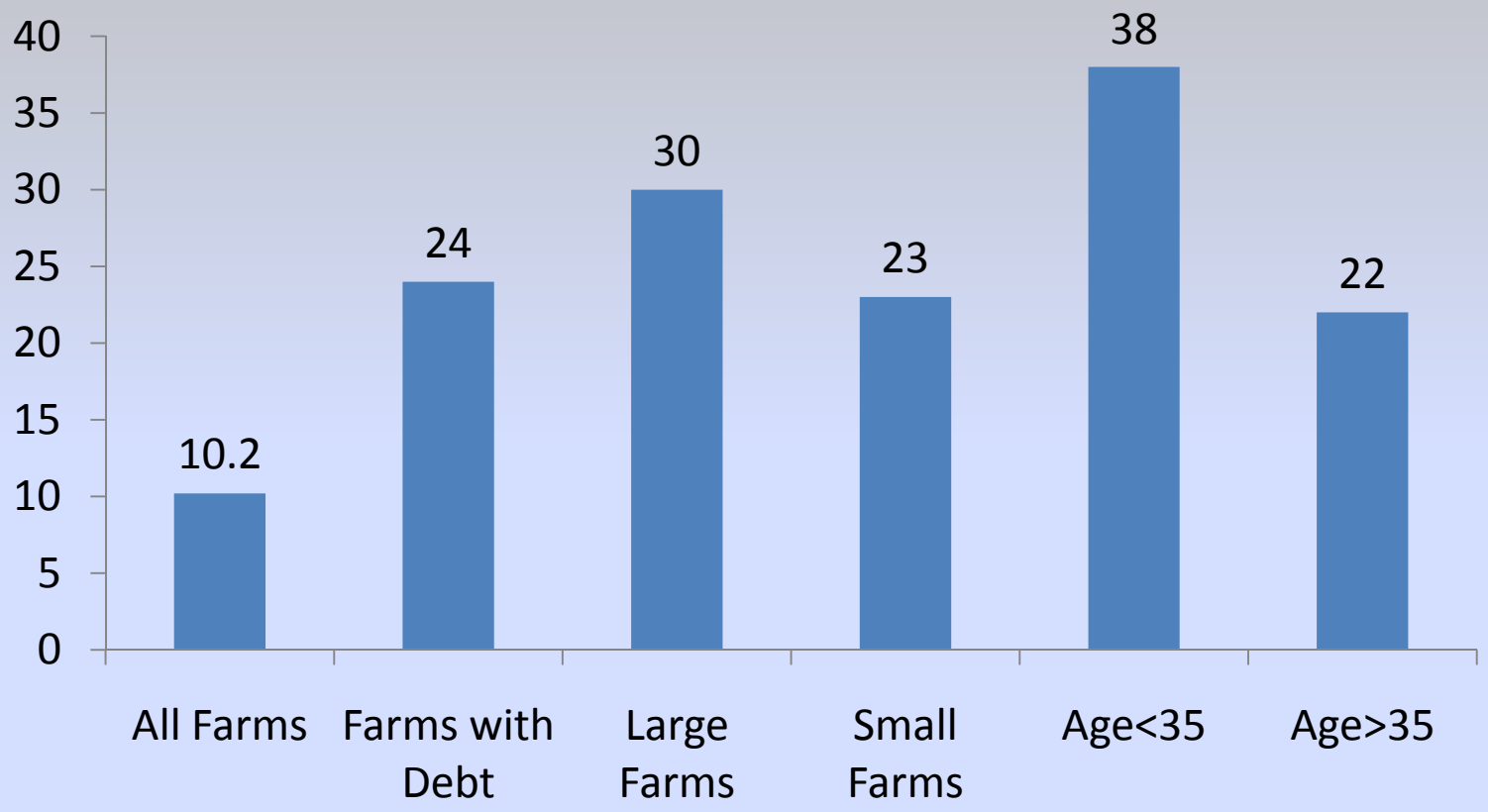
What to look for and what to avoid

US Farm Balance Sheets: Debt to Asset Ratio's

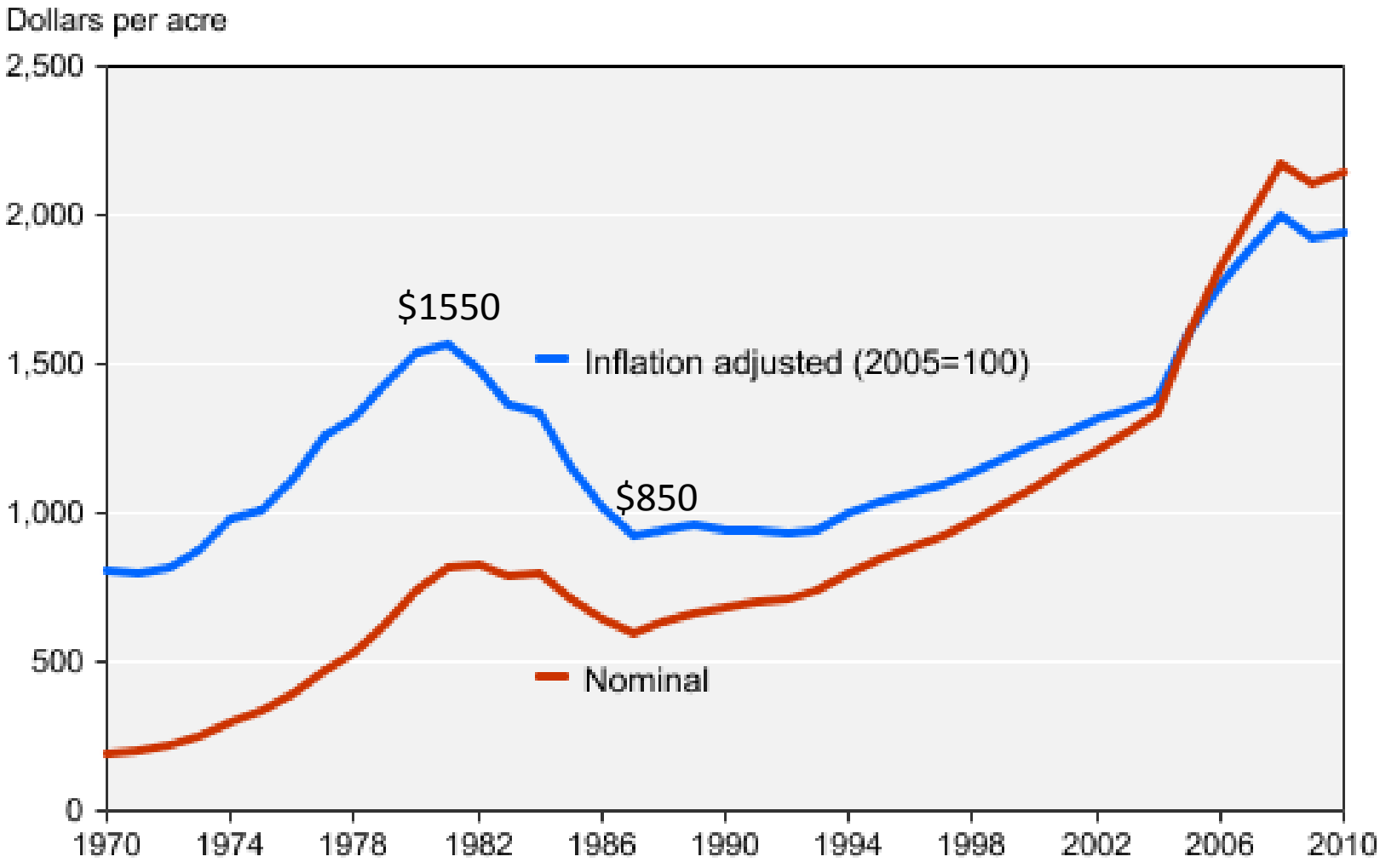


What to look for and what to avoid

US Farm Balance Sheets: Debt to Asset Ratio's

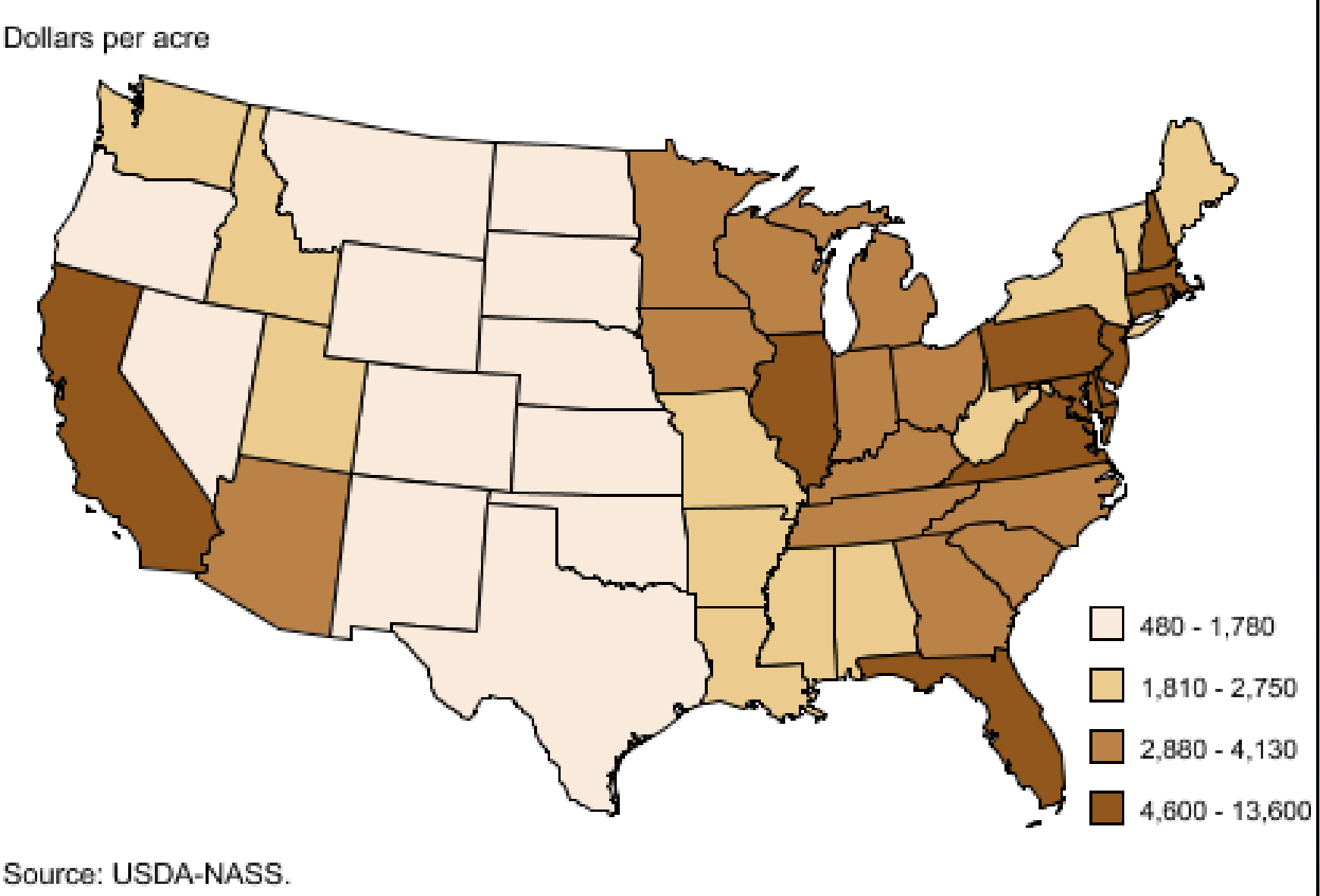


Average U.S. farm real estate value, nominal and real (inflation adjusted), 1970-2000



Note: The GDP chain-type price index is used to convert NASS current-dollar statistics to 2005=100 equivalents (Bureau of Economic Analysis, Dept. of Commerce).
Source: USDA-NASS.

Average value per acre for farm real estate, 2010



Source: USDA-NASS.

Determinants of Land Value (Gloy, et al.)

- Farm Income (expected earnings)
- Interest Rates
- Residential and business development
- Recreational demand
- Tax considerations
- Others …

- The point here is – all of these can change outside of the control of the land owner.

What to look for and what to avoid

Profit = Y*P - Cost

Summary on farm planning:

- Be conservative on yield expectations and run scenarios to address farm income and cash flow potential
-Try to minimize price volatility within your farm (This is the hardest thing to do).
- Budget for cost increases each year. Inflationary pressures will continue to lead to cost increases. Budget for increase.

-Be honest with yourself when developing farm plans. (Remember, you are trying to reach your goals and not just fool the banker into giving you a loan)

What to look for and what to avoid

Profit = Y*P - Cost

Summary on the financing side:

-Debt to Asset Ratio's are currently at their lowest level in about 50 years. This is great news for agriculture.

-However, the Debt to Asset Ratio is heavily influenced by farmland value which represents 80 percent of a farm's total net worth.

-Farmland values are at unprecedented all time high levels. In my opinion, they are at unsustainable levels (creates huge entry barriers for new farmers and it's a much higher level to fall from if/when land values drop)

What to look for and what to avoid

Profit = Y*P - Cost

Summary on the financing side:

-A 50 percent reduction is farmland values leads to, on the average, a 35 percent reduction in farm net worth.

-Try to be in a position that will not destroy you financially if it happens.

-Finally, monitor your financial progress over time.