Don't Put Your Ranch in Jeopardy

Industry experts offer their list of concerns that can threaten ranch business' financial stability.

by ***Kindra Gordon***

"If we will consider changes not when we feel the heat, but when we see the light, we will be better prepared." That's a piece of philosophical advice that Texas A&M AgriLife Extension Economist Jason Johnson wants ranchers to ponder. Particularly as the beef industry has seen a downturn in cattle prices over the past year, ranchers may be faced with making some "belt-tightening" business changes.

With that in mind, Johnson has surveyed lenders, as well as Extension and academic specialists, to gather their candid comments regarding the biggest threats they see to ranch businesses. It is advice many producers may have heard before, but it bears repeating and, hopefully, prevents a wreck or two.

Lender perspective

Topping the list of factors that contribute to ranch business wrecks, according to lenders, is failure to communicate. Johnson explains, "The sooner you let a lender know you might be having repayment issues, the more options there are to deal with it. They can't do anything after the note is due. They can't backdate information. But if you alert them three to four weeks in advance, some flexibility options may exist."

The second threat identified is being over-leveraged. "Just because you can borrow 70 cents on the dollar doesn't mean you should. All businesses need some cushion," says Johnson.

Unrealistic expectations or projections and overly ambitious expansion plans are also factors that can jeopardize businesses, according to lenders responding to Johnson's informal survey. To that, he advises ranchers, "Incremental is the best way to grow."

Regarding debt, lenders say business wrecks are more likely when owners fail to recognize good debt vs. bad debt. Johnson acknowledges that businesses typically aren't debt free. But he adds, "The object has to earn a rate of return higher than the cost or loaned rate, or it must appreciate and add to the bottom line."

A final concern identified by lenders was what Johnson refers to as the "investor's dilemma." He explains, "Business owners must decide if they will reinvest in the operation or if they should diversify in investments outside the business." To that, he says either way a 5 to 6% return is needed to make a worthwhile investment.

Extension and academic perspectives

From the perspective of Extension and academic experts, high-ranking and continual threats to cow-calf operations are weather and stocking rate implications. For instance, a drought may require cutting herd numbers by half, resulting in overhead costs doubling per head. Thus, Johnson recommends pasture, rangeland and forage insurance where available.

An "overzealous attitude or the fear of missing out" is another factor that can threaten ranch businesses. Likewise, Extension and academic specialists say they most often see bad judgment about business decisions occur during times of prosperity.

To this, Johnson emphasizes it is important not to let operating expenses get out of line. And he says, "Sometimes you need to walk away." As an example, he cites times when heifer prices are too high. He also says buying something to avoid paying taxes is usually not a good rationale.

Failure to assess how much "return to labor" or family draw the operation can support is also a threat to the business.

Lastly, Johnson and his colleagues emphasize the importance of fundamental productivity and efficiency issues. Johnson says, "Don't overlook doing breeding soundness exams (BSE) for bulls, and monitoring body condition scores (BCS) and nutritional needs of cows so they will rebreed. Other factors to monitor include an analysis of optimal cow size for your operation situation and keeping herd-age composition in balance."

Combat complacency

Johnson says, most importantly, cow-calf producers must realize that things do change. "You can't get too comfortable with high cattle prices and you can't get lulled to sleep by low feed costs," he says.

He encourages producers to continually evaluate opportunities as well as to know when to cut their losses. Johnson concludes, "What made sense during a time of increasing cattle prices may not be profitable during the trend toward lower cattle prices." HW

Additional admonishments

Texas A&M Extension Economist Jason Johnson has compiled a list of six strategies that he dubs "lessons learned from 15 years of SPA (Standardized Performance Analysis)." What are they?

1) Minimize investments in depreciable assets, namely machinery and vehicles.
2) Avoid production of hay. Instead, build a shed, buy hay and minimize feeding losses.
3) Optimize the grazing system to keep production costs low.
4) Monitor and control purchased-feed expense.
5) Focus on reproduction, the number one production factor for cow-calf producers.
6) Minimize investment in horses.

Johnson also likes to relate a story he calls "lessons of Monopoly." He compares three teams: Team A has a large amount of cash but no properties; Team B has four railroad properties plus a bunch of cash, and Team C has all remaining properties and a small amount of cash. Which team will fare the best?

Johnson reports: Team C goes broke first because it is land rich and cash poor. Team A is the second group in trouble because every time it rolls the dice it owes money. "They are living beyond their means and have no income," Johnson says. Team B has the best result. It has a few good assets, but has enough liquidity.

Johnson concludes, "The old rule in Monopoly to buy all the properties to win is not true." He implies that these scenarios can apply to the real world as well. HW