

Farmer Cooperatives Conference

Meeting Competitive Challenges

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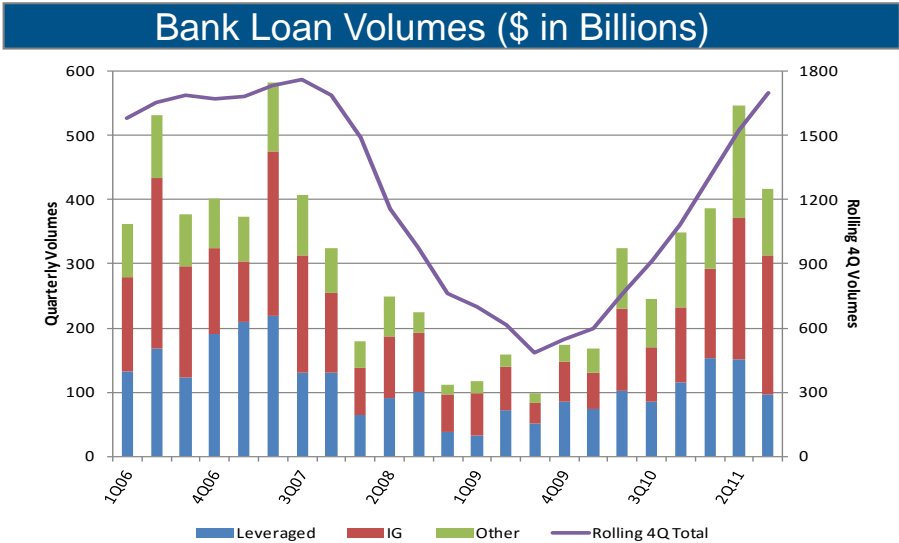




- The banking environment.
- Volatility? What volatility?
- What has volatility done to borrowers?
- What has this lender done to respond?
- What are things coops can do to help themselves?



- Even in light of continued volatility in the market (PIIGS, US Debt, etc.), loan volumes continue to rebound from 2008 lows.
 - 3Q11 volumes lower than previous quarter, but still exceeded the average.
 - Rolling four quarter volume has exceeded \$1.5 trillion.
- Both investment grade and leveraged loans experienced growing volumes.



Investment Grade / High Yield Distinction

| | S&P / Fitch | Moody's |
|-----------------------------------|----------------|----------------|
| Investment Grade or High Grade | AAA | Aaa |
| | AA+ | Aa1 |
| | AA | Aa2 |
| | AA- | Aa3 |
| | A+ | A1 |
| | A | A2 |
| | A- | A3 |
| | BBB+ | Baa1 |
| | BBB | Baa2 |
| | BBB- | Baa3 |
| Leveraged or High Yield | BB+ | Ba1 |
| | BB | Ba2 |
| | BB- | Ba3 |
| | B+ | B1 |
| | B | B2 |
| | B- | B3 |
| | CCC+ and Below | Caa1 and Below |



- The general economy has been lackluster. Will corporate profits grow fast enough to keep default rates declining?
 - The commodity market rally is causing global inflation concerns.
 - Bank liquidity remains strong.

- We believe the major volatility risks remain similar to those in 2010-2011.
 - Political / event risk.
 - European debt crisis.
 - Domestic legislative uncertainty (e.g. cap & trade, healthcare, taxes, deficits).
 - Monetary policy.
 - Increased bank capital requirements (Basel rules).
 - Continued uncertainty regarding real estate problems (e.g. foreclosure litigation of late).
 - Down grade in the U.S. Government debt rating by S & P.



➤ Farm Credit System

- The loan portfolios of FCS institutions are characterized by good and improving credit quality.
- Well capitalized, these lenders retain ample lending capacity for commodity-based financing opportunities.
- Associations and banks have annual asset growth objectives of mid- to upper single digits.
- FCS institutions have strong interest in adding loans, particularly funded assets.

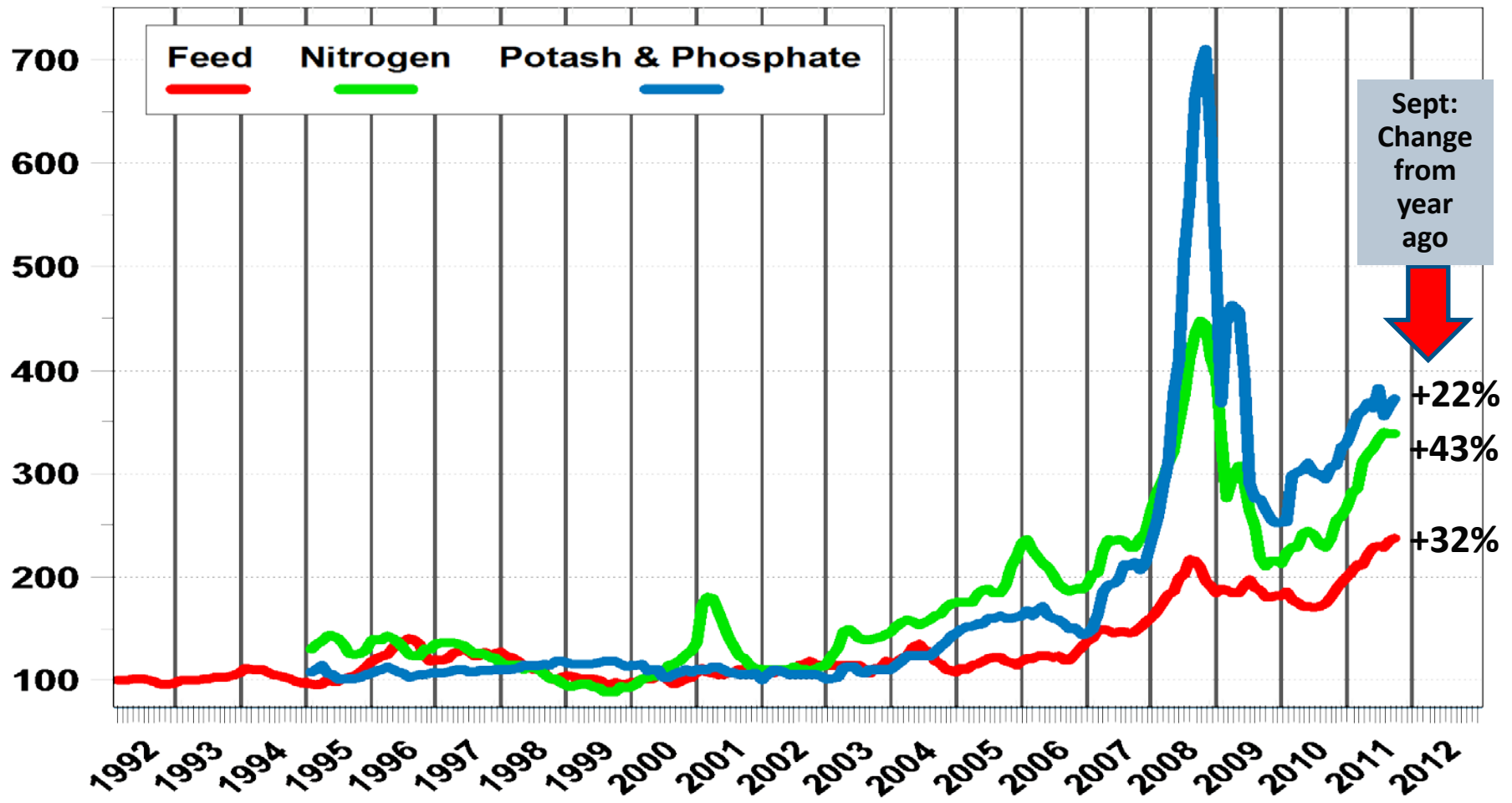
➤ Domestic Commercial Lenders

- Executing plans for desired business lines and relationships.
- Portfolio growth objectives and improving capitalizations are fueling the next wave of aggressively priced and structured loan assets.

Key Crop Input Prices Set Globally and Likely to Remain Volatile



Index (1990-92=100)



Volatility Remains Constant Feature in Commodity Markets



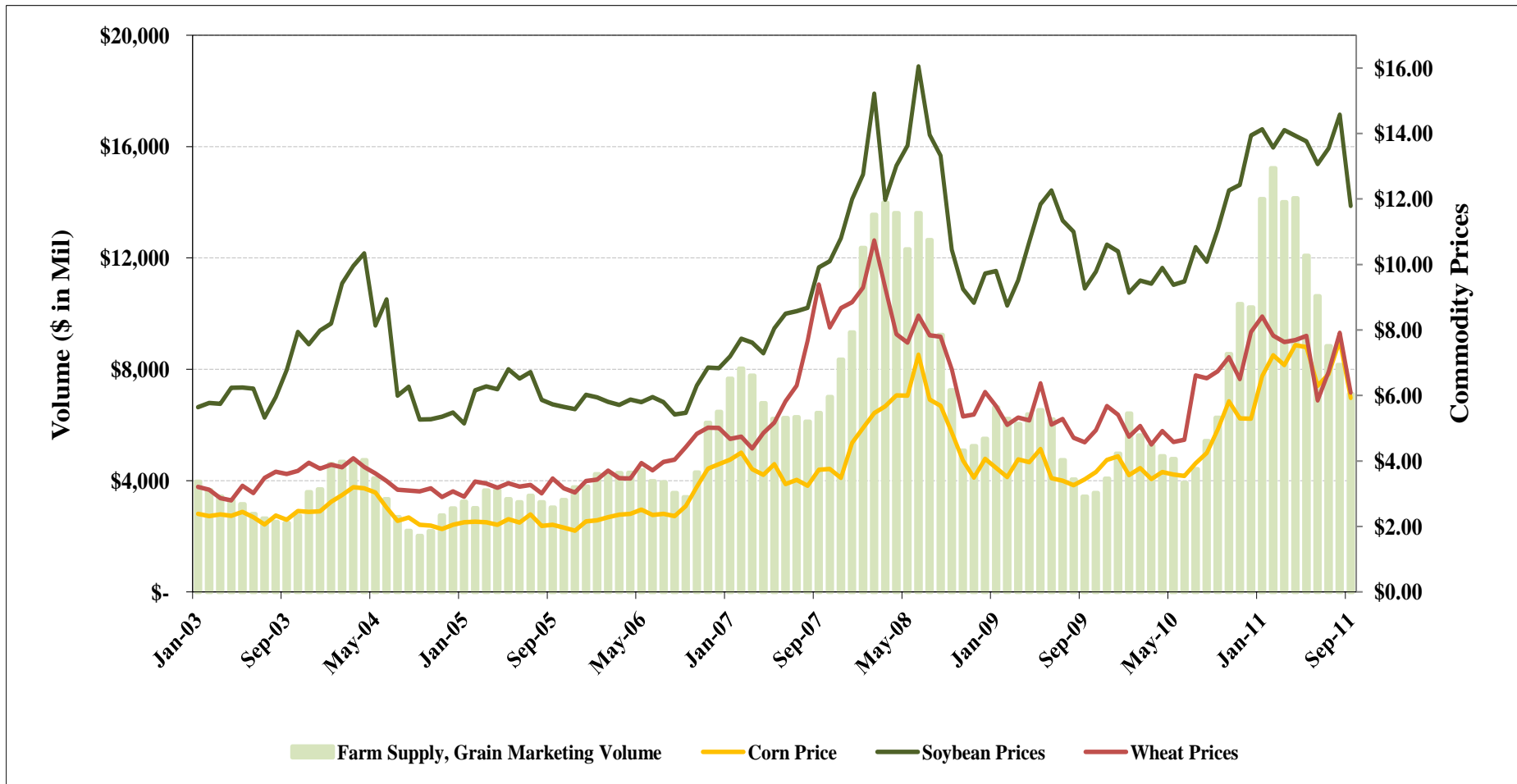
| Year | <u>Corn</u> --- \$/ bushel (Chicago) --- | | | <u>Soybeans</u> --- \$/ bushel (Chicago) --- | | | <u>Wheat</u> --- \$/ bushel (Chicago) --- | | |
|---------------------|---|------|-------|---|-------|-------|--|-------|-------|
| | Low | High | Range | Low | High | Range | Low | High | Range |
| 2006 | 2.04 | 3.92 | 1.88 | 5.36 | 6.96 | 1.60 | 3.22 | 5.57 | 2.35 |
| 2007 | 3.09 | 4.57 | 1.48 | 6.57 | 12.30 | 5.73 | 4.12 | 10.10 | 5.98 |
| 2008 | 3.06 | 7.65 | 4.60 | 7.76 | 16.54 | 8.78 | 4.71 | 13.35 | 8.64 |
| 2009 | 3.02 | 4.50 | 1.48 | 8.38 | 12.91 | 4.53 | 4.39 | 6.77 | 2.38 |
| 2010 | 3.25 | 6.30 | 3.05 | 9.00 | 13.95 | 4.95 | 4.26 | 8.41 | 4.16 |
| 2011 | 5.88 | 7.87 | 1.99 | 11.58 | 14.51 | 2.93 | 5.85 | 8.86 | 3.01 |
| 2008-11 avg. range= | | | 2.78 | | | | | | |
| | | | | 5.30 | | | 4.55 | | |



How did CoBank respond to volatility in grain oilseed prices in 2008 & 2010 & fertilizer volatility in 2009?

- CoBank loan volume increased.
 - \$5.8 B in first two months of 2008 and \$5.9 B first two months of 2011.
- Not a one size fits all strategy.
- Significant difference between well capitalized, profitable companies, & highly leveraged break even companies.

ABG Loan Volume and Commodity Prices (as of September 30, 2011)





1. **Expertise** and long term commitment to your industry.
 - Do they understand margin requirements on financial contracts and will they (can they?) fund?
2. **Responsiveness** – Can they consistently make decisions on your time line?
 - Are they distracted with other priorities such as troubled loans?
3. **Capacity** – Do they have balance sheet or access to participants to meet future financing needs?
4. **Competitive Rates and Terms**



➤ Rates remain near historic lows. Over the past 20 years:

- Three Month LIBOR has exceeded its current level 90% of the time.
- The Five Year Treasury Yield has exceeded its current level 99% of the time.
- The 10 Year Treasury Yield has exceeded its current level 99% of the time.

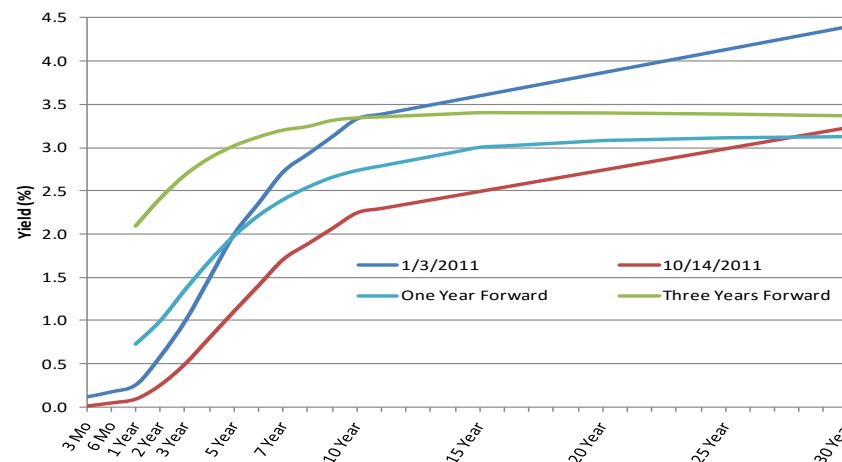
➤ The steepness of the yield curve points to higher future rates.

- The 10 Year Treasury Yield is ~110 bps below levels from the start of the year (~2.24%).
- The One Year Forward Curve projects a 10 year yield near 2.74%.
- The Three Year Forward Curve projects a 10 year yield near 3.34%.

Historic Interest Rates



Yield Curve: Historical, Current and Forward





- **Need to address open position limits on Energy and Crop Nutrients**
- **Energy and Crop Nutrient policy formulation is in its infancy when compared to Grain Risk Management**
- **Should establish required pre-payment level (30%, 50%, 100%) – enough to keep producer from walking away**
- **Establish means to track risk exposure on a frequent basis**
- **Should include limits on open positions or allowed price risk – VaR (Value at Risk) limit which is computation used to determine value at risk**
- **Should include the types and amounts of derivative instruments that are allowed (short swaps, long swaps)**



- **Strengthen dialog among CEO, CFO, and grain department**
 - Know what's coming in, going out, basis objectives
 - Consider impact of additional storage capacities since 2008
- **Who is responsible for grain quality?**
 - How often is grain quality checked?
 - Review warehouse examination with manager
- **Internal controls – fraud, theft, shrink**
 - Consider having your controls reviewed by a third party
 - Pay attention to management letter from your auditor
- **Consider fixing a portion of your long term debt**
 - Can your company survive a significant run up in interest rates?

May You Prosper and Live a Long Life!



- These are the best of times. Make a margin on what you sell.
- Projects are big and cost a lot of money. Make some and save some.
- How do you prepare for the future (capital needs, leadership, labor, market synergies)?
- If volatility and capacity are issues, what gives you the most comfort to know your needs are met?
- What risks are new (or bigger than they used to be) for your business?