FINANCING IN AN EVOLVING AGRICULTURE DOWNTURN

Federal Reserve Bank of Chicago
November 29, 2016
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GreenStone

- $8.0 billion in assets
- 24,000 members
- 36 branch offices
- 510 employees
- Diversified Portfolio
  - Traditional Ag
  - Rural Lifestyle
  - Capital Markets
HOW DID WE GET TO 2016?

Source: USDA
U.S. Real Net Farm Income

Real U.S. Net Farm Income from Farming, 1930 to 2014 (actual) and USDA Forecast from 2015 to 2025

Source: USDA-ERS, February 2016 Farm Income and Finances Update
Note: Real values calculated using GDP chained price index, 2009 = 100, U.S. Bureau of Economic Analysis.

Proper Context

Good news, we have been through the cycles before. Bad news, we are in the correction portion of the cycle.....
Unlike the 1970’s and 1980’s, recent debt to asset ratios look good even when looking at deflated asset values.
## FAPRI Projections – August 2016

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<thead>
<tr>
<th></th>
<th>2014</th>
<th>2016</th>
<th>2021</th>
</tr>
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<tbody>
<tr>
<td>Fed Funds Rate</td>
<td>0.1%</td>
<td>0.4%</td>
<td>3.0%</td>
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<tr>
<td>Corn Farm Price $ / bu.</td>
<td>3.70</td>
<td>3.19</td>
<td>3.87</td>
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<tr>
<td>Soybean Farm Price $ / bu.</td>
<td>10.10</td>
<td>9.29</td>
<td>9.99</td>
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<td>5-area Fed Cattle $ / cwt.</td>
<td>155</td>
<td>126</td>
<td>113</td>
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<tr>
<td>Lean Hogs $ / cwt.</td>
<td>76</td>
<td>48</td>
<td>55</td>
</tr>
<tr>
<td>All Milk $ / cwt.</td>
<td>24</td>
<td>16</td>
<td>18</td>
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Food and Agricultural Policy Research Institute – University of Missouri
Our Outlook for Agriculture

- After a decade of record profitability ending in 2014, “back to average”
- Currently, excess supply all commodities
- Current correction period below trend line, followed by prolonged period of “average” prices
- “Efficiency Cycle”: Low cost producers with solid balance sheets will be the winners, all other things being equal
- High cost, low equity borrowers are vulnerable
Lessons Learned - How Have We Evolved?

- Quality Information
  - Portfolio Information – treat our customers differentially
  - Benchmarking - Peer groups
    - Low vs high cost producers
    - Balance sheet leverage
  - Industry Outlook – staying power
    - Liquidity burn rate forecasts
    - Residual borrowing capacity
Lessons Learned - How Have We Evolved

- Identify Causation of the Problem
  - Don’t treat the symptoms, deal with the challenge

- Quality Conversations
  - GreenStone’s “At-Risk” Customer Approach
    - Customer and staff *awareness*
    - Create a *sense of urgency*
    - Quality communications internally and externally
    - Staff focus on “Crucial Conversations”

- Monitor the Execution of the Plan
GreenStone’s Goals

- Build on reputation as the preferred Ag lender
  - Past, current and future generations
- Be proactive in everything we do
  - Internally and externally
  - Anticipate & address cash flow shortages
  - Be forward looking, multi-year horizon
- Get customer through the cycles
  - Viable plans and shared solutions
  - Be realistic & transparent
  - Be timely with decisions
GreenStone’s Philosophy

- Agriculture is cyclical, we have been through this before …. no material changes to our approach
- Customer Segmentation – treat our customers differentially
GreenStone’s Philosophy

- Portfolio Selection… we will treat our customers differentially based on their financial position
  - Top Quartile … Volatility = Opportunity to grow
  - Middle Half … Opportunity to improve, limited term debt growth
  - Bottom Quartile …. business is “At Risk”, our area of focus starting in 2015
Customer Evaluation: High versus Low Cost Producers

MN Cash Rent Corn Production
Total cost per bushel, **61% variance**. Analysis: Dr. Michael Swanson, Wells Fargo

- Low cost quintile
“AT-RISK” CUSTOMER FOCUS
“At- Risk” Customers

❖ Create an *Awareness & Sense of Urgency*
  • Identify and pursue options
  • Time is our enemy

❖ *Communication* - Frequent and Detailed
  • Include all stakeholders, owners, creditors, consultants, accountants, legal, etc.
  • Agree on and document future expectations
  • Legal documentation, covenants, entity reviews
  • Monitor and follow up
Awareness – Sense Urgency

✧ Financial and Operational Information
  • Another form of communication
  • Verification of financial information and projections to minimize surprises

✧ Quality Financial Information
  • Operational trends
  • Peer Group Data - how do they stack up?
  • Set expectations for quality and timeliness
Awareness – Sense of Urgency

Industry Outlook
- Commodity prices
- Duration of market prices

Liquidity Burn Rate - staying power
- Economic / Typical Year modeling “what if”
- Reasonable projections
- Scenario analysis – residual borrowing capacity
- Another communication tool
With Good Information….

- Identify and treat the causation of the underlying financial challenges
- Customer Plan – “Self-help”
- GreenStone’s role is to provide a “helping hand” versus enabling unsustainable behavior
- Lender – Borrower “Partnership”
  - Are we philosophically aligned on the outlook, options and roles within this partnership
  - GreenStone is a lending cooperative… we do not take equity ownership risk for debt capital rates of return….
Transparent Communications

★ Goal

• Facilitate their decision making process, Preservation of owner equity
• Proactive versus Reactive – time is a finite and priceless commodity

★ Fundamental – Critical Planning Focus

• “Get the room right”
• Key influencers, stakeholders, trusted advisors
• Everyone hears it at the same time

GreenStone®
FARM CREDIT SERVICES
Transparent Communications

- Be Prepared & Present Options
- Be Prepared to Actively Listen
- Facilitate Decision Making as Much as Possible
- Clarity and Focus
  - Filtering “We all hear what we want to hear”
  - Teamwork - witness the discussion
  - Confirm the conversation… in writing
- Customer and other creditors “all-in”
Transparent Communications

✔ Set the Table for the Next Conversation
  • Letters Understanding – Post Close Letters
  • Setting expectations – Plan “B” or “C”
  • Action steps, timelines, responsible parties

✔ Controls
  • Loan agreements
  • Collateral controls

✔ Follow up – “Trust but Verify”
Lender’s “Basic Toolbox”

- Adjust repayment terms to type of asset
- Limit capital spending and owner withdrawals
- Have a Plan B and Exit Plan
- Consider alternative sources of capital
- Frequent lender/borrower meetings
- Interest only payments for a period of time
- Risk-based pricing

Monitoring:
- Monthly or weekly cash flow projections
Summary

- Most cash flows could be negative for 4 years
- Assets will lose significant value
- Debt will be reduced or at least rebalanced
- Quality financial statements and projections are required for management and bank decisions
- Decisions should focus on per unit profitability, risk scenario analysis, and liquidity
- Proactive communication, planning & execution
- “One customer at a time” focus