CoBank Knowledge Exchange

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Agronomy Outlook: Not the Spring Ag Retailers Hoped For

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Inside…

Key Points:

- The farm supply sector will be stressed in the year ahead on the combined impacts from inclement weather and strained farm financials.
- Ag retailers will be put to the test in a compressed spring agronomy season beset with bad weather, adding to the pressure from last fall's poor weather. Some ag retailers may incur additional costs as a result.
- Poor spring weather also puts sales and service revenue at risk from a shifting acreage mix and potentially higher prevented planting acres.
- Stressed farm financials will continue to negatively affect ag retailer margins and impact farmer decisions that could reduce sales volumes.
- The fertilizer segment may be a lone bright spot as prices move higher this spring and acres potentially shift out of soybeans and into corn if spring weather improves.

Introduction

The agronomy and farm supply outlook for 2019 is one of concern. Last year's poor fall weather, 2019's wet spring with regionally catastrophic floods, and stressed farm financials weigh on the outlook. Possible acreage shifts to corn and increasing fertilizer prices are the potential bright spots for the sector.

Profitability will face a multi-pronged threat that includes:

- Gross margins under pressure from weak farm financials.
- Operating expenses (labor, equipment, and other expenses) rising due to a compressed, hard-hitting spring season.
- Accounts receivable likely increasing as cash farm income in 2018 dropped nearly 10 percent year-over-year, according to the USDA.

The USDA predicts higher income in 2019. However, this income will not be realized until the end of 2019, leaving many farmers cash-strapped for the current planting season.

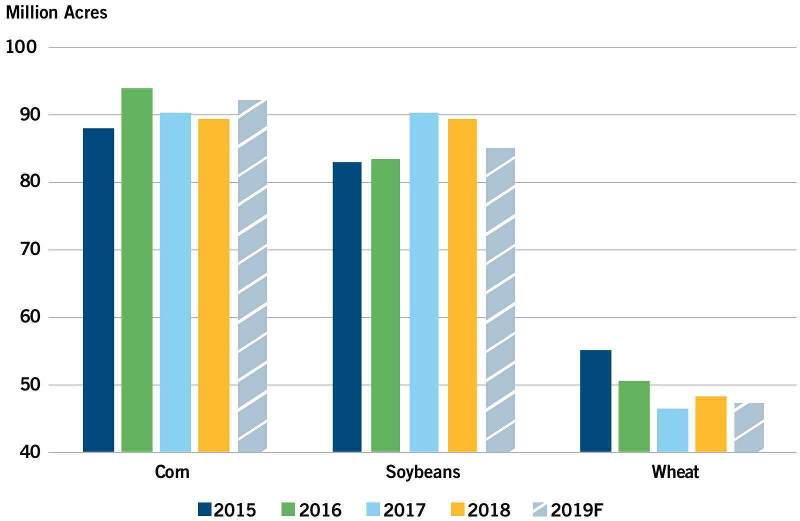
On the bright side for ag retailers are higher retail fertilizer prices year-over-year and a potential shift to corn, which requires more inputs than wheat or soybeans. However, this shift to corn hinges on good spring weather, which has been hard to come by so far. With the weather outlook remaining bleak for much of the Midwest, the shift to corn will be under pressure, putting a lid on the positivity from this factor. Additionally, sales may drag because of a potential reduction in principal crop acres according to USDA's prospective plantings estimates.

Top Three Drivers

1. Bad Weather

Bad weather (the Midwest at large), flooding (Western Cornbelt and Northern Plains), and significant snow cover (Northern Plains) have kept many farmers and applicators out of the fields this spring. This comes after last fall's wet weather that prevented many farmers from accomplishing the typical fall fieldwork. Much of that fall fieldwork has now been pushed to this spring. This includes any tillage, pre-emergence herbicide spraying, and fertilizer applications. However, the current state of significant parts of the Midwest makes accomplishing these tasks, on top of planting, extraordinarily difficult.

EXHIBIT 1: U.S. Planted Acres, Select Crops



Source: USDA-ERS; USDA-NASS

Farmers who did not prepay still have some flexibility in fertilizer purchases and seed decisions. This flexibility has created enhanced inventory risk for ag retailers, particularly in the fertilizer segment. One area is in nitrogen fertilizer. Farmers who typically apply anhydrous ammonia in the fall but were kept out of the field due to weather will likely look to change to urea or liquid nitrogen this spring. Additional factors that will impact this decision include relative prices between fertilizer options and how soon spring weather arrives. These changes – and the uncertainty it creates for ag retailers – pose a risk to inventory values, fertilizer sales, and application services in the spring ahead.

While largely dominated by the bad spring weather at this stage, the poor fall weather delayed harvest in many areas, which in turn pushed back farmers planting decisions. The lack of fall fieldwork provided farmers an opportunity to re-evaluate planting intentions without having any sunk fertilizer costs or seed purchases.

Significant portions of the Midwest, meanwhile, have been crippled by flooding while saturated fields will likely delay fieldwork well into the planting season across the region. Major snowfall hit western parts of the Midwest and Northern Plains in mid-March. The recent precipitation combined with spring thaw to create devastating flooding conditions in the Midwest, especially in Nebraska and Iowa. Other areas of the Corn Belt and the Dakotas are under significant flood threat as well, especially the Red River Valley.

This weather has set back spring fieldwork and will pressure acres out of corn. One of the initial positives for ag retailers was the anticipated acreage shift out of soybeans and into corn. The USDA projected corn acres in 2019 will jump to 92.8 million acres, up nearly 3.7 million acres YoY, while soybean acres will drop over 4.5 million acres to 84.6 million acres. All wheat acres are figured to decline by over 2 million acres to 45.8 million acres, the lowest on record (*Exhibit 1*). With corn requiring more inputs, a potential increase in corn acres would have a greater impact on sales for ag retailers. This is especially the case for fertilizer.

The current situation will likely curtail some of the acreage shift that was expected. As farmers are kept out of wet or flooded fields, the window to plant corn shrinks. At some point, farmers in areas under water or snow pack may shift to an alternative, shorter-season crop, like soybeans or sorghum, or may not plant the field at all. As a result of the flooding, prevented planting acres are expected to rise.

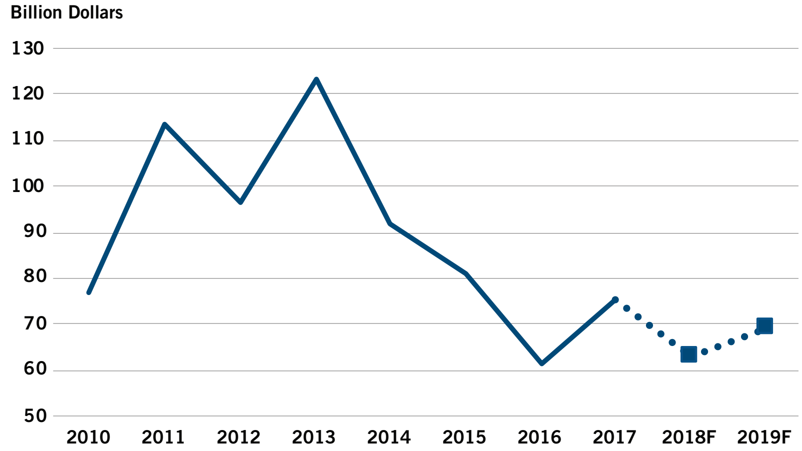
With soybean prices hurting the most in the Dakotas, much of the acreage shift would have occurred in the Northern Plains. However, this area had significant snowpack heading into April, which combined with forecasted spring rains, will keep flooding risk elevated through May.

The concern for ag retailers is three-fold. First, a more compressed spring can increase costs. Compounded with the poor fall weather, ag retailers will be stretched to fulfill service requests this spring and may have to rent additional equipment, hire more seasonal labor, or pay additional overtime hours to meet the needs in their area. Alternatively, ag retailers that have significant capacity in labor or equipment welcome the upcoming, hard-hitting spring.

Second, the high water is wreaking havoc on Mississippi waterway shipping. Smaller tows are being required, and traffic flow restrictions will likely impact fertilizer availability for many areas this spring. Most ag retailers have larger supplies than normal, but are unlikely to have adequate inventory to meet all of their needs (as a risk management strategy). Those that typically use barge markets may find it logistically difficult or impossible to obtain additional fertilizer this year via the waterways. Having to use a higher-cost transportation channel like trucks will increase the price of fertilizer the ag retailer sells. The alternative, however, is missing out on the sale altogether.

Third, current acreage changes at this stage will likely be more of a headwind than a tailwind. Larger than expected soybean acres pencil out to fewer sales than initially forecast. Additionally, if prevented planting acres increase significantly, total sales will also decline as fewer acres receive inputs. One caveat here is that there is still some time for fields to dry out in a majority of the Corn Belt for corn acres to be planted. If the Midwest receives a reprieve from this bout of bad weather, corn may yet gain some acres.

EXHIBIT 2: Net Farm Income



Source: USDA-ERS

Total principal crop acreage is projected to decline in 2019 according to USDA estimates. Their forecast comes from farmer planting intention surveys completed during the first two weeks of March, prior to the major floods hitting the Midwest. The flooding will likely reduce acres further. A shift to corn is positive, but an overall reduction in crop acres will constrain sales.

Going forward, the weather outlook is unhelpful. Current NOAA forecasts project a wetter and colder than normal April-May-June outlook. This points to continued flood concerns and wet fields.

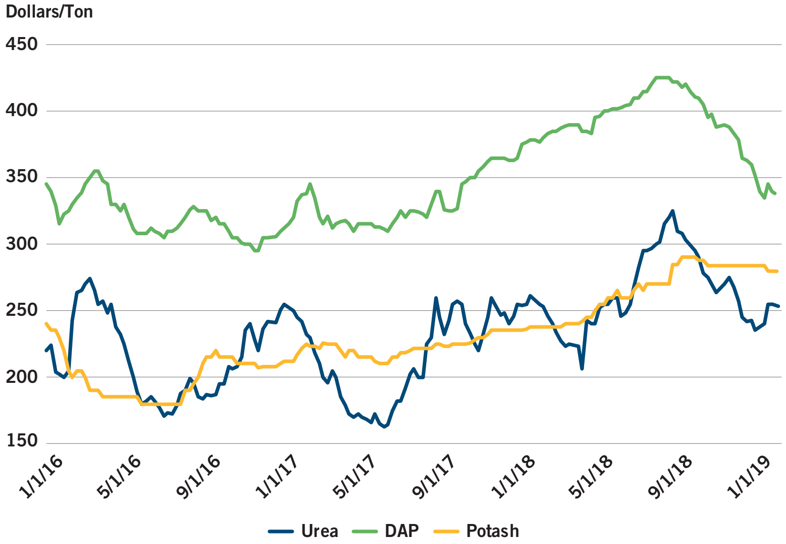
2. Stressed Farm Financials

The USDA has estimated a significant decline in farm incomes in 2018, while 2019 could rebound modestly (*Exhibit 2*). However, farm finances have been buoyed by big yields and Market Facilitation Program payments. These two factors have likely kept many farm economy issues at bay for at least another year.

Weak farm financials are impacting ag retailers in these four ways:

- **Delayed farmer decisions.** Prepays were down for many ag retailers this year. In some cases, they were lower by 20 to 30 percent. The lack of prepays – and, more broadly, the delayed farmer decisions – has created inventory risk for ag retailers. Ag retailers found this year's inventory decisions less clear than in previous years as a result of this lack of clarity.
- **Increased accounts receivable risk.** As farm incomes decline, the risk increases that some accounts receivables will need to be written off. This risk remains low in absolute terms, but is rising.
- **Constrained fertilizer volume and seed choices.** Tight farm finances are driving spring purchasing decisions. At the margin, farmers may cut back on fertilizer rates to reduce costs. The lack of fall fertilizer applications and additional fieldwork in spring could trigger a pull-back on macro-nutrient fertilizers like potash or phosphorus. Applications of micronutrients like sulfur or zinc, or biologicals, are also less likely due to their additional cost. Farmers who are tight on cash may plant a lower-cost crop even if a higher input-cost crop provides a better return. For example, corn usually costs more to produce on a per acre basis than soybeans. A farmer may plant soybeans instead of corn despite a potentially lower return because they do not have the additional funds to plant corn.
- **More price shopping.** As commodity prices have declined, farmers are looking to cut costs. Variable costs like fertilizer, seed, and crop protection products are key targets. Farmers are increasingly price shopping by accessing websites to learn what those in nearby markets are paying for inputs. They use this information to negotiate lower prices. While price shopping is not new, a possible sixth year of low income and more information availability makes this pressure more intense. The continuation of this trend will squeeze margins for many in ag retail.

EXHIBIT 3: Fertilizer FOB Prices, Gulf



Source: Bloomberg

3. Fertilizer Prices Increase

Fertilizer prices are expected to rise as the spring application season kicks into high gear (*Exhibit 3*). This should provide a good margin opportunity for ag retailers who purchased product before the run-up in prices last fall. Additionally, ag retailers that locked in prices on prepays or back-to-back sales should maintain a good margin.

Fertilizer inventory purchased at high prices last fall, and still unpriced going into the spring, is at risk. Though prices look to increase further this spring, it is unclear by how much. Margins for unpriced carryover inventory will shrink if spring prices don't increase to equal what was paid last fall.

On the demand side, higher fertilizer prices may push some farmers to pull back on their purchases. This is unlikely to be the case for most farmers, but it may be a phenomenon that reduces overall sales for the segment.

Conclusions

For the remainder of 2019, most ag retailers and agronomy departments will be stressed. This stress is driven by last year's long, wet harvest, the continuation of inclement weather into the spring planting season, and the farm sector's financial weakness. Potential acreage changes and fertilizer price increases provide some rare bright spots in the outlook.

The key determinant of success for both ag retailers and farmers will be any break in the spring weather. The compressed spring ahead will increase costs and affect farmers' ability to complete all of the necessary work. Additionally, the potential for sizable prevented planting acres will reduce revenue as fewer inputs are sold. Add all of this onto a stressed farm economy, and the financial outlook for many ag retailers this spring is under pressure, requiring ever-greater discipline on cost, and innovation on value-creation for farmer customers.

CoBank's Knowledge Exchange Division welcomes readers' comments and suggestions. Please send them to KEDRESEARCH@cobank.com.