How to Get the Support of Your Banker

Claude Bilodeau

National Bank of Canada, 555 Blvd Rolland-Therrien, bureau 400, Longeuil, QC J4H 4E7;
Email: claude.bilodeau@bnc.ca

▪ Introduction

The world market for pork meat has been more difficult for the Canadian industry in 2005 and 2006. The world exportations of pork meat that had an annual growth exceeding 10% since 1993 have now plateaued. Exports of pork by the largest exporting countries were estimated at 5.1 million tons in 2006 compared to 5.0 million tons in 2005.

Even if the Canadian production represents only 2% of the production worldwide; Canada is a very large exporter with 21.8% of the world exports in 2004. We are extremely dependent on the export market. 50% of the Canadian pork production is exported; since Canadian consumption of pork is relatively stable, most of the increases in production are directed toward the export market.

As a result of the decrease of the US dollar relative to international currencies, Canada becomes less competitive on the American and Japanese markets. Canadian exporters had to turn to other markets (Australia, Mexico, Taiwan, Russia, etc). We have also been the arrival of new international competitors (e.g. Chile). In addition, our traditional opponents (e.g. United States) seem to do better and the markets are always more demanding. Considering the strength of the CDN dollar, it is predicted that the Canadian pork imports will increase by more than 15% in 2006.

In summary, Canada is less competitive on the exportation markets and there is competition in our domestic Canadian markets.

▪ The Situation in Quebec Pork Production

The production years 2005 and 2006 were particularly difficult for Quebec pork producers and according to the analysts, 2007 also promises to be difficult because of lower market prices.

Production was reduced by 6% in 2005 (458,000 less pigs) and by approximately 3% after the first 39 weeks in 2006. There was also reduced productivity in pig herds because of PMWS and PRRS problems (more than half of the producers were affected).

Increase in production costs. In 2005-2006, the mortality rate almost doubled to reach an average of approximately 8%. The producers that were the most affected (i.e. more than 15% mortality) have seen their production cost increase by approximately $15/pig.

However, increased performances in herds have been observed since spring 2006. Most of our clients have readjusted their production and the use of two new vaccines against PMWS has shown good results.

In 2005 and 2006, many producers suffered financial loss mainly because of PMWS problems. The CAIS program (Canadian Agricultural Income Stabilization Program), which helps to stabilize the global income of farming businesses, compensated some producers for a portion of their loss attributed to PMWS in 2005.

The market value of pigs significantly decreased in 2006 (average price paid in 2005: $145/pig vs. $125/pig after the first 39 weeks of 2006). In 2006 (after 39 weeks) Quebec producers were paid $7.75/100 kg less than their American counterparts, while traditionally our producers were obtaining approximately the same price after conversion into $CDN.

Meat processors also operated for several months with negative margins in their fresh pork divisions. The strength of the Canadian dollar was detrimental for pork meat exportations by pork processors.

The environmental issue is still present and severe regulation limits the possibilities for the producers to modify and improve their production installation to increase efficiency or reduce cost.

In summary, our clients are faced with important challenges. The number of producers and pork production itself has diminished, thus producers are in financial crisis. The implementation of strategies to control disease is essential. The producers and meat processors will have to lower their production costs to improve their competitiveness, to better coordinate different aspects of the industry and to better serve specialty markets (which are less sensitive to market prices).

■ Short Introduction of the National Bank of Canada

Active on the economic and social scene for 140 years, the National Bank of Canada (NBC) is now ranked the sixth most important Canadian chartered bank with assets of more than $100 billion. The NBC has 17,300 employees and its head office is located in Montreal. Across Canada, it has 453 branches and 49 Commercial business centres, including 3 centres in Western Canada involved in agricultural financing.

The NBC is a major player in Quebec agribusiness where it owns approximately 25% of the agricultural market and 50% of the agri-food industry. 85% of the NBC agricultural loans portfolio is located in Quebec; the corporate objective is to have 25% of its portfolio outside Quebec within 5 years. Approximately 20% of its agricultural loans are in the swine industry.

Since 2001, NBC has diversified its portfolio geographically. More than 20% of its loans to swine producers are now from Western Canada. The NBC is financing every area of the swine industry: feeds and feeding, genetics, equipment manufacturing, production, processing, secondary processing and distribution.

Even with all the unfavourable events affecting the swine producer's earnings and although the risk rating of this portfolio is deteriorating slightly for the last 2 years, the NBC remains confident that the majority of our best clients will overcome the current crisis. Historically, our swine producers, processors and exporters have overcome the challenge of that competitive market.

■ What is a good business plan in today's pork market?

A good business plan explains to your partners <u>why the company will succeed in the context of the actual swine industry market</u>. This written document must describe the future orientation of your company and demonstrate your strategies to minimize the risk associated with your industry. A good business plan will discuss the following:

Market risk:

- Advantages of your long term agreements with your processors or your piglet buyers.
- Your strategies for the use of term markets for swine, for your inputs and for the fluctuations of the $CDN.

Management risk:

- Your accomplishments as an entrepreneur, the quality of your management and your management competence must absolutely appear.
- Choosing partners (in genetics, in feed and feeding, veterinarians, accountants, consultants) that are leaders in the industry is an undeniable advantage.

Production risk:

- The technical performance of your herd and constant improvement in your production or performance must be demonstrated.
- Functional, well-arranged and well-located facilities operated by qualified personnel will instill confidence amongst your financial partners.
- In Quebec with the PMWS crisis, our best clients implemented action plans to improve their productions, with realistic objectives and schedules to achieve or re-evaluate the results.
- Having a bio-security strategy is impossible to circumvent. The lenders are more and more sensitive to disease-associated risk.

Environmental risk:

- In the last 10 years in Quebec, the costs associated with environmental compliance have increased substantially.

Financial risk:

- In swine production, low cost producers have the most successful businesses. A study by the Quebec pork producers' federation showed that farrowing barns in the leading group (20% of the businesses) have a production cost of $10/piglet lower than the average and the leading wean to finish operations have a production cost of 8.50$/pig lower than the average.
- <u>Verify the relevance of your financial forecasts</u>. For your banker, finances are the most important part of your plan. Thus make sure to test the reliability of your forecasts. Forecasts too optimistic in price or productivity, or errors in exploitation cost estimate, destroy the credibility of your business plan.
- The main ratios to consider are your reimbursement capacity, your working capital and your equity (**Table 1**).

Table 1. Financial Ratios

	Debt coverage *	Working capital	Equity value
Very low	Less than 1.00	Less than 1.00	Less than 25%
Low	1.00 to 1.15	Less than 1.25	25 to 35%
Average	1.15 to 1.30	1.25 to 1.50	35 to 50%
Good	1.30 to 2.00	1.50 to 2.00	50 to 60%
Excellent	2.00 and more	2.00 and more	More than 60%

* 3 years average

Why prepare a business plan?

- The preparation or the revision of your business plan will lead you to self-question your company. It will also allow you to explore new options, to better identify the risks and to test some of your predictions.
- A business plan allows you to evaluate the financial needs of your company.
- A business plan is a privilege tool to obtain financial support (banks and investors).
- A business plan informs the employees and the investors of your plans and strategies.
- A business plan also serves as a reference point. You can therefore use it to measure the growth and performance of your company.

As agricultural bankers, we are expecting regular business plan updates from our biggest borrowers. However, small farm owners generally prepare a brief business plan at startup, when transferring the company or when a major change occurs within the business (very often when a new investment or an additional loan is required).

What are the rules to produce a good business plan?

- Be ready to invest time.
- Write your business plan yourself. Stress the parts of your plan that are important and explain why your company will succeed.
- Share your draft versions with the key people in your business and use their feedback.

- Write the synopsis last. The synopsis is the most important section of your business plan because it is the first section read. It is even likely to be the only section read if it is not convincing.

▪ What to include in a good business plan?

Here is the principal information that should appear in a good business plan:

Synopsis

It should not be too long (2 pages maximum); it should focus on the important aspects of your plan and should arouse interest about your business.

Description of your company

- A company history.
- A statement of your company's mission.
- Short and long term key projects and objectives.

Description of your market

- Overview of activity in your sector based on facts and data from your research and market study.
- Your vision of the principal tendencies, threats and opportunities of your industry.
- Market risk and others.

Your product and marketing plan

- Characteristic of your product and the key market targeted.
- Your marketing plan, the targeted market and your competing situation.
- Comparative advantages production-wise.
- Your location and the quality of your installations.
- Your principal suppliers (genetics, feeding, etc)

Description of management

- A list of the management staff and shareholders and their distinctive competences and achievements.
- A list of business partners (accountants, veterinarians, etc)
- Organizational structure, staff training and replacement.

Financial plan

- An evaluation of your financial needs.
- Realistic pro forma scenario.
- Credible sales forecast and expenditure.
- The company financial statement over the last 3 years.
- Details on the investments, the equity and the guarantees offered.
- Examination of the industry ratios.

Implementation plan

- Activities and implementation schedule.

▪ How to prepare for a meeting with your banker?

Your banker's evaluation of your business is a mix of objective factors (financial ratios) and subjective factors (your integrity, your entrepreneurship and your management qualities). In difficult periods your integrity, your management aptitudes and your previous accomplishments will make all the difference for your banker's confidence.

Make sure that your account director knows your company and your team well. Be transparent and require the same transparency from your banker.

Have a good analysis of the situation and an accurate estimate of your financial needs.

Remember

Your financial partner is uncomfortable with a financing application that is:

- Poorly prepared.
- Written at the last minute.
- Without an analysis of the situation.
- Non-compliant with your original business plan

Confidence is hard to gain but easy to lose.

▪ What to do during a low income cycle?

At the beginning of a low cycle, be certain to have the liquid assets to survive the crisis: A cash flow budget to the best of your knowledge according to your production costs and the anticipated prices (for pigs and grains) by the analyst remains the best tool.

According to your cash flow budget, evaluate the possible compensations from the CAIS program with your accountant. According to your asset portfolio, different measures could be evaluated with your business partners: special agreement with your suppliers, refinancing of recent unfinanced investments, reamortization of long term debt and in certain cases, a moratorium on the reimbursement of capital.

The strategy you plan to adopt to face the market cycles requires a lot of rigor.

During profitable periods it is necessary to rebuild working capital and to avoid non-productive investments.

Historically, our best clients benefited from the opportunities offered by the market during the low cycle periods: acquisition of a company at low cost and expansion and modernization of their business.

The investments to lower your production costs and the changes to your productions should be done during the low price period in order to be more profitable when the prices go up, and thus better able to repay loans.

▪ Conclusion

The pork market continues to have price cycles. A good business plan is necessary in all parts of the cycle. It will help your business thrive during good times, prepare for poor times and help keep your banker and investors confident throughout.