Understanding Cooperative Financials and Impacts to Your Farm

Production & Marketing Risk Seminar

Iowa State Bank and Sac Realty & Insurance

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Why (Co-op) Financials Matter to Producers

- Co-op members are impacted by co-op financial performance via equity and patronage
- Cash patronage changes per bushel net marketing
- Producers who sell grain on credit sale contracts are unsecured creditors—this holds for sales to co-ops and independents

Four Basic Conditions to Know About Your Co-op

- Is my co-op profitable?
- Does it have sufficient working capital to meet its obligations, including CSCs?
- How are we capitalized / leveraged?
- What is the company’s allocation strategy?

Evaluating A Company's Financial Position before Selling Grain on Deferred Price Contracts: A Simple Calculator

The following template will calculate the key financial indicators used to assess the financial position of a company for purposes of establishing a short-term credit relationship. **Users can enter the values from a firm's recent audited financial statements in the yellow highlighted cells. Financial measures in table 1 of FMR 1893 are calculated automatically and displayed in the 'Output Values' table (below right). Please refer to that publication for an explanation of these values.**

START HERE: Is the firm you wish to evaluate a cooperative?

From the Balance Sheet

Assets	
Current Assets	
Net Fixed Assets (NFA)	
intentionally blank	
Liabilities and Equities	
Current Liabilities	
Long-Term Debt	
Total Equity	

From the Operating (Income) Statement

Grain Sales	$-
Total Sales	$-
intentionally left blank	$-
Net Income (Pre-tax)	$-

Calculated value are formatted to indicate strength: green = above recommendation; yellow = at or near recommendation; red = below recommendation.

Output Values

Measures	Calculated Value	Guideline	Qualifier
Working Capital	$0	$0	*approx. minimum*
Current Ratio	#DIV/0!	≥ 1.0	*varies*
Working Capital to Sales	#DIV/0!	#DIV/0!	*approx. minimum*
Leverage	#DIV/0!	≤ 50%	*varies*
Term Debt to NFA	#DIV/0!	≤ 50%	*varies*
Income to Sales	#DIV/0!	#DIV/0!	*approx. minimum*

This file accompanies the publication, "Evaluating a Company's Financial Position before Selling Grain on Deferred Price Contracts" (FMR 1893)

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Evaluating a Company's Financial Position before Selling Grain on Deferred Price Contracts

Terminology - Profits

Profits / profitability – aka "savings"

Local savings = gross margins + other operating income – operating expenses

- ✓ Some of this is from member business, some from non-member business

Net Savings (before taxes) = local savings + other income

- ✓ Income from regional cooperatives, joint ventures, etc.

Terminology – Uses of Profits

Patronage – a return of profits based on use

- Allocation of the net savings before taxes from member business to members in proportion to each member's use in that year.

Retained Savings (Earnings) – retaining non-member profits and designated portion of member profits; co-op pays the tax

Dividends – a return to equity

- Very few co-ops do this; dividends are to be subordinate to patronage

Terminology – Designation of Patronage

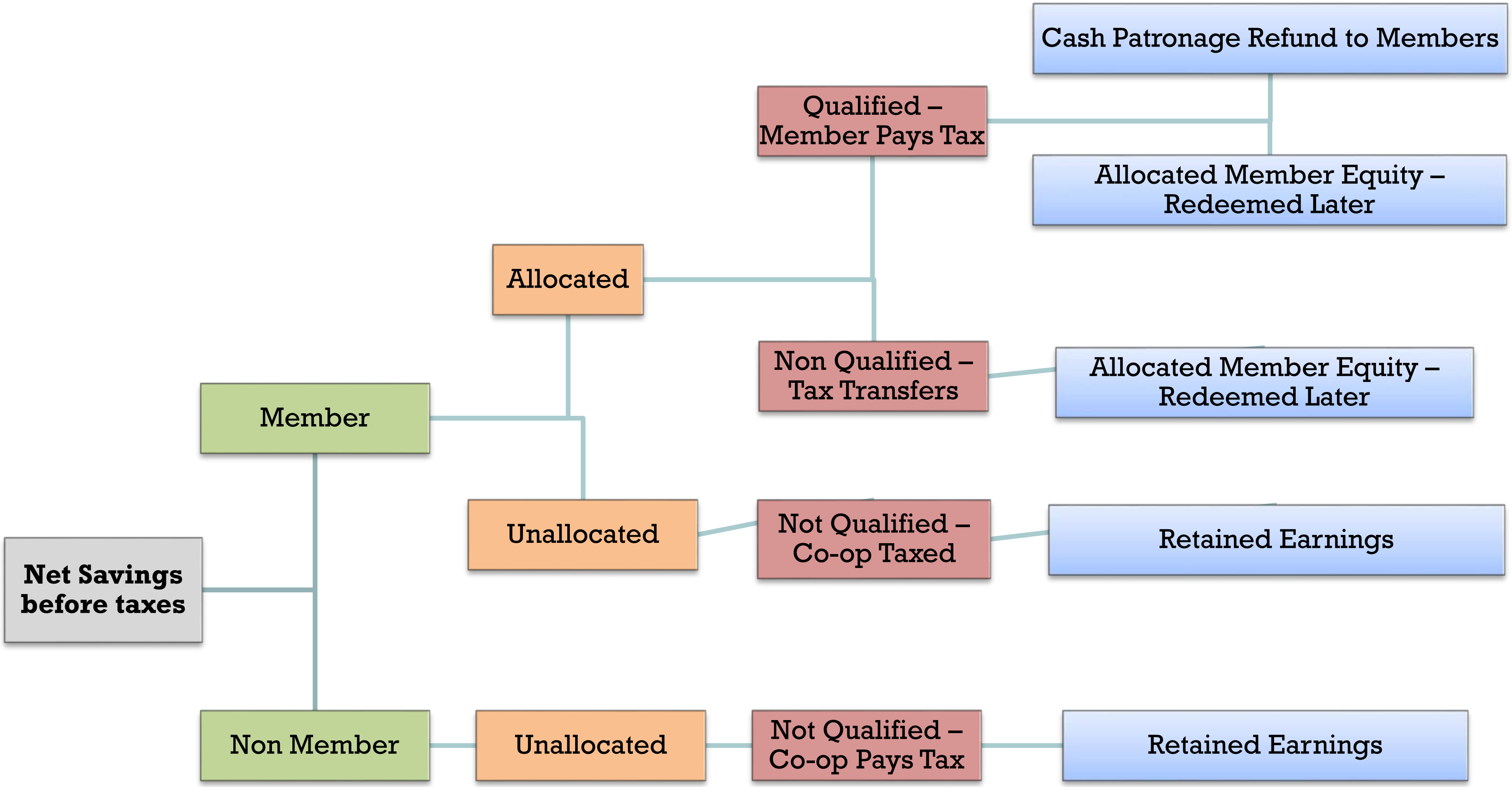
Qualified Patronage Allocation

- Min 20% must be paid in cash, the remainder is retained as allocated member equity, member pays the tax when the allocation is made (no tax liability at redemption)

Non-Qualified Patronage

- No cash, all is retained as allocated member equity, co-op pays the tax when the allocation is made, member pays the tax when redeemed (and co-op receives tax deduction)

David Barton's Savings Distribution Tree



Enterprise Mix - proportion of grain and non-grain sales matters to working capital and profitability

Gross Margins – what was made on marketing grain and resale of inputs

Local Savings – profits generated from the co-op's own operations.

Patronage Received – income from regional co-ops (CIPCO, CHS, LOL, AGP, CoBank), combination of equity and cash.

	2015	2016
Sales		
Grain	$110,898,520	$72,721,940
Farm Supplies	$36,995,170	$40,077,100
Total Sales	$147,893,690	$112,799,040
Cost of Goods Sold	$140,314,000	$105,545,570
Gross Margins	$7,579,690	$7,253,470
Other Income		
Service Income	$5,527,810	$5,142,900
Finance Charges	$702,040	$566,220
Total Other Income	$6,229,850	$5,709,120
Gross Income	$13,809,540	$12,962,590
Expenses		
Personnel Expense	$4,497,100	$4,589,870
Fixed Expenses		
Interest	$1,628,210	$1,758,740
Depreciation	$1,813,240	$1,740,870
Insurance	$261,130	$251,400
Property Taxes	$504,100	$565,500
Variable Expenses	$2,066,520	$3,338,980
Total Expenses	$10,770,300	$12,245,360
Local Savings (Loss)	$3,039,240	$717,230
Patronage Refunds Received	$239,900	$477,700
Net Savings (Loss)	**$3,279,140**	**$1,194,930**

	2015	2016
ASSETS		
Current Assets		
Cash on hand	$1,542,630	$4,971,560
Accts Receivable	$5,792,150	$4,178,530
Inventories	$6,090,410	$4,697,820
Others	$2,362,500	$777,560
Total Current Assets	$15,787,690	$14,625,470
Fixed (Long Term) Assets		
Land	$1,751,110	$1,751,110
Building & Equipment	$35,245,720	$35,608,220
Less: Accum Depreciation	$13,930,270	$15,605,890
Total Fixed Assets	$23,066,560	$21,753,440
Other Assets		
Investments in Co-ops	$8,774,160	$9,078,390
Total Assets	$47,628,410	$45,457,300

Assets: Investments in Regional Co-ops

This is the paper value of your co-op's equity in the regional (e.g., CHS, AGP, LOL, CoBank, CIPCO, etc.)

No control over when it is redeemed

Lenders discount this when calculating borrowing ability

This is net of newly allocated equity and the annual redemption (if any).

Payables

- Customer prepays and grain payables
- These are the unsecured obligations of the co-op to producers
- CSCs not covered by the IA grain indemnity fund

	2015	2016
LIABILITIES		
Current Liabilities		
Accts Payable	$1,887,010	$82,530
Operating Line	$0	$0
Current portion of long-term note	$1,420,000	$1,420,000
Accrued Expenses	$2,118,930	$2,945,680
Total Current Liabilities	$5,425,940	$4,448,210
Term (Long Term) Liabilities		
Mortgages / Term Notes	$9,219,800	$7,799,800
Member Notes	$0	$0
Total Long Term Liabilities	$9,219,800	$7,799,800
EQUITY		
Common Stock	$156,500	$156,500
Deferred Patronage Refunds	$24,046,010	$23,980,270
Retained Earnings	$8,780,160	$9,072,520
Total Equity	$32,982,670	$33,209,290
Total Liabilities and Equity	$47,628,410	$45,457,300

Equity

- Member-provided
- Member equity – capital in an individual's name, will eventually be paid back (redeemed)
  - o Revolving equity (aka "Age of Equity")
  - o Age of Patron
- Retained savings – not allocated; permanent equity

	2015	2016
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Local Equity

- The amount of equity that the co-op **controls**
- Calc: **Local Equity = Total Equity – Investments in Other Co-ops**

Potential issues of allocating more equity than is controlled

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IS MY CO-OP PROFITABLE?

Local Return on Sales

✓ Indicates degree to which co-op is generating profits at the local level from its sales

Calc: = Local savings ÷ Total sales

- =\$.7 ÷ \$112.8 = 0.6%
- Guideline: 1% of grain sales + 2.5% of non-grain sales

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Farm Supplies	$36,995,170	$40,077,100
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DOES IT HAVE SUFFICIENT WORKING CAPITAL?

Working Capital

What happens to WC if this goes bad?

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Others	$2,362,500	$777,560	Accrued Expenses	$2,118,930	$2,945,680
Total Current Assets	$15,787,690	$14,625,470	**Total Current Liabilities**	$5,425,940	$4,448,210

- Indicates availability of funds to meet current obligations in a timely manner

Calculation: Current Assets – Current Liabilities

✓ Grain guideline: seasonal operating line 5 – 7 times WC

✓ FS guideline: seasonal operating line 3 – 5 times WC

Alternative (adjusted) Calculation: WC ÷ Sales = $10.2 / $112.8 = 9%

✓ Guideline: 7% of non-grain sales + 1.5% of grain sales

HOW ARE WE CAPITALIZED / LEVERAGED?

Local Leverage

- ✓ Indicates ability to meet long-term financial obligations

Calculation: **Long Term Debt ÷ Local Equity = $7.8 ÷ ($33.2 - $9) = 32%**

- Guideline: < 50% (<0.50), but depends on revenues generated

Fixed (Long Term) Assets		
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Term Debt to Net Fixed Assets

- ✓ Indicates degree to which term debt is financing NFA and whether it matches life expectancy of assets – collateralization factor

Calculation: Long Term Debt ÷ Net Fixed Assets = \$7.8 ÷ \$21.7 = 36%

- Guideline: < 50% (<0.50), but depends on revenues generates from assets

Land	\$1,751,110	\$1,751,110
Building & Equipment	\$35,245,720	\$35,608,220
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WHAT IS THE ALLOCATION STRATEGY?

Equity

How much equity is allocated to members?

=$24.1 ÷ $33.2 = 73%

Have they allocated "too much"—was regional equity allocated (member equity divided by local equity)?

= $24.1 ÷ ($33.2 - $9.0) = 99.5%

Other Assets		
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Parting Thoughts

- Financials best viewed as trends over time
- Makes sense to know who you are doing business with (co-op or not)
- Overall, co-op financials still suggest strong balance sheets and available WC for short-term deficits.

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