

Environment for Economic Recovery and Agribusiness Lending

National Grain and Feed Association Conference
December 7, 2009



Proud Member of the Farm Credit System 

Global GDP growth

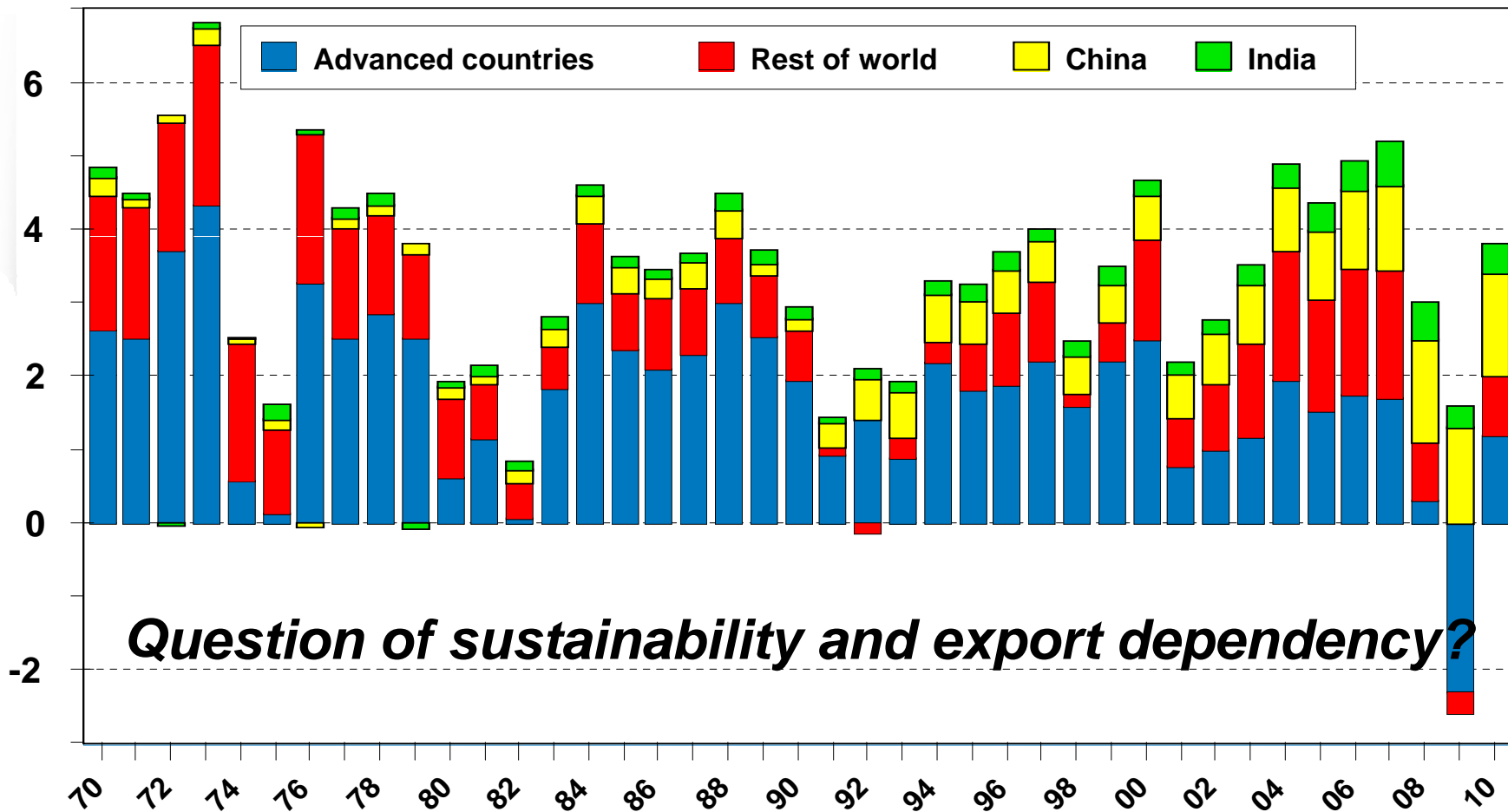


- Continued Asian growth spilling over into other emerging market countries
- Developed countries emerging from recession in Q3
- U.S. likely emerging from recession, but to-date growth largely government stimulus derived
- Unemployment rates likely to continue to climb for 2-4 more quarters
- Consumer sector will remain strained for at least the next year
- Savings rate skyrocketing
- Export sector may lead recovery underwritten by weak dollar

Global GDP Recovery



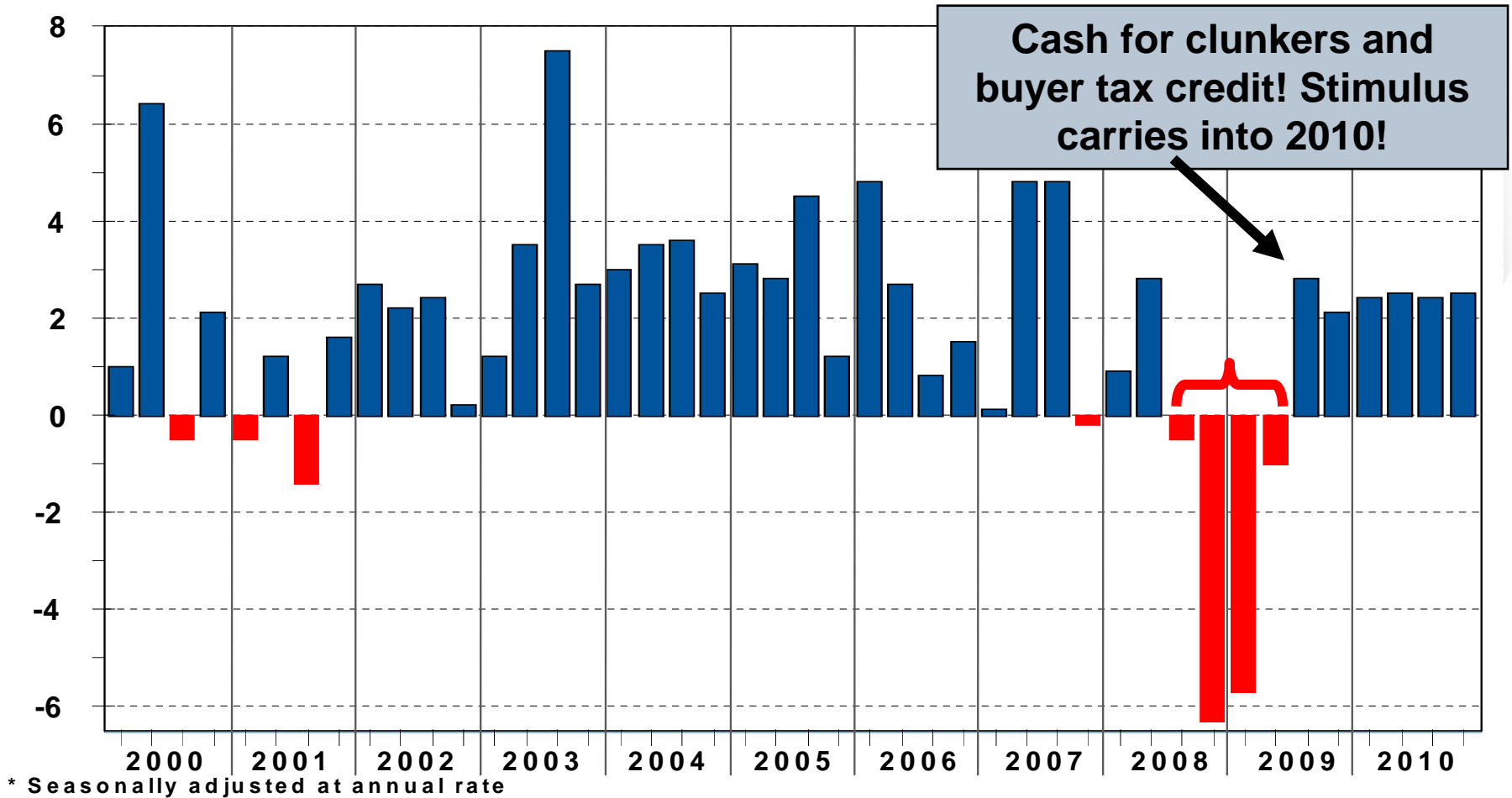
Percent change in annual world growth (purchasing-power parity rates)



Growth Rates Will Slow In 2010



Percent change in quarterly Gross Domestic Product (Chained 2000\$)*

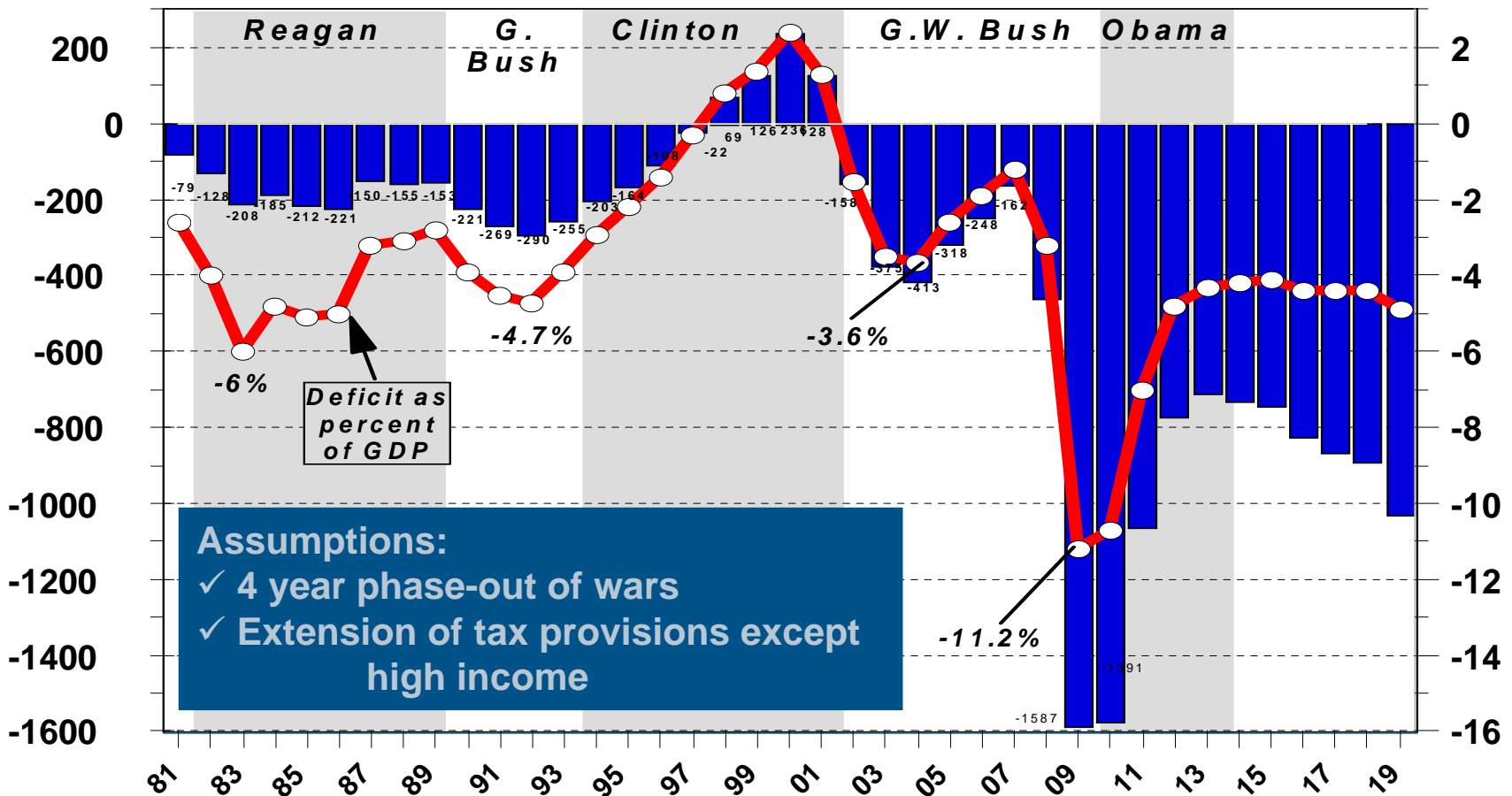


Government spending is major growth driver; record deficits



Deficit in billion dollars

Percent of GDP



Assumptions:
 ✓ 4 year phase-out of wars
 ✓ Extension of tax provisions except high income

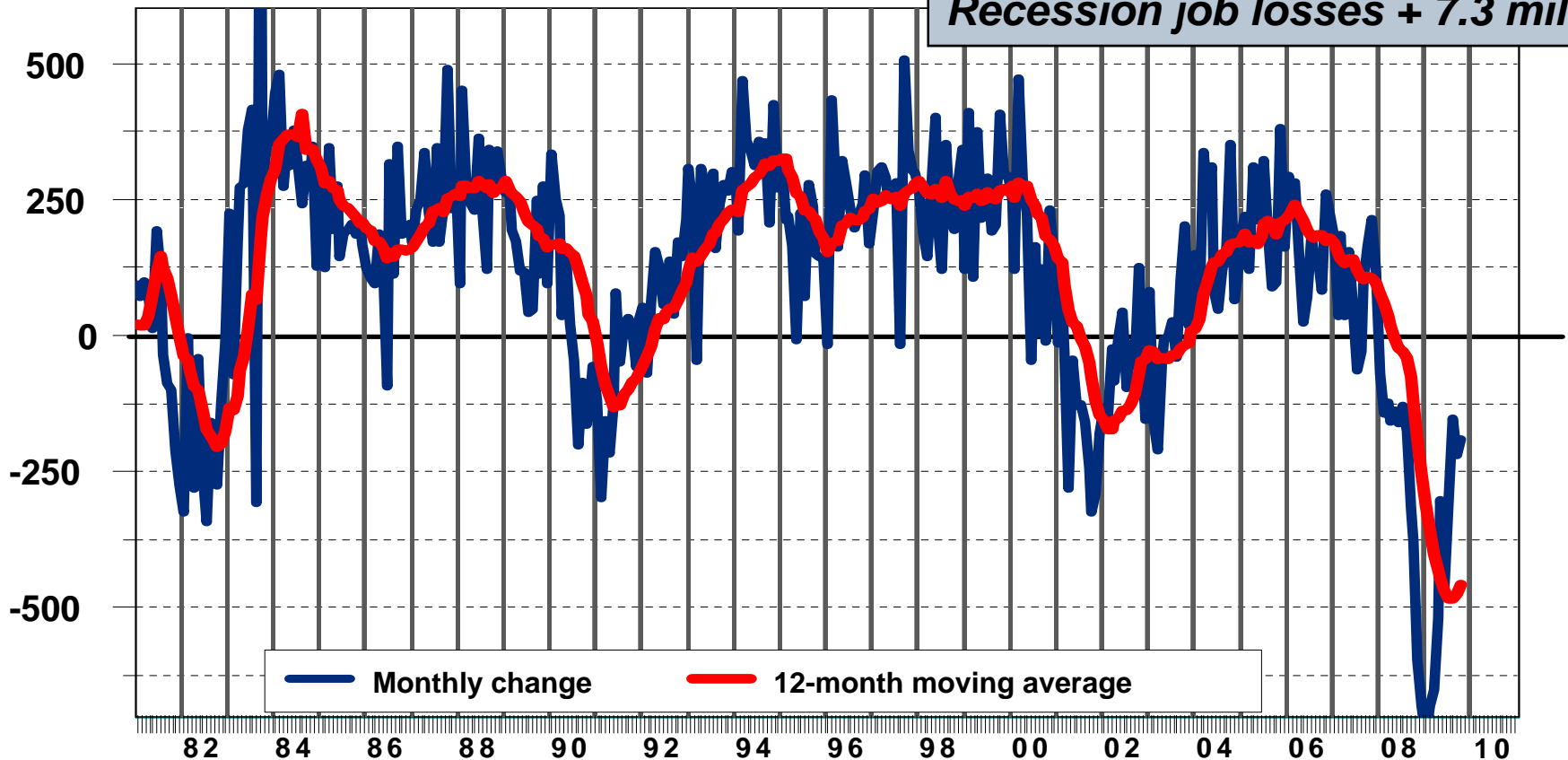
Source: Congressional Budget Office (Sept, 2009), BEA and Treasury Department and forecast

Continuing Job Losses Keep Consumer Uneasy



Change in nonfarm payrolls (thousand)

Unemployment rate = 10.2%
Recession job losses + 7.3 mil.

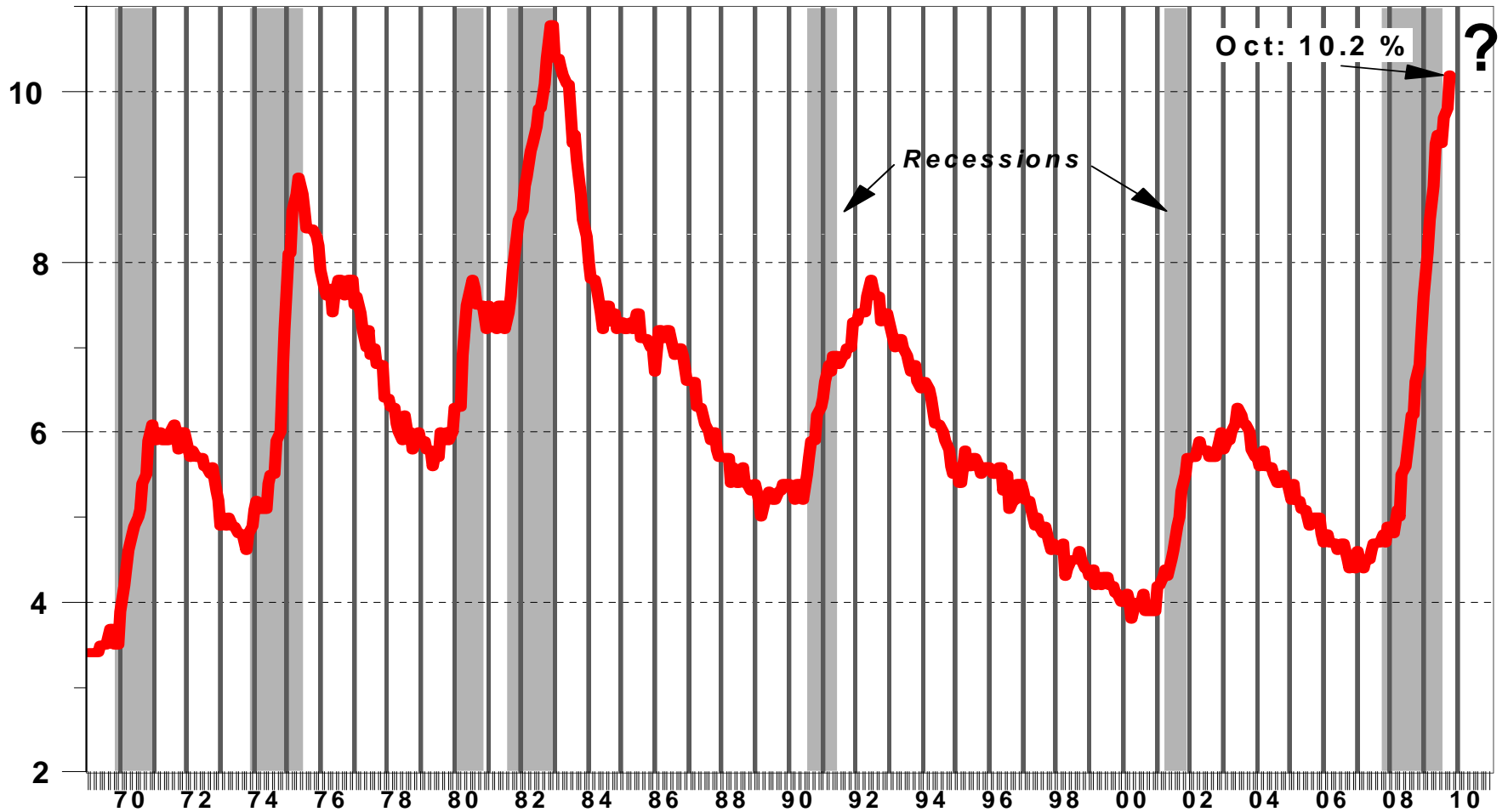


* *Business cycle troughs: Nov 1982, March 1991 and November 2001.*

Unemployment Rates Peak Well After Recession Ends



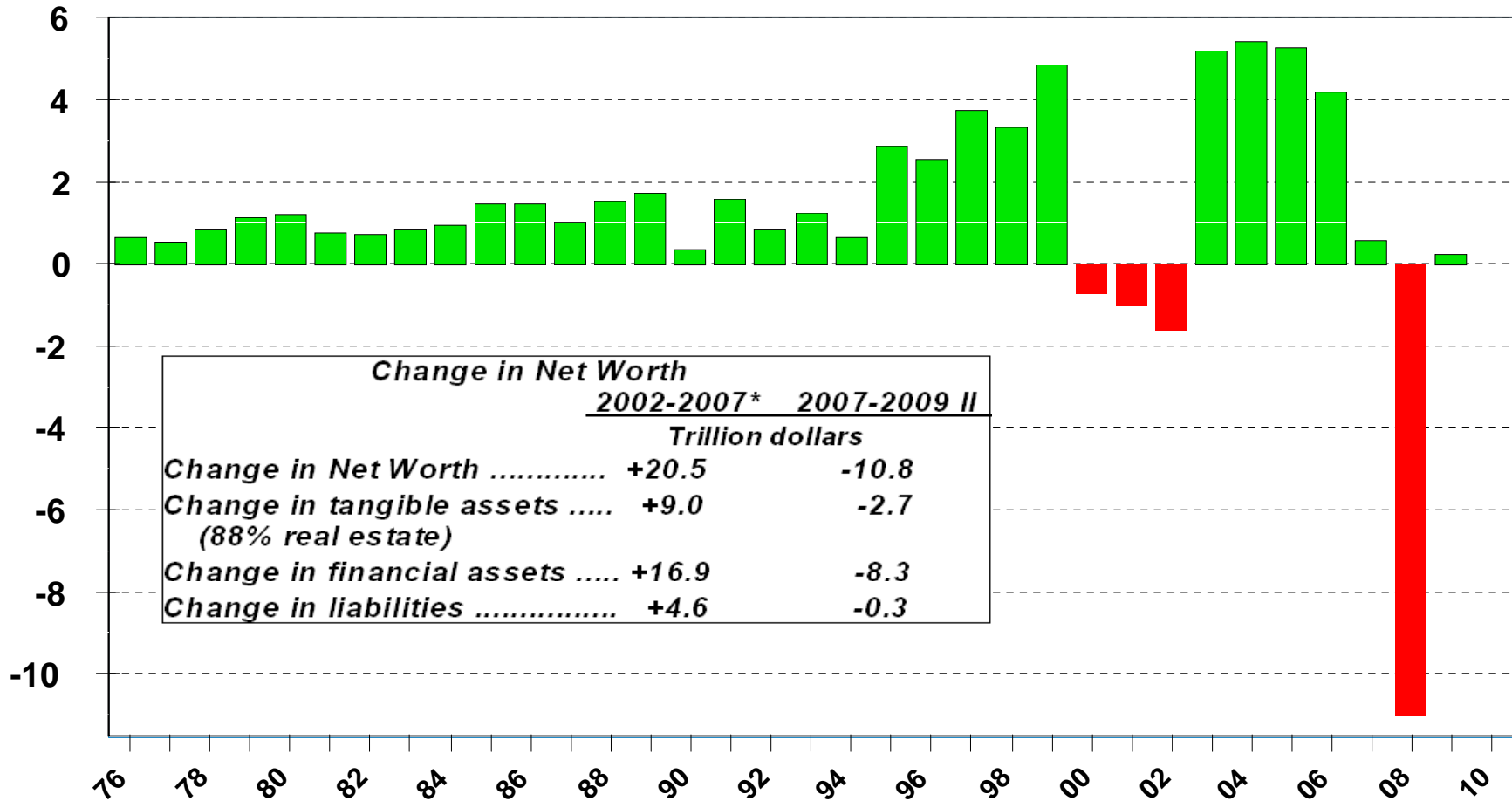
Percent rate



Consumer Net Worth



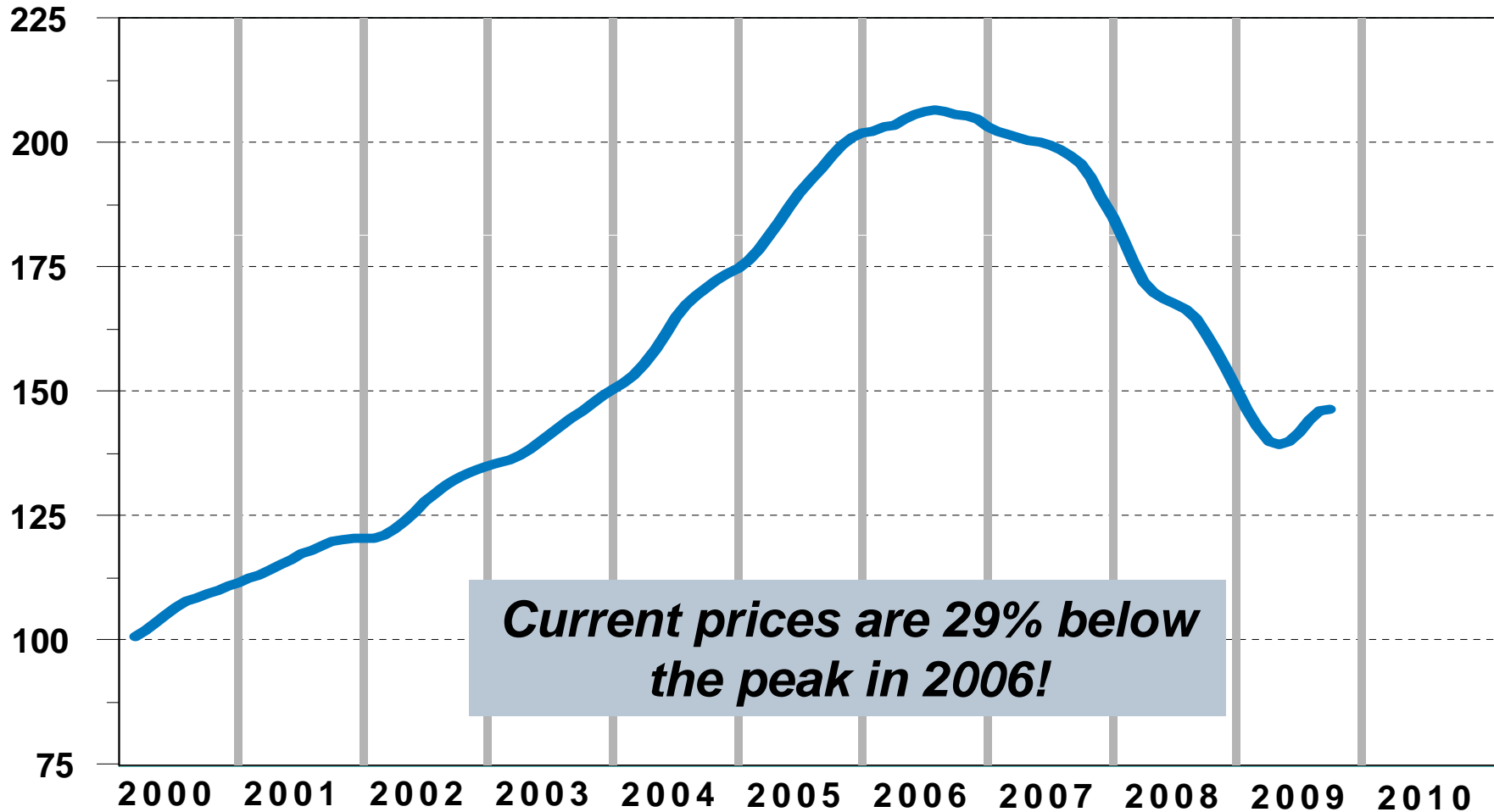
Change in trillion dollars



Home Prices Show Some Signs of Improvement



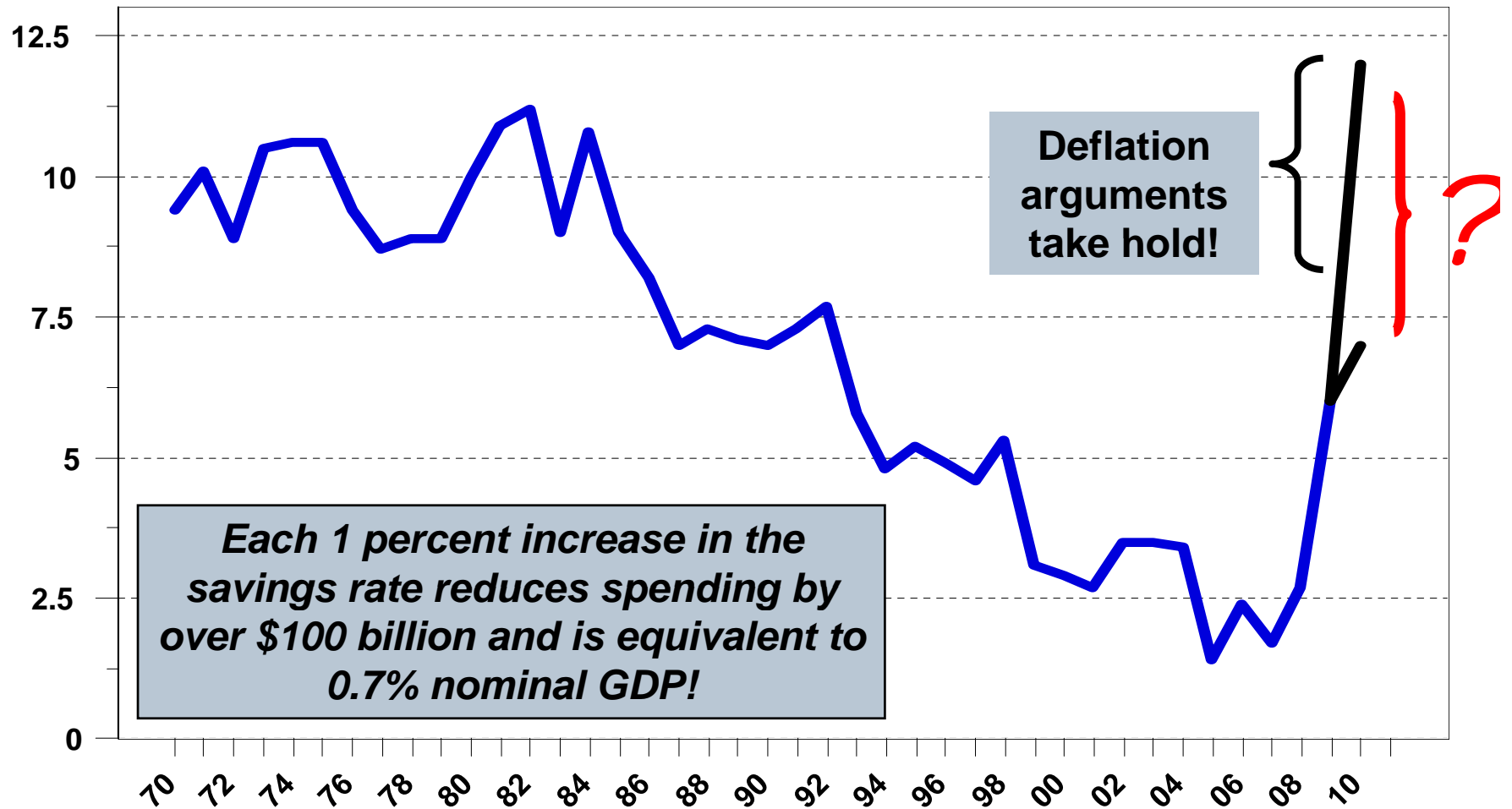
Monthly S&P/Case-Shiller 20-City Home Price Index



Consumer Saving Rate



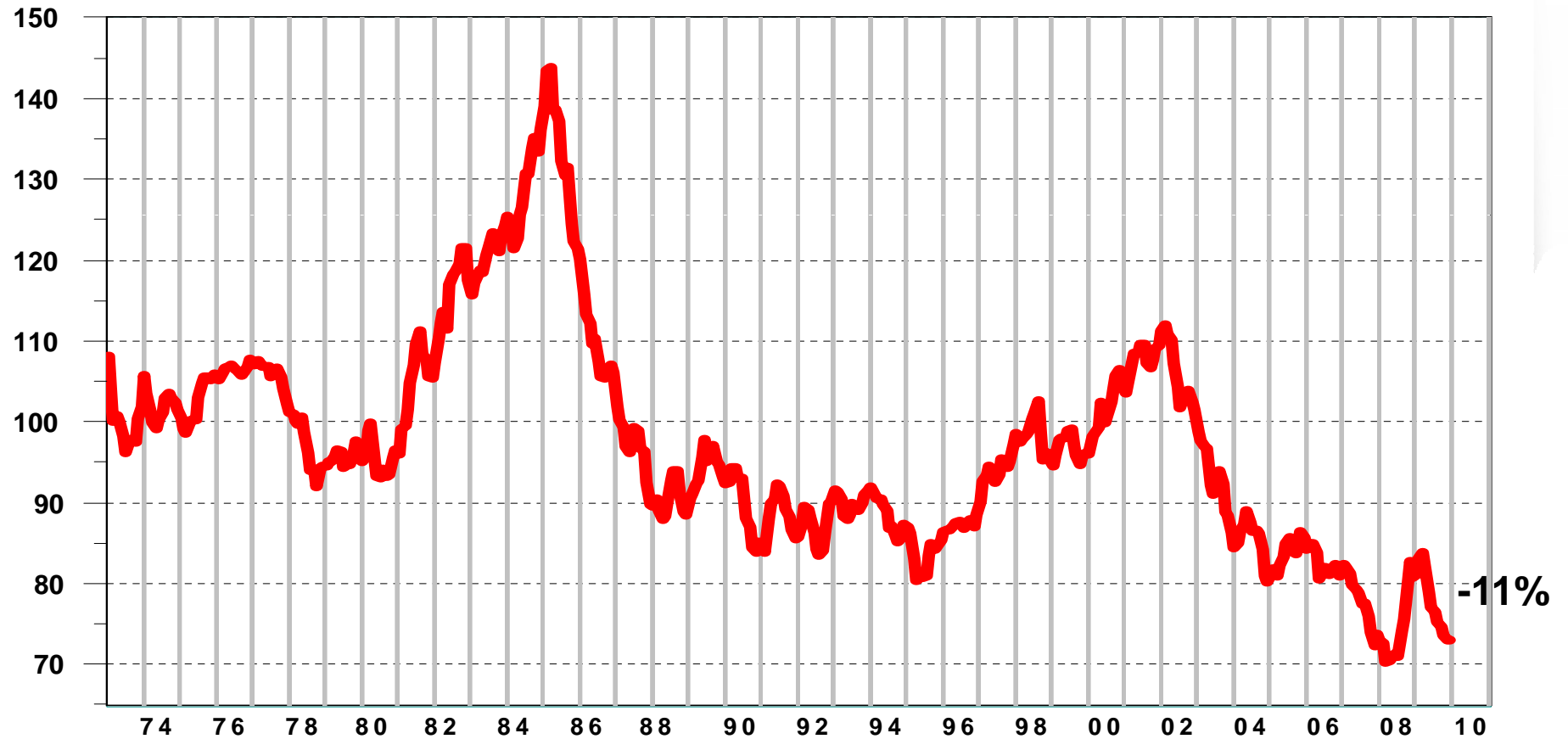
Annual percent: Savings as percent of disposable income



Dollar Weakness



Indexes of major currencies/US\$ (March 1973=100)

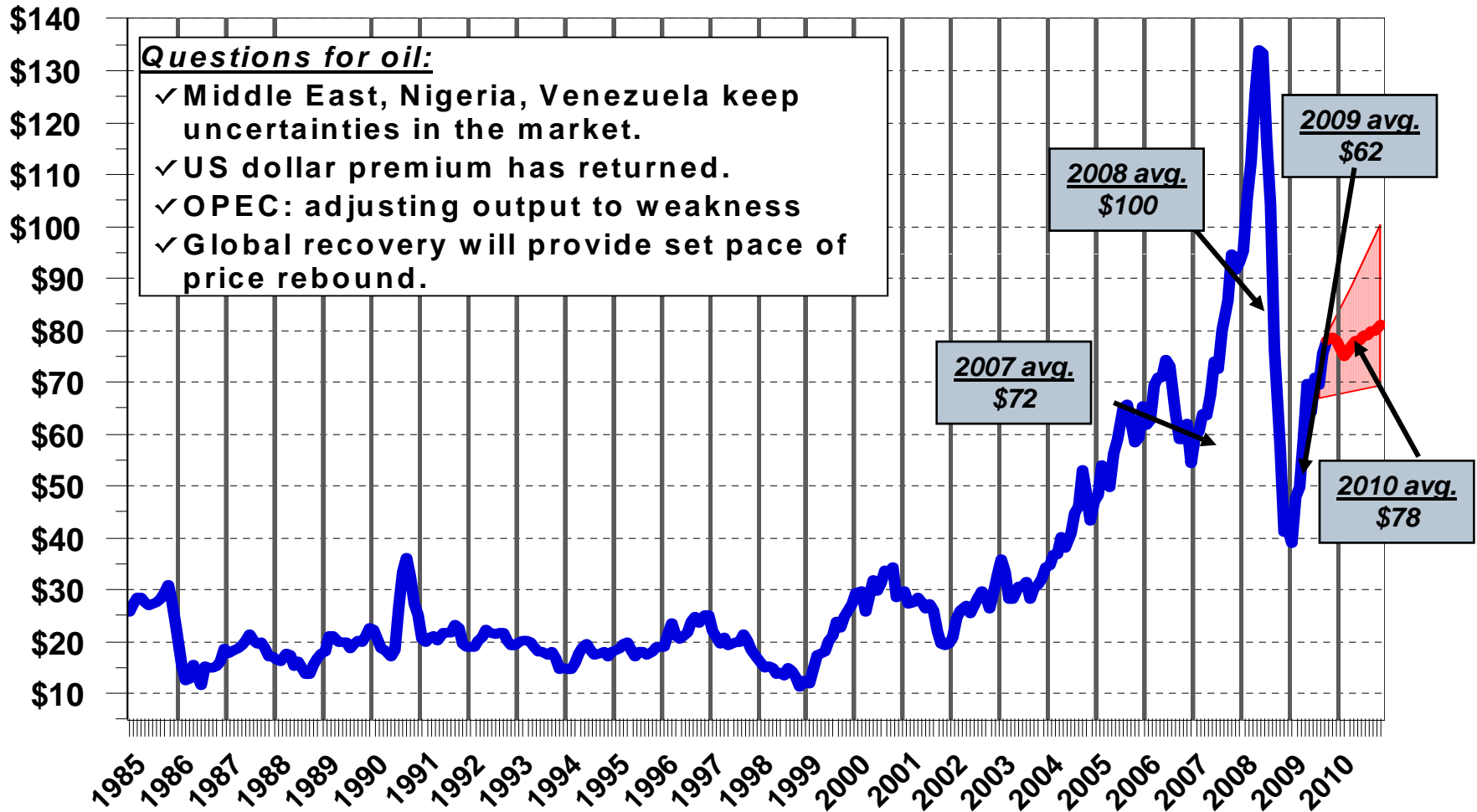


* Currencies weighted by relative market importance to total U.S. trade.

Oil Price to Track Global Rebound



Dollars per barrel; spot price West Texas Intermediate





- Fed extending aggressive monetary stimulus
 - Unemployment expected to be high for next year
 - Steep yield curve to rebuild bank balance sheets
 - But is Fed policy underwriting the next asset bubble?
 - U.S. role in stimulating the “carry trade”

- Implied forward interest rates show short-term rates 130 basis points higher in one year

- Strong recent rally in equity markets, relatively strong quarterly earnings

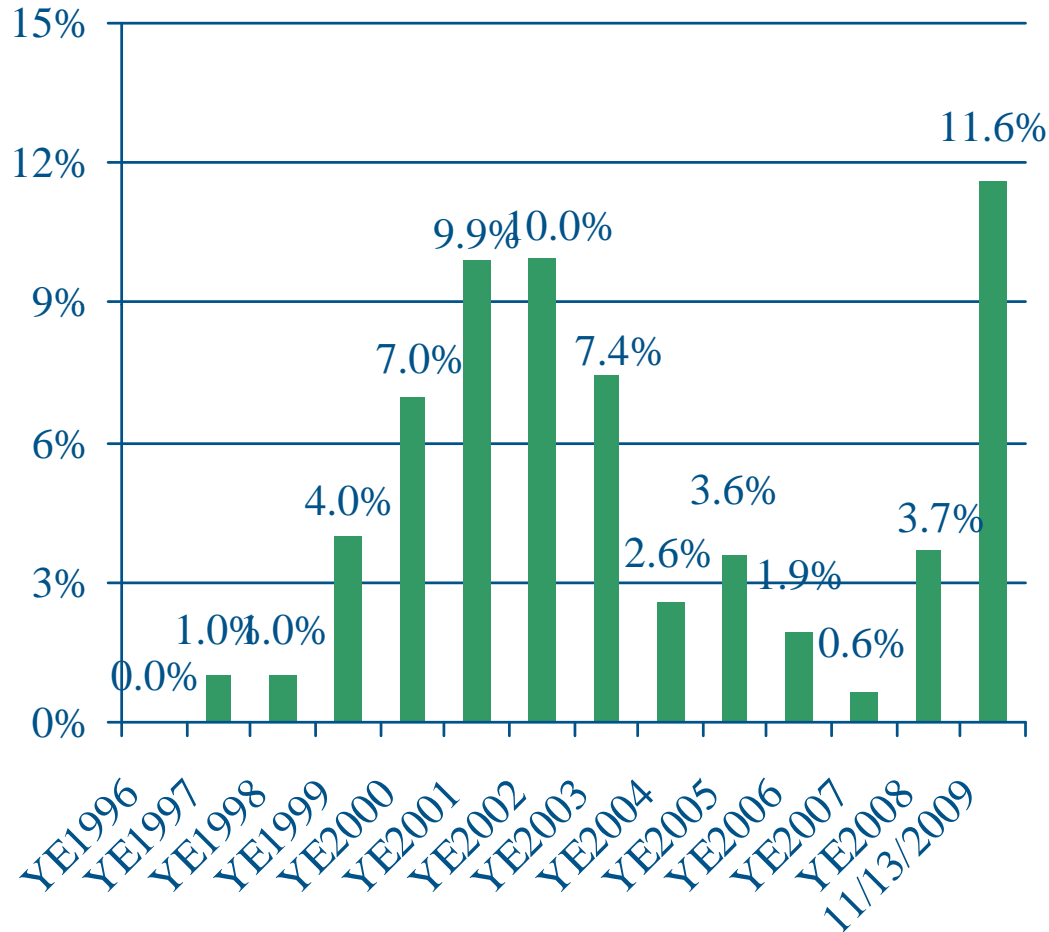
- Leveraged finance (loans and bonds) rallying as well
 - YTD net HY bond inflows of \$18.3 billion, highest since 2003
 - Bond market adding technical support to loan market through deal refinancing
 - Secondary market trading spreads have narrowed off of unprecedented high levels at beginning of the year but still remain very high for any market cycle
 - Dispersion of spreads for any given credit profile very wide, lack of market consensus on pricing

Debt Market Overview



- Loan market still somewhat sluggish due to on-going problems of banks
 - Consumer lending portfolios tied to deteriorating unemployment fundamentals
 - Commercial real estate portfolios also deteriorating now
 - Corporate loan demand is off as well as companies are slashing cap-x budgets
 - Corporate defaults are on the rise
 - Very large debt maturities over next five years
- IMF recently estimated that only 60% of bank losses have been recognized in U.S., only 40% in Europe
- Moody's tracking approximately \$10 trillion of bank debt maturities by end of 2015
- In last 5 years average U.S. bank debt maturities have dropped from 7.8 years to 3.2 years
- Although bank funding costs have narrowed off the peak, chronically higher funding costs are likely to persist

Percent of Leveraged Loans in Payment Default or Bankruptcy

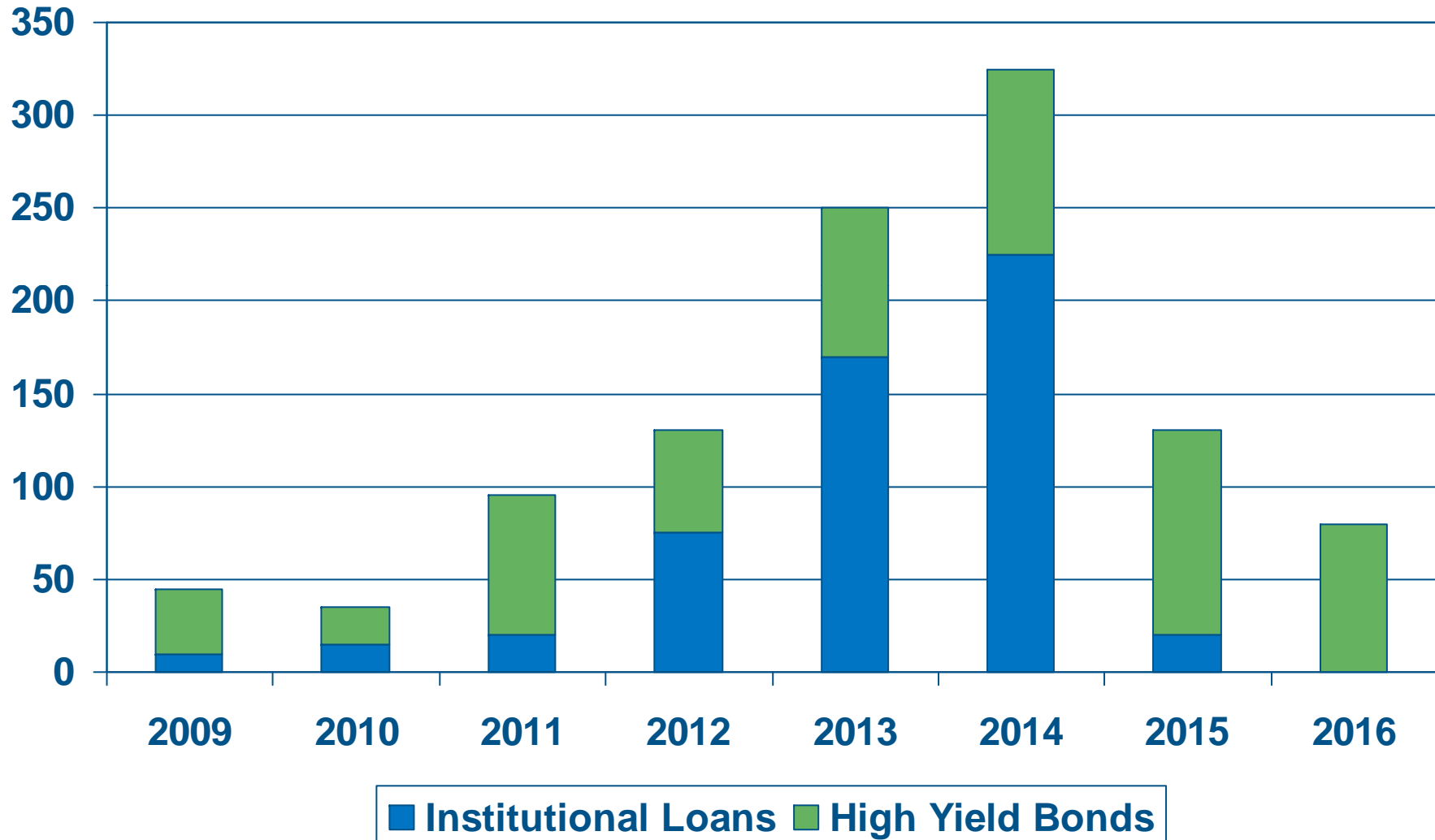


As of
15

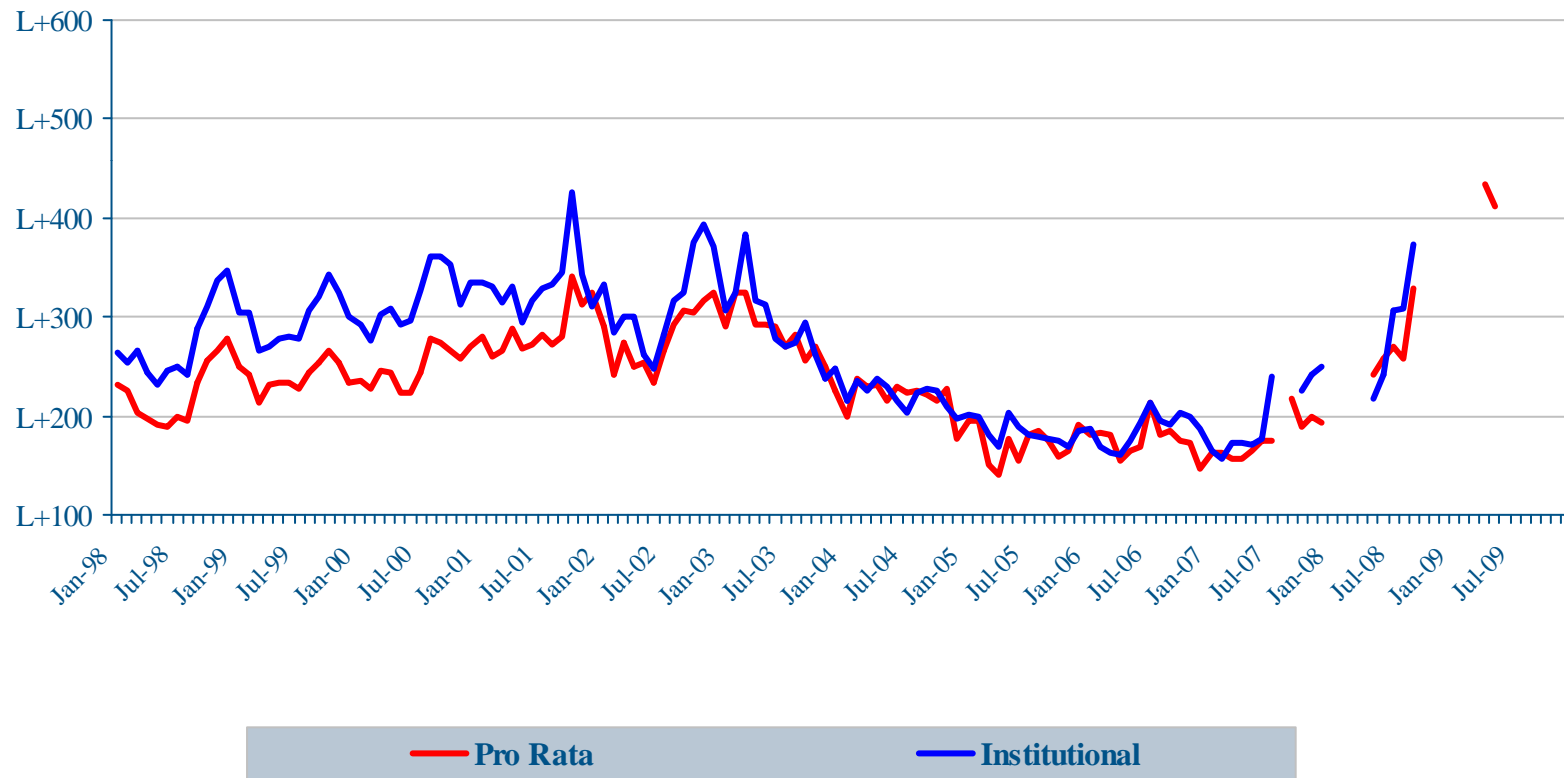
High Yield Bond and Lev. Loan Maturities



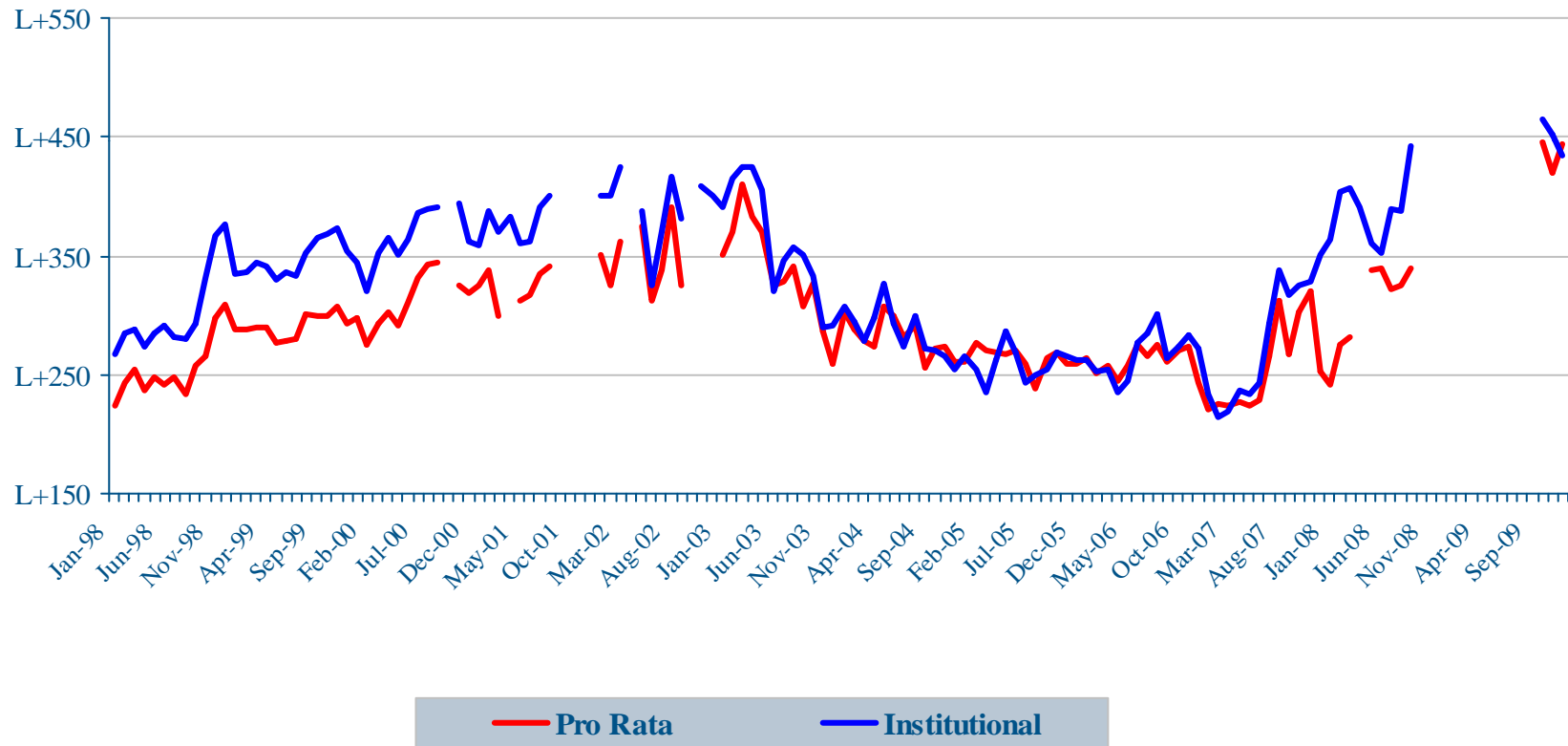
(\$billions)



Loan Spreads Over LIBOR for BB/BB-



Loan Spreads Over LIBOR for B+/B

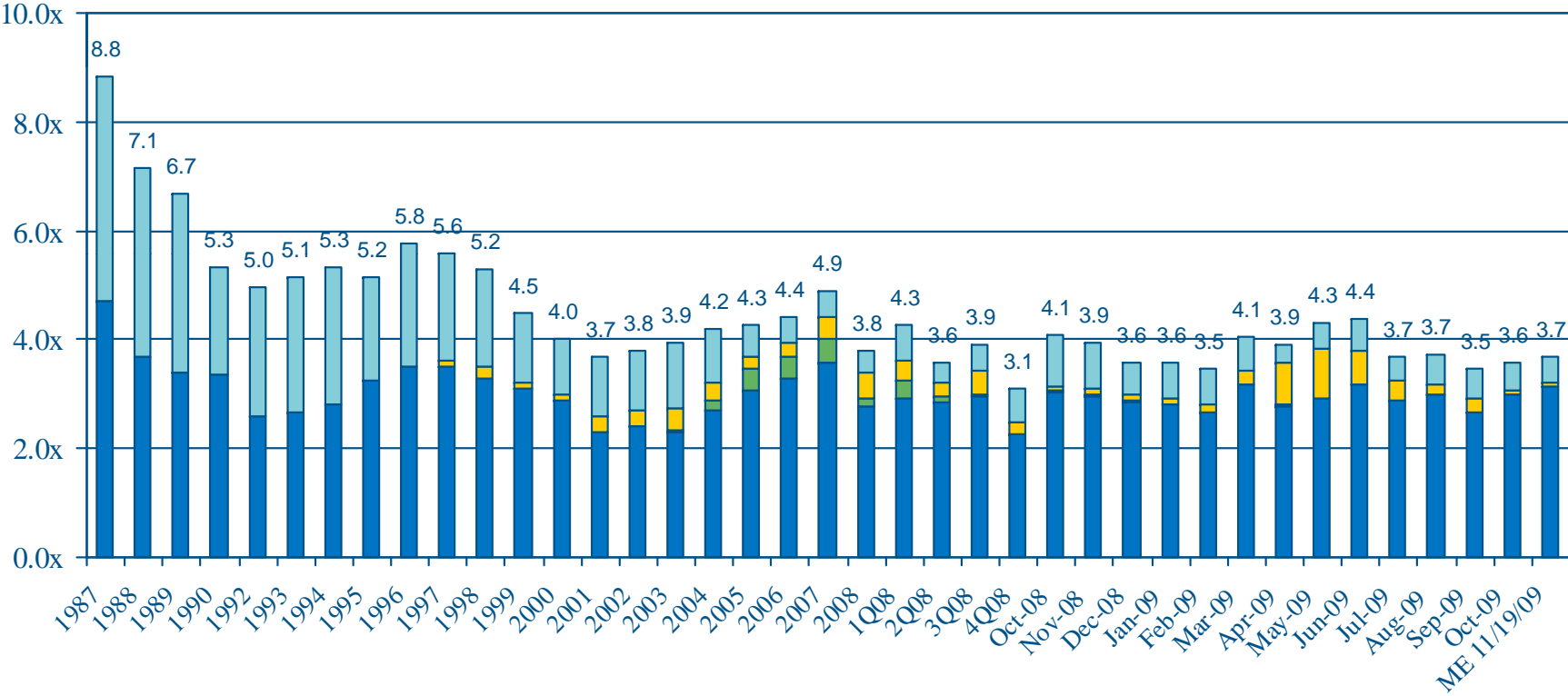


Deal Structure Trends



- Lower leverage, higher equity levels required
- Tighter covenants and security packages
 - More asset-based financing
 - Borrowing bases
- Shorter maturity loans
- Very few dividend recapitalization deals
- Original-issue discounts, higher up-front fees
- Libor floors often set at 2 to 2.5%
- More rigorous excess cash flow sweeps

Average Debt to Cash Flow Multiples



Credit Crisis Impact on Agribusiness

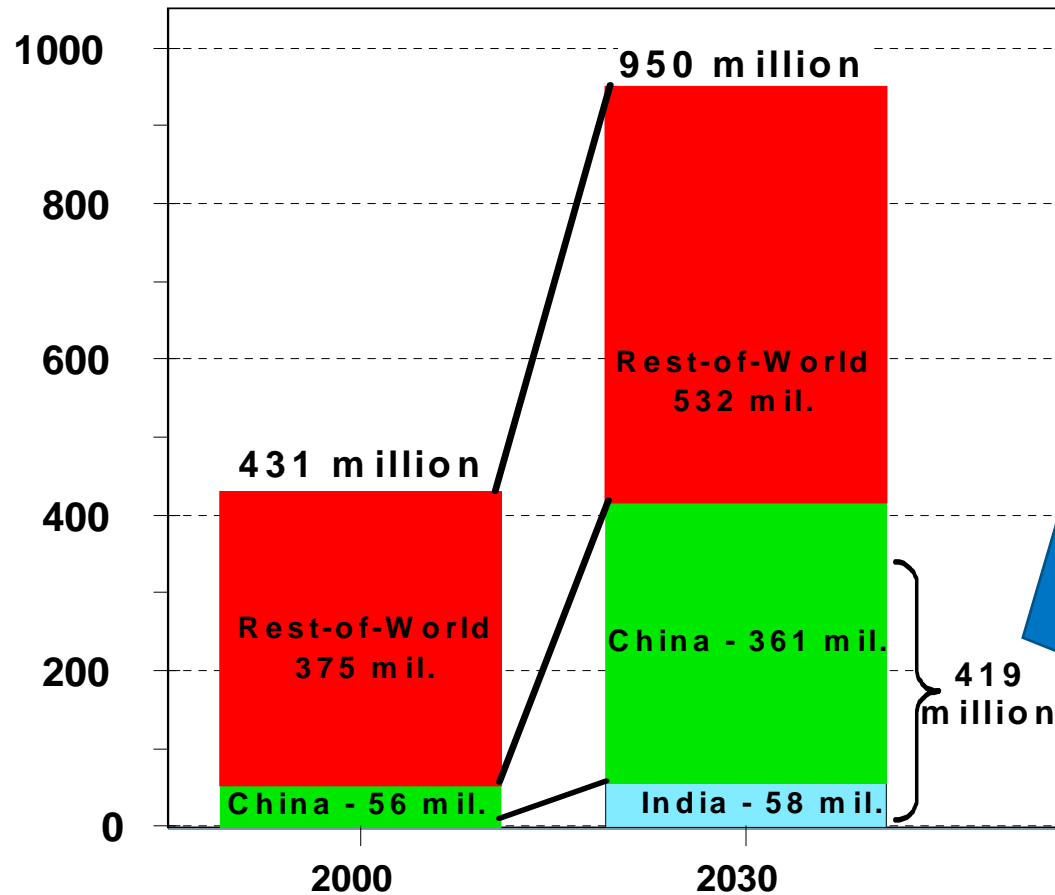


- Financing liquidity and working capital
- Volatile grain, petroleum and fertilizer prices
- Impact on agricultural futures prices
 - Financial investors' positive long term view
 - Funds flow related volatility: hedge funds, commodity index funds and ETFs
 - Commodities as a low correlation asset class
- Deflation bad for commodities, inflation good
- How long will deflation last?
- Fiscal and monetary stimulation vs. recession and deleveraging



Million people

Growing Middle Class



China and India will account for 70 % of the increase in the middle class from 2000-2030. Their "ability to pay" will set global market prices!

- ✓ Income growth (source?)
- ✓ Market access (protectionism)
- ✓ Yield technology (biotech)
- ✓ Political decisions (inward?)

But it is not a straight line growth path!!! Significant volatility will prevail around the growth path!



➤ Commercial banks

- Supportive of top tier relationships
- Reconsidering desired business lines, markets, industries, corporate relationships
- Distracted by mergers and comprehensive restructuring events
- Focused on
 - Credit quality and risk
 - Conservative structures: shorter tenors, tighter covenants, cash flow sweeps, hedging requirements, borrowing bases, and security packages
 - Loan purpose important
 - Higher loan spreads and fees, OID discounts, Libor floors
 - Ancillary business
- Some banks implementing capital allocation committees in addition to credit committees as second level of relationship evaluation

Investor Segments



➤ Insurance companies

- Private placement market following recovery of public bond market
- Selectively returning to the investment grade market
- Sub-investment grade market (NAIC 3 and below) effectively non-existent
- Only very small allocations for floating rate market

➤ CLOs

- Enjoying strong technical factors (loans converting to bonds), loan repayment net inflows
- Loan funding costs still very high
- Some fund merger/consolidation and liquidation

➤ Hedge funds and private equity firms

- More stable now
- Deleveraging at slower pace
- Shifting emphasis to bankruptcy, restructuring, advisory, and distressed trading
- Merger and acquisition activity slowly returning

Farm Credit System



- Generally FCS institutions have strong capitalization ratios
- Relatively clean loan portfolios with historically high credit statistics going into the credit crisis
- Relatively strong GSE funding source
- Virtually all buy-side participants open for new business
- Most buy-side groups have annual asset growth objectives of mid to upper single digits
- Some credit stress in dairy, ethanol, protein, and building products sectors



➤ Global Unwinding of Leverage

- Banks, hedge funds, private equity, and consumers, all in process of unwinding leverage
- Rapid unwinding of leverage associated with the structured finance (securitization) industry
- Government sector taking on new debt, risk of crowding-out of private sector
- Derivative exposure concentrations still unknown to investors

➤ Commercial/investment banks likely to remain under extreme pressure through 2009 and likely into 2010

- Higher minimum capital requirements for all financial institutions likely
- Need to raise more capital, who will provide it?
- Rethinking risk management models
- Substantial internal restructuring and deleveraging
- How will regulatory environment change?

Credit Market Outlook



- Fundamentals of real estate and consumer credit problems likely to have a long tail and tied to unemployment dynamics and deleveraging
- Lender perspective that the economy is poised for recovery. But will it be a jobless recovery?
- Expectation of higher credit losses in many segments
- Credit spreads likely to tighten from current levels as economy continues to recover but refinancing calendar likely to put floor on spreads
- Multiple levels of uncertainty: global economy, role of government (ownership), credit availability, dollar value, financial strength of institutions/counterparties, derivative exposure concentrations, risk management (model) risks, regulatory changes, etc.

Agribusiness Finance Outlook



- Agricultural commodities likely to be volatile
- Lenders will stay focused on risk management practices
- Quality of management teams and ability to mitigate risk will be paramount
- Continued consolidation in the grain/farm supply sector expected
- Capital will be available for strong grain and farm supply operations