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Price and Income Risk Management

Perspective of an Ag Banker

Dairy Policy Workshop

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Sam Miller
SVP Agribusiness/Food Banking
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M&I Agribusiness and Food Continuum

Suppliers
seed, fertilizers, chemicals, feed

Producers
dairy, grain, vegetables, other livestock

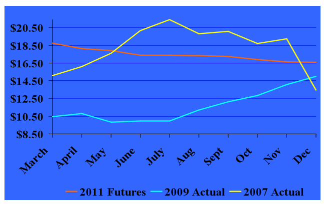
Buyers
grain elevators, milk processors, fruit/ vegetable processors

Distribution
storage, transportation

End Users
grocery, quick service, casual, fine dining

Ag Marketplace

Volatility → Opportunity



Risk Management
Education
Monitoring Systems
Planning

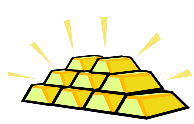
Stability

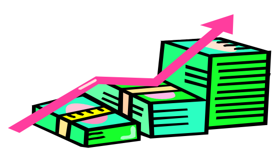
Risk Management

- Price
- Counter Party
- Succession
- Crops/Feed/Weather
- Environmental
- Interest Rates
- Inputs
- Management
- Labor
- Financial

Net Income Risk

Income Statement		Price Variable
Revenue	➪	Price variable
Less expenses	➪	Feed
		Fertilizer
		Fuel
Net Income		





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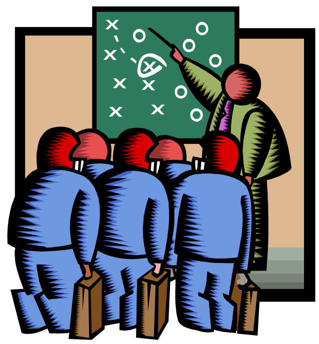
Marketing Strategies

- Put option
- Hedge
- Forward contract
  - Call options
  - Hedge
- LGM – Dairy (?)
- Do nothing



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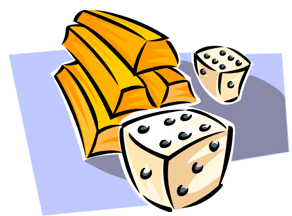
Why Manage Margin Risk?

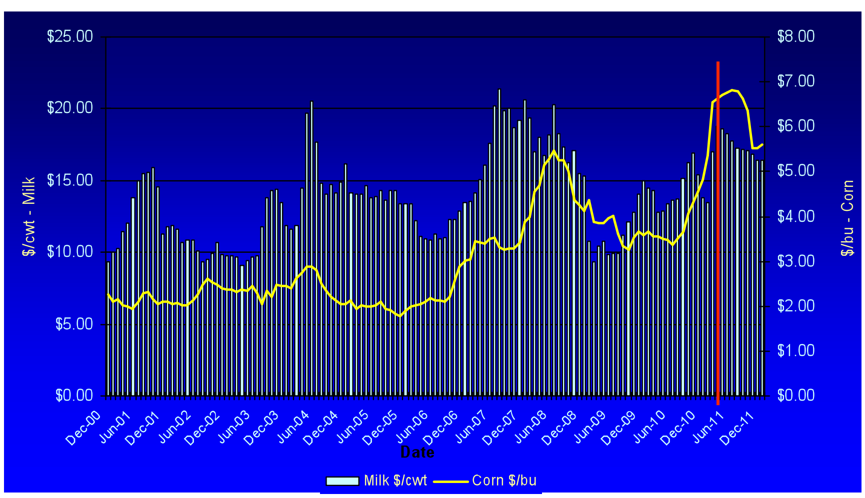
- Reduce net income variation
- Obtain financing
- Peace of mind / Sleep
- Added profits to borrower
- Reduce risk to bank

Ground Rules

- Understand the plan (start simple)
- Adequate credit availability to feed the hedge
- Meet margin call timetables
- Settle up to plan monthly
- Only trade in commodities sold/used
- Trade within quantities produced/used
- No other trading accounts with broker
- Milk is produced daily how often is it marketed?
- Speculation is Bad!



Price Trends



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Fictional Dairy

	2007	2008	2009	2010	2011
Leverage	1.0	.95	1.4	1.25	1.2
Current Ratio	1.5	1.7	1.1	1.3	1.4
Net Income/Cow	$1,200	$750	($720)	$300	$300
Debt/Cow	$4,800	$5,100	$5,820	$5,500	$5,250
Price Variation/cwt	$7.82	$4.97	$4.89	$4.16	$5.92
Loss Cost/cwt	----	----	----	$.58-.74	

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Debt – WI Farms

Debt on Wisconsin Dairy Farms in 2010

	Herd Size					
	<50	*50-99*	*100-199*	*200+*	*Organic*	*Full Sample*
Debt Compared to 2 Years Ago*						
Much higher	17%	22%	28%	45%	4%	26%
Somewhat higher	30	29	37	34	26	32
About the same	37	33	23	14	35	29
Somewhat lower	13	12	11	7	26	11
Much lower	4	4	0	1	9	3
Ratio of Farm Debts to Value**						
Debt <10% assets						
Jan. 2008	52%	39%	34%	16%	-	37
Jan. 2010	38	28	15	6	-	24
Debt 10-40% assets						
Jan. 2008	40	53	51	62	-	51
Jan. 2010	40	47	48	41	-	44
Debt >40% assets						
Jan. 2008	8	8	15	22	-	12
Jan. 2010	22	25	37	53	-	32

**Question:* How does the current financial level of debt on your farm compare to the level of debt 2 years ago, before the financial crisis started?
***Question:* On the following dates, what was the approximate ratio of farm debts to value on your farm?

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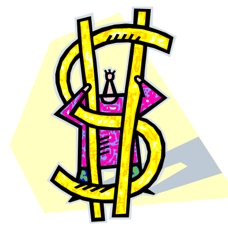
Risk Management Financing Pitfalls

- Inadequate line availability
- Borrower speculation
- Margin call need without borrower consent
- Price higher/input cost lower than hedge
- “You made me do this.”
- Use of line for other needs
- Waiting too long to settle positions
- Trading in other commodities



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Summary

- Price and input cost volatility are here to stay
- Borrowers must have a marketing plan
- Bankers must understand marketing tools
- Banks can provide financial tools to meet the need
- Returns to Borrower – reduce net income volatility
- Returns to Bank – Added value to relationship
  - Stronger loan portfolio