promar matters

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WELCOME:

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The October edition of Promar Matters considers the implications of recovering milk price on cashflow. Without appearing to be the prophet of doom amidst what feels like a period of recovery, businesses need to remain focussed on cash.

I recently met with a senior banker from a national high street bank. He advised extreme caution with regard to the recovery period of an industry that has witnessed a period of sustained low prices. The feeling of comfort that things are on the up, coupled with an extended period of belt tightening, usually results in further requests for extension of credit – a situation that your bankers may not be comfortable with following a period of support.

Our article by Nigel Davies is written with very recent experience of the banking environment and thus provides an insightful viewpoint. The milk price has turned the corner but the volatility remains.

We value our customers at Promar and if you have any comments on this or subsequent editions of Promar Matters, please contact me on james.dunn@genusplc.com

MAKE SURE YOU UNDERSTAND YOUR CASH POSITION IN ADVANCE THIS WINTER

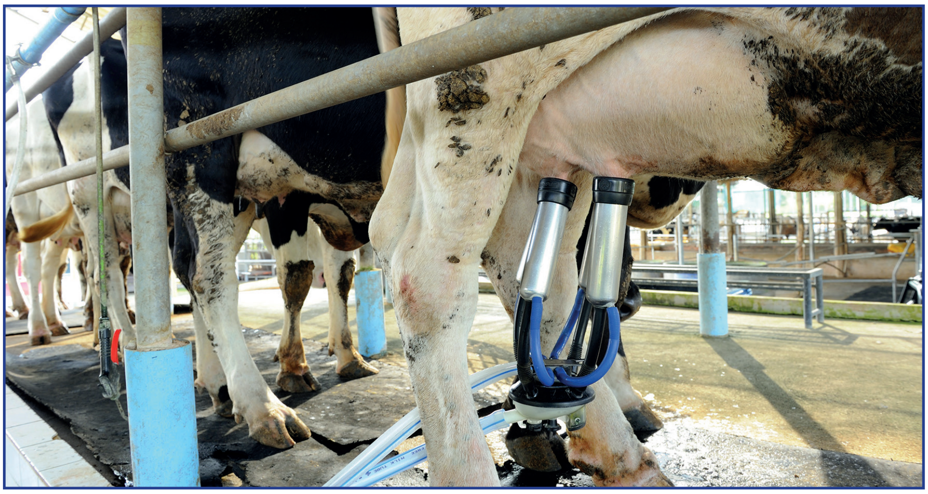
Nigel Davies
Consultancy Manager

Promar International National Consultancy Manager, Nigel Davies discusses the importance of foretelling your cash position over the next seven months.

Although milk prices have started to rise, clearly this does not mean that the cash position on farms will improve instantly.

The experience of many businesses coming out of historic troughs in profitability is that there is delay or a lag effect in any positive impact felt on the cash position.

This time round, on this cycle of volatility, it is likely that there will a further strain on cash resources over the next three months for a number of reasons:



1. Poorer cash position going into the winter – in general, milk prices over the last six months have been around 1.5ppl lower than for the same months last year, meaning cash income was lower, a situation compounded by lower milk output in many cases. The result is that going into the winter months, on many farms the starting cash position is worse than 12 months ago.
2. Expenditure on items and infrastructure not maintained over the last year (e.g. machinery and property repairs) can't be put off for ever, meaning that money not spent last year may have to be spent this year. Many businesses negotiated 'capital loan repayment holidays' with their bank and on HP agreements. In many cases these will be coming to an end, potentially resulting in capital repayments starting up again unless further 'holidays' can be negotiated.
3. Forage is generally of poorer quality meaning expenditure on purchased feed could increase. At the same time, feed prices are generally moving upwards.
4. On a number of farms, cows have not milked as well as last year, often as a deliberate strategy. The consequence now is that milk production and sales may be lower.
5. Creditor Support – the cash position of some businesses will have benefitted from extended credit in the last 12 months. Will the same or further extensions be available this year?

Combined, these factors mean that the spectre of continued cash pressure is a harsh reality on many farms, so the question is what can be done?

Quite rightly, there will be individual solutions for individual businesses, but the key for all is not to avoid or ignore the undoubted challenge and discomfort. Make sure that everyone who needs to know or can help are informed and on board. Don't hide the situation.

By being proactive, you have more time on your side and are more likely to find a better way ahead.

I would advise all dairy farmers to make the time to follow a four stage plan.

Know your current commitments and don't abuse them

Whatever the current sources of credit and cash to the business, be clear on what your commitments are for repaying that credit or cash and honour them. If you have an overdraft limit or credit agreement, honour them [this doesn't mean not making a case for more funding if justified].

Take the ultimate responsibility for a forecast cashflow for your business

You may prepare this yourself or if time is tight and it is an unfamiliar task for you, then delegate or outsource it to a reliable, competent consultant, but choose your consultant wisely. Done properly, it should give you the best possible line of sight to the cash position month by month and at the end of the winter, but also critically, the peak funding requirement of the business during the month, which is often on the day before the milk cheque is received, not the last day of the month.

Once the budget is completed, how does it compare with the cash, credit and limits available?

If there is any danger that balances will get anywhere near the limits, then it's time to act, because you should build in contingency in good time.

Don't hide the answer

As a short term expedient, it could be wise to share the position with other relevant business partners, your spouse etc. who may themselves have private sources of cash to inject. If these sources are not available, then it is time to plan the approach to potential external sources of cash such as the Bank, but not before you have a clear appreciation yourself of the long term future and viability of the business.

In the context of the long term

Before taking on more debt and approaching a potential lender, it will help the business if it clearly understands what its long term viability is, so that it can be clearly communicated (again potentially with the involvement of a competent consultant) to a lender. Otherwise, the lender will justifiably ask, why am I lending this money? In this sense, a business which is able to communicate that it has made a profit in the last 4 years out of 5 is clearly in a different position to one which has made a loss in the last 3 years out of 5. A business which is able to have an appreciation of its average cost of production over the last 3 years is better placed than one that is guessing its cost of production.

In summary, the cash challenges ahead are not likely to be easy for many, but with courage, planning, proactivity, strong communication, and often sensibly, with the involvement of a competent consultant, then they can be addressed, enabling business managers to then focus and enjoy more confidently their other key tasks in getting their businesses to perform well over the winter.

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