Focusing on asset management that builds working capital has become a priority for Karmen Mehmen, of MBS Family Farms.

Lenders Requiring Higher Working Capital

Minimum levels average an all-time high of 25 to 30%.

BY BARB BAYOR ANDERSON

MBS Family Farms, north of Waterloo, Iowa, used to pencil in $100 per acre of working capital for their 90% corn production operation. But risk the past couple of years has nearly doubled that figure to $150 to $200 per acre, depending on the cost of inputs. Farmers are finding many lenders are hiking the necessary working capital minimum higher, perhaps for good.

"Farm people are not traditionally accustomed to having to carry working capital. This is a paradigm shift, but a necessary one, for farmers to access credit in the future," says Allen Lash, of AgriSolutions in Brighton, Ill. Lash defines working capital as the difference between the sale of current assets (those typically sold over the next 12 months) minus liability owed over the next 12 months.

For MBS's Karmen and Stan Mehmen, the deeper understanding of the value of working capital began with expansion in 2006 when son Kyle and daughter-in-law Kerri joined the operation. In addition to corn, the Mehmens raise specialty beans and have seed and trucking enterprises.

"We had to evaluate how much we were able to grow the business based on whether we could maintain the minimum working capital," says Karmen. "We believe we must maintain at least 15% of the cost of putting our crop in as a minimum acceptable working capital. We take our available working capital and divide it by our acceptable level, which tells us how many acres we can comfortably maintain or grow."

BLAME HIGHER VOLATILITY. Until 2008, Lash says the generally accepted lender minimum for working capital was about 15 to 20%. For example, 170-bushel-per-acre corn sold at $2 per bushel provided $340 in total revenue. That translated into about $50 to $70 per acre in needed working capital, which Lash says satisfied most lenders. Then commodity prices ▶

Working Capital Calculations

MIDWEST	Pre-2008	Post-2008
Revenue/A	$375	$800
Working Capital %	15	25-30*
Working Capital/A	$56	$200-$240
Working Capital Increase	$144 to $184	

HIGH PLAINS	Pre-2008	Post-2008
Revenue/A	$280	$450
Working Capital %	15	25-30*
Working Capital/A	$42	$112-$135
Working Capital Increase	$70 to $93	

MID-SOUTH	Pre-2008	Post-2008
Revenue/A	$340	$680
Working Capital %	15	25
Working Capital/A	$50	$170-$200
Working Capital Increase	$120 to $150	

*PERCENTAGE IS SPECIFIC TO LENDER SOURCE: ALLEN LASH, AGRISOLUTIONS

took off and volatility rose, followed by input costs. Lash says many lenders moved the acceptable range to 20 to 25% to cover risk.

For 2009, the credit crisis raised the minimum working capital level again to 25 to 30%, the highest ever. Lash says one lender he knows even sought 35%. Pencil in $650 per acre based on cash rents of $300 and input costs, and 30% is $195 per acre of working capital—four times as much as two years ago. In many instances, Lash says the minimum is non-negotiable. Farmers in this scenario have to come up with an additional $150 per acre just in working capital.

"The good news for crop farmers is that 2010 looks like a profitable year if they can lock in $4 corn for 2010 now. Show lenders that $650 in costs with $4 corn and 200 bushels to the acre will provide $150 in profit margins for working capital," says Lash. "Astute marketers will be able to lock in an even better margin. So if you make $150, and have your pre-2008 usual working capital of $50, then your lender should be more comfortable with the loan."

Karmen Mehmen has observed that having the right collateral can go a long way in furthering lender permissiveness. "Understand what your lender wants. Our experience has been that owning land is stronger than cash in the bank," she says. "Agriculture as an industry does not manage asset management very well. Farmers do not like assets sitting around where dollars are not working. Spending a dollar on something that builds working capital is better than spending a dollar on a new pickup where it is no longer producing for you."

Lash encourages farmers to be proactive and meet with lenders now to determine 2010 working capital needs. "If you can figure out how to lock in profits for 2010, there is optimism for having enough working capital to please your lender," he says. "Farmers will find the greatest stability now and in the future will be meeting lender requirements by locking in those profits ahead of time." ●

Working capital crunch

For farmers who face a working capital crunch, Lash offers several alternatives, listed in order of priority. While he says these are universal solutions for U.S. crop and livestock producers, livestock owners may find these options are not as viable with the recent pork and dairy losses.

1 PROFITABILITY. Lash advises farmers not to buy equipment or land if they need working capital. Leave dollars in current assets—cash, stored inventory, investments in growing crops and prepaid expenses—and agree during your loan not to buy fixed assets.

2 NON-CURRENT ASSETS. Once profitability is addressed, but working capital is still short, Lash recommends liquidating non-current assets. For example, a farmer who owns land worth $500,000 with $300,000 in debt could use the $200,000 less taxes for working capital if the land were sold.

3 CAPITAL. "The third option is to put more capital into the business," says Lash. "The bad news is if none of your relatives are willing to die so you can inherit their assets, this might not be a viable option. If you are a sole proprietor, another option may be to borrow from Aunt Millie. If you are part of a corporation, all owners should put in capital."

4 DEBT. Once these alternatives are covered, Lash says the fourth option is to restructure debt. Farmers can take current debt and shift it to long-term debt. The challenge is restructuring only provides a short-term advantage for unprofitable farmers. The position will deteriorate in three to five years and erode working capital. And while refinancing real estate at more favorable rates is sound, Lash says the long-term practice doesn't solve the underlying profitability issue.

"If you try the first four alternatives and still are short working capital, the final alternative is to ask your lender to forgive debt," says Lash. "That usually means filing for bankruptcy, which is never a good alternative.

"Farmers have to watch working capital like a hawk now. Stay in communication with lenders to stay ahead of the game. Farmers may find that some lenders will not be patient waiting for them to solve working capital problems."