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One Page Recovery Plan

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Now entering the fourth year of the economic reset, most sectors in the agriculture industry are exhibiting financial stress. In agricultural lending schools and conferences across the country, discussions center around which customers need to refinance or restructure debt, and which should be removed from the portfolio. One popular recommendation continues to be the development of a one-page recovery plan. With some important aspects, let's examine what should be included in this short plan.

First, a recovery plan is the producer's responsibility. Next, the plan must be detailed in writing. Many lending institutions grant a refinance or a restructuring of debt based on profit, cash flow, or working capital. To circumvent lender liability, the producer must drive the recovery. Further, a producer's willingness to develop a simple recovery plan can also measure the motivation one has to implement recovery adjustments. Reluctance to change is an important factor in evaluating the customer's account. The appropriate role of the lender is one of an informed advisor, working side-by-side with the customer. In fact, the lender should encourage producers, especially those in recovery, to engage a team of advisors for counsel.

Goals

In a recovery plan, the customer must articulate goals for the short (one to two years) and the long term (three to five years). Again, this needs to be in writing; not in thought only. The S.M.A.R.T. (specific, measurable, attainable, realistic and rewarding, and timely) principle is a good tool to use in goal development. As a lender, perhaps provide suggestions of past goals from other customers. Through the process, customers must think critically about their business, family, and personal goals in order to provide balance. It forces the consideration of many variables including business sustainability, as well as potential improvements. In refinancing and restructuring, many customers seek a quick fix to problems that often have been brewing for multiple years. A one-page plan dissolves the magic of the silver bullet approach, and demonstrates that no single change is sufficient to return the business to sustainable profitability.

Cash flow

The cash flow statement is 80 percent of a business plan. Thus, it is critical in a recovery plan. The customer should think through strategies for production, and marketing and risk management; as well as revenue and expense streams throughout the year. Specifically, lenders can motivate customers by having them develop a production plan with a timeline, and then, putting in the numbers.

For the customers that protest cash flow development because of the uncertainty in production or cost, have them start with a scenario plan first. Start with changing assumptions regarding price, production and costs and place them in a simple spreadsheet. As with the cash flow, this process establishes a vision of possible outcomes, and can be used to track progress throughout the year. One can use the best, worst and average case scenarios to develop applicable boundaries for this sensitivity analysis. In today's challenging economics, the best case scenario can be used as a motivator to stretch the customer's commitment and focus.

Monitoring

The real value of monitoring results is the ability to make adjustments and tweaks throughout the year. If one strategy is not working well, monitoring will reveal a problem and allow time for change. It is also valuable to the lender and advisors as they suggest solutions and evaluate performance.

In developing the recovery plan, be careful to avoid one-time revenues or costs such as the sale of capital assets, or the purchase of equipment. These numbers can easily compromise the projections as well as eventual success of a recovery plan. They may improve the short term perspective, but cannot be relied upon over a period of time. For example, limiting fertilizer and other agronomic practices could show positive numbers initially, but might be detrimental to income flows in the long run. The same can be said for off-farm income. Consider what amounts, for how long, on what terms, and from which parties off-farm income is contributed.

Next, any recovery plan should outline people's roles and specific responsibilities. If there are new "rules of engagement" they must be spelled out clearly. Action items should also be included. Times of financial stress can be emotional, which makes it wise to cover all expectations and any resulting consequences directly and up front.

Finally, include in the recovery plan some alternatives like a plan B, C or even D. If other options become necessary, back-up plans can aid in discussions of restructuring or liquidation. On the positive side, if the best-case scenario plays out, a customer may be in a place to grow or expand the business, or for others it may be the best time for the next chapter.

This plan for recovery was designed to be used for customers in financial distress. However, a one page plan with supplementary documents would be a valuable tool for all customers, and would support verification for loan files and loan narratives.

Management Tip:

Be cautious and conscious in all written communications with customers. In one case of lender liability, courts requested emails and information from ten years prior. Remember that financial distress can spiral out of control quickly resulting in improbable outcomes.

Global Economy

The recent elections in Europe, and particularly in France bode very well for the possibility of globalism versus nationalism. Of course, the fall election in Germany will be a trendsetter. Chancellor Merkel continues to perform well in runoff elections leading in to the pre-election hype of the summer.

The European economy is now showing signs of growth. This is positive for agriculture and the United States because the European Union is the U.S.' fourth largest trading partner. However, Europe has numerous issues such as BREXIT, Greek debt, and insolvent banks in Italy and Spain with which to still deal.

The recent agriculture trade deals with China are a sign of export growth for agriculture. Through the combined efforts of former Iowa Governor and current Ambassador to China, Terry Branstad, Commerce Secretary Wilbur Ross, and the U.S. Secretary of Agriculture Sonny Perdue, the poultry and beef industries are welcoming positive news. Only time will tell whether this trend will continue, but these initial steps are a good start.

As the third largest economy in the world, Japan is exhibiting growth. However, other economies such as those of North Korea, South Korea, and to some extent China and Russia must all be closely watched.

Additionally, with OPEC production on the rise, energy prices have declined, which normally favors U.S. production and cost controls. Overall, global economic growth, while not stellar, is modest, which is very positive for U.S. agriculture.

Domestic Economy

As one travels across the country, the bifurcated economy is quite obvious. The Coastal and Southern economies are doing well, largely due to consumer consumption. Dependent on agriculture, manufacturing, and energy, the Midwest economy is struggling to modest. Of course, this is analogous to the 1980s when farm sectors were stressed, but the Coastal regions grew, particularly in high tech areas. Indeed, economic indicators confirm this comparison.

The LEI (Leading Economic Index) has continued to climb at least four-tenths of 1 percent every month since January. The diffusion index is strong at 70 to 80 percent. The strength of the dollar as compared to the Euro and Yen has weakened slightly due to economic growth, political rhetoric, and election outcomes in other regions of the world.

The PMI (Purchasing Managers Index) points to a trend of economic growth. Still above 50, the PMI has indicated growth for all but one of the last 18 months.

Unemployment numbers (U-3) are at the lowest levels in nearly 15 years. Including discouraged workers, U-6 is also low at 8.4 percent. These numbers, along with wage and job growth numbers must be monitored as they are an anchor to the Federal Reserve action on interest rates. In fact, these numbers undoubtedly played a role in the recent increase.

Housing starts are still dragging at between 1.0 and 1.2 million annually. Lack of supply, especially in the moderate price range is problematic, especially when added to the amount of Millennial student debt. Together, these factors are a strong headwind to housing starts. As an important area in the domestic economy, these numbers press the issues of exactly when and how housing starts will get back to the 1.5 million annual range.

Factory capacity utilization has had a solid base in recent months, up almost 1 percent, and nearing the green light metric. This metric will be interesting to watch as the current Administration continues to place emphasis on job and economic growth in the areas of manufacturing.

On the inflation front, numbers can be described as just right; they aren't too hot and not too cold. Like unemployment, inflation bears weight in the Federal Reserve's considerations on interest rates. A trend either way could be significant. Growth for the first quarter, as measured by GDP is the strongest in recent years coming in at 1.2 percent.

In summary, the 800 pound gorilla in the economy is the consumer. The Consumer Sentiment Index from both Michigan and the Federal Government are still strong even with the recent, small decline. The wealth effect from the stock market, low unemployment rates, and the increase in home values are spurring the U.S. consumer to new levels.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	126.9 (Apr)	✓		
LEI Diffusion Index	80% (Apr)	✓		
Purchasing Manager Index - PMI	54.9	✓		
Housing Starts (millions)	1.092		✓	
Factory Capacity Utilization	76.6		✓	
Unemployment Rate	4.3%	✓		
Core Inflation	1.7%	✓		
Headline Inflation	1.9%	✓		
Oil Price ($/barrel)	$49.39	✓		
Yield Curve	1.23	✓		

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