

# MANAGING THE POSITIVES AND REALITIES OF ECONOMIC TRENDS



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## Super Global Trend Disruptors

- One half of the world's population will experience a major election
- \$68 trillion of wealth will transfer from 2025 to 2040
- 1/3 of wealth owned by females in 2025 & 2/3 of wealth owned by females by 2040
- Stages of diffusion innovation for green energy/AI
  - Infatuation: 2022-2024
  - Disillusionment: 2024-2027
  - Reorientation: 2027 & beyond
- Globalization, deglobalization
- Black swans vs. grey rhinos
- Dollar vs. new digital currency



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## Ag Views Watchlist

- Export markets
- Global economic slowdown
- Weather & production in Southern Hemisphere
- U.S. economy- “tight rope”
- Global debt vs. paper wealth gains



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## Pulse of the Agricultural & Rural Economy Challenges

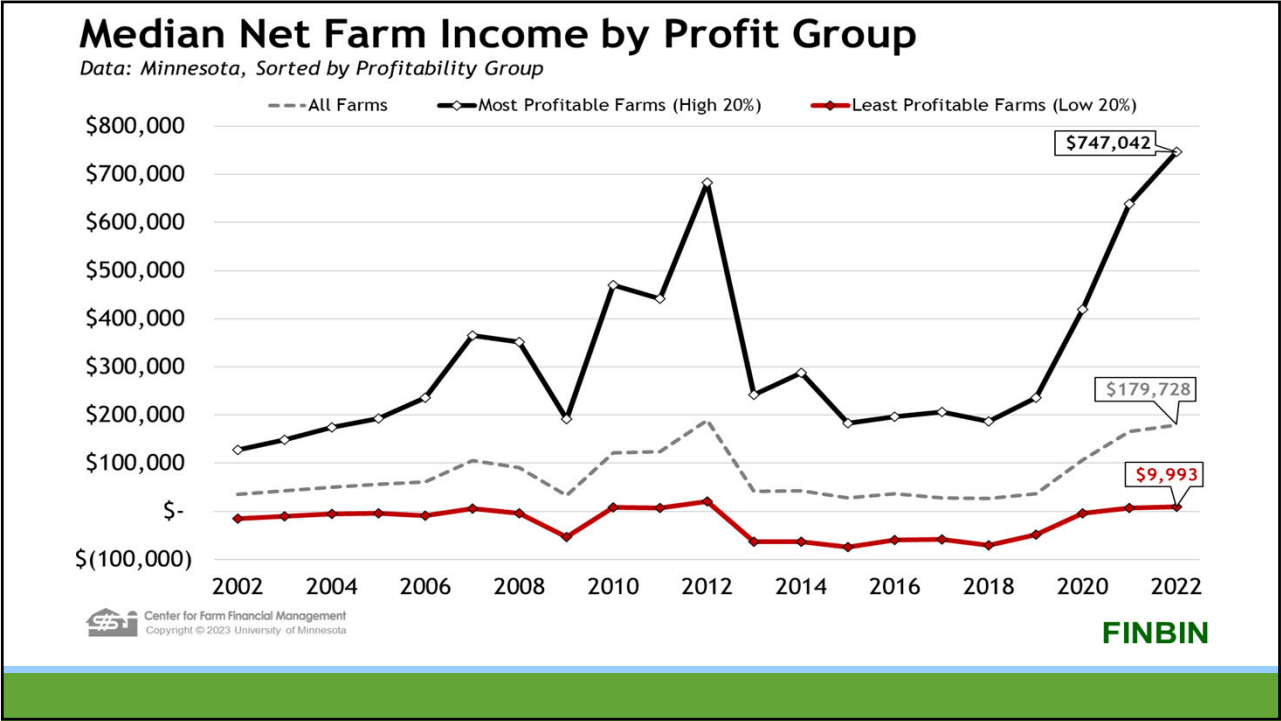
- Margin compression, resilient, inflated cost, lower commodity prices
- Higher interest rates
  - Impact on operating money
  - Possible impact on long term rates- “resets”
- Shrinking working capital cash positions
- Storage of grain commodities with declining prices
- Protein sector, dairy, poultry & pork margin compressions
- Beef & livestock industries continue to be economically strong
- Land values
  - Reduced number of buyers in some areas
  - Solid demand other areas
  - Cash rents: resiliently high



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## Quote for the Quarter Century

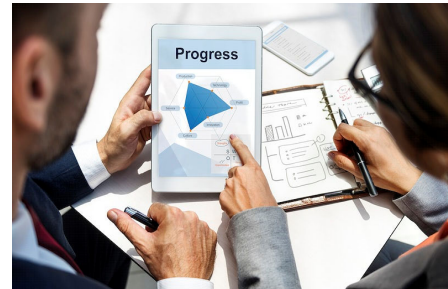
“The opportunity for business and personal prosperity is not about the size, the enterprise or the next big thing. It is about being a ‘five-percenter,’ meaning being a little better in many components of production, operational efficiency, marketing, risk management, finance, human resources and in the focus on your values and goals.”

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## Business Development: Top Half 20-40%

- Selective growth & expansion
- Align with the next generation if in transition
- >50% working capital to expenses
- Selective cash rents & leases
- Focus on earns & turns



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## Selective Refinancing: Average & Below Average

- Selective refinancing
- Working capital burn rate <1 year
- Debt to asset ratio <40%
- Plan for workout



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# China's Walk Around & Slow Growth

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- 2<sup>nd</sup> largest economy globally
- Demographic issues
  - One child policy
  - 4-2-1 issue
  - 20% of 20-30 year olds unemployed
  - Government enforcement of technology
- Spending issue
  - Chinese citizens saved \$2.4 trillion during 3 year lock down
  - Uncertain future, not spending, prepaying mortgages
- Manufacturing/technology
  - Slow export markets- U.S. down 40% & Europe down 44%
  - Consumes 10-15% global oil & energy
  - Exports are down 14%





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# China's Walk Around & Slow Growth

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- Debt issue
  - Household debt to GDP 110%
  - Housing devaluing by 25-50%
  - Government spending stimulus minimal
- China's growth rate as a result of deleveraging\*
  - 2000-2010 10.6%
  - 2010-2020 6.2%
  - 2020-2030 2-4% estimated
- A1 negative rating - downgrade of Moody's credit outlook
- U.S. agriculture's largest trading partner for cotton, soybeans, pork & milk



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\*Source: WSJ June 11, 2023

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# Global Walk Around - India

- Surpassed China in population
    - Demographic divided
  - Median Age: 29
  - 5<sup>th</sup> largest economy globally
  - 3<sup>rd</sup> largest economy by 2029
  - India GDP per capita \$2,280
  - Large exporters of: rice (Basmati & non-Basmati), sugar, onions, wheat
- 
- Government limitations on exports
  - Farm policy protectionism
  - Only three-fourths of the population is literate
  - Females in the workforce: 23%
  - One-third live in cities
  - >55% of population are farmers and live on small family farms

# Global Walk Around - Europe

- 20% of world economy
- European Union & Germany negative growth in Q3 of 2023
- Russia - China economic trap
- Immigration issues
- Increasing interest rates
- Tourism boom – U.S. stimulus money
- NATO & European unity – war in Europe
- Watchlist
  - Winter weather
  - Climate/social changes
  - Interest rates
  - Greenlash



# Global Walk Around - Southern Hemisphere

- Brazil’s agricultural competitiveness & expansion
  - Soybeans
  - Corn
  - Protein industry
- Each year land equal to half the size of Illinois goes into production in Brazil
- Belt & Road Initiative
  - China 2013
- Alternative currency to U.S. dollar
  - New Development Bank (NDB)
  - Asian Infrastructure Investment Bank (AIIB)
- Oceania & Southeast Asia



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# Dollar vs New Currency

## NEW DEVELOPMENT BANK

- Multilateral bank established by BRICS
- Headquarters in Shanghai, China
- Reliance on U.S. currency 2/3
- Russia owns 20%- “new leader”
- New expensive debt
- Seeking membership from Saudi Arabia, Argentina, Honduras
- Russia invasion quadrupled borrowing cost

## ASIAN INFRASTRUCTURE INVESTMENT BANK

- Financed China’s Belt & Road Initiative
- Infrastructure for Tomorrow
- Designed to reduce dependence on dollar based funding
- Alternative to IMF
- Western countries are members



## Global Indebtedness: Debt Tsunami

- \$305 Trillion Global Debt Q1 2023
  - \$45 Trillion increase since 2020
- \$309 Trillion Global Debt Q4 2023
- \$100 Trillion Debt in Emerging Nations
  - 20% increase in the last three years
  - China, Mexico, Brazil, India & Turkey posted biggest increases
  - 250% of GDP in Emerging Nations
- Global Debt in Developed Nations
  - 110% in 2012
  - 332% in 2024
- 14% of companies in U.S. are “zombies”
  - “Zombie” companies are earning enough to pay expenses & service interest but not able to pay principal



**Sources:** Data Compiled by IIF (Institute of International Finance- Washington, D.C.) & CNBC Morning Show on February 7, 2024

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## Potential Tailwinds to the U.S. Economy

- Stock market
- Election year
- Inflation decline
- Decline of interest rates
- Employment strong
- Demographics



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## Headwinds to the U.S. Economy

- Student debt payments
- Labor strikes
- Budget impasses
- Rapid acceleration of government debt: \$33 trillion
- Fiscal unsustainability
- Erosion of governance through election cycle
- Rapid rise in long term interest rates
- War in the Middle East
- Oil exceeding \$100/barrel



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## Leading Economic Indicators Blinking Red

- LEI – Leading Economic Index
  - Down at least three tenths of one percent each month this year
  - Diffusion index < 50, 60% of the time
- PMI- Purchasing Manager Index
  - < 50 in 2023, a sign of a contracting economy
- Index of Consumer Sentiment (University of Michigan)
  - <75 since mid 2022
- Inverted yield curve
  - Inverted since May 2022
  - Predicted every recession since 1959
  - 19 to 24 month lag time
- Housing starts
  - Pressure from high median home prices & down payment requirements
  - 44% of household income



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## Factors for Interest Rate Decline

- Inflation
  - Headline 4.0%
  - Core 2.0%
- Unemployment
  - U-3: 4.5%
  - U-6: 7.5%
- Two quarters of negative GDP
- Yield curve – flat to positive



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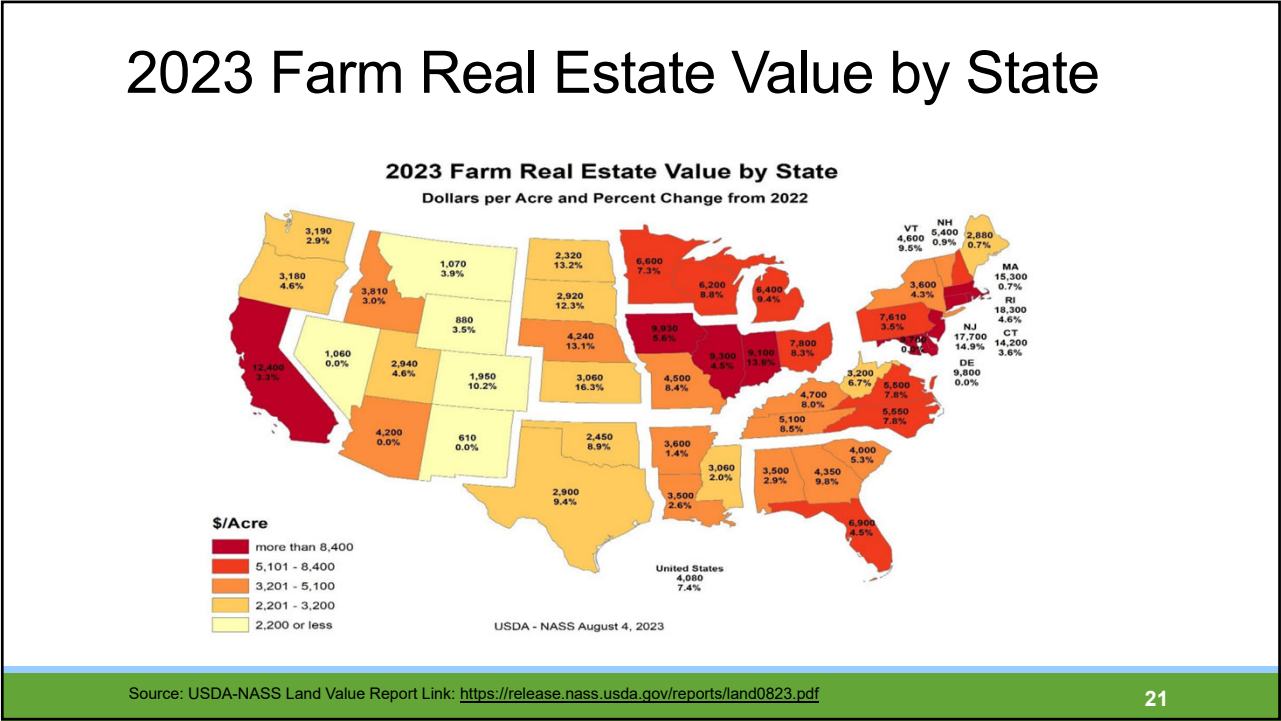
## R-star: The Natural Rate of Interest

- $R^*$  is the short term interest rate that would exist when inflation and unemployment are at levels that do not stimulate or restrain the economy.
  - 2.25% to 3.25% Fed funds rate
  - 5.25% to 6.25% Prime rate
- Days of zero-bound interest rates (2008-2020) are in the rear view mirror.
- Fiscal policy has an instantaneous impact with checks in the mail
- Monetary policy (Fed action) has a lag effect of 8 to 18 months




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## Farm & Ranch Values Watch List

- Demographics – baby boomer farms/millennial owners
- Narrowing of buyers
- Outside investors withdrawals
- Opportunity investments - CD's & money markets
- Green energy movement vs. “greenlash”
- Earned net worth gains vs. losses
- Appreciated net worth - gains vs. losses
- Water, mineral, & other value enhancements




### Bubbles of Credit Financial Risks of the 2020s – It’s Not Your Grandparents’ 1980s Farm Crisis!

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- Fraudulent activities
- Marketing ego/complacency
- Deadly “D’s”
- Growth
  - Management
  - Working capital
  - Debt levels
- Non productive capital expenditures

- Next generation management levels
- Next generation financial debt commitment
- Spouse’s/partner’s financial debt commitment
- Third party, counter party risk:
  - Integrators, consolidation
- Ownership of the numbers



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### Bubbles of Credit Financial Risks of the 2020s – It’s Not Your Grandparents’ 1980s Farm Crisis!

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- Technology without technicians
- Side ventures
- Family living inflation & too many family members
- Management decisions based on schedules “F” & “C”
- Risk management-insurances, contracts

- Chasing the “next big thing”
- Lender commitment
- Margin shrink & inversion-interest rates, cost impacts, etc.
- Black swans & gray rhinos
- Lenders/regulators/credit card build up



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## Agricultural Lending Financial Spectrum

Collateral Lender

Profit, Cash flow, Sixth C Lender

- Don't know cost of production
- Monitor financials once a year for tax reasons, no ownership of the numbers
- Shoot from the hip, marketing & risk management
- Family living cost issues
- Lender develops the statements
- <25% debt to asset ratio with land collateral

- Knows cost of production & break evens via enterprise
- Develops & monitors financials & cash flows frequently
- Marketing & risk management plan executed and monitored
- Family living budget separate from the business budget
- Team of advisors
- Aforementioned is critical for producer renting & leasing and > 50% debt to asset ratio.

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## 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 adjusted	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

**\*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, strong potential for resiliency & agility
24-34	Moderate management rating, potential issues in resiliency & agility
<24	Weak management rating, potential major issues in resiliency & agility

2024 Version - Developed by: Dr. David M. Kohl, Professor Emeritus, Ag & Applied Economics, in cooperation with Dr. Alex White, Dairy Science, 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 Scores & Successfully Navigating Adversity

Business IQ Score	Success Rate in Adversity	Stoplight Indicator
<25	Very low	Red
26-30	Low to moderate	Red
31-39	Average to above average	Yellow
40+	High to very high	Green

# Bridge & Pier Concept

- Are you building a bridge or a pier?

The more you go down the pier, the deeper the water. This increases the need for a higher level of expertise, and there are fewer options.



# Working Capital by the Numbers

- Working capital to expenses
- >25% green light
- 10-25% yellow light
- <10% red light



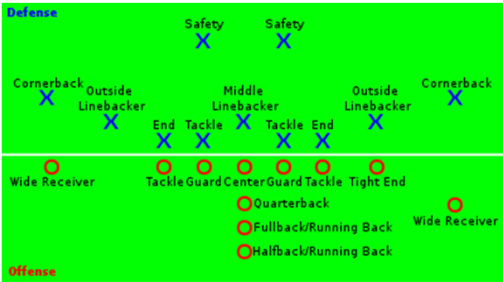
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“44/11: where do you stand?”



# Playing Defense vs. Risk

- Defensive Line = Cash Flow & Profits
- Linebackers = Working Capital
- Pre-Safeties = Equity
- Safety = Collateral



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# The Burn Rate on Working Capital

## ■ Defensive

Current Assets: \$2,000,000  
-Current Liabilities: \$1,000,000  
= Working Capital: \$1,000,000

**Projected Loss: \$500,000**

\$1,000,000 (Working Capital) = **2 Years**  
\$500,000 (Projected Loss)

**Green** >3.0 Years  
**Yellow** 1.0-3.0 Years  
**Red** < 1.0 Year

## ■ Offensive

Current Assets: \$1,000,000  
-Current Liabilities: \$ 200,000  
= Working Capital: \$ 800,000

**Debt Service Payments: \$160,000**

\$800,000 (Working Capital) = **5 Years**  
\$160,000 (Debt Service Payments)

**Green** >5.0 Years  
**Yellow** 2.5-5.0 Years  
**Red** < 2.5 Years

## The Burn Rate on Core Equity

(Assume \$500,000 Earnings Loss & 20% land value decline)

Assets- Market Value	Estimated Value	Loan Maximum	Collateral Position	Remaining Principal	Equity Excess Reserves
1. Long Term (20% Decline on Land)	\$6,000,000 \$4,800,000	X 70% X 70%	= \$4,200,000 = \$3,360,000	- \$2,200,000 - \$2,200,000	= \$2,000,000 = \$1,160,000
2. Intermediate	\$3,000,000	X 60%	= \$1,800,000	- \$800,000	= \$1,000,000
3. Current	\$1,650,000	X 80%	= \$1,320,000	- \$860,000	= \$460,000

**Burn Rate: Land & Long Term Equity Reserves**=  $\frac{\text{Excess Reserves}}{\text{Earnings Loss}^1} = \frac{\$2,000,000}{\$500,000} = 4.0 \text{ Years}$

**Burn Rate: Land & Long Term Equity Reserves**=  $\frac{\text{Excess Reserves}}{\text{Earnings Loss}^1} = \frac{\$1,160,000}{\$500,000} = 2.32 \text{ Years}$   
(20% land value decline)

**Red < 4.0 Years = Vulnerable**

**Yellow 4.0-7.0 Years = Resilient**

**Green > 7.0 Years = Agile**


<sup>1</sup> Assume Earnings Loss of \$500,000

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## Banker Frank Philosophy: Wisdom for Banking and Life

- Can I trust you?
- Do you know what you are talking about?
- Do you care about me as a person?
- Success is often measured by dollar signs. Significance is making a difference in peoples lives.



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## Future-Proofing Your Business & Life for Success

- There is no culture without success in agriculture.
- If it grows too fast, it's a weed.
- You are no better than the people you know and interact with.
- Net worth in financials & quality of life is = to your network of people.
- There are no traffic jams in the extra mile!
- Success is often measured by dollar signs. Significance is giving back and making a difference in people's lives.
- Write a handwritten letter to three people annually that are important in your journey of business and life.



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## Top Questions from the Road

- What are some immediate red flags that can be spotted while collecting and analyzing financials from customers/prospects?
- What are your thoughts on budget monitoring by banks? I am told that banks are doing less of it because it is too time consuming and inconvenient for the borrowers.
- What are the largest changes you have observed in agriculture and ag lending over the years? What do you see changing in the future?
- What advice and wisdom are you suggesting for new ag lenders at your agricultural training? What are some characteristics of new lenders?

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# Q&A with Dr. Kohl

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