

Communicating With Your Lender

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Editor's Note: Following are tips and strategies you may use while working with your lender. We plan to include similar information and articles in upcoming issues of the Michigan Milk Messenger.

On a recent Sunday afternoon I was trying to complete a crossword puzzle. I needed to find a four letter word for debacle. Eventually I had to cheat because the only word I could think of after working dairy loans all week was milk. Milk, of course, didn't fit. The correct word was rout.

Participants in the dairy industry might feel like a rout is on after the first quarter of 2009. The precipitous collapse in milk prices, the historically low milk feed ratio and declining asset values are causing more than a few dairy producers and loan officers to wring their hands. The prevailing price of milk is below its cost of production, leading to milk checks that are not covering all of the cash demands.

This problem cannot be ignored for long. Modest and temporary cash flow shortages are not uncommon in agricultural businesses and are often managed by increasing accounts payables to suppliers. This strategy may not be a solution during this downturn. First, suppliers may have restricted access to credit due to the wider crisis in the banking industry and may not be willing or able to extend generous terms. Second, cash flow shortages may not be modest. GreenStone Farm Credit Services can forecast cash flow shortages of \$2 to \$3 per cwt. depending on a producer's cost of production and debt service demands. This

can be as much as \$500 to \$750 per cow which is significant to most producers.

Dairy producers will likely turn to their bankers for help in addressing their cash flow issues. The solution will differ from producer to producer depending on the scope of the problem and the producer's financial strength and cost of production. It is important for a producer to preserve their access to financing by maintaining a good credit history. Therefore, choosing to not make timely payments or requesting interest only repayment plans and other deferrals may not be the best option.

If the dairy business is experiencing cash flow problems, it needs more working capital. If new working capital is not available from outside sources, it will have to be created by additional term financing. In the short term, an increase in operating loans secured with livestock, equipment or real estate will solve the immediate cash needs. However, after the full scope of the problem is known, additional secured term financing to be repaid with future earnings is probably necessary.

Developing a plan with your lender depends on communication, timely and accurate financial information and a realistic assessment of the 2009 cash flow. It also depends on determining how much additional debt is going to be

created from the 2009 losses and an assessment of future cash flows and debt service capacity for 2010 and beyond.

GreenStone looks for a plan to include as many stakeholders as possible. For example, the borrower's self-help plan for conserving cash such as operating cost cutting measures and deferral of expenditures for equipment and improvements as well as obtaining additional supplier credit to the extent possible and other lender concessions including family debt.

Approval of additional financing will depend on the borrower's performance against industry standards over the past few years, additional collateral offered and the viability of the business plan when more favorable prices return. Low cost producers and borrowers with strong balance sheets have more staying power and more options.

CME Class III futures look better for the second half of 2009. Profitability for at least low cost producers should return if prices hold up. However, the price of milk is linked to the performance of the overall economy, if not the world economy, and although some seers are looking for a turnabout in late 2009, it remains uncertain. In the meantime, watch operating costs, conserve cash, be thoughtful and realistic about your financial plans, and stay in touch with your lender.