Financing Agriculture in the Future

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Introduction

AgStar Financial Services is a cooperative, owned by client-stockholders, and is one of 95 institutions that together comprise the Farm Credit System. AgStar provides a broad range of financial services and business tools for agricultural and rural clients, primarily in Minnesota and northwest Wisconsin. AgStar is one of the larger Farm Credit associations, serving more than 24,000 clients and managing nearly $8 billion in loan and lease assets.

My presentation today represents the views of AgStar and does not necessarily represent the views of the entire Farm Credit System.

My primary role at AgStar is managing the company’s swine portfolio, representing over $1.4 billion in loan and lease volume serving nearly 1,200 clients throughout the United States. I manage swine loans and leases and work closely with producers of all sizes. I was born and raised on a hog farm in Southern Minnesota and have been involved in the swine industry for my entire business career. I will focus my presentation on the swine industry because that is where most of my time is spent.

A Look Back at the Past

Prior to 2008, the livestock sector did not experience extreme volatility in commodity prices. If corn was above $3 a bushel (which is still the primary driver to almost any type of livestock cost of production), it was considered high. Cost of production ranged in the U.S. for a period of years, anywhere from $100-$120 a head depending on your sale weight.

2008 to Present Time

Ever since 2008 we have had significant volatility in the marketplace and in all commodities. In this presentation, I'll show you breakeven in the pork industry
go from $115 a head in 2007 to over $160 a head in 2008. The recent volatility can be seen even today, as I write this paper; from October 7, 2010 to October 12, corn went up over a $1 a bushel in a period of three business days. Just accounting for corn prices alone causes an increase in cost of production of over $1.1 billion a year, if prices stay at current levels. In addition, hog prices have had significant movement in the last 14 months. In August of 2009, swine producers were receiving barely a $100 net for their hogs, one year later we had producers that were receiving over $180 a head for the hogs. The level of volatility experienced by producers in all agricultural commodities is unprecedented.

### Financing Agriculture in the Future

Looking ahead there are tremendous opportunities as well as challenges for people that are involved in agriculture. Every year, there are almost 70 million more people on this earth to feed. Many experts are claiming that we need to double, maybe triple, food production over the next 40-50 years. The challenge and the opportunity here is tremendous.

I believe, that future population growth will continue to perpetuate tremendous volatility in all commodities. When you have tremendous variability, and predictable revenue streams are unprecedented, it presents a challenge to lenders. Lenders will require much more live budgeting and financial forecasting than ever before. Margin management and/or risk management of your business is essential. What is your company doing to stabilize and present business plans that will have a higher degree of predictability? Access to capital requires a sound business and risk management plan.

Lenders will also need to be proactive on providing capital to clients during times of volatility, to not fund a hedge line would be of grave risk to the client and also to the lender if the margin call is not funded. In addition because of market volatility, rapid response to client needs will be more important than ever before. The main item in our organization is working capital and providing the amount of cash and/or working capital that is needed to run your business. Volatility puts even more emphasis on the crucial need for working capital and liquidity going forward.

### Requirements for Producers to Access Capital

The need to have sound financial records has never been more important. I have stressed this to many producers. A farrow-to-finish producer, with 2,500 sows running a $7 million dollar manufacturing business needs to know their cost of production. In addition, the producer will also need to know how they are performing financially on a monthly basis. To not know this information when you are running that large of a business is not acceptable. Producers must know where they are from a cost and financial standpoint.
Budgeting and forecasting are now more important than ever. We have many clients today that look at 12 month cash flows daily. They have very sophisticated financial forecasting models that give them a snapshot everyday of what their company might look going forward, based on current markets along with their current risk management strategy. We see this every day from our very successful clients. You must always look at ‘what if’ scenarios and how the volatility of the markets might influence the financial performance of your organization.

**Requirements for Ag Business to Access Capital**

If you are an Agri Business that provides feed inputs to the Livestock industry, you also have experienced the same volatility. The working capital or cash needs for managing through high volatility are also great. The main item for Agri Business is how many dollars are needed from your Lender based on your past years volume of business. You will need to provide financial models based on grain going up $1 a bushel and predict what operating line will be needed, in addition to what it does to your financial ratios. The other important part of an Agri Business is managing your accounts receivable. We saw numerous instances in 2008 and 09 where accounts receivables were aged and they were questionable as to whether or not they were collectable. This will be closely monitored by your Lender and a more proactive approach on managing accounts receivables will be very important. There were also times in 2008 that even the largest grain suppliers (Cargill and ADM) would not forward sell grain due to financial ratios of their business, this might occur again in the future if grain prices spike out of control. We are at price levels that could be unprecedented and from a Lenders view if your company’s financial ratios are stretched to a point that puts your company at risk you might need to alter your grain procurement strategy.

- **Conclusion**

You also must be a student of and have a passion for your business. Your organization must continually work on having a better handle on what could affect the financial performance of your business. Wayne Gretzky once said, “You want to know where the puck is going, not where it has been.” Successful companies need to have that type of mindset.

Last but certainly not least, you must be above the industry average in whatever you produce and you must continually work on improving in that area every day to survive. The opportunities for successful companies that are above average in risk management have never been brighter.