



**Making the Tough Choice: Should We Stay or Should We Go**  
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Life is all about choices. Some work out great, some not well at all. The key though is to always have a choice, because the alternative is not pleasant. I have experienced such situations in my life time. I have also worked with business owners who have found themselves in this situation. The current economic crisis will certainly put some dairy producers in this uncomfortable position. They would like to exit the dairy business, but seem to have no way out. How can that be? Anyone always has the choice of milking cows or not, right?

I remember working with a producer, who after many years of dairy farming, decided that maybe it was time to quit. Life had not been what he and his wife had envisioned when they quit their jobs and invested their life savings to start dairy farming. Over the years they dealt with all the problems that most dairy producers face at sometime or another. The hard physical labor and stress of trying to manage the finances had taken their toll. They were mentally and physically exhausted.

The operation was not as profitable as the couple had thought it would be when they first started to farm. But their **balance sheet**, which was based on **market values**, indicated they still had equity in the business. They never seemed to have to pay any taxes. They thought this was a good thing. It was not! What the couple and their accountant failed to do was to develop and examine a **cost basis balance sheet**. After I got a copy of their depreciation schedule and developed one for them, I saw a condition I have seen far too many times in evaluating the financial condition of dairy farms. The business had a negative equity position! The original assets, that were purchased years ago, had been fully depreciated. Cash flow did not provide adequate cash reserves for timely replacement of capital assets. Capital purchases had been very limited and those that were purchased had to be financed. Operating losses accrued over the years. The couple was paying down the mortgage, but the mounting debt from refinanced operating losses created additional cash flow problems. The mounting cash deficits had to be refinanced several times. Eventually the lender rolled these loans into a long term loan, secured by.....a mortgage on the farm. In essence, the couple just purchased the farm again. This is a common condition of farms that have been unprofitable for long periods of time. It is not an isolated situation!

To make matters worse, the market basis balance sheet did not accurately reflect the couples' true equity position. Their assets were over-valued. I explained that the average value for the cattle was probably high; at least 15-20 percent of the herd would likely not be worth much more than cull

prices. The equipment was also overvalued and so were the feed inventories, since buyers discount them severely for the time and costs of moving them. In addition, there were no deferred taxes listed. What are deferred taxes? They are the taxes that a business must pay Uncle Sam when it is liquidated, mainly capital gains taxes. When we sat down and estimated what those taxes would be, the couple was astounded. "That can't be right", was their response. Unfortunately it was. After accounting for all these adjustments, if the couple were to liquidate, they would not even have enough money to pay off all of their debt. In addition, they would still have over \$100,000 in taxes to pay. I could see the tremendous stress these folks were under.

I suggested they contact an attorney to discuss their options and suggested bankruptcy, but the couple said that was not an option. I explained that many businesses have filed for such relief, but the producer would not consider it. I have found over the years that farmers are very proud. They often will not even consider bankruptcy, even if it could provide them protection over the short term, while they work to implement strategic changes that will enable them to improve profitability and cash flow or to work out an exit strategy.

My next suggestion was to set up a meeting with their lender. In the meantime, I called an accountant that I knew might be able to help. We discussed options involving the capital gains taxes. After several meetings with the lender and the accountant, we developed a strategic plan to enable this couple to liquidate their business and move on with life. The lender informed the couple that he would do everything he could to ensure that their debts would be completely satisfied with the proceeds from the sale, even if it meant writing off some of the debt. Of course, that could possibly present additional tax consequences, but the accountant felt confident it could be dealt with. A date was set for the liquidation sale.

I made sure I was there on sale day, as I did for most of the farmers I helped transition out of the dairy business. The couple's mood was somber and anxious, but I could also sense feelings of reserved relief. The lender was there to oversee the dispersal of their collateral. The sale was going a little better than we expected. However, for the couple there were still many unknowns. Would all of their debt be satisfied or would they still owe money after the sale? How would they pay for their day to day expenses until they found employment? What would they do? They had only worked for themselves for the past 15-20 years. They had no recent employment history to put on a resume; no past employment referrals.

One of the more rewarding things that occurred that day happened when the last things, some small tools and household goods, were auctioned off. They were declared personal property by the

lender. This allowed the auctioneer to give the money directly to the couple and at the end of the day they walked away with close to \$3,000 in their pocket. Not much to show for all the years of hard work, but better than nothing at all. At least they had some money to pay for day to day expenses and rent. But those deferred taxes still loomed on the horizon.

Fast forward to six months later! The couple had moved back closer to their support system (family members and old friends). They had rented an apartment and both had found jobs. The accountant had filed for partial relief of the capital gains taxes, citing severe financial distress as a reason for such action. He had worked with the head of the regional IRS office and presented an “offer in compromise”. This involved evaluating the couples’ financial position and earning potential, calculating a payment they could afford, given their current situation and determining how much of the capital gains they could afford to pay over a given time period. The couple wound up paying approximately 15-20 percent of the total tax owed and paid it off over a five year term. Not an ideal situation by any means, but certainly better than what we had thought months ago when we first started evaluating their situation.

Years later, I ran across my former client. The tell-tale signs of the years of stress seemed to have disappeared from his face. Things were going well. He had been hired as a shop supervisor by the state. He and his wife had health care for the first time in years. His wife was still working, but only part time. He was building money for their retirement, although he jokingly said, he would have to work until he was 90 to have enough to live comfortably. I asked him if he ever missed farming and his response was, “Not really, I never realized the toll that it took on my family and me. It is so nice to leave work at the end of the day and know that I can go home to relax.” I replied, “Less stress I’ll bet”. He just looked at me and smiled. That said it all.

Unfortunately, there are some dairy producers who will probably be faced with a similar situation in the next six to twelve months. **Although it might look like you have no options, never give up and for goodness sake, don’t bury your head in the sand!** Follow these recommendations and you might just find that you have more choices than you think.

**Seek help!** Talk to your support system and your most trusted advisors. If they cannot help, ask them if they can suggest someone who might be able to. Involve your lender and your accountant in the discussions. Ask them to help you identify at least three alternatives you might be able to pursue.

**Evaluate your true equity position.** Examine the values you have assigned to your assets. Pay particular attention to inventories, cattle, and equipment. Consider having cattle and equipment appraised by a knowledgeable auctioneer or a certified appraiser. You may also have to adjust real

estate values given the current economic environment. Be sure to include deferred taxes as they will reduce what you will walk away with at the end of it all. Consult your accountant to assist you with this task. However, it has been my observation over the years that many farms use tax preparers and not accountants to file their taxes and never receive the financial statements they need to regularly evaluate their business. If this is you, reconsider your choice of advisors.

Be sure to list ALL of your debts by category, starting with debts secured by mortgages, debts secured by cattle and machinery, debt secured by other liens, and finally unsecured debt. Is all the secured debt adequately collateralized? How are your lenders secured? Have they cross collateralized their debt? Many primary lenders will secure their loans with different types of collateral. They may have secured debt for cattle and equipment with a lien on those assets, but also with a second mortgage position. Understanding liens and how they must be satisfied can help you establish strategies for handling the process of liquidating your business. How much unsecured debt is on your balance sheet? Do you have any credit card debt? How much money will be left after paying off secured creditors? How much money will you need to pay those deferred taxes? Will unsecured creditors be willing to settle their debts at a reduced level? Knowing the amount of debt you have and how it is secured will help you and your advisors determine what options you might have.

**Discover your Passion!** What do you really enjoy doing? What drives you to wake up and get moving in the morning? If you can find a job doing what you really enjoy, you will be successful. This may take some soul searching, but if you look deep enough, you will find it.

**Take Stock of your Talents; Develop a Resume.** You may have been self employed for many years, but you can still build a resume that will get the attention of potential employers. Everyone has talents in one area or another. What are yours? Are you better at managing cattle or crops; or are you an excellent mechanic? List your skills and accomplishments in the areas where you excelled. For example, if you received awards for the low somatic cell count herd in your county or for producing top corn yields, include that in your resume. Also include any boards or other committees you may have served on. I remember helping one producer exit the dairy business and suggested that he talk to his neighbor, whom I knew could use a field operations manager and good mechanic. I then told his neighbor that he should talk to this producer, because the man would be an excellent asset to the operation. My client hired the guy and things have worked out very well.

**Communicate with your Network.** Tell people that you are contemplating changes! You don't have to be specific or divulge sensitive information about your business or finances. Tell them what you are looking for and ask if they know of a business that might be in need of such an employee.

**Develop and Execute your Exit Plan.** Don't avoid the inevitable; things will only get worse. Face the crisis head on and work with your advisors to develop a plan. Then execute it. Procrastination is your worst enemy. It is one way to ensure that your choices will be limited and will likely put you in a situation where you have none. Someone will make your decisions for you. Believe me, you don't want that!

**Finally, Don't Listen to the Gossip.** I have been in this business long enough to know that people love to gossip. I have heard stories over the years of successful operations that were supposedly in terrible shape and were going out of business, yet they continue to thrive today. It does not matter what others may think or say. What matters is that you make a decision that is in the best interest of you, your family, and the animals you care for! If you and your family are better off and happier, like my former client, you have succeeded.

Yes, life is all about choices. You may have more than you think.

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