



**Completing Your Farm Physical
– Does Your Farm Feel Healthy?**

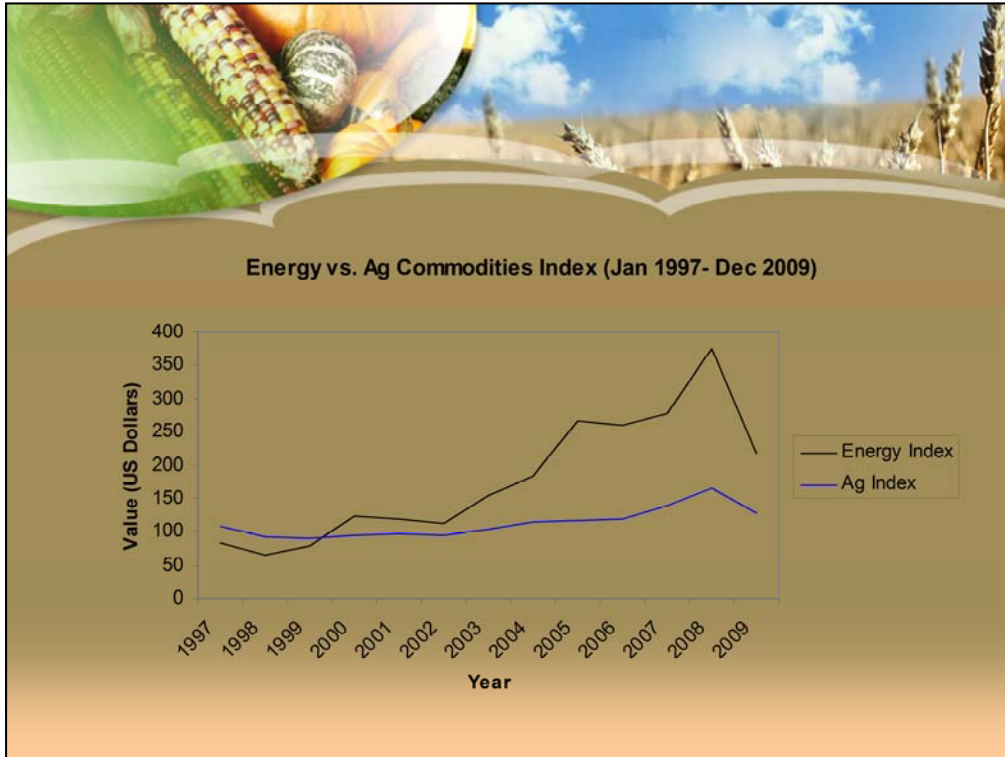
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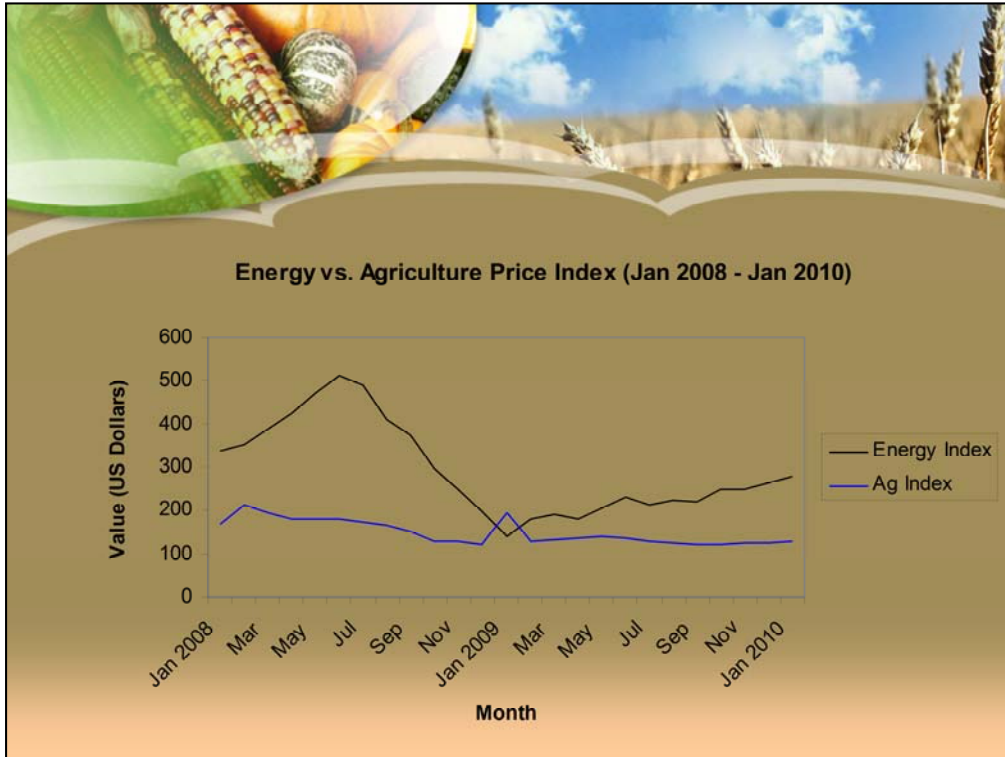
Threats to your farm in the next three years

1. **Variability in Input and Output Prices (Market Risk)**
 - Find your B/E and determine what price is required to generate a reasonable ROI (20-30%)
2. **Rising Interest Rates (Financial Risk)**
 - Determine how a 4 to 6% increase in interest rates impacts your farm
3. **Decreasing Cash Flow (Financial Risk)**
 - Look at past five years of revenues, expenses, & interest rates and use it as a base to forecast ahead

Younger Farmers/Expanding farms are particularly at risk – Take action now!!!

- Risk management is especially critical if you are experiencing financial stress and therefore, have little tolerance for downside events.
- 20-30 years – information age – a lot of risk has been removed. Decisions based on real time info. More reaction to volatility in markets.
- Got to understand what will happen if a risk event occurs. Feast or Famine – Have to handle properly. Understand what it means, don't be come overly optimistic. Can't go buy \$300,000 piece of equipment based on 1 or 2 years income.
- Two types of risk:
 - Producers are very comfortable with production risk (know what they can and can't control)
 - Financial Risk (Debt obligation) – extra risk attached to debt resulting from obligations associated with financing. Added variability in returns. C.O.P and scale means that we typically have a large amount of debt as farmers.
 - Market Risk – Variability in Input and Output Prices
 - Technology and obsolescence risk – increasing. Used to have 5 years with equipment, new equip. coming out every 2 years.
 - Price Risk – Use futures, options, forward contracts
- Managing risk
 - Avoid it – only way to guarantee yield is not to growing anything
 - Reduce the likelihood and impact and risk (usually costs money). I.e. insurance
 - Transfer the risk to others (I.e. crop insurance – pay someone to take on the risk).
 - Assume the risk – Accept it as part of the business
 - What information do you have to make the decision to assume the risk?
 - I.e. custom harvesting before harvesting your own – assuming the risk of rain, bad weather as harvest goes on.
 - Talk about your decisions!
 - Hedging the market
 - Scenario planning a must
 - Build risk management into margins
 - Never will eliminate all risks.
 - Where risks are small, so are the profits.
- Managing risks are a matter of evaluating alternatives and finding the tradeoff between risk and profit where you are comfortable. Find your comfort zone
- What are the probabilities (WAGS) – price and yield data, or just based on past years
 - - 2 ways to characterize probabilities – Objective (historical data, recognizing patterns, modeling trends) and Subjective (making an educated guess or using your intuition about your own operation).
- Time is of the essence – it is the constraint
- Choice criteria (risk/return tradeoff)
- Aggressively pursue production and market price risk management strategies such as crop insurance, government business risk programs when it is cost effective to do so. Commodity marketing strategies such as forward contracting, futures and options should also be considered as part of an overall marketing strategy.





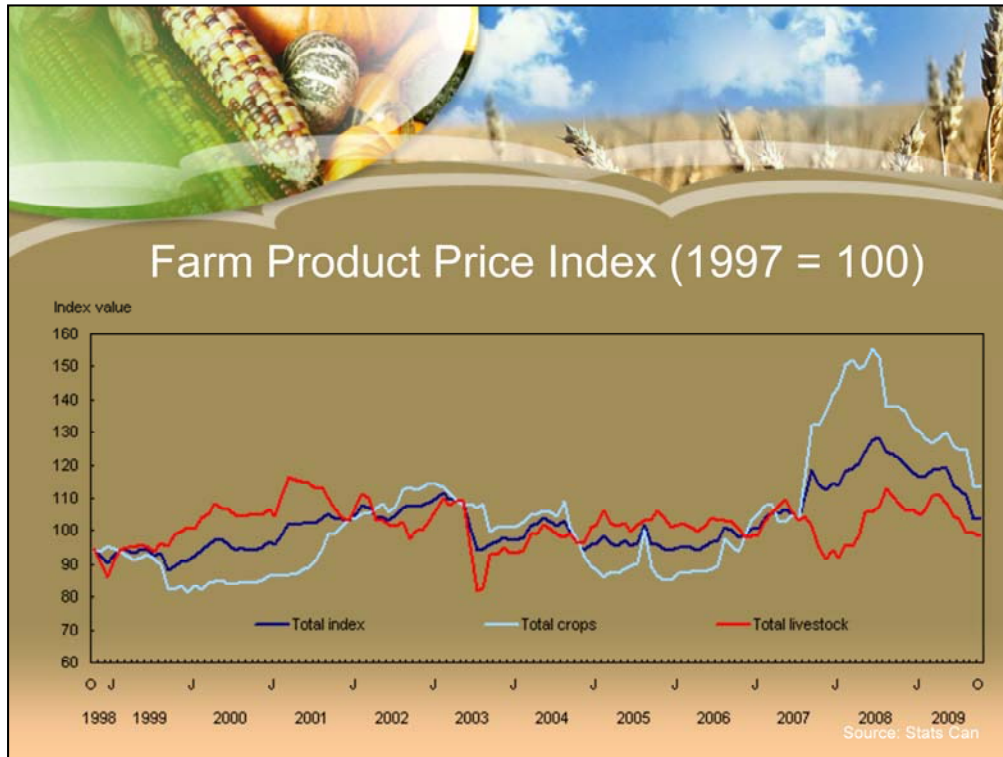
Energy Index includes coal, crude oil, and natural gas

Agriculture Index includes crops, livestock and fish

Increasing spread between energy and ag prices indicates a declining net income margin



- Key here is debt payout (total liabilities/net farm income). Shows # of years it would take to pay off debt if all farm income was directed towards principal reduction.
- Avg. Alberta Farm = 6 years. The key is the trend analysis. If the trend is upward, it implies the debt load is increasing at a greater rate than farm income. This trend cannot be sustained over the long run and is a warning signal of future financial stress.
- Is the trend due to individual farm factors or caused by general economic or weather factors?



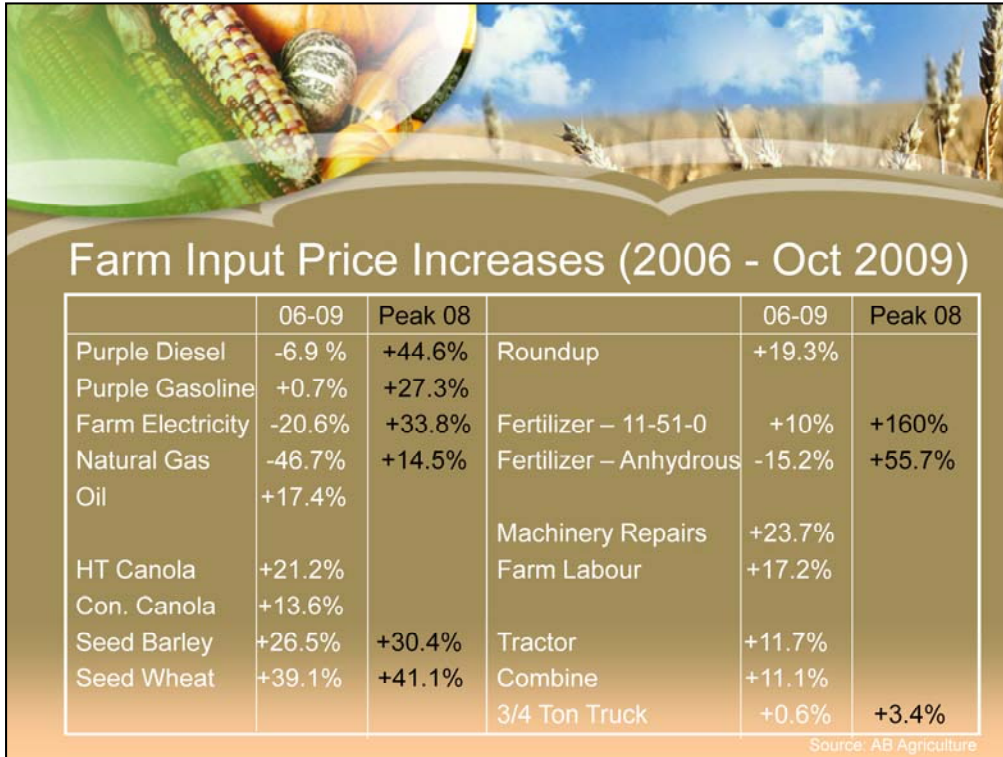
- 2008 – Both Yield and Price cooperated for the grain producer. It was a homerun year.
- Looking at 2007-08, is there a fundamental shift in grain prices like beef industry went through in the 80's?
- In terms of overall returns for crop producers, the last three years have really been a turbulent time starting in the fall of 2006. We saw major increases in crop prices that continued to escalate until the early summer of 2008. Unfortunately, the cost of production also escalated, but it lagged the upward movement in crop prices, so this gave the 2007 and 2008 crops very strong margins for crop producers. After the peaks in 2008 crop prices began to drop, but input costs continued to rise. So it was the 2009 crop where most producers had the maximum investment cost. However, the 2009 crop prices did not stay as high. Many producers felt the pinch.
- Grain prices down 10 to 20% from 2008
- Despite the decline, at 124.1, the crops index remained well above the 115.1 from three years ago, when crop prices started their ascent to reach a peak in June 2008.
- Grains index recorded the largest drop of 22.5% resulting from drought and wet conditions in some parts of Canada.
- Supply is adequate and demand is stable for commodities
- Oilseed demand is strong and supply is tightening, making room for some potential price increases



2010 Fall Crop Price Forecasts

- Feed Barley: \$2.60 - \$3.04
- Oats: \$1.50 - \$1.75
- Wheat (mid-protein): \$3.75 - \$4.00
- Wheat (#1): \$4.90 - \$5.10
- Canola: \$8.00 - \$8.50
- Lentils: <\$.25 per pound

Source: Informa Economics



Avg. Annual Increase, 2002-2006 FIPI - Overall+2.0%

When in the past have we seen fluctuations like this?

Important Point #1: Market Volatility in Agriculture seems to be the new norm. As such we must find ways to smooth the volatility and create more consistent returns.



Watch for these indicators:

- Growth of emerging countries
- Inflation cycles
- Global commodity prices (especially oil and gas)

- BIRC countries – 10% growth rate puts upward pressure on grain and oil prices. 3% GDP growth in these nations puts downward pressure.
- India and China are investing in S. America and Australia so don't rely so much on N. America
- Military conflict in oil producing places and cold weather also influence agriculture input prices
- Benchmarks - \$.91 CAD for loonie, \$80 barrel of oil
- Inflation kicks in 3.5 years after printing lots of money. Currently 20-25 months into this cycle from last big US currency print



Crude oil prices drive farm fuel costs

Natural gas prices drive farm fertilizer costs

Cash management is key as it will provide the flexibility to make purchases throughout the year. Not just at year end or in the spring.



The Successful Farm – Rules for Success

• Proper size and scope	\$300,000 to \$400,000
• Net farm income	\$60,000 to \$90,000
• Low debt levels	< 40% Debt to Assets
• Modest living expenses	< \$50,000
• Retirement plan	80 to 90% rule
• Off-farm income	\$25,000+

Debt levels = efficiency and scale of the operation



Health Check – Key Indicators

- Operating Loan < 50% current value of unsold inventory
- Operating expenses < 65% gross revenue (averaged over past four years)
- Net Revenue > 2x cash rent
- Machinery investment < 2x gross revenue per acre (averaged over past five years)
- < 20% total income from gov't programs
- Net Income > 20% gross (excluding gov't programs)
- Cautious use of off-farm income in farm operations

Where's the biggest bang for the buck

It's about doing 10 things 10% better, not 1 thing 100% better

Avg over 4 years

Have pay back period for off-farm income

Looking in the rear view mirror is key

Once you exceed 2x gross revenue over 5 years, your depreciation costs per acre will start to exceed 15% of gross revenue.