FARMER MAC

DAVE'S GPS

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<u>The Super Bowl of Banking</u>

By Dr. David M. Kohl

The American Bankers Association's Annual National Agricultural Bankers Conference was held this year in Kansas City, Missouri. This conference is the super bowl of banking education. This year's event, with the themes of positioning for transition and navigating volatile times, was superbly coordinated by Cynthia Watkins and the planning committee. Looking ahead, I believe a summary of the topics covered will be helpful for the coming New Year as you navigate the economic white waters.

Despite direct competition from the Kansas City Chief's football game, the Sunday afternoon pre-conference session had a large audience. Bob Craven, Director of University of Minnesota's Center for Farm Financial Management and Dale Nordquist, Assistant Director for the Center delivered a compelling program. Using FINBIN data, the two illustrated how changing economic times continue to impact producers' profit margins.

The highest risk appears to be with the "go-go" producers renting and leasing high-priced farm ground. These producers plowed all their profits into growth without reserving necessary working capital. Bob stressed that family living costs and capital expenditures outside the business increased during good times. Now, those costs must be curtailed. Both Bob and Dale highlighted the importance of the accrual adjusted income statements with a focus on earned net worth gains or losses.

Curt Covington, Senior Vice-President of Agricultural Finance at Farmer Mac, delivered an excellent presentation on the complexities of credit. Farmer Mac along with FINPACK sponsored this session. Curt stated if a customer has an operating loan with another institution, it is imperative to know the details of that arrangement. Instability in operating credit can begin quickly and because it provides short-term liquidity, any issues therein can stress the business. Of course, this could in turn, stress any other finances of the business. Curt also emphasized the importance of monitoring credit, specifically, large accounts, for outside-the-number influences like divorce, disagreements or disillusionment. Terms and covenants must be taken seriously by all parties in the times ahead.

At the end of my educational session, I presented a screening guide for lenders to use with customers showing negative margins or requesting a refinance of the operating loan to term debt. Factors in the screening guide include trends and profitability analysis, willingness to cut living expenses, working capital status, protection of current assets with marketing risk management programs, and a focus on elimination of unproductive assets. From discussions in this session, I believe this screening guide will be a good tool for both lenders and producers.

The attendance at this conference was one of the largest since the 1980s farm crisis era. The general sessions presented a wide range of perspectives and thoughts. Mike Beal, Chief Operating Officer of Balls Foods Stores in Kansas City, discussed consumer trends driven by millennials, technology, and big data that tracks food from the farm to the plate. The consumer trend is better living. Food products that are local and antibiotic-free will be the differentiators in the future consumer marketplace. Mike shared that his stores actually provide financing to some of the farms that supply products to his stores. Specifically, Ball Foods provides operating loans. From his presentation, one must wonder if this type of lending will be a format for competition to traditional lenders.

On another important topic, Eric Snodgrass, of University of Illinois, is a new up-and-coming weatherman. He served as a compelling luncheon speaker. According to Eric, El Nino will bring warmth to the North, cooler temperatures to the South and wet weather to the West Coast. He provided a glimpse of a future prediction tool with weather applications. Farms can use this tool to maximize potential in yields and cut costs, all based upon timing land applications according to local weather conditions.

Dr. Mike Swanson of Wells Fargo gave his usual; a stellar presentation. He indicated there is a gap or slack in the growth of the economy as a result of social and regulatory policies. The result of these policies is lower productivity and available capital sitting idle due to regulation. To navigate the future, agricultural producers will have to draw upon enhanced financial management skills and perhaps, a bit of good luck in regards to timing.

During the conference, I had opportunity to share the podium with Dr. Barry Flinchbaugh of Kansas State University as two millennial bankers, randomly selected from the audience, peppered us with questions compiled from bankers throughout the year. As the “professor prophets,” Dr. Flinchbaugh and I came away from the experience optimistic about the future of agriculture. There are large numbers of young people entering the industry. Young individuals that exhibit knowledge of technology paired with responsible work habits are the ones to target for future management of our farms, ranches, agribusinesses, and lending institutions. I admit that Dr. Flinchbaugh may have displeased the audience with his favorites in the presidential election, but it was an unexpected question. I will leave it up to you, the reader, to guess his choice candidate.

A special series at the convention this year was the “New Ag Banker Track.” The series included lessons of the 1980s, documentation, making good loans, fundamentals of credit analysis, and distressed credit. For sound credit analysis, the sessions highlighted the need for accrual adjusted statements utilizing a set of five to seven key ratios. Utilization of a few, enforced covenants was also stressed as important. The topics of lessons learned from the 1980s and distressed credit covered proactive approaches to problem loans and the importance of providing a customer with a second alternative for possible credit.

In a luncheon session on uncertainty and risk, Nathan Kauffman of the Federal Reserve Bank of Kansas City discussed the looming issue of the strong concentration of debt amongst larger producers. The current level of losses and delinquent payments could quickly escalate if only a few large customers begin to exhibit financial difficulties.

Sam Miller of the Bank of Montreal moderated a great session on “bankers making bankers better bankers.” Whether it is a young or experienced banker on the panel, the importance of knowing your customer’s goals, communication methods and styles was imperative for success. Keith Phillips, a banker from Virginia indicated a good working relationship with the younger lender can be beneficial, especially, in learning new technology. A willingness to learn from others or engage in “shared learning” can enhance lender performance as well as customer relations.

The conference also took the time to recognize several outstanding contributors to the banking industry. With a record number of exhibitors, bankers and lenders in attendance, this year’s Bruning Award winner was Terry Barta, a banker from Kansas. Terry is an outstanding banker with whom I enjoyed working at the Kansas and Nebraska banking schools for a number of years. Next, John Blanchfield, the former Senior Vice President and Director of the Center for Agricultural and Rural Banking was a visionary for the American Bankers Association for 25 years. Retired in January, he was the first recipient of the Blanchfield award, named in his honor. In addition, Cynthia Watkins was recognized for her 25th year of dedicated service to the conference. This stellar educational event is certainly a team effort!

In closing, it was a pleasure be in Kansas City with the World Series crowds and hear Baseball Hall of Fame Player, George Brett, address the conference. Known for his exceptional hitting, Brett suggested a good set of mentors, working after practice, and playing as a true team player, as elements of success. The benefit of these principles is not limited to baseball but extend to agriculture and lending as well. Especially in today’s environment of change, educational opportunities are vital to continue moving forward.

Management Tip:
Make it a point to study the millennial generation. They had a large presence at the conference and will be the drivers of social, political, and consumer trends in the next 10 to 15 years. The study and inclusion of millennials should be a high priority for any strategic planner in the lending industry.

Global Economics

The global economy continues to slow down. In Europe, the tragedy in Paris along with the Turkish downing of the Russian military plane, put forth more geopolitical risk for the future. Mr. Draghi, President of the European 21Central Bank, shocked world equity markets after the announcement of an unlimited duration on the stimulus of the economy for the European sector. Despite the continued stimulus from the central bank, regulation and social programs are challenging. In addition, the regions that are dependent on global exports slow the economy's growth. Watch for the outcomes of the Paris climate meetings as they will have a direct impact on the agriculture sector in the U.S. and abroad.

China and Asia continue having modest growth which is reflected in the agricultural and rural areas that export to that region. The acceptance of China's currency into the International Monetary Fund (IMF) was a symbolic move indicating the Chinese economy, 15 percent of the world's gross domestic product (GDP), has arrived. Watch for the possible slowdown of the Chinese economy in 2016 and perhaps more interest rate cuts and further devaluation of their currency. Continued struggles with natural resources such as, land toxicity, and water and air quantity and quality, will continue as a challenge to growth and productivity not only in China, but in the overall Asian region.

Maintain a close eye on South America. The newly elected leader of Argentina, Maricio Macri, is very business positive. Contrast that to Brazil where possible impeachment of leaders and a deep recession has this country's economy on its heels. As the first 15 years of the new century close, the global economy and the emerging nations are on a critical crossroads. One way leads to years of prosperity while the other way yields moderation, decline and possible stagnation.

Domestic Economics

The U.S. economy is nearing its 80th month of business expansion since the last recession. Lately, discussions have emerged concerning the possibility of economic recession for the U.S. in 2016. As always, one needs to examine the economic variables to discern any trends.

First, the leading economic index (LEI) is still in ascent as of the last reading. The diffusion index is 55 percent indicating just over one half of the ten factors contributing to this index each currently register in the positive.

The U.S. dollar is strong compared to other major currencies. This is reflected in economic stress in agriculture, energy, manufacturing, and multi-national firms dependent on exports.

A negative sign that verifies this trend is the Purchasing Manager Index or PMI. This number is 48.6 which indicates the manufacturing economy is contracting. While one month does not make a trend, monitor the PMI as it could possibly indicate a recession for the manufacturing industry. Granted, this section of the economy is not as significant as it was decades ago, but reduced income and earnings in the sector could spill over into the larger, service-based economy.

Another stagnant trend is housing starts. This metric has had difficulty achieving the 1.5 million mark which is necessary for a strong housing industry. As it relates to agriculture, a strong housing industry is important to the timber sector. Unemployment still registered in at 5.0 percent (U-3) and 9.9 percent when U-6 numbers are included. With job starts tallying in above 200,000 monthly, the strong job market was a factor closely examined by the Federal Reserve when deciding to increase interest rates, their first interest rate hike in nearly a decade.

Factory utilization is slipping, which reflects the sluggish manufacturing industry. Layoffs and reduction of hours are additional closely watched numbers by policymakers to determine whether another recession is looming.

With a strong dollar and cheaper imported goods, the re-entrenchment of commodities is reducing inflationary pressure. Core inflation, excluding food and energy, registers in at 2.0 percent. Including food and energy, headline inflation is 0.5 percent. The index of consumer sentiment is above 90 which suggests the service sector economy is performing quite well.

Overall, the fourth quarter of 2015 finished solidly. The main question remaining is whether the downturn in the manufacturing economy will spread to the general economy. Historically, a downturn in one sector eventually becomes contagious.

P.S. On a side note, my friends that drive trucks professionally indicate a current slowdown in loads and backloads. As a real-world indicator, we must watch this progression closely!

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	124.6	✓		
LEI Diffusion Index	55%		✓	
Purchasing Manager Index - PMI	48.6		✓	
Housing Starts (millions)	1.173		✓	
Factory Capacity Utilization	77.0		✓	
Unemployment Rate	5.0%	✓		
Core Inflation	2.0	✓		
Headline Inflation	0.5	✓		
Oil Price ($/barrel)	$39.08	✓		
Yield Curve	2.17	✓		

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