

Agribusiness Banking

Are California Cows Really Happy?



A Presentation to:
Center for Dairy Excellence

Presented by:
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Senior Agricultural Risk Manager

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Greeting from the Richly Blessed Land of California



Agenda

- About Bank of the West
- Bank of the West Business Model
- California Agriculture - The Big Picture
- Challenges in the Market
- Question and Answer Period

Our corporate organization



Full-service commercial & retail bank with \$58 billion in assets, over 700 locations and over 10,000 employees. Presence in 19 state regions, representative offices in New York, Taipei and Tokyo.

Our parent company, one of the six strongest banks in the world* with a presence in more than 83 countries.

Hawaii's largest full-service commercial and retail bank, with over \$12 billion in assets and 63 branches in Hawaii, Guam and Saipan.

*As ranked by a major independent credit rating agency.

Bank of the West – Who we are

- Started in San Jose, CA in 1874 as Farmers National Gold Bank
- Third largest bank based in California
- Second largest commercial bank lender to production agriculture
- \$58 billion in assets
- Tier 1 capital ratio of 13.36%

CREDIT RATINGS*

S & P (Uninsured CD's):
 Long-term A+
 Short-term A-1

Moody's (Deposits):
 Long-term A1
 Short-term P-1

Fitch (Deposits):
 Long-term AA-
 Short-term F1+

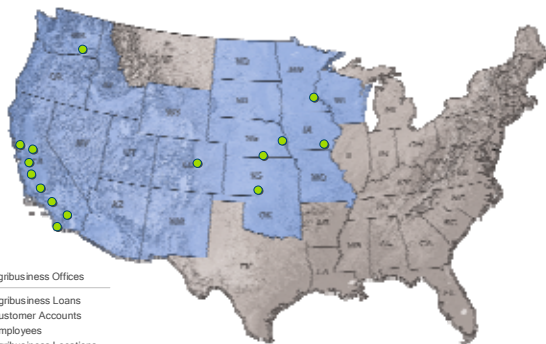
Bank of the West – Competitive Position

- Bank of the West is one of the few US commercial banks with a dedicated Agribusiness Division
- Bank of the West is the 2nd Largest Commercial Bank lender to Production Agriculture in the United States

Bank Name	Year							
	2003	2004	2005	2006	2007	2008	2009	2010
Wells Fargo	3,878,000	5,685,000	6,108,000	6,797,000	6,697,000	8,384,000	8,569,000	9,164,000
Bank of the West	1,035,816	1,416,755	1,567,007	2,017,920	2,370,083	2,744,464	2,965,813	2,997,362
Rabobank		680,194	1,051,896	1,516,008	1,722,073	1,818,450	2,089,500	2,600,592
Bank of America	2,634,677	2,564,387	2,538,292	2,880,528	2,852,578	3,221,157	3,327,500	2,540,390
U.S. Bank	2,024,516	2,012,759	2,123,275	1,993,704	1,881,592	1,830,545	1,787,220	1,696,609

With expertise through many parts of United States

Our network of regional offices, located in major agricultural markets, is staffed by long-term industry experts - most with more than 20 years of experience in agricultural financing.



Sector Driven Business

- Bank of the West is a Sector Driven Business
 - Key Players
 - Key Industries
 - Key Geographical Regions
 - Ag Sector
 - Use of Credit is Much Higher than the C&I Business
 - Cash Management is Significantly Lower

(000's)	Outstandings		Deposits		%
AG Banking	\$	3,249,789	\$	587,725	18.1%
C & I		3,843,089		7,594,267	197.6%
REID		2,407,396		1,042,854	43.3%
Church		1,316,208		99,695	7.6%
Total		10,816,482		9,324,541	86.2%

Snapshot of California Agriculture (2009 statistics)

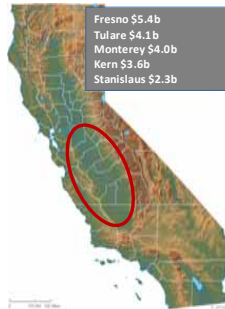
- \$ 35 billion farm output or 16.5% of national farm revenue

Texas	\$21.0b	Illinois	\$16.2b
Iowa	\$24.0b	North Carolina	\$10.4b
Nebraska	\$17.0b	Florida	\$ 7.6b

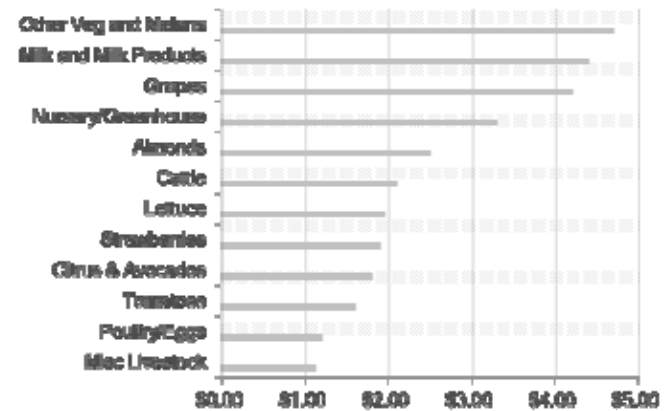
- 9 of top 10 US counties in terms of crop revenue are all in California and account for 7% of national farm revenue
- Comprised of 37 crop segments representing 350 +/- crops
- The State leads US in the production of more than 70 crops
- California is the exclusive U.S. producer of at least 12 crops including, but not limited to:

Almonds	Figs	Pistachios	Raisins
Artichokes	Olives	Pomegranates	Walnuts
Dates	Persimmons	Prunes	

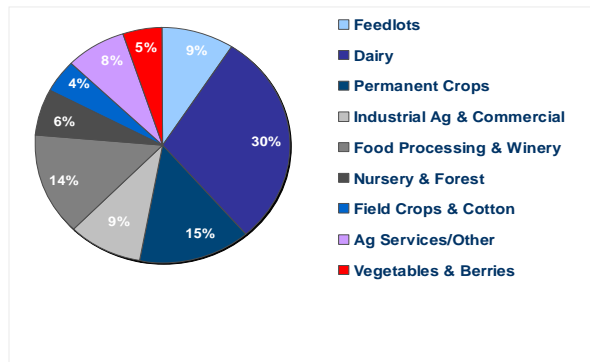
- The State produces 70% to 99% of 11 other crops, including table & wine grapes, stone fruit and fresh market citrus.
- Vast majority of crops are harvested by hand.
- California's production of fruits, nuts, and vegetables accounted for more than 55% of the nation's total production



Revenue of Various Commodities (in \$ billions)



Granularity of Portfolio and Geographic Diversity



About the California Dairy Industry

- In 2010, California was the largest producer of milk in U.S. accounting for 21% of total production.
- 5 counties located in the Central Valley recorded 71% of the state's milk production and 15% of the nation's milk production.
- 41% of CA's milk supply went to cheese production and over half of the cheese produced was mozzarella.
- USDA reports 1,710 licensed dairies in CA averaging 1,083 milking cows per farm (ranging from 300 +/- to 15,000 cows)
- In comparison, the second highest milk producing state is Wisconsin with 12,710 licensed dairies, but an average of only 99 cows per farm. Wisconsin was responsible for production 13.5% of the national production.
- The industry faces enormous challenges that may well put it at a competitive disadvantage in the future.

Today, Challenges Outweigh the Opportunities

Two Californias

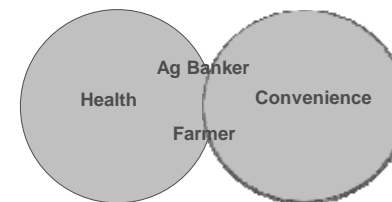


California Consumption Habits "Gravitating to Extremes"



- ❑ Consumers are persuaded by factors other than price
- ❑ Retailer are driving consumer preferences capitalizing on either convenience or health trends

Consumer Habits "Extremes are Beginning to Merge"



- ❑ Some Farmers are getting swept away unable to adapt.
- ❑ Some Bankers struggle with sales concentration, market transition and competency risks.

California Consumption Habits Milk Products are More Elastic Than They Used to Be

Elasticity of Demand – How sensitive is the demand for a product to the change in the price of that product.



What is the most inelastic ag product according to research?

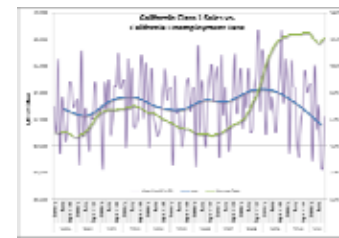
Coffee

Starbuck served 20 million customers a week in 2002. In 2007 it was closer to 57 million!

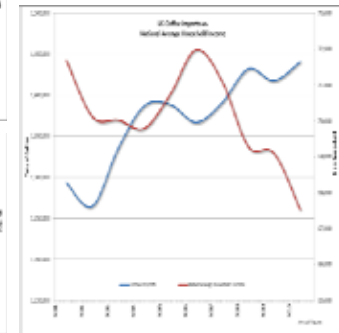
What is the next most inelastic ag product according to research?

Bottled Water

More than half of all Americans drink bottled water; a 1/3 consumes it regularly. Sales have tripled in the past 10 years, to about \$4 billion a year.



I may be just a dumb banker, but someone could draft a thesis around this kind of stuff.



Key Drivers of Global Demand through 2020

US continues to be “food wasters”- growth comes from what we throw away.

80% of world population will be in developing countries

- > Slowing Population Growth
- > Expansion of the middle class
 - > Higher standard of living
 - > Increased Urbanization
 - > Convenience and pre-packaged foods
- > Hunger will not go away because of political and social availability of resources
 - > Caloric intake continues to suffer in under-developed countries
 - > For the foreseeable future there will continue to be the need for basic protein

Key Drivers of Global Supply through 2020

- 68% of arable land is currently in production. More land is expected to come into production.
- Genetic seed development and higher use of fertilizer in developing countries will expand production even without an increase in production acreage
- Water availability is going to be every farmers issue. In some areas it won't be whether you have it, but who owns it.
- Comparative advantage appears to be moving to South America, Oceania for grain, dairy and protein

FAO Report – Global Demand for Food Will Slow!

- ❑ Growth rates of world agricultural production and crop yields have slowed. This has raised fears of prolonged food shortages
- ❑ Slowdown is not because of shortages of land or water but rather because demand for agricultural products has also slowed. Growth rates have been declining since the late 1960s, and fairly high levels of food consumption per person are now being reached in many countries, beyond which further rises will be limited.
- ❑ As a result, the growth in world demand for agricultural products is expected to fall from an average 2.2% per year over the past 30 years to an average 1.5% per year for the next 30 years. In developing countries the slowdown will be more dramatic.

❑ Global food shortages are unlikely!

10% Population growth through 2040
26% Consumption growth
38% More supply

Challenges Specifically Facing the California Dairy Industry

- Lack of processing capacity. It is not going to get better anytime soon because of environmental, health, permitting restrictions and the changes many years ago in the federal government price support programs for low value dairy products.
- More production per cow, more cows and feedlots full of young replacement heifers.
- High input cost dependency
- National supply management proposals that I believe would be unfavorable for the state's most efficient producers.
- Price risk management "knowing-doing gap" vs. pressure by lenders to manage profitability long-term.
- Manure management /dairy bio-gas systems are one of the important means producers use to comply with environmental regulations and create energy for the dairy. Regulatory burdens, disparate technical information and utility interconnection have made it very difficult.

Opportunities

- Near to intermediate global demand appears healthy
- Consolidation of dairy cooperatives has enhanced the members' bargaining powers. (some argue the average dairyman, however, is losing his/her influence in the cooperative as larger operators have better negotiation power)
- Value added opportunities for large processors and the small dairy farmer.
 - The probiotic, energy bar craze and has been a boon for processors and dairy cooperative member
 - Pharmaceutical ingredients
 - Strong consumer interest in locally produced foods like artisan cheeses has opened marketing channels for many small and some larger dairies. This is a tough road to hoe because of the higher cost of operation, remoteness to major markets and competitive global landscape. The challenges are similar to the California ultra premium wine market.

2011 Outlook

- Herd and feed Loans are structured on a revolving basis
 - Herd Loans are amortized 84 months or less with monthly payment = to 1/84th of the loan commitment . The payment can be borrowed back for herd replacement or general operating expenses.
 - Feed loans require a monthly payment based on predetermined feed usage. Again, the payment can be borrowed back for feed purchases.
 - Occasionally, corn silage purchases are structured on a straight 12 month note with monthly payment equal to usage.
 - Maximum advance rate against the herd is 65% of Bank approved collateral values. Values are updated at least annually and represent about 75% of market value. So, advance rate is 65% of 75% of market value. (What gets banks in trouble is advancing against some local market value)
 - Maximum advance rate against the feed is 100%

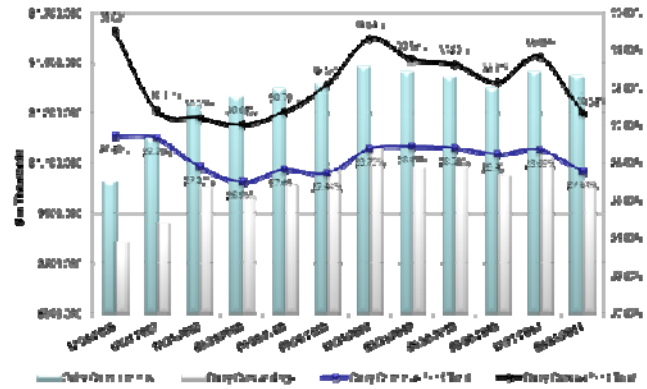
- Maximum advance rate against the feed is 100%
- Hedge lines of credit

Loan Monitoring

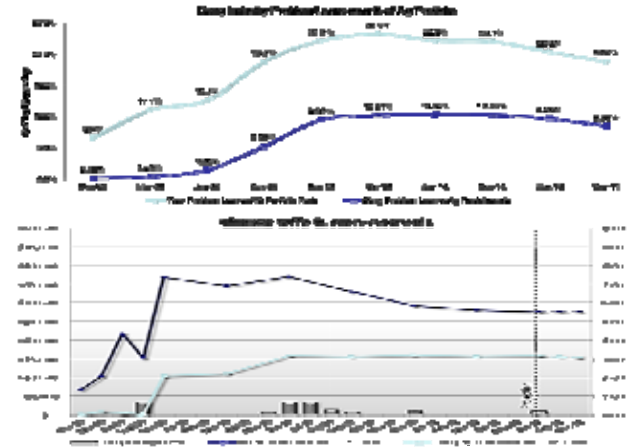
- At least quarterly loan position reports provided by the borrower detailing collateral and advance rates:
- Position report includes all payable offsets that could impair collateral position. Such items would include payables for roughage, grain and concentrates
- BOW maintains its own field department that inspects each dairy at least twice a year and provides a independent loan position report, facility, feed and herd maintenance report.
- Well over 70% of our borrowers are required to provide CPA reviewed quality financial statements by an industry savy accounting firm such Genske Mulder or Frazier Torbett.
- Access to monthly creamery statement and full assignment of milk checks is pretty standard.

Risk Management and Strategy

Portfolio History



Problem Loan History



Risk Management

We treat the Dairy Industry as a specialization

Dairy Sector Specialists

- In California (Chino, Fresno, Tulare, Modesto, Sacramento)
- In Colorado (Fort Collins)
- In Washington (Tri Cities)
- Midwest (Omaha)

Instrumental in all decisions concerning the sector including:

- Review of all dairy sector relationships and credit actions by one of two sector specialists prior to submission for approval
- Standardized template for dairy underwriting
- Participate in pre-screening of all new dairy requests over \$5MM
- Prepare annual industry Segmentation Report with periodic updates
- Maintain dairy sector risk database

Dairy Sector Risk Migration

- ABD, Credit Administration and Ag Field Office began joint effort to forecast dairy sector migration in February 2009 and projected out on a rolling 6 month basis. Migration based on known LTV's and forecasted future losses (derived from analysis of milk price futures vs. feed costs)

State	Count	1 MONTH			2 MONTHS			3 MONTHS		
		7's	8's	9's	7's	8's	9's	7's	8's	9's
WASHINGTON	6	\$ 12,238.8	\$ 6,030.8	\$ -	\$ 12,238.8	\$ 6,030.8	\$ -	\$ 12,238.8	\$ 6,030.8	\$ -
SACRAMENTO	1	\$ -	\$ 2,840.1	\$ -	\$ -	\$ 2,840.1	\$ -	\$ -	\$ 2,840.1	\$ -
WICHITA	1	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
MINNESOTA	6	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
VISALIA	23	\$ 51,261.6	\$ 22,882.3	\$ -	\$ 51,261.6	\$ 22,882.3	\$ -	\$ 51,261.6	\$ 22,882.3	\$ -
FRESNO	12	\$ 51,228.7	\$ -	\$ -	\$ 51,228.7	\$ -	\$ -	\$ 51,228.7	\$ -	\$ -
CHINO	60	\$ 66,177.9	\$ 77,857.9	\$ 4,720.7	\$ 66,177.9	\$ 77,857.9	\$ 4,720.7	\$ 66,177.9	\$ 77,857.9	\$ 4,720.7
MODESTO	27	\$ 32,577.8	\$ 10,126.2	\$ 131.6	\$ 32,577.8	\$ 10,126.2	\$ 131.6	\$ 32,577.8	\$ 10,126.2	\$ 131.6
FT. COLLINS	47	\$ 12,238.8	\$ 27,963.2	\$ -	\$ 12,238.8	\$ 27,963.2	\$ -	\$ 12,238.8	\$ 27,963.2	\$ -
SUB TOTAL	243	\$ 227,824.1	\$ 147,860.1	\$ 4,852.3	\$ 227,824.1	\$ 147,860.1	\$ 4,852.3	\$ 227,824.1	\$ 147,860.1	\$ 4,852.3
TOTAL DAIRY COMMITMENTS	243	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3
TOTAL DAIRY OUTSTANDINGS	243	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3	\$ 186,135.1	\$ 136,841.6	\$ 4,852.3

Appetite Matrix

Existing Relationships				
Herd LTV	< 50%	50% - 65%	65% - 75%	> 75%
Feed LTV	Conforming		Non-Conforming	
Sustainability @ \$40/hd/mo loss	18 mos +	12 mos - 18 mos	6 mos - 12 mos	< 6 mos
Management	Excellent	Strong	Average	Weak
Hedging/Contracting Strategy	In place, covering inputs and outputs, looking in margin	In process of developing all inclusive hedging strategy to lock in margins	Covers only inputs or outputs - doesn't lock in margin	None
Typical Risk Grades	5	5 / 6	6W / 7	7 / 8

New Relationships				
Herd LTV	< 50%	50% - 65%	65% - 75%	> 75%
Feed LTV	Conforming		Non-Conforming	
Sustainability @ \$40/hd/mo loss	18 mos +	12 mos - 18 mos	6 mos - 12 mos	< 6 mos
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Typical Risk Grades	5	5 / 6	6W / 7	7 / 8

STRATEGY

- Maintain a conservative approach to dairy lending.
- Become the sought after dairy lender based on our conservative, consistent and pragmatic approach. We do not want to finance every dairyman.
- New opportunities should be the larger dairy operations with sophistication in management, good books & records and ability to adapt to changing market conditions.
- Continue to use specialization to maintain portfolio quality.
- Educate dairy clients on the benefits of price risk management
- Continue with existing portfolio management strategy and add a "sustainability quotient" (that I would like to share with you today)

With All That Being Said, There is One Last Important Graph.....

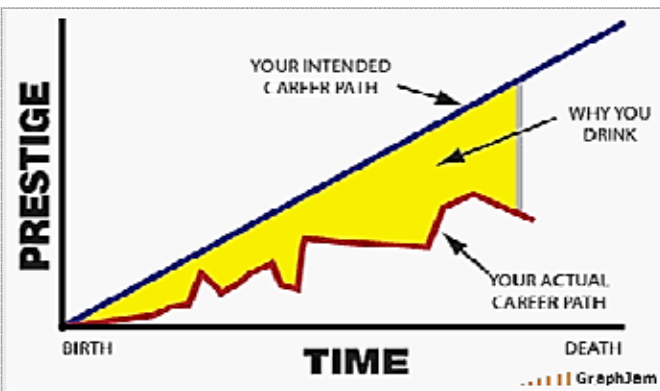


Table Top Exercise

- All In Breakeven Analysis
- Sustainability Analysis
- Stress Testing

BANK of WEST 

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