

# SHOULD YOU EXPAND YOUR FARMING OPERATION?



## According to ag lenders, the most important question is why you want to grow your business

By Chris Seelen, shareholder/member Ruder Ware Ag Focus Team

Flyte Family Farms in Coloma, Wisconsin, has grown a lot over the years. Not only has Flyte grown tons of crops, but the business itself has also grown, expanding to include five greenhouses and 3,200 acres.

Adam Flyte and his wife, Carrie, started their business growing corn, soybeans and fresh vegetables, which they sold at seasonal farm stands. In 1999, Adam and Carrie expanded into hydroponics. But, expansion has been gradual.

"As opportunities presented themselves, and if they made financial sense, we expanded to meet demand," says Adam, who built one greenhouse in 1999, one in 2000, two more in 2001 and another in 2004. Along the way, Adam and Carrie also acquired three farms.

The Flyte Family Farms business expansion has been a success. But, what makes a business expansion successful? What should you consider when deciding whether to expand your own business? What do ag lenders say about business expansion? Here are some things to consider:

**Why now?** According to ag lenders, the most important question is why do you want to expand? "You need to ask yourself, 'What's driving the need for expansion?'" says Rich Wilcox, an ag lender who is a vice president at BMO Harris Bank.

Terry Johnson, vice president of ag/commercial lending at Pioneer Bank agrees. "It all starts with the ability of the producer to explain why he or she wants to expand,"

Johnson notes.

In a 2012 article on growth management strategies, David Coggins, executive vice president and chief banking officer at Investors Community Bank, wrote that, "Operators have all kinds of reasons for growing/expanding ... It all comes down to finding out your own 'why' before developing a plan to get there."

### WHY EXPAND?

In the case of Flyte Family Farms, the "why expand?" question was answered when Adam and Carrie saw

**Above:** A drone image of Flyte Family Farms, LLC shows the hydroponic greenhouses, with the 10-acre organic blueberry patch in the background and more organic acreage among the surrounding fields.



demand for hydroponics that also fit the couple's educational backgrounds in horticulture and agri-business. That would be classified as a good reason to expand.

What are bad reasons to expand? "My neighbor is expanding, or I read an article that says you need to expand to be profitable," Johnson answers.

Going big doesn't always mean becoming profitable, and that leads to the next consideration.

#### Is your current operation profitable?

Ag lenders will tell you there is nothing magical about business expansion that will make you more profitable.

"If you have high operating ratios now, you're probably going to have high ratios in expansion," says Johnson, who indicates you should take a look at your existing operation and figure out how to become more

profitable before expanding.

If your goal is to increase revenue, then expansion should not be the first step you take. Rather, Coggins writes, you should take "advantage of all the opportunities to 'get better' before you work on 'getting bigger.'"

Wilcox concurs, asking, "Can you work to do better before you strive to do more?"

**Have you factored in a drop in commodity prices?** When commodity prices are high, it is natural for farmers to want to expand their business so they can make more money.

But, Johnson cautions that growers should not "make long-term decisions based on short-term economics." Johnson points out that expansion is a 20- to 25-year decision that a farmer might make when prices are high, but what happens when

prices drop?

#### COMMODITY PLAN

Therefore, it is very important that growers have a plan in place for dealing with a downturn in commodity prices. If revenue falls short, how are they going to pay for the costs of expansion?

"I would advise them to think it through and record their thoughts as part of a business plan that would include projections of best-case, middle-case and worst-case scenarios with odds of each," says Wilcox.

To protect against fluctuations in commodity prices, Flyte Family Farms diversified its products. Flyte grows corn, soybeans, hay and sweet corn. Flyte also has 800 acres certified as organic. Organic crops include blueberries, sweet potatoes, sweet corn, seed corn and hay.

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## Expanding Your Farm. . .

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**Maintain healthy equity in your assets.** Johnson advises that businesses should “not borrow their last dollar in expansion.”

“You may need to borrow additional money in the future to deal with unexpected costs. If you have strong equity, you can get through the hard times,” Johnson says.

Wilcox agrees that expansion may cause some issues that were not anticipated. Therefore, he asks, “Is the business strong enough financially to absorb a post-expansion drop in equity or missed problems with expansion plans?”

### MANAGE DEBT LOAD

Adam Flyte acknowledges that managing your debt load is very important and that “working capital is key.” So, what percent of your assets is it smart to borrow against?

From a collateral standpoint, Wilcox answers, “A business should borrow no more than 70 percent of the asset value on the high side. Lower levels might be smarter.” From an owner-equity standpoint, Wilcox does not recommend getting below 40 percent assets to debt.

Ideally, the goal would be a “debt to assets ratio of 50 percent or less,” Johnson says.

**Make sure everyone is on the same page.** Expansion sometimes means family members or friends are coming together to boost business. But, your family or friends may disagree on their roles or how the business will be conducted.

Wilcox wants to know, “Is the family and employee base on board with expansion plans?”

Johnson relayed a story about a father who expanded his dairy business so he could farm with his five sons. Later, when the operation was struggling, the sons admitted at a family meeting they didn’t like



milking cows. The moral of the story is communication between family members and business partners is critical.

### EXPANSION HEADACHES

Expansion may also bring you additional responsibilities and headaches. Coggins writes that an expanded organization can test your management skills and you need to ask yourself the hard question of whether you have the talent for taking on a bigger and much different job and a more strategic role in the organization.

**Seek Out Trusted Advisors.** A good ag lender can be a helpful adviser. Johnson notes that you should not run away from a lender who asks

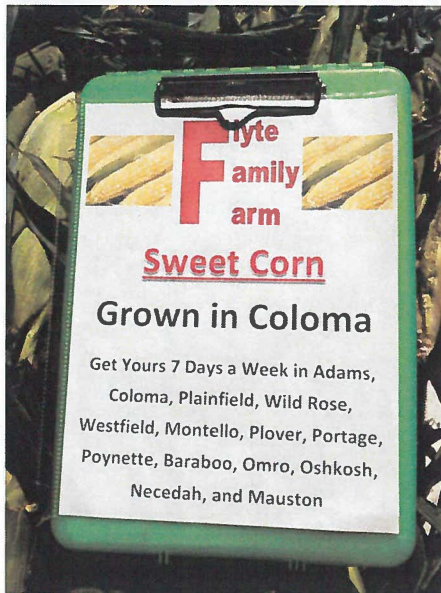
you lots of questions. “The questions are designed to help you understand whether expansion is appropriate for you,” he explains.

Coggins writes, “Your banker is going to look at a whole host of factors in considering your request for expansion, from working capital to long-term cash flow assumptions, transition and construction phase issues, contingencies and having a well-documented plan.”

Adam Flyte agrees that your ag lender can be a critical part of your success. The lender is a “friend and a partner,” Adam relates.

Finally, be aware that legal issues can arise as you expand your business. Such issues include: partnership





or LLC operating agreements, construction agreements, estate and succession planning, leases and offers to purchase, and employment agreements, to name a few. So, don't be afraid to add an attorney to your

circle of trusted advisors.

*Chris Seelen is a shareholder in the Ruder Ware law firm and a member of the firm's Ag Focus team. Chris represents lenders in bankruptcy court and state court. BC'T*

**Above and Opposite Page:** Adam Flyte and his wife, Carrie, started their business growing corn, soybeans and fresh vegetables, which they sold at seasonal farm stands. Flyte Family Farms has grown to include its own farm market, and in 1999, Adam and Carrie expanded into hydroponics. But, expansion has been gradual.

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