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Miell Agri-Business Agricultural Insights

2015—Mid-Year Review

Seasonal conditions have been challenging for many U.S. grain producers so far this year. Due to ongoing wet weather, farmers struggled to complete both corn and soybean plantings. In some regions, a lot of plantings will not get completed at all. The impact of these delays were reflected in the much awaited release of the United States Department of Agriculture's (USDA) June U.S. crop plantings and July World Supply and Demand Estimates (WASDE) forecasts, see Table 1.

Table 1. USDA's June Crop Planting & WASDE Production Forecasts

Commodity	2014 Acreage (million)	2015 Acreage estimate (million)	Acreage Change (million)	Estimated 2015-16 Yield (bushels/acre)	Forecast 2015-16 Production (million bushels)
Corn Planted	90.6	88.9	-1.7	166.8	13,530
Soybeans Planted	83.7	85.1	+1.4	46	3,885
All Wheat Planted	56.8	56.1	-0.7	43.3	2,148
Sorghum Planted	7.1	8.8	+1.7	65	505
All Rice Planted	2.9	2.7	-0.2	7,544 (cwt/acre)	207 (million cwt)
Cotton Planted	11.0	9.0	-2.0	819 (lbs/acre)	14.50 (million 480 lbs bales)

Source: USDA

To date this summer has seen some of the highest rainfall levels on record in key corn and soybean growing states, potentially drowning-out some of the planted corn acres and delaying completion of soybean plantings. If this scenario continues to play-out over the remaining months of the summer, expect to see further downward revisions to planted acres and, importantly, to final yields and production output.

Not only are planted acres on the decline, but doubts now exist about final yield potential and this goes to the heart of recent market reaction. Estimates of total production, consumption and ending stocks will now be key price drivers for the next 2-3 months.

The immediate market reaction to the latest USDA forecasts was predictable for corn, soybeans and wheat prices. If the production forecasts outlined in Table 1. eventuate, the flow-on impacts on commodity prices, farmland prices and farm rents will help to boost industry confidence that there may now be a base in prices that will prevent further erosion of profit margins.

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Special points of interest:

- Commodity prices re-bounding.
- Seasonal conditions mixed.
- Sorghum plantings expand.

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Following the release of USDA's July WASDE forecasts, market analysts have been releasing their updated 2015-16 crop production estimates. The major takeaway message is that current conditions are supportive of improvements in near-term price outlooks for all grain commodities.

After the 2014-15 season that resulted in prices delivering losses for many producers, the current forecasts present a welcome outlook for producers.

While harvest in still some months away, farmers are now optimistic that 2015 market prices will deliver at best modest profits or small, manageable losses.

Charts 1 & 2 illustrate recent price action for corn and soybeans and show a strong recovery in prices over recent weeks.

Chart 1. Corn Daily Price Chart - March – July 2015

For both corn and soybean markets, price action over the past 2-3 months initially reflected continued bearishness in response to record production in 2014. However, since June, as wet planting conditions prevented a lot of acres from being planted, markets have responded in a positive manner to reflect the prospect of less acres and smaller 2015 production.

Chart 2. Soybean Daily Price Chart - March – July 2015

Many market analysts are now increasingly confident that prices have established their seasonal lows and should continue to trade around current levels, or perhaps even higher under some scenarios.

What's happening to U.S. land values and farm rents?

Despite the impact of record U.S. corn and soybean production in 2014, farmland values have not exhibited a major sell-off as had been feared. In fact, land values have been relatively stable in many regions.

While the market tone has seen a weakening trend, the reduction in purchaser demand combined with fewer properties for sale has helped to ease downward pressure on prices.

In addition, the general level of agricultural debt which is much lower than in previous commodity price downturns is another reason we are seeing a more stable market response to market pressures. Overall, farmers' balance sheets are more robust than in previous economic cycles, providing greater capability to manage today's market pressure.

Regions that have suffered from or continue to be caught in a prolonged drought cycle as well as those states with a greater dependence on corn and soybean revenues are the major pressure points. Water shortages in many irrigation regions are pressuring land values and farm production.

As always, there are clear distinctions between values achieved for farms producing corn, soybean and other grains and those with livestock operations or more intensive permanent plantings such as wine grapes, vegetables and citrus.

The prospect of the Federal Reserve raising U.S. interest rates later in 2015 is also a factor influencing farm land prices. Loan rates are currently at historically low levels and have underpinned farm prices and borrowing costs for investment and operating expenses. Astute investors have been locking-in current interest rates and today's land prices, a winning combination!

As producers look to drive down their operating costs, it is encouraging to compare the period of farm crisis in the 1980s to today's economic climate. Table 2 helps to explain why farmland prices are more stable in today's market environment. With farmers' balance sheets much stronger, all of the factors at play today are helping to provide farmers a cushion to work through this period of market stress.

It is also easy to see that as market conditions improve, the grains sector is well positioned to expand from its current position, while those farmers with permanent plantings who are currently suffering drought-induced production problems will also boost production quickly. Livestock producers continue to enjoy favorable market and seasonal conditions. Overall, for all commodities demand from domestic and global markets remains strong and underlying investment fundamentals support continued consideration of agricultural investment opportunities.

Table 2. A Snapshot Looking Back to Visualize the Difference from 35 Years Ago

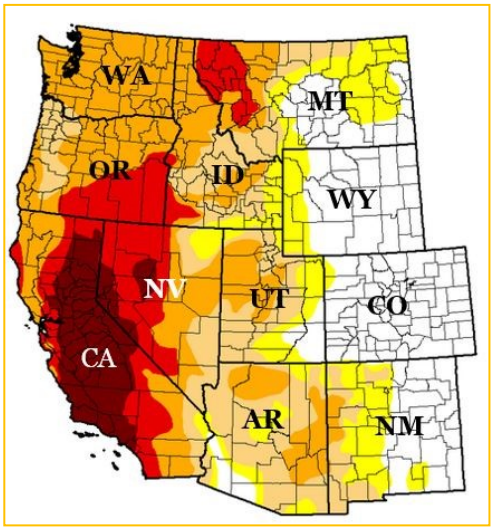
1980s	TODAY
In 1979, 70% of farm debt was held by approximately 30% of farming operations. These operations produced approximately 42% of the net farm income.	In 2013, 68% of the farm debt was held by approximately 4% of the farming operations. These operations produced approximately 48% of net farm income.
In 1979, the percentage of farming operations with no debt was approximately 32%.	In 2013, the percentage of farming operations with no debt was approximately 75%.
Historically, high interest rates. Prime rate in 1981 was 21% and fed Funds rate in 1981 was as high as 19%.	Historically low interest rates. Prime rate is 3.25% and Fed Funds rate is 0.25%
Most loans had variable interest rates	More use of fixed interest rates, with many borrowers having already locked-in record low rates
In 1983, total farm interest expense was approximately 150% of net farm income.	In 2013, total farm interest expense was approximately 14% of net farm income.
Commodity and land prices we in decline.	Commodity price cycle and land prices are retreating from record levels.

Drought Devastating Agriculture in Western States

Drought conditions continue to impact the agricultural sector in many western states of the United States. In California, severe water-use restrictions are in place across the state and long-held agricultural water rights are being challenged by actions of the California administration.

While severe drought conditions in Texas and other mid-west state have been broken by flooding rains, the states of Washington, Oregon, Idaho, Nevada and California are still in the grips of a multi-year drought.

Map 1. U.S. Drought Monitor



Click map for larger image

Other neighboring states are experiencing abnormally dry conditions, leading to widespread challenging agricultural production conditions. In total, almost 57 million people are impacted by droughts at this time. Map 1, the current U.S. Drought Monitor clearly illustrates the reach of the drought conditions.

Without question, California, the nation's top agricultural state, is the worst hit by drought. This state is still counting the damage from the 2014 drought, which resulted in an estimated $200 million in losses in the dairy and livestock industry and a staggering $810 million in crop production. Early predictions are for even greater losses in 2015.

Flow-on impacts are now being seen in challenges to senior water rights, water allocations and water use in both urban and agricultural regions.

Farm investment values and demand are not immune from the impacts of the drought, with both prices and demand reflecting these dire circumstances.

If the drought conditions persist through 2015, expect to see significant long-term structural reforms of water and land use as industry participants seek to protect their existing investments and respond to government and social pressures. Already, there are reports that some farmers who have the option, are seeking to relocate their farming operations to other states with more reliable water resources and rainfall patterns.

This will impact market conditions in these competing regions and boost underlying property values.

The longer the drought persists, the tougher the operational decisions confronting farmers in these regions. Permanent plantings of nuts, wine grapes and citrus for example will be lost, impacting production for years. This scenario is now providing investment opportunities for investors who are seeking to establish similar farming activities in areas that provide a more reliable production outlook.

Drought and downturns in commodity price cycles provide astute investors with timely investment signals.

The current environment presents market conditions that are attractive for strategic investment action.

For further information or to discuss your strategic agricultural investment plans please contact:

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