Weathering droughts, storms & trading conditions

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- For many, trading conditions are more difficult since the drought ended compared with trading conditions during the drought.
- Practical cost cutting has already been addressed by business owners and so other options need to be considered.
- Business sustainability demands a full understanding of the true costs of production.
- Avoid undermining your balance sheet beyond what is absolutely necessary.

Rainfall in 2010 and 2011 has been above average, bringing to an end the prolonged drought of last decade. But it never rains dollars! Rainfall only creates the opportunity to generate cash and recover some of the ground lost during the drought.

Other factors are now putting increasing pressure on the business bottom line, highlighting the need for ever-diligent business monitoring.

The drought breaks....

Rainfall in Griffith in 2010 was 605 mm and in 2011 was 490 mm. Both well above the long-term average rainfall of 396 mm. A further 285 mm was recorded by early March 2012. Irrigation allocations for 2010–11 and 2011–12 have been 100% – the first time 100% has been allocated since 1996–97. Burrinjuck has spilt so it is likely irrigators will have a 100% allocation for 2012–13. Likewise, dryland farmers are commencing 2012 with a full soil profile with beneficial implications for the 2013 crop.

High rainfall in late February and early March 2012 has filled soil profiles for winter crops, but some areas may be too wet to sow a winter crop if average rain falls over the next few months. The high rainfall was devastating in some areas with near record floods in the Lachlan and Murrumbidgee rivers and the Broken Creek, and an unprecedented flood in the Mirrool Creek. Summer crops and permanent plantings were inundated and the damage to these crops, livestock, pastures and farm infrastructure will be significant for many farmers. Some government assistance is available, including low interest loans through the Natural Disaster Relief Scheme administered by the Rural Assistance Authority (RAA) in NSW. Recovering from this flood will be a challenge for those most impacted.

Once the country dries out, full soil profiles and high irrigation allocations will create the opportunity to return to high levels of production. However, in this phase of drought recovery other factors are now conspiring against farmers' profitability, in particular the high Aussie dollar which has been at, or above parity (with short minor exceptions) since December 2010. Since our agricultural industries are export focussed, or at least heavily influenced by global forces, this high exchange rate has meant product prices have significantly declined. The partial easing of costs of imported goods has been a relatively minor offset.

Cost control is something farmers focus on and are even more diligent about during droughts. Therefore most businesses would not have the capacity to further reduce costs without, at the very least, adversely impacting on productivity. With low prices being received for goods, farmers are compelled to focus on yield to maintain any semblance of profitability. As always *yield is king.*

Commodity outlooks

During the drought, with low irrigation allocations irrigators were able to temporarily sell their allocations for higher value than they could generate by cropping themselves. The temporary water market has retracted back to less than $20/ML and irrigators are compelled to find a productive use for the water – which is a challenge with low commodity prices.

A large area of rice was grown in the Riverina in 2011–12. In addition to the uncertain price outlook, many producers faced increased costs from replanting and early season pest control. Low prices and high costs demand high yields will be required to generate worthy returns.

Contracts were difficult to access for other summer crops, such as sunflowers, soybeans and corn with indicative returns looking modest at best. Cotton is being grown in the region with varying yield potential, and on balance this crop looks promising. Cotton is a highly technical crop to grow, has high growing costs and is susceptible to cold weather. All of this means that potentially high returns need to be balanced against a high level of risk. Notwithstanding, in terms of summer crop budgets, cotton is the only annual crop that is currently showing reasonable returns.

The indicative outlook for winter crops such as wheat and canola is, at best, unattractive. Again the only way to compensate for these lower prices, other than prudent cost control, is to achieve high yields. As always prudent cost control and high yields need to be carefully balanced. The worst outcome will be pruning costs to the point of decimating yields.

The more intensive irrigation industries are also experiencing significant problems at the moment. Wine grape growers are experiencing low prices, low yields and bad weather. Prices received by fruit and vegetable growers are down as a result of various factors, including competition from overseas products and manipulation of the market by the two major supermarkets.

So what's the answer?

Again, yield is king. But, it's not just about yield. It is *yield and price, less costs*, that provides the gross margin. When prices are low and/or farmers have little ability to impact on prices yield becomes the primary focus. There is often a compromise between costs and yield to be managed with the ultimate aim to maximise the margin. The relationship between yield and cost of production must be understood. For example a 0.5 t/ha wheat yield increase can reduce the cost of production by more than $50/t (including fixed costs and debt servicing).

The true costs of production and all business operating costs need to be understood. To best do this, a budget should be prepared for at least the next three years and costs monitored against the budget to identify and understand any variations. With a trend towards more grain storage on farm, the timing of grain sales has a big impact on cash flow. Consider the opportunity cost of delayed sales and cash position in the decision-making process. In addition it is important to obtain an objective opinion from trusted business advisors. This information generated from this process should be routinely reported to your financier to ensure they are comfortable with your progress and direction.

Protect your balance sheet

During the drought many farmers needed to extend their finance facilities to cover accruing losses. At the time, with land values buoyant and a reasonable outlook for commodity process, financiers were usually supportive. However, in this current difficult environment financiers have tightened their lending criteria and at the very least, are demanding more detail with most proposals to support loan extension applications. In many circumstances they are refusing requests for additional finance or requiring conditions which will undermine your capacity to generate future profits and ultimately undermine the viability of your business.

If seeking additional finance, it is important that to understand the ramifications. The worst outcome could be a financier approving the request without ensuring the applicant fully understands the potential undermining of their balance sheet. In the budgeting process, a three to five year cash flow budget should be used to determine the ability to pay back additional funds and/or maintain the balance sheet of the business. The budget analysis must include an opening and closing balance sheet to ensure that a strong cashflow is not being achieved by the undermining of a balance sheet.

Further information

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Editor's note

This article was written before the full extent of the autumn rains and flooding in the Riverina was understood. The context of some statements in the article may have changed during the design, printing and delivery process of this magazine.

The Riverina has very unluckily gone from drought to flood, but there is "more money in mud than dust".