

Committed to the business of agriculture.



The Egg Industry – A Lender’s Perspective

April 21, 2016

Agenda

- **A Look Back at 2015 and the High Path Avian Influenza Outbreak**
- **A Look Forward – The Cage Free Movement**





**Farm Credit Services
of America**

Who Is Farm Credit Services of America?

- **Farm Credit Services of America is one of 75 cooperatively owned Associations in the Farm Credit System.**
- **The Farm Credit System was created by an act of Congress 100 years ago to provide dependable funding for American agriculture and rural America and today serves more than 500,000 member borrowers across the U.S. and Puerto Rico.**
- **Today the System's loan portfolio exceeds \$200 billion.**
- **Farm Credit Services of America is headquartered in Omaha, Nebraska and is the nation's largest assoc. with approx. \$25 Billion in Assets. It's assigned Territory includes the states of Nebraska, Iowa, South Dakota, Wyoming and now Eastern Kansas through a recent Alliance with Frontier Farm Credit.**
- **Industry Specialization and Expertise in the Poultry, Dairy, Beef, Pork, Ethanol and Agribusiness Lending Industries help set us apart.**
- **Today the Poultry Team manages a \$1 Billion Loan Portfolio and is one of the Largest Egg Industry Lenders in the Nation.**



A Look Back at 2015 and the HPAI Outbreak



Topics of Discussion

- **What We Experienced**
- **What We Discovered**
- **Actions We Took**
- **The End Result!!**
- **Steps you Should Take**





**Farm Credit Services
of America**

What We Experienced

Unfortunately for some of the Egg Industry clients we serve the impact was great. All told, those clients lost approx. 27MM of the 41.7MM Commercial Layers and Pullets lost to HPAI in 2015.





What We Discovered

- **A Government Indemnity Program that provided reimbursement at or above Net Book Value for the layers and pullets lost to HPAI as well as funds to cover bird depopulation and disposal costs and facility cleanup and disinfection costs.**

Funds that proved essential in providing;

- **working capital to support the dollar investment required to repopulate impacted sites with new laying hens.**
- **flexibility in restructuring long term debt obligations during the time required to repopulate production sites.**





Actions We Took

- In some cases, where only one of a customer's multiple egg production locations was impacted by HPAI, no debt restructuring was required as sufficient net funds from other income sources existed to service scheduled principal and interest payments.
- In other cases, depending on other available net income sources, one of the following courses of action was taken;
 - Interest only payments during the repopulation period with principal payments due during the repop period deferred, re-amortized and scheduled to commence after site repopulation is completed.
 - Capitalization of interest payments and deferment of principal payments due during the repop period all re-amortized and scheduled to commence after site repopulation is completed.





**Farm Credit Services
of America**

The End Result!!

We can Proudly claim that all of the impacted clients we serve our in the process of repopulating their HPAI impacted facilities and that most of them will complete that process in late 2016 or early 2017!!





**Farm Credit Services
of America**

Steps You Should Take

- **Prepare and Plan from a Financial Standpoint for an Avian Influenza outbreak.**
- **Generate projection forecasts to understand the impact a partial or complete outbreak would have on your Company's financial position and future.**
- **Find out what your Lender is prepared, willing and able to do for you if your Company experienced such an unfortunate event.**
- **Insure access to Government Indemnity funds by having and following a written Bio-Security Plan. Establish an internal or external auditing program of said plans to insure compliance with it.**
- **If further Bio-Security changes are needed, what will the cost to complete them be and can you count on your Lender to provide financial support assistance for them?**



A Look Forward – The Cage-Free Egg Movement



Topics of Discussion

- **Cage-Free Commitments To Date**
- **Number of Laying Hens Needed to Meet that Commitment**
- **Potential Capital Cost to Meet that Commitment**
- **Can the Egg Industry Rise to the Challenge?**
 - **Potential Obstacles**
 - **Reason's to be Optimistic**





Cage-Free Commitments to Date

Restaurant Chains - 44



Includes 15 of the Top 25 Restaurant Chains



Cage-Free Commitments to Date Cont.

Food Service – 6



Includes the Nation's Top 5 Food Service Company's





Farm Credit Services
of America

Cage-Free Commitments to Date Cont.

Food Manufacturers - 12



Cage-Free Commitments to Date Cont.

Hospitality & Travel - 7





Farm Credit Services
of America

Cage-Free Commitments to Date Cont.

Grocery Stores - 61





Farm Credit Services
of America

Cage-Free Commitments to Date Cont.

Grocery Stores 61



Cage-Free Commitments to Date Cont.

More to Come???





Estimated Hens Needed to Meet that Demand

As referenced in a recent UEP article, there are approx. 13,000,000 cage-free non organic hens that produce approx. 3.5 billion eggs per year (assuming a rate of lay of 270 eggs per hen per year as per current NASS data). Assuming the same rate of lay, it would take approx. 145 million additional hens to produce the est. eggs needed to satisfy all of the current Commitments.

Food Category	Annual Egg Need*	Hens Needed
Restaurants	8,200,000,000	30,300,000
Food Distributors	1,000,000,000	3,700,000
Hospitality & Travel	110,000,000	400,000
Grocery Stores	<u>33,450,000,000</u>	<u>124,800,000</u>
Sub Total	42,760,000,000	157,800,000
Less Current Production	<u>-3,500,000,000</u>	<u>-13,000,000</u>
TOTAL NEED	39,220,000,000	144,800,000
For Each 5% Increase	1,960,000,000	7,260,000

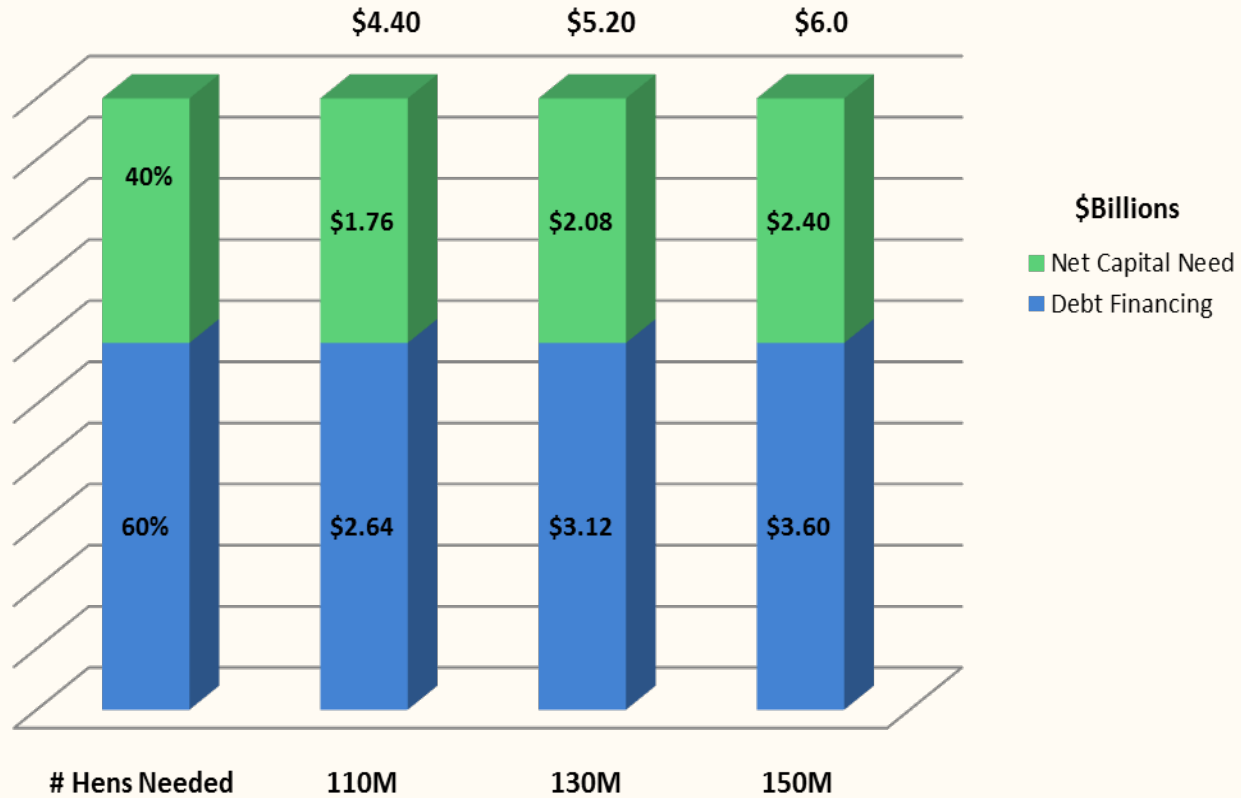
* Does not include food manufacturers.

Source: USDA Agricultural Analytics and United Egg Producers (est.)



Potential Capital Cost to Meet That Commitment

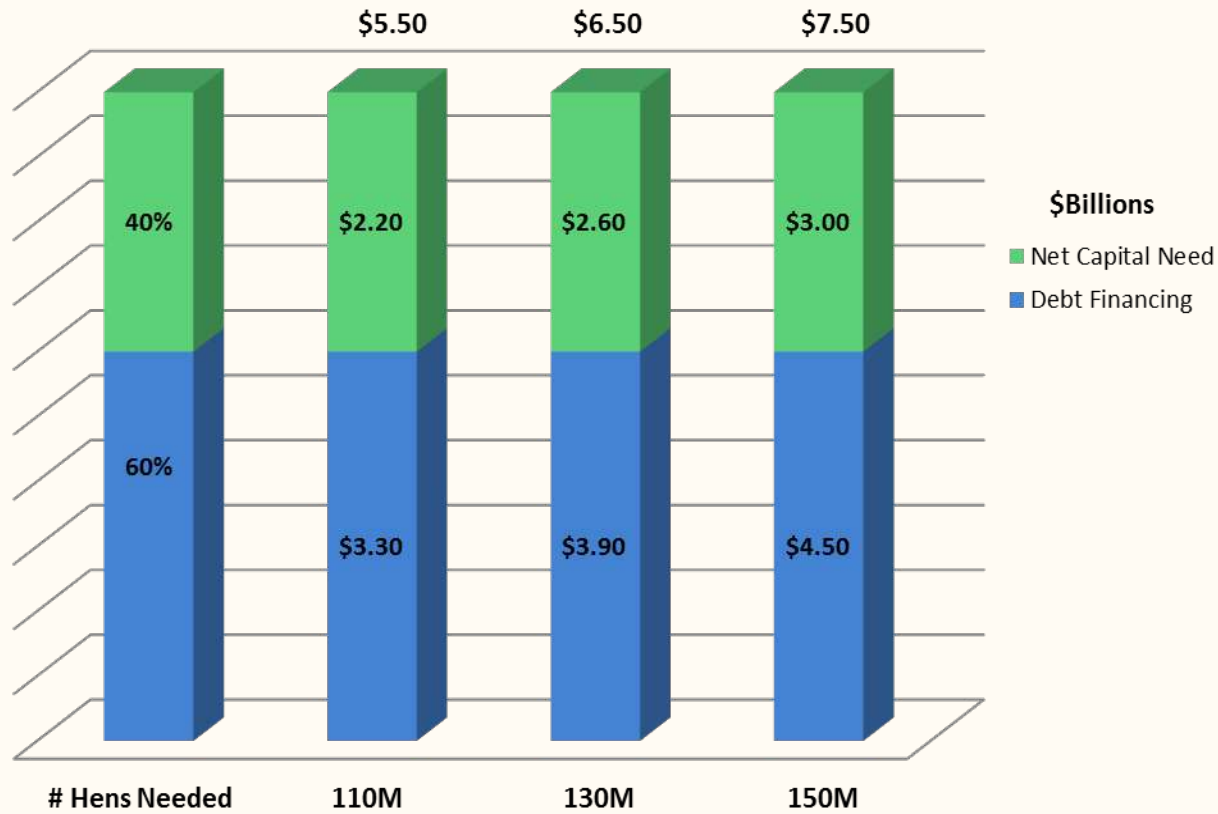
Estimated Capital Cost Per Hen = \$40





Potential Capital Cost to Meet That Commitment

Estimated Capital Cost Per Hen = \$50



Potential Capital Cost to Meet That Commitment

Key Assumptions and Considerations;

- **Capital cost estimates do not include working capital required for birds, feed, other inventories and supplies. Capital which already in part exists if new cage-free hens are truly replacing hens in existing non cage-free housing systems.**
- **Acknowledges that the facility requirements needed to meet current Market Commitments will vary in size and scope and those variances will affect per hen costs to convert i.e.**
 - **Greenfield Project versus the Conversion and/or Expansion of Existing Facilities.**
 - **Processing and/or Feed Mill facilities may not be required at many locations.**
 - **Costs and spacing requirements of Cage-Free Aviary Systems versus Cage-Free Floor Systems.**



Potential Capital Cost to Meet That Commitment

Key Assumptions and Considerations (Cont.);

- Acknowledges that Terms and Product Specifications between Producer and Retail Buyers may vary and in turn affect project costs.
- Acknowledges that the available Financing Levels will vary by Project depending on;
 - The Strength of the Historical Lending Relationship between Lender and the Borrower and its Owners.
 - The Financial Position and Historical Profit Performance of the Borrowing Party and its Owners.
 - The Projected Financial Returns of the Project and Borrowing Parties.
 - The strength of the Marketing Plan for the Cage-Free Eggs being produced and the length and terms of Egg Supply Contracts between Producer and Retailer relative to that plan.
 - Loan Guarantor Support (if any).
 - The Level of Collateral Support for the required Loans.





**Farm Credit Services
of America**

Can the Egg Industry Rise to the Challenge?

- **Potential Obstacles**
- **Reasons to be Optimistic!**



Potential Obstacles

- **Availability of Credit**
 - **Lender Appetite - Post 2015 HPAI Outbreak?**
 - **Some Lenders may choose to not finance the Egg Industry based on this risk.**
 - **Would expect those Lenders already involved to continue, but would anticipate their Lending Requirements will tighten and their Hold Limits may Shrink.**
 - **Future Appetite if another HPAI Outbreak occurred?**



Potential Obstacles Cont.

- **Availability of Credit (Cont.)**
 - **Impact on Future Value of existing Non Cage-Free Facilities on Lender Capital Availability?**
 - **To reduce risk Lenders typically secure a Collateral interest in all Fixed Assets of a Company.**
 - **Today many Company's have Multiple Production Sites.**
 - **Over this period of transition the Market Value of Non Cage-Free facilities may decline which would negatively impact the Collateral Support provided by such facilities.**



Potential Obstacles Cont.

- **Performance of Egg Markets during this Transition Period?**
 - A down turn in Egg Markets to levels below the cost of production will erode existing Industry Capital levels.
- **Availability of Construction Materials, Contractors, Equipment & Labor needed for such a Large Undertaking?**
- **Ability to Obtain Permits at Existing or New Locations?**
 - Obtaining Permits has often been a challenge for the Egg and Livestock Industries and continues to be one, even in Rural Areas.



Potential Obstacles Cont.

- **Impact of a Higher Cost Cage-Free Egg on Consumer Demand?**
 - Today's Markets provide the Consumer of Eggs the ability to choose between Cage-Free and Non-Cage Free Eggs.
 - What impact will the Elimination of the Lower Cost Choice have on Consumer Demand?
- **Future HPAI Outbreak?**



Reasons to Be Optimistic!!

- **The Financial Foundation of the Egg Industry Is Strong!**
- **Consumer Demand for Eggs is Growing!**

While HPAI caused Demand to drop last year as Product Availability Fell and Egg Prices Escalated. Per Capita Demand for Eggs is now back on the Rise!

- **In 2014 the Nielsen and the American Egg Board reported average Per Capita Egg Consumption at 267 eggs per person. This compares to a 2015 average of 253 eggs per person and a 2016 projected average of average of 267 eggs per person!**
- **Eggs are not just for Breakfast anymore!**
- **Eggs continue to be one of the Healthiest, Most Nutritious and Lowest Cost Protein Choices!**
- **Quick Serve Restaurants and Quick Serve Egg Products have made it easier for a World on the Go to consume Eggs!**



Reasons to Be Optimistic!!

- **Other Sources of Capital are Available!**
 - Private Investment Companies and/or Individuals with a desire to diversify their investment pool.
 - Formation of a Joint Venture with other Egg Company(s) to pool capital and spread out risk.
 - Contract Farm Arrangements
 - Public Offerings.
- **The Market and the Consumer is Asking for this Change!**
- **This Movement is Considered Positive from a Hen Welfare Standpoint!**



Questions?



Thank You!!

Contact Information

Jeff Coit

605-261-7957

jeff.coit@fcsamerica.com

