Spring 2020 Agronomy Outlook: Retailers Are Adequately Prepared to Ride Out the Storm

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Key Points:

- Agricultural retailers are on relatively firm footing as they prepare for spring following last year's complicated agronomy season, according to our analysis of CoBank's proprietary borrower database.

- The data indicates that farmer prepayments, accounts receivables, and delinquency trends reported by CoBank farm supply cooperative customers remain in line with 2018, indicating a stable-to-improved outlook for agronomy sales and services.

- Ag retailers' inventories of seeds, agrochemicals, and fertilizer should meet customer needs during the 2020 planting season, which is expected to see an expansion in planted corn and soybean acres.

- Adverse weather and specifically flooding remain elevated risk factors this season with forecasts for above-average precipitation this spring, on top of already saturated soils. Agronomy sales and service could take a hit if weather once again leads to high prevented planting.

- COVID-19's global spread may continue to impact supply chains and the availability of certain imported crop inputs retailers rely upon in the short-term, while also potentially affecting commodity prices and farmers' planting decisions.

Introduction

Last year, producers of corn, soybeans and wheat faced a complicated growing season, characterized by bad weather and excessive flooding, trade tensions, low grain prices and margin pressures. Against this backdrop, we asked the following question: How would the operational and financial hangovers of 2019 affect crop input retailers in 2020? To answer this question, we analyzed consolidated U.S. farm financial data and studied CoBank's proprietary customer database. Weather permitting, ag retailers are reasonably well positioned for an improved outlook on sales and services this spring.

Review of 2019, Preview of 2020

The 2019 season began with wet weather and major flooding which delayed spring applications and planting, and resulted in an estimated 20 million unplanted acres, known as "prevent plant." At harvest, September rains and an October blizzard restricted harvest in North Dakota and delayed harvest activities in certain parts of the Corn Belt and Midwest Great Lakes region. Putting this in perspective, USDA's annual December survey estimated that 8% of the U.S. corn crop went unharvested in 2019, compared to an average of 1.4% during the previous three years. North Dakota was hit the hardest with an estimated 50% of its corn acres unharvested as of USDA's January survey.[1]

The above is important because the large amount of unplanted and unharvested acres from 2019 will create more work and complexity this spring for two reasons. One, unharvested acres will not be serviceable from an agronomic perspective until the crop is brought in from the field. Thus tillage, chemical and fertilizer application and other field activities will take place later than normal. Two, acres that go unplanted in one year require extra maintenance for weeds, disease, and insects the following year. Considerable rainfall and excess humidity during much of 2019 and into winter 2020 exacerbates this problem.[2,3]

USDA also predicts a substantial increase in corn and soybean planted acreage this year, which would result in greater farm input purchases and agronomy services. In its February 2020 estimate, USDA forecast U.S. corn acreage to increase 4.8% to 94.0 million acres, and soybean acres to increase 11.8% to 85.0 million acres.

However, there is growing concern that 2020 may also experience planting delays due to continued flooding following recent Midwestern and Southern storms that have affected the Mississippi, Ohio and Missouri rivers.[4] Midwest soils are also fully saturated, according to the National Weather Service's Climate Prediction Center, raising the risk of delayed field operations in the event of normal to above-normal precipitation.
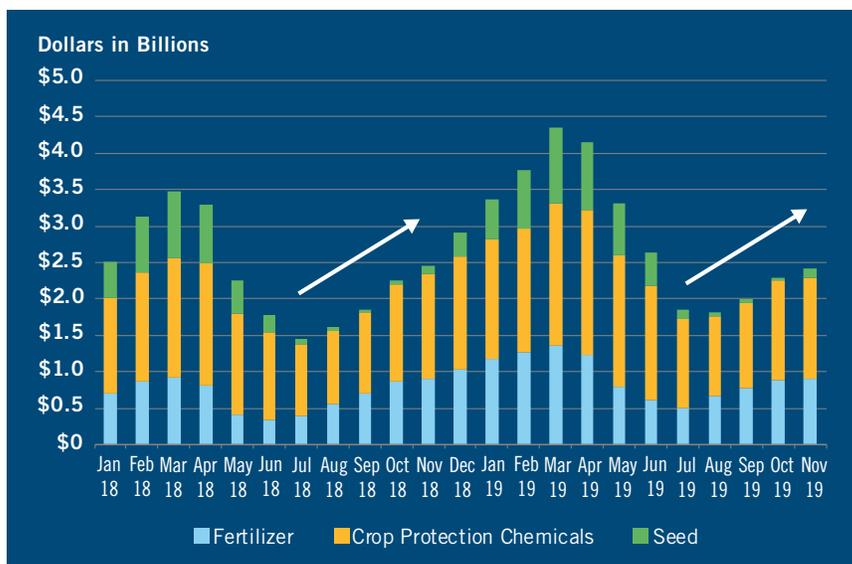
U.S. Farm Financial Health

To assess the health of the U.S. farming sector, we analyzed consolidated industry financial information from USDA and agriculture loan data from the Federal Reserve. Following are our observations:

1. **Net Farm Income:** Despite 2019's difficulties, USDA reported that U.S. net farm income totaled $93.6 billion in 2019, up 12% from the year prior. While this appears positive at first glance, net farm income included nearly $24 billion of support provided through various USDA farm subsidy programs including market facilitation payments in 2018 and 2019.

2. **Working Capital:** Current assets minus liabilities, or working capital, has fallen from a peak of $165 billion in 2012 to $61.1 billion in 2019, and is expected to decline further to $52 billion in 2020 according to USDA's forecast. This translates to a working capital/gross revenue ratio of 14% in 2019 and 12% in 2020, a highly concerning figure that may ultimately force financially weak players to merge, sell, or exit.

3. **Agricultural Loan Terms:** While working capital is tightening, interest rates on new commercial farm operating loans are trending lower, averaging 5.49% as of the February 2020 Federal Reserve Bank of Chicago report vs. 6.07% a year earlier, and alternative sources of credit exist with non-bank agriculture lenders. This coupled with the aforementioned government support, has allowed cash-constrained farm operators to remain operationally solvent. Additionally, with the sharp drop in interest rates amid the market panic caused by the COVID-19 epidemic, farmers can take advantage of historically low interest rates that will free up capital for the 2020 growing season.

CoBank Ag Retail Customer Analysis

As part of CoBank's collateral monitoring efforts, CoBank maintains a proprietary borrower database of the hedging and business flow activities of over 200 grain and farm supply cooperative customers. Following our industry review, we studied this database to obtain a more granular financial picture of farm supply companies to determine how ag retailers in general are positioned for the 2020 growing season.

To ensure anonymity, we aggregated the available information from five of CoBank's regional banking centers, focusing on three important variables: agronomic (seed, chemical, and fertilizer) inventories, inventory prepayments for those inventories, and 90 day or greater accounts receivable delinquencies. Following is a summary of our findings along with the aggregated data[5]:

EXHIBIT 1: Agronomy Inventories Owned by Farm Supply Cooperative Customers

Source: CoBank

1. **Agronomy Inventories:** The value of seed, fertilizer and crop protection chemical inventories held by CoBank's farm supply cooperative customers, which peaked in March 2019, was consistent with March 2018 but at a much higher level *(Exhibit 1)*. Given reasonably stable prices, we attribute the bulk of the increase to timing, namely farmers taking possession of crop inputs earlier than usual due to weather-related planting delays in 2019. The situation

normalized in the September, and the latest three months of data for 2019 look remarkably similar to the 2018 period. We believe this indicates that inventories are sufficient for an expected increase in corn and soybean acreage this spring.
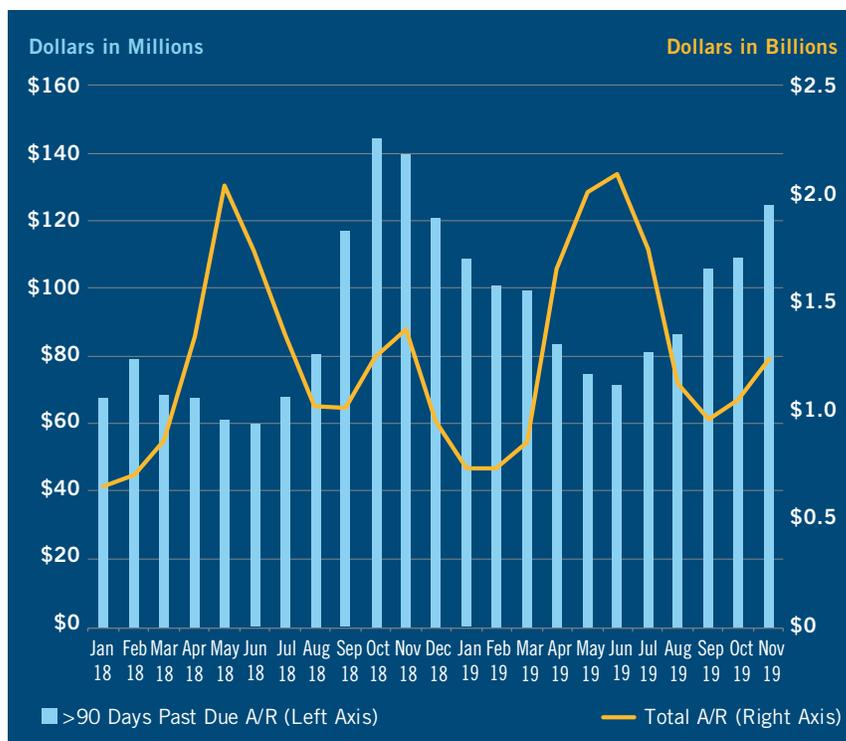
2. **Inventory Prepayments:** Farmer prepayments on agronomic inventories *(Exhibit 2)* show similar trends: 1) levels peaked in March 2019, at a higher level than the previous year; 2) levels reached a trough during August / September; and 3) levels picked up through November. With farmer prepays even with last year, we believe this is a strong indication that farmers had sufficient capital leading into the new growing season.

3. **Accounts Receivable and Delinquencies:** In addition to the favorable trends above, we are very encouraged to observe that 90 days or greater past due accounts receivables *(Exhibit 3)* were trending reasonably similarly as of November 2019 but peaking below the 2018 period (which actually occurred in October). We expect the reported delinquency ratio to decline in line with seasonal patterns when December, January, and February numbers are reported. However, we will monitor the situation carefully given the risk of adverse weather for a second consecutive year.

EXHIBIT 2: Inventory Prepayments by Farmers to CoBank Farm Supply Cooperative Customers
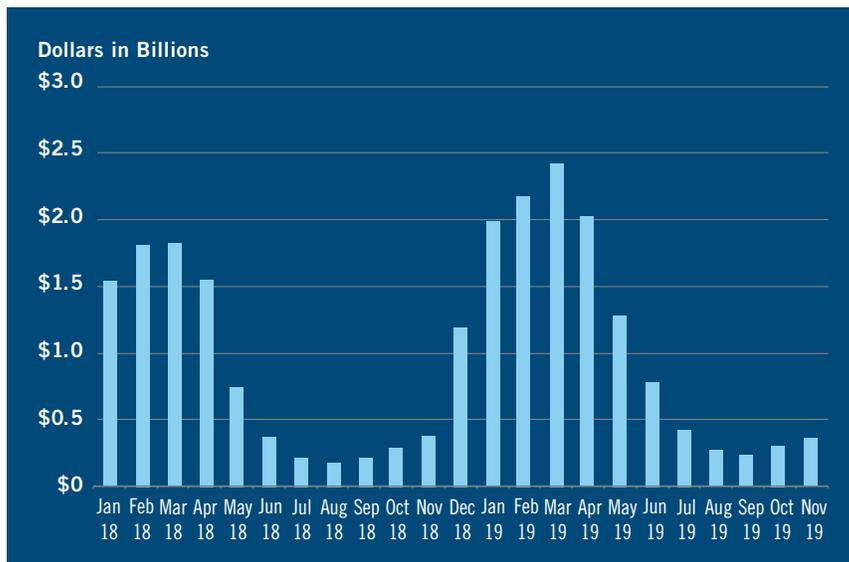
Source: CoBank

EXHIBIT 3: 90 Days Past Due Accounts Receivables

Source: CoBank

Conclusion

Although crop farming financial fundamentals remain challenging, ag retailers enter the spring 2020 growing season on relatively stable footing amidst low interest rates and ample liquidity (thus far). Our view is based on a detailed review of CoBank's proprietary customer borrower database, showing that retail customer prepayment and delinquency trends are in line with last year's figures. Furthermore, cooperative-owned agronomic inventories appear adequate to serve farm customer needs during a growing season where demand for crop protection products and spraying, fertilization and other customized application services will likely be robust given current field conditions and the large expected increase in corn and soybean acres.

However, weather remains a major risk factor this spring, given the recent barrage of forecasts calling for above-average precipitation amidst already wet field conditions. Agronomy sales and service would be negatively impacted if adverse weather leads to planting delays and/or high prevented planting. Another risk – although difficult to quantify at this juncture – relates to COVID-19 (coronavirus) and its potential to derail input supply chains, negatively affect farmer psychology, and cause volatility in commodity prices, which may influence spring planting decisions.

References

[1] Walljasper, Christopher. Feb 11, 2020. The Counter. Half of North Dakota's corn is still in the field; USDA calls it on-farm storage. https://thecounter.org/snow-north-dakota-corn-usda-on-farm-storage/

[2] According to USDA, six states had over 1 million acres that went unplanted due to adverse weather during 2019: South Dakota (3.9 million), Ohio (1.6 million), Illinois (1.5 million), Missouri (1.4 million), Arkansas (1.3 million) and Minnesota (1.2 million.) https://idahofarmbureaunews.blogspot.com/2019/08

[3] AgWeb.com, https://www.agweb.com/agweb-crop-comments, Feb 14, 2020

[4] Sullivan, Brian K. Feb 29, 2020. Bloomberg. U.S. Heartland Once Again Faces Multi-Billion Dollar Flood Costs. Bloomberg. https://www.bloomberg.com/news/articles/2020-02-28/u-s-heartland-once-again-faces-multi-billion-dollar-flood-costs

[5] Note that CoBank Borrower Base data is reported on a three-month lagged basis.

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