Views From Cyberville for 2020 & Beyond

- a black swan usually occurs each decade with two babies
- a black swan accelerates change for consumers, society, and businesses
- black swans are disruptors and challenging but they also create opportunities
- the COVID-19 black swan accelerated the economic and financial divide for the decade of the 2020s
Commodity Super Cycle

- BRICS & KIMT’S
- 2x emerging PPP
- weather
- declining interest rates
- ethanol

Government & Central Bank Super Cycle

- government payment stimulus boom
- China effect, temporary
- export market, low value dollar
- weather climate change
- low, stable interest rates- Central Banks, moving investors out on the risk curve
Global Macro Economic Risk (1)

- globalization vs. deglobalization
  - 1995-2017 purchasing power parity, hyperglobalization
    - emerging nations 2x plus
    - rich nations 44%
  - 1990-2008 global trade share of GDP 39% increase to 61%
  - 2009-2017 global trade share down 9%
    - financial crisis
    - governments, businesses and consumers agendas
- (ISI) import substitution industrialization strategy
  - supply & marketing chains
  - made in China 2025
    - India, Europe, & U.S. more self reliant
    - concentration vs. diversification

Global Macro Economic Risk (2)

- disjointed U.S. & global recovery
  - 90% economy
  - 50-75% economy
  - 125% economy
- trade agreement uncertainty
  - Australia vs. China
  - rich nations vs. China
  - Belt & Road Initiative, medical innovation path
- central banks/government supports for ag
  - U.S./global support $2 billion per day
  - duration of support & global competitiveness
  - government encroachment, taxes, regulations, other
Chat Question 1

List the top two non-financial factors that represent credit risk to your customers.

Click on the Chat button at the bottom of the Zoom window.

Toggle the drop down to ‘All panelists and attendees’ then type your response.

Rising of Asia

![Pie charts showing the distribution of the world economy in 1990 and 2020.](chart)

* ROW- Rest of World

Source: Global Insights, August 2018
Trade Paradigm Shifts
Globalization Vs. Regionalization

China’s Dual Circulation Strategy

Global Trade Perspectives

<table>
<thead>
<tr>
<th>Trade Agreement</th>
<th># Countries</th>
<th>Population</th>
<th>GDP</th>
<th>Trade Value</th>
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</thead>
<tbody>
<tr>
<td>RCEP¹</td>
<td>15</td>
<td>2.7 Billion</td>
<td>$25.8 Trillion</td>
<td>$12.5 Trillion</td>
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<tr>
<td>CPTPP²</td>
<td>11</td>
<td>508 Million</td>
<td>$11.1 Trillion</td>
<td>$7.6 Trillion</td>
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<tr>
<td>USMCA³</td>
<td>3</td>
<td>493 Million</td>
<td>$24.4 Trillion</td>
<td>$7.8 Trillion</td>
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</tbody>
</table>

¹RCEP- Regional Comprehensive Economic Partnership (15 Asian Countries)
²CPTPP- Comprehensive & Progressive Agreement for Trans-Pacific Partnership (Canada & 10 countries in the Asia-Pacific region).
³USMCA- United States-Mexico-Canada Agreement (North America)
Grain Industry Radar Screen for U.S. & Abroad

- economic health of protein sector
- economic health of trading partners
- weather
- value of the dollar
- consumer trends
- trade issues
- ethanol

Livestock & Other

- access to markets & marketing changes
- concentration, cannibalization
- competitive products
  - non-meat alternatives
  - non-dairy alternatives
- regulation
- labor, immigration
- health of the U.S. economy
Greatest Threats to Net Farm Income & Cash Flow

- loss of government supports, one third of net farm income since 2016, higher for some commodities
- tax implications of the government stimulus programs-for example, reduced expenses, due diligence
- weather in extremes- globally, Canada, U.S. & locally
- loss of markets & global competition
- supply & marketing chain disruption
- changes in consumer habits
- inflating expenses, technology inputs, higher taxes, labor
- loss of non-farm revenues, fringe benefits, other

Land Value Resilience

- low interest rates
- T.I.N.A.
- refinance/restructure cycles
- baby boomer farmers will be investing another decade
- rural property renaissance
- 79% rule
- 88% rule
Factors That Could Collapse Land Values

- rapid rise in interest rates
- knee jerk reaction of restructuring/refinancing of working capital, credit needs with regulators/lenders
- investment sentiment
  - BBB's
  - urban migration
  - land investment groups
- regional or local economics spiraling downward
- U.S. & global debt & liquidity crunch
- downward trend of commodity prices, global trade contraction, government payments

Factors That Collapsed Land Values in the 80s

- rapid rise in interest rates, rapid decrease in inflation
- knee jerk reaction to regulators/lenders
- collapse - global trade
- collapse - commodity prices
- debt of baby boomer farmers/ranchers
- government assistance on the credit side, but not the cash flow side
2020 Pandemic

- sudden impact/shock disruption
- economic behavioral changes/basics
- no pattern of corrective action- health
- three D’s: Depth, Diffusion & Duration
- Nike swoosh shaped recession with a jagged tail “w”
  - size 6 or size 14-18?
- deeper global recession?
- re-emerging bio shocks / cyber attacks
- southern hemisphere bio shocks

Chat Question 2

As a lender, what would be the top two actions on a wish list from your customers?

Click on the Chat button at the bottom of the Zoom window.

Toggle the drop down to ‘All panelists and attendees’ then type your response.
Four Pillars of the Business Model of the Future

Four Pillars:

**Resilient**
- know cost of production
- marketing & risk management program
- capital/equity borrowing capacity

**Agile**
- working capital
- market for product
- optimization/efficiency vs. diversification/resiliency

**Entrepreneurial / Innovative**
- “people first” business
- invest in people
- align with rapidly changing marketplace
- quarterly sprints/journey of sustainability

**Strong Business IQ**
- high scores in all 15 areas
- plan, strategize, execute & monitor
- written plan for improvement
- dashboards

Which pillar is more important?
Aligning with Mindsets

**Producer A**
- How do I compare?
- What are others doing?
- think longer term & what is on the horizon

**Producer B**
- Will a lender finance me?
- Will I survive for another year?
- often a know it all or victim

School vs. Real World Perspective:
In school, you get the lesson first, then the test.
In the real world, you get the test first, then the lesson.

Management Assessment

**Greens**
- adaptive to a situation- proactive
- 5% rule
- get efficient before getting bigger
- sweat the small stuff
- plan, strategize, execute & monitor
- process oriented
- advisory teams

**Yellows**
- success because of equity & history vs. profitability & cash flow
- preparing the next generation
- bigger before better, examine human horse power
- magic bullet- the next big thing

**Reds**
- waiting for prices & markets to save them
- excuse game, not my fault
- lose money, equity keeps them going
- 80/20 rule is alive & well
# Business IQ: Management Factors
## Critical Questions for Crucial Conversations

### Farmer Checklist | Your Score | Green (3 points or 4*) | Yellow (2 points) | Red (1 point)
--- | --- | --- | --- | ---
1. Knows cost of production | | Written | In head | No idea
2. Knows cost of production by enterprise | | Written* | In head | No idea
3. Goals - business, family, & personal | | Written* | In head | No idea
4. Record keeping system | | Accrual | Schedule F (one & done) | No idea
5. Projected cash flow | | Written* | In head | No idea
6. Financial sensitivity analysis | | Written* | In head | No idea
7. Understand financial ratios, break evens | | Written* | In head | No idea
8. Work with advisory team and lender | | Yes* | Sometimes | Never
9. Marketing plan written and executed | | Yes | Sometimes | Never
10. Risk management plan executed | | Yes | Sometimes | Never
11. Modest lifestyle habits, family living budget | | Yes* | Sometimes | Non existent
12. Written plan for improvement executed & strong people management | | Yes* | Sometimes | Non existent
13. Transition plan/Business Owner plan | | Yes | Working on plan | Non existent/controversy
14. Educational seminars/courses | | Yes | Sometimes | Never attend
15. Attitude | | Proactive* | Reactive | Indifferent

### Total Score | Score | Overall Analysis
--- | --- | ---
35-50 | Strong management rating & viability
20-34 | Moderate risk & viability; will most likely show previous refinancing
<20 | High risk & lack of long term viability

### Progressive Business Characteristics:
To be considered a “Progressive” Business, farms must score in the green in four of these five checklist items (#2, #6, #7, #8, #14).

- **#2 Know cost of production by enterprise:** Know the cost of production by enterprise and are able to readily explain which enterprise is the most profitable.

- **#6 Financial sensitivity analysis:** Know how changes in price, production, cost and/or interest rates affect the bottom line. Complete different scenarios in their cash flows to test this for their business/operation.

- **#7 Understand financial ratios:** A dashboard of financials (5 to 7 ratios) that they do a 3 to 5-year trend analysis on their business? Second, benchmark these ratios to other businesses like the Illinois FBFM or University of Minnesota’s FINBIN.

- **#8 Work with an advisory team and lender:** Establish an advisory team consisting of a lender, crop or livestock consultant, and possibly a financial planner, etc. If so, do they meet 2 to 4 times a year?

- **#14 Educational seminars/courses:** Attend or take five educational seminars or courses a year. One should be outside of the industry of agriculture.

*Extra Points:*
- Progressive Business may receive 4 points for #2, #6, #7, #8, #14.
- Struggling Business Attempting Turnaround may receive 4 points for #2, #6, #7. 

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Developed by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, Virginia Tech
Struggling Business Attempting Turnaround Characteristics:

To be considered attempting a successful turnaround, farms must score in the green in four of these five checklist items (#3, #5, #8, #11, #12).

#3 Goals - business, family & personal: Written business, family and personal goals.

#5 Projected cash flow: Completed a cash flow.

#8 Work with an advisory team and lender: Exhibit willingness to be coached by an advisory team and lender.

#11 Modest lifestyle habits, family living budget: Take modest family withdrawals and have a family living budget.

#12 Written plan/business owner plan: Developed and executed a one-page written plan on how they will improve cash flows, profits and what is the likelihood of the turnaround of business. If not, problems can continue.

Developed by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, Virginia Tech

Business IQ Exercise

After completing the Business IQ: Management Factors Scorecard, what are three areas/points in your business that you will continue and three areas/points for improvement?

Three areas/points to continue:
• ______________________
• ______________________
• ______________________

Three areas/points to improve:
• ______________________
• ______________________
• ______________________
Business IQ
Applications/Perspectives - Lenders

- each family member, business partners, spouses complete Business IQ separately
- assist in prioritizing improvements
- communication tool with customers, internal loan committee & credit analysts
- loan narrative management
- assists in circumventing lender liability
- customer develops plan of action
- objective method to measure management
- monitoring tool year over year

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Business IQ: Management Factors
Critical Questions for Crucial Conversations

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<tr>
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<th>HUSBAND</th>
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<th>Yellow (2 points)</th>
<th>Red (1 point)</th>
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<tbody>
<tr>
<td>1. Knows cost of production</td>
<td>3</td>
<td>Written</td>
<td>In head</td>
<td>No idea</td>
</tr>
<tr>
<td>2. Knows cost of production by enterprise</td>
<td>4</td>
<td>Written*</td>
<td>In head</td>
<td>No idea</td>
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<tr>
<td>3. Goals - business, family, &amp; personal</td>
<td>4</td>
<td>Written*</td>
<td>In head</td>
<td>No idea</td>
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<tr>
<td>4. Record keeping system</td>
<td>3</td>
<td>Accrual</td>
<td>Schedule F (one &amp; done)</td>
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<tr>
<td>5. Projected cash flow</td>
<td>4</td>
<td>Written*</td>
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<td>6. Financial sensitivity analysis</td>
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<td>Written*</td>
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<td>7. Understand financial ratios, break evens</td>
<td>4</td>
<td>Written*</td>
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<tr>
<td>8. Work with advisory team and lender</td>
<td>4</td>
<td>Yes*</td>
<td>Sometimes</td>
<td>Never</td>
</tr>
<tr>
<td>9. Marketing plan written and executed</td>
<td>2</td>
<td>Yes</td>
<td>Sometimes</td>
<td>Never</td>
</tr>
<tr>
<td>10. Risk management plan executed</td>
<td>3</td>
<td>Yes</td>
<td>Sometimes</td>
<td>Never</td>
</tr>
<tr>
<td>11. Modest lifestyle habits, family living budget</td>
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<td>Yes*</td>
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<td>12. Written plan for improvement executed &amp; strong people management</td>
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<td>3</td>
<td>Yes</td>
<td>Working on plan</td>
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<td>3</td>
<td>Yes</td>
<td>Sometimes</td>
<td>Never attend</td>
</tr>
<tr>
<td>15. Attitude</td>
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*Extra Points:
- Progressive Business may receive 4 points for #2, 6, 7, 8, 14
- Struggling Business Attempting Turnaround may receive 4 points for #3, 5, 8, 11, 12
(See pg. 2 for Progressive and Attempting Turnaround definitions)

Score | Overall Analysis
---|---
35-50 | Strong management rating & viability
20-34 | Moderate risk & viability; will most likely show previous refinancing
<20 | High risk & lack of long term viability

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### Business IQ: Management Factors
#### Critical Questions for Crucial Conversations

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<th><strong>Farmer Checklist</strong></th>
<th><strong>WIFE</strong></th>
<th><em><em>Green (3 points or 4</em>):</em>*</th>
<th><strong>Yellow (2 points):</strong></th>
<th><strong>Red (1 point):</strong></th>
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<tr>
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<td>5. Projected cash flow</td>
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<td>7. Understand financial ratios, break events</td>
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**Total** 39

*Extra Points:
- Progressive Business may receive 4 points for #2,6,7,8,14
- Struggling Business Attempting Turnaround may receive 4 points for #3,5,8,11,12

**Score** 35-50
**Overall Analysis**
- Strong management rating & viability

Developed by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, Virginia Tech

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### Business IQ: Management Factors
#### Critical Questions for Crucial Conversations

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<tr>
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**Total** 38

*Extra Points:
- Progressive Business may receive 4 points for #2,6,7,8,14
- Struggling Business Attempting Turnaround may receive 4 points for #3,5,8,11,12

**Score** 35-50
**Overall Analysis**
- Strong management rating & viability

Developed by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, Virginia Tech
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*Extra Points:*
- Progressive Business may receive 4 points for #2,6,7,8,14
- Struggling Business Attempting Turnaround may receive 4 points for #3,5,8,11,12

Development by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, Virginia Tech

### Score | Overall Analysis
---|---
35-50 | Strong management rating & viability
20-34 | Moderate risk & viability; will most likely show previous refinancing
<20 | High risk & lack of long term viability
Business IQ Summary: Areas to Continue/Improve

HUSBAND – BUS IQ: 53
3 Areas to Continue
1. Irrigation/manure mgmt
2. Intense office management
3. Improve crop/livestock efficiency

3 Areas for Improvement
1. Office management using CFO’s talent
2. More efficient labor
3. Executing the marketing plan

LENDER – BUS IQ: 35
3 Areas to Continue
1. Crop production KPIs
2. Using equipment longer before trading
3. Getting outside advice

3 Areas for Improvement
1. Crop/livestock inventory

WIFE – BUS IQ: 39
3 Areas to Continue
1. Record keeping, ratios, B/E
2. Cost of production (livestock)
3. Productivity of crops & livestock

3 Areas for Improvement
1. Financing without high interest rate
2. More seminars on ratios/break-even
3. Communications & employees’ knowledge of how the business works

DAUGHTER – BUS IQ: 38
3 Areas to Continue
1. Researching cost effective crop/livestock mgmt practices
2. Diversifying the farm in livestock
3. Searching for a new ag lender with better rates

3 Areas for Improvement
1. Employee handbook with written guidelines & perf. evaluation
2. Lease equipment to avoid high repair bills and subscription fees
3. Crop/livestock KPIs

CFO – BUS IQ: 40
3 Areas to Continue
1. Crop Production
2. Custom Hire
3. Diversifying in livestock

3 Areas for Improvement
1. Debt restructuring-reduce interest expense-improve cash flow
2. Lease versus buy equipment
3. Pay invoices within terms to avoid finance charges & get cash discounts

Financial Ratios Across Business IQ Percentiles

Debt/Total Asset

- TOP 1/3: 17.45%
- MIDDLE 1/3: 28.70%
- BOTTOM 1/3: 58.20%

Preliminary Study of Kentucky Farm Business Management Association data - Ben Isaacs, Undergraduate Research Study at University of Kentucky
Financial Ratios Across Business IQ Percentiles

Return on Assets

<table>
<thead>
<tr>
<th>TOP 1/3</th>
<th>MIDDLE 1/3</th>
<th>BOTTOM 1/3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medal: 2.25%</td>
<td>Mean: 3.16%</td>
<td>Median: -0.20%</td>
</tr>
<tr>
<td>Medal: 0.45%</td>
<td>Mean: 0.94%</td>
<td>Median: 0.173%</td>
</tr>
</tbody>
</table>

Financial Ratios Across Business IQ Percentiles

Net Farm Income

<table>
<thead>
<tr>
<th>TOP 1/3</th>
<th>MIDDLE 1/3</th>
<th>BOTTOM 1/3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median: $109,947</td>
<td>Mean: $202,120</td>
<td>Median: $14,349</td>
</tr>
<tr>
<td>Median: $45,243</td>
<td>Mean: $123,766</td>
<td>Median: $53,406</td>
</tr>
</tbody>
</table>

Preliminary Study of Kentucky Farm Business Management Association data - Ben Isaacs, Undergraduate Research Study at University of Kentucky
Chat Question 3

As a lender, what is one positive aspect of the pandemic that you have observed?

Click on the Chat button at the bottom of the Zoom window.

Toggle the drop down to ‘All panelists and attendees’ then type your response.

What Moves a Credit from a 7 to 11 Risk Rating? “Sour Sixteen” (1)

- weather, natural disasters
- it grows too fast- “working capital”, “management” and/or “capital”
- fraudulent activities
- inventory & receivable management
- four P’s for ag lender:
  - Policy, People, Priorities, Philosophy
- competition in the industry
- killer toys, misallocation of profits
- adversity after capital expansion
What Moves a Credit from a 7 to 11 Risk Rating? “Sour Sixteen” (2)

- 25% rule for time & capital expenditures
- transition of management
- integration of new players
- deadly “D’s”
- decline in asset values
- supply & marketing chain disruptions
- third party, counter party risk
- other

11 to 7 Risk Rating Credit Movement: Lemons to Lemonade

- improve prices, new markets
- scale down or right size
- controls of spending- living, dividends, business expenses
- good to excellent production
- sustained positive economic cycle
- inheritance, gift, or capital infusion
- management intensity
- micro managing the financials- KPI’s
- improved operational efficiencies
- government assistance, side by side lender relationship, luck
Financial Sensitivity Testing
Circa 2021

- 5-5-3
- 10-10-3
- government payments 25-50-70% reduced
- flock placement, lay out times, vertical integration
- off-farm, gig income
- enterprise analysis break evens
- burn rate on working capital
- burn rate on core equity

Trouble Shooting Matrix

**Insufficient Repayment Capacity**

- **Cut Business Cost**
  - Reduce Four Largest Expenses: Crop, Feed, Labor, ??

- **Non-Farm Revenue**
  - Job Stability/Availability, Job Cost
  - Job Earnings, Skills, Time Management

- **Increase Income**
  - Sell Capital Assets, Deferred Taxes,
    Increase Production, Increase Price

- **Cut Living Withdrawals**
  - Purchase Financial Software, Small Cost Containment

- **Restructure Debt**
  - Longer Term, Interest Only,
    Principal/Interest Deferred

- **Capital Infusion**
  - Equity Capital, Family Capital,
    Supplemental Cash Flow

- **Bankruptcy**
  - Voluntary, Involuntary,
    Chapter 7, 11, 12, 13
Season & Cycle of Servicing
Proactive Approaches

- shock test portfolio, portfolio concentration
- current financial information
- due diligence on financial information quality
- reviewing all loans, lower owner equity, higher loan to value
- more phone calls & business operations visits where appropriate
- lowering rates and/or modifying terms that maintains contact with the customers
- note modifications - allow one to update financials

Season & Cycle of Servicing
Proactive Approaches

- watch Dunn & Bradstreet and credit reports
- note modifications with customers for new loan opportunities
- monitoring harvest & marketing programs & execution of programs
- possible income tax issue 2021-2022 due to expense reduction as a result of government programs
- networking
Value Added Servicing

- provide expertise that adds value for customer segment
- align & mirror the mode of communications
- edu-marketing to provide value added experience
- relationship with key influencers
- advisory team
- 96-4-50 people rule
- education in bits & snippets

Chat Question #4

What is the most enjoyable aspect of being involved in agriculture?

Click on the Chat button at the bottom of the Zoom window.

Toggle the drop down to ‘All panelists and attendees’ then type your response.
Quotes for the 2020s

- “Black swans accelerate changes and disruptions but also create opportunities.”
- “Success is about attitude, do you own it or make excuses?”
- “Execution requires the HUT principle - Hear, Understand and Take action.”
- “Your network of people will be equal to your self worth & financial net worth.”
- “Never equate your self worth to your net worth, it is only one of the pillars of success.”