

AgStar Outlook

YOUR GUIDE TO RISK MANAGEMENT SOLUTIONS — 365 DAYS A YEAR

As Seen In
**Successful
Farming**

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It's hard to forget the record volatility producers experienced over the last year. Let's not forget the less than ideal growing conditions – wet spring, cool summer with little or no rain, topped off by a wet, snowy harvest. I mention these challenges only to make this point – having a solid, overall risk management plan is more important to your operation than ever before.

Consider this: the grain industry is experiencing an entirely different environment than that of just one year ago. Market volatility has grain producers considering LDPs one day and something entirely different the next. Swine producers are experiencing over two years of little or no profits while dairy producers have experienced both record high and low milk prices within months of each other. Who knows what's just around the corner? This begs me to ask the question:



Are you thinking about your risk management plan?

AgStar is.

This past year, we have heard producers loud and clear. That's why we developed *Risk Management Solutions – 365 Days a Year*. It's a comprehensive protection plan that gives producers greater confidence and control, every day. We don't know where the markets will go – a week or even six months from now. But isn't it reassuring to know that having a plan to strengthen your balance sheet, pay down debt, and build working capital can help position you for whatever lies ahead?

AgStar is proud to provide you with this special insert dedicated to financial counseling and risk management solutions. You'll also find comments from nationally known agricultural economist Dr. David Kohl regarding the importance of understanding key financial ratios.

AgStar is committed to helping our clients manage through these challenging times. We're dedicating more resources and spending more time listening and providing you with the information and tools you need to be successful.

It's our hope you find the information in this insert useful to your farming operation. Here's looking forward to another year of "successful farming!"

Paul DeBriyn
President and CEO, AgStar Financial Services

Call AgStar at 866/577-1831 or visit www.AgStar.com to find your local FSO, read informative articles about financial planning, and more. You'll also find useful online calculators for loan amortization and comparison, cash grain pricing, and estimating crop revenue guarantees.

Put your finances to the test

We are living in interesting and often frightening financial times. Over the past decade, milk prices have plummeted, and input costs and grain prices have gone through the roof. “From 2010 to 2020, getting the balance sheet in order is going to be critical,” says Dr. David Kohl, Professor Emeritus of Agriculture and Applied Economics at Virginia Tech. He has devised a series of ratios to help producers test their financial strength.

Liquidity: Net working capital (current assets - current liabilities) / total farm revenue = liquidity

In times of volatility, Kohl says, financial liquidity is critical. “I feel this is one of the top areas as far as risk management is concerned,” he says. “If a producer is heavily financially leveraged and carrying a lot of debt, and doesn’t have the necessary crop insurance and marketing plan, then working capital better be north of 25% to 33%. So if you have \$1 million in revenue, you’d ideally have \$333,000 of working capital.”

Doing shock tests is a good way to plan for many possible scenarios. For example, Kohl says, last fall, producers had great working capital. “They had \$6 corn in the bins, so everything was good. When it dropped to \$3, that working capital was eaten up,” he says. “They need to ask themselves what they’ll do if this happens.”

Solvency: Total farm liabilities / total farm assets = debt-to-asset ratio

If a business has assets of \$1 million and has \$500,000 in debt, the debt-to-asset ratio is 50%. If that ratio goes above 66%, Kohl says, “the operation is extremely vulnerable to outside shocks and management issues, and you can be put out of business very quickly.” He says liabilities shouldn’t amount to more than 30% of assets.

Keep in mind these values can change quickly. “We see some very positive debt-to-asset ratios because of high land values,” Kohl says. “We need to shock test that. How would you be influenced if your land values drop?”

Fluctuating interest rates can also affect this ratio. “When interest rates drop, the amount of financial leverage is very in line with the intensity of management,” Kohl says. “Risk management is not an option, it’s a requirement. Having interest rates and debt structured properly is critical.”

Repayment capacity: Capacity available / interest and principal payment = term debt and lease coverage ratio

This metric measures cash flow, or how much is left after debt payments have been made. If you pay \$100,000 annually, and your capacity to pay is \$150,000, your term debt lease coverage ratio is 150%. “In these volatile times, anything less than 125% puts you in the red light zone,” Kohl says. If it’s above 200%, “you’re very strong.”

The more cushion you have, the better, because “any change in input costs, revenue, or interest can eat that excess margin up very quickly,” Kohl says.

Financial efficiency: Operating expenses (excluding interest and depreciation) / gross revenue = efficiency

If your farm has \$1 million in revenue and \$750,000 in operating expenses, your ratio is 75%. “Peak performers tend to be under 70%,” Kohl says. “The people who are good marketers with a good risk management plan are usually those with approximately a 15% margin.”

Another measure of efficiency is asset turnover (gross revenue / average total farm assets). If you have \$1 million in revenue and \$1 million in total assets, you’re at a 1:1 ratio, Kohl explains. “You turn your assets every year. The faster this is, it’s good for the business. Success in business is all about earns and turns,” he says. “Generate a margin and turn your assets.”

Take a broad view

“The key for risk management is to never just look at one year,” Kohl says. “Use the past three to five years to set your baseline, then do shock tests and make a plan.”

When making that plan for the next one to two years, Kohl recommends “economic war gaming” with a trusted financial advisor. “Producers should do shock tests for anywhere between five and 10 scenarios. Some people take a hat, throw a bunch of scenarios in, pull them out, and see what they’d do,” Kohl says. “That’s a good way to develop strategies. There’s no one ratio that’s going to guarantee success. It’s all about balance.” ★

Take a year-round approach to risk management



From planting through harvest, emotions run high. Will there be enough rain? Too much moisture? Will high winds or hail wreak havoc on your crop? Once the grain is in the bins, though, those worries fade away until the following spring.

A new awareness campaign from AgStar, RMS-365, reminds producers that risk management solutions should be at the top of their minds 365 days a year, not just when the crops are in the field. It's time to challenge conventional thinking. It's time to reconsider how and when you plan your entire year.

"In the winter, when the crop is out of the field, farmers quickly forget the emotions of the previous growing season. They're already making plans for spring," says Greg Eaton, AgStar Risk Manage-

ment Team Leader. "For instance, they don't remember the summer hailstorm that narrowly missed their farm by a couple of miles. What if they hadn't been so lucky? We need to rethink how we manage risk. Remember that hail in July? It didn't affect your crops, but it easily could have."

More than just insurance

Crop insurance is an important part of risk management, and most producers are taking advantage of this program. In fact, over 90% of the acreage currently farmed in Minnesota is insured. But figuring out which crop insurance policy is right for your operation can be confusing. "Crop insurance is an incredibly complex product that's

always evolving," Eaton says.

When growers purchase crop insurance from AgStar, they are assigned a team of professionals and receive an annual on-farm visit. "We go to them and find out how their operation changes each year," Eaton says. "For example, if they're in a crop rotation, there may be more risk on one crop than another in any given year."

There are other factors to consider when choosing the best crop insurance plan for your farm. "Different people have different needs," Eaton says. "A heavy contractor with an aggressive selling style has different risks than a post-harvest marketing producer. Dairy, ethanol, and cash grains all have very different needs. We tailor the risk management plan to fit their needs, which results in specialized programs jointly developed with the farmer."

Don't go it alone

It's important to take a consultative approach to risk management, Eaton says. "You can buy the right seed and apply the right chemicals, but there isn't a guarantee when it comes to managing your revenue risk. That's where having a personal relationship with a team of professionals comes into play. It takes time to determine the best course of action, but the investment is worth it."

Crop insurance is a significant key toward reducing risk, but it's not the only tool in the risk management toolbox. Producers should consider loan structures, life insurance, long- and short-term goals, and marketing plans. "You have to look at it holistically," Eaton says. "Taking all of these factors into consideration and maintaining constant communication allows us to address the issues that keep our clients up at night."

The on-farm visits, team of professional advisors, and complete view of risk management come with every crop insurance policy AgStar sells. "The federal government sets the price, so that will be the same no matter where you buy your crop insurance," Eaton says. "Clients choose AgStar based on our knowledge and outstanding service." ★

Your guide to risk management solutions



There's more to selling crop insurance than just selling insurance.

Years of specialized training and industry expertise. The ability to respond quickly to ever-changing rules and conditions. A fundamental understanding of your entire operation. And a deep-rooted desire to help our clients succeed.

This is what it takes to sell crop insurance at AgStar Financial Services. This is what **Risk Management Solutions: 365 Day a Year** is all about.



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AgStar financial counseling goes beyond the books



When it comes to running a farm business, it often seems there are more questions than answers. Should we trade tractors, buy the 160 acres next to us, or stick with what we have? Can we afford to expand? Will we be able to retire while our family continues to operate the farm?

The way you handle scenarios like these can make or break an operation. And while you might hesitate to ask for help with milking or planting, when it comes to finances, teaming up with the right expert might just be the best decision you ever make.

Help is on the way

Dave Farm is the Vice President of Field Operations for AgStar. “Financial counseling is a key focus of what we do,” he says. This type of service isn’t reserved for only large-scale producers. It’s what AgStar does for all of its clients, large or small.

When a new client comes to AgStar, a financial services officer (FSO) takes the time to really get to know the business. “We conduct a financial needs assessment, examine the business structure, and go over the financial record-keeping system,” Farm says. “We find out about the farm operation’s profitability and cost of production.”

They also discuss who handles the books, does the taxes, hires labor, and makes marketing decisions.

“It’s important to know what kind of marketing tools are in use, whether there’s a marketing plan, and if it’s followed.”

But since farming is about so much more than just numbers, the FSO also gets to know the operator and family. “We talk about both farm and personal goals with them,” Farm says. “We ask where they see themselves in five years, when they want to retire, and if they have children they want to bring into the operation. We talk about what is and isn’t working in their current operation.”

Once the information has been shared, the next step is analyzing the financial position. The AgStar FSO and client track the past three to five years, including working capital, earnings, net worth, and repayment capacity. AgStar also uses financial standards and guidelines to compare where your farm’s financials are to others.

This may seem a little intimidating to someone who has never worked with a financial counselor, but it’s important to be up-front. “You have to trust your financial advisor and be willing to put everything out there on the table,” Farm says. “It’s important to gather very accurate information to provide sound financial advice.”

Operators are generally very anxious to hear what the FSO has to say after their data has been analyzed,

Farm says. "They don't feel at ease until they know how their operations did this past year and how they stack up to other similar farms."

Looking to the future

The advisor and operator then talk about short- and long-term goals, and what needs to be done to achieve them. They will prioritize tasks and determine follow-up actions. "We stress keeping as much working capital available as possible, especially during these volatile times." Farm says. "This helps our clients withstand adversity and a downturn in the farm markets and economy."

They'll also discuss different scenarios, like interest rates increasing, milk prices dropping, or crops being damaged, and ways to manage those risks. "We identify troubling spots and help correct problems before they arise," he says. Practicing good risk management helps farm operations stay in business during adversity.

The analysis is just the beginning of AgStar's financial counseling. "We go over the balance sheet and earnings information with a client on an annual or quarterly basis, or monthly if need be," Farm says.

And if the operator has a question at any time, the FSO is there. "We'll trend where their operating expenses are going and help make buying decisions about land, tractors, or whatever. We don't want them to risk their equity," he says. "We'll talk about margin management, to help them be profitable and grow."

Still your decision

At regularly scheduled reviews and throughout the year, the FSO will go over different situations and weigh the pros and cons of all options, but the decisions ultimately lie with the producer. "When making any kind of decision, it's important to know your breakeven and what the risks are," Farm says. "The larger you get, the better you have to understand your finances."

He encourages operators to ask questions, examine production levels, compare costs, and have a handle on their working capital. "You really have to understand your business financially," he says.

When seeking financial counseling, it's important to find someone you're comfortable with, and that you trust. Farm is confident AgStar's FSOs will more than fit the bill. "If our clients aren't successful, then we aren't successful." ★

Your guide to risk management solutions



We look at your entire operation top to bottom. That's how you know everything is covered.

Crop insurance. Debt structure. Equipment needs. Succession planning. Expansion. Inputs. Marketing. Maintenance. If it affects your bottom line, it affects your risk management plan.

That's why AgStar Financial Services offers **Risk Management Solutions: 365 Days a Year.**

It's a comprehensive planning and protection service that works for your entire operation, every day of the year.



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Our crop insurance plans include experience, insight and understanding. No extra charge.

At AgStar Financial Services, we look at crop insurance differently. We take the time to understand every detail of your operation. We travel the distance to see your challenges firsthand. We apply what we've learned from years in the field to make a one-of-a-kind recommendation that's right for you.

It's all part of a comprehensive planning and protection service we call **Risk Management Solutions: 365 Days a Year**. This is more than crop insurance.

This is a new way to protect your entire operation, every day.

So, before you make a major planting or purchase decision, talk to an AgStar specialist about **Risk Management Solutions: 365 Days a Year**. At this time next year, you'll be glad you did.



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