

# Agri-Service Industry Report

December 2016

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## 2017 U.S. Industry Outlook

“A little better or a little worse” is the quickest way to sum up the expectations for the agricultural equipment industry in 2017. Consumer confidence is low right now, due largely because of declining farm income levels and persistently low commodity prices. Farmers will likely continue to hold off on upgrading their equipment fleets in the near term.

AGCO data shows that North American agricultural equipment sales have declined Y/Y every month since January 2014. Furthermore, industry sales are expected to decline around eight percent in 2017, which would be the lowest level since 1994 after adjusting for inflation. Cash receipts have been declining, meaning farmers have been receiving less income for their products (see Figure 1). Consequently, they have been forced to tighten their budgets and are electing to extend the use of their current machines. In a recent AgWeb survey, 63.3 percent of farmers said they will wait until at least 2018 to make their next major machinery purchase.



**Figure 1: Net Cash Income** – Farmer net cash income has been declining since 2013 when the value was \$135.6B. Net cash income is predicted to be \$94.1B in 2016 and decline further next year.

Sources: 2000-2016F historical statistics - USDA Farm and Wealth Statistics, updated August 30, 2016. 2017-18 Forecasts statistics - USDA Agricultural Projections to 2025, released February 2016.

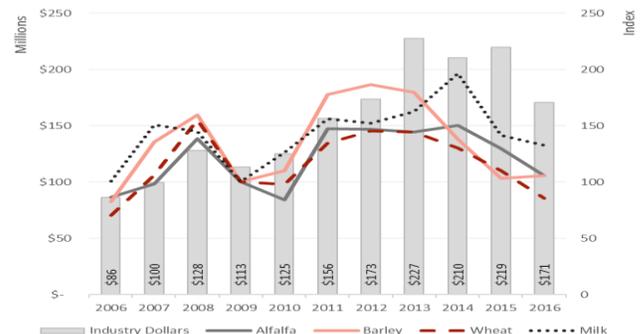
North American dealers are cautious heading into the new year. Ag Equipment Intelligence has reported that nearly 45 percent of dealers expect 2017 sales revenues to be flat. About a third of dealers expect revenue to decline next year, which is about a ten percent improvement in dealer optimism compared to last year’s survey.

For all the negatives surrounding the industry, one constant positive is that farmers always continue to plant. Despite the decreased returns, farmers have increased production for many crops in 2016. The USDA November Crop Production report shows that total U.S. production of corn, soybeans, sugarbeets, alfalfa hay and wheat are all up this year relative to 2015. Increased production results in more wear on machines and should increase the replacement frequency for farmers.

The oversupply of used equipment has provided farmers with a favorable market; they can purchase relatively new, good-conditioned machines at discounted used prices. The glut of used equipment has certainly had an impact on new sales and lease data suggests that this issue will likely persist in the upcoming years.

Vertical Research Partners reported that nearly 35 percent of rolling 12-month North American new tractor deals were completed on leases in mid-2015, which was about 15 percent higher than mid-2013. The trend has continued in 2016 and the yearend value of equipment on operating leases is expected to increase again. Considering the average lease term is around three years, much of the increase in lease activity has yet to return to the market.

Despite this, dealerships across the country are making a strong push towards reducing used inventory, which in time will lead to a stronger new market for dealers. The rate of decline in industry sales has also been declining, suggesting that the cycle may be nearing the low point. Unfortunately, agricultural equipment sales are not expected to increase much in 2017. Commodity prices are a significant driver behind consumer activity in the industry and most analysts do not expect major increases in the prices for crops and livestock next year.



**Figure 2: Idaho Industry Dollars and Commodity Values** – Commodity values have been transformed to an index value, using the average monthly 2009 price as the base. The graph shows that there is a correlation between the prices received by Idaho farmers for their commodities and the amount of new equipment they purchased.

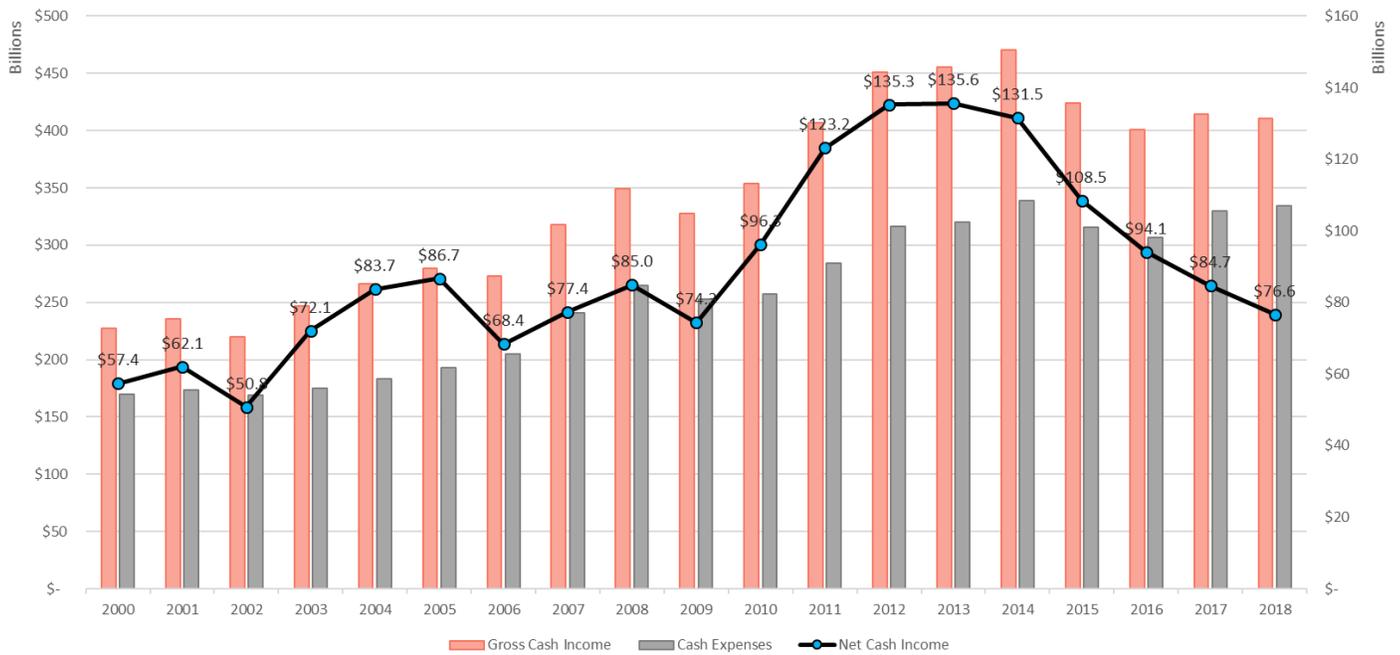
Sources: AGCO Oct. DBI, USDA Agricultural Prices extracted from future.aae.wisc.edu

Without an increase in commodity prices it is unlikely that consumer confidence will improve significantly in the upcoming year. Farmers will likely need to see a consistent upwards trend in commodity prices before they feel comfortable spending significant amounts of income on new machinery. Nonetheless, equipment will age and breakdown forcing replacement. Farmers will continue to purchase equipment; the key is to identify the product segments with the greatest growth opportunities.

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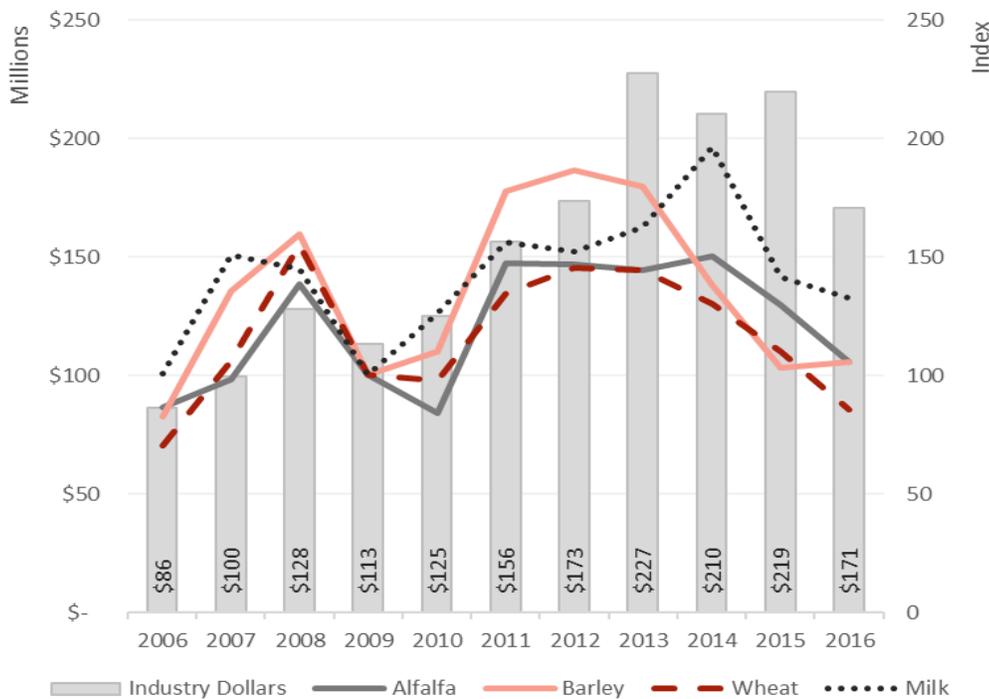
Charts

Figure 1: Net Cash Income



Note: Gross cash income includes crop and animal receipts, farm related income and total direct government payments. Cash expenses include interest, labor, property taxes, feed, livestock and poultry, seed, electricity, fertilizer, fuel and oil, pesticides, and net rent to landlords.

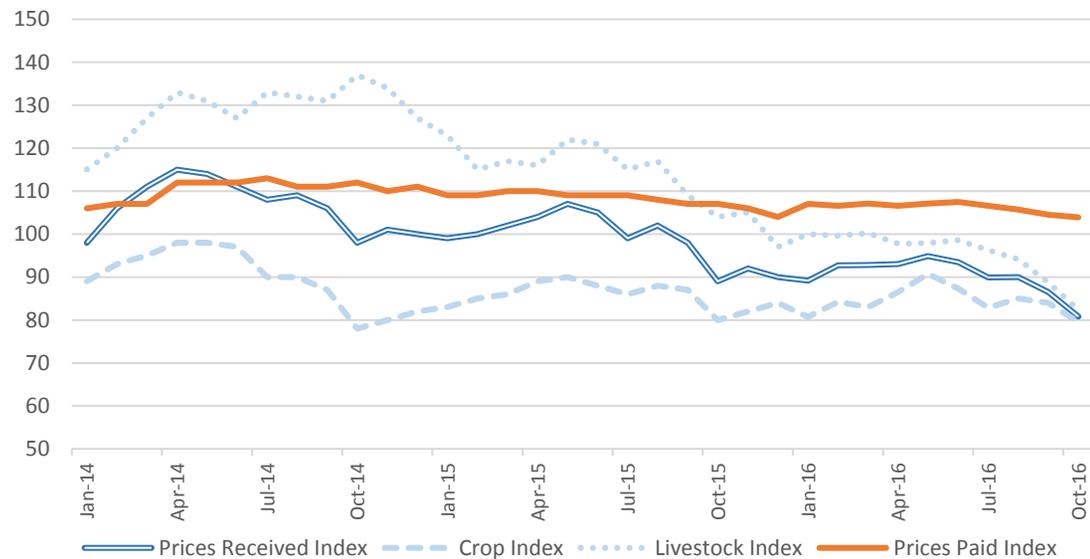
Figure 2: Idaho Industry Dollars and Commodity Values



Note: Commodity values have been transformed to an index value, using the average monthly 2009 price received as the base.

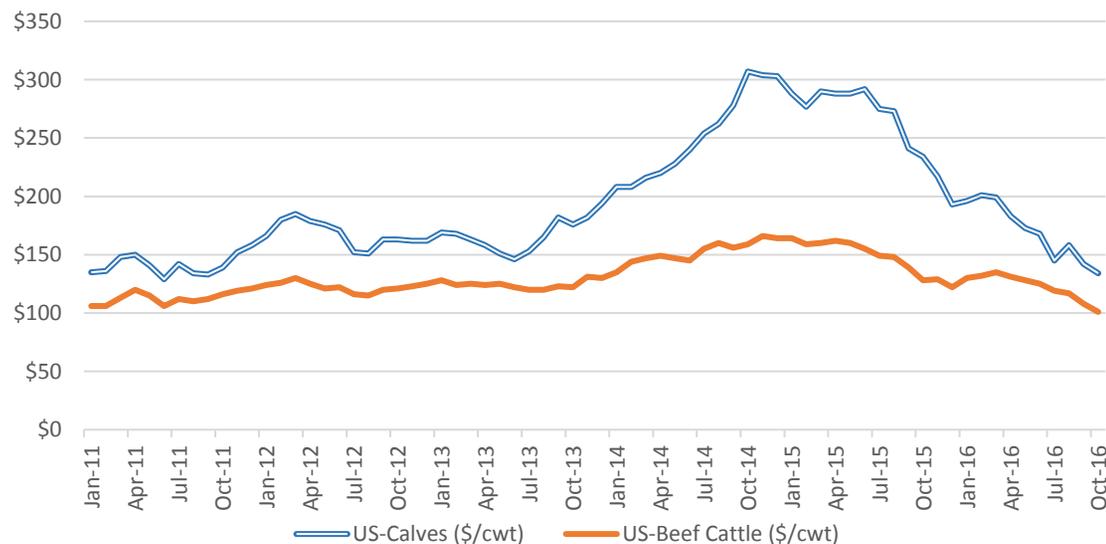
## Commodity Prices

### Agricultural Production Index, United States



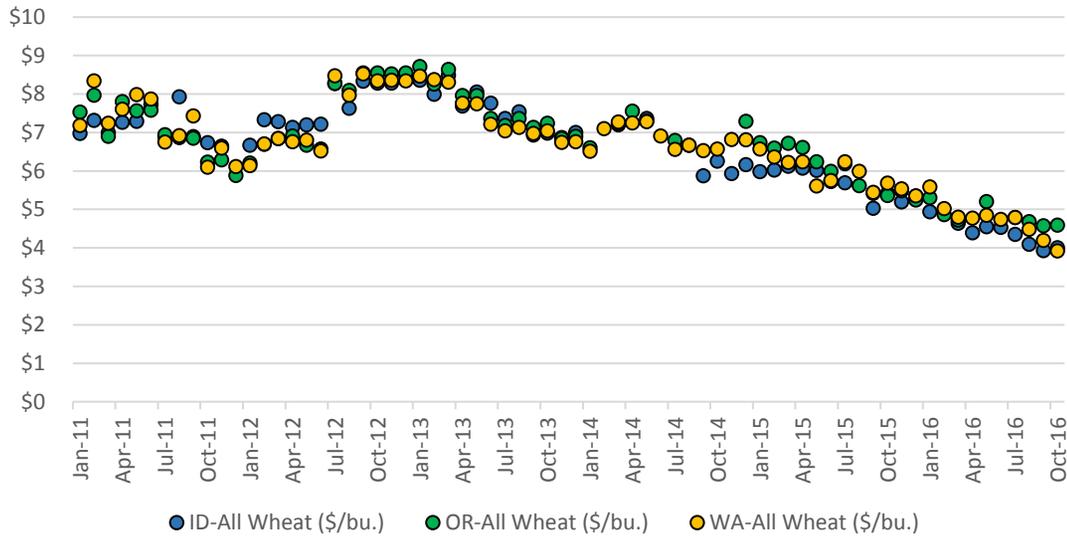
The November release of the USDA’s Agricultural Prices report showed another month of declining prices received by farmers. The October Agricultural Production Price Received Index fell 6.6 percent M/M and both the Crop Production Index and Livestock Production Index declined in October. Compared to a month earlier, the October crop index declined 5.4 percent and the livestock index fell 7.1 percent. The Agricultural Production Index was also down 9.3 percent relative to a year earlier. The October Prices Paid Index declined slightly (0.8 percent M/M) due to lower prices paid for feeder cattle, complete feeds and concentrates.

### Calves and Beef Cattle Prices Received, United States



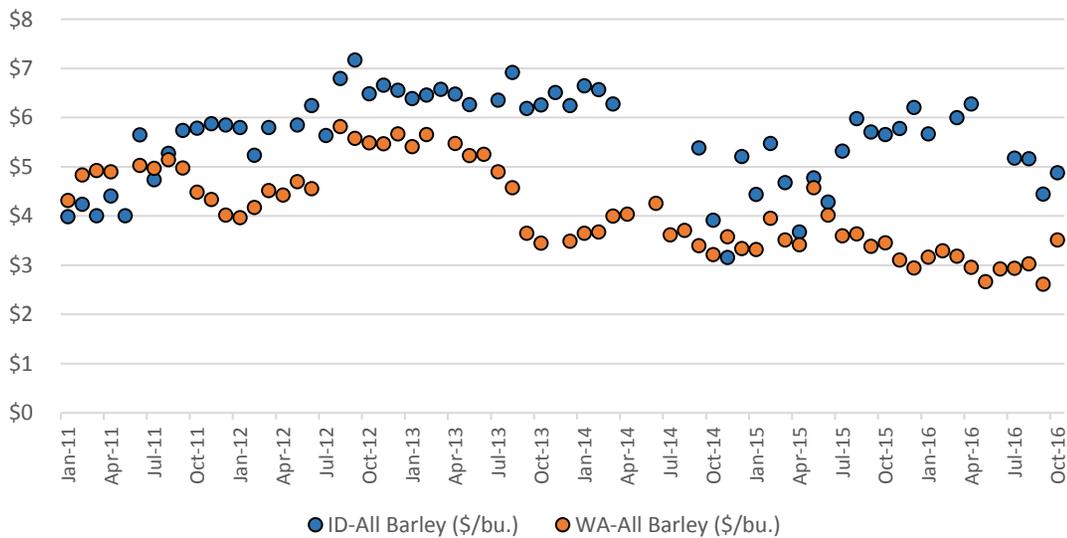
The U.S. price received for calves and beef cattle declined in October. At \$134/cwt, the price received for calves declined 5.6 percent M/M and 42.7 percent Y/Y. Beef cattle declined from \$108/cwt in September to \$101/cwt in October. The M/M change has been negative for seven consecutive months. Rabobank expects US beef production to increase 2.5-3 percent in 2017 due to lower feed costs and heavy carcass weights. Increased production would likely keep prices low next year.

## Wheat Prices Received, by State



Idaho and Oregon farmers experienced slight gains in the price received for wheat in October. The price increased to \$4.01/bushel in Idaho (+1.8% M/M) and \$4.60/bushel in Oregon (+0.4% M/M). Washington, however, saw the price decline from \$4.20/bushel in September to \$3.93/bushel in October. The price received in all three states was at least 14 percent higher in October 2015.

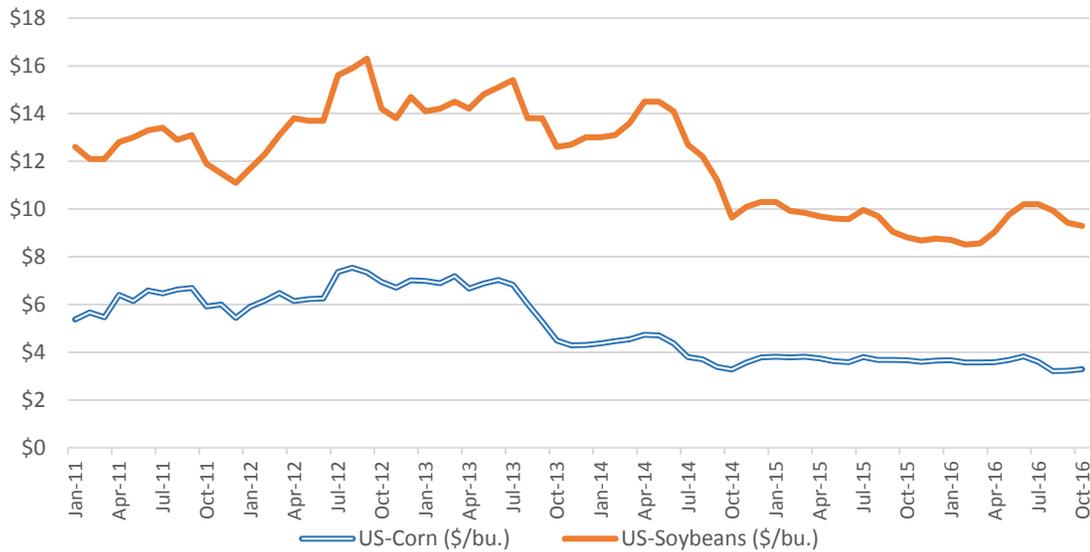
## Barley Prices Received, by State



The price received for barley increased significantly in Idaho and Washington in October. At \$4.89/bushel, the price received in Idaho increased 9.6 percent M/M. The price received in Washington increased from \$2.63/bushel in September to \$3.53/bushel in October, which was a 34.2 percent increase. In its November WASDE report, the USDA forecasted the average U.S. farm barley price will be in the \$4.55-\$5.15/bushel range for the 2016-17 marketing year, down from the 2015-16 estimate of \$5.52/bushel.

\* Barley marketing year beginning June 1

### Corn and Soybean Prices Received, United States

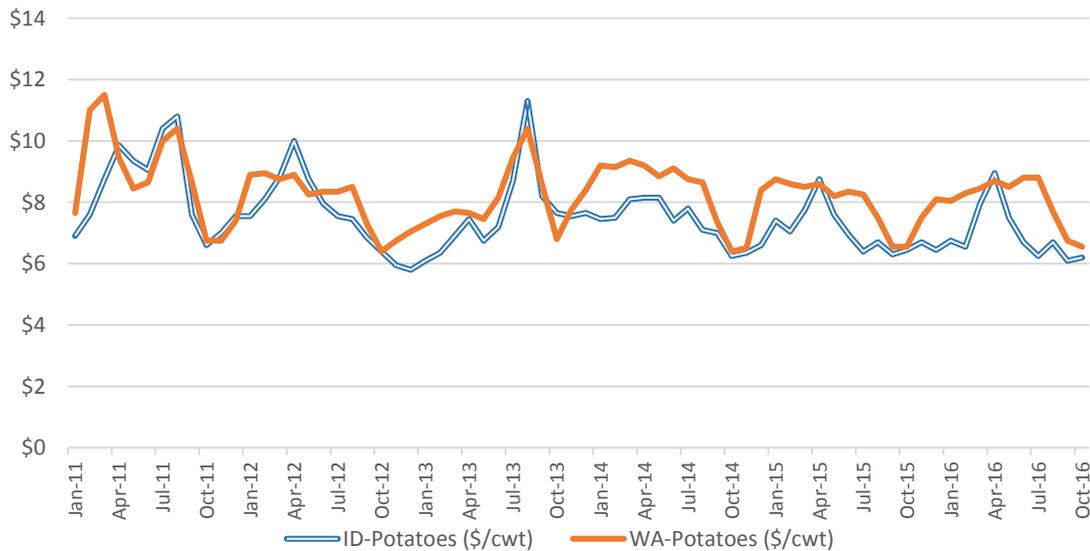


The U.S. corn price increased for the second consecutive month in October but remained below the price received a year ago (+2.2% M/M, -10.4% Y/Y). The price received for corn was recorded at \$3.29/bushel. Rabobank expects the price of corn to increase in early 2017 but this year's record harvest will likely keep the price below \$4.00/bushel.

Soybeans lost value for the third consecutive month, however, dropping from \$9.43/bushel in September to \$9.30/bushel in October. Compared to October 2015, this year's price was up 5.6 percent. The USDA increased its U.S. soybean price forecast for the 2016-17 marketing year in the latest WASDE report to a value of \$8.45-\$9.95/bushel.

\* Soybean marketing year beginning September 1

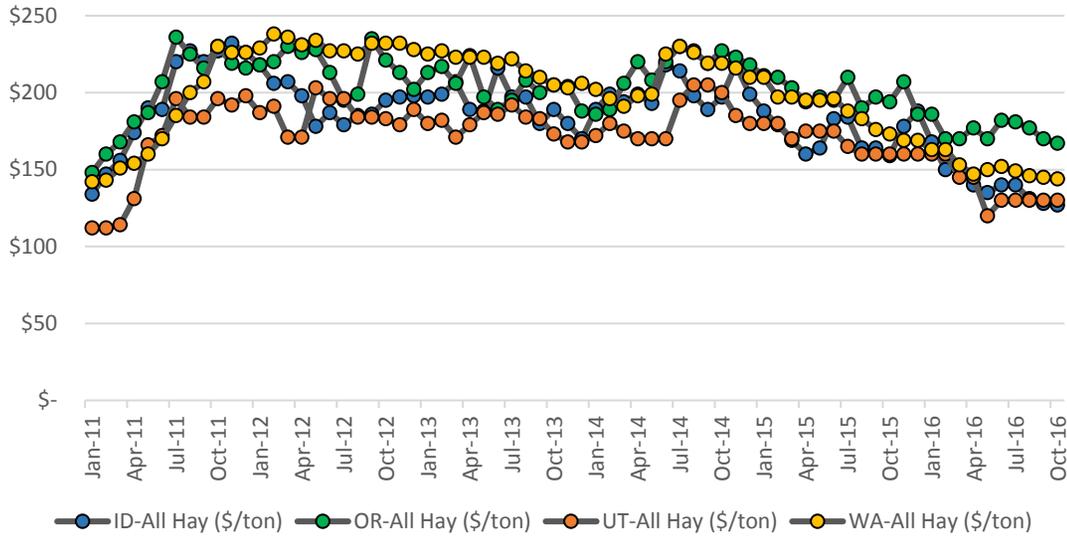
### Potato Prices Received, by State



Idaho farmers received \$6.20/cwt for their potatoes in October, which was 1.6 percent more relative to September but 3.9 percent less than October 2015. The price received in Washington declined 3.0 percent M/M to a value of \$6.55/cwt, which equaled the price from a year earlier.

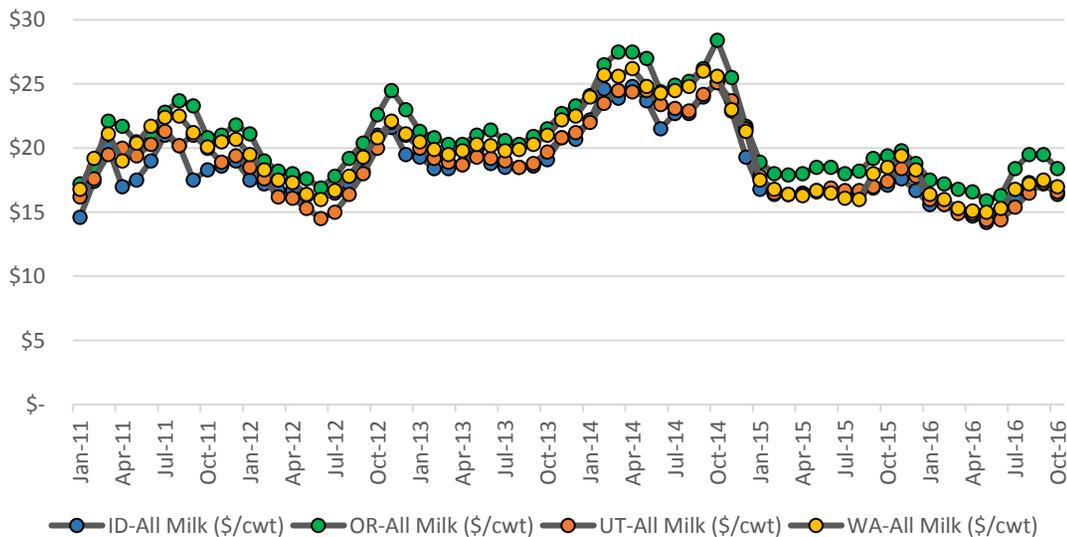
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### Hay Prices Received, by State



Regional hay prices did not experience significant movement in October as all states reported a value within \$3/ton of September's price. In Idaho, the price received declined from \$128/ton in September to \$127/ton in October. The price received in Oregon dropped 1.8 percent to a value of \$167/ton. For the fifth consecutive month, the Utah all hay price was reported at \$130/ton. In Washington, the price declined a dollar per ton to a value of \$144/ton. The Y/Y change ranged from -20.1 percent in Idaho to -13.9 percent in Oregon.

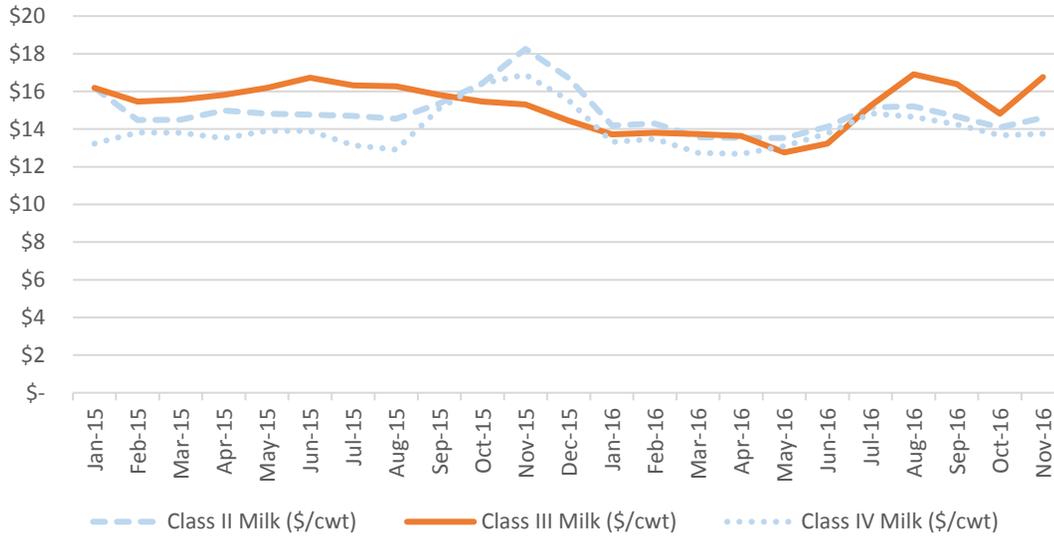
### Milk Prices Received, by State



Milk prices fell M/M and Y/Y in all four states in October. The price received in Idaho was reported at \$16.40/cwt, down from \$19.50/cwt in September and \$19.40/cwt in October 2015. Oregon had the most significant monthly drop with the price received declining 5.6 percent to a value of \$18.40/cwt. Compared to a year earlier, Utah's reported price of \$16.60/cwt declined 4.6 percent. At 17.00/cwt, Washington had the smallest M/M decline (-2.9%) but the largest Y/Y drop (-8.1%). Rabobank suggests that the combination of increasing global demand for dairy products and the contraction of supply due to the persistent low prices may help increase pricing in the upcoming year.

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## Announced Milk Price, by Class



The November class III milk price increased 13.1 percent relative to October and was reported at \$16.76/cwt. It was the third time in the past four months that the price was reported above \$16/cwt. November's price was also a 9.5 percent increase compared to a year earlier. Class II (\$14.60/cwt) and class IV (\$13.76/cwt) prices were also reported up M/M in November.

## Crop Progress Report

The growing season is nearing completion and the USDA released its final Crop Progress and Conditions report on November 28. The Idaho winter wheat crop progressed four percent during the week ending November 27 and was reported to be 97 percent emerged, three percent above last year's pace. Sugarbeet harvest was trailing the normal pace, however. At the end of the week 95 percent of the harvest had been complete, while the harvest had been fully complete on average during the past five years. With 94 percent of the 4<sup>th</sup> alfalfa cut complete, the pace for hay equals that of last year and the five-year average.

In Washington, 94 percent of the winter wheat crop had emerged by November 27, which is significantly beyond last year's pace when just 86 percent of the crop had emerged. Field corn harvest is moving at a slower pace in 2016, however, as just 81 percent of field corn harvested for grain had been complete compared to 99 percent last year. The corn harvest progressed four percent during the week in Oregon and finished at 93 percent complete.

Utah reported that 97 percent of its winter wheat had emerged by the end of the week, which was above last year's pace (95%) and the five-year average (94%). Corn harvest was reported to be 90 percent complete, which compared favorable to 2015 (83%) and the normal rate (86%).

## Ag Barometer

The Purdue/CME Group Ag Barometer suggests that agricultural producers are significantly less pessimistic about the future than they were last month. The Ag Barometer is a nationwide measure of the health of the agricultural economy that provides an index score based on the survey results collected from 400 agricultural producers. November's index was reported at 116, which was up from 92 a month earlier and was the highest level since October 2015.

The overall index is a combination of the Index of Current Conditions and the Index of Future Expectations. While ag producers feel that current conditions are improving (the Index of Current Conditions has increased each of the past three months), the overall gain is primary due to the spike in the Index for Future Expectations from 95 in October to 130 in November. Rising corn and soybean future prices were cited as reasons for the increasingly optimistic outlook of producers.

The percent of respondents who expect good times financially over the next five years increased two percent in November to a value of 37 percent. More

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significantly, the percent who expect bad times financially declined from 56 percent in October to 42 percent in November.

It is important to note that the survey aims to have at least 53 percent of respondents involved in corn and soybean production. Given that these crops are not dominant in the Agri-Service territory, the survey results may not fully reflect the feeling of our customer base but nonetheless, is valuable to understanding producer confidence on a macro-level.

## Machinery News

A total \$5.1 billion of U.S.-made agricultural equipment was exported in the first three quarters of 2016, per AEM. Compared to the first nine months of last year, 2016 exports were down 14 percent. Furthermore, third quarter sales decreased Y/Y by 17.6%, which was the highest Y/Y quarterly decline so far in 2016. Benjamin Duyck, AEM's director of market intelligence, pointed to low commodity prices and the strength of the U.S. dollar as major reasons for the decline.

Canada remained the largest importer of U.S.-made agricultural equipment as \$1.5 billion worth of equipment made its way across the northern border during the first three quarters of the year. Despite exports to Canada declining 15 percent Y/Y, the country imported nearly twice as much as the second largest importer (Mexico, \$873 million). Australia (\$353 million), Germany (\$185 million) and China (\$156 million) rounded out the top five as the largest importing countries. Of the countries listed in the report, Ukraine had the most significant Y/Y increase (\$123 million, +244%), while China had the largest decline (-66%).

AEM does not expect fourth quarter results to show much improvement. Duyck explained that, "expectations for the fourth quarter remain subdued as the U.S. dollar is experiencing its longest rally in 16 years." A strong U.S. dollar makes domestic products costlier to foreign consumers and weakens demand for domestic goods.

## AGCO Earnings Outlook

Despite adjusting the 2017 estimate from \$3.00 to \$2.60 in its late November Equity Research report, Wells Fargo Securities (WFS) expects AGCO earnings to increase 10.6 percent Y/Y next year. In the short-term, AGCO's revenue will continue to be adversely impacted by low demand but WFS believes the global agricultural equipment downturn has begun to bottom and predicts AGCO will experience growth in the second half of 2017.

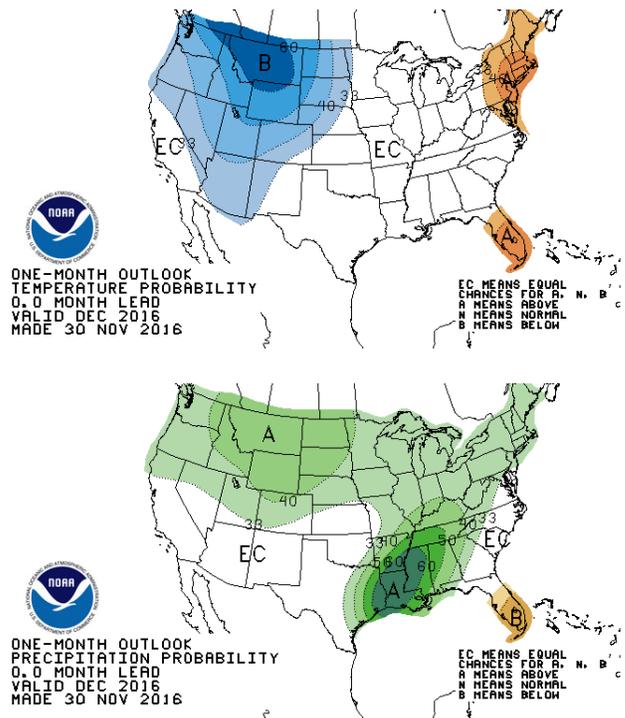
WFS explained that South American demand is already showing improvement and expects European demand to rebound in mid-2017 following increases in dairy prices. The company also predicts U.S. farmer income to turn positive in the next six to twelve months and believes North American equipment demand will begin to modestly increase in 2018.

### Agricultural Exports

The USDA bumped up its 2017 fiscal year (ending Sept. 30) export forecasts in the Outlook for U.S. Agricultural Trade report, released at the end of November. Total U.S. agricultural exports are now forecasted to be \$134.0 billion in FY2017, up \$1 billion from the August forecast. The USDA raised the forecast due to rising demand for dairy and livestock byproducts. China is expected bring in \$21.8 billion of U.S. agricultural goods and is projected to be the largest export market in FY2017, followed closely by Canada (\$21.3 billion) and Mexico (\$18.3 billion). Exports in FY2016 were reported at \$129.7 billion.

### Weather Outlook

The National Weather Service has predicted that December temperatures will likely be below normal for much of the western United States. Additionally, the Agri-Service territory can expect above normal precipitation this month, particularly in Eastern Idaho. The combination of lower temperatures and increased precipitation could have a positive impact on next year's growing season by providing ample amount of snow water runoff.



Source: NOAA Center for Weather and Climate Prediction. One-Month Outlooks, official forecasts. Created 30 Nov 2016.