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Boehlji warns of competition's impact on corn

Although ethanol remains an important fuel alternative, bankers should not expect the ethanol industry to increase farmer's incomes, said Michael Boehlji, the well-known agricultural economist and Purdue University professor. Boehlji was a speaker at the Bankers Seminar hosted by the Eide Bailly consulting firm in Sioux Falls, S.D., on Nov. 17.

Ethanol has contributed to the strong agricultural economy of the past few years. "We are living in historic times," Boehlji said. "The main purchasers of corn have been livestock producers until this year. Ethanol plants now purchase more corn than livestock producers."

Ethanol production, however, is driven by government mandate more than consumer demand. "The government has told petroleum companies that they have to buy 15 billion gallons of ethanol, about 5.2 billion bushels of corn. The government has also said that no matter the price of corn, the petroleum companies must buy it," he said. "Forty percent of the demand for corn today is absolutely guaranteed, no matter the price."

Boehlji does not believe these ethanol-driven boom times will last long. "When the technology comes along, we will have cellulosic ethanol produced primarily in the tropics from sugar-cane, it will not be corn-based," he said. "Sugar produces 10 times the amount of cellulose that corn stalks do," he added.

Boehlji, who is working with a company that is building three 100-million-gallon sugar-based plants in Brazil for cellulosic ethanol, observed "When you harvest sugar you cut the cane and take it to the sugar plant; all of the cost of gathering it has already been incurred. It's a free good." With corn-based ethanol on the other hand,



Ag expert Michael Boehlji (center) was the featured speaker at the Eide Bailly Banker's Seminar Nov. 17 in Sioux Falls, S.D. Greeting him are Eide Bailly's Greg Honl and Linda Koerselman.

the harvest costs account for 65 percent of the cost of producing ethanol, he said. "We could ship ethanol into the United States from Brazil at about a 20 percent cost savings," Boehlji commented.

"If you hear a little cynicism about ethanol you hear it right. It is a mandated requirement. Of the 36 billion gallons of renewable fuels required by law, only 15 billion gallons can come from corn; the remainder has to come from other sources. Currently, the ethanol import tariff is keeping the Brazilian ethanol out," he said.

Despite the mandated domestic demand, a significant amount of U.S.-produced ethanol is going overseas, which is not sitting well with some in Congress. "We are exporting roughly one billion gallons of ethanol," he said. "That is why Congress is saying 'We have a policy to try to encourage this industry and we are exporting the stuff. We've got to rethink the policy.'" Boehlji predicted a diminished future for ethanol but does not see the market disappearing.

In addition to his comments on the future of ethanol, Boehlji had advice for community bankers who work with

farmers. "You have to work with your farm customers to increase their working capital positions," Boehlji said. "I think you ought to raise the bar to 30 percent or more of working capital. Working capital is the first line of defense against financial stress. If your farm customers have extra cash and don't know what to do with it, tell them to hold it. It can have value for its liquidity," he advised.

"I had a farmer tell me in a meeting last month, 'you know what, I have a problem, I have made so much money I can't even figure out how to hide it anymore,'" Boehlji said. Agriculture set record income levels this year and next year will be about the same, he added.

However, "history will show that the good times are not permanent, that never occurs. Agriculture has a history of what is called short peak, long trough behavior," Boehlji explained. When the market has good prices and good income every producer around the world expands production and increases output. Farmers, however, do not typically change their output even after demand falls, Boehlji said. "But the farmers are

doing what they should because agriculture is a high fixed-cost industry,” he said. “When the costs are fixed like this you do not get the supply reductions when prices go down that other industries do.”

Boehlji has participated in studies that have shown this cycle to be very predictable; the only variable is the length of the troughs which range from five years to 17 years; the peaks are one year to two years at most. Boehlji’s concern is that after one more good year in 2012, the American ag sector is headed to a trough for 2013 through 2017.

He counseled bankers to be watchful of international economic problems, particularly the threat of default

from Italy and economic conditions in China. “Twenty-five percent of every dollar that farmers make in terms of gross revenues comes from sales of products overseas,” he said.

Boehlji said if the United States had not had a very strong movement to keep the foreign trade markets open, U.S. agriculture would not have been so robust. All economies showed a dip in 2007 through 2009 but the United States and Europe slowed down to negative growth, whereas the emergent economies like China and India never went negative and recovered much more quickly, he said. “China has been growing at 10 percent per year for the last 20 years and India at 8 percent per year for 10 years, so

it appears to be sustainable,” he said. “China could have a bad year but will they have a bad decade? I doubt it. My belief is that China and India will continue to grow economically,” he said.

“The question we worry about,” he said, “is if we do have a second recession, will agriculture be as recession resilient as it was?”

Boehlji said if Europe goes into recession as a result of Italian default, and China’s economic growth slows to 3 percent to 4 percent, then the global economy would likely go into recession. Another global recession is worrisome, Boehlji said, because it means a decrease in the demand for agricultural exports from the United States.

By Matt Doffing

Leadership, exam prep, keys to survival, experts say

Bank owners attending the Eide Bailly Bankers Seminar in Sioux Falls, S.D., on Nov. 17 were advised to reach out to their community leaders, to continue to look for non-interest income, and to prepare for tougher regulatory examinations. Greg Honl, CPA at Eide Bailly, and Doug Hajek, with the Davenport, Evans, Hurwitz and Smith law firm, addressed these and other issues in their panel presentation at the seminar.

“Identify the leaders in your community,” Honl said. “Look at your board members and your existing shareholders. Look at your employees. Develop incentive programs for those individuals to invest in your bank,” he added.

“You can spread the ownership of your bank into the community,” Honl said. “Have community leaders on your advisory board or involve them as owners.” He urged bank owners to develop stock incentive programs that tie talented employees to the institution.

Honl also urged bank owners to continue to search for other sources of non-interest income. He acknowledged “it is really disappointing that, with the Consumer Financial Protection Bureau, it seems like every time you come up with a fee it will get criticized for being excessive.” Honl encouraged bank owners to work with their associations on this challenge.

The panel also emphasized the importance of thorough preparation when facing regulatory examinations. “Identify your risks before the examiners do,” Hajek said. “You’ll get good grades for demonstrating that you have put together a good viable plan to get yourself back on good footing.”

Preparation can help with examinations, but there will be times when a banker will disagree with the interpretation of an examiner, Hajek said. The best course in these cases is to make your point and then figure out how to deal with it from there, he said. “The last thing to do is lose your

cool, especially in an exit interview,” he added.

Hajek said he was amazed by some of the written comments in examiners’ files about the people they deal with at banks. Examiners keep these files for years, he said. With new regulations coming, preparation and attitude can go a long way, but “don’t try to reinvent the wheel on all the new regulations,” Honl said. “If you are a community bank you will overload your compliance person.”

“A buzz word for regulators now is stress testing,” Honl said. “You can stress test just about everything including a capital plan. If you say you will maintain certain capital levels then you should do some financial projections based on your assumptions once a year. Stress test the plan for positive or negative changes in your ROE, ROA, net interest margin, and other applicable ratios you have built into your model.”

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