WHAT DOES YOUR FINANCIAL FUEL GAUGE SAY?

BY LEE POTTS
VICE PRESIDENT/LOAN OFFICER
SECURITY BANK | LAUREL

As producers go through the year, one of the many things they pay attention to is how much fuel is being burned: What does that combine burn per hour? What kind of mileage does the truck get? “Oh man, we need to fill the fuel barrel again!” Without an adequate amount of fuel, nothing will get done in a farm operation.

The same is true for your finances. Even as you are reading this article, your operation may be burning financial fuel. You can probably tell right now as you’re reading this how much fuel is in your pickup or tractor, BUT, do you know how full your financial fuel tank is today? Is your financial fuel tank increasing or decreasing? Irrigation is running in summer, markets are ever-changing, yields vary, fertilizer is put out to get the max yield, and on and on. All of the moving parts of an operation affect the level of financial fuel on a daily basis in some way.

Looking for tools to help you make sound financial decisions that are best for you and your operation?

Ask how our Annual Renewal Portfolio™ can improve your operation!
Time to get a bit more technical. In past articles, you have seen information about working capital. As a quick review, working capital, a liquidity measure, is a measure of the amount of funds available to purchase inputs and inventory items after the sale of current farm assets and payment of all current farm liabilities. Strong working capital is the second line of defense behind earnings itself, to combat tough times or pounce on opportunities. As an operation tends to have positive earnings, in general this should increase one’s working capital. Conversely, if an operation experiences losses, the first thing to suffer is usually one’s level of working capital.

It is no secret that grain markets are poor, and livestock (though improved) could be better. In general some people may likely lose money this year. As mentioned, the first place losses will show up is in working capital. Or in other words, working capital is being burned like fuel. It can only go so far before the tank is empty unless it is being filled on a regular basis.

Dr. David Kohl talks about one’s “working capital burn rate.” In years where losses are experienced, how many additional years of similar size losses can be endured before working capital is depleted, thereby making it necessary to either sell assets or refinance carryover operating debt to longer term to restore working capital? Knowing this measure means knowing how full your financial fuel tank happens to be. For example, if a producer has $200,000 working capital and seems to be losing $50,000 per year, that producer has 4 years of being able to sustain similar size losses before working capital is depleted. Then what?

If working capital would fall into negative territory, that means a larger line of credit is needed, which is also saying the operation has to recoup the losses during the next 12 months. That may not be realistic. Thus, there are three things that can be done to remedy a negative working capital and refill our financial fuel tank:

**INCREASE EARNINGS** Easier said than done in a low price, high cost environment, but can be done in some cases. This approach requires allowing more time, however, and some folks may not have time.

**REFINANCE CARRYOVER OPERATING DEBT** Term out debt against equipment or land. The thing to watch here is to ensure payment per acre (fixed cost) does not get out of hand!

**SELL ASSETS TO REDUCE DEBT** This is usually the last resort that people go to in this situation. However, continuing with too high of a debt load can usually compound the situation, so restoring the operation to a more reasonable debt level, while a bit painful to make changes in the short-term, can help add to the long-term chance of success.

Are you curious to know if your financial fuel gauge is running on “E” or how close it might be? You may know how long your pickup will run on low fuel, but why risk it? The same thing goes for your finances.

Nothing runs on “E” for very long. Is your operation overflowing with financial fuel? Or could it be running on fumes? When would you like to find out?