Consolidation and Producer Impacts in U.S. Ag Co-ops: Is Bigger Better?

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The Landscape in the U.S. Midwest: Consolidation of Local Cooperatives

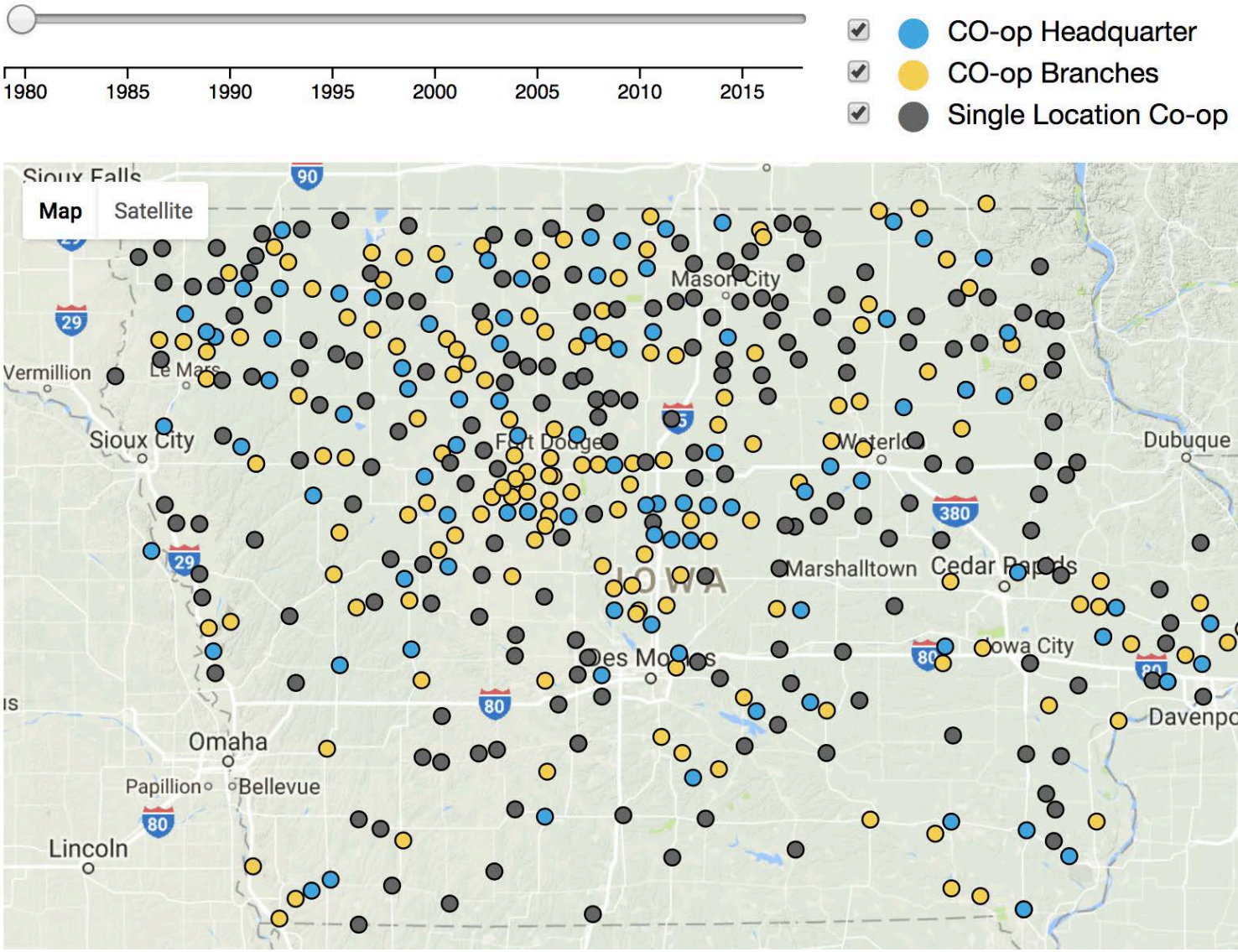
Consolidation at all levels of the ag supply chain

- Fewer marketing firms, but not necessarily fewer grain-buying locations
- "Co-ops are getting too big."
- "There's less competition."

What, if at anything, has been the impact of consolidation on producers?

- Is there evidence of market power?
- Are co-ops getting better through consolidation?

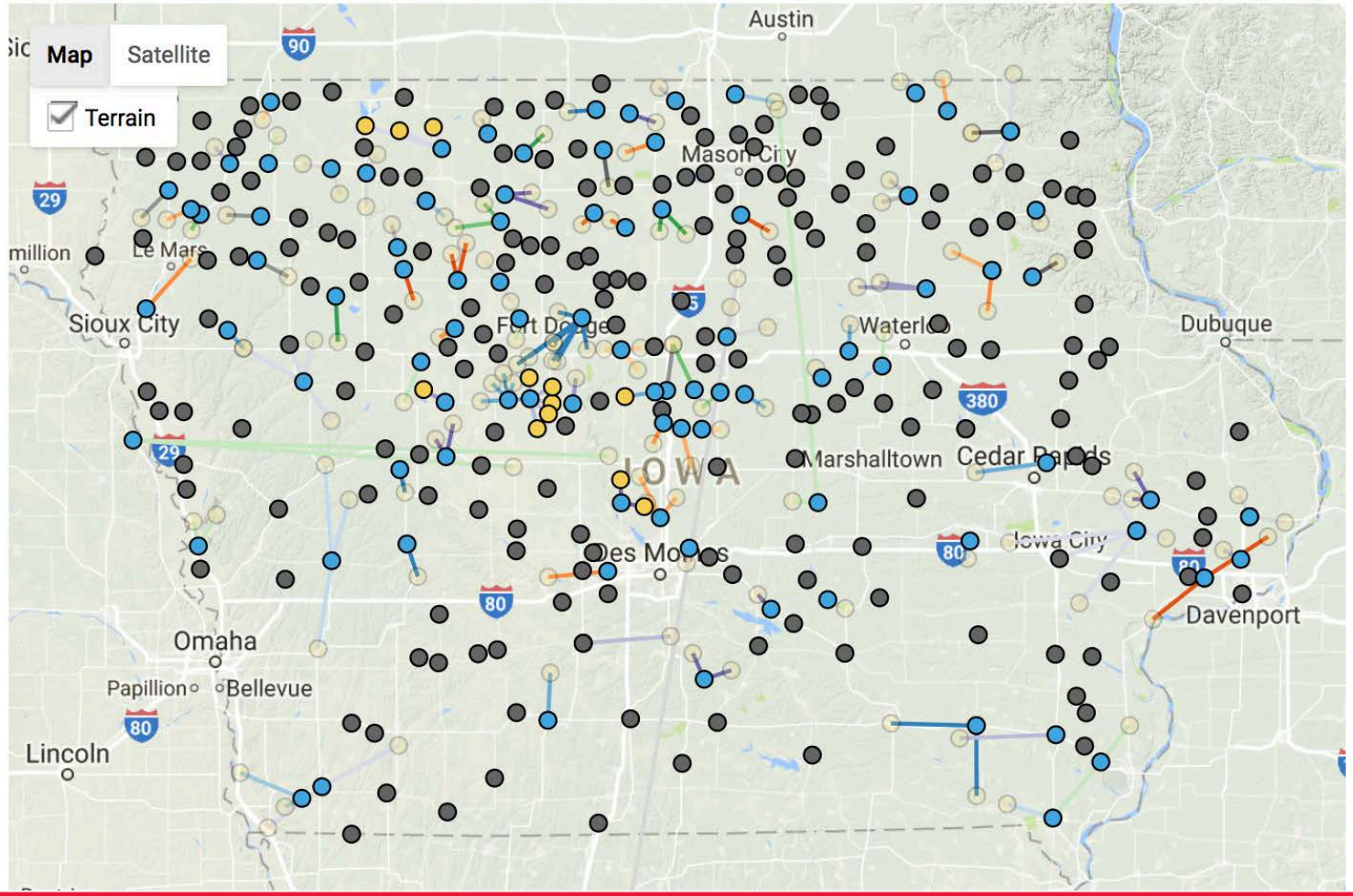
Location of Co-ops in Iowa at 1979



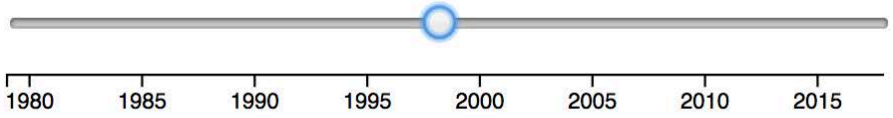
Network of Iowa Co-ops in Iowa at 1979

1980 1985 1990 1995 2000 2005 2010 2015

CO-op Headquarter
CO-op Branches
Single Location Co-op



Network of Iowa Co-ops in Iowa at 1998



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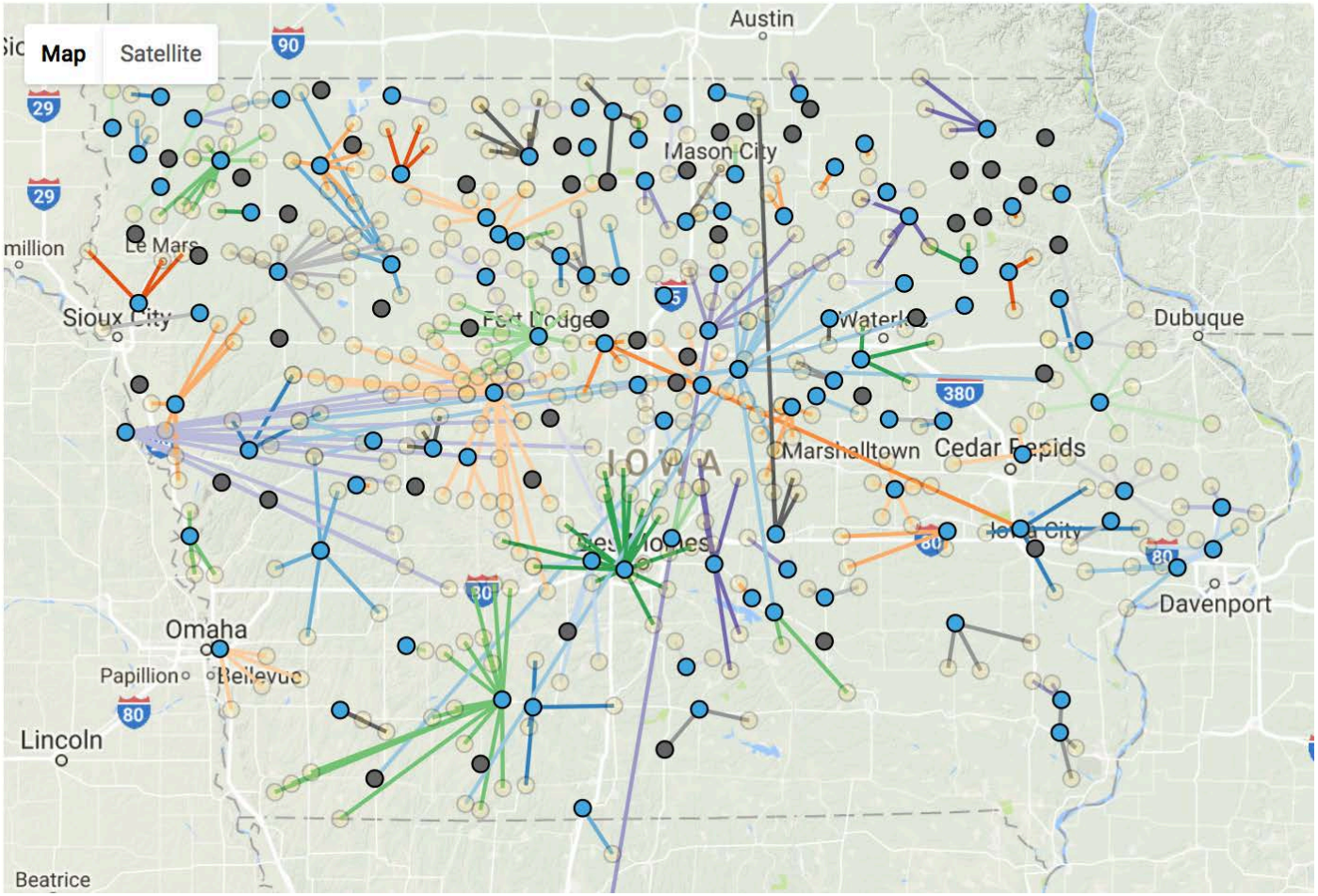

Network of Iowa Co-ops in Iowa at 2018

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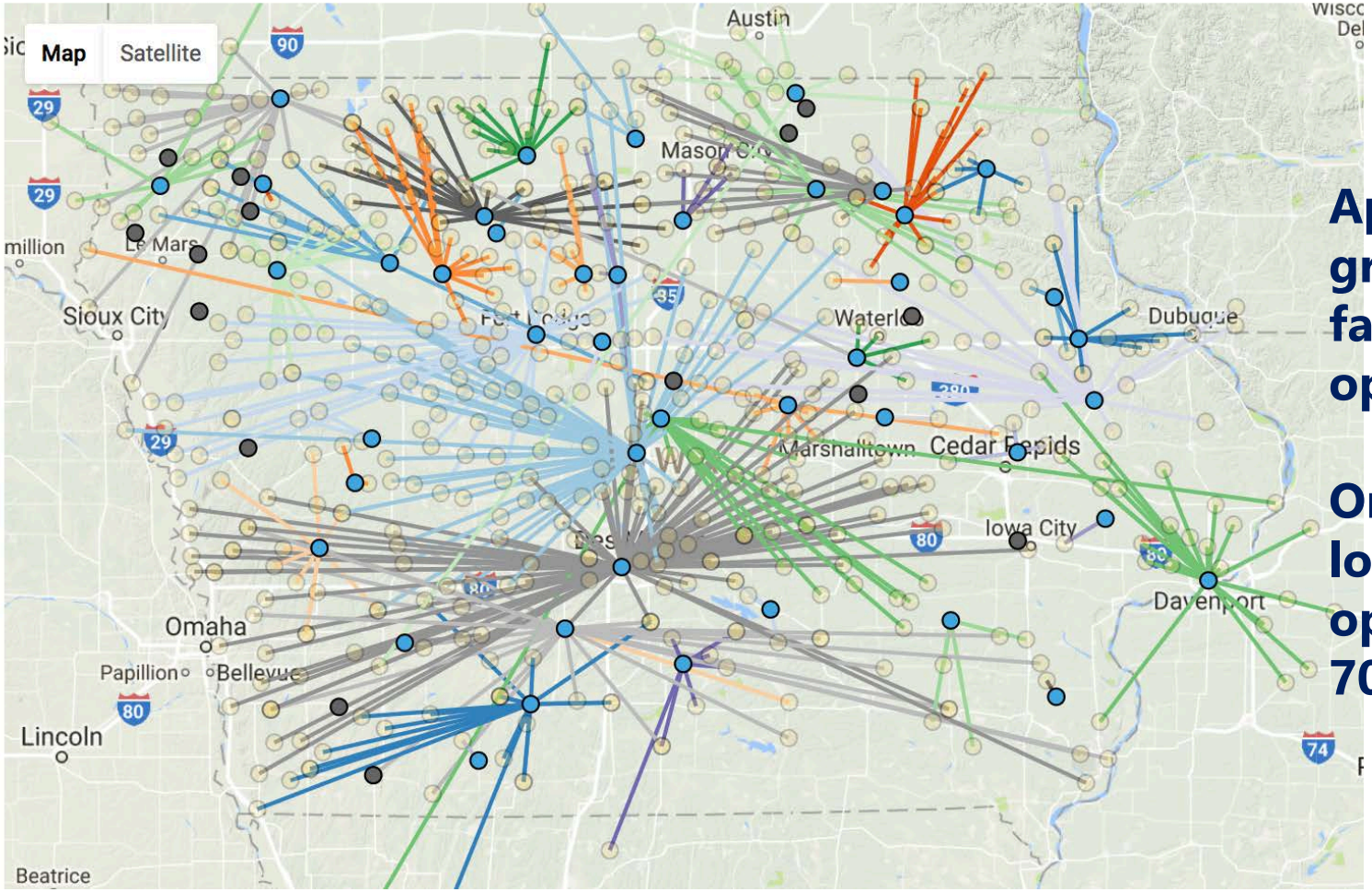
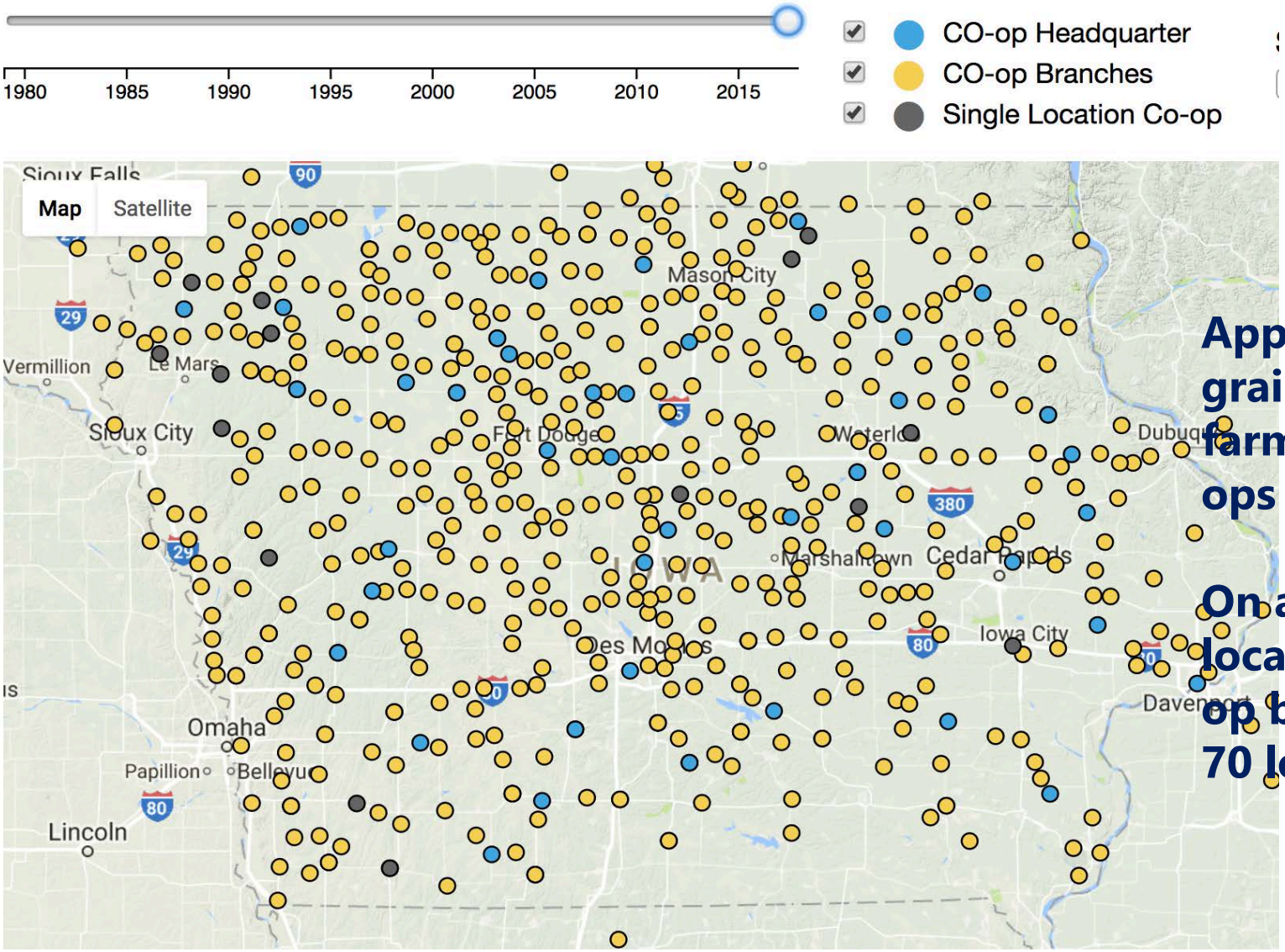


Approximately 50 grain marketing & farm supply co-ops today

On average, 12 locations per co-op but as large as 70 locations

Location of Co-ops in Iowa at 2018



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Consolidation observations

- **Drivers**
  - ✓Access to strategic assets
  - ✓Succession and retention, access to talented GM
  - ✓Enhanced operational efficiency
  - ✓Access to capital
  - ✓Market protection for producers
  - ✓Everyone else is doing it
- **Nearing tolerance threshold with producers**

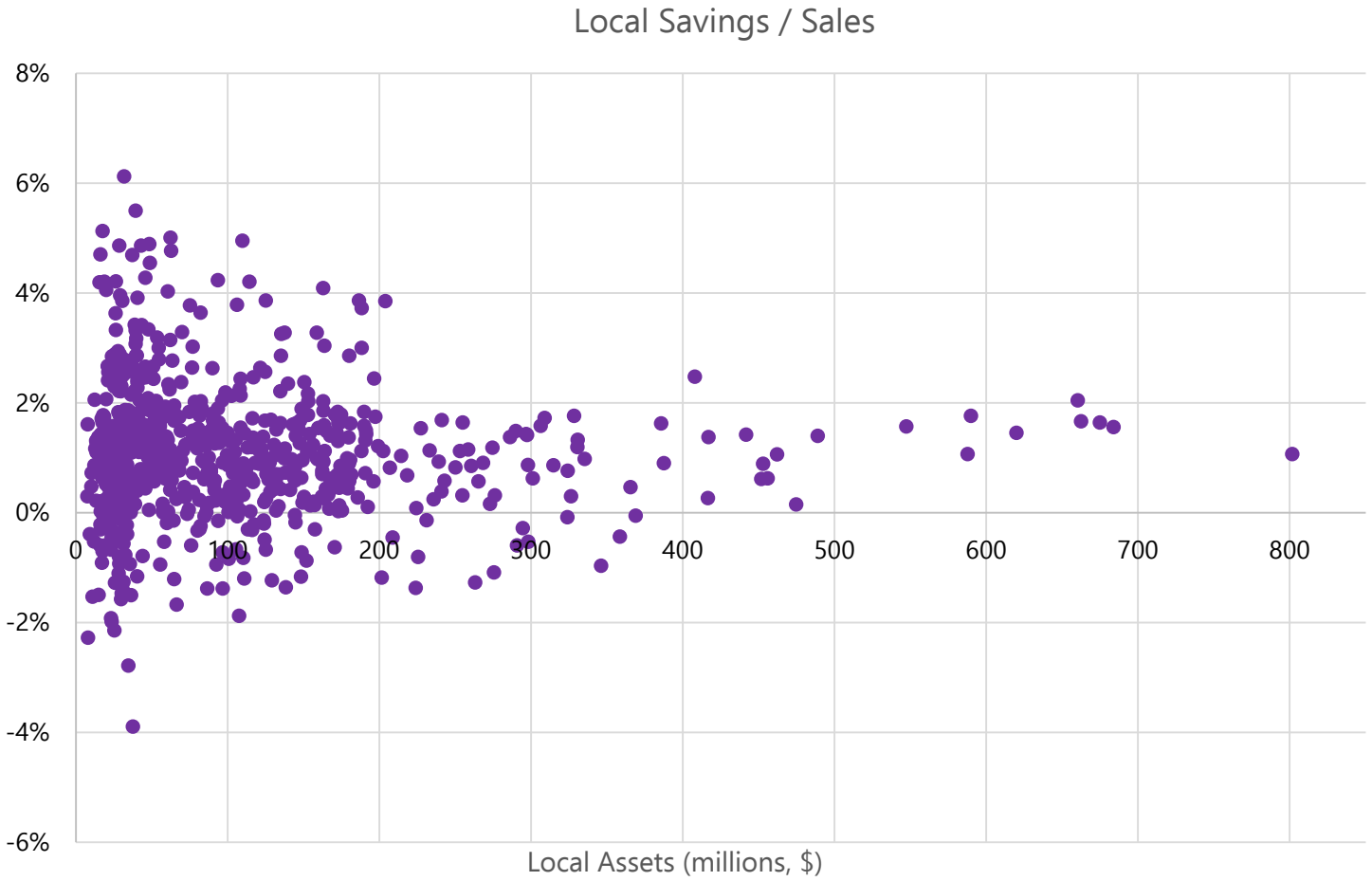
Key Indicators of Financial Positions and Performance, 2016 Qtr 3

	Average Value by Quartile Group†		
	Low	*Mid*	*High*
Balance Sheet			
Current Ratio	1.357	1.596	1.458
AR to WC	2.182	1.009	1.075
LTD to NFA	34.10%	39.71%	31.21%
Total Debt to Assets	46.15%	41.28%	39.35%
LTD to Local Equity	39.05%	48.75%	36.59%
LTD to Total Equity	28.52%	31.57%	26.67%
Member Equity to Total Equity	45.48%	41.27%	49.83%
Income Statement			
Margins			
Product Gross Margin	8.72%	7.07%	8.94%
Gross Profit Margin	12.25%	11.15%	12.61%
Operating Margin	-1.22%	0.17%	1.44%
Net Profit Margin (w/ Patr)	0.64%	1.63%	3.14%
Net Profit Margin (w/o Patr)	-1.18%	-0.08%	1.52%
Expenses			
Personnel Expense/Gross Margin and Service Revenue	54.78%	46.14%	44.61%
Personnel Expense/Total Operating Expense	46.94%	46.19%	50.59%
Plant, Building, Plant Expense Ratio	19.64%	20.36%	21.12%
Depr & Amort Expense Ratio	17.58%	19.83%	16.70%
Operations Expense Ratio	10.84%	7.54%	5.80%

Key Indicators of Financial Positions and Performance, 2016 Qtr 3

	Average Value by Quartile Group[†]		
	Low	*Mid*	*High*
Efficiency and Performance			
WC to Sales	5.72%	4.51%	4.15%
Target WC to Sales	4.37%	3.66%	4.16%
AR Collection Days	51	31	37
Fixed Asset Turnover	1.901	2.815	2.331
Times Interest Earned	2.579	6.841	14.321
Return on Total Assets including Patronage	0.95%	3.88%	6.75%
Return on Equity including Patronage	2.03%	7.87%	12.39%
Local Return on Member Equity	-9.37%	-0.38%	11.59%
Total Return on Member Equity	5.27%	18.29%	25.61%
Interest and Finance Income to Op Margin	-22.76%	0.20%	10.08%
Overall Performance Measures			
Local return on NFA	-6.54%	-0.13%	7.34%
Local ROE	-6.50%	-0.09%	7.50%
Local Return on Sales	-1.16%	-0.01%	1.54%

Profitability metrics are not enhanced by more sales alone



Has consolidation allowed co-ops to achieve purported efficiencies? (Correlations with Assets $)

- Profit margin
- Return on sales
- Return on assets
- Return on equity
- Asset Turnover **(-0.17 to -0.21)**
- Operational exp. **(-0.17 to - 0.27)**
- Labor exp. efficiency **(0.19 – 0.26)**
- Members' share of total equity
- Members' share of local equity **(-0.17 to -0.21)**

Competition Factors

- The co-ops are price takers
- Significant competition
- Co-ops unable to eliminate redundant assets
- A survey of Iowa landowners shows that approximately 45% of landowners use a co-op to some degree for marketing, custom services, or to purchase inputs; equates to approximately 33% of land (acres).
- Market share of co-ops is falling according to U.S. Dept of Ag data

Why NOT merge?

- Managing members' value proposition from co-op easier for smaller companies
- Financial strength with a solid core business
- Culture
- Able to innovate and be nimble by staying strategically small
- Governance

The Crux of the Issue

- "The co-op is just another big business."
- "It's not my co-op anymore."

The member-level frictions created through consolidation have significant financial implications.

Consolidation – the act of it – is fundamentally putting at odds members' values and perceptions with leaderships' values and perceptions.

What Co-ops Need to Figure Out…Quickly

- At what point does a co-op cross the threshold from being "the farmers' co-op" to "another big business"?
- How does heterogeneity of members impact the value proposition of the co-op and what can be done about it?
- How do you ensure that all members benefit from the joint provision of value in a perceived and real way?

Economic Impacts

- Grain price effects through consolidation
- Cash flows from co-op to producers

Social Impacts

- Loss of co-op "feel"
- Loss of trust
- Loss of unified vision

Questions

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