

It's A Great Time To Be Farming

For nearly a decade I've said farmers will have the opportunity to create more wealth in the next 10 years than they have in the last 25. I feel more strongly about that now than I ever have.

One reason is the uptrend in the CRB. The Commodity Research Bureau Index is what some refer to as the "Dow Jones of everything pumped, mined or produced from land." It was in a 22-year downtrend that ended in 2001. Since then it has been up and recently exceeded a level that it hadn't been above in 25 years.

During the next several issues I'll address some of the trends I see coming in the years ahead and what you'll need to do to capitalize on those changes.

Seize the day and you'll be in the driver's seat. Hesitate or miss the key leverage points to catapult your farming career and you'll be history. With any opportunity comes difficulty, and the coming volatility will present ever increasing needs for riskwise decisions.

In general, I believe the coming

15 years will be somewhat like the period between 1965 and 1982. Incomes were up, costs were up, leverage was up and volatility was up.

With higher grain prices, tiling land for better drainage, facilities for drying and storage, new equipment technology or new seed genetics may significantly add to your bottom line now where they didn't before.

However, the framework for decision making and discipline needed haven't changed. We all still have limited dollars and they need to go where the net present value and internal rate of return are the greatest or your return on equity will not be optimized.

Spending the 1980s in the lending business taught me that wealth can evaporate much more quickly than the years and years it took to accumulate it.

All of the great companies in the world use the same decision models of net present value and internal rate of return I referenced above. If followed, they lead to higher equity values in your business through

good times and bad.

The key standard great companies adhere to is that new investments must have returns above their cost of capital. Not just returns that have a positive cash flow. We need to keep that in mind in agriculture. A minimum cost of capital I use is 10%, which provides about a 5% risk premium over 10-year treasuries. As interest rates increase, that discount rate needs to increase in proportion. ■

Bulletproof Your Balance Sheet

Many farming operations hit the wall in the mid-'80s because they didn't have strong balance sheets. Cash flow was often there but many operations had no risk-bearing ability. We can learn from those lessons.

Working capital is the first "shock absorber" for your balance sheet when bad bumps in the road appear. Working capital is the dollar value of current assets minus current liabilities.

Rather than use a ratio, I like to use working capital in proportion to annual expenses. Having working capital equal to half of your annual expense is a minimum comfort level.

This, along with good risk management practices, will allow you to keep your powder dry. So when an opportunity arises you'll be able to shoot quickly and capture opportunities your competition is trying to convince their lender they should consider.

Overall equity is another balance sheet factor, and having greater than 60% equity is a good goal. When figuring balance sheet values I suggest stating land values about 75% of recent market values to have some buffer for capital gains taxes and selling costs.

Having these goals in mind will bulletproof your balance sheet and allow you to capture opportunities as they arise. ■

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