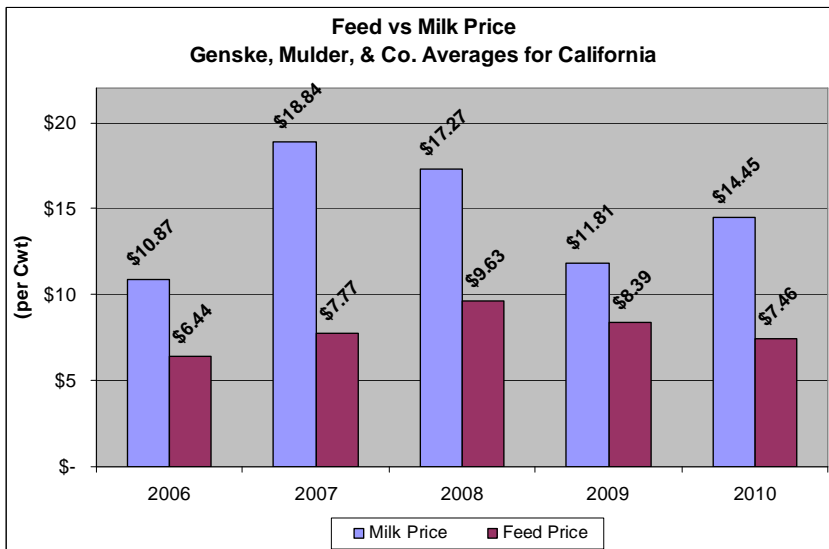


# DAIRY FINANCIAL TIMES

## What to Expect From 2011



After the disastrous year of 2009 and a less than spectacular 2010, most producers I talk to are looking to 2011 with anxiety and apprehension. So what can we expect from 2011? To answer that question I think we first need a reminder of perhaps the most important lessons of 2009.

### **Improbable does not mean impossible:**

In his book *The Black Swan*, Nassim Nicholas Taleb describes this by looking at the life of a turkey. For a thousand days a turkey might get fed by the farmer's hand. From that thousand days the turkey could determine that the good farmer would never hurt him – until that fateful thousand and first day. The dairy industry

has made similarly ill-fated assumptions that were proven false during the recent past:

1. "It's not possible to lose \$650 per cow in a nine month period."
2. "It's not possible for the value of cows and heifers to drop by 40% in less than six months."
3. "It's not possible to have record high feed costs and record low milk prices simultaneously."

Because most dairymen had never seen anything like 2009 before, and because they still had very fresh memories of an outstanding 2007, the disasters that took place were not on anyone's radar until it was too late to do much about it. So what does this mean for 2011?

### **The battles of 2011 will likely be different than the battles of 2009:**

As feed prices are once again rising and milk prices have been swinging quite dramatically (I am writing this on January 25), I hear the refrain "here we go again" sounding from many dairymen. I don't think we are in for a repeat of 2009 for two main reasons. First, the majority of clients that I am working with don't have enough equity to absorb a loss of \$650 per cow. Second, there is substantially less credit available now than in 2009. This lack of credit is where most dairymen need to be focused. Perhaps the most critical and most dangerous assumption that could be proven wrong in 2011 is that "because I have been given credit in the past I will be given credit again." While a tremendous amount of energy has been spent focusing on milk and feed prices, very little attention has been given to the diminishing credit markets.

The first and most obvious source of credit is from the banks. In recent months most banks have been decreasing the amount they will lend on cows to the point that they are not lending a whole lot more than what current beef prices will yield. Keep in mind that most feed and herd loans renew annually which allows the lenders to change the rules and / or call in loans as they deem necessary. It is also important to remember that the loan officer that you deal with does not set policy for the bank. There are persons higher up the ladder of that institution that ultimately determine the level of commitment they are willing to show to individual dairy farmers and / or the industry as a whole.

The second source of credit is from vendors. Many of these vendors were caught off guard by the losses of 2009 and many did not know how bad things were until it was too late. As such, they had no strategy for dealing with increased receivables from dairymen and by default many of them extended credit hoping things would eventually turn around. Now that many dairymen have gotten more caught up with these vendors I have my doubts about whether the vendors will be willing to go down that road again.

Because no credit relationship is 100% safe or guaranteed, the first line of defense is to be aware of this uncertainty and shore up your balance sheet in the event that you need to attract new suitors. While it is not a great environment to find new credit, a strong balance sheet certainly increases the chances that you won't need to find a new source of credit. If you do find yourself in need of a new source of credit, a strong balance sheet is about the only way it will be possible. For those of you who have \$200 per cow of working capital and debt to equity of less than 2 to 1 – congratulations. You are in a great position to survive and possibly thrive in the coming years. For those of you in a less enviable position the best way to improve the marketability of your balance sheet is to shore up working capital and decrease leverage. This may be easier said than done, but here are a couple of ideas:

1. Use any profits to pay down short-term debt and payables. The trend in the past ten years has been to use profits to fund growth. A dairy's working capital is its first line of defense against periods of loss. Growth that contributes to erosion of working capital could very well be the fatal blow to dairy's with a weak balance sheet.
2. Shed assets that are not essential to the survival of the farm. For dairies that have inadequate or negative working capital, it may be a good idea to sell quota and any growing stock that are not needed to maintain the current herd size. Some will argue that those assets could yield profits in the future and I would agree. But for many dairy farmers, selling these assets might be the only option that allows them to get to the future.

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