# THE WISE AG UPDATE

MURRAY WISE ASSOCIATES LLC

SECOND QUARTER, 2012 VOL. XXVII, NO. 2

## COMMENTARY by Ken Nofziger

### Don't Bet the Farm

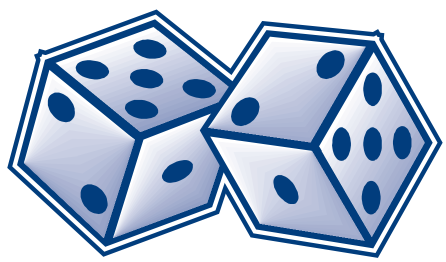
The last time I did this column, I concentrated on the trend in agribusiness to vertical integration of suppliers, producers and processors. This time I'd like to continue on this theme by posing a hypothetical situation to demonstrate why I chose the title above.

Put yourself in this situation:

You're a successful second generation grower with years of experience. You've taken what your parents started, continued to build a comfortable life for your family and accumulated some assets, chiefly farmland. Life is good.

Still, you have some issues with which to deal. You feel that your input suppliers are either too pricey or fall short of delivery and service expectations. You may also believe that the processors to whom you deliver are inefficient and make more profit than deserved from your hard work. You know that others in your business are experiencing similar irritation…and you begin to see opportunity. You mention to a colleague at a regional growers' meeting and eventually determine among yourselves that your base operation could be enhanced if you had control of your supply line and/or the processing operation you currently serve.

The appearance of opportunity outweighs the appearance of risk, and you take the plunge, leveraging your farming assets to enhance your overall operation through the perceived advantages of vertical integration.



I am aware of a number of situations quite like this one that have proven successful, providing the founders with improved operational efficiency, lower costs and a bigger piece of the revenue stream. I know of as many that have failed as an operational project due to start-up delays, cost overruns and poor management decisions, ultimately costing the grower the farm he or she used as collateral! Whether it's dairy, beef, pork or poultry; fruits, vegetables, nuts or grain crops, I've seen that there is no commodity or crop that is fail safe from too much leverage, poor planning and mismanagement.

Unfortunately, that's often where we come in. In worst case scenarios, we are often brought in to liquidate assets to satisfy lenders and creditors. In those troubled situations where the asset value has not been completely depleted, we can help the strapped grower locate and involve strategic or financial partners who can assist in weathering the storm. The role of such a financial partner would be clear enough: inject sufficient capital to "right the ship" and get the integrated business on sound financial footings. A key here is the cost in terms of ownership and control…and it can be steep. Finding investors for troubled or stalled operations is no small task.

A strategic partner could be a supplier or customer who's willing to commit long term to your operation, giving you some much needed working capital as well as the credibility inherent in a "going concern." Once again, that's easier said than done once the difficulties in the project are apparent.

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## COMMENTARY *CONTINUED*

I began the earlier paragraph with the word "unfortunately" for a reason. It wouldn't be unfortunate for us. We, of course, are pleased to be of assistance whenever a client requires. The "unfortunate" part is that we weren't involved with the project from day one. Had this grower involved professional assistance when the project was in the planning stage, he or she might have fared better when it was time to execute. The capital cost and risk to the grower's successful farming operation would have been carefully assessed and communicated. It might be determined that the project made sense, but that the risk involved argued for some sort of partnership with the sort of financial or strategic partner I mentioned above. I can tell you from long experience, it's much easier to find investors and involve potential long-term clients and suppliers before there's an obvious problem. By involving such partners, our grower would have been in position to reap the benefits sought through the expansion while effectively "laying off" a substantial portion of the risk involved.

The moral of this story is simple: Don't bet the farm until you've involved a professional advisor capable of helping you identify and plan for risks as well as helping you build a capital structure sufficient to mitigate them.

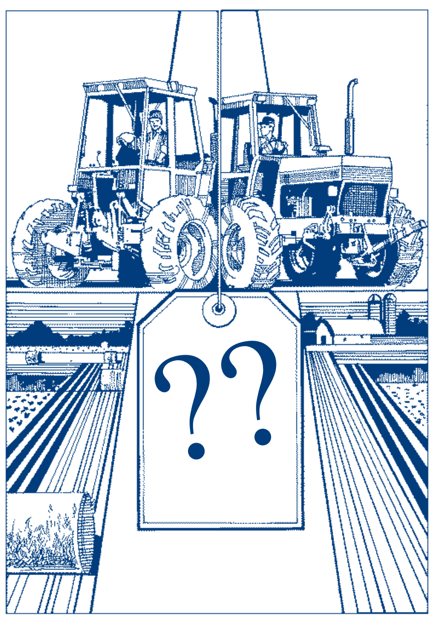
## INTEREST RATES AND FARMLAND VALUES

We've an old friend in the real estate business who was a great believer in leverage. He was fond of pointing out that, at least in his eyes, the price of a piece of real property was determined by the offered amount plus the interest cost. He was fond of saying in any deal he would offer the other party the right to "Either name the terms and I'll name the price or name the price and I'll name the terms." Our friend would find the farmland market puzzling on that basis as most farmland being purchased is not being financed with traditional leverage…. half of his equation would be gone!

Current interest rate levels are impacting the farmland market in several ways besides their absence in many transactions. Obviously, if one is a believer in leveraging real assets, today's record low financing costs make farmland acquisition even more attractive than the long term value trend line. On the other hand, it can be hard to find acquisition targets because there is so little quality farmland for sale.

And why is that?

A major reason so little farmland is on the market is the dearth of alternative investments that reliably produce anything like the cash return on quality land. An ever higher proportion of farmland owners have reached the age where insured Certificates of Deposit and high quality bonds are their investments of choice. These folks see no advantage in selling the farmland on which they can realize 3% to 5% cash returns so they can see their bank balances balloon…and get paid less than half that! They're also aware of the potential for growth in value, but we think the cash return is the key variable.




And then there's the risk of inflation.

CD rates are negligible, to near non-existent. An indexed bond fund likely saw 6% to 7% total return last year as government policy continued to manage interest rates down. How long can that policy be sustained? We don't know the answer, but we can say that at Murray Wise Associates, we have never lost our concern about inflation. And farmland is our preferred inflation buffer. Over many cycles, farmland has closely tracked inflation. And unlike gold, it provides a cash return. So, to the extent we're seeing artificially low rates, it's possible—even likely in some views—that bond performance will wane.

Continued growth in global demand for food, fiber, and even fuel is the primary driver of agricultural commodities' prices, and they, in turn, the primary driver of land values. However, the interest rate environment in which we find ourselves is also a contributor as it restricts supply by dampening any advantages to selling land even at today's prices.

## Technology Forcing Change in Publishing

**At Least They Can't Make Corn Without Dirt!**

When we sit down in a coffee shop with almost any group of local farmers, we're nearly certain that at some point one of the older fellows will comment on "the way we used to have to do that." The changes in agriculture resultant from technological innovation just in the past couple of decades are stunning: from mechanically modified seed genetics to harvesting equipment, the changes are profound.

Lest you think we're alone, we offer you the case of the newspaper publishing industry. From the very beginnings of the Republic, the newspaper has been seen as more than just an industry. Freedom of the press is enshrined in our Constitution because the founders saw the industry as the driver of the sort of information required to maintain an informed electorate.

Now, the phrase "all the news that's fit to print" may be fading. Not because the information in less important, but because technology is changing the delivery system. We're just not doing as much "printing." This situation was called to our attention in an e mail we received regarding the announcement that three major newspapers in Alabama will soon be printed only three days per week. Other papers are still printed daily, but only sold at newsstands, not delivered to homes. The writer of the e-mail reports that the Annenberg School of Journalism at the University of Southern California predicts that in five years only four papers will still be printing daily: the New York Times, Wall Street Journal, USA Today, and the Washington Post.

He notes other implications in the trend to digital delivery of "news," but it was the simple disappearance of the "daily paper" that struck us. We suppose the analogy in agriculture would be the invention of a "synthesizer" that just manufactures food, skipping the growing process. They had one on Star Trek.

Incidentally and appropriately enough given the story above, you can arrange to get your copy of this newsletter electronically. Just visit our website www.murraywiseassociates.com and make arrangements.

## Briefs

**Stop the Presses: No Drones**

As this issue was being prepared by the printer, we found ourselves with the same sort of egg on our faces that appeared on those of many who relayed information about EPA drones monitoring farm and ranch activity in Iowa, Nebraska and Kansas.

The story, as we heard it, was that the unmanned drones were quite like those used as weapons in the middle-east and that they were being used to scout farming operations for violations of environmental regulations. Like others, we penned an article filled with the sort of righteous indignation we all love to have once in a while.

Only there is apparently nothing about which to be indignant. Today, we are informed that the entire story was false and that no drones are being for surveillance on US citizens anywhere. As a result, we had to pull the story… and had to fill the space with this confession. We suppose we're better off than those who ran with the story.

**MWA Partner Wins Auction Awards**

We're very pleased to announce that our good friends and business associates at Schrader Real Estate & Auction Company were named Grand Champion in the National Auctioneers Association annual marketing competition. They won five other awards as well, including Auction of the Year. The winning auction marketed the Anderson Circle Farm, a 5,529 acre property in Kentucky. Selling price was $25 million.

We're proud to be associated with the Schrader Company, but then we've been proud of our association for years. Our staff at MWA has been working with the folks from Schrader for over twenty-five years successfully completing major farmland auctions.

Congratulations to Schrader for a remarkable year and thanks for the years over which we've worked together.

# THE WISE AG UPDATE

## Upcoming Auctions & Current Listings

**Upcoming Auctions**

Friday, July 20 at 10AM – 605± Acres in Iroquois County, Illinois – Offered in 8 Tracts including quality Illinois farmland and Highway 24 frontage.

Wednesday, July 25 at 1PM – 1,265± Acres in Winnebago and Ogle Counties, Illinois – Offered in 16 Tracts ranging in size from 15.5 acres to 188 acres with multiple combinations of tracts possible - Great investment opportunity as the property is located less than one mile from one of the top 25 U.S. cargo airports.

**Current Listings**

Webster County, Iowa – 98± Acres (95.1 Tillable Acres) – 3/4 Acre Pond – Asking Price: $10,500 Per Acre

Bonita Springs, Florida – 15.68± Acres – Excellent development opportunities off Interstate 75. Prime location for hotels, gas stations, restaurants, car dealerships, grocery stores, medical facilities, and much more – Asking Price: $5,160,000

*Visit www.murraywiseassociates.com for more information on these properties.*

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