The ARC Group, LLC.

Justin Lovegrove

President

agriskconsulting.net 402.484.7474

Spring 2018

Lesson #1: Compounding

One of the most valuable financial lessons that I learned in college came from a lecturer in a financial management class. He showed us a compound interest chart. My mind was blown. He was a Nebraska Wesleyan graduate that had gone into a career in wealth management. It seemed so easy to get wealthy - just put away as much money as possible, as early in life as possible, reinvest all the dividends back into the high yielding asset, sit back and watch your assets build. Easy. No problem.

Lesson #2: Debt Service

The second lesson that changed my life in college was a basic accounting/financial theory, you must pay down long-term debt using after tax dollars, period - there is no other way. You must make enough money after taxes and living expenses to make payments on debt or you have no reason to take on the debt in the first place. In lean years you will have to adjust your cost of living because your payment will not change.

If your net income is $100,000 and you purchase 80 acres of ground with a $50,000 annual principal payment, your cost of living had better be less than $29,000,or your banker is NOT going to want to hold your note any longer. I would love for someone to show me their cost of living being that low with a straight face. The only way around it is if you are inheriting tax free dollars every year; in that case, SIGN ME UP!

Example:		
Net Income	=	$100,000
Taxes		($21,000)
Net Cash	=	$79,000
Land Payment		($50,000)
Living Expenses	**=**	**$29,000**

The Reality Check

In the past 5 years or so I have met many hedge fund managers, fund of fund managers, private offices, high frequency traders, and bond fund managers and have seen many of their returns. Some average 3%. Some average 15%. They will all accept notional amounts to fund your account, meaning you only have put down $100,000 cash to back an account worth $1,000,000. You put 10x leverage on a fund that can average 15% returns and BAM, you get 150% returns on your invested cash.

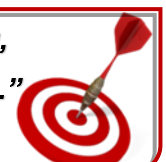
The first question that comes to my mind is, “If your clients all get 30% to 150% returns on their investment every year, and they have the ability to compound those gains into larger and larger amounts, where is all their money?” They must all be wealthy. That is awesome.

As it turns out, most people are pulling money out during good years to buy expensive toys, make a house payment, or pay their living expenses. Many are borrowing the money they put into their accounts and then leveraging that money 5 or 10 times. This kind of leverage really, *really* works when there are gains. But in a fund that is making those kind of returns, they are obviously taking on a certain amount of risk. They are not always profitable. The one year that the fund is down 30%, it wipes out all the equity the client has borrowed in the first place and they have losses that they cannot afford.

Most farmers that I meet with have decided that they love the lifestyle that farming lets them enjoy. Raise your children in the country, teach them the wonderful, lifelong values of hard work, determination, and perseverance - I get it. I believe a key lesson that is sometimes lost across the country is the magic of working

“If you aim at nothing, you’ll hit it every time.”

- Zig Ziglar



capital and the assumption that an asset is more valuable if, and only if, it creates more cash flow for the owner.

Every investment decision made should be compared to the return on risk free capital. Usually the 10-year yield on US treasuries are used. That yield is around 3.0%. The theory is that if an asset comes along that yields the same as a treasury but will be more volatile and higher risk, you should not buy it. If an asset comes along that yields 15% but is a little higher risk and a little more volatile, you should back up the truck.

On the other hand, if an asset is **more volatile** and **riskier** than the treasuries but **yields less**, don't walk – ***RUN AWAY***!

At today's land values, call it $8,500 for irrigated dirt, with **no borrowed money** and **no interest payment**, this is how land looks like it must perform to compete with the 10-year treasury:

Cash Return from Owning Treasuries

$8500 acre x 3% yield = $255

Top Line	=	$374/acre
Less RE Taxes	=	$70
Less Insurance	=	$10
Less State Taxes	=	$19
Net Income	**=**	**$255**

If you only put 50% cash down and borrow the rest, you must **also** make a $213/acre interest payment. You had better be able to show how you can make top line $567/acre to compete with the risk-free rate of treasuries.

Top Line	=	$567/acre
Less Interest	=	$213
Less RE Taxes	=	$70
Less Insurance	=	$10
Less State Taxes	=	$19
Net Income	**=**	**$255**

With revenue of 225 bushel corn at a $3.70 cash average only gives a gross revenue of $832.50/acre.

My Question Is:

Can you get a crop planted, all your inputs, irrigation expense, harvested and hauled for only $265.50/acre?

I don't think so. I think farm ground is going to have to come down in value to become competitive with the risk-free rate, which is also rising. This is to say that farm land has the same risk profile and volatility as treasuries. This should put pressure on land values and rents until either higher prices are back and sustainable, or yields rise enough to offset the low price.

I bring up these financial thoughts because one of the main ways to increase your wealth is to purchase assets that allow you to compound your earnings. When other assets show a better rate of return than treasuries, buy the other assets. On the other hand, when the higher rate of return is through treasuries, buy the treasuries. Over the long run, your wealth will be compounded at much higher rates and protect you from the dreaded "Loss" that is compounding's worst nightmare.

Conversation with a Banker

One banker I met with in the past month told me that under 20% of his farmer clients were profitable last year. It's been a tough renewal season for them. He asked what the average price our clients received for their grain last year was. I explained our obsession with futures benchmarks. A seasonal average was $3.90 last year, carry to May was around .19 cents. A good number to compare with would be $4.09 May Futures. We could trade at least .25 under basis in almost all Midwest locations, so a good cash benchmark would be a $3.84 cash average.

He had no one near that average price. This banker said he had a few that had a little sold higher and a lot had a portion sold a lot lower. But most had a huge percent of their old crop in the bin, completely unprotected against price movements, absolutely no carry sold, and really no plan to do anything about it. He said it is the same thing year after year – most of them start with a plan, but it does not take them long to be trading a hedge account daily, weekly, monthly based on the latest rumor from their local expert at coffee, or something they heard about South American weather. No plan, or if there was a plan, a poorly executed plan.

My Perspective

After being in this business for the past 15 years and talking to as many farmers and bankers that I have had the opportunity to, I am convinced that we are the only people in the country educating the farmer on grain marketing basics. Teaching farmers how to hedge off price risk, then roll carry, then next summer look at basis levels can add $112.50 in additional revenue per acre on 225 bu. irrigated corn. That income alone can turn a sub-par returning asset into a much higher yielding asset.

Recently, I heard about how a major grain company reprimanded their salesmen because they had been talking too much about basis to their clients and it was cutting into profits. *Makes me want to puke*. We all know who grain company salesmen represent and where their financial incentives align, and it's not with the farmer. I feel like we have the best job in the world. Every day we get to talk to our clients and execute a marketing plan for them totally independent of end users. I take great pride in knowing that every trade I do for a client is the exact same I would do on my own farm.

Final Thoughts

If I thought cash forward contracting my family's corn to one specific end user was the best decision for my farm – I'd do it.

We're not going to fall for a salesperson trying to fool us with shiny objects.

We're not going to be locked in to terms we don't like or trades we don't understand.

I believe making a futures decision, rolling carry, and trading basis ***INDEPENDENT*** of all end users is the best way to go for great long term financial results on your farm.

As for me and my farm, that's what we're going to do.

New to The ARC Group

We found a few more great people to add to our team this year.

Wade Stevens

Wade Stevens
Harlan, Iowa

We made an excellent addition to our coverage in Western Iowa by bringing another great merchandiser from a commercial facility to join our team. We are very excited to announce that Wade Stevens is opening an office in Harlan, Iowa. Wade grew up in Columbus, NE and graduated from Nebraska Wesleyan University. He has extensive commercial grain experience having spent 2010-2018 as a grain buyer for Cargill. Wade is going to be an invaluable asset to his clients. He and his wife Erica live in Harlan, Iowa.

Jenna Keim

Jenna Keim
Lincoln, Nebraska

Jenna joined our team as our new Grain Settlement Clerk. She grew up on a farm near Wilber, Nebraska, and currently lives in Clatonia with her husband Mike. Jenna graduated from Southeast Community College – Beatrice with an Associate's Degree in Agricultural Business, and then went on to Northwest Missouri State University and graduated with a Bachelor's Degree in Animal Science. From the day she started she has been awesome at improving efficiency at her desk, getting cash grain contracts settled and paid out to our clients quickly and accurately. We are very excited to have her on our team.

I want to thank you again for your continued business and hope you have a great, safe summer.

Justin Lovegrove
President, The ARC Group, LLC.
(402) 484-7474

P.S.

I will leave you with a picture of our US Ag Secretary – Sonny Perdue holding up a great t-shirt…