

THE ART AND SCIENCE OF AGRICULTURAL LENDING

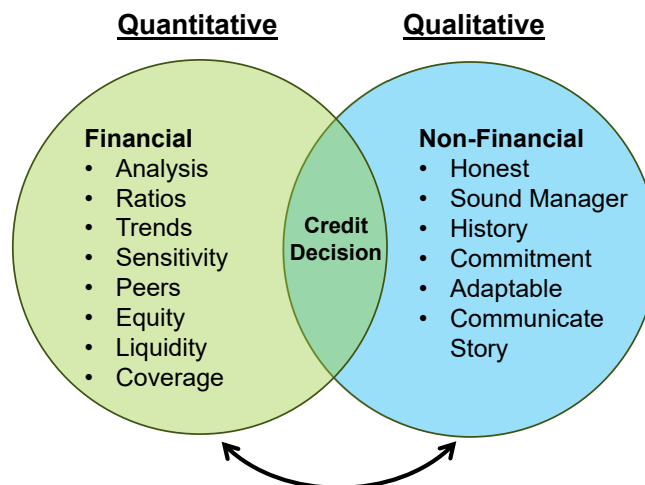


Dr. David M. Kohl

Professor Emeritus, Agricultural and Applied Economics
Member of Academic Hall of Fame, College of Agriculture & Life Sciences
Virginia Tech, Blacksburg, VA
Email: sullylabvt@gmail.com

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The Art & Science of Ag Lending



How Do They Link Up? Connect the Dots!

Agricultural Lending Financial Spectrum

Collateral Lender

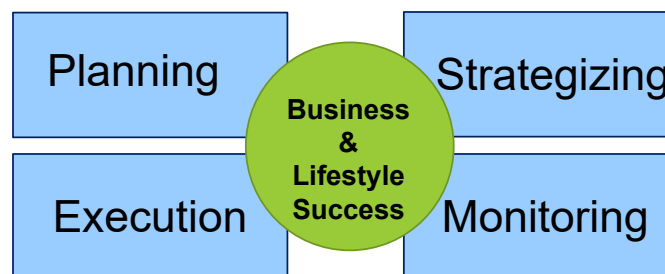
- Don't know cost of production
- Monitor financials once a year for tax reasons, no ownership of the numbers
- Shoot from the hip, marketing & risk management
- Family living cost issues
- Lender develops the statements
- <25% debt to asset ratio with land collateral

Profit, Cash flow, Sixth C Lender

- Knows cost of production & break evens via enterprise
- Develops & monitors financials & cash flows frequently
- Marketing & risk management plan executed and monitored
- Family living budget separate from the business budget
- Team of advisors
- Aforementioned is critical for producer renting & leasing and > 50% debt to asset ratio.

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Four Cornerstones of Success



R.E.M. Strategy:
Respond
Execute
Monitor

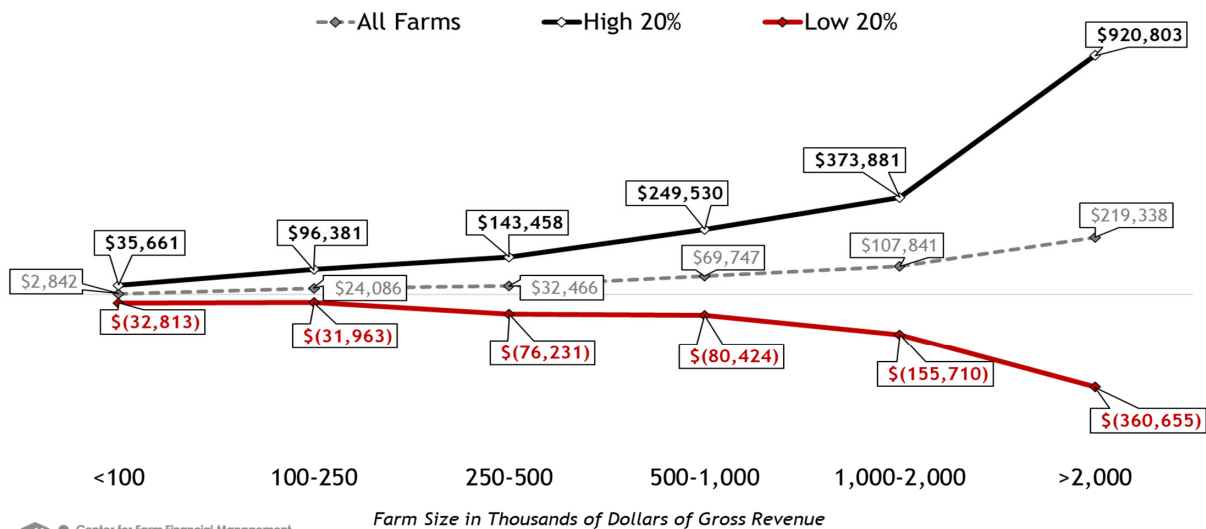
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Banker & Borrower Engagement: Both Sides Add Value

Borrowers:	Bankers:
Provide up-to-date balance sheets	Monitor financials
Provide quality projected cash flow	Provide feedback on financials
Complete financial sensitivity testing on prices, costs and interest rates	Provide financial benchmarking
Articulate goals	Are part of the advisory team
Fill out a short and long term Business IQ	Fill out the Business IQ Assessment
Use financials & Business IQ for managing the business	Demonstrate the C's of banking

2023 Median Net Farm Income by Farm Size

Data: Minnesota, All farms, Farm size measured by gross revenue in thousands of dollars



Quote for the Quarter Century Part 1

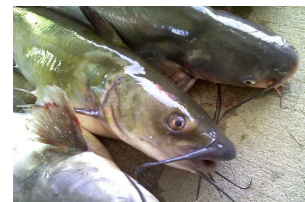
“The opportunity for business and personal prosperity is not about the size, the enterprise or the next big thing.”



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There Is No Such Thing as the Next Big Thing!

- Hemp
- Llamas
- Catfish
- Broccoli
- Emus
- Green energy payments
- Government bailout payments



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Quote for the Quarter Century Part 2

“It is about being a ‘five-percenter,’ meaning being a little better in many components of production, operational efficiency, marketing, risk management, finance, human resources and in the focus on your values and goals.”



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Lenders: What is Headed Your Way?

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Lenders: What is Headed Your Way? Lower Coverage Ratios

- Operating losses
- Refinances at higher rates
- Substantially higher living costs
- Low 20% negative ratios



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Lenders: What is Headed Your Way? Decline in Working Capital

- Devaluation of inventory
- Operating losses
- Capital expenditure decisions
- Lenders replenish working capital
 - Plan to preserve
 - Burn rate
 - Long term debt obligations



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Lenders: What is Headed Your Way? Monitoring Intensity!

- Once a year is not acceptable
- Accounts payable
- Credit card debt buildup
- Numbers decline, acceleration in larger customers
- Producers seeking new lenders
- Split lines of credit

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Lenders: What is Headed Your Way? Surprises

- Fraudulent activities
- Bills unpaid & left off payables
- Capital expenditures – deferred payments & maintenance
- Non-collectible accounts receivable
 - Custom work
 - Grain/livestock
- Loans from friends and/or relatives
- Machinery & equipment values decline by 50%
- Divorce, depression & disengagement

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Economic Down Cycle Focus

Focus on the Controllables, Manage Around the Uncontrollables

■ Controllables

- Monitoring with financial shock testing
- Servicing of debt
- Risk management risk
- Cash flow plan
- Profit plan
- Articulate how you got here
- How are you going to get there?
- Mental health

■ Uncontrollables

- Weather
- Geopolitics
- Trade tariffs & sanctions
- Other



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Thoughts on Credit Risk

- Non-financial factors move the credit quality needle quickly
- Non-financial factors behind the numbers
- Set proper customer expectations at closing
- Develop a plan & hold accountable
- Structure loans properly i.e. advances, rates, covenants & follow the process
- No surprise borrowing & lending
- Lender who thinks like business people but are lenders

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Business Development Wisdom

- Find a way to be a welcomed guest
- Plant seeds, be patient, place yourself #2, let #1 make mistakes
- Student of the industry, credit, & people
- Lender speak to customer speak
- Amish Belt Buckle: 10-20 years later
- Quick money & growth builds ego, consistent, steady to build character & culture
- How does the business make money, generate a cash flow

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Bridge & Pier Concept

- Are you building a bridge or a pier?

The more you go down the pier, the deeper the water. This increases the need for a higher level of expertise, and there are fewer options.



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Conditions that Drive the Customer to End of Pier

- Non-responsive customer/lender
- Lack of execution
- Got the equity, give me the refinance without a written plan that's monitored
- Unreasonable expectations to breakeven
- Focus on swamp issues
- Surprises, hidden debt, timing of processes



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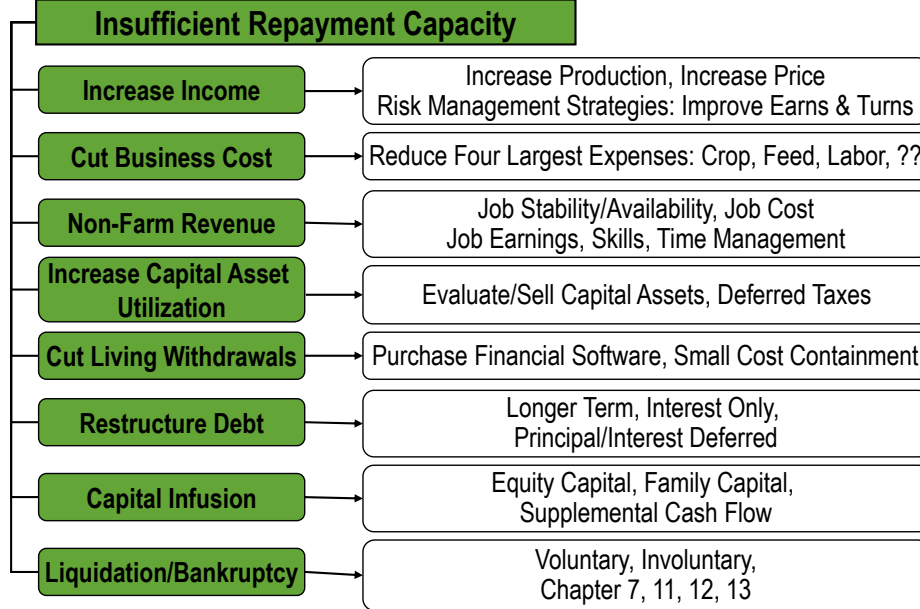
Conditions that Build the Bridge to Success

- Plan in writing by the customer/consultant not the lender
- Mini victories by monitoring, monitoring & monitoring
- Frequent communications: relationship officer/credit analyst & loan committee/customer
- Willingness to develop cash flow, balance sheet & Business IQ
- Transparent no surprises by borrower & lender



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Trouble Shooting Matrix



Business IQ: Management Factors Critical Questions for Crucial Conversations

Farmer Checklist	Your Score	Green (3 points or 4*)	Yellow (2 points)	Red (1 point)
1. Knows cost of production		Written	In head	No idea
2. Knows cost of production by enterprise		Written*	In head	No idea
3. Goals - business, family, & personal		Written*	In head	No idea
4. Record keeping system		Accrual adjusted	Schedule F (one & done)	No idea
5. Projected cash flow		Written*	In head	No idea
6. Financial sensitivity analysis		Written*	In head	No idea
7. Understand financial ratios, break evens		Written*	In head	No idea
8. Work with advisory team and lender		Yes*	Sometimes	Never
9. Marketing plan written and executed		Yes	Sometimes	Never
10. Risk management plan executed		Yes	Sometimes	Never
11. Modest lifestyle habits, family living budget		Yes*	Sometimes	Non existent
12. Written plan for improvement executed & strong people management		Yes*	Sometimes	Non existent
13. Transition plan/Business Owner plan		Yes	Working on plan	Non existent/controversy
14. Educational seminars/courses		Yes*	Sometimes	Never attend
15. Attitude		Proactive	Reactive	Indifferent

***Extra Points:**
 - Progressive Business may receive 4 points for #2,6,7,8,14
 - Struggling Business Attempting Turnaround may receive 4 points for #3,5,8,11,12
 (See pg. 2 for Progressive and Attempting Turnaround definitions)

Score	Overall Analysis
35-50	Strong management rating, strong potential for resiliency & agility
24-34	Moderate management rating, potential issues in resiliency & agility
<24	Weak management rating, potential major issues in resiliency & agility

Business IQ Exercise

- After completing the Business IQ: Management Factors Scorecard, what are three areas/points in your business that you will continue and three areas/points for improvement?

Three areas/points to continue:

- _____
- _____
- _____

Three areas/points to improve:

- _____
- _____
- _____

Business IQ Scores Successfully Navigating Technology/Innovation & Adversity

Business IQ Score	Success Rate of Adopting Technology/Innovation & Adversity	Stoplight Risk Rating
<25	Very low	Red
26-30	Low to moderate	Red
31-39	Average to above average	Yellow
40+	High to very high	Green

Top Ten Quotes

- “If you’ve got the dirt, then you can’t get hurt.”
- “If it grows too fast, then it’s a weed.”
- “Family living cost is like concrete; once it sets up then it’s difficult to change.”
- “Most credit issues start and advance outside the numbers.”
- “The number one sign that a business is in trouble is build up of accounts payable and credit card debt.” “Not meeting payroll is the last sign.”
- “It takes four times the amount of time, money, and effort on a problem loan versus a performing loan.”
- “Know the cost of everything, but the value of nothing.”
- “Cash/liquidity is Queen on the chessboard.”
- “Cheap money trap: borrowers often say borrow all I can because the money is cheap but it is about repayment and debt service.”
- “Dry Powder Rule: cash not earning any returns in bank, big returns when you purchase assets or inputs at discounted rates.”

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Q&A with Dr. Kohl

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Dr. David Kohl's Contact Information:

Office:

(540) 961-2094

Alicia Morris

Scheduling:

(540) 493-2724

Angela Meadows

Email:

sullylabvt@gmail.com

Online Articles:



- Farm Progress Weekly Article:
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