

Consider Your Options

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After a lengthy stretch in which cash was tight, improved cash flow creates a fork in the financial road!

With milk prices finally at or above break-even levels, many dairy producers are wondering whether to pay down debt or start building cash reserves in case there is another downturn. Our advice: take the balanced approach. The best way to improve your current financial position is to pay off past-due supplier accounts. These businesses don't want to become lenders, so they usually charge higher interest rates. An operating loan from a financial services provider— at a lower interest rate— may be a better option. Maintain your repayment schedules for intermediate— and long-term loans. You might be able to take advantage of historically low interest rates and restructure or fix loan rates. Depending on your situation, now might be the time to balance long-and short-term debt, freeing up more cash to pay off high-interest accounts.

Build Savings: Once the right side of your balance sheet has been fixed, it's time to focus on savings. Rebuild working capital to fix the left side of your balance sheet. Focus on accumulating liquid assets such as money markets, current investments, and savings or checking accounts. Producers should have \$200 cash and/or liquid assets per cow. For example, a 200+cow dairy should list \$40,000 in cash and/or liquid assets on its balance sheet. Many dairies had negative working capital in early 2003. Plus, many only had \$0.80 in cash for every \$1.00 due in bills. As lenders, we understand you need time to fix your balance sheet. Setting aside \$40,000 may not be possible right now, but develop a long-term plan to accumulate the targeted level of savings.

Lesson learned: look farther ahead: One lesson that many dairy producers learned over the past year was to look farther ahead when making capital purchases. Some got into financial trouble by taking out loans with 0% interest for 12 months, followed by a large balloon payment. While such a loan structure made the purchase possible, it doesn't fit with reality. If a producer's operation isn't cash flowing today, one can't assume that it will cash flow in 12 months. Talk with your business consultant, lender or Extension agent to gain a better understanding of your dairy's balance sheet and develop strategies to strengthen your financial position. During difficult financial situations, producers sometimes avoid talking to suppliers and lenders, embarrassed to admit their difficulties. However, open communications can actually make suppliers more willing to work with you, and more willing to continue providing supplies or credit during challenging times. It's also important to be up front with lenders. They can anticipate possible cash flow problems. But lenders won't know the extent of your problems, unless you share them. If there is one thing the past 12 months has taught lenders, it's that we need to ask more questions. Just because a customer is current with his account doesn't mean his business is healthy. In some cases, customers were paying their Farm Credit accounts but accumulating large accounts payable with other suppliers. Lenders need to be aware of what's happening with their customers' cash reserves, so they can be more proactive in reducing principal payments and offering other forms of help.

Consider Restructuring Loan: Lenders also need to look at the balancer sheet's structure. When a business has accumulated losses or accounts payable, it may not be possible to pay everything within one year. Even if it's possible, it may be best to negotiate longer terms. Restructuring loans over a longer term can provide more flexibility for your business now. Everyone wants to repay debt quickly, but there is a happy medium between reducing debt to save interest and rebuilding the cash position. Many dairy owners and operators focus so much on managing expenses they often over look income opportunities. The present dairy market is providing some opportunities for the forth quarter of 2003 and into 2004. In July, one customer contracted January milk for \$11.85/cwt. He's not concerned with receiving the highest milk price. His goal is to turn a profit. By forward contracting through January, he was assured of six consecutive profitable months. Marketing milk is analogous to football. If the market provides an opportunity, take advantage of it. The economic downturn taught us that it's not important to throw deep and attempt a touch down pass on a first down, which allows you to gain yardage, get first downs and ultimately score.