

Financing Grazing Operations Opportunities and Risks

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Benefits from Grazing Dairies

Grazing dairies provide states like Missouri a viable alternative for maintaining or expanding the existing dairy infrastructure.

- Potentially lower barriers for entry that may enable new or younger farm operators to begin dairying.
- Compliments the terrain and highest and best use of agricultural properties.
- Dairies can provide greater profit potential compared to other agricultural enterprises.
- Energy independence by better align production to the processor and end user.

Benefits of Grazing Operations

- Can provide more stable profit margins and supplemental income via sale of excess breeding livestock.
- Supports rural infrastructure and employment.
- Reduced perceived environmental impact on the community and land stewardship.
 - County health and zoning ordinances
 - Permitting
- Aligns with consumer preferences for “natural” products.
- Real property has alternate uses that may help to preserve asset values.

Lending & Risk Considerations

- Start-up or rapidly expanding operations inherently represent a greater challenge to management and increased risk to the lender.
- Potential concerns:
 - Management transition from production focus to:
 - Human resources
 - Business planning
 - Financial analysis and reporting
 - Risk management
 - Cow Procurement & Production
 - Genetics
 - Cull rates and Herd health
 - Forage Quality and Seasonality

Business Planning

A written business plan is critical to the producer and lender to evaluate risks and cash flow needs of the business.

Business plan should include the following:

- Cow procurement plan
- Budget – listing of all expected capital expenditures
- Cash flows (Sources and Uses):
 - Monthly cash flow of each income and expense line item from beginning until steady state is forecasted to be achieved either the second or third year.
 - Crucial to quantifying cash flow deficits that must be addressed.
 - Supported explanation of assumptions.

Sensitizing the Cash Flow

Develop “what if” scenarios to determine the impact of changes to the original business plan. Sensitize the budget and cash flow for impacts from revenue and operating cost adversity. Factors to consider:

- Milk price
- Production
- Feed costs
- Cull rates
- Interest
- Consider combinations of two or more factors.

Financial Targets

- Ownership equity of $> 50\%$;
- Working capital or current ratio of 2:1;
- Debt cow -- \$3,000 maximum; and
- Interest and term debt principal payments 20% or less of gross income.

Operating efficiencies vary and impact the debt servicing ability of individual businesses.

Loan Terms and Conditions

Typical loan structure:

- *Seasonal operating* for periods of reduced income or to cover prepaid feed or expenses. Expectations are to be repaid when cash flow increases.
- *Cattle revolver* perpetual funding of cattle inventory supported by a borrowing base. Term loan with revolving feature with shorter maturity – three years. Lenders may accept quarterly or monthly interest payments.
- *Term loan* for real property and improvements. Maturity based on the a combination of useful life of improvements and value of bare land. Producers may find it prudent to obtain longer term fixed rate loan to assist in managing interest rate risk.