

Current Issues Affecting Retail Agribusinesses and Cooperatives

2008 Risk and Profit Program

K-State Alumni Center

Presented by
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Introduction and Objectives

- What do you want to achieve today?
- My objective is to present an overview of industry factors and firm factors that are driving changes to the retail agronomy and grain origination industries in Kansas.
 - Likely lead to restructuring
 - David Barton / I have been charged to conduct a national program on this topic by the Farm Foundation and USDA in 2009
- My slides use data and figures from a variety of sources including USDA ERS, USDA NASS, and AgManager

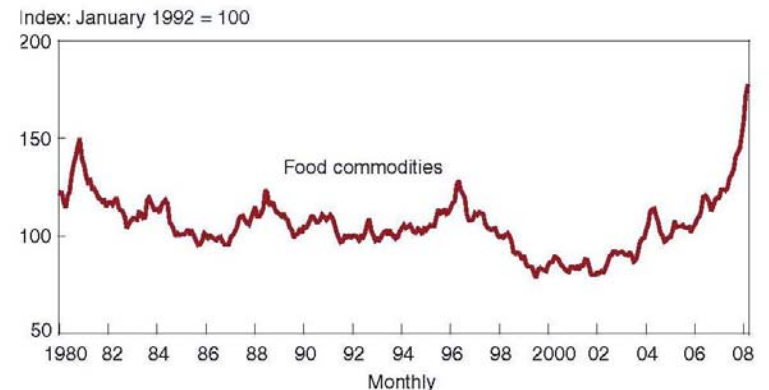


Firm and Industry Effects

- Industry effects – outside environment and cannot be controlled often
 - KState research suggests these are about 2/3 of industry profitability in food economy
- Firm effects – internal environment and can be controlled by management
 - KState research suggests these are about 1/3 of industry profitability in food economy



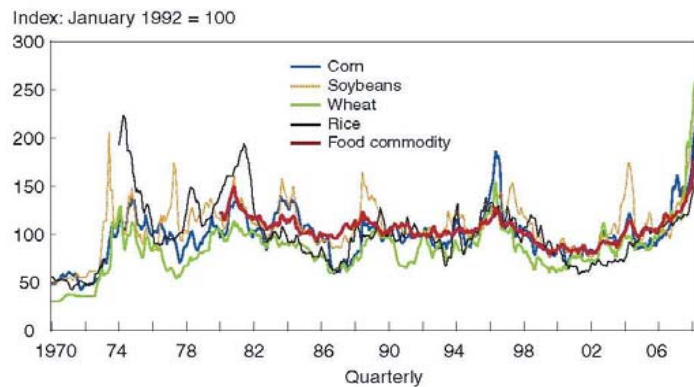
Figure 1
Food commodity prices rose more than 60 percent in the last 2 years



Source: International Monetary Fund; International Financial Statistics.



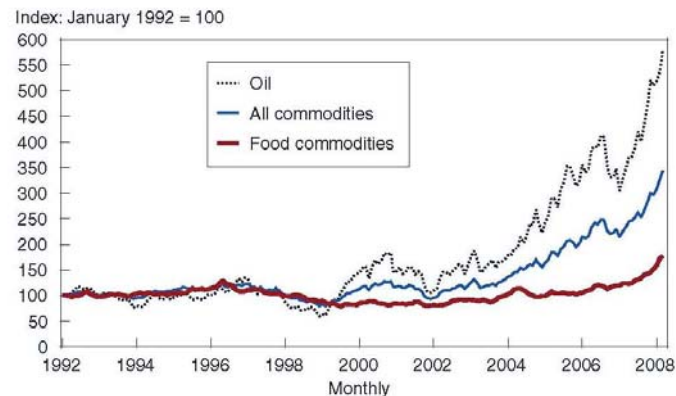
Figure 2
Food commodity price spikes since 1970



Source: International Monetary Fund: International Financial Statistics.



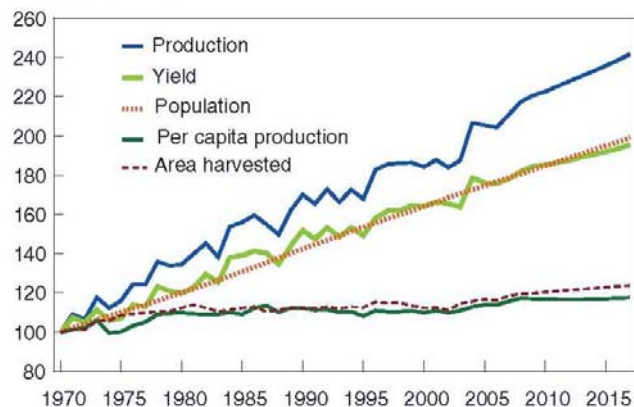
Figure 3
Prices of many commodities rose



Source: International Monetary Fund: International Financial Statistics.



Figure 4
Total world grain & oilseeds¹
Production, yield, area harvested, population & per capita production

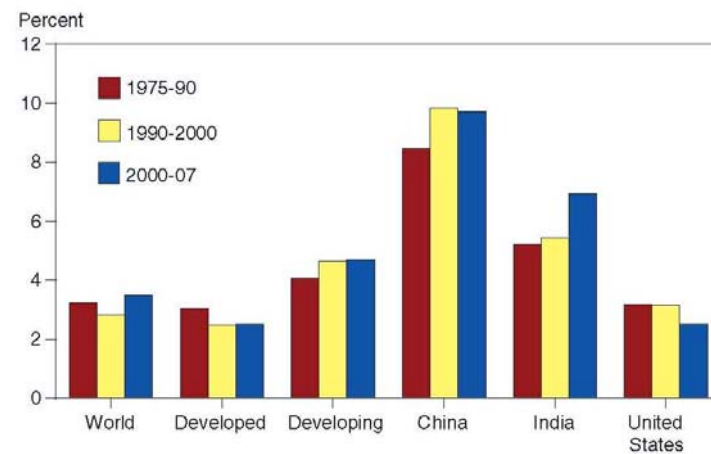


¹Total oilseeds = soybeans + rapeseed + sunflowers.

Source: USDA Agricultural Projections to 2017.



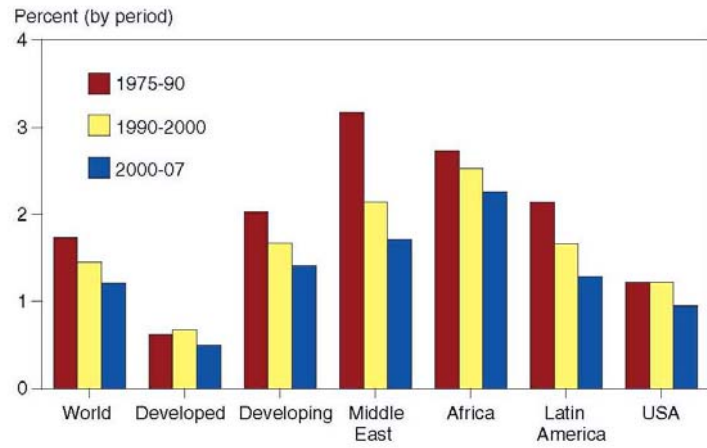
Figure 5
Strong economic growth
Average real GDP growth rates



Source: USDA Agricultural Projections to 2017.



Figure 6
Population growth rates decline
But still high in developing countries



Source: USDA Agricultural Projections to 2017.

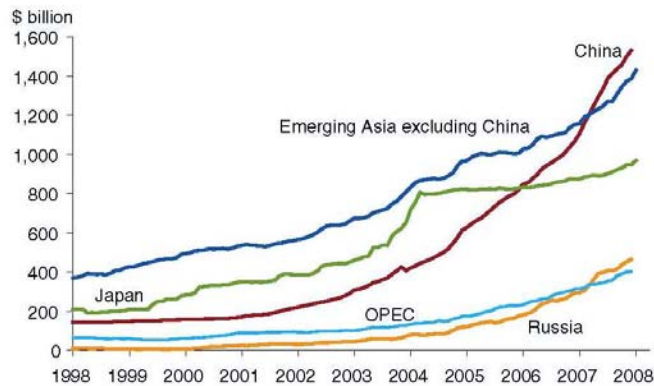
Figure 16
Value of U.S. dollar declines after 2002¹



¹Real U.S. agricultural trade-weighted dollar exchange rate, using U.S. agricultural export weights, based on 192 countries.

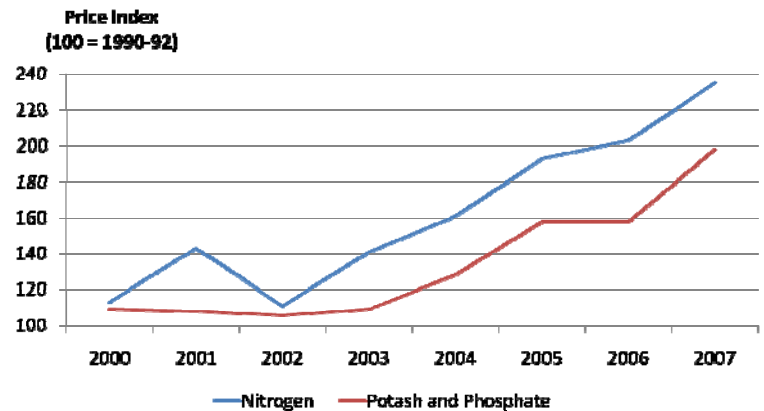
Source: ERS International Macroeconomics Dataset.

Figure 24
Foreign exchange reserves

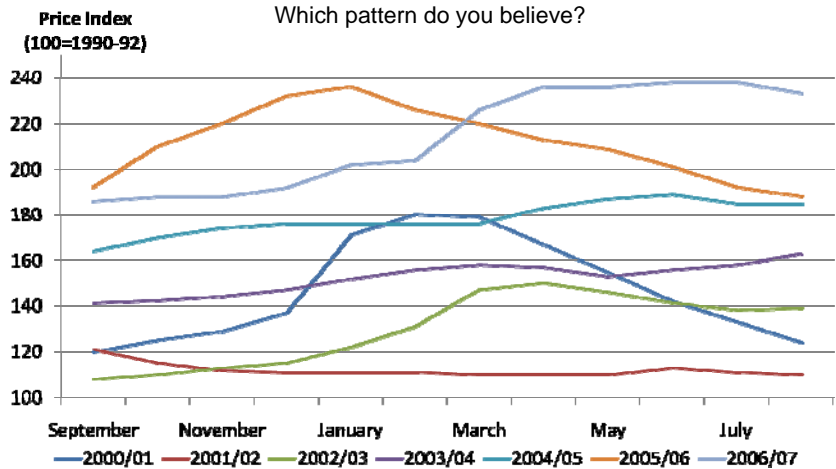


Source: Oxford Economics / Haver Analytics

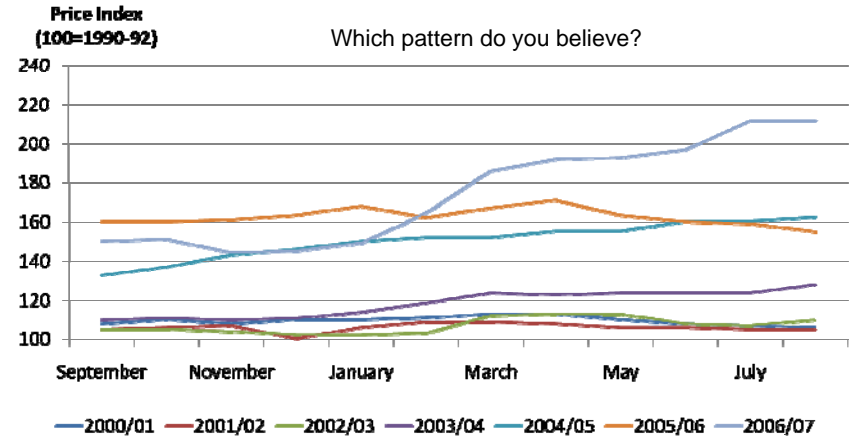
What has happened to fertilizer prices?



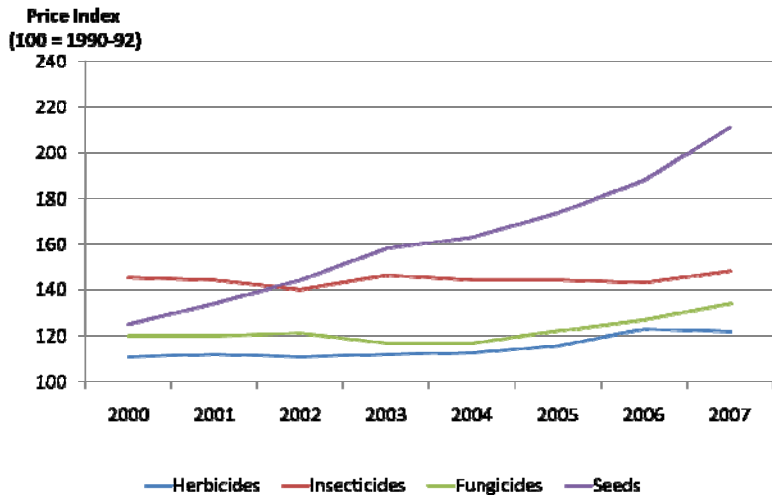
What has really happened in N?



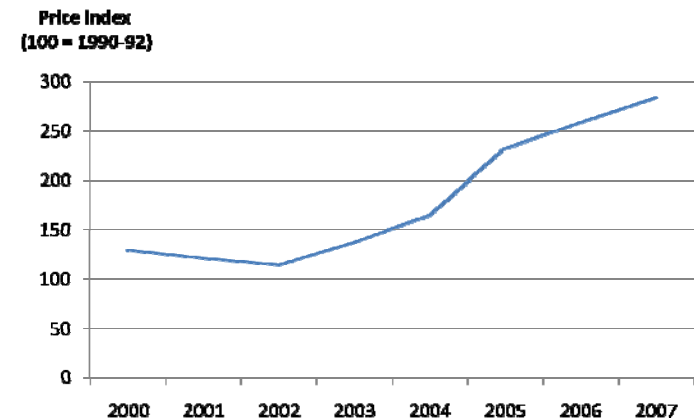
What has really happened with P?



What has happened to chemical prices?



And farm diesel?



Summary of Industry Effects

- In 2004 and 2005
 - Prices of agricultural inputs increased
 - Disruptions in supplies of inputs (labor, energy, etc.) occurred
- In 2005 and 2006
 - Hedge funds, index funds, and sovereign wealth funds became more involved in commodity markets
 - Rationale was to diversify their portfolio and they held a large percentage of the open interest in the futures markets
 - No delivery intent and they knew little of fundamentals of ag markets
 - Likely increased short-term volatility
 - US Energy Policy Act of 2005
 - Mandate on renewable energy and no liability protection for MTBE
 - Adverse weather in Russia, Ukraine, and Australia



Summary of Industry Effects

- In 2007,
 - Adverse weather everywhere including dry spring and floods in northern Europe
 - Drought in southeastern Europe
 - Ukraine and Russia were in 2nd year drought
 - Late spring freeze in US damaged HRW wheat crop
 - Canada had a warm summer that led to low yields
 - Northwest Africa had drought
 - Australia had 3rd year drought and worst yields ever recorded
 - Argentina had late freeze and drought



Summary of Industry Effects

- By spring of 2007, average global yields had two years of reduced yields in grains and oilseeds. This had occurred only three times since 1970.
- Importers began to get nervous over supplies and began contracting aggressively
 - Prices rose and contracted volumes rose
 - Longer-term contracts (move from 3-4 months to 5-10 months)
- Countries with large foreign exchange reserves could contract at high prices for large volumes
 - Oil-exporting countries (OPEC, Russia, Ukraine)
 - Non-oil exporting trade surplus countries (China, Japan, Asian countries)
 - Bid away supplies from other smaller traditional importers
- In fall of 2007, wheat and rice prices increased sharply
- In spring of 2008, floods and a wet spring have delayed plantings



Summary of Industry Effects

- Internal unrest due to high food prices has led to policies to reduce effect of high prices in domestic markets and discourage ag exports in 2007
 - China eliminated export subsidies on grains
 - China and Argentina placed export taxes on grains and oilseeds
 - Russia and Kazakhstan placed export taxes on wheat
 - Malaysia imposed export taxes on palm oil
 - Argentina and Ukraine restricted volume of wheat exports
 - India and Vietnam restricted volume of rice exports
 - Ukraine, Serbia, and India banned wheat exports
 - Egypt, Cambodia, Vietnam, and Indonesia banned rice exports
 - India banned exports of rice except basmati
 - Kazakhstan banned exports of oilseeds and vegetable oils



Summary of Industry Effects

- Internal unrest due to high food prices has led to policies to reduce effect of high prices in domestic markets and discourage ag exports in 2008
 - India reduced import tariffs on wheat flour
 - Indonesia reduced import tariffs on soybean and wheat and wheat flour
 - Serbia reduced import tariffs on wheat
 - Thailand reduced import tariffs on pork
 - EU reduced import tariffs on grains
 - South Korea and Mongolia reduced tariffs on various foods
 - Morocco and Venezuela increased their food subsidies to consumers
 - Iran imported corn from the US which it had rarely done
- Bottom Line: Prices increased and demand increased. Policies designed to restrict exports results in lower global supplies. This stimulated buyers to increase import volumes in a world with fewer participating countries. The combination of reduced supplies from traditional exporters and increased demand from importers at a time of low inventories increased prices.



What are Industry Effects in Agriculture?

- Increasing risk and volatility
- Access to partners with supply
- Inability to recruit talent to rural areas
- Increasing cost of entry in agriculture
- Fewer buyers and suppliers
- Cost efficiency everywhere
- Rise of part time farmers
- Increasing number of commercial producers
- Improvements in information sharing
- Developing societal awareness of environmental issues



What do margin calls mean for a grain elevator?

	2006			2008 (large crop)			2008 (small crop)		
	Bushels Purchased	Price	Total	Bushels Purchased	Price	Total	Bushels Purchased	Price	Total
Corn	1,000,000	\$2.30	\$2,300,000	1,230,000	\$4.00	\$4,920,000	1,100,000	\$7.00	\$7,700,000
Soybeans	400,000	\$5.50	\$2,200,000	428,000	\$9.50	\$4,066,000	375,000	\$15.00	\$5,625,000
Wheat	150,000	\$3.50	\$525,000	180,000	\$8.50	\$1,530,000	170,000	\$10.00	\$1,700,000
Cost - Inventory		\$5,025,000			\$10,516,000			\$15,025,000	
Harvest Inventory Cost Increase					209.30%			299.00%	

Source: Grain Service Corporation



Interest Costs – 2008 and 2009 Forward Hedging

- 2008
 - Corn 10.2 cents/bushel
 - Soybeans 31.2 cents/bushel
 - Wheat 24.6 cents/bushel
- 2009
 - Corn 15.3 cents/bushel
 - Soybeans 46.8 cents/bushel
 - Wheat 36.9 cents/bushel



Federal Reserve Bank of Kansas City

- Local grain elevators receive credit from
 - Farm Credit System (65%)
 - Commercial banks (29.3%)
 - Private equity or parent firm (5.7%)
- What is financial position of grain elevators?
 - Struggling to acquire cash for margin calls (23.5%)
 - Enough cash to just manage current margin calls (39.7%)
 - Ample cash to manage margin calls and reserves (36.8%)



Federal Reserve Bank of Kansas City

- Earning performance of commercial banks
 - Decreased from 2% of average assets to 1.6% from 2002 to 2007
 - ROA is at historical average and ag banks were stronger than other small banks
 - Bottom line: banks have ability to lend
- Will they lend?
 - Greater participation with other banks
 - Greater care and attention being paid to risk management operations



Input Costs in Production Agriculture

- Production costs are sourced globally
 - Energy
 - Seed
 - Fertilizer
- Exchange rates matter!
- Likely to be supply shortages in
 - Fertilizer
 - Potash?
 - Diesel?
- Retail agribusinesses will respond by
 - A and B lists



What is happening inside firms?

- Less talent is available
 - Production ag has increased demand
 - Earlier retirement ages means less supply
 - Impending retirements of managers
- More capital on the balance sheet
- Change in cropping patterns and logistics
- Less corn for export and need to move corn internally
- Increased risk and rewards

- These will lead to more restructuring



What are firm effects in agriculture?

- Increase local footprint
- Superb support role skills
- Access to quality of assets (physical, financial, people)
- Build organizational skills
- Recruit, hire, and retain talent
- Respond quickly to local needs
- Access to timely and effective logistics
- Provide outstanding information
- Shift risk to those better able to manage it



Summary

- Industry effects and firm effects impact a firm's strategy
 - Affect retail agronomy and grain origination
- Important to understand which are controllable and which are not
 - Firm effects are good reasons to consider for restructuring
 - Industry effects matter but not as much for restructuring



How can you help your ag retailer?

- Consider all the risks your retailer has that are different in years past.
 - Small wonder they are asking for more information about grain trades, crop insurance, etc?
- Consider whether your retailer has a program so you can “lock in a profit” the fall before planting.
 - Depends upon your balance sheet and level of risk
 - Younger vs older producers
- If your co-op is a natural extension of your farm business, it is only natural that they will want more information to help you achieve the best performance

