









November 10, 2016

Co-op Equity Management





CoBank's View of Equity



CoBank's Equity Plan

- Target Equity = 8% of clients average loan balance's over 10 year period.
- Patronage Payments = 1% of clients average loan balance during the year.
- Patronage Payment = 75% cash & 25% equity
 - This has been as low as 50% cash & 50% equity when CoBank was first formed.
- CoBank's target return on equity is 20%.





CoBank's View of our Clients Equity



Regional Agribusiness –

Local Leverage %



((Long Term Debt + Capital Lease Obligations + Subordinated Debt) / (Total Net Worth – Investment in CoBank – Investment in Other Coops – Investment in Subsidiaries)) * 100

- Essentially we are measuring total debt to core net worth.
- This shows how a borrowers finances their organization (% of Debt vs. % of Equity).
- 80% is considered minimally adequate by CoBank Credit Division
- 50% or less is my personal recommendation
- 35% or less is considered strong by CoBank Credit Division





CoBank's View of our Clients Equity



<u>Utility Lending Division -</u>

Equity / Total Assets (Total Net Worth / Total Assets)

Measures % of assets financed by equity vs. debt



Generation & Transmission Coops

- 2.5% is considered minimally adequate by CoBank Credit Division
- 6.5% or more is considered adequate by CoBank Credit Division
- 10.5% or more is considered strong by CoBank Credit Division

Electrical Distribution Cooperatives

- 12.5% is considered minimally adequate by CoBank Credit Division
- 20% or more is considered adequate by CoBank Credit Division
- 27.5% or more is considered strong by CoBank Credit Division





Allocated vs. Unallocated vs. Retained Earnings



Allocated Equity

- Cooperative receives the benefit of reduced tax liability.
 - Member pays the taxes but also the expectation of future payout of the equity.
 - Expectation that active users of the cooperative should hold the bulk of the equity.
 - If equity is not actively revolved it losses it's value for the member.





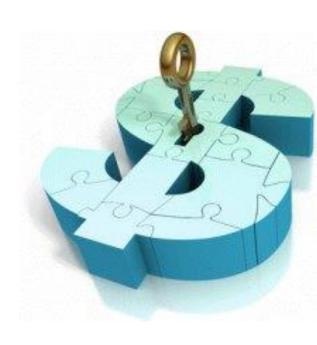


Allocated vs. Unallocated vs. Retained Earnings



Unallocated Equity

- Cooperative pay's the taxes upfront on the equity but receive tax refund if equity is distributed to the membership.
 - No expectation of future payout of the equity.
 - Flexibility to utilize the equity to grow the cooperative or retire equity back to the shareholders.
 - Some view this as a violation of cooperative principles.
 - "Ownership in relationship to utilization"







Allocated vs. Unallocated vs. Retained Earnings



Retained Earnings

- Cooperative pays the taxes on the earnings.
- Used to grow cooperative, repay debt, or build balance sheet strength.
- Most patient source of equity for the cooperative with no expectation of disbursement.







Current Equity Levels vs Historical



Regional Agribusiness Averages (1170 Borrowers)

2011

- Total Net Worth = \$32,926,371
- Debt to Net Worth = 1.52 : 1.00
- Local Equity = \$27,730,449
- Local Leverage = 57.23%

<u>2015</u>

- Total Net Worth = \$43,550,248
- Average Net Worth increased \$10.6MM
- Debt to Net Worth = 1.18 : 1.00
- Average debt only increased by \$410k
- Local Equity = \$36,703,735
- Local Leverage = 52.58%

Analysis

- Borrower's took advantage of historically profitable years to significantly increase equity levels (and working capital).
- Allocated Earnings increased by \$400k.
- Retained Earnings increased by \$10.6MM.
- Preferred Stock decreased by \$78k to \$340k. (18% decrease)





Risks of having too little equity



- More debt needed to finance operating needs.
- Higher risk profile from lenders.
- Leads to higher interest rates.
- Higher interest expenses due to higher debt levels and higher rates.
- Ripe for hostile take over bids.
- Member that has low amount of equity and/or no equity revolvemer could be tempted with sweet cash offer.









Risks of having too much equity



- Member resentment.
- Low ROE.
- Hurting members profitability / growth potential?

Other risks?







Thoughts on Equity



- How closely to do you look at ROE?
- Does your cooperative have a target ROE?
- One potential way to increase ROE is via leverage would you consider taking out a loan to retiring equity and therefore increase ROE?







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12



