



Peoples Federal Savings Bank



QUARTERLY AGRICULTURAL NEWSLETTER

Volume 8, Issue 3- Fall 2011

September 28, 2011

Working Capital—Why Do I Need It Now More Than Ever?

Why is working capital important?

Everywhere you look today we see volatility; there's pricing volatility, input cost volatility, volatile counter-party risk and financial market volatility just to name a few. As volatility continues to loom on the horizon, having liquidity available is more important than ever.

We've all heard the statement that 'Cash is King'. Working capital embodies this statement by giving you the liquidity to take advantage of future opportunities but more importantly, in today's environment, it gives you the staying power to weather the storm. You may think of it as your 'rainy day' fund.

"A lack of working capital can be a serious problem especially since the amount of capital needed to farm has nearly tripled compared to two years ago," according to Bill Craig an Agricultural Business Management Educator with the University of Minnesota Extension. Without working capital you may need to sell less liquid assets to meet obligations and create liquidity. Creating liquidity from sources

other than earnings can be painful, because it comes in the form of selling real estate to catch up on bills or borrowing money from your lender for operating expenses.

Working capital buys time until you can get back on your feet or until income returns to a more normal pattern.

How much working capital do I need?

How much working capital you need is different based on your obligations, income stream and size of your operation. For example, if you have regular monthly payments from a contract source (keep in mind counter-party risk however) or off-farm income, you might need less working capital than someone who has seasonal grain income.

Dr. David Kohl is warning grain producers that their working capital needs to be increasing in the current environment. To be on the safe side, Kohl suggests maintaining something between 15-33% of revenue and if you are conservative or desire flexibility, maintain levels above 33%.

Net working capital is calculated by deducting current liabilities from current assets. While this absolute number is important, the ratio of net working capital to accrual-adjusted gross farm revenue gives a good guideline to use for benchmarking purposes.

What is considered a good ratio? Generally speaking, if working capital to revenue is below 10 percent, you are on thin ice if an economic hiccup comes along, regardless of enterprise. At the other end of the spectrum, above 33 percent would be quite favorable.

After you crunch this number, then determine if working capital is protected with a risk management plan. Grain and livestock inventory without a marketing plan can result in a wide variation in value over a short period of time. Prepaid expenses in crops without the necessary insurances in place can also have a similar impact.



Dates to Remember:

- September 30 - Sales closing date for 2012 wheat
- October 20 - Final plant date for wheat
- October 31 - End of insurance period for 2011 wheat
- November 14 - 2011 Wheat production report
- November 15 - 2012 Wheat acreage report
- December 10 - End of insurance period for corn and soybeans
- Don't forget to report your 2011 corn and soybean production!

Prepare Yourself Now for a Successful 2012

With harvest upon us, now is also the time to be planning for 2012. Next year's growing season starts right now.

I will begin with sound herbicide management. An upcoming issue for our area is the onset of glyphosate resistance—primarily marestail. We have been seeing more marestail this year surviving glyphosate applications than ever before. As you can see in the picture, one of the marestail plants was successfully burned down while the other 3 are healthy. The concerning thing is these marestail were sprayed with 1.5 times rate of glyphosate. These plants are within the same square yard of each other. When plants are sprayed with glyphosate and survive, there is a high likelihood they will produce seed that is resistant to glyphosate applications. When one marestail plant can produce over 1 million seeds, it presents a concerning potential problem.

There are fields east of us in Ohio that have been noted as severe glyphosate resistance that have actually been abandoned because they cannot control the problem. There is resistance too in southern states such as Missouri with severe cases as well. We want to stay ahead of this issue before it reaches these types of situations.

Fall herbicide applications are instrumental in preventing this problem. Problem weeds such as marestail are most effectively controlled in the fall. Residual herbicides coupled with 2,4-D and Dicamba are most successful at controlling marestail. In extreme cases, a fall residual followed by an additional spring residual may be warranted. We are ahead of the curve at this point and the ball is in our court to stay ahead of this issue. Be aware of your own fields to make effective decisions going into the 2012 season.

Secondly, fall is the best time to complete your fertilizer program ahead of 2012. It appears inputs such as fertilizer are continuing to rise in cost especially as corn price holds. Plan ahead now to make fertilizer purchases. Agronomically, we recommend making your fertilizer applications at harvest time before the ground freezes. Frozen ground applications increase potential for nutrient run-off which in turn pollutes our waters and hinders crop production.

Good luck and be safe this fall!

Greg Kneubuhler, CCA

President, G & K Concepts





Indiana Sees Big Drop in Yields

The latest estimates from the U.S.

Department of Agriculture show lower-than-normal corn and soybean yields across the nation, with the biggest crop losses in Indiana.

This is the second consecutive year for national crop yields below the expected average, straining already tight world grain supplies and keeping commodity prices high, said Purdue University Extension agricultural economist Chris Hurt.

According to the USDA's National Agricultural Statistics Service September Crop Production report, released September 12th, national corn yields could average 148.1 bushels per acre, down about 13 bushels from trend yields. Soybeans followed suit at 41.8 bushels per acre, down 1.5 to 2 bushels from trend.

In Indiana, a state hit hard by spring floods and summer drought, average projected corn yields are 145 bushels per acre down from trend yields of near 165.

"When we're talking about lower commodity prices, a loss of 20 bushels per acre doesn't seem quite as bad," Hurt said. "But when we have corn prices in the \$7 range, that's a big hit."

The news on soybeans in Indiana was slightly

better, with projected yields at 42 bushels per acre, down 6 bushels from what they might have been with normal weather.

Yields that low will keep world grain stocks very tight, Hurt said. By August 2012 predicted U.S. stocks of both corn and soybeans look to be around a bare minimum of just a 19-day supply. That means usage has to be reduced, and prices are likely to climb until they reach a point where end users, such as processors and livestock producers, are forced to reduce consumption.

"End users of corn will have to cut back by about 400 to 500 million bushels, which primarily will come from 300 million bushels in livestock feed and a 185-million-bushel cut in exports," Hurt said. "There will have to be some cut-backs in soybean use, as well - the USDA says 110 million bushel, mostly from an 85 million bushel reduction in exports.

The major wildcard is whether soybean stocks continue to shrink is the South American crop, which is being planted now. Should South America have favorable weather, Hurt said the crop could make up for the shortages from the U.S. yields. This is especially true since farmers in countries such as Argentina and Brazil will grow more acres of soybeans than in previous years.

"The amount of Chinese soybean purchases will be up 9 percent this year," he said. "South American exports will increase, as both

Argentina and Brazil have about 5 percent more acres and should return to more normal yields after a 5 percent below-trend line yield last year. South America will cover all of the new purchases from China."

If the weather in South America holds up, farmers in the United States can expect to see soybean prices remain strong through Thanksgiving, Hurt said. After that, prices could be fairly flat through the winter. However unfavorable growing conditions in South America would send prices up quickly.

USDA currently expects the U.S. average farm price for soybeans to range from \$12.65 to \$14.65 per bushel.

"Prices are expected to provide a positive return for on-farm storage into December or January, but maybe not beyond," Hurt said. "Commercial storage may not pay this year, especially if the South American crop is large.

Corn farmers also aren't likely to see a profit from commercial storage. USDA projects average farm prices for corn at a record high \$6.50 to \$7.50. Hurt said on-farm storage looks profitable into spring and early summer, with prices rising more than enough to cover storage costs.

This article is from The Farmer's Exchange newspaper.



September is Farm Safety Month

Even as September winds down it's a good idea to remember that this is Farm Safety Month.

Based on Twitter chatter and other sources, there's been a rise in deaths around grain bins. That's probably due to the fact that people are emptying out bins more than ever before to move grain in this hot market. But slowing down and being more careful is critical.

As we go into the heat of harvest in the Midwest and parts north, please keep that in mind. We've all invested in a lot of new technology to make us smarter, faster and more efficient. Frankly, that does you little good if you're maimed or killed because you made one wrong move.

And agriculture does remain one of the most dangerous businesses in the country based on death and injury stats. Even with the latest safety equipment, a busy owner-operator rushing around to harvest grain because that's really your only payday each year, can find themselves in trouble.

So as you fire up the combine, take a deep breath. Make sure all operators are retrained in the tools they're using so no one

has to hesitate when something bad happens.

Take rest breaks - regularly - to avoid fatigue, because a tired mind can make big mistakes.

And be sure that all the safety shields and systems are in place and working before a machine heads out to do work. I know this can be a pain, but its necessary.

These are big machines. They do a LOT of work. And they can kill you just as fast.

As someone once said, there's nothing wrong with having a healthy fear of something that can do you great harm. So stay a little scared, because I know when I'm a little scared I'm a heck of a lot more alert.

Enjoy this harvest. Reap what you've sown. And prosper into the fall of 2011. But as Sergeant Phil used to say on *Hill Street Blues*, "Let's be careful out there!"

From Farmer Iron - the Blog on Indiana Prairie Farmer's website.





Which Entity is Best for My Estate Plan?

It is time to do estate planning and one of the decisions that you will have to make with the help of an attorney is what entity, if any, you should use to hold the investments to protect it and allow you to transfer it to the next generation. While this discussion is centered around a farmer, it has application to anyone doing estate planning. This discussion only covers the basics and observations. Further in depth discussion is needed in your specific case.

Prior to the 1970's, most farms operated as a combined business and personal accounting (sole proprietorship) because farming was a business and the family life. The problem was the estate plan had to include the business and the family life in the same plans. Lawsuits could take all assets. Self employment tax was owed on all income produced, but it was such a small amount of tax back then. While step up valuations were available in estates, difficulties arose when two farmers combined their operations to better share machinery and labor.

Thus, general partnerships came about as a popular choice to combine farmers. However, the disadvantage was that the partners were liable for the actions of his partner(s). The advantage was that we now had a means to separate the business from the personal life. We could still step up basis of assets when an estate occurred. General partnership partners generally pay self employment tax on all their earnings.

Often, the farmer wanted to specifically control his assets from the grave...thus we bring in a trust. The trust follows the instructions in the trust document, or if not covered, it follows state law. If still not covered, it will follow federal law. Trusts generally do not have any self employment tax unless the trustee pays on his trustee fee, but only if he is in the business of

managing many trusts. Once a person gifts his assets into a trust while he is still alive (irrevocable trust) the trust has his original basis and does not get step up basis on his death.

A revocable trust is created before death and the stepped up basis of the assets are what goes into the trust.

Corporations can be either a "C" or an "S". They do a good job in splitting the management and labor returns from the investment side of the business. Thus, self employment taxes are reduced because the farmer only owes FICA and Medicare taxes on the wages he pays himself. Shares can be gifted to the next generation for transitional planning. They create a good shell for liability protection. A disadvantage is that the money in a "C" corporation will get double taxed if you want to pull it out. A "C" corporation does not get preferable capital gain tax rates.

An "S" corporation offers a liability shell, but the advantage of preferable individual tax and capital gain tax rates. Basically, the individual shareholders pay the taxes for the "S" corporation so the corporation should distribute at least the cost of taxes out to the shareholders.

LLC's (limited liability companies) are like a modern version of the partnership in that it can be one individual or a combination of several persons to carry on a business or hold assets. It has a shell to protect it; thus protecting the individual members. It can be used to gift an interest to the next generation. Individuals should pay self employment tax on their earnings if it is an active business. They do not pay self employment tax if it is a rental/investment business. This is a very popular entity to put a trucking business in to protect the farm and other personal assets in case of an accident on the road.

The LLP (limited liability limited partnership) is a

newer version of the FLP (family limited partnership) and is superior in the area of cross liability between the members. Basically, either entity is a good choice if all the children have moved off the farm and the parents want to start gifting shares of the farm to them now, but are not ready to retire and still want to manage the farm. The parents would have a small percentage of ownership as general partners (active management) and most of their percentage ownership is in limit shares which they gift annually over to the children. The limit for this year is \$13,000 but you can have a discount if the gift is a minority share. You need to get a land appraisal and a discount appraisal every time you make the annual gifts. Liability protection is maintained from outside lawsuits and accidents. This is important as the children grow up and move away and have families. Only the general partner(s) owe on self employment taxes...not the limited partners (unless they work on the farm). And the limited partners do not get a "pass thru loop" -- as it is passive income and subject to those rules.

By the way, the IRS is very critical of discounting done on these entities. You have to cross every "T" and dot every "I". You should not get a cheap appraisal, but only one from a reputable appraiser that has done these "discounts" before. These are generally done by a CPA firm. So you first get a land appraisal from a real estate appraiser licensed in your state; then get a discounting appraisal from a CPA firm. Then those are given to your tax preparer for the reporting to IRS on the changes in ownership. This whole process is not cheap, but then you are saving substantially more than this cost on future estate taxes.

The chart below should help to summarize the issues:

| Entity | Liability Protection | Management Separate From Investments | Could Reduce Self Employment Tax Owed | Estate Step Up Basis Available | Minority Discount Available |
|---------------------|----------------------|--------------------------------------|---------------------------------------|--------------------------------|-----------------------------|
| Sole Proprietor | No | No | No | Yes | No |
| General Partnership | No | No | No | Yes | Yes |
| Trust - Irrevocable | Yes | Yes | Yes | No | No |
| Trust - Revocable | No | No | No | Yes | No |
| "C" Corporation | Yes | Yes | Yes | No | Yes |
| "S" Corporation | Yes | Yes | Yes | No | Yes |
| LLC | Yes | No | No | Yes | Yes |
| FLP/LLP | Yes | Yes | Yes | Yes | Yes |

