INSIGHTS REPORT

VOLUME 14 WHAT'S INSIDE

Five considerations for effective financial planning in 2018.

Revisit your risk management strategies to prepare for success in the beef industry.

How changes to the farm bill could impact crop insurance.

Every farm, business and community is unique. How can you adapt to changing local risks and opportunities while also keeping an eye on global trends and the nation's economy? With nearly 90 offices and more than 1,100 employees, Farm Credit Mid-America is constantly working to help farmers in Indiana, Ohio, Kentucky and Tennessee leverage the economics of change in their favor. This report shares some of our insights to help you manage your operation and stand strong in today's competitive, ever-changing marketplace.

Brent Ditmars
Regional Vice President–Indiana

FROM TAX REFORM TO RISING INTEREST RATES, 2018 HAS A NUMBER OF FINANCIAL FACTORS TO CONSIDER. HERE'S WHAT THEY MEAN FOR YOUR OPERATION.

A FARMER'S GUIDE TO 2018 FINANCIAL PLANNING

Financial planning is more than just updating your farm's balance sheet; it requires an understanding of what is influencing the economy and how that will impact the year ahead. With rising interest rates, tax reform and tight margins, 2018 has quite a few considerations. But what do these mean for farmers and their operations?

1: The ag economy is projected to remain flat

Most projections show that the ag economy will stabilize. While small pockets of sporadic growth may be seen on a regional basis, overall, commodity markets were sitting on a large inventory leading into last year and strong yields in 2017 mean even more inventory in an already crowded market. Therefore, it's unlikely prices will increase significantly in the short term. In addition to a large supply of both corn and soybeans, the overall United States economy continues to strengthen, which has resulted in a rising interest rate environment.

What this means for farmers: Operations should continue to find ways to become more efficient and look for opportunities to add income if possible. It's also important that producers market their product effectively by having a sound risk management plan and sticking to it.

2: Margins will remain tight

Due to commodity markets remaining largely unchanged, most operations will continue to cope with leaner margins and tighter liquidity.

What this means for farmers: There are a number of ways to develop an operational strategy that will provide some padding for shrinking margins.

- Take time to examine your break evens on a per unit basis. As prices stay relatively flat or possibly decline, knowing your break evens will ensure that you can market your product with confidence.
- Examine your operation's asset utilization. Capital assets that are not being maximized hurt efficiency as those dollars could be utilized elsewhere, such as reducing debt or investing in an asset with a higher return.
- Work with your lender to ensure your operation's debt is structured appropriately for today's margins. A balance sheet structure that worked when margins were wider may not work today.
- A down ag economy is a crucial time to closely analyze production costs. Producers should pay close attention to both their variable and fixed cost structures to determine where their strengths and weaknesses lie. Every operation is different, but we generally recommend that variable costs (fertilizer, chemicals, seed, etc.) make up 45 to 55 percent of your gross income while fixed costs (land payments, equipment payments, cash rent, etc.) make up 30 to 40 percent.

3: Interest rates are projected to rise

The U.S. economy continues its recovery after bottoming out in 2009. Economists expect this trend will continue, which is why short-term interest rates are projected to rise three times, or by .75 percent in 2018. Long-term rates are rising as well, but haven't risen as quickly and remain relatively low.

What this means for farmers: If your operation has real estate loans on variable or adjustable products, now is the time to convert or refinance those into long-term fixed rates. With a relatively flat yield curve, producers have an opportunity to pay a minimal premium to lock in long-term rates. We encourage producers to work with their lender to determine the best loan product mix for their operation and take advantage of this window of opportunity.

4: Tax reform changed rules for depreciation

Farmers will begin to see benefits from the tax reform bill passed in 2017 as early as this year. While the bill has some estate tax implications for families going through a farm transition, the majority of farmers will be impacted by lower tax rates and the updated rules for depreciation. Beginning in 2018, farmers are now able to write-off 100 percent of equipment purchases in the first year. Purchases made after September 27, 2017, are eligible for the 100 percent bonus depreciation as well.

What this means for farmers: The updated rules for depreciation mean farmers have greater flexibility from a tax management standpoint. However, producers making major equipment purchases in 2018 should work with both their lender and tax consultant to make the best decisions possible for their operations. Overall, it's key that tax management strategies align with the long-term goals and profitability of an operation.

5: Opportunities still exist

Tight balance sheets and a down ag economy don't always mean doing things the same way. Downturns are an important time to look at opportunities to improve your farm's efficiency and/or diversify your income. It also provides growth opportunities for those who are well positioned to take advantage of them.

What this means for farmers: Adding income and diversity during tight times can help mitigate the impact of a down economy. Some families may wish to explore off-farm income options to help offset tight margins. Others may look at diversifying their production mix, such as raising crops for which they can get a premium or looking at becoming a contract grower for a livestock integrator. Whatever your individual situation is, we encourage producers to be progressive and look for ways to ensure the longevity of their operation.

Though the financial landscape for 2018 is complex and current margins are tight, producers should feel optimistic about the long-term prospects for the agricultural economy. By carefully analyzing and understanding your financial picture, you will have a much better chance to not only weather a down cycle, but thrive over the long haul. As mentioned above, every operation is unique and we encourage folks to work with their lender and financial advisors regarding their individual situation.

Brent is a regional vice president serving central Indiana. To discuss anything you've read above, please contact him at brent.ditmars@e-farmcredit.com.

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SMART PLANNING CAN INCREASE PROFITABILITY WHEN MARKETS ARE UNCERTAIN.

BEEF INDUSTRY UPDATE: POSITION YOURSELF FOR SUCCESS IN 2018

After the second-most profitable year ever in 2017, cattle producers are wondering how long the good times will last. But with a growing global middle class that has a taste for red meat, it appears the long-term outlook is positive. According to the International Monetary Fund (IMF), by 2030 nearly 5 billion people will be in that category, up from 2 billion in 2014. In fact, CattleFax forecasts that beef production will climb to the highest levels in history from 2018 to 2020. While this news should create optimism among producers, experts warn that volatility and uncertainty could disrupt the industry.

Anticipate challenges

Every production year is fraught with challenges, and 2018 will be no exception. A variable market is expected to produce price swings that could range from 20 to 30 percent, making economic certainty hard to come by. Broader factors, including trade policy, currency fluctuation, rising interest rates, unpredictable cattle prices and rising feed prices, could also affect cattle producers' profitability. And that doesn't include other potential issues, such as extreme weather and cattle health.

Government policies, specifically those covering trade, will likely affect the way cattle producers operate. Some ag economists estimate that approximately 20 percent of net farm income is attributed to exports, which means that as U.S. cattle herds continue to grow, it will be critically important to keep export channels open and thriving. The North American Free Trade Agreement (NAFTA), the United States–Korea Free Trade Agreement (KORUS) and other bilateral trade agreements will all have a direct impact on producers' bottom lines, while restrictive trade with China and a competitive disadvantage in Japan due to tariff rates will lead to even greater export challenges for U.S. producers.

Canada and Mexico are among the top destinations of U.S. ag exports; a breakdown in NAFTA negotiations would most certainly negatively affect U.S. cattle producers. In the past, the U.S. was a net exporter of beef into NAFTA countries, but that has changed. According to CattleFax, it's estimated that the U.S. ran a negative beef trade balance with Canada and Mexico of nearly $1.8 billion in 2017. The bottom line is that the long-term growth and profitability in protein production for the U.S. is dependent on an increase in exports.

Measure to manage

What's left is a cautiously optimistic future for the beef industry. The good news is that recent profitability and growing demand puts producers in a favorable position to safeguard their businesses against potentially tumultuous times ahead. Smart planning and decision-making will set the foundation for future success. But you can't manage what you haven't measured, and it's impossible to develop a strategy if you don't know what you're starting from or where you'd like to go. With that in mind, here are a few recommendations to manage risk and help ensure more profitable outcomes:

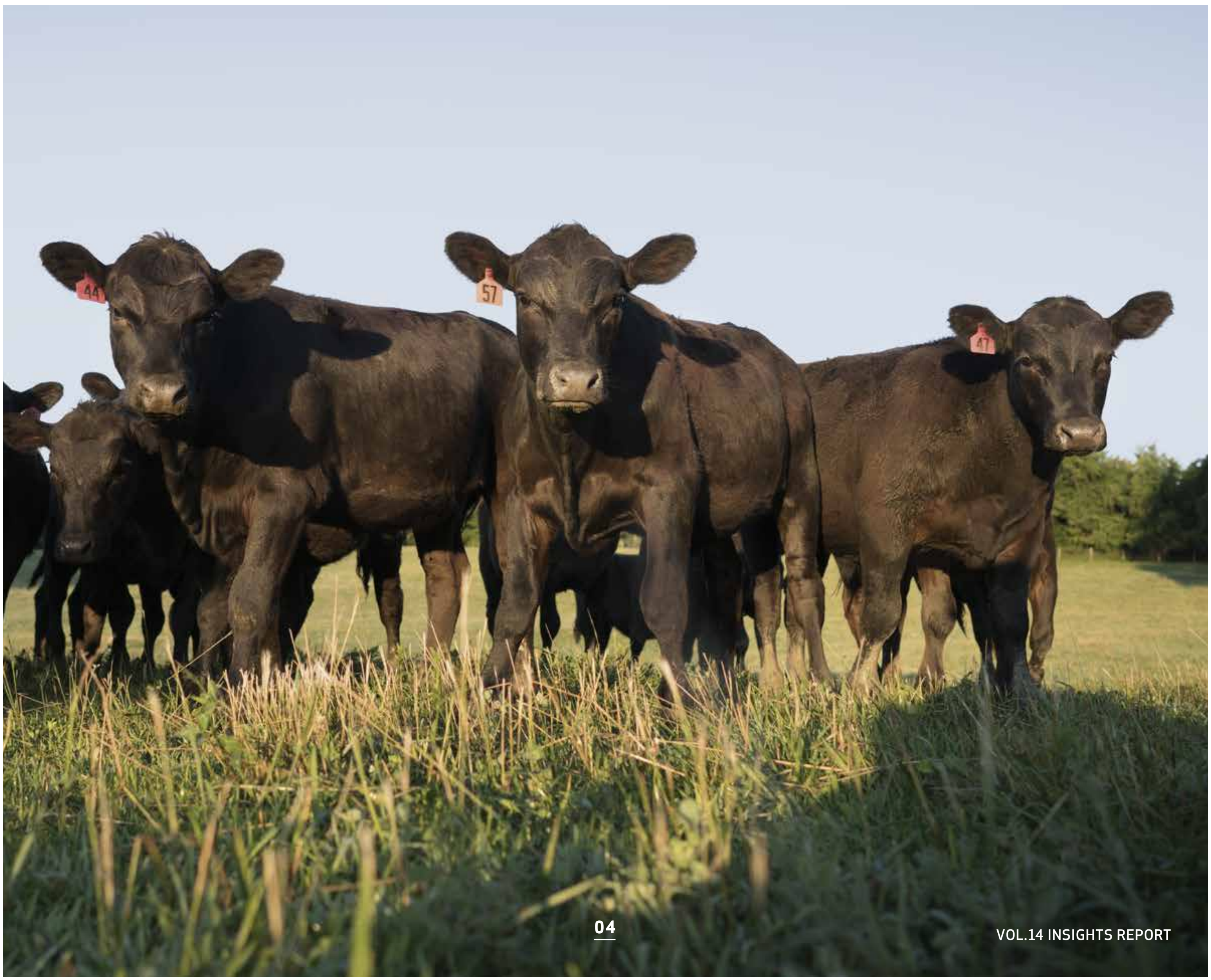
- Know your production costs and break-evens. Understanding your cost of doing business is essential, so consider both fixed and variable costs and keep accurate records. The key is using this data to reach a determination on capital expenditures and marketing decisions. You can also make your money work harder by locking in land rent for pasture, saving on feed costs by utilizing by-products and other cost-efficient alternatives or forward contracting feed while prices are low.
- Understand how much risk you can afford (and are willing) to take. Every producer has different circumstances. Take the time to think through the short- and long-term goals of your operation. The level of risk you can afford to take today may be different from what it was even two or three years ago. Work with your trusted advisors to understand the implications of your risk-management strategy and how it could affect your business in both the long- and short-term.
- Play the "what if" game. Review your financial position to learn how potential market changes would affect your liquidity and profitability. Variables that are largely out of your control could have significant impacts on your bottom line. Simulate how market changes could affect the way you do business. It's important to be proactive in monitoring your financial position early and often as the market changes to manage risk.

– Stay the course with risk management. Stick with your plan, even during tough times. A downturning market can cause people to make emotional, reactive decisions that aren't good for their businesses long-term. Discipline is critical; focus on margin management rather than swinging for the fences.

– Manage your balance sheet. A healthy balance sheet is a key component to a successful risk management plan. Maintaining a sound working capital and owners' equity position not only aids in withstanding adversity but also positions the operation to take advantage of opportunities in the future. Be deliberate about where you spend money and consider the returns to the operation when making capital expenditure decisions.

The current year has the potential to be profitable for cattle producers, in spite of challenges that could disrupt the market. It's a good time to re-evaluate risk management strategies with trusted advisors to ensure you're ready to ride the wave of uncertainty.

Our group of specialized beef industry experts help large-scale producers stay competitive and manage, improve or enlarge their operations. Email Josh at josh.davis@e-farmcredit.com for more information.



Jason Alexander
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CROP INSURANCE PROGRAMS ARE UP FOR DEBATE AS CONGRESS CONSIDERS FARM BILL REAUTHORIZATION.

WHAT DOES A NEW FARM BILL MEAN FOR CROP INSURANCE?

In the United States, consumers spend just 6 percent of total expenditures on food consumed at home, the lowest rate in the world. In fact, only seven other countries in the world spend less than 10 percent, illustrating the importance of a strong, reliable domestic food supply. Today's farm safety net provides modest help to U.S. farmers in weathering distorted global markets and natural disasters, but the importance of maintaining a strong crop insurance program in the upcoming farm bill is more important than ever.

Every four to five years, farmers and ranchers across the country turn their attention to Congress, as they wait to see whether legislators will reauthorize U.S. farm policy through the farm bill. With the current farm bill set to expire at the end of September, 2018 is one of those years. One part of the bill that will be up for discussion is crop insurance policy. Some in Washington are proposing changes to crop insurance, which could impact farmers based on the way crop insurance pricing works.

Sharing the risk

Before crop insurance's rise to prominence, American taxpayers would often be on the hook when a disaster struck farm country through the enactment of ad hoc disaster relief legislation. That approach was costly and inefficient to both taxpayers and farmers alike. Today, a public-private partnership exists through the federal crop insurance program, where private insurance companies deliver affordable risk mitigation tools to farmers across the country for more than 100 eligible crops. Crop insurance has become a cornerstone of comprehensive risk management planning. Most importantly, federal crop insurance is a win-win for taxpayers and farmers because it is actuarially sound. That means that more participants and acres in the program helps spread risk, keeping premiums and costs down for all participants.

The same justification when Congress enacted the federal crop insurance program is still true today, but vocal critics are trying to make changes to the program that would negatively impact farmers and taxpayers. One proposed change would cap crop insurance premium support at $40,000 for growers. Another would limit crop insurance policies to those growers with an adjusted gross income (AGI) of $500,000 or less. Critics will say that these proposals make fiscal sense, but experts and farmers know the proposals run counter to the economics behind delivering affordable insurance products. A potential result of enacting one or both of these proposals would be a smaller risk pool where premiums are determined. A smaller risk pool introduces greater volatility in premium pricing, which could have negative impacts on operations under the AGI limit or premium support levels that depend on crop insurance to mitigate risk against weather and disease events that inevitably occur in America's farmland each growing season.

Strong policies support farmers

Putting a crop in the ground is a risky business, and having a sound risk-mitigation plan is a key element of good operational management for farmers. The USDA projects that 2018 farm profits will decline and that farm income, adjusted for inflation, will be flat for the next few years.

For young farmers, their success depends on affordable, reliable crop insurance and access to credit. Today, the average age of a farmer is 58, and 78 percent of principal farm operators have been on their farms for more than 10 years. As these farms are passed on to a younger generation, who'll likely face more risk with tighter margins and lower cash reserves to cushion them through tough years, affordable crop insurance will make it possible for them to maintain financial stability during difficult times.

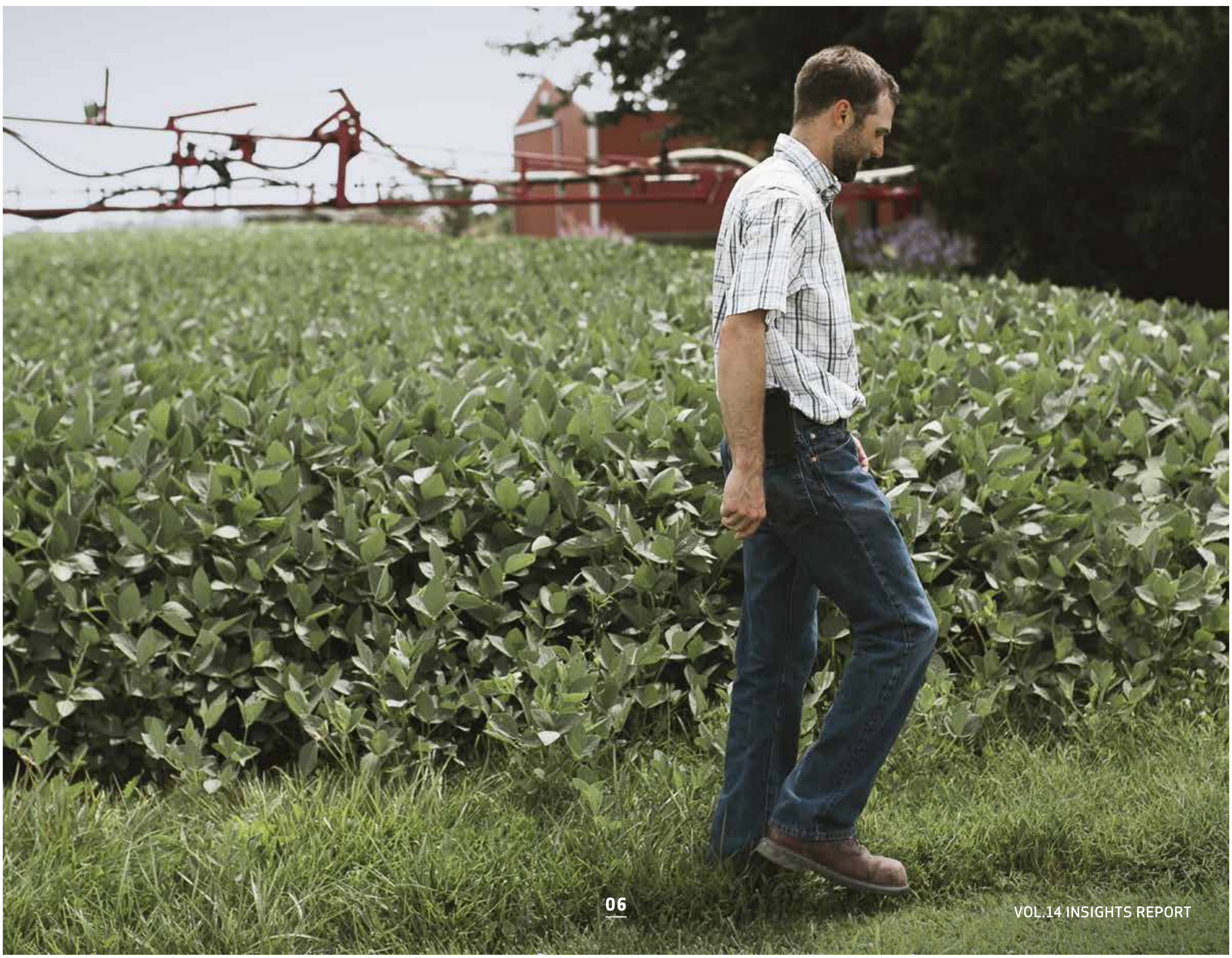
Crop insurance now and in the future

Crop insurance is a fundamental component of a complete risk management plan, and it works together with other mitigation strategies to create a valuable safety net. When more acres are covered under crop insurance programs, the price of coverage is more affordable for all, and changing policies to eliminate or discourage eligibility in crop insurance programs may have a negative consequence for all farmers, not just those with large operations.

Farm Credit Mid-America places a priority on maintaining a robust private-sector-delivered crop insurance program. In the current farm economy, it's important that farmers continue to have access to affordable crop insurance coverage that's delivered in a timely and personalized manner. Farm Credit remains dedicated to our purpose of securing the future of rural communities and agriculture.

Our licensed crop insurance specialists will meet with you to discuss coverage levels or a plan specifically tailored to your needs. Email Jason at jason.alexander@e-farmcredit.com for more information.

“Crop insurance is a fundamental component of a complete risk management plan.”



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