

Farm Financial Standards Council

Using the Standards and Ratios

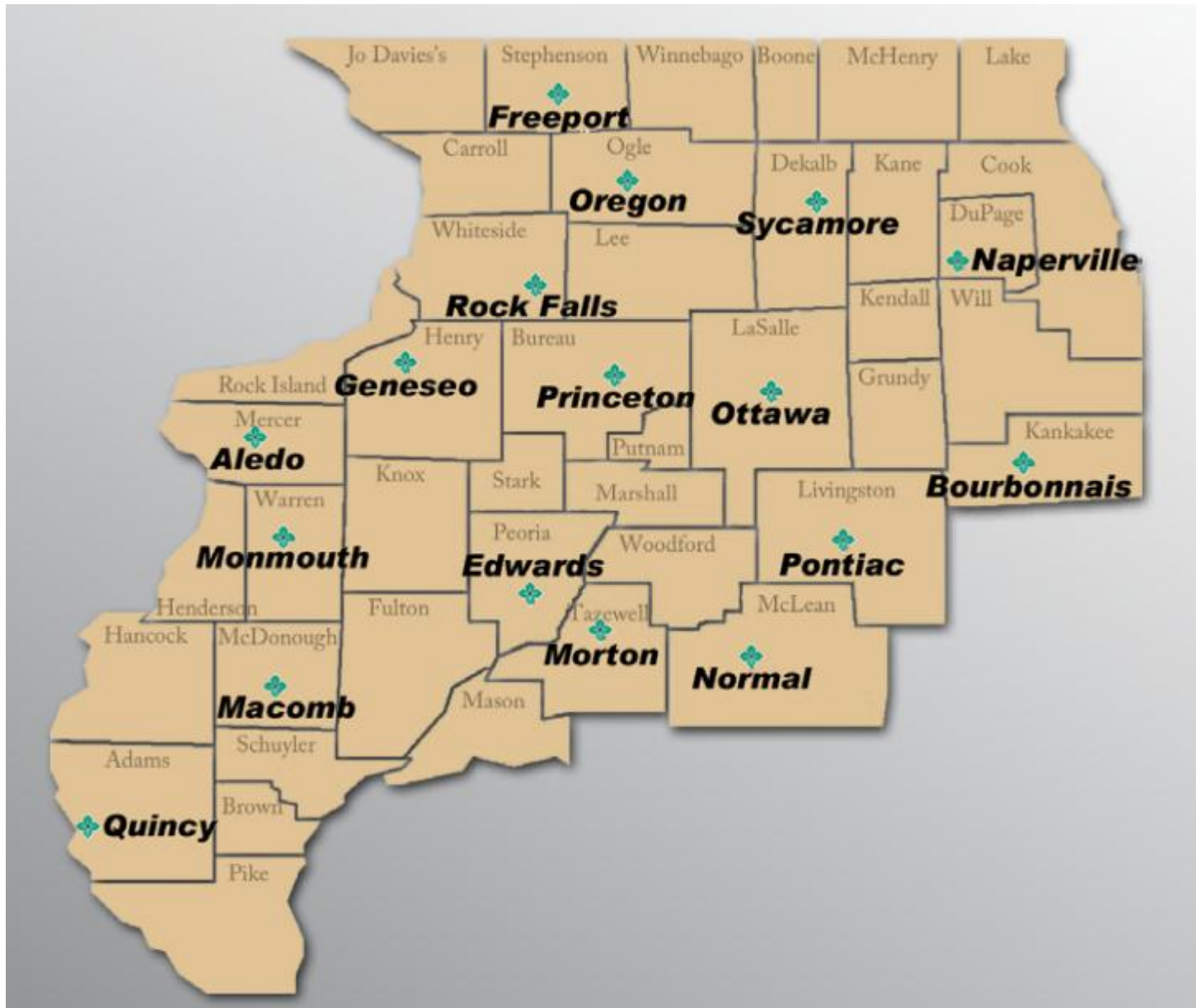
August 1, 2012



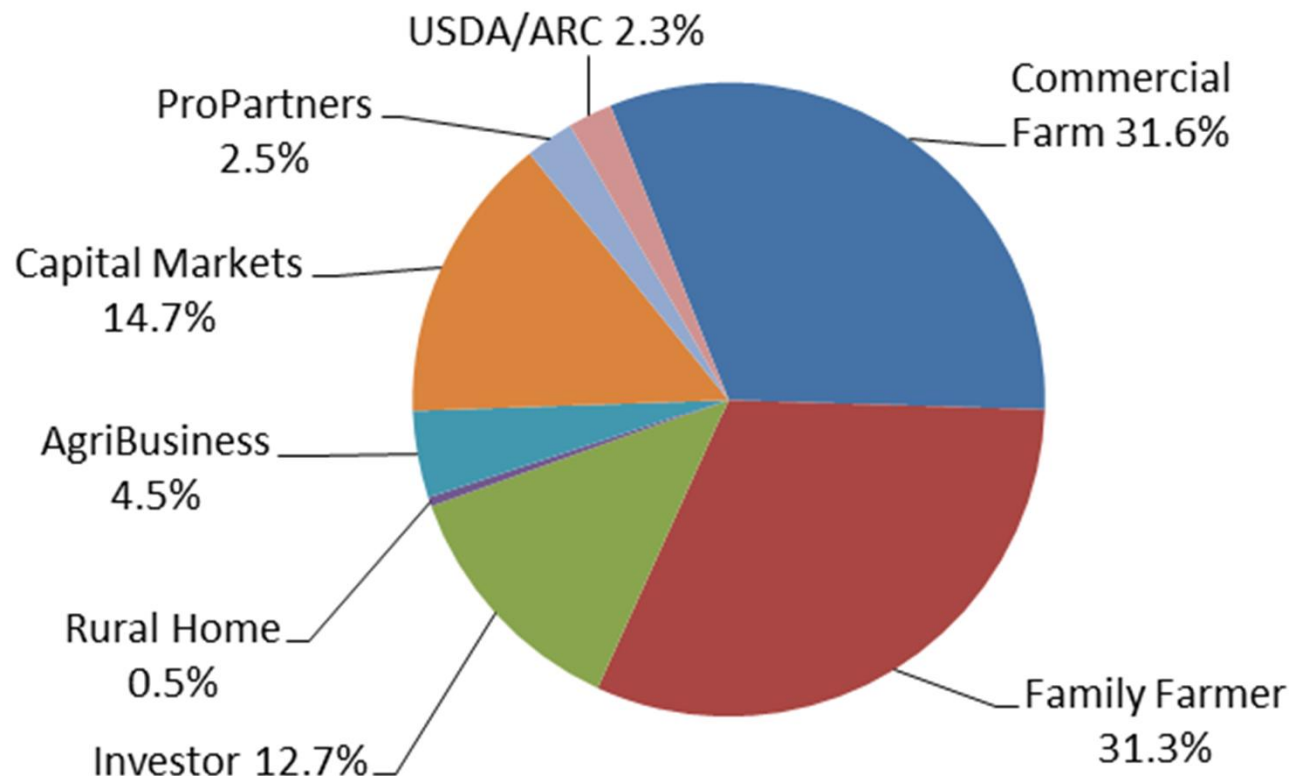
1st Farm Credit Services

- Cooperative providing financial services to rural America
- Northern 42 Counties in Illinois
- \$4.3 Billion Total Assets
- \$700 Million Total Capital
- 12,400 clients
- 260 team members
- 17 offices



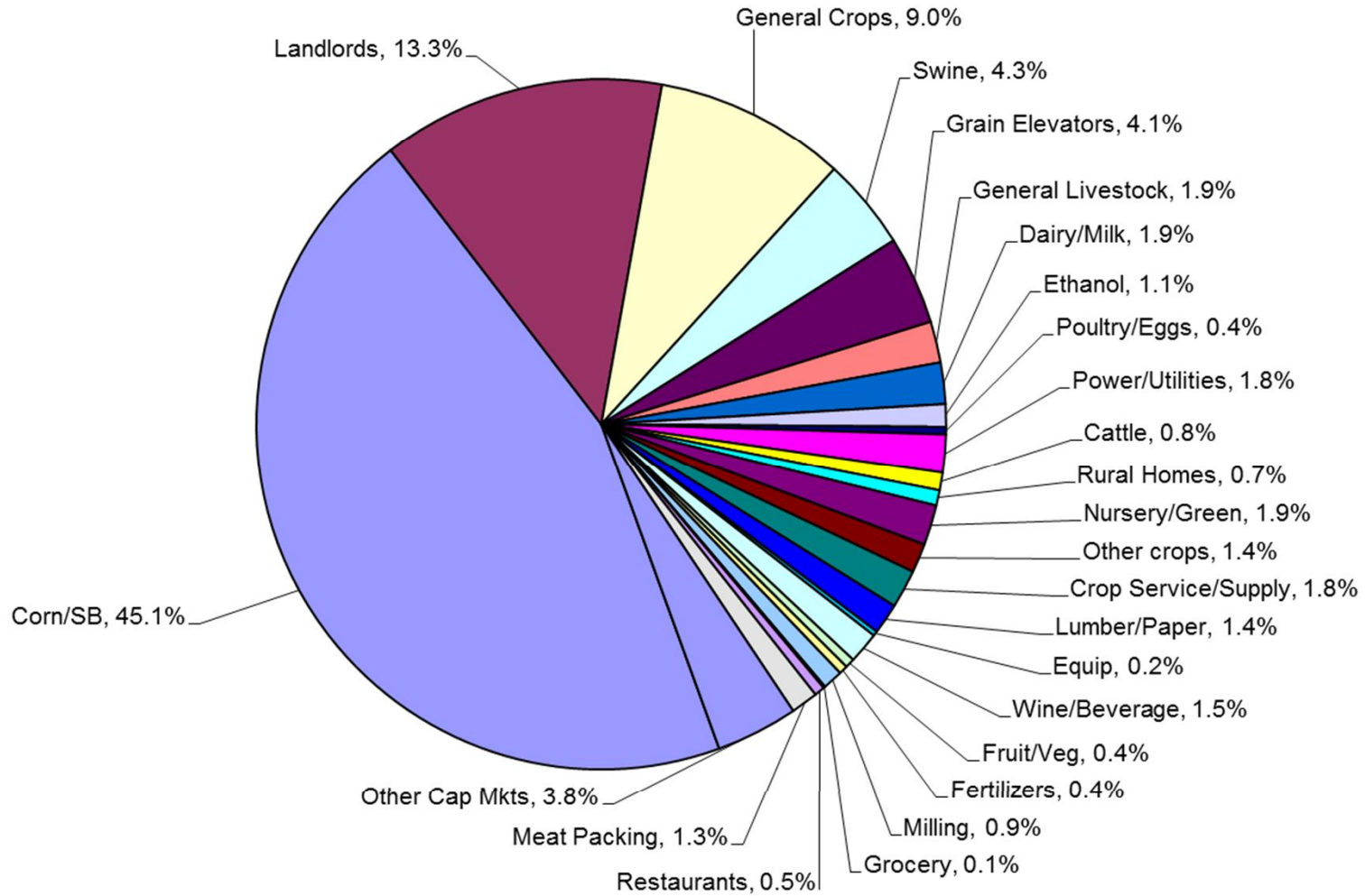


1st FCS Client Segments 06/30/12



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Commodity Concentration By Volume 06/30/12



Scored Loan Approval (On The Spot)

- Limited information loan origination
- Loans up to \$250,000 (\$500,000 line of credit)
- Balance sheet and income statements not required
- Prefer balance sheet review for red flags
- Odds based filtering developed by Fair Isaac
- Separate scoring process for Ag Operating, Ag Term, Ag Mortgage, and Lease
- Multiple factors other than FICO score
- Financial information – Total Assets, Total Liabilities, Gross Farm Income, Non Farm Income



Scored Override Worksheet

- Analysis worksheet with several related ratios that are assigned points based ranges
- When score is below approval threshold, the override worksheet can support approval
- Financial ratios
 - Loan/Net Worth
 - Owner Equity %
 - Debt Exposure – Gross Income/Total Liabilities
- Non ratios – existing client, credit score



Trade Credit & Leasing

- Trade Credit follows origination processes similar to in house underwriting
- Dealer gathers information and processing occurs in a central location, usually through scored analysis
- Lease application processing is usually scored as most leases are less than \$250,000
- Fixed assets would prompt greater likelihood of a balance sheet review



Scored + Balance Sheet (AgPremier)

- Next step in limited information approval
- Loans up to \$500,000 (\$1.25M line of credit)
- Use the same process as scored loans with additional financial requirements
- Higher credit score
- Minimum 65% Owner Equity
- Minimum 1.25:1 Current Ratio



Investor Loan Approval

- Landlords – Investors and Retired Farmers
- Three Investor segments
 - Professional/Executive
 - Business Owner
 - Wage Earner
- Rural Consumer
 - Homes, Lots, Recreational, HELOC
- Investor analysis up to \$1,000,000
 - Traditional analysis above \$1M
- Analysis uses an Investor Scorecard with points assigned based on strength of underwriting ratios



Investor Loan Approval

- Financial ratios
 - Owner Equity %
 - Liquid Assets/Total Monthly Obligation
 - Total Monthly Obligation/Total Monthly Income
 - FICO Score
- One non financial ratio – Loan/AV plus Term
- Rural Consumer up to \$250,000 uses the Consumer Mortgage Scorecard
- Loans above \$250,000 use the Investor Scorecard
- Post close minimum Owner Equity %
- Home Equity Lines of Credit use the Home Equity Scorecard



Loan Analysis

- Loan Officer is responsible for obtaining information from the client
- Verification completed by the Loan Officer
- Initial asset adjustments by Loan Officer, further adjusted by Credit Analyst
- Financial information is entered into Excel spreadsheets by a Credit Assistant
- Financial analysis completed by a Credit Analyst
- Specialized Credit Analysts for Swine and Horticultural industries



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Basic Loan Underwriting

- Owner Equity %
 - Net Worth ÷ Total Assets
 - Same as FFSC
- Working Capital to Adjusted Gross Income
 - Similar to FFSC Working Capital to Gross Revenues
 - AGI = Value of Farm Production + Non Farm Income
 - VFP = Gross Farm Income minus Purchases for Resale and Feed



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Basic Loan Underwriting

- Net Capital Debt Repayment Capacity %
 - Similar to FFSC Replacement Margin Coverage Ratio
 - $(\text{Net Earnings} + \text{Interest on Term Debt} + \text{Capital Asset Replacement Allowance}) \div (\text{Term Debt Principal} + \text{Interest on Term Debt} + \text{Capital Asset Replacement Allowance} + \text{Working Capital Deficiency})$
 - Capital Asset Replacement Allowance = Use Cost – Principal on Term Debt
 - Use Cost 10-15% of Machinery and 4-7% of Buildings
 - Working Capital Deficiency = 25% of the shortage to lending standards



Probability of Default

- Aligned with Uniform Classification System
 - Acceptable (PD 1-9), OAEM (PD 10), Substandard (PD 11-12), Doubtful (PD 13), Loss (PD 14)
- Probability the obligor will default within 12 months
- Assigned based on:
 - Solvency – 35% weighting
 - Liquidity – 20% weighting
 - Capacity – 45% weighting



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Underwriting Standards

- Underwriting standards align with PD8
- Guidelines established for:
 - Cash Grain
 - Contract Swine/Broiler
 - Dairy
 - Independent Swine
 - Cow Calf
 - Beef Feedlot
 - Winery
 - Citrus
 - Fruit
 - Permanent Plantings
 - Rural Home
 - Grain Elevator & Farm Supply
- Underwriting ratios for Cash Grain:
 - Solvency – 50% OE
 - Liquidity – 15% WC/AGI
 - Capacity – 115% Long Range CDRC



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Commercial Farmers

- Clients with Gross Farm Income > \$1,000,000
- Underwriting approach adjusted when client demonstrates good risk management practices
- Capacity
 - 115% Net CDRC, or
 - 110% Net CDRC and 120% SRCDC (Term-Debt Coverage Ratio)
- Liquidity
 - 10% WC/AGI, or
 - Current Ratio > 2:1



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Agribusiness

- Non Producers or very large producers
- Lease Adjusted Total Debt / Capital
 - $(\text{Total Debt} + 7X \text{ Rent Expense}) \div (\text{Net Worth} + \text{Total Debt} + 7X \text{ Rent Expense})$
- Fixed Charge Coverage
 - $(\text{Operating Income} + \text{Depreciation \& Amortization} + \text{Rent Expense} + \text{Interest Income} + \text{Cash Patronage Income} + \text{Cash Income from Subs \& JVs} - \text{Maintenance Capex} - \text{Taxes} - \text{Cash Patronage Dividends Paid} - \text{Common \& Preferred Dividends}) \div (\text{Principal Payments} + \text{Interest} + \text{Rent})$
- EBITDA / Interest
- Lease Adjusted Total Debt / EBITDAR



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Loan Approval Types

2011				
Millions	#	% #	\$	% \$
Traditional Analysis	1,704	24%	\$885	32%
Scored	4,687	67%	\$455	16%
AgPremier	414	6%	\$164	6%
Agribusiness	89	1%	\$626	23%
Capital Markets	89	1%	\$649	23%
Total	6,983		\$2,779	



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Financial Statements

- Large variance among client segments
- Grain and Livestock producers showing some migration away from Cash
- Agribusiness generally Audited or Compiled
- Prefer Fiscal Year End statements
- Prefer a multiple year trend
- Typically market basis for producers
- Try to get cost basis on fixed assets



Balance Sheets

- Obtain on all Entities
- Consolidate when > 50% ownership
- Judgment when ownership between 20% and 50%
- Verify material assets, particularly those > 10% of total assets
- Adjust values to conservative market
- Adjust nonearning assets – a lot
- Do not reflect contingent tax liability



Balance Sheets

- Adjust current assets and liabilities
 - Principal Due in 12 months aligned with crop year
 - Livestock/Dairy/Contract producer show 1 month income in CA and 4 months Principal Due in CL
 - No Principal Due for Rural Consumer or Investor
 - Growing Crops – cost at 90 days out up to 85% last 30 days
- Leases are shown on producer statements



Income Statements

- Use what we can get
- Commonly tax returns with producers
- Some producers have good accrual records
- Less progress than we had hoped over the past couple decades
- 1st FCS will pay part of record cost for Young or Beginning Farmers
- Agribusiness and Commercial Farmers are almost always accrual
- Prefer 5 years, will accept 3 at a minimum



Capacity Analysis

- When possible, use/create accrual view
- Typically cash basis analysis
- Adjustments made for unusual years
 - Remove high/low, remove 2008, reduce high years by a %, remove drought?
- Include Capital Gains if they are recurring
- Capacity based on historical earnings, not a projection



Capacity Analysis

- Use a projection when there is a significant change in scope or change in type of ag production
- Use a cash flow for clients with weak financial position to analyze timing of cash needs and repayment
- Earned Gain analysis if income statements inadequate or to confirm results of cash analysis
- Sensitivity analysis removes a % of income and/or expense



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Capacity Analysis

- Living expenses at \$35k minimum, prefer closer to \$60k
- Adjust tax liability to align with demonstrated capacity – you can't avoid taxes forever
- Leases are shown as an operating expense, not a term payment (even though shown on B/S)
- Use Cost for capital expense rather than depreciation
- Material non farm business income is shown with farm income/expense rather than net non farm



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Financial Analysis Spreadsheet



Financial Guidelines Adjustments?

- Long Range Repayment Capacity with a charge for insufficient liquidity
- Benchmark ranges for the existing ratios
 - Consider a stoplight chart
- Scored approval guidance
- Additional emphasis on trend

