Farmer Mac Refresh: Managing Expectations

Dr. Dave Kohl

Road Show 2019

Topics to be covered:

- capital, liquidity, and credit risk management options for ag lenders,
- U.S. agricultural outlook – 2019 and beyond,
- new Farm & Ranch loan products and pricing options,
- ag real estate financing case studies,
- meet your underwriter – tips for successful loan originations,
- utilizing AgXpress – our new scorecard underwriting option, and
- working with USDA Rural Development, Farm Service Agency, and the secondary market.

www.farmermac.com/news-events/road-show

Managing Expectations

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Macro Clinic Video Blog: www.compeer.com/education
Road Warrior of Agriculture: www.cornandsoybeandigest.com
Ag Globe Trotter: www.northwestfcs.com
Dave's GPS & Dashboard Indicators: www.farmermac.com

Low Margin Era

- technology- supply exceeds demand
- worldwide- new resources in production
- weather and climate changes
- base hits vs. home run profits & cash flow
- managing expectations
- focus on fiduciary fundamentals

Volatility of Profits/Cash Flow

- trade negotiations and expectations
- weather/African swine flu
- political uncertainty
- consumer demand shifts
- structural changes in industry

Worst Lending Experiences

- fraud: missing grain, livestock and/or machinery
- excessive family living based upon good times
- attempting to bash an existing customer
- didn’t follow the plan
- continued refinances, switched lenders
- hidden account payables
- didn’t use line of credit properly
- rumors that were verified
- inherited business debt free/next generation broke

Best Lending Experiences

- family business, transition old to young- lender transition at the same time
- young producer FSA/bank now 10 years later, million in equity 5-45-50 program
- successfully developed and executed marketing plan
- followed a business plan, very successful advocate for other producers
- used financial benchmarking as a tool to improve the business
- developed a young producer educational program- investment paying off a decade later
- assist a customer work out of the business without losing all the equity

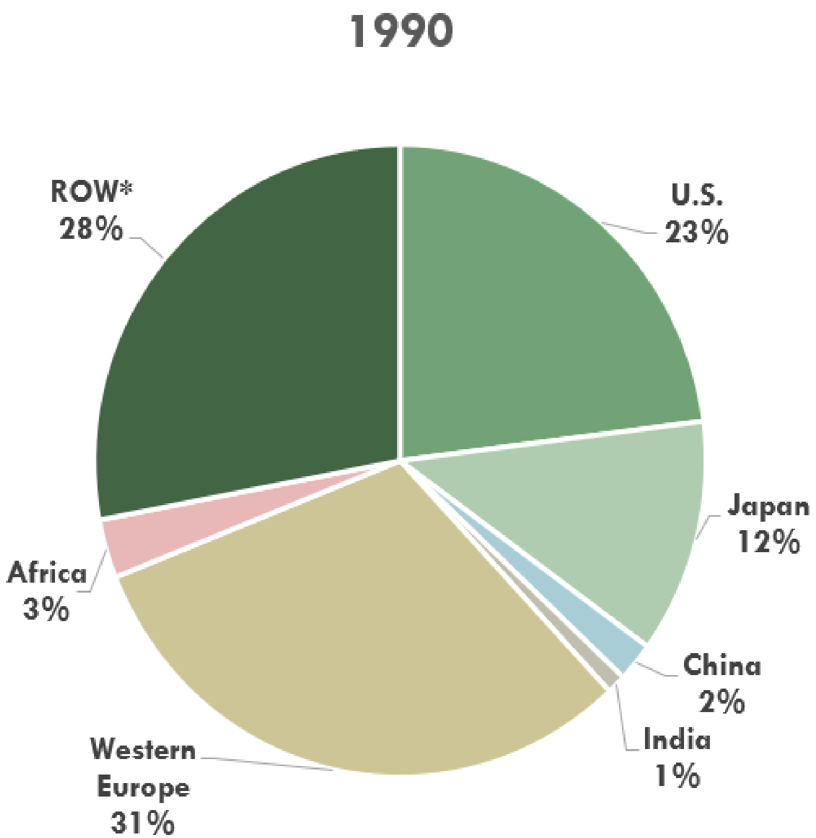
Economic Radar Screen

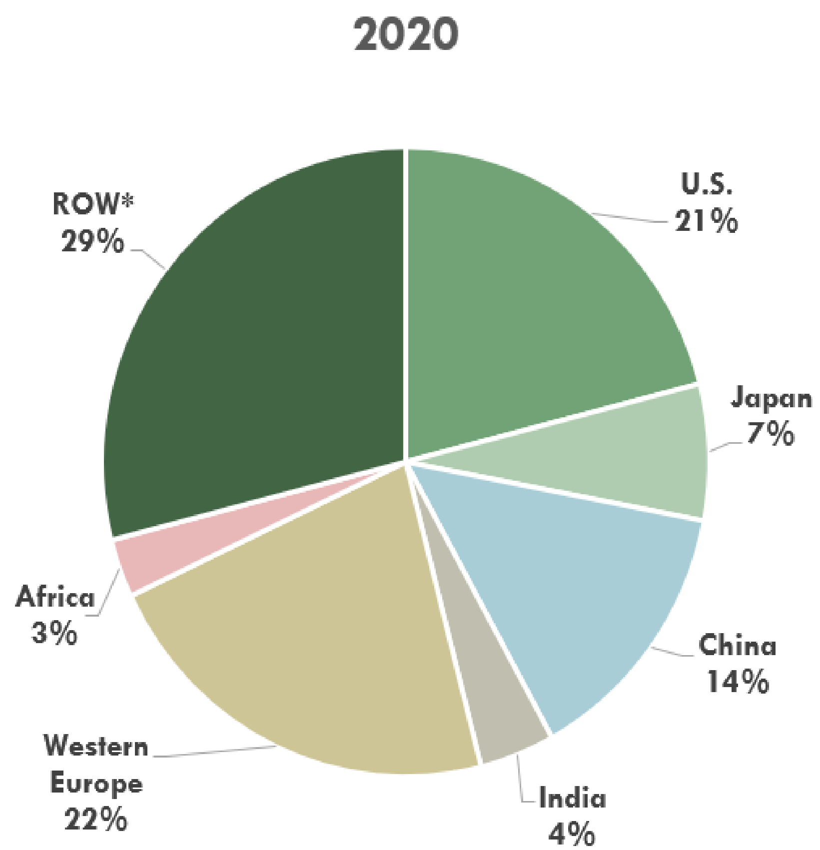
- international trade
  - USMCA
  - China's Belt & Road Initiative
- synchronized global economic moderation
  - China- slowest growth rate in 28 years
  - Japan- negative growth rate
  - Germany – negative growth rate
  - Central Bank's stimulus in China
  - high debt levels in urban real estate in China
- political uncertainty
  - Brazil
  - Venezuela
  - Mexico
  - Argentina
  - Germany, Britain & Euro Sector
  - U.S.

North America's Economic Power Block

- 28% of the global economy's GDP
- energy & oil
  - U.S. #1
  - Canada #4
  - Mexico #8
- 450+ million people
- 47% of Mexico's population is under 25
- ag trading partners:
  - Canada #1
  - Mexico #3

Rising of Asia





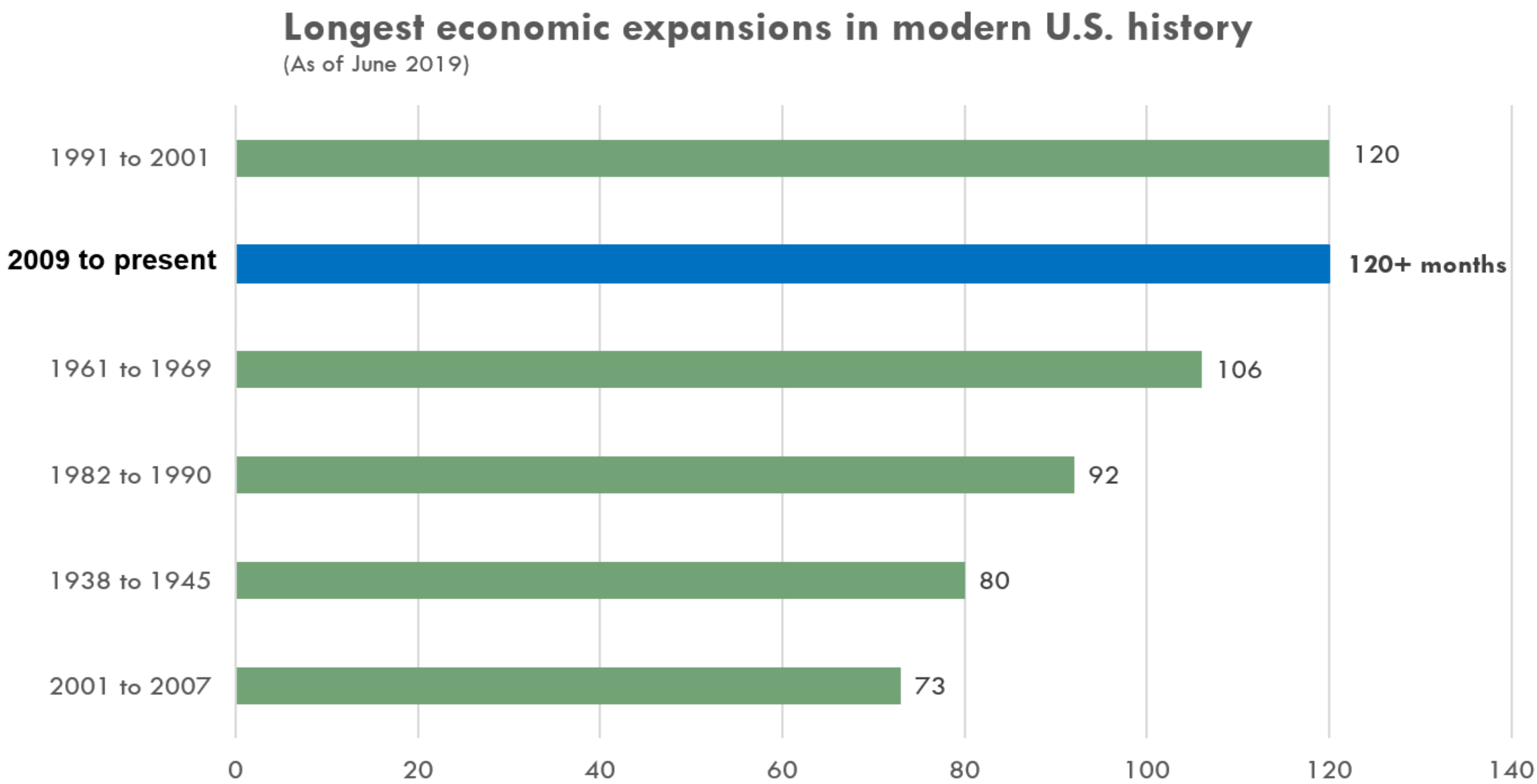
* ROW- Rest of World

Source: Global Insights, August 2018

Volatility on Balance Sheet

- lender appetite for refinances/restructure
- customer appetite for refinances/restructure
- supply/demand- real estate, equipment and/or livestock
- regulators
- suppliers of operating credit

By Mid-June, Longest Economic Expansion in the U.S.



Source: NBER, Economic Cycle Research Institute **(Note: current expansion still in progress)**

GSBC Survey Results

Graduate School of Banking at Colorado

Hot Off the Press – When Will the Next Recession Begin?

Estimated Start Date	Percent
First Half of 2020	8%
Second Half of 2020	36%
2021	38%
2022	8%
2023	10%

Hot Off the Press – *When the Next Recession Occurs, It Will Be….*

Recession Type	Percent
Very mild and short like recession in early 2000	72%
Similar to Great Depression in 2009 Era	10%
Possible depression in U.S. similar to the 1930's	0%
Great Recession in the U.S. and globally	18%

Hot Off the Press – Cause of Next Recession (More than 1 selected)

Cause of Next Recession	Percent
Trade issues	40%
2020 U.S. Presidential Election results	10%
2020 U.S. Presidential, Congress, and Senate results	25%
Debt issues: personal, corporate, government and student	45%
Asset price bubbles	19%
Stock market crash, more than 40%	8%

Hot Off the Press – *How Would You Resolve the U.S. Federal Debt Issue?*

Solution	Percent
Raise taxes	1%
Cut the budget	22%
Combination of tax increases and budget cuts	35%
Cut taxes	1%
Cut entitlements and spending	15%
Implement fiscal and monetary policy designed to grow the economy	16%
Other	10%

Hot Off the Press – *Will the U.S. and China Sign Meaningful Trade Deal in the Next 12 Months?*

Answer	Percent
Yes	52%
No	48%

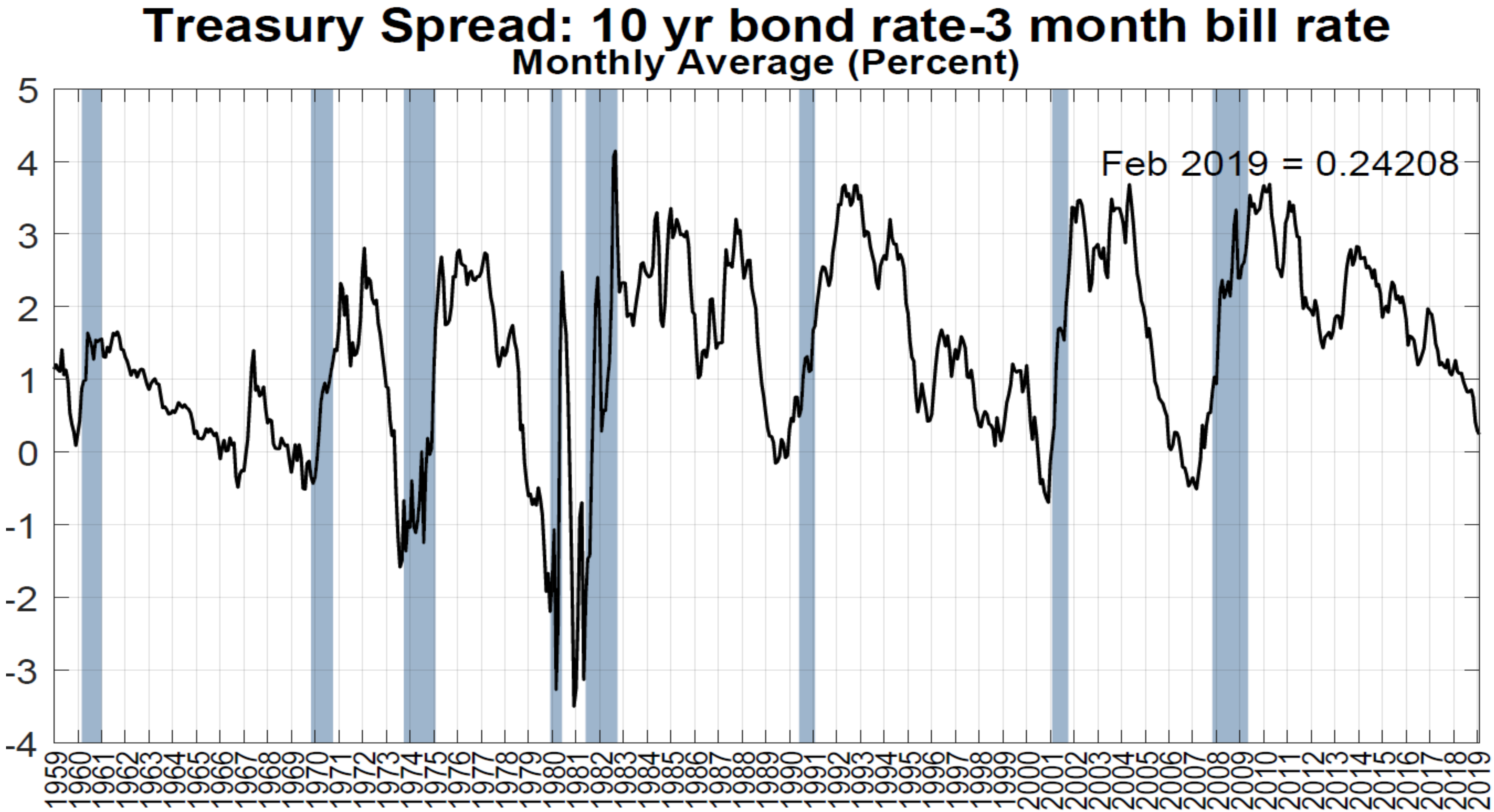
Hot Off the Press – *Will a Meaningful USMCA Trade Deal be Passed Within the Next 12 Months?*

Answer	Percent
Yes	74%
No	26%

Top Five Economic Indicators

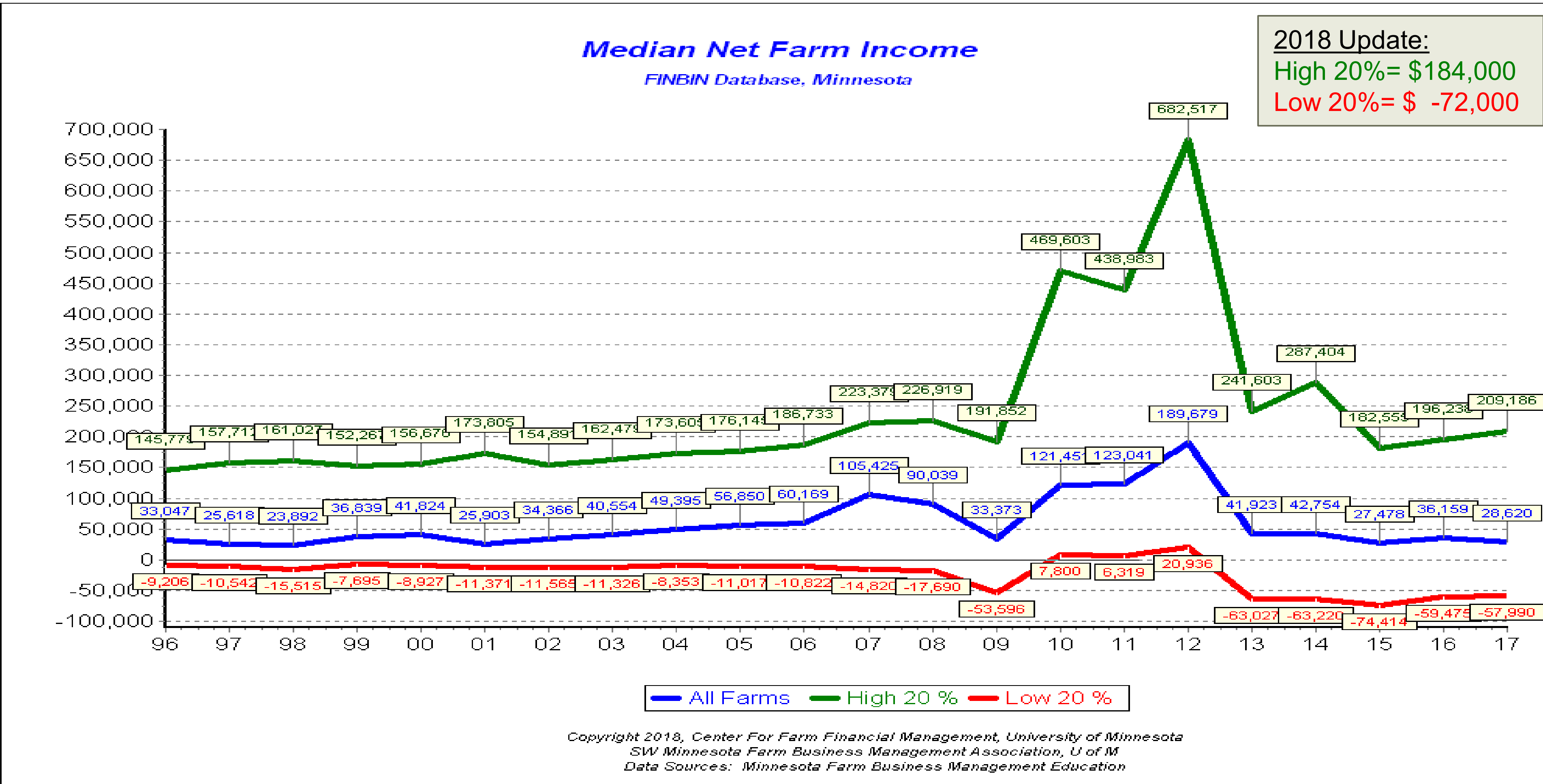
Indicator	Growth	Neutral	Recession
LEI/Diffusion Index	Positive	Flat/Decline	Decline 0.3% for 3 consecutive months AND >1% overall
Consumer Sentiment	>90	80-90	<80
Housing Starts	1.5 Million	1.0-1.5 Million	<1.0 Million
PMI	>50	41.7-50	<41.7
Stock Market	10% increase	Flat	>30% decrease

Yield Curves and Recessions

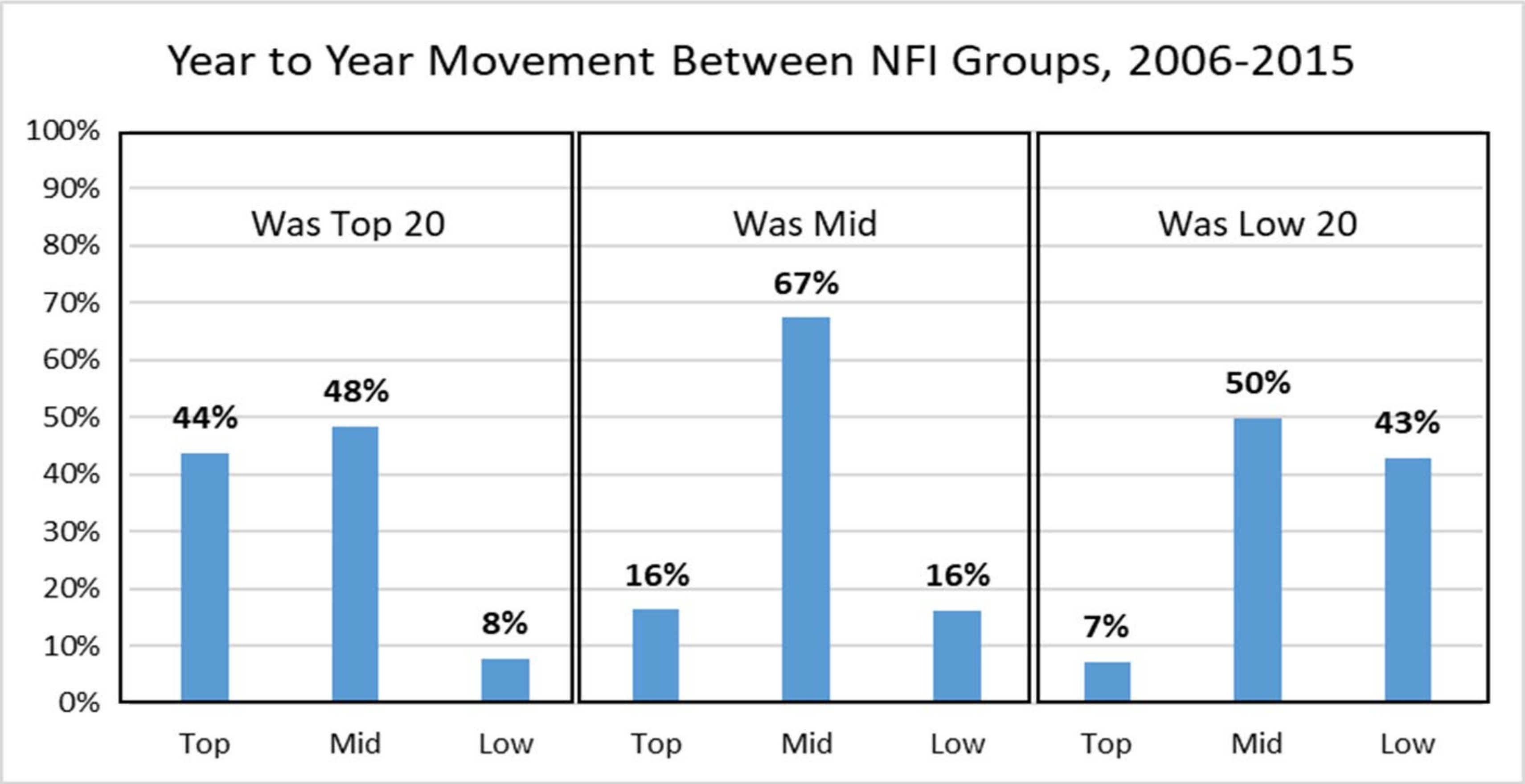


Source: Federal Reserve https://www.newyorkfed.org/medialibrary/media/research/capital_markets/Prob_Rec.pdf

Median Net Farm Income- All, High 20% and Low 20%

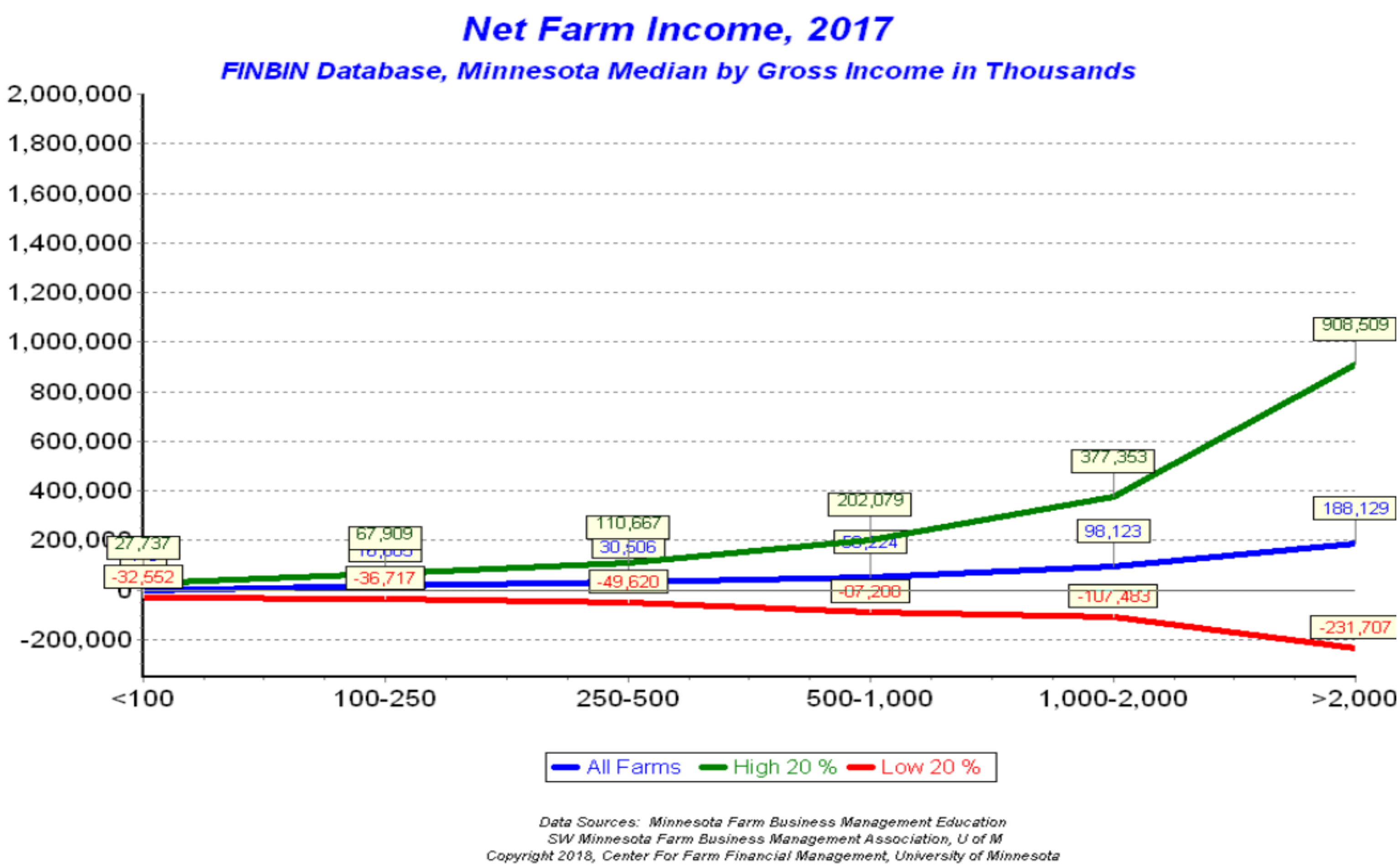


Year to Year Movement Between NFI Groups, 2006-2015

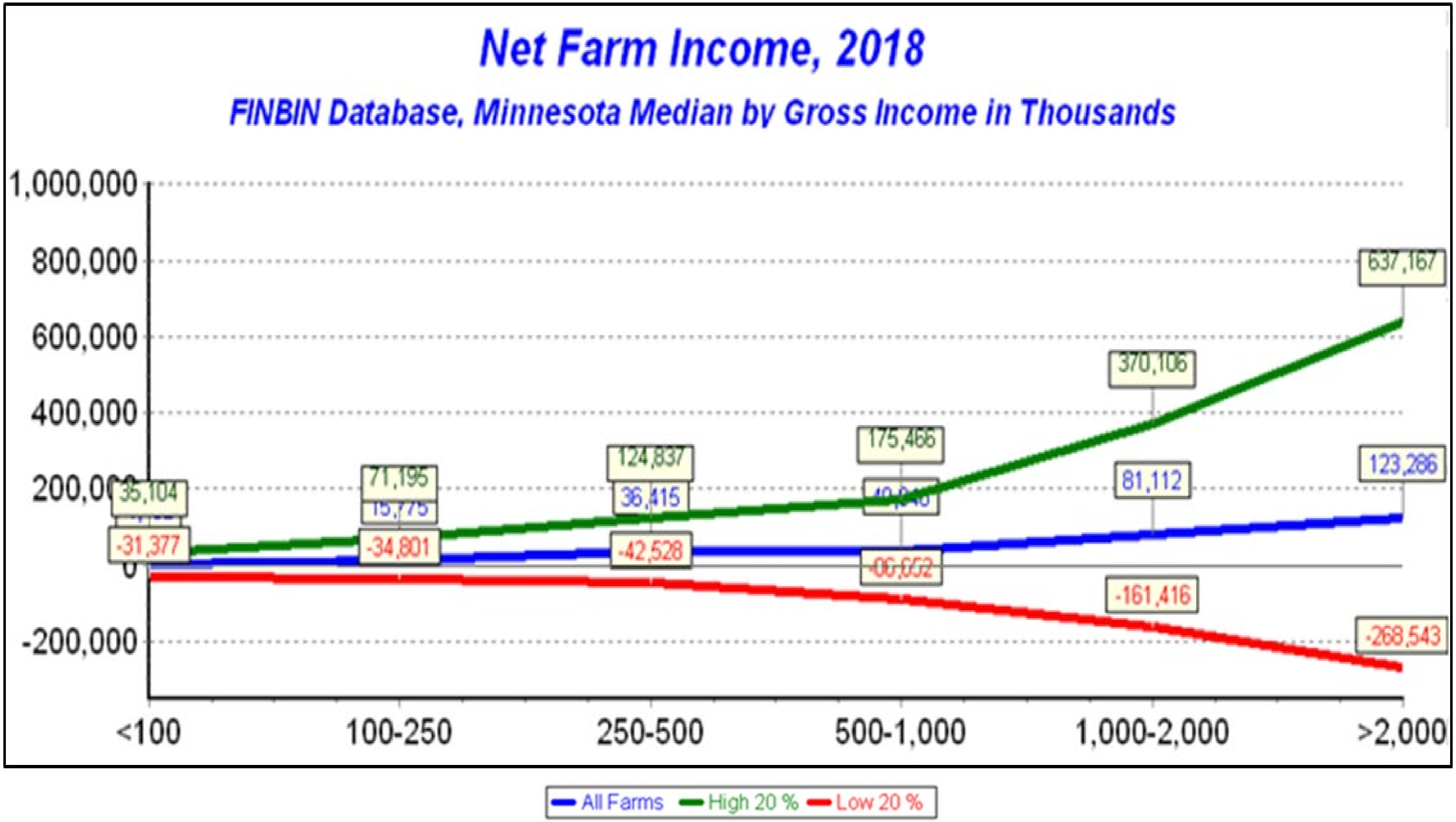


Sources: Minnesota Farm Business Management Education
SW Minnesota Farm Business Management Association, U of M

Net Farm Income, 2017



Net Farm Income, 2018



Data Sources: Minnesota Farm Business Management Education
SW Minnesota Farm Business Management Association, U of M

Tim's Triple Play

- cost control, right cost
- marketing and risk management
- asset, capital and human efficiencies

Trouble Shooting Matrix

Insufficient Repayment Capacity

Cut Business Cost	Reduce Four Largest Expenses: Crop, Feed, Labor, ??
Non-Farm Revenue	Job Stability/Availability, Job Cost Job Earnings, Skills, Time Management
Increase Income	Sell Capital Assets, Deferred Taxes, Increase Production, Increase Price
Cut Living Withdrawals	Purchase Financial Software, Small Cost Containment
Restructure Debt	Longer Term, Interest Only, Principal/Interest Deferred
Capital Infusion	Equity Capital, Family Capital, Supplemental Cash Flow
Bankruptcy	Voluntary, Involuntary, Chapter 7, 11, 12, 13

The Burn Rate – Working Capital Adversity vs. Opportunity

Defensive "Adversity Oriented"

Current Assets: $2,000,000

-Current Liabilities: $1,000,000

= Working Capital: $1,000,000

Projected Loss: $500,000

Working Capital = **2 Years**

Projected Loss

Red < 1.0 Year = Vulnerable

Yellow 1.0-3.0 Years = Resilient

Green >3.0 Years = Agile

Offensive "Opportunity Oriented"

Current Assets: $2,000,000

-Current Liabilities: $1,000,000

= Working Capital: $1,000,000

Debt Service(Existing & New) Payments: $200,000

Working Capital = **5 Years**

Total Debt Service Payments

Red < 2.5 Years = Vulnerable

Yellow 2.5-5.0 Years = Resilient

Green >5.0 Years = Agile

Burn Rate on Core Equity Adversity vs. Opportunity

(Assume $500,000 Earnings Loss & 20% land value decline)

Assets- Market Value	Estimated Value	Loan Maximum	Collateral Position	Remaining Principal	Equity Excess Reserves
1. Long Term (20% Decline on Land)	$6,000,000 $4,800,000	X 70% X 70%	= $4,200,000 = $3,360,000	- $2,200,000 - $2,200,000	= $2,000,000 = $1,160,000
2. Intermediate	$3,000,000	X 60%	=$1,800,000	- $800,000	= $1,000,000
3. Current	$1,650,000	X 80%	=$1,320,000	- $860,000	= $460,000

Burn Rate: Land & Long Term Equity Reserves= <u>Excess Reserves</u>= <u>$2,000,000</u> = 4.0 Years
Earnings Loss[1] $ 500,000

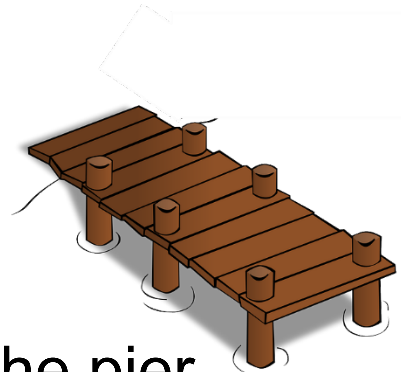
20% Decline
Burn Rate: Land & Long Term Equity Reserves= <u>Excess Reserves</u>= <u>$1,160,000</u> = 2.32 Years
Earnings Loss[1] $ 500,000

[1] Assume Earnings Loss of $500,000

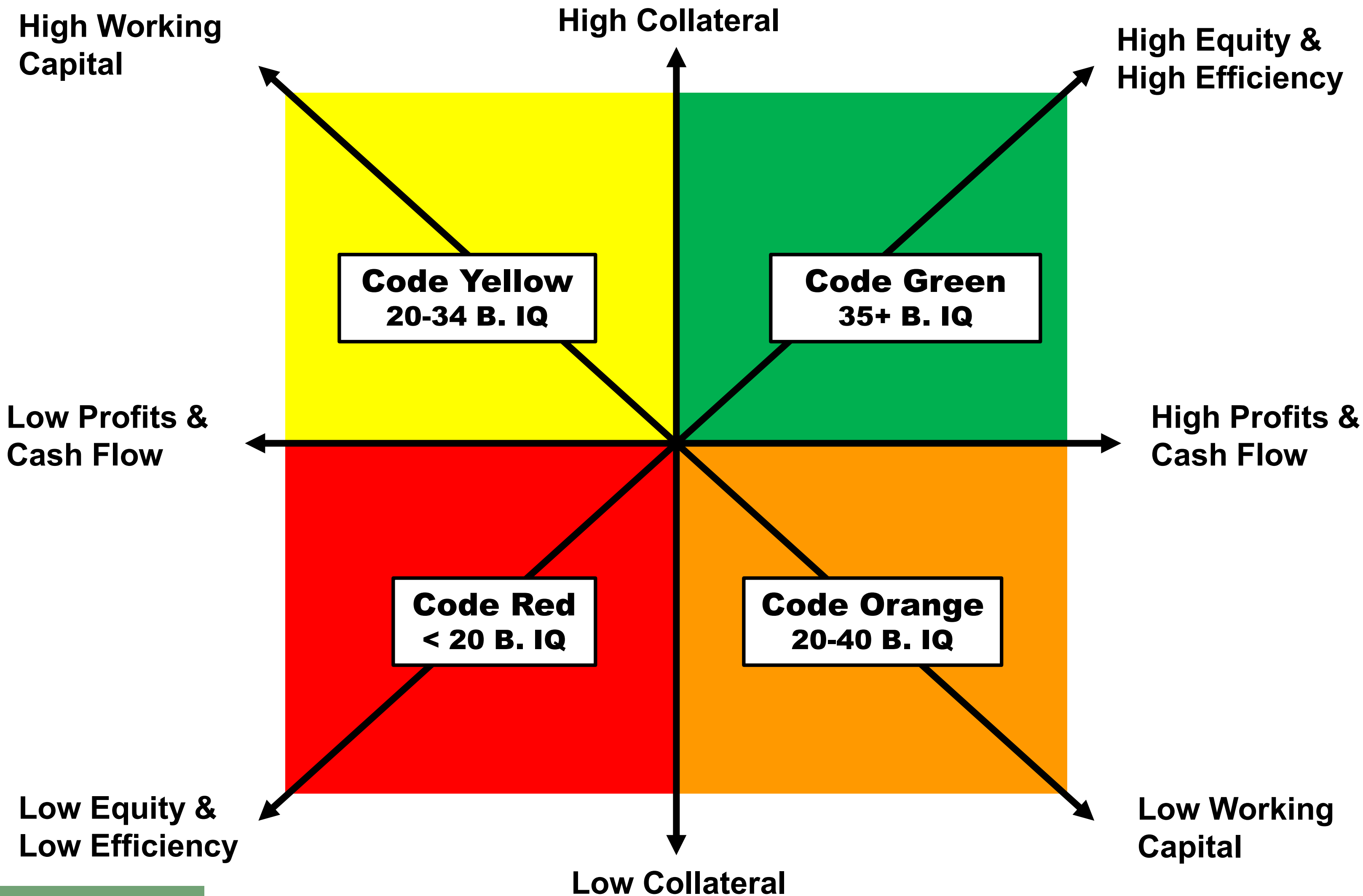
Red < 4.0 Years = Vulnerable
Yellow 4.0-7.0 Years = Resilient
Green >7.0 Years = Agile

Bridge or Pier Concept

- before: $\frac{\text{Term Debt}}{\text{EBITDA}} = \frac{\$1{,}000{,}000}{\$250{,}000} = 4 \text{ to } 1$
- after: $\frac{\text{Term Debt}}{\text{EBITDA}} = \frac{\$1{,}250{,}000}{\$250{,}000} = 5 \text{ to } 1$
- no improvement in EBITDA
- refinancing using land equity
- debt levels higher
- owner equity loss, more debt service
- water is deeper near the end of pier
- the longer the pier, then the narrower the pier



Business IQ:
Spectrum of Performance Possibilities



B. IQ= Business IQ

Bottom of Cycle Perspectives

- monitor financials monthly or quarterly
- one page plan
- be careful of technology: lender liability
- large specialized farm issues
- DISC personality profile: know communication styles
- build better business in down cycle

Thriving Lenders/Lending Institutions

- use financial statements as a mode of communications
- trust and verify using a network of people
- education/personal development/training
- six C's
- A.R.E.'s