The New Normal is the Old Normal

While listening to business channels or reading financial and business publications, the term “new normal” is often discussed. When economic times were hotter than a pepper sprout in agriculture, the thought was that the industry was in a “new plateau” or “new normal.” Let’s take a different twist and determine if the new normal in the road ahead is similar to the old normal. The FINBIN database from the Center for Farm Financial Management at the University of Minnesota, which summarizes data from 20 states and thousands of farms, will be examined as a backdrop to this question. Then we will analyze what steps producers can take given the economic fortunes that have beset the industry.

Analysis of median net farm income in constant dollars adjusted for inflation from 2013 to 2017 finds that the average profit generated was $35,000. This period is considered as the beginning of the agriculture economic reset following the economic super cycle. These figures were contrasted to the period from 1996 to 2001, prior to the economic super cycle. Interestingly enough, the median net farm income during that five-year period was approximately $50,000. This is $15,000 higher than in recent years! The period from 2001 to 2005 was more financially robust with $54,000 as the median net farm income measured in constant dollars. When contrasted to the economic super cycle years of 2007 to 2012, one can quickly see the magnitude of profits and cash flow generated in that period. The median net farm income was more than double when compared to any other period registering at nearly $125,000 when constant dollar analysis was applied.

The bottom line is the period from 2007 to 2012 was truly an aberration that has only been replicated three times since 1910. The convergence of ethanol mandates combined with the growth of emerging nations’ economic status, a low value of the dollar which encouraged exports, and a low interest rate environment were ingredients in the recipe to make large profits in most agricultural enterprises.

This analysis points to the fact that the “new normal” may be similar to the period from 1996 to 2005. Yes, an occasional weather blip or an unusual economic event may create a one or two-year spike in net incomes. Tighter margins with extremes in volatility may be the industry’s new normal. The major question amongst producers, lenders, and the agribusiness community is what is the duration of the economic reset? Six years of an economic reset is a given with the fortunes of 2018 nearly in the books. Trade tensions and higher interest rates driven by the economic performance of the coastal and urban economies are major headwinds. A strong dollar, as a result of higher interest rates, and currency adjustments by other countries to gain a competitive edge are factors that indicate the duration could be extended. The net income pie will be smaller with a group of farmers and ranchers earning a larger portion of that smaller pie.

Proactive Manager versus Reactive Manager

In the elongated reset, there appears to be two sets of managers. One is the reactive or passive manager. In the economic super cycle, this group did not heed the warning to build working capital. Instead, they grew and invested in capital assets, such as machinery and equipment, to curb income taxes. The reactive managers enjoyed excess profits and lifestyle pleasures and did not take the opportunity to pay down principal on intermediate and long-term debt. This group's focus was on production at all costs, often garnering rental ground regardless of the economics. This segment of producers is now in their third and fourth round of debt restructuring. Carryover operating debt is being refinanced over 10 to 20-year terms using the land and real estate equity as a negotiating tool. In some cases, this group is spiraling down financially and burning through land equity as losses mount. This is particularly concerning in areas and regions of the county where land values are declining.

This group, while often very good production managers, lacks the ability or incentive to be better marketing and business managers. If the reactive manager operates a larger business, of course there will be more zeros added to the numbers. Financial problems for larger businesses can quickly get out of control.

In contrast, the proactive manager built working capital and liquidity during the heyday years from 2006 to 2012. This group paid down principal and their business growth was very calculated. They stayed within the parameters of financial leverage and working capital that positioned the business to be resilient and agile. Their family living costs and lifestyle habits were disciplined with the perspective that the good times may not last. This group has burned through some of their working capital reserves and, in some cases, has refinanced their debt. The one key that sets this group apart from the reactive managers is that they have a plan moving forward to adapt and adjust to the "old normal" economics. They are working side-by-side with their agriculture lenders and other advisors to tweak the business and work on the business basics.

Some proactive managers have changed enterprises or aligned with the market changes and conditions. Others have drilled down on their cost of production metrics and executed marketing plans when the opportunity for profits presented itself. Cutting both fixed and variable costs have been a high priority for many producers. However, proactive managers have cut the right cost that matches the optimal economic outcomes. Still others have tightened their belts with better awareness of family living withdrawals. Some producers have made tough decisions by eliminating unproductive people from their operations, including family members.

The fall and winter renewal season will be one at the crossroads. The reactive manager in the “old new normal” may be denied refinancing or restructuring debt without a plan for financial improvement. Preservation of wealth, partial liquidation, and scaling down may be action items for this group.

The proactive manager will be more balanced in production, marketing, finance, and operational efficiency. While profits going forward may not be stellar like what were experienced during the economic super cycle, innovation and adaptation will provide this segment with opportunities for long-term sustainability. Very similar to the 1980s or the “old normal,” this period of adversity will bring out changes in management practices and new approaches that use resources linked to the marketplace. For those that make the shift, they will be well positioned for the turnaround and fortunes of agriculture.

Perspective

Recently, an agricultural lending organization indicated that young producers are adjusting to the agriculture business downturn better than the older generation with more equity. The reason was that they had stronger business and financial acumen or business IQ. The younger generation was more innovative, flexible, and adaptable. The older generation is using their equity, particularly land equity, as a cushion for the financial stress to obtain multiple refinances to weather the storm. Whether it is the “new normal” or the “old normal,” profits and cash flow service debt. Partial or total liquidation can reduce or eliminate debt, but in the long run it is not a sustainable strategy.