Financial Challenges Facing Nebraska Producers in 2015

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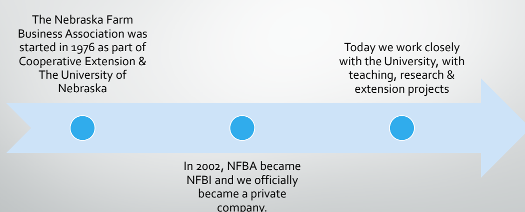


Nebraska Farm Business, Inc.

What Change 5 Years Make

A Comparison of 2009 & 2013 Average Costs

Looking Back

- The last year our averages reported less than $4.00 per bushel for corn was 2009.
  - Average Net Income = $180,197
  - Expected Average Income for 2014 = < $40,000
  - What's the difference? **Input costs**

Cost Comparison

	2009	2013	Difference	Percent of Total Difference
Seed	$68.05	$89.49	$21.44	9.3%
Fertilizer	$143.87	$163.80	$19.93	8.6%
Chemicals	$50.75	$56.16	$5.41	2.3%
Crop Insurance	$23.36	$40.36	$17.00	7.3%
Operating Power/Machine Costs	$74.52	$112.50	$37.98	16.4%
Land Rent	$171.74	$274.74	$103.00	44.5%
Other Direct Costs	$84.14	$106.91	$22.77	9.8%
Overhead Expenses	$71.84	$75.67	$3.83	1.8%
Total Expenses	$688.27	$919.63	$231.36	100%

Included in our Operating Power/Crop Machinery cost is Fuel & Oil, General Repairs & Supplies, Machinery Repairs, Custom Hire and Machinery Leases. If we include Machinery Depreciation and Intermediate Interest, the total climbs to $168.61 per acre. That is $36.56 more than the total of $132.05 in 2009.

Cost Comparison

- Total increase per acre = $231.36 per acre
- Total Increase overall = $254,496
  - Average Acres = 1,100
- Increase per Acre = $1.10 per bushel
  - Average Yield = 210

What do we do?

- Step 1: Know YOUR costs
  - Average Costs are only good for so much
  - Know where your money is going instead of wondering where it went
  - Create good "working" cash flows
    - Not your banker's cash flow
    - Updated regularly, includes cost of production estimates, etc.
  - Hirer it done if you can't do it or don't have the discipline to do it.

Reduce the Costs you Can

- Crop Insurance:
  - Crop insurance (Revenue Coverage) prices will go down due to the drop in prices
  - Don't fall into raising coverage at the same cost
    - Use YOUR costs to determine YOUR risk level
    - Make sure you have just enough insurance to be able to farm next year if you have disaster
  - Think of it as health insurance
    - You're better off if you don't collect but you need to protect your risk.

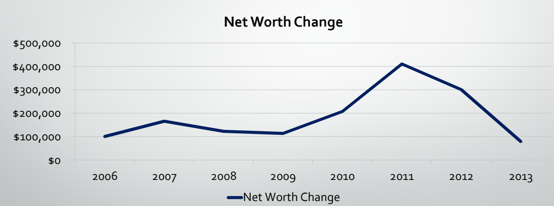
Controlling Input Costs

- Seed, Fertilizer & Chemicals together make up only 20% of the increase over 2009
- Make sure your choices are good financial choices
  - Example: $20 per acre of extra fertilizer, expected yield bump of 5 bushels
    - Definite "Yes" when corn was $7.00 ($35 return)
    - Not a good choice when corn is $3.50 ($17.50 return)
  - Concentrate on NET return not GROSS return
- Watch your Salesmen…

New Era

- May need to look at **Minimizing Losses** rather than **Maximizing Profits** for a few years.
- Are you in a position to do that?

Average Net Worth Change



8 Year Total Increase over $1.5 Million

Cash Rent

How to handle high cash rents?

Farm Journal Survey

- How will your 2015 cash rent rates compare to 2014 rates?
  - 60% expect the same
  - 17% expect lower
  - 1,200 respondents

Two Sided Story

- Landlord
  - Increasing Real Estate Taxes
  - Increasing Land Values (Return on Investment)
  - "Coffee Shop"
- Tenant
  - Rapidly dropping commodity prices
  - Input costs holding steady

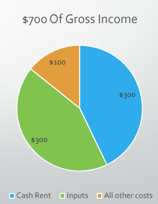
Landlord

- RE Taxes – One cost expected higher in 2015
  - May be as much as $20-$25 per acre
- Opportunity Cost
  - Average land cost more than doubled
    - Pivot Irrigated Ground – UNL Real Estate Survey
- "Coffee Shop"
  - Rare instances of excessive high rents become "norm".
  - "Average Rents" not that high

	2009	2013
Cash Rent	$172	$275
RE Taxes	$31	$46
Ave Land Price	$3,304	$7,590

Tenant

- Gross Income = $3.50/bu x 200 bu = $700 / ac
  - $300 – Cash Rent
  - $300 – Seed, Fertilizer, Chemicals & Crop Ins.
  - $100 left for:
    - Equipment ($175)
    - Irrigation ($60)
    - Other Overhead ($80)
    - Family Living & Taxes ($125)



Compromise

- For rental agreements that went up rapidly:
  - Need to expect correction quickly
- For those raised in the last two years:
  - Tenants took advantage of good prices for 2-3 years before "sharing"

Risk / Reward Relationship

- Cash Rent for tenant is High Risk/High Reward
  - For landlord it's low risk/low reward.
- If the landlord wants to share in the good times, they need to accept a share of the bad times.

Communication

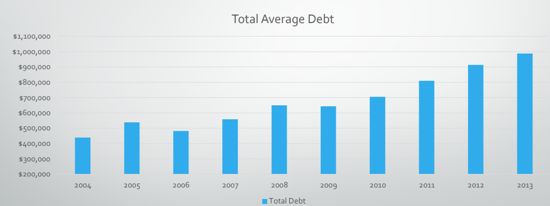
- The ultimate arrangement should be one that makes both parties money.
- The tenants needs to be open and transparent with landlords with their costs/income.
  - Can't just be in bad times, must also be transparent in good times.
- Consider alternate rental arrangements
  - Bushel Rent, Share Rent, Flexible Cash Rents

Machinery Costs

Machinery Cost Increase

- Average Machinery Cost increase $37 per acre (2009 to 2013)
  - 20% of total cost increase
- Income tax law encouraged overspending and rapidly increasing demand/prices
- Hard Cost to bring down quickly
  - Depreciation 7-10 year cost
  - Principle payments to be made for several years

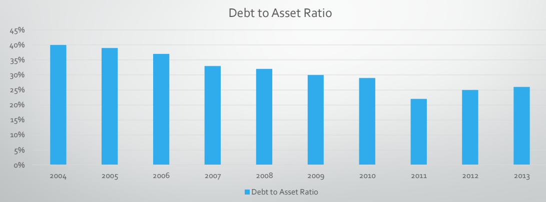
Average Debt



Debt Climbs

- Ten years of highest profitability on record
- Debt More than doubles
  - $438,895 in 2004
  - $987,640 in 2013
- Beware of rising interest rates

Debt-to-Asset Ratio

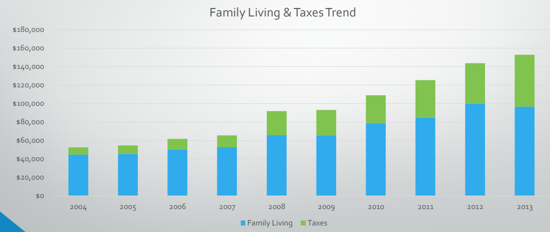


Debt-to-Asset Ratio

- Decrease from 41% in 2004 to 26% in 2013
  - Good? What's happened?
  - Land values dramatically increased
    - Made one time adjustment in 2011 (Dropped the average from 29% to 22%)
  - Current Asset Value dramatically dropped
    - $7.00 corn to $3.50 corn?
    - Average Crop Value on:
      - 12/31/04 = $157,462
      - 12/31/09 = $423,656
      - 12/31/13 = $571,023

Family Living Costs

Family Living & Taxes



Family Living & Taxes

- Prior to 2004, costs stayed under $40,000 per year
- Increases in income leads to increases in family living
- Categories with highest increases:
  - Food, Household Supplies, Personal Care, Recreation
  - NOT – Medical Care/Health Insurance
- Average farm in 2013 took out over $200,000 from farm for personal use

Non Farm Capital Purchases

- Non-Farm Capital Purchases = $43,472
  - Annual Expense
  - Up from $7,243 in 2004
- Vehicles, Houses, Vacation Homes, RV's, Boats, Etc.
- Non-Farm Savings = $11,357
  - Could be money that was put aside and could be brought back into the farm

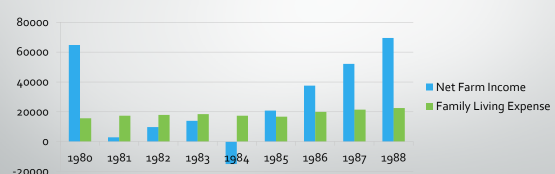
Reducing Non-Farm Costs

- Non-Farm Costs could put a farm out of business by creating net worth losses
  - Living on more than you make
- Compare your costs to averages for red flag areas
  - May be something you can control, may not be
- Each family has to make decisions on what they are willing to cut
  - Cell phones, eating out, vacations, new vehicles, DVR & Cable, etc

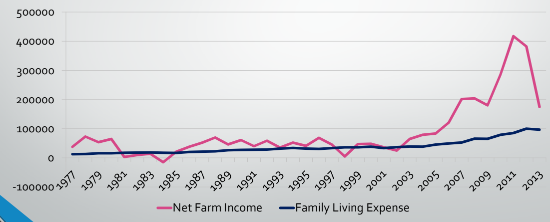
Reducing Non-Farm Costs

- Takes Discipline by all family members
  - Watch all year! Year-end is too late
  - Hard with an operating note versus a monthly paycheck
    - Consider setting a monthly budget transferred to a separate account
- May take increased non-farm income

Family Living vs Net Farm Income 1980-1988



Net Farm Income vs Family Living 1977-2013



Living like the Jones'… & the Smiths' & the Johnson's

- Trouble phrases…
  - "The Jones' went on a three week cruise this summer."
  - "The Smith's built a new house."
  - "The Johnson's have a new Escalade."
  - "The Anderson's bought a lake house."
- Why can't we??

Living like the Jones'… & the Smiths' & the Johnson's

- We don't know if:
  - The Johnson's haven't taken a vacation in 10 years as they would they prefer to travel to town in comfort every day instead.
  - The Smith's received an inheritance from a long-lost uncle with the money to build that new house.
  - The Anderson's purchase was financed and may be the final straw that will keep them from making their loan payments and they will be forced to have a farm sale next year
- My first lesson: Financial things are rarely as they appear from the outside.

High Profitability Lessons for Livestock Producers

What Can We Learn from Crop Producer's Profitability Trend?

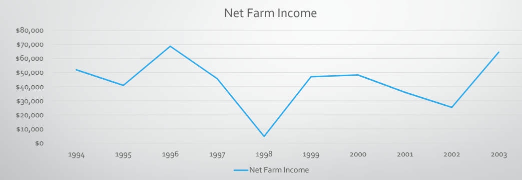
Lessons to learn…

1. Be careful of buying your way out of taxes
2. Use the extra profits to reduce debt and get into a better financial position
3. Don't fall into the trap of reaching a "new plateau"
4. Enjoy the profitability but don't take your family living to new heights you can't stand to come back from

Buying Yourself Out of Taxes

- Congress may help by not increasing Section 179 but…
- Buying equipment, cattle, pickups, etc that you don't NEED never makes financial sense.
  - Spending $100,000 to reduce $30,000 in taxes doesn't add up
  - If you're going to use enhanced depreciation, buy equipment with cash
    - Don't use your deduction today and have to generate cash in the future to make principle payments
- Watch the "Snowball" with prepaids and income deferral

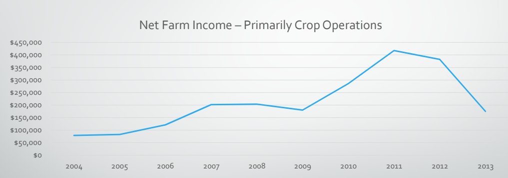
Net Farm Income Trend



Traditional Planning

	1st Year	2nd Year	3rd Year	4th Year	5th Year
Accrual Income	$75,000	$25,000	$50,000	$65,000	$35,000
Prior Year Prepaids	$0	+$25,000	$0	$0	$15,000
Cash Income		$50,000	$50,000	$65,000	$50,000
Prepays	-$25,000	$0	$0	$15,000	$0
Taxable Income	$50,000	$50,000	$50,000	$50,000	$50,000

Net Farm Income Trend



Snowball Effect

	1st Year	2nd Year	3rd Year	4th Year	5th Year
Accrual Income	$150,000	$150,000	$150,000	$150,000	$150,000
Prior Year Prepaids	$0	+$75,000	+$150,000	$225,000	$300,000
Cash Income		$225,000	$300,000	$375,000	$450,000
Prepays	-$75,000	- $150,000	$225,000	$300,000	$375,000
Taxable Income	$75,000	$75,000	$75,000	$75,000	$75,000

Improve Your Financial Position

- Use extra profits to reduce debt and increase working capital
  - Cash grain operations who did this, are sitting in a prime financial position to take advantage of land sales & rental opportunities
  - Those whose debt increased dramatically are going to be at their lending limits when opportunities come up.
- Reducing debt means paying taxes
  - Principle is not deductible so you must generate taxable income to reduce debt.
  - Paying taxes is GOOD thing!

New Plateau Trap

- Corn will never be less than $5.00
- Calves will never be below $2.00

- You never know what will happen and you need to be prepared
  - "Shock test" your cash flows for an outbreak of BSE or some other major storm

Control Family Living

- Think before you spend
- It's easier to enjoy a nice Chevy rather than giving up an Cadillac
- Take a vacation rather than buying a vacation home
- You don't have to build your "forever" home at 25 years old
  - Makes plans for expansion/renovation in the future
- Lower family living means you have more cash to improve your financial position

Beginning Farmer Analysis Program

Calling All Beginning Farmers

- Looking for up to 55 beginning farmers to participate in our analysis program
  - First Year Free
  - Discounted pricing for another four years

Calling All Beginning Farmers

Beginning Farmers Get:

- One-On-One Consulting
- Bookkeeping Advise
- Year-End Analysis
- Cash Flow Preparation
- Good Financial Habits from the Start

Additional Services Available

- Record-keeping
- Tax Planning
- Tax Preparation
- Transition Planning

Questions

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