INSIGHTS REPORT

VOLUME 11 WHAT'S INSIDE

Three fundamental traits of successful operations that pave the path to profitability.

How to make the right decision when an opportunity to purchase additional farmland arises.

Effective approaches to having difficult family discussions about your farm's future.

Every farm, business and community is unique. How can you adapt to changing local risks and opportunities while also keeping an eye on global trends and the nation's economy? With nearly 100 local offices and more than 1,200 employees, Farm Credit Mid-America is constantly working to help farmers in Indiana, Ohio, Kentucky and Tennessee leverage the economics of change in their favor. This report shares some of our insights to help you manage your operation and stand strong in today's competitive, ever-changing marketplace.

Matt Davis
Vice President – Agribusiness

FARMING TECHNIQUES MAY CHANGE, BUT THE FUNDAMENTALS OF RUNNING A PROFITABLE FARM YEAR AFTER YEAR REMAIN THE SAME.

THREE TRAITS OF A SUCCESSFUL OPERATION

There's no one-size-fits-all approach to successful farm management. From crop production to marketing, agriculture has grown vastly more complex. Still, for the many factors that have changed, there are three commonalities that pave the path to profitability.

1: A crop production plan that fits the farm

While the actions of Mother Nature weigh heavily on yield opportunities, farmers still play a key role in maximizing yield potential. Selecting the right seed and crop inputs, combined with effective in-season management, are primary factors for improving yields.

Reaching maximum profitability is a different story. Each field has a distinct history and characteristics that will determine its profit potential. And in a pure commodity production environment, the market determines prices and returns available at the farm level, which are currently at or near cost of production.

The key is to know what the market is offering and what each field is capable of producing, then creating a plan to heighten the return for each field. It could be a maximum yield approach, a minimum cost approach or somewhere in the middle. Being profitable with commodities requires being above average in some way, whether that's in production output, input costs, marketing revenue, efficiency or some other profitability factor.

2: True understanding of production costs

Regardless of your business, a good rule of thumb is to not sell your product until you know the cost of production. That's especially true in agriculture.

Many farmers calculate costs by the acre, but that may not be accurate enough. Grain isn't sold by the acre; it's sold by the bushel. Your goal should be to know the production costs of every unit for sale. That requires a thorough understanding of all costs, including fixed costs, not just direct crop input costs. Be sure to include capital replacement, debt payments, family living expenses, taxes, etc.

The next step is to determine a realistic desired market price. Putting your marketing plan in writing is important. It's easy to get busy in the fields and put off creating marketing plans or to waver from plans that only exist in your head. Having your plan written down and reviewing it regularly can help keep your targets top of mind as prices fluctuate.

Last, it's important to implement your plan. Volatility is the new norm in agriculture. Marketing can be an emotional task, so sticking to your plan helps overcome some of that emotion when it is time to make the sale. Strong emotions can lead to missed opportunities.

3: Well-balanced family living expenses

Balancing family living expenses with business profitability is a concern many farmers share.

Larger houses, vacation homes, recreational vehicles and other forms of leisure create fun, memorable experiences for your family, but can add stress if they begin to stretch your financial resources. Assets purchased with available cash during good times are easier to maintain. But when assets are financed, it may be difficult to sustain extra payments and recurring maintenance costs while trying to trim the family budget to help the farm cover its overhead expenses.

Every family's needs are different, based upon size of family, age of children and desired lifestyle, but knowing your total family living costs is critical to operational success. Creating a family budget at the beginning of the year will help you determine if your operation can support your living expenses. If something doesn't add up, you'll be better prepared to adjust your lifestyle or seek off-farm income sources to maintain it.

With so many responsibilities involved in running a farm, it can be easy for family budgeting to lose priority. Rather than thinking of budgeting as something that limits your family's quality of life, it may be helpful to consider it something that protects your family's quality of life for years to come.

In lean times, it's common to face difficult financial decisions, and it can be challenging to find a way to maintain profitability every year through market ups and downs. But thoughtful planning can help you find sustained success. You can't control the grain market, but you can change how you run your operation and how you spend your money.

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David Albin
Regional Vice President – Western Kentucky

CAREFUL PLANNING AND LONG-TERM THINKING WILL HELP YOU MAKE THE BEST REAL ESTATE DECISIONS FOR YOUR OPERATION.

SIX QUESTIONS TO ASK BEFORE PURCHASING FARMLAND

As farmland values potentially diminish from their sustained peaks of previous years, it may be tempting to take advantage of the lower prices. With the right timing and opportunity, adding property can be a wise investment. But purchasing farmland involves more considerations than most capital expenditures. The questions below can help guide your property search and inform the best decision for your operation.

Planning ahead

How productive is the land? A little homework can pay dividends later by helping you understand the property's income potential. The seller should be able to provide information on criteria such as the number of tillable acres, soil type, soil fertility and drainage, all of which have an impact on profitability. For example, if you find the land has poor drainage and needs to be tiled, you'll need to include that cost in your calculations.

Does the land have an accurate legal description? The key word to focus on here is accuracy. A good legal description will help you understand the exact acreage you intend to purchase. Look for a detailed survey with a metes and bounds description, then do some calculating on your own to ensure the advertised acreage matches up. Property Valuation Administrator records are another option to see how many acres are reported within the tract in legal records. And your local Farm Service Agency office may be able to provide aerial photos that give you an unbiased view of the land.

When should I start working with my lender? Strong relationships can play a significant part in determining the success of your operation. Consulting with your lender a year or two in advance of a major purchase will help you both evaluate the financial strength of your operation, which you can use to start your search. And the sooner you get started, the sooner you can prepare to meet the down payment and other cash flow demands. Your lender also can help determine the financing package that works best for your needs, such as establishing a fixed interest rate to make long-term budgeting easier.

Thinking long term

What effect will this have on my operation next season and beyond? A significant purchase should come only after a thorough examination of your operation. One consideration is your role after the purchase. Additional land means additional responsibilities. This means either more hands-on time by you managing the farm or finding additional help, giving you a more managerial role. Either way, a shift in day-to-day decision-making is required.

A significant purchase should also have you thinking about succession planning. If you don't already have a plan in place, start thinking about how more land and a potential long-term loan will affect your operation's stability in the future. If you do have a succession plan in place, evaluate how this purchase will affect whoever will take over the business.

Is my operation financially strong enough to take this on right now? The million-dollar question is, what can you immediately afford? To answer this, look at your working capital situation. Do you have enough cash on hand to make a down payment and meet your other financial demands? Generally, you will need to contribute 25 to 30 percent cash as a down payment; otherwise, you'll need to meet that minimum range with additional collateral in lieu of cash.

Consider how using cash or assets as a down payment will affect other areas of your operation. Extra expenses beyond the purchase of the land and daily operation, such as facility improvements, fencing and equipment upgrades, might be necessary with more acreage. You'll need some cash to handle those additional obligations.

What are my operation's expenses and income potential? Think about the land's long-term potential to generate income beyond the first year or two of the purchase. Financing with a long-term loan requires close analysis of your operation's fixed costs, variable costs and income potential. Above all, you'll need sufficient financial capacity to withstand inevitable market downturns. Yield and grain prices will fluctuate, but knowing your five-year yield average will help evaluate your operation's longer-term financial strength.

Investing in additional acreage for your operation isn't a decision to be made overnight and should not be taken lightly. But as you spend time going over plans for your operation, these questions will help you identify the right decision when an opportunity arises, with an emphasis on long-term prosperity.

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– Does the land have an accurate legal description?

– When should I start working with my lender?

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– What are my operation's expenses and income potential?

Lori Tennell
Regional Vice President – Indiana

CONVERSATIONS ABOUT SUCCESSION PLANNING CAN BE CHALLENGING. HERE'S HOW TO MAKE THEM EASIER FOR ALL GENERATIONS.

IS IT TIME FOR A CONVERSATION ABOUT YOUR FARM'S FUTURE?

Whether it's due to very different personalities or conflicting visions for the future, farm families often experience tension when making decisions about the future of the business. While every family has its own unique dynamic that can make those choices hard to discuss, these are the most common topics that lead to disagreement:

- Whether to buy land or equipment
- When to start estate planning
- How to bring another family member into the operation
- Issues related to marriage and divorce
- Financial challenges
- Changes in management structure
- Labor issues

While these conversations will always be challenging, successful resolution is possible. A few communication strategies go a long way toward ensuring individuals are heard and consensus is reached.

Before the conversation

Operation-oriented discussions with family are a business conversation, first and foremost, and that calls for preparation. We encourage customers to do a few things before any family conversation:

Set aside the time. It's important to approach family members and let them know you want to have a discussion. Don't just sit down at Sunday dinner and start asking your relatives questions about estate planning; they may leave feeling attacked or disoriented. It is far more important to express concern about a certain issue and ask to talk about it. You can then find a time that works for all interested parties.

Gauge your family members. While brainstorming how to approach a certain issue, think about your family members' personalities and anticipate their reactions. Try to identify and avoid any triggers, such as specific events or words, that have caused negative reactions in the past. The goal is to create an environment where each family member feels accepted and heard, and is not put on the defensive.

Do your research and write things down. Prior to sitting down with family members, do some research. That could mean asking an expert for guidance or exploring options online. The more complicated the issue, the more research you should do. After you feel comfortable with available options, take time to write out your talking points, questions and goals for the conversation. This will help keep the group on track.

Consider bringing in a third party. If a topic is especially sticky, it may be best to bring in a third-party financial advisor, attorney or other expert. Conversations about money can be particularly hard, and individuals may be judged as protecting their own self-interests. A neutral third party can suggest solutions and provide professional guidance without this negative perception. Your loan officer can be a wise choice, as he or she has a holistic view of your operation's short-term and long-term goals, as well as industry expertise.

During the conversation

With your prep work complete, it's time to sit down with your family. While having your talking points and research laid out will help you follow your agenda, the tips below can help keep the conversation from devolving into an argument.

Be intentional. While some conversations are emotional, it's vital to be intentionally patient, thoughtful and kind. Be aware of your body language and make sure you appear open and receptive. Above all, take time to listen to what others are saying without appearing defensive. Don't shy away from apologizing if needed; these discussions aren't about who is right, they are about what is right for the farm.

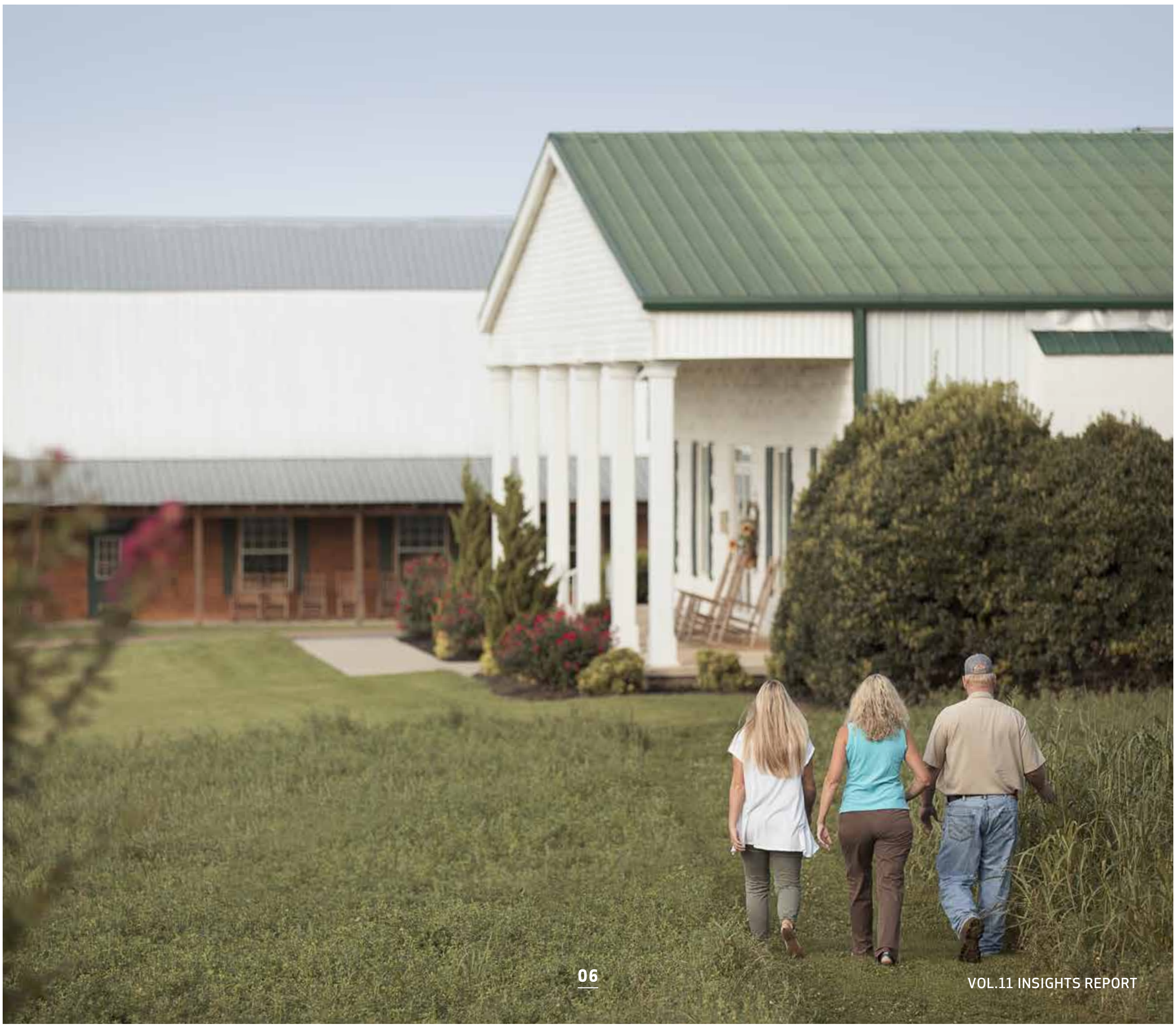
Know when to take a break. Things can easily get heated and people can begin to lose their tempers. If this happens, take a 10- to 15-minute break to give everyone a chance to cool down. It may be necessary to pause the conversation and schedule a different time to pick it back up.

Focus on what matters. In the end, two things are most important: your relationship with your family and the long-term success of the operation. The person who controls the assets is ultimately the one who must make decisions. Don't sacrifice the joy of rewarding family relationships or the overall success of the operation for short-term gains.

Moving forward

You may want to consider scheduling regular family meetings. When these kinds of conversations become an established part of the operation, it relieves tension and helps people open up over time. Annual family meetings can include discussions on financial performance, short-term and long-term goals, and planned production improvements.

Having family conversations about your business may not be easy, but avoiding these discussions can have a detrimental effect on your relationships and the farm. Taking the time to prepare, knowing when to bring in a third party and coming to the table with empathy can move you toward positive, healthy decision-making for your family's farm.



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