



A Lenders View of the Swine Industry

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Vince Lombardi Quotes



- It's easy to have faith in yourself and have discipline when you're a winner, when you're number one. What you got to have is faith and discipline when you're not a winner.
- It's not whether you get knocked down, it's whether you get up.
- People who work together will win, whether it be against complex football defenses, or the problems of modern society.
- Leaders are made, they are not born. They are made by hard effort, which is the price which all of us must pay to achieve any goal that is worthwhile.

Agenda



- How did we get to this point?
- Today's financial snapshot
- Benchmarks for producers
- What's ahead for producers and access to capital
- Lesson learned (we hope)
- Q&A

2000-Present : Let's Learn From This



- 2004-2007 Large run of profits
- Triumph plant got up and running Jan 2006 – all packers wanted everything still at capacity
- Atkins diet helped domestic demand
- Exports helped demand
- Producers made a lot of money
- Lenders had very little debt and more liberal terms were accepted
- Producers built contract barns and sow units with very little down

The 2008-2009 - Harsh Realities



- Corn has gone from \$3 to \$8 per bushel
 - back to below \$4 per bushel
- Breakevens have ranged from \$110 a head to \$160 a head
 - now around \$130 - \$135/hd – keeps changing rapidly by day
- Pig prices went from \$120 a head to \$170 a head to \$90 a head
 - now \$155 a head
- Are we ever going to settle in a range?
- What is normal anymore?

2008-Present



- Largest Equity erosion I have ever seen
- Largest swing in volatility I have ever seen
- 2009 – thank God it is over
- Producers don't want to leave the industry – it is their way of life and they will do anything to stay in
- 2010 is the road to recovery — how fast can your operation improve your balance sheet financially

Swine Portfolio Overview



- Many modifications have been made
- Many covenant changes
- Producers have put all their chips in – amazing amount of cash or equity has been put into keeping raising pigs
- Separation from the have not's and survivors

Current Financial Snapshot



- <35% Owner's Equity
- YTD in the black for 2010 operationally
- Big differences in recovery
- Some producers barely in the black and others as much as \$18 a head through May
- Look at operational profits and separate out hedge losses

Financial Snapshot



- Where do you stack up and how fast can you improve your balance sheet?
- You will be measured by this over the next 12 months
- Cost management
- Margin management

Costs YTD for 2010



- Costs YTD are \$130 - \$135 a head (\$65-\$67 carcass breakeven)
- Heavier weights lower breakevens
- Small group that we see are at \$62-\$64 breakeven (sale weight is > 275#)
- Breakeven difference of still from <\$.45 live to \$.55 - \$.10 difference!
- Wean pig costs are < \$32
- The major difference we see are feed costs per head and health (lower mortality, better ADG, lower FC)
- There is still way too much disparity in costs and margin – higher costs of production has led to a higher disparity

The Have Not's



- Not a function of size
- Function of risk management on feed risk and hog margin management
- Certain models struggled more than others – wean pig buyers with contracts got hit first
- Wean pig producers next
- Farrow to finish with the little risk management was next – Southeast was hit harder than the Midwest – cost of production is higher in SE
- Model to get capital will be much more emphasis on farrow to finish

The Have Not's



- Too much leverage going into 2008 – less than 50% equity & expanded with no risk management – deep trouble
- Just focused on costs and not on margins – not good enough any more

The Survivors



- Still have working capital
- Current ratio > 1.4:1
- Have operating line availability
- Owner equity > 40% GAAP
- Locked in margins for 08 and 09
- Sometimes minimized losses – the industry average was \$25 per head – where did you stack up
- Tremendous amount of resources were dedicated in this area
- Hedge lines and operating lines
- Alliance with a packer – very little of the industry has this: < 5%
- Many of these will have very little operating debt by the end of 2010 – we have some that are at \$0 NOW

Survivors



- Financial reporting is very good
- Monthly accrual statements
- Monthly cost of production – many by flow
- Monthly cost of inventory – we look at this number – today average cost of inventory wean to finish is in the low \$70's after latest downturn in feed
- If you don't have this information - access to capital will be difficult

Capital Availability



- Very little dollars were spent the last two years
- Lots of capital expenditures need to get done
- Prioritize on what can make your operation more competitive – feeders, filters, feed mill, etc – investing and improving existing assets might be a much better deployment of capital

Capital Availability



- New Construction – bring your checkbook
- Contract barns – before many were done at cost today minimum 75% loan to appraised value
- Contract Growers will need more skin in the game – they will not be able to leverage off the pig owner
- Exception to this will be young beginning farmers – there will be special programs – we need to keep young farmers in the industry

Capital Availability for New Sows



- Loan to appraised value of < 65%
- Owner equity post close > 50%
- Is it the right model – farrow to finish vs. farrow to wean (Long term farrow to finish is the right model)
- You must have skin in the game on the sow side – too many problems with producers backing out of weaned pig contracts

Capital Availability



- Costs of interest is minimum 300 often 500 bps over 30 day libor – effective rate – 3.25% - 5.25%
- Upfront fees to commit 25bps often 100 bps or 1% of the deal
- Personal signatures – fewer non-recourse loans
- Fees for modifying current deal 50 – 200 bps
- Hold Limits are changing – they are going down an example would be a \$50 million deal – before 2 lenders – today it might be 5 or 6 – smaller bites or more deals – not as many eggs in one basket

Capital Availability



- Producers that are survivors will attract capital
- They will get better rates, lower fees, better deals from lenders
- Lenders will actively pursue strong credits
- Theory – if you are over 40% GAAP now you are a survivor
- The weaker credits will be closely monitored and if they don't significantly improve over the next 12 months – tough decisions will need to be made – there will be more consolidation occurring and more contraction because of this
- There will be a push to improve portfolio quality
- Looking at pay down on higher risk assets

Capital Availability



- Borrowing base values – items to consider
- Cost of inventory in 2008 was over \$90
- Today it is about \$75
- How much should be borrowed per head on inventory?
- 60-65% on pigs that are not hedged
- 75-80% on pigs that are hedged or covered with a positive margin
- Maximum debt per head needs to be < \$55 (preferably \$50)

Capital Availability



- Hedge Lines and Operating Lines – I like the separation – easier to understand and monitor
- Operating Line of \$50 per head and Hedge Line of \$10-\$15 per head
- Hedge Lines: you MUST have reporting to get these dollars and make sure cash comes back to the lines when that marketing period is over – if you have margin calls you must repay when that marketing period has ended – if not we have issues
- Please have your broker generate summary reports to explain positions
- Get on the phone or do Go To Meetings to explain your market positions – communication is extremely important
- More clear information the more access to capital you will have

Items to Discuss



- Owner Equity % vs. Net Worth
- If we don't build new barns GAAP owner equity % will continue to decrease – do we need to think about a minimum net worth \$?
- Hard to have one set of credit standards for the entire industry
- Many different types of organizations - example

Example:

Balance sheet of Company A



- Operating company just inventory 2500 sows farrow to finish
- 2500 @ \$250 sow = \$625,000
- 2200 pigs on sows at \$25 = \$55,000
- 25000 pigs on feed @ value \$75 = \$1,875,000
- Total assets - \$2,555,000
- Liabilities @ \$1,000,000
- Net Worth - \$1,555,000 or 61%
- Lose \$10 head on 25000 head = \$250,000
- Owner Equity drops by almost 10%
- In 2009 - \$25 loss was the norm that is 25%
- Owner equity drops potentially in 6 months to 36%
- This happened a lot in 2009

Need to Look at the Entire Picture



- If they own other assets – i.e. – land, buildings
- What is their debt per acre, per sow space, per finishing space
- As a lender, to me, that is your risk
- Loan to appraised values is what you want to know – but
- 2500 sow unit in a bio secure area might be worth \$800 a sow in a pig dense area it might be less than \$400 a sow

Need to Look at the Entire Picture



- Finishing spaces – smaller sites < 2400 higher value than > 4000 head spaces
- Nurseries – appraised values are suspect due to wean to finish being the norm
- We need to understand the true value of system
- We need to fully understand the entire balance sheet when it comes to analyzing and risk rating the credit

Items to Discuss



- GIPSA ruling has huge implications for the industry and access to capital
- The Future of Packer Agreements and what a packer can offer and will offer going forward
- Current proposal needs to be fully understood by the industry
- My view – this will speed up more integration – you will want to control all – buildings, livestock, packer, land (huge implications for the future of the industry)
- GIPSA ruling could affect current values of assets because you might not be able to get access to ANY packer agreement
- If you want all pigs bought the same – very good prices when we are short on supply – HORRIBLE when we have too much (remember 98-99?)
- Extra costs on the entire industry to document (packer & producer)– can we remain competitive - we export 20% of our supply
- We need to all provide input on this from either side

Items to Discuss



- Producers need to sell some pigs on the open market: 5-10% at least would be a good start
- Supplies are tight – packers will bid more on the live market to not effect their base prices on contracts
- Producers need to have some open market pigs for price discovery
- GIPSA ruling might force – a new integrated plant will be built – (Triumph 2)
- What does the industry want to be – independent, aligned, or integrated – the more independent more capital will be required

Lesson Learned



- You can never have enough working capital
- Leverage will be dirty word for a period of time
- You will need to manage margin risk from now on & it will be as important as production risk
- Volatility looks like it will be the norm
- You will need to be even better at managing your business to survive – production/costs/margin – the people that are left are good and getting better every day
- Things continue to change and you MUST keep adapting – producer - lender - processor

Lessons Learned - Dennis



Lesson Learned



- Time is short – have your priorities right
- Don't sweat the small stuff
- Thank your employees – the survivors would not be here today without having great employees – we often over look this
- To be successful you have to have great people

Summary



- The road to recovery is on
- Capital is available for the survivors – better rates and terms, etc for stronger credits
- You will be measured on how fast you recover
- Timely financial reporting is a must
- Margin and cost management will separate the best from the rest
- Live budgeting – forecasting on your operation to get access to capital is vital
- You must continue to get better in all aspects of your business to survive

Questions?



“To give anything less than your best is to
sacrifice the gift.”

Steve Prefontaine