

Agribusiness Banking

A Presentation to:

Federal Reserve Bank of Kansas City
Recognizing Risk in Global Agriculture

Curt Covington

Senior Vice President / Senior Risk Manager

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Snapshot of California Agriculture – “The Strengths”

- \$ 41 billion farm output in 2009 (CDFA)

Texas	\$21.0b	Illinois	\$16.2b
Iowa	\$24.0b	North Carolina	\$10.4b
Nebraska	\$17.0B	Florida	\$ 7.6b

- Top 5 US counties in terms of crop revenue are all in California
- Comprised of 37 crop segments representing 350 +/- identifiable crops
- The State leads US in the production of more than 70 different commodities
- California is the exclusive U.S. producer (99% plus) of at least 12 commodities including, but not limited to:

Almonds	Figs	Pistachios	Raisins
Artichokes	Olives	Pomegranates	Walnuts
Dates	Persimmons	Prunes	

- The State produces 70% to 99% of 11 other crops, including table & wine grapes, peaches/plums/nectarines and fresh market citrus.
- Vast majority of crops are harvested by hand.
- California’s production of fruits, nuts, and vegetables accounted for more than 55% of the nation’s total production

Snapshot of California Agriculture – “The Weaknesses/Risks”

- Most if not all of our crops are “at risk” in nature. California receives far fewer subsidies as a proportion of its total production compared to most other states because its main crops are not eligible.
- Most crops are “retail driven” with rapidly expanding organic segments. Retailers chasing consumer preferences has fostered market volatility.
- Politics and Special Interest Groups Dominate the Landscape
 - An outdated and woefully inadequate water storage and distribution system for what is essentially an irrigated desert.
 - Water Sales and Transfer Rights are particularly unpopular but necessary
 - Illegal immigration is a double edged sword.
 - ESA is pervasive
- Crop Insurance is widely available but for some crops can be prohibitively expensive with marginal benefits.
- Farming has succumbed to the “dumbbell effect”

“At Risk” Nature

Banker’s Natural Tendency	Borrower’s Natural Tendency
<p>Drive working capital levels above 20% of budgeted Expenses</p> <p>Drive B/V B/S leverage below 2:0:1</p>	<p>Vertically Integrate to capture a greater share of the marketing channel profits</p>
<p>Apply a “sustainability quotient”</p> <ul style="list-style-type: none"> • 40% rule <p>Require and monitor monthly budget</p> <ul style="list-style-type: none"> • 10% rule <p>Rigorous Monitoring</p> <ul style="list-style-type: none"> • 2x inspections and monthly reviews 	<p>Seek higher margin crops (even if it implies higher risk) through the development or acquisition of exotic (and many times untested) varieties</p>
<p>Encourage: (1) Hedging when available; (2) take or pay contracts for non hedged crops</p>	<p>Seek minority partners that have less to lose than they do but usually end up making the most important decisions.</p>
<p>Covenant the living daylight out of the deal to prevent leakage of cash.</p> <ul style="list-style-type: none"> • Min line clean down provisions • Maximum CapEx and Distributions 	<p>Seek production oligopolies when possible</p>

Retailer Driven Markets- Large Retailers Generally Drive the Specialty Crop Markets. They Dictate:

- Size, quality and varieties they want in a particular store
- Packaging “styles”
- Grower/Packer/Shipper is ultimately responsible for store inventory management

Banker's Natural Tendency	Borrower's Natural Tendency
Limit sales concentration to large retailers	Expand concentrations. A good thing is never good enough.
Expect a deep analysis of counterparty risk.	Ask why? Would you rather do business with the devil you know or don't know?
Look for prolonged termination period with compensation factors in the contract	“They need us as much as we need them”. They could never replace us without a certain amount of pain.

Political Risk

Banker's Natural Tendency	Borrower's Natural Tendency
<p><u>ESA & Biological Opinions</u>: Comply and don't fight it, no matter the cost (at least for this year).</p>	<p>Fight it up to a point, then give in. Look for others to share in the misery.</p>
<p><u>Water & Biological Opinions</u>: {We will stop talking about the 2010-11 snowpack . . . sometime. How about next week since the snowpack is mostly now gone?}</p> <p>Find a way to buy it, bank it. Find someone else to finance it.</p>	<p>I (we) paid for the development of that water back the 50's. You (the Government) never made me comply with the rules for acreage limitation.</p> <p>Find a way to buy it, bank it or steal it!</p>
<p><u>Immigration</u>: {Whatever happened to the Bracero Programs that seemed to work so well after WWII?}</p>	<p>Use farm labor contractors when at all possible to avoid missteps and shift the burden of risk.</p>

Dumbbell Risk - Agriculture is becoming increasingly polarized in California. There are fewer farmers in the middle.

- Cult Farmers: Small specialty farmers growing on contract for the likes of Whole Foods and Trader Joe's.
- Institutional Farmers: Grower/Packer/Shipper that alone cannot fill the needs of the chain stores. Form alliances among larger growers, influence cultural and management practices through rigorous quality control guidelines

Banker's Natural Tendency	Borrower's Natural Tendency
Cult Farmers are in every bank's portfolio but we try and limit the number and size because of concentration and business specific risks	Institution Farmers and chain stores are trying to garner a piece of the specialty organic markets.
Migrate from fully contained Institution Farmers to those that form alliances. Results in the transfer of risk to other lenders.	Migrate from alliances to self contained for quality control purposes.

Observation: Ag Lender vs. Borrower

Banker's Natural Tendency	Borrower's Natural Tendency
Generally know a little bit about a lot. (This is not a good thing)	Generally know a lot about their little world. (This is a good thing as long as they don't wander out of their little world).
Decision making: Good Negotiating: Good Doing: Not so good Transition: Not so good	Decision Making: Marginal to Good Negotiating: Not so good Doing: Good Transition: Not as bad as bankers!

Risk Management Tool Box

The Banker

A culture that promotes Consistent, Conservative and Pragmatic lending practices. Anything less and you are finished!

- Consistent set of policies and procedures is the foundation of Performance Lending.
- Conservative advance rates on crops and real estate
- Pragmatism. There will be bad times ahead so don't flinch.

The Farmer

There is a large “knowing /doing” gap.

- The dairy crisis of 2009 continues to expose the gap.

Cash is king and equity is a cushion (not the other way around)

Seek advice from sources other than lawyers, bankers and CPAs.

Trends/Practices

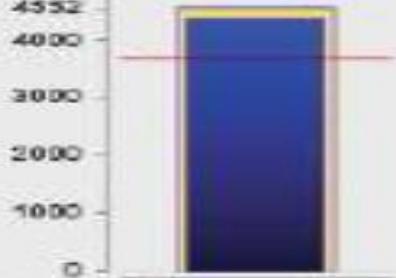
The Institution

- Limit exposure to any one sector to no more than 10-15% of the entire portfolio
- Where exposure exceeds 15% employ lender specialization strategy.
- Key player, key industry in *key geographic region(s)*.
- Entrench the idea of “sustainability quotient” for the most volatile sectors and those segments where portfolio exposure is the greatest.
- Encourage and foster market risk management strategies

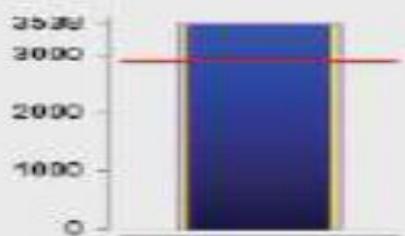
The Farmer

- There is a large “knowing /deciding/doing” gap.
 - The dairy crisis of 2009 continues to expose the gap.
- Cash is king and equity is a cushion (not the other way around)
- Protect downside risk. Take a long term view of marketing challenges
- Seek advice from sources other than lawyers, bankers and CPAs.

LEGEND



Shasta Reservoir
96% | 119%



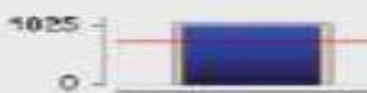
Lake Oroville
100% | 121%



Folsom Lake
97% | 116%



Don Pedro Reservoir
96% | 122%



Exchequer Reservoir
98% | 135%



Millerton Lake
98% | 126%



Pine Flat
98% | 135%

