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The Hot Seat
By: Dr. David M. Kohl

In my travels around the country, one of my favorite activities at seminars is to solicit written questions from the audience on 3 x 5 cards. Then, I select an individual to ask me the questions in a rapid-fire exchange similar to *Mike and Mike in the Morning* on ESPN. In this final edition of the 2014 article series, let's examine some of the top questions from the road on a variety of subjects.

What will be the extent and duration of the economic moderation agriculture?
The economic moderation of the great commodity super cycle is in its early stages. While there are many factors that could impact the depth and breadth of this moderation, a convergence of events will need to be carefully observed.

The slowdown of the emerging nations must be monitored. Particularly, watch the *fragile five*: Brazil, India, Indonesia, Turkey, and South Africa, for economic, political, social, and military unrest. The 800-pound gorilla in the emerging nations is China, which represents one-half of the developing countries' collective gross domestic product (GDP). Possible social unrest, the condition of the economic and banking systems, and, of course, natural resource limitations including land, water, and air quality will have to be closely watched. China is a large agriculture trading partner with the United States, and it will become a tough negotiator. Do not bet the farm or ranch on China because agricultural trade deals can come and go very quickly as a result of agricultural and non-agricultural issues. The recent corn and soybean trade issues and poultry trade inconsistencies in the past are test cases.

In addition, observe bioenergy mandates, the amount of Federal Reserve stimulus, and weather in major production areas worldwide. If all four of these factors are in an unfavorable position, the economy may face challenges for an extended period of time.

What is your interest rate forecast?

Interest rates are a powerful topic in agriculture because over 90 percent of the recent prosperity can be linked to low interest rates and low value the dollar. While many agricultural producers have locked in intermediate and long-term rates, the vulnerability is in the operating money, which immediately impacts profit margins and cash flow. Watch for three variables in economic reports: unemployment rate, inflation rate, and GDP growth rate. According to Federal Reserve comments, an unemployment rate under 6.5 percent, an inflation rate above 2.5 percent, and a sustained GDP growth rate above 2.5 percent to 3 percent will result in a 25 basis point or quarter percent increase in interest rates. A spike in interest rates would be "back to normal" at 6.5 percent prime rate. Producers and lenders must financially shock test changes in interest rates of 1 percent, 2 percent, and 3 percent on cash flow to see how they impact profit margin.

How much will land values correct?

The trillion dollar question concerns land values because much of the wealth thru paper gains or land appreciation has resulted in strong equity on balance sheets. Two marginally profitable years will result in a softening of land prices and cash rents. How much? If the convergence of events discussed earlier occurs in a negative manner with rising interest rates, a correction of 20 percent to 40 percent in some regions could occur, depending on local dynamics. Those who are good managers with liquidity reserves, particularly cash, will weather the land devaluation white waters and capitalize on opportunities to buy land at lower prices.

Do you see a generational shift in agriculture?

Generational shifts in agriculture are well underway, particularly in the livestock industry and retail entrepreneurial segments. The grain side of the industry has not seen as much of a shift due to the use of technology, less labor-intensity throughout the year, and the barrier of entry created by high land prices and cash rents. This results in an older age group and consolidation in the grain sector. For the older generation in transition, finding the right people from the younger generation segment, who may not necessarily be family members, will be important in carrying on a legacy and giving back to agriculture. On the other side, planning, patience, and execution of operational, management, marketing, and risk management plans will be critical for the new kids on the block. The economic moderation in some sectors and prosperity in others will weed out marginal or average managers, which is just the nature of the business cycle.

Should a young person study agriculture?
Yes, yes, yes! Of course, I am biased because I have passion for the agricultural industry. First, education is a lifelong journey, not just for those in their twenties and younger. In your studies, select the teacher, not necessarily the course. Outstanding teachers in any discipline, like outstanding business people and coaches, are few and far between. Along with agricultural studies, I suggest studying a little business, economics, finance, and a touch of the sciences and communications. A couple of internships should be on the docket in your educational journey, as well as state or national ag leadership programs in the U.S. and abroad. Staying current on information, networking, and action will be critical for success.

When is the best time to buy land?
Anytime can be the right time to buy land; however, the decision must pass these sniff tests. Is the land purchase consistent with your short-term and long-term goals? Second, conduct scenario tests on cash flow with various yield, cost, and price projections to see how they impact coverage ratio, ROA, and profit margins. Next, assess resources such as machinery, equipment, labor, and management to determine if you have sufficient assets for expansion. Finally, examine debt load, i.e. debt to asset ratio and total debt to EBITDA. When the debt to asset ratio exceeds 50 percent and total debt to EBITDA (earnings before interest, taxes, depreciation, and amortization) is above 6 or 7 to 1, you are out there on thin ice. By the way, liquidity above 33 percent working capital to revenue and a risk management program will be critical as well. I also encourage businesses to keep one year of debt service as cash in the bank.

What topics should be emphasized in a farm management course?
This question came from a very young instructor just recently. Budgeting and cash flow are very critical elements that need to be emphasized in a farm management course, along with sensitivity testing, financial analysis and financial benchmarking. Best management practices, which include soft skills or human resource skills, will be also a very important aspect to be covered, along with marketing and risk management. One area that is often not emphasized enough in my experience is personal finance, which examines the household, credit history, investments, wills, insurances, etc. This is an area that can be used by anyone inside or outside of agriculture.

I hope you have enjoyed reading about some of the hottest questions from the road. Be safe in the upcoming planting season. The future is bright for those producers with mental discipline, follow through and execution, with good mentors and a team of advisors. Best wishes for 2014!