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Super Conference Focusing on the Super Cycle

By: Dr. David M. Kohl

The 60th annual American Bankers Association (ABA) Agricultural Bankers Conference in Milwaukee, Wisconsin in early November was an opportunity for lifelong learning at an exceptional venue. John Blanchfield and his team at the ABA, with input from leadership of the ag and rural bankers committee and planning committee put together a conference full of cutting edge information and networking opportunities with more than 35 companies displaying products and services in the exhibit area. This was my 35th consecutive conference, where I led the panels and addressed the audience, but it was also an opportunity to recharge my batteries with power-packed sessions. Let us examine some highlights of the conference.

Matt Williams, Chairman of the ABA and President of Gothenburg State Bank in Nebraska, provided a power-packed presentation on his work nationally with the ABA. He discussed the core values of a leader, including, “Leaders do not take credit; they step up and take responsibility. They cultivate an environment that allows people to work together in a united format, striving to reach their potential. They know the importance of family and friends, and they are focused on doing what is right.”

After a reception at the Harley Davidson Museum the evening before, Ken Schmidt, former communications strategist for Harley-Davidson, presented the Harley-Davidson story. He discussed that they do not have “customers,” but they have “disciples.” Success is about marketing the experience and customizing the product or service to meet individuals’ needs, to make selling an emotional event after seeking input from the buyers. These points are very relevant as agriculture banking is trending from a very technical and credit score-based focus back to relationship-oriented lending.

Next up was “the Professor,” the farm policy legend from Kansas State University, Dr. Barry Flinchbaugh. The Professor was very frustrated with the current state of politics in Washington, DC, and who isn’t? He expected the Farm Bill would most likely be passed in April 2013, with the likely outcome being the Senate’s version. If parity was reestablished, the good Professor forwarded some interesting information concerning commodity prices. Wheat would cost $18 per bushel; corn would be $12 per bushel; soybeans would be $27 per bushel; and milk would be $52 per hundredweight. Wow! This really demonstrates how economics of the agricultural landscape have changed in the past century.

Slipping into some of the concurrent sessions, Bob Craven, of the Center for Farm Financial Management at the University of Minnesota, evaluated the new century "go-go farmer." These hard-charging producers in the go-go super cycle have the following characteristics. Yes, they are aggressive, with a focus on expansion. They are also willing to take a risk out on the edge. This often results in liquidity issues with gross income exceeding total assets. In other words, these businesses are renting and leasing many of their assets. Working capital was defined as the first line of defense in the volatile economic environment, with collateral being second in line.

The top 20 percent of producers with financial records on the FinBin database had 46 percent of their revenue as working capital, while the low 20 percent only maintained 13 percent of revenue as working capital. However, not all working capital is treated equally. As lenders, you must consider the cash conversion cycle. For example, how long does it take to turn inventory, receivables, and prepaid expenses to cash without experiencing a significant discount? Prepaid expenses could require 1 to 2 years. Feed could require up to a year. Grain contracts could take up to nine months. Bob further stated that this is where the go-go producers in expansion mode get into a severe cash flow crunch despite exhibiting strong financial ratios. In other words, cash is king! Global cash flow analysis includes analysis of all entities and sources of income, including personal income, direct and indirect liabilities.

A session on "old, bold lenders" presented by Claude Springfield brought home many good points. "Your first loss is your least loss." Sometimes you have to be aggressive in handling problem loans and issues concerning loans. He also discussed the James Bond rule, like James Bond in the movies. "Think through your second and third exit plans. When clients need an answer immediately before you get the facts, give them one: Just say no! Lenders who build careers on rapid growth are often faced with career busters or are out the door, only to have others clean up the mess!"

Booming land values were the talk of the conference in the halls, restrooms, and during meals. Land value increases of 30 percent plus in Iowa and Nebraska were not seen as sustainable. Dr. Brent Gloy, of Purdue University, indicated farm booms always end, but how they end is the concern. Changes in the forces that created the super cycle, supply and demand for commodities, along with net income and interest rates, could be the trigger events.

Darren Frye, of Water Street Solutions, presented an outstanding session on growth of agricultural producers. He contrasted good and bad managers. Good managers develop and execute processes and procedures. They plan, remove bottlenecks, set goals for steady growth, and measure results. Poor managers, on the other hand, pursue reckless growth, have little direction or goals, show poor financial metrics, and they do not understand the impact of decisions on other parts of their business.

Farmer Mac's workshop, titled "Agricultural Jenga: Tower of Risk" brought forward a panel of ag lenders who discussed the tools they used to help their customers manage volatility, while further strengthening the borrower-lender relationship. At the top of their list was using Farmer Mac's fixed rate loan products, enabling their banks to offer a much broader array of risk management options to their customers.

In summary, this was a super conference in the super cycle, and it followed the "WAYNE" principle, which I discussed in my address. It was "way above your normal expectations!"

Lender Tip

A minimum of one percent of your earnings, or two to six hours per week for employees, management, and board members, needs to be devoted to education on an annual basis. Next year, the ABA's 61st Ag Banker Conference will be held in Minneapolis, MN on November 10-13, 2013. It needs to be on your agenda! This year our bank, First Bank and Trust Company of Abington, Virginia, sent eight representatives consisting of loan officers, management, and board members. The bank has $1 billion plus in assets, with over $200 million in agricultural loans. How does this institution benchmark to your institution?

Global Economics

Since my last column, Europe has slipped into recession, with ongoing debt issues particularly in southern Europe. This is a continuing saga that will be closely monitored by others throughout the globe because the European Union represents 26 percent of the world economy.

A fast trek to the other side of globe finds the Chinese have new leadership in place for the second phase of authoritarian capitalism. The new leader will have issues concerning social control, as China moves from a rural to an urban nation with large disparities in wealth. The ABA Agricultural Bankers Conference was truly international this year. James Su Hao, managing director of East Rock Limited in Beijing, China, who specializes in dairy, indicated that the Chinese dairy industry is still largely made up of small, low-producing dairy herds, with production of just 60 percent the volume of U.S. dairy cows. He and his family of four lived in a 700 $ft.^2$ home, and it it cost him $32,000 to pay the government to have a second child.

These points illustrate how China compares with the rest of world, as a fulcrum of the emerging economies, particularly in the Asian region. The recent spat with Japan over territorial islands, the ban on the sale of Toyota vehicles in China, and the threat to call bonds issued to Japan illustrates what could happen in negotiations when this power nation with $3 trillion in cash reserves flexes its muscle.

Domestic Economics

The U.S. economy is still struggling as politics are trumping the structural changes that will need to be made in the economy. The good news is the housing market is making a nice, steady comeback particularly in the southern and western states where the housing bubble collapsed, despite housing starts being down 3 percent for November. Manufacturing, based on factory utilization, presents solid but not outstanding numbers, while core and headline inflation are residing in limits acceptable to the Federal Reserve.

Unemployment remains stubbornly high. The uncertainty over taxes, regulation, and healthcare are factors contributing to the reported unemployment rate remaining at 7.7 percent, and real unemployment slightly over 14 percent. Do not be too impressed by the reduction in unemployment, as workforce participation was actually down, so this was not a good sign. While the lead economic index remains positive, the purchasing manager index dropped back down below 50 in November, which indicates a slowing economy. One month does not make a trend, however, this number bears watching along with slowing retail sales.

The impact of going over the fiscal cliff or slope could potentially be 2.6 to 3.6 percent off the U.S. GDP growth rate, 2 million jobs lost, and a possible downgrade of U.S. debt. This will be interesting soap opera politics as political parties negotiate in front of the media. Where are our statesmen who put our country first and utilize the art of compromise?

Lender and Business Dashboard Economic Indicators (for the month of November)

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	95.8	✓		
LEI Diffusion Index	50%		✓	
Purchasing Manager Index - PMI	49.5		✓	
Housing Starts (millions)	0.861			✓
Factory Capacity Utilization	78.4%		✓	
Unemployment Rate	7.7%		✓	
Core Inflation	1.9%	✓		
Headline Inflation	1.8%	✓		
Oil Price ($/barrel)	$107.46			✓
Yield Curve	1.54		✓	

Lender and Business Dashboard Economic Indicator Benchmarks

Indicator	Green	Yellow	Red
The Conference Board Leading Economic Index® - LEI	Increasing	Flat to Decline	Decline 0.3% for 3 consecutive months AND >1% over the period
LEI Diffusion[1]	>60%	40%-60%	<40%
Purchasing Manager Index - PMI	>50	41.7-50	<41.7
Housing Starts (millions)	>1.5	1.0-1.5	<1.0
Factory Capacity Utilization	>80%	70%-80%	<70%
Unemployment Rate	5%-6%	6%-8%	>8% or <5%
Core Inflation	0%-2%	2%-4%	>4% or <0%
Headline Inflation[2]	0%-4%	4%-5%	>5% or <0%
Oil Price[3] ($/barrel)	<$50	$50-$100	>$100
Yield Curve[4]	Steep	Flattening	Inverted

[1]Ten indicators make up the LEI - measures % that are increasing; [2]Includes food & energy; [3]Consumer's perspective; [4]3-Month Treasury Bill rate to 10-Year Bond rate