

THE NEW ECONOMIC REALITIES IN AMERICAN AGRICULTURE

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Macro Clinic Video Blog: <http://agstar.com/edge/>

Road Warrior of Agriculture: www.cornandsoybeandigest.com

Ag Globe Trotter: www.northwestfcs.com

Dave's GPS & Dashboard Indicators: www.farmermac.com

Five Macro Factors Impacting Agriculture: Rural America's Bottom Line

- emerging nations
 - economic slowdown
- biofuels, oil, & technology
- central banking strategy
 - U.S. & abroad
- king dollar & duration
- mother nature
 - weather- U.S. & globally

2016 – 2020 Economic Reset 1

- BRICS & KIMT's – 58% of world economic growth
- growth 8-10% during super cycle
- current growth under 4%
- China's growth officially 6.9%, but most likely 2-3%
- one half of emerging nations are in recession
- period of economic moderation impacting America's core



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2016 – 2020 Economic Reset 2

- ethanol, biofuels, alternative energy
- oil "recession effect"
- oil- extreme volatility
- commodity deflation
- the road trip



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2016 – 2020 Economic Reset 3

- 40% of commodity prices & asset values due to super cycle
- U.S. Central Bank's strategy moving forward
- European Central Bank's unlimited stimulus
- Bank of Japan's stimulus
- China's devaluation of currency
- China's IMF



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2016 – 2020 Economic Reset 4

- weather wild card
- political & military sanctions, social unrest worldwide
- consumer trust
- quality standards



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Global Economics: Europe

- France- economy sluggish
- Germany- export driven
- Europe & China connection
- Greece
- central bank stimulus extended
- Ukraine



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Global Economics: China

- China PMI <50
- exports down >10%
- lowered rates five times in 2015
- stock market up 105%, down 30 to 40%
- devalued currency
- natural resource issues
- shadow banking



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Global Economics: Other

- Russia
 - oil
 - Mr. Putin
- Brazil
 - recession
 - infrastructure
- Argentina
 - tax
 - political dysfunction
- Brazil & China connection



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Global Economics: Japan/Asia

- debt issues
- demographic wedge
- South Korea sluggish
- India quite strong



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U.S. Economy Watch

- lead economic indicators
 - PMI
 - LEI
- housing
- factory utilization
- business cycle duration
- CORR coastal decision

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Federal Reserve's Interest Rate Barometer

Indicator	Possible Change	Definite Change	Current Status
Unemployment	7.0%	6.5%	4.9%
GDP Growth	2.0%	2.5%	0.7%
Core Inflation	2.0%	2.5%	2.1%
Headline Inflation	4.0%	5.0%	0.7%

Watch List:

- Dr. Yellen
- FOMC voting
- FOMC minutes
- Rail traffic
- Shoe shiners
- Copper prices
- Overland trucking
- Baltic Sea index

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Nine Innings of an Evolution of a Cycle Reset

1. profits start to decline but asset appreciation continues
2. new lenders enter the market place
3. strong equity growth mentality creates complacency
4. machinery & equipment values first to decline
5. aggressive growth businesses & fraudulent activities occur
6. margin negative cash flow & operating lines of credit become an issue
7. marginal assets discounted
8. non-traditional & new lenders retreat
9. quality assets adjust in value depending upon length of adjustment

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Dangerous Customer 2016-2020

- balance sheet bully: 80% of growth through appreciation vs. earned net worth
- gunslinger never leaves money on the table
- Alpha Dog & Alpha Pup: bigness on the brain
- high maintenance lifestyle
- interconnected risk
- victims & know it all's
- fraudulent activities
- 96-4-50 Rule
- 1 to 1 ½% Rule
- split lines of credit rule- 5 to 7 lines

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Credit Financial Analysis in the Past

- stable income, high government payments
- low quality information
- lack of standardized information
- strong debt to asset ratio
- strong collateral position
- few benchmark ratios

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Credit Financial Analysis- Now & in the Future

- volatility in price, cost, and markets
- international trade risk
- economic cycles are more abrupt
- concentrated debt
- interconnected debt
- control vs. ownership of assets
- sensitivity analysis- profit and cash flow
- liquidity/burn rates for liquidity and equity

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Producers/Lenders Side by Side Producers Expectations 1

- don't go to the lender requesting money
- go to the lender with a business & financial plan
- proactive vs. reactive when working with the lender
- keep open communications for problems, issues & growth
- use variance analysis to monitor the business

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Producers/Lenders Side by Side Producers Expectations 2

- goals for short & long run
- up to date balance sheet
- projected cash flow
- corrective actions with S.M.A.R.T. goals
- review the plan with an advisor, peer or lender

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Producers/Lenders Side by Side Lender Rules

- Three C's of Lending
- knowledge of the business industry
- no surprise borrowing & lending
- regulators & examiners
- lenders' strategic objectives

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Screening Guide for Negative Margins

1

Historically has the producer/entity:	Yes	No
Been profitable above interest rates and rate of inflation?		
Shown growth of balance sheet which is earned vs. appreciated net worth?		
Has built and protected working capital in positive cycle?		
Been able to cut living expenses if needed?		
Been able to sell unproductive assets?		
Followed and executed a marketing risk management program?		
Have the ability to cut 10 to 30% of costs?		

Lender Version

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Screening Guide for Negative Margins

2

Historically has the producer/entity:	Yes	No
Been able to shed unprofitable land, machinery, livestock, & human assets if necessary?		
Had a burn rate for working capital 2.5 years or more?		
Had a term debt/EBITDA ratio <5 to 1?		

Scoring Key:

- >8 Yes boxes checked= strong candidate for refinance & workout
- 4-7 Yes boxes checked= possible problem loan
- <4 Yes boxes checked= problem loan now

Lender Version

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The Burn Rate – Working Capital

Revenue	\$2,000,000	Current Assets	\$1,000,000
Expenses	<u>2,200,000</u>	Current Liabilities	<u>500,000</u>
Loss	\$200,000	Net Working Capital	\$500,000

Net Working Capital \$500,000 = 2.5 Years

Projected Loss \$200,000

Green >3.0 Years

Yellow 1.0-3.0 Years

Red <1.0 Year

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The Burn Rate – Debt Service Payments

Revenue \$2,000,000 Current Assets \$1,000,000
 Expenses 1,800,000 Current Liabilities 500,000
 Profit \$200,000 Net Working Capital \$500,000
 Debt Service Payments = \$100,000

Net Working Capital \$500,000 = 5.0 Years
 Debt Service Payments \$100,000

Green >5.0 Years

Yellow 2.5-5.0 Years

Red <2.5 Years

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Key Ratio Questions

Question	Green	Yellow	Red
1. What is the debt to asset ratio?	<30	30 to 70	>70
2. What is the working capital to revenue ratio?	>33	10 to 33	<10
3. What is the coverage ratio?	>150	125-150	<125
4. What is term debt/ ¹ E.B.I.T.D.A. ratio?	<3.5/1	3.5/1 to 6/1	>6/1
5. What is burn rate on working capital?	3/1	3/1 to 1/1	<1/1

¹E.B.I.T.D.A.- (Earnings/Net Income) Before Interest, Taxes, Depreciation & Amortization Expense

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Key Ratio Calculations

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Ratio Name	Ratio Formula	Ratio Example
1. Debt to Asset Ratio	$\frac{\text{Total Debt}}{\text{Total Assets}}$	$\frac{\$300,000}{\$1,000,000} = 30\%$
2. Working Capital to Revenue Ratio	$\frac{\text{Net Working Capital}}{\text{Revenue}}$	$\frac{\$200,000}{\$1,000,000} = 20\%$
3. Coverage Ratio	$\frac{\begin{array}{l} \text{Net Income} \\ +\text{Non-Farm Income} \\ +\text{Interest Paid} \\ +\text{Depreciation Paid} \\ -\text{Living Expenses \& Taxes} \end{array}}{\text{Repayment Ability}}$	$\begin{array}{l} \$100,000 \\ +\$25,000 \\ +\$25,000 \\ +\$50,000 \\ -\$100,000 \\ \hline \$100,000 \end{array}$
	$\frac{\text{Repayment Ability}}{\text{Total Debt Service}}$	$\frac{\$100,000}{\$50,000} = 200\%$

¹Net Working Capital = Current Assets- Current Liabilities

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Key Ratio Calculations

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Ratio Name	Ratio Formula	Ratio Example
3. Term Debt to E.B.I.T.D.A Ratio	$\frac{\text{Term Debt}}{\text{E. B. I. T. D. A.}}$	$\frac{\$300,000}{\$175,000} = 1.72$
4. Working Capital to Revenue Ratio	$\frac{\text{Working Capital}}{\text{Projected Loss}}$	$\frac{\$200,000}{\$100,000} = 2.0$

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Ten Golden Rules of Banking 1

- tag team tough accounts
- document in writing- agenda, minutes, timeline
- three C's of banking
- 1- 1½% & 67 x's loan volume rule
- 3-5 training venues annually
- teacher, coach, & facilitator



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Ten Golden Rules of Banking 2

- management, board & owners support agriculture
- don't rely on credit scoring- i.e. don't check brains at the door
- hear the silence- balance high tech, high touch
- six degrees of goal setting



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