"What the Financial/Credit Crisis Means To the Agriculture and Food Industries"

Remarks by Paul E. Marsh, Principal
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Introduction

Good morning. It is my pleasure to join this distinguished panel today to discuss the potential impacts of the recent financial/credit crisis upon agriculture. We have experienced an unprecedented change in the outlook for the farm sector in just the last six months brought on, in part, by the fallout from the current U.S. financial/credit crisis. I would like to make a few comments about insurance company lenders, the lending environment, and challenges to the farm economy, land values, and investors.

First, let me say that the comments and opinions I express today are my personal views based upon my professional experience in agriculture. My perspective comes primarily from my role as the portfolio manager for Prudential's $2.49 billion Ag mortgage portfolio as of 9/30/08. Prudential has been serving the long term financing needs of family farm land owners, operators, and agribusinesses for more than 100 years. Today we have Ag lending relationships in more than 30 states.

Ag Lending from Insurance Companies

Historically, insurance companies have provided mortgage financing for the intermediate and longer term segments of the Ag credit market. We offer a variety of variable and fixed rate pricing structures for loans typically from 3 to 20 years. Insurance lenders receive their funds primarily from insurance policy and retirement product premiums, or from other institutional investors. These policy premiums must be invested to meet the long term obligations under various insurance policies and retirement products. Insurance lenders typically utilize "matched funding" strategies to balance long term liabilities with long term assets, thus we are able to offer competitive long term, fixed rate mortgage loans.

Total credit provided to the Ag sector by the Insurance company lenders was $18.2 billion as of 6-30-08. Excluding timberland loans, insurance lenders provide approximately 13% of the total US Ag real estate debt projected by USDA for 2008. Like most Ag lenders, insurance company Ag loan portfolios are in good shape with very low delinquency rates (0.38%) as of June 30th.

However, going forward, with reduced margins expected for many Ag sectors in 2009, the perceived risks in Ag have increased somewhat. Accordingly, spreads have widened and rates have increased, but loan funds are available. Higher mortgage rates today are consistent with nearly all other aspects of the longer term credit markets in today's environment. With the financial turmoil, investors have moved funds to more liquid and lower risk assets such as Treasuries. Within insurance companies, funds committed for agricultural lending must compete with the risks and returns (spreads) available in other segments of the fixed income capital markets.

Impacts on the Ag Sector

Most segments of the Ag economy are in a relatively strong position to face the current financial conditions. According to USDA, the Ag sector has a very strong balance sheet with a record low debt to asset ratio around 10% projected for 2008. This is an average, and of course there is significant variation in the debt structures amongst different Ag segments, Ag producers, and agribusiness firms. A significant portion of agricultural landowners in the U.S. have no debt.

USDA's forecast for net farm income in 2008 is a record $95.7 billion, which would be more than 50% above the last 10 year average. Conditions in the U.S. farm economy are much improved over conditions in the 1980's, the last time we experienced such a precipitous decline. A lower debt structure, lower interest rates, new global food feed and fuel demand, and lenders who focus more on cash flow and debt service capacity versus asset based lending make this environment different than in the 1980's.

However, with the recent rapid decline in commodity prices and a slowdown in the global economy, I expect farm earnings to decline in 2009. Agricultural producers are facing challenges:

- Profits for livestock producers have been squeezed in recent years and losses have occurred due to high feed and energy costs. However, with the recent decline in these costs many livestock producers will be in a better position, unless they are too highly leveraged or their primary markets are dislocated.
- Most crop producers are concerned about lower commodity prices and significantly increased costs of production for 2009. For example, the production costs for corn growers (seed, fertilizer, chemicals, fuel, etc.) are nearly double the average costs during 2003-2007. While harvest prices for corn today are around $3.50/bu in the Midwest, breakeven costs for 2009 are nearly $4.00/bu before adding the land costs according to some university projections. Prices for fertilizer and fuel are now declining, but higher cost inputs purchased by suppliers earlier in the season will have to be cleared out of the pipeline or averaged into the costs of lower priced supplies before spring.
- Many farmers missed out on the opportunity to lock in higher prices for the 2008 crop due to the uncertainty of how much crop they would have to sell from the weather challenges this spring, plus some grain elevators stopped offering forward contracts due the extraordinary costs for margin calls caused by the volatility in the market.
- Land costs (rents) have been increasing. Some of the very high headline rents negotiated in late summer and early fall before the dive in commodity prices may be a real challenge for those producers unless crops were hedged or contracted to

lock in margins. Mother Nature will need to be reasonably kind next year, but as always, one never knows. High rents or debt service costs may increase the breakeven costs for corn production to more than $5.00/bushel according to some university analyses. Unless producers receive adequate price incentives to produce high cost crops such as corn and cotton, we may see some cutbacks in fertilizer or other inputs, or shifts to lower cost crops such as soybeans.

Most credit worthy borrowers will receive adequate operating capital but some highly leveraged borrowers may have challenges as lenders impose stricter credit standards to reflect the current conditions. Lenders will be looking even more closely at projected cash flow and will require that borrowers have adequate levels of working capital from retained earnings versus relying too much upon borrowed funds. Lenders will look more closely at crop insurance and other risk protection strategies, and may require more scenario or sensitivity analysis to be sure those borrowers can repay loans or make required debt service payments under these more volatile conditions. Some leveraged borrowers may need to term out some of their short term operating debt. Many Ag borrowers have capacity to do so on their balance sheets if cash flow is adequate. Further consolidations may occur as stronger producers absorb the assets of more highly leveraged participants.

Farmland Values

- Recent farmland auctions in the Midwest indicate that farmland values may have reached a plateau and are beginning to soften. High quality land is still in demand, mostly by neighboring farmers, some of which are paying cash for smaller sized parcels. While some sales are strong and have occurred at prices near the peak last summer, others have traded at prices around 5-10% below the peak.
- The market for lower productive land or land for recreational use has softened more significantly.

Farm Investors

- With the break in the housing bubble, the demand from developers a few years ago for so-called “path of progress” farmland has nearly dried up. In the last few years with higher commodity prices and expected earnings, farmers have been the most significant buyers.
- Farmland values have been bid up but rents have not kept pace with the rapid increase. Accordingly, Rent-to-Value ratios in the Corn Belt states have declined from the 4-5.5% range in 2004 to the 2-4% range in 2008 according to data from Doane’s Agricultural Service. Increased volatility implies that income capitalization rates should rise and this may also contribute to lower land values.
- Outside investors make up a relatively small but important part of the Ag sector’s equity capital structure. Some investors have been attracted to farmland in recent years with the expectation that long term global demand for food and biofuels will continue to support farmland earnings and values. However, with the recent rapid

decline in commodity prices and reduced earnings expectations, I would expect that some investors may be inclined to pause to see how all of this may shake out, or look very carefully at opportunities. A few landowners are selling land in the expectation that capital gains tax rates will be increased to help pay for the substantially increased federal debt.

My Biggest Concerns:

1. How long the global recession will last and how deep it will go since this will impact demand for US agricultural products.
2. Exchange rates. With a stronger dollar, US Ag exports are less competitive in global markets.

Summary

The Ag sector, Ag lenders, and most Ag borrowers are reasonable well positioned to face the challenges of the current environment. Near-term, producer margins are being squeezed in several Ag sectors and there are challenges with the increased volatility and financial market uncertainty. I am hopeful the unprecedented liquidity pumped into the financial system by the Fed will have its intended effect and help stabilize financial market conditions soon. However, the success of the farm economy will depend upon the global recession not going too deep or lasting too long. While we have near-term challenges, I am optimistic that longer term, with growing populations, the global demand for food, feed, fiber and biofuels will provide fundamental strength to the U.S. farm economy.