WELLS FARGO

Outlook: Macro + Execution v. Environment

June, 2019

Michael Swanson Ph.D.
Agricultural Economist

© 2019 Wells Fargo Bank, N.A. All rights reserved. Internal use.

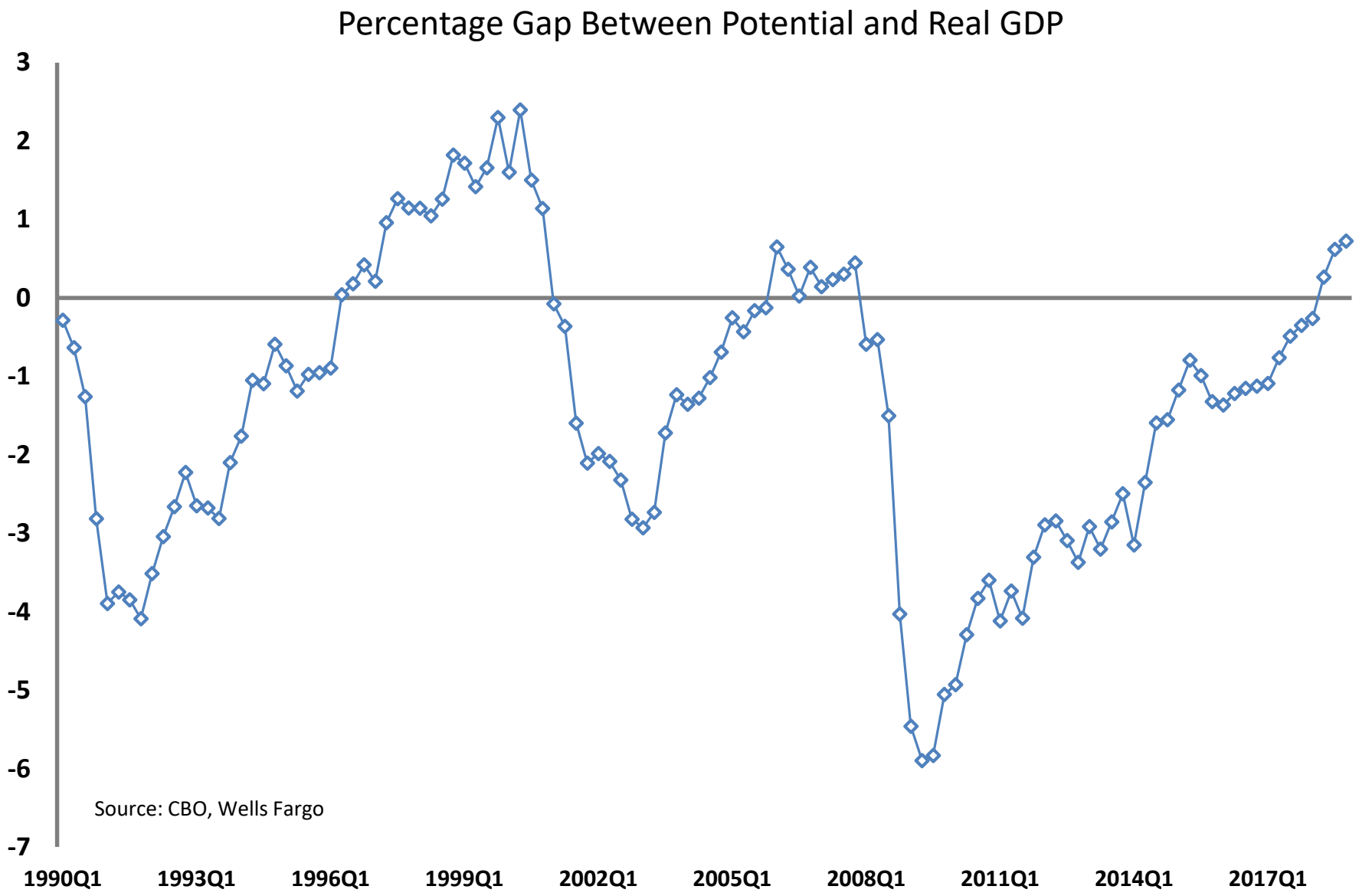
All economics are personal.

- Why is someone always predicting a recession?
- What happens if it's true? "this time"
- What does it mean to me?

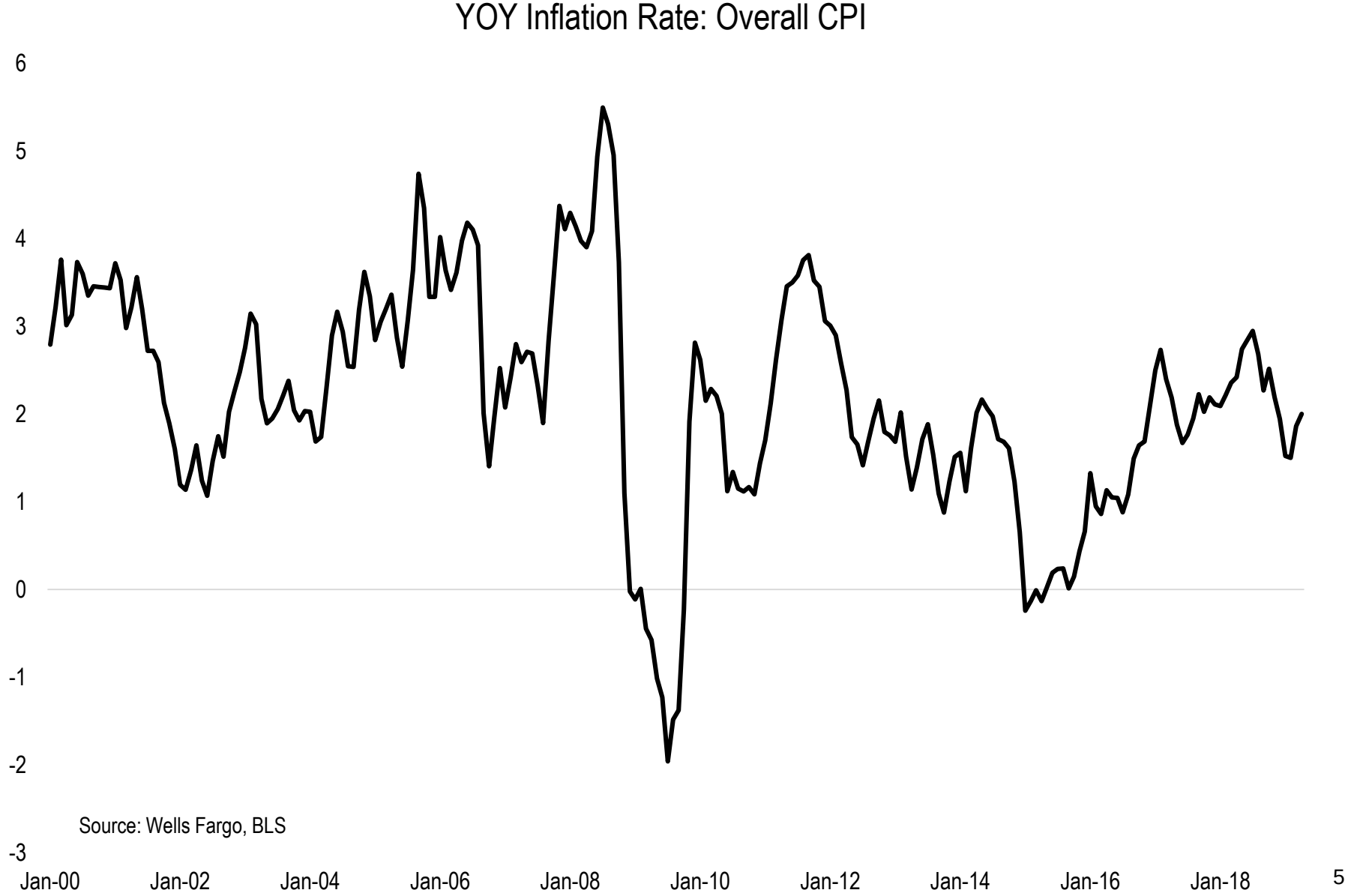
What's your biggest fear? And, why?

- **Unexpected**
  - Tariffs
  - International shock
  - Legal/regulatory shock
- **Environment**
  - Rising interest rates
  - Rising wage rates
  - Pricing pressure
  - Irrational competitors
- **Execution**
  - Internal talent
  - Technology change
  - Moving up in your space

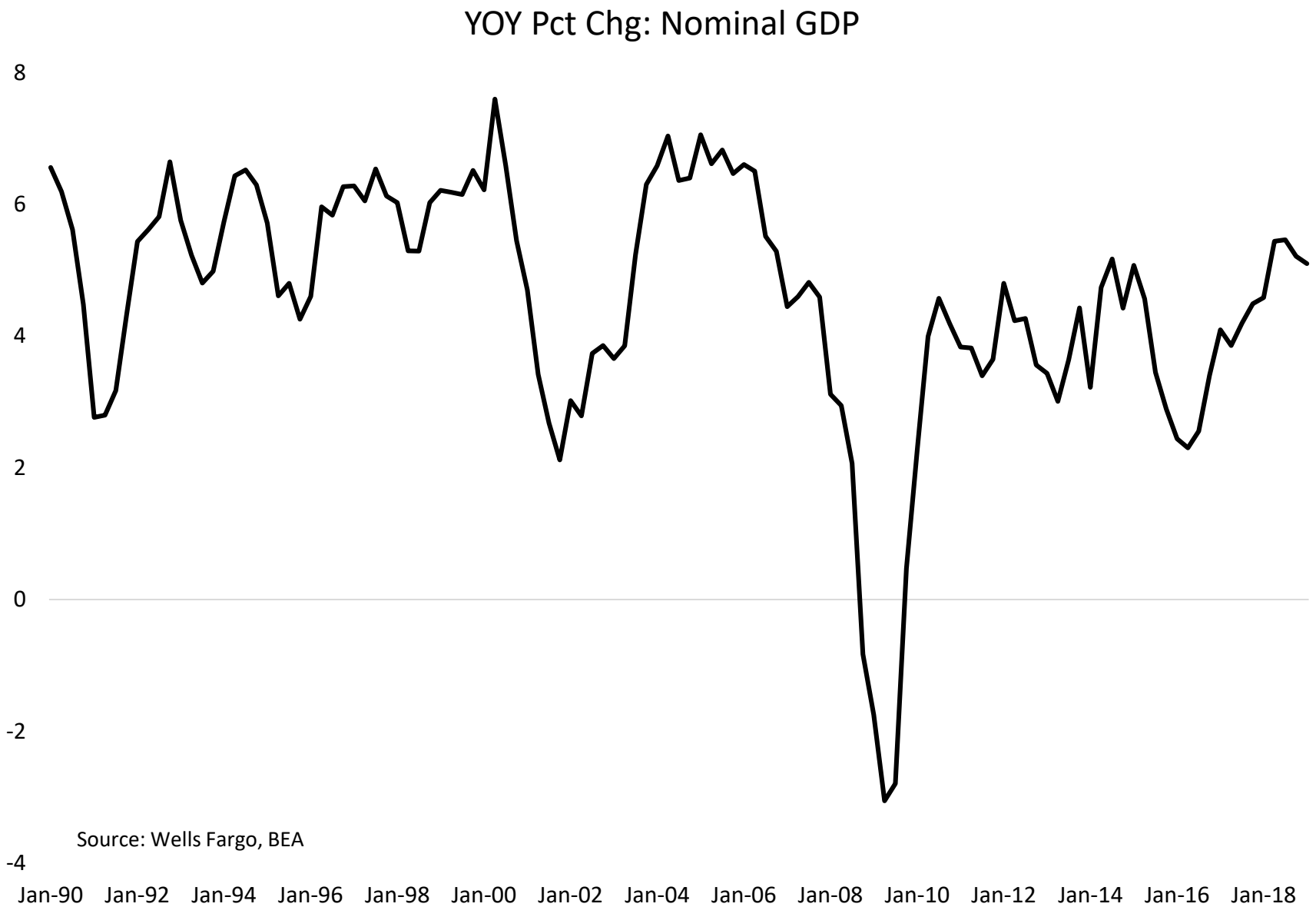
Is the Federal Reserve behind the curve?



Core inflation? Who and whom

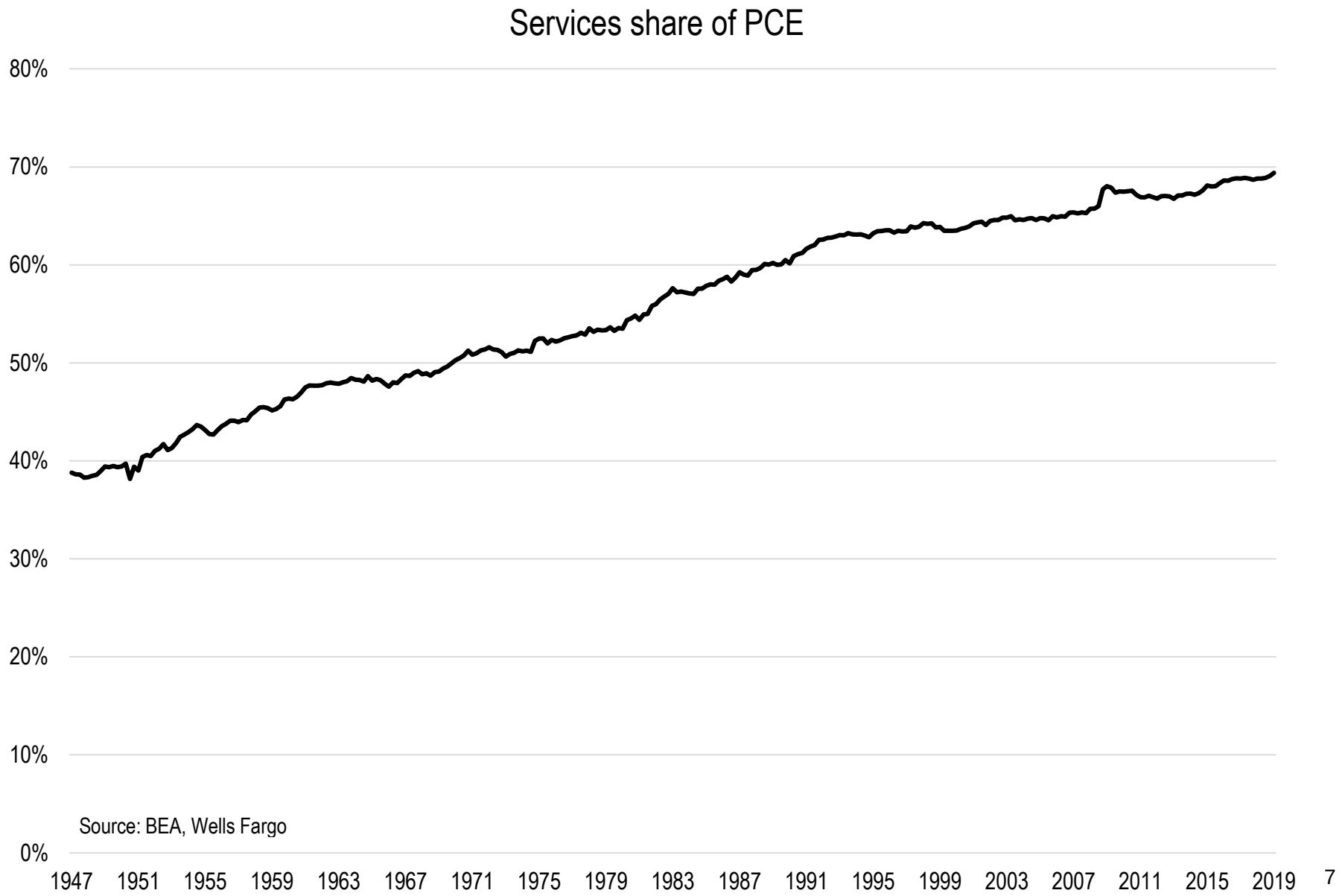


No one reports their numbers adjusted for inflation



Source: Wells Fargo, BEA

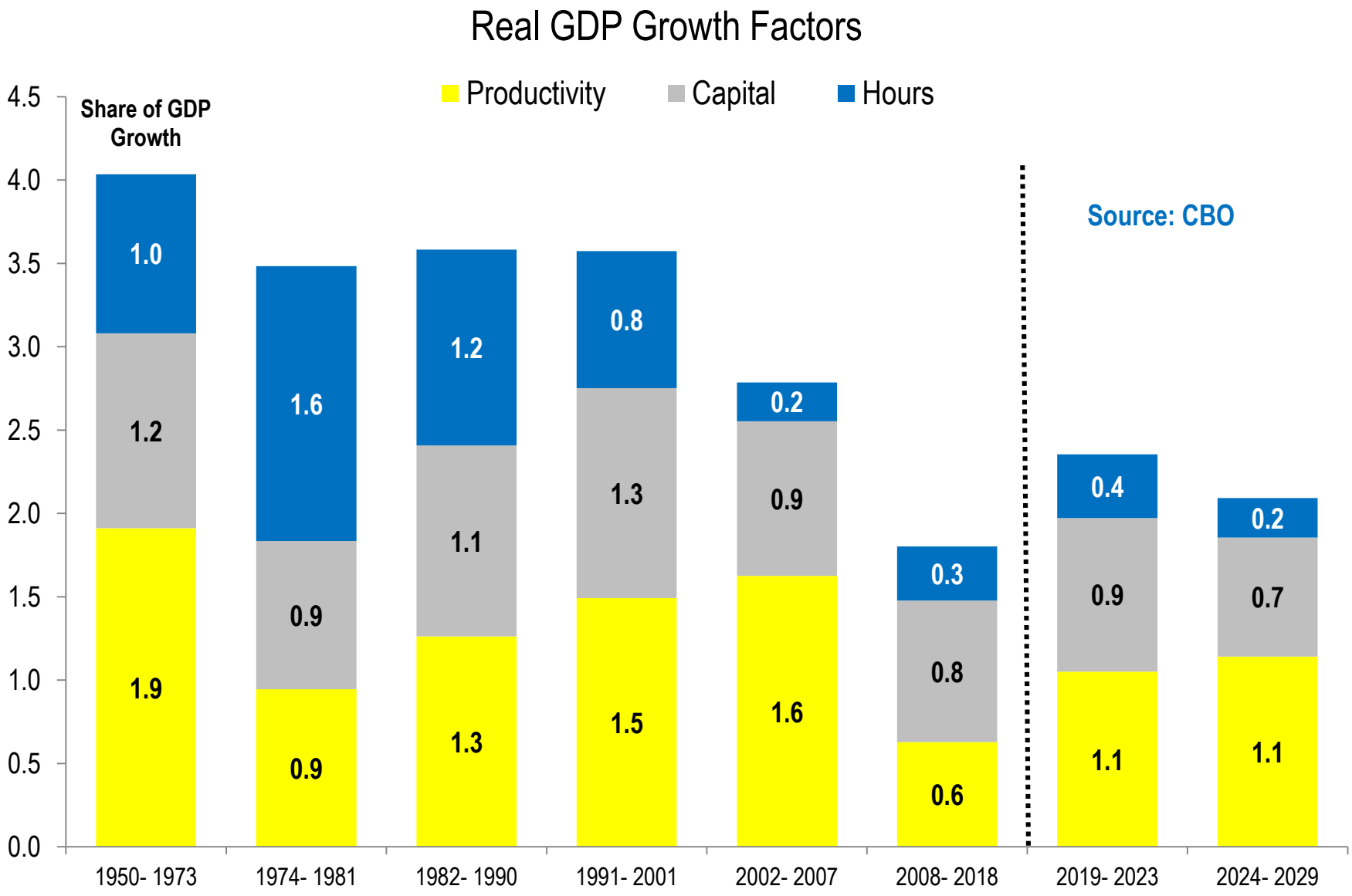
Slow but steady change makes models obsolete



∑ Micro = Macro (how do you grow your business)

- Capital
  - Buildings
  - Equipment
  - Inventory and Accounts Receivable
- Labor
  - Employees
  - Hours worked
  - Skill sets
- Technological change
  - External change
  - Internal adaptation
  - Effectiveness of combinations

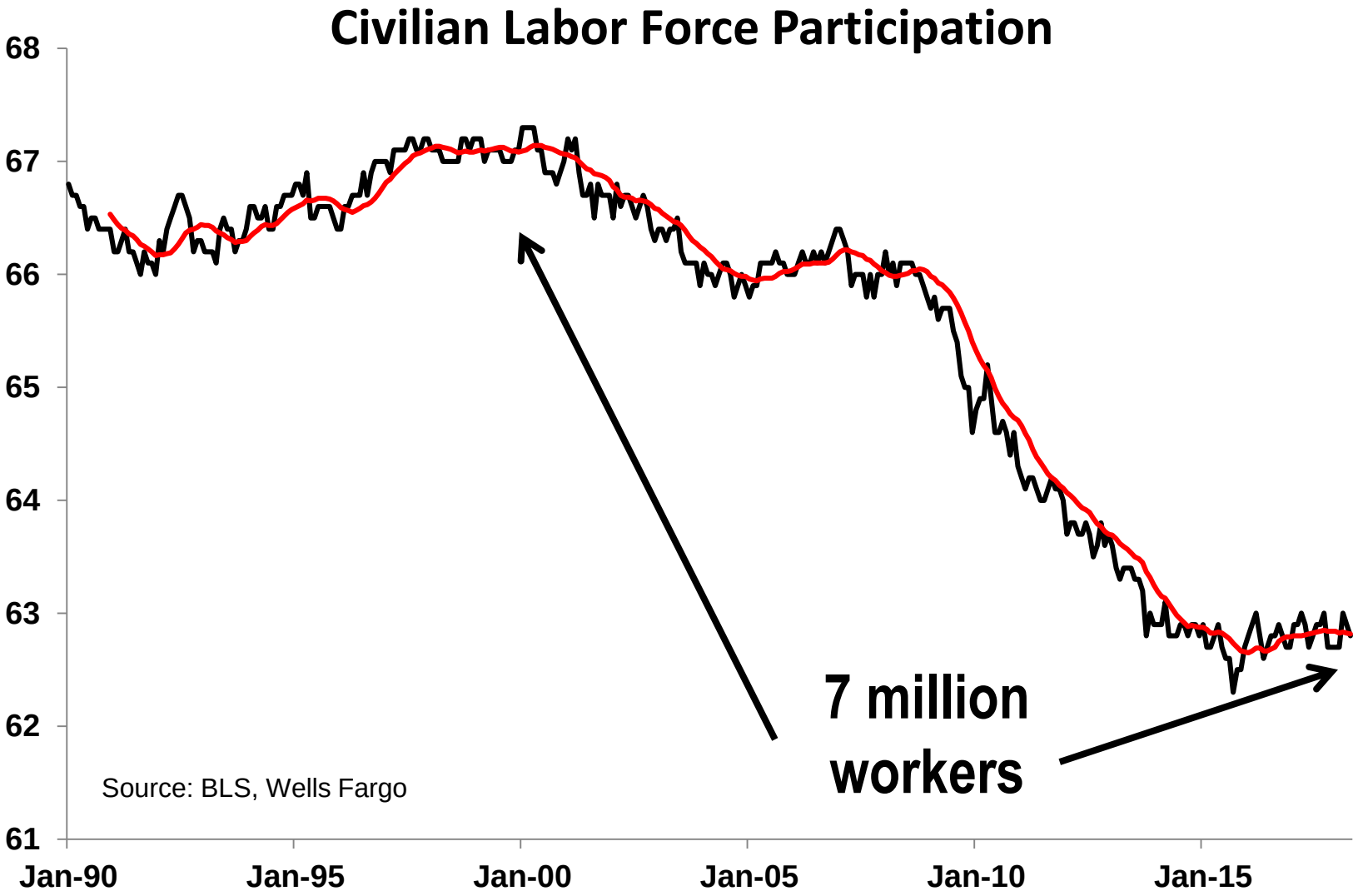
The art of guessing "potential GDP"



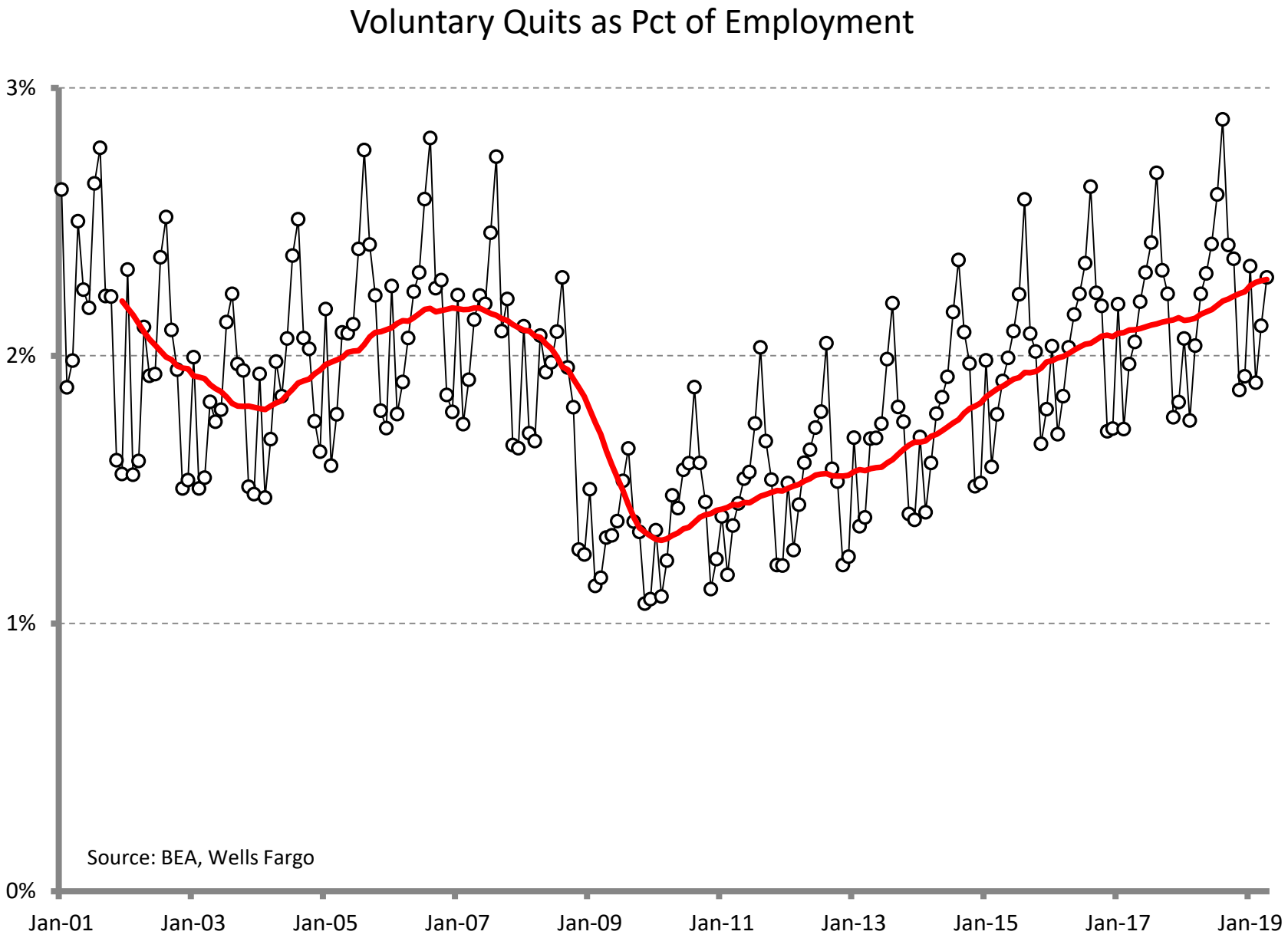
When it involves people

There are no constants in economics. People can always change their minds, and that changes everything.

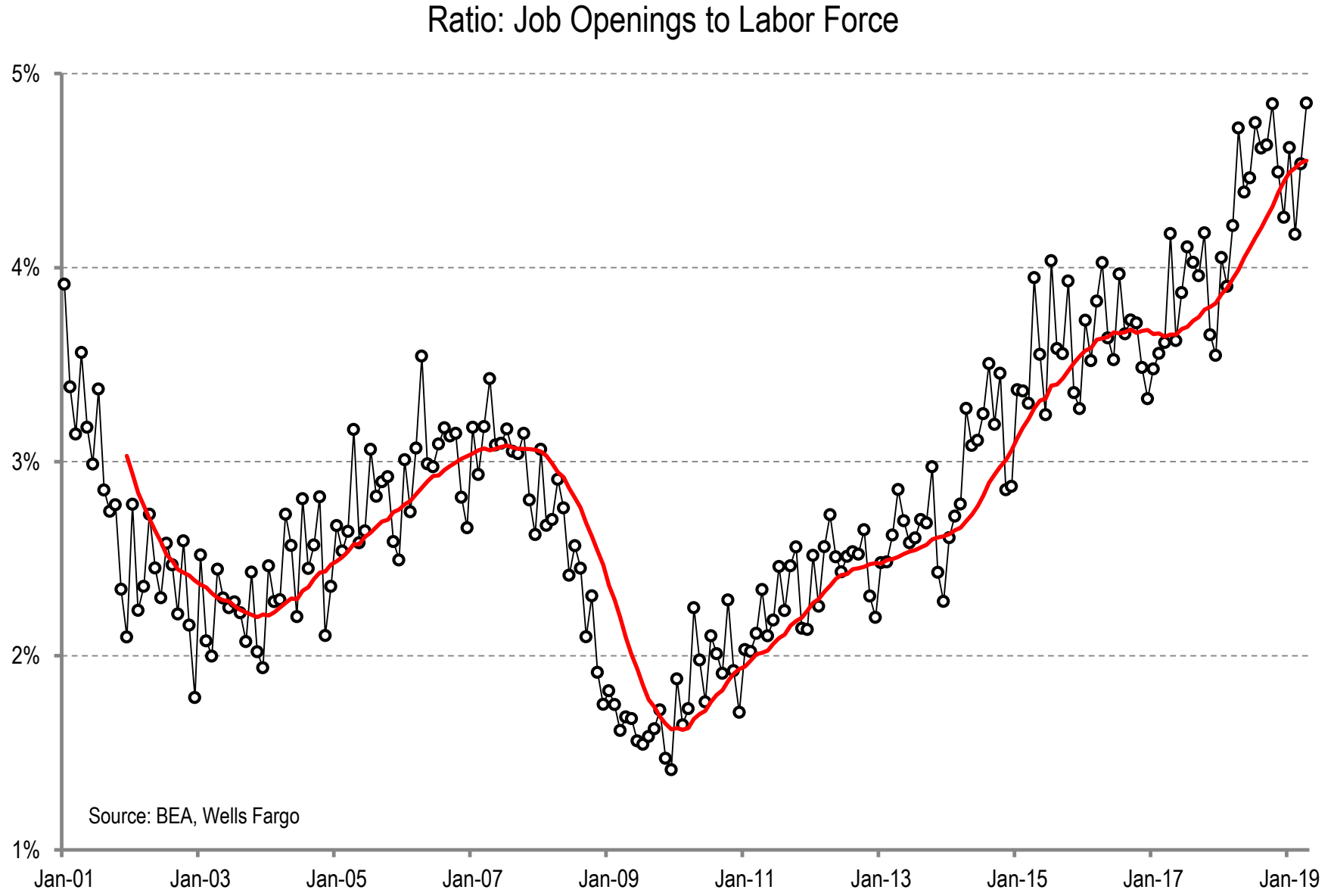
What if labor participation "recovers" to 64%?



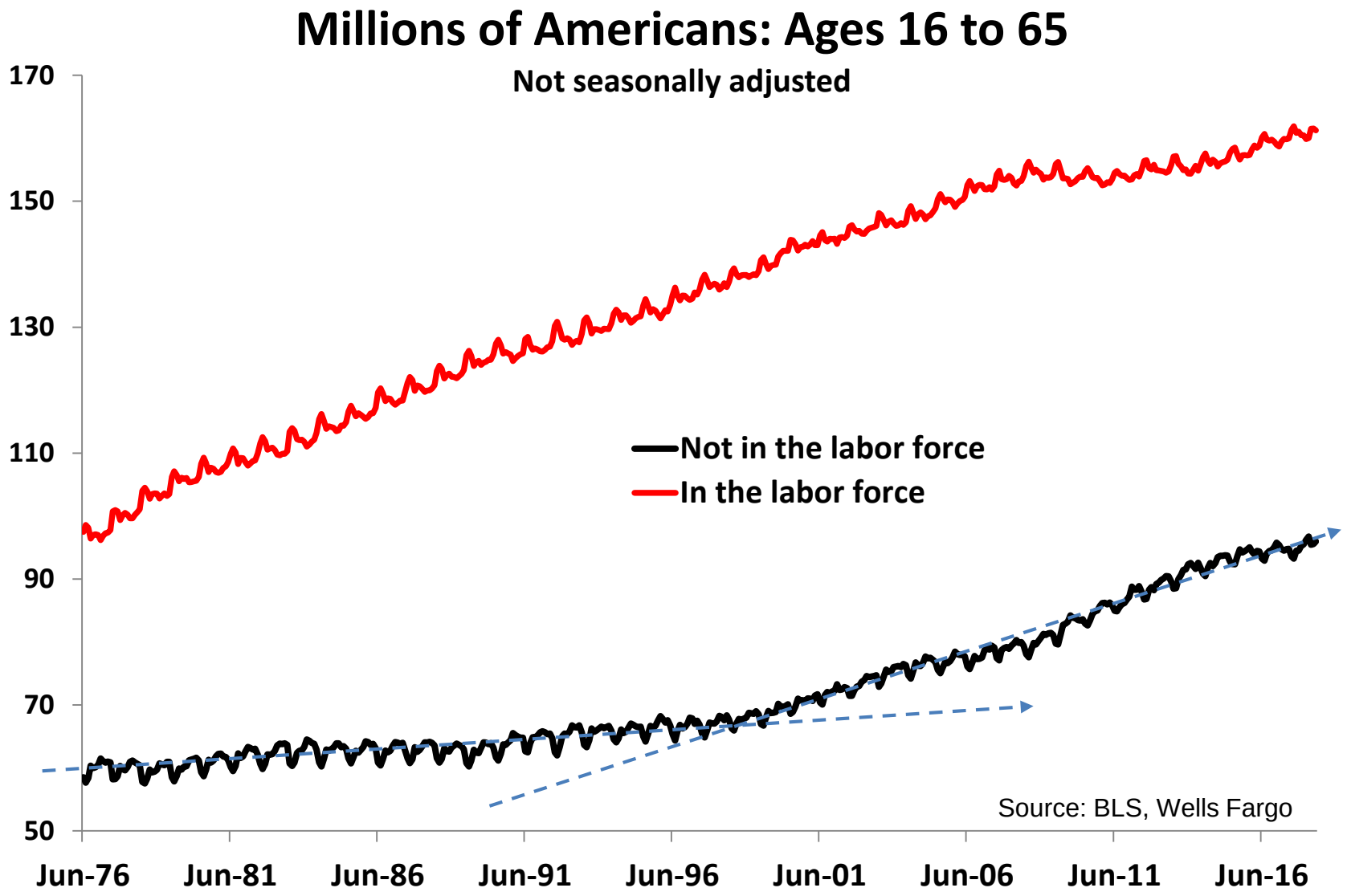
You don’t have to tell a Millennial twice



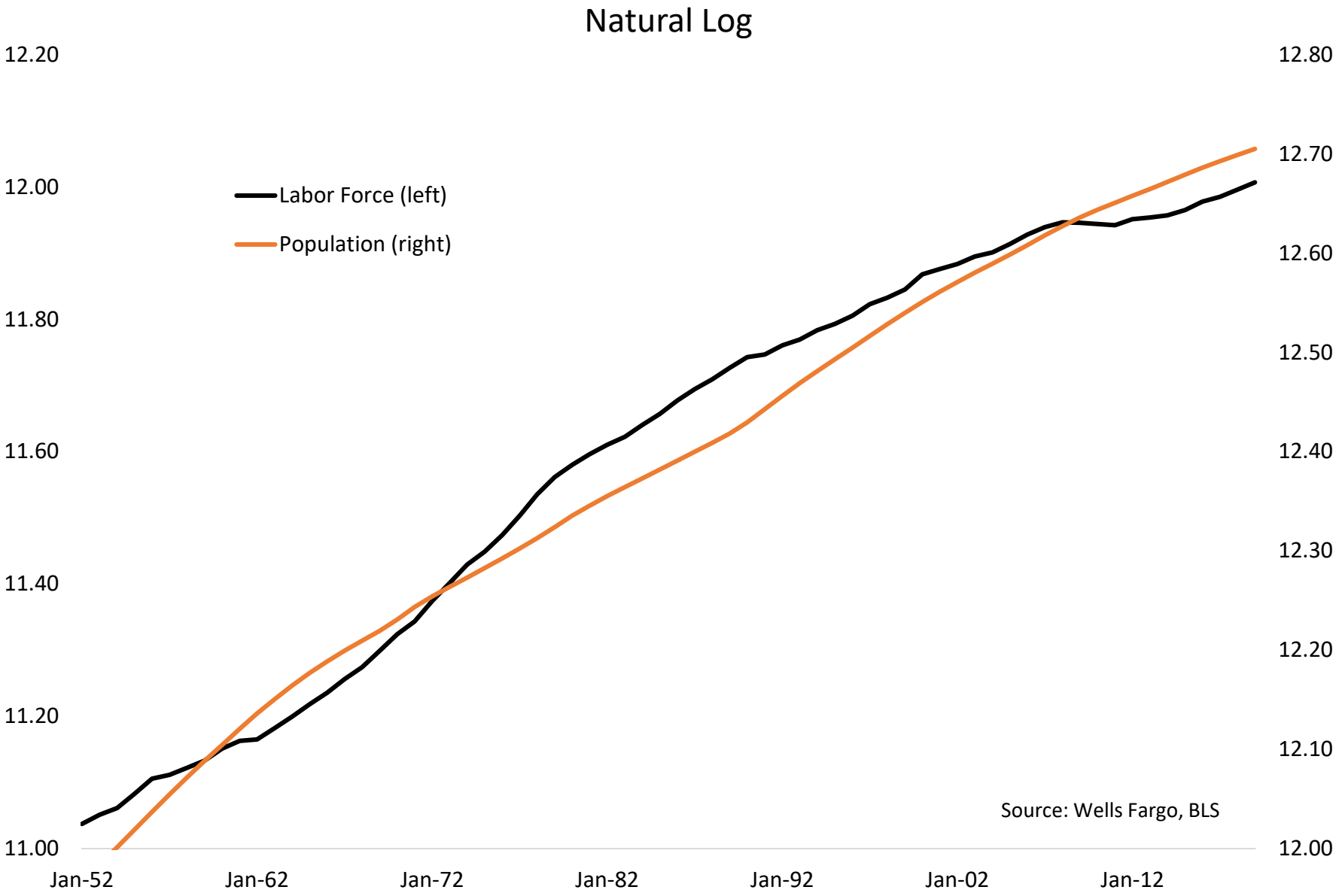
What brand of lattes do you serve in the break-room?



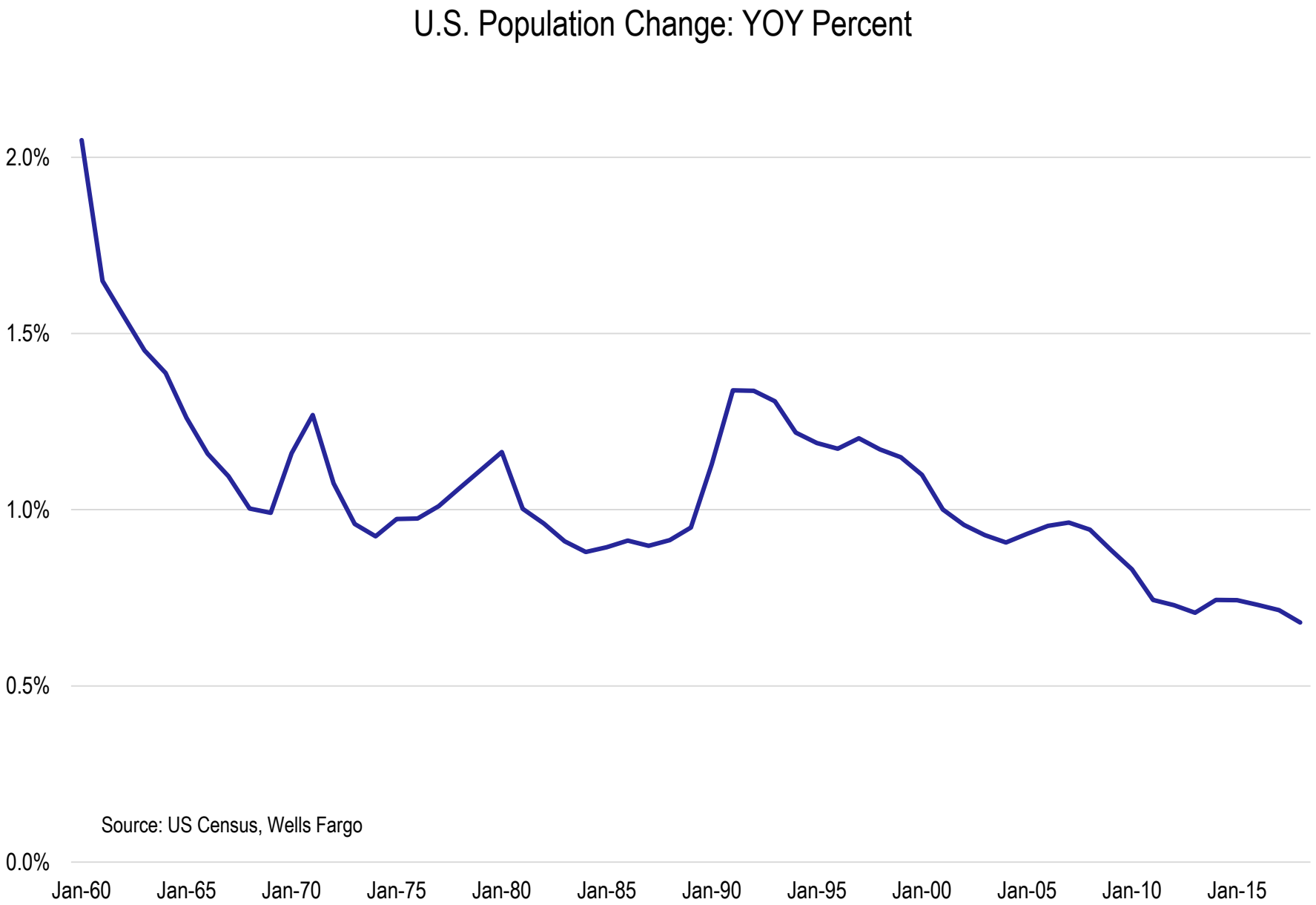
These trends take years to move the needle



The CBO's projection can't "predict" this



This is not about any industry



Everything is connected.

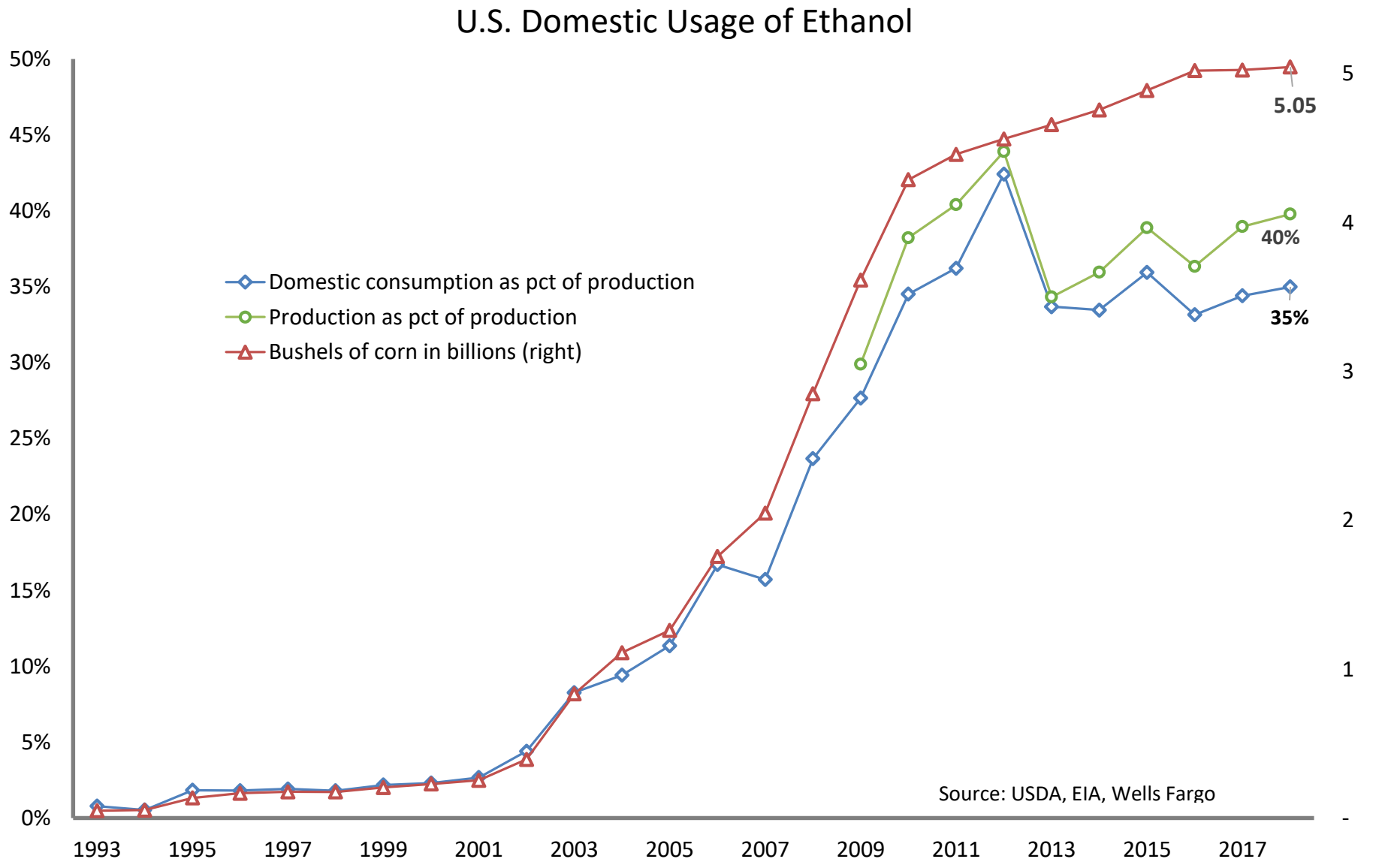
We just don’t see how.

Connection corollary: Nothing natural moves in a straight line.

Change the rules – Change the game

- **40% of U.S. corn goes to ethanol**
  - Currently stable
  - Growth is +/- 1%
  - Poor profits pushing a shake-out
- **Battery technology will dominate**
  - 7 to 9 percent improvement annually
    - Cost of manufacturing
    - Absolute performance
      - Chemistry
      - Anode/cathode performance
    - Network of availability and faster charging
    - Thousands of R&D initiatives

As goes ethanol so goes corn

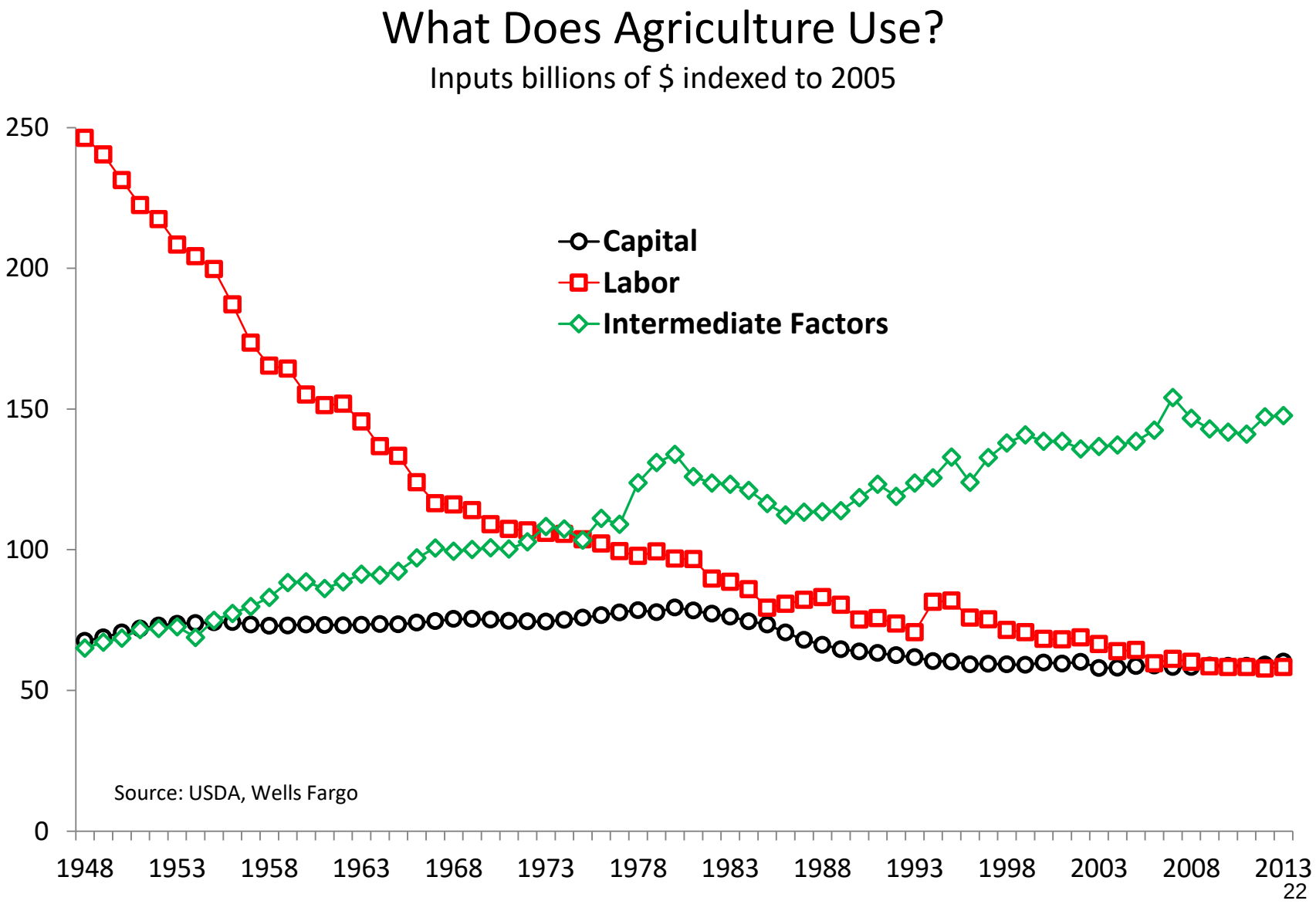


How can they think that?

- Same price – different response
  - Different cost of production
  - “” historical asset value
  - “” levels of leverage
  - “” costs of borrowing
  - “” dividend needs
- Easier said than done is a real business model
  - It’s lots of little things
  - Are you “putting off” unpleasant decisions
  - Where is the problem?
    - Out there
    - In here

You only get paid for
what you bring to the game.

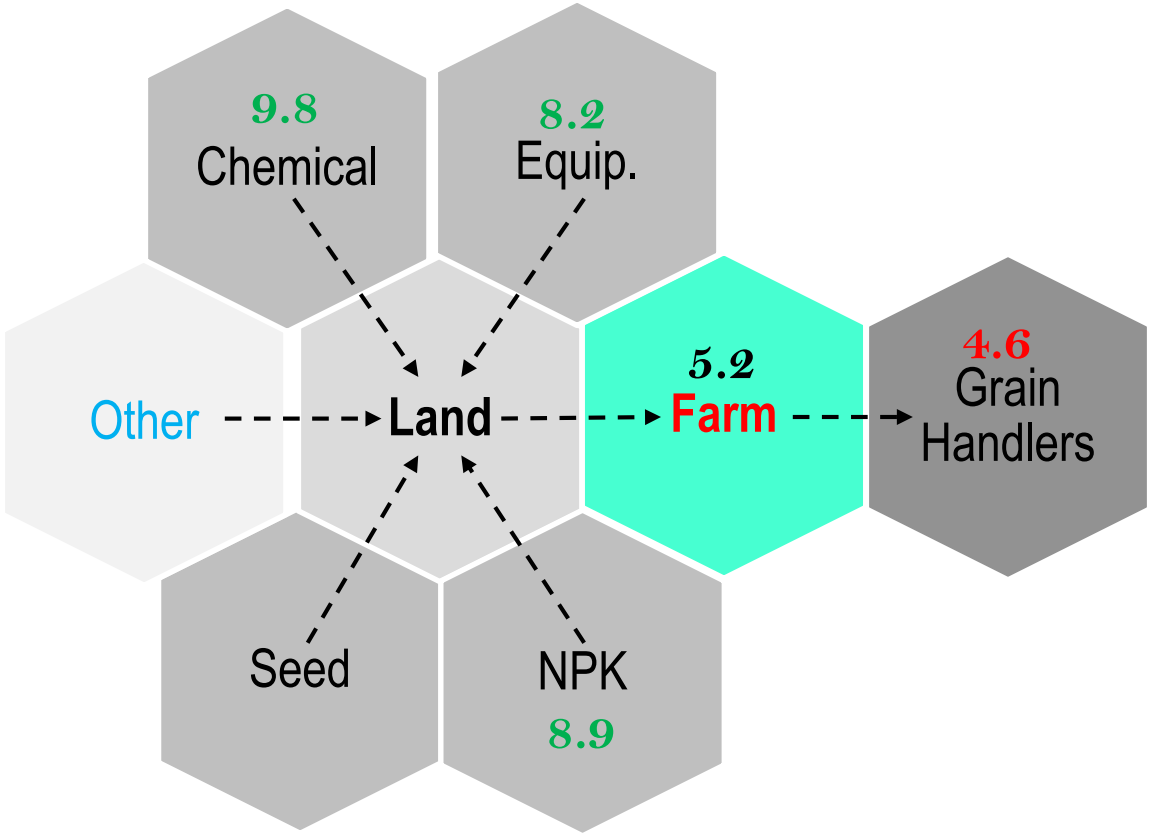
Substituting technology for labor



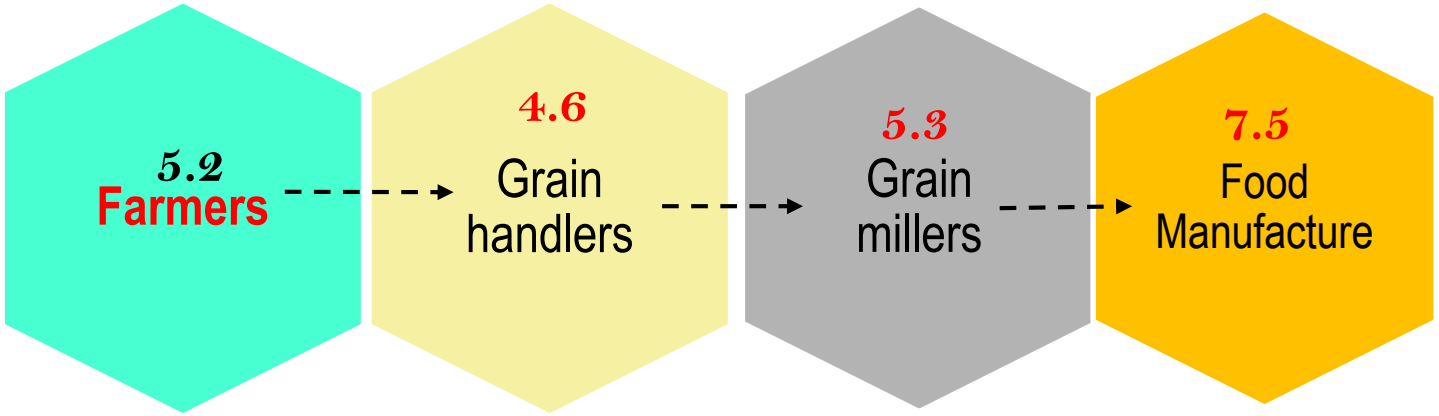
Return on Assets =

$ profits / $ of assets

One Step Adjacencies in Farming

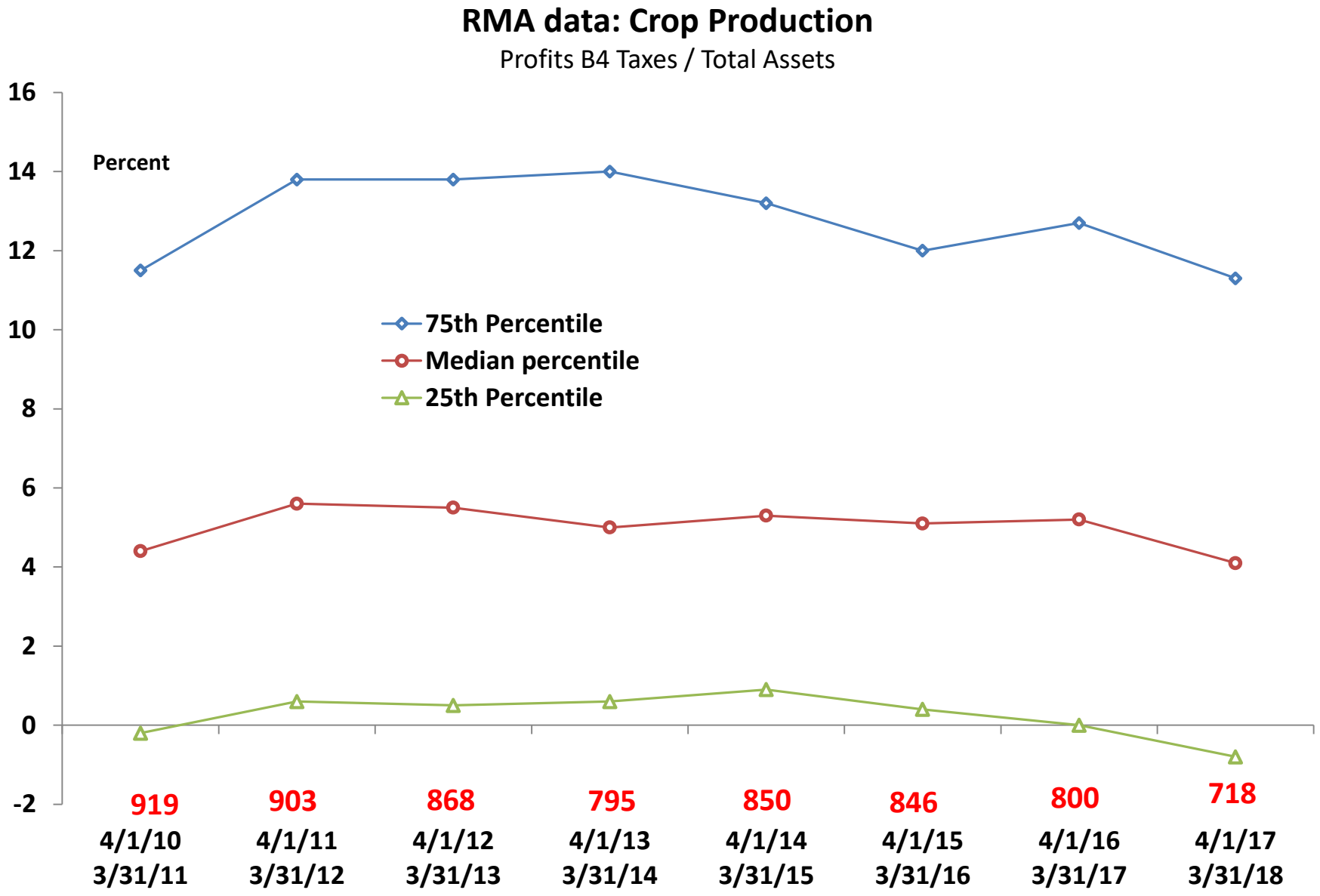


The ROAs of the milling

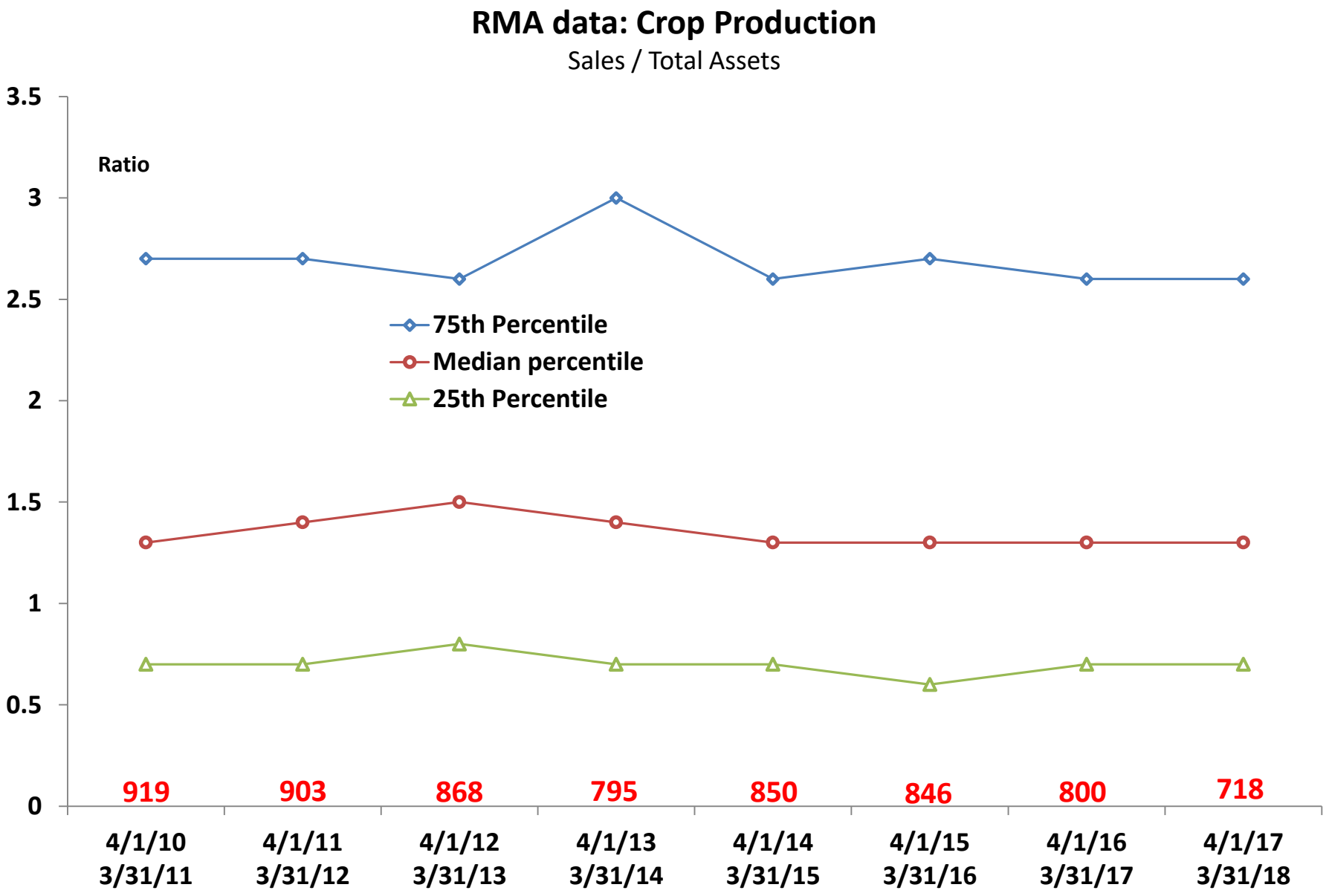


Source: RMA, Wells Fargo

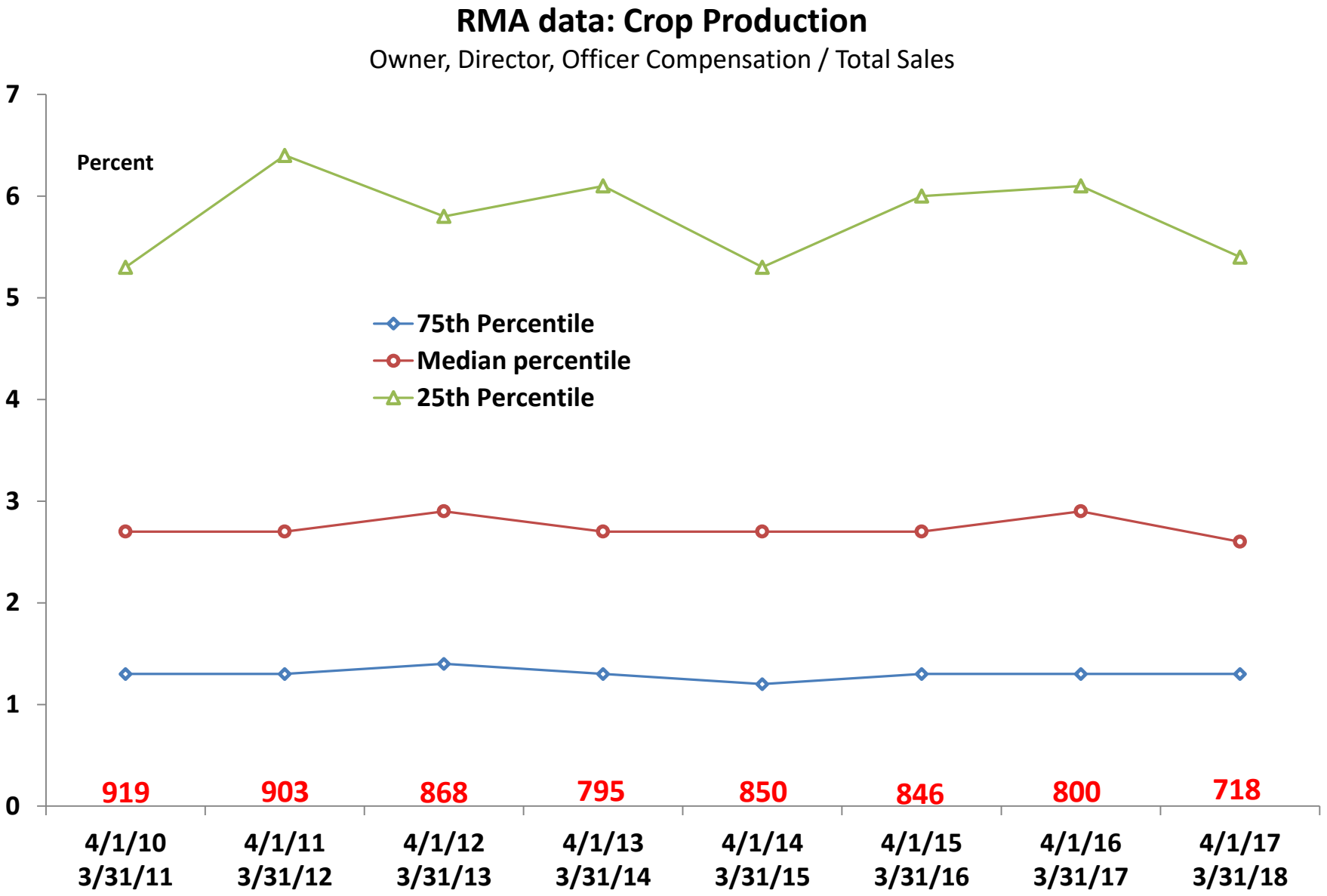
Environment v. Execution: Which rules?



Should you sell your lazy assets?

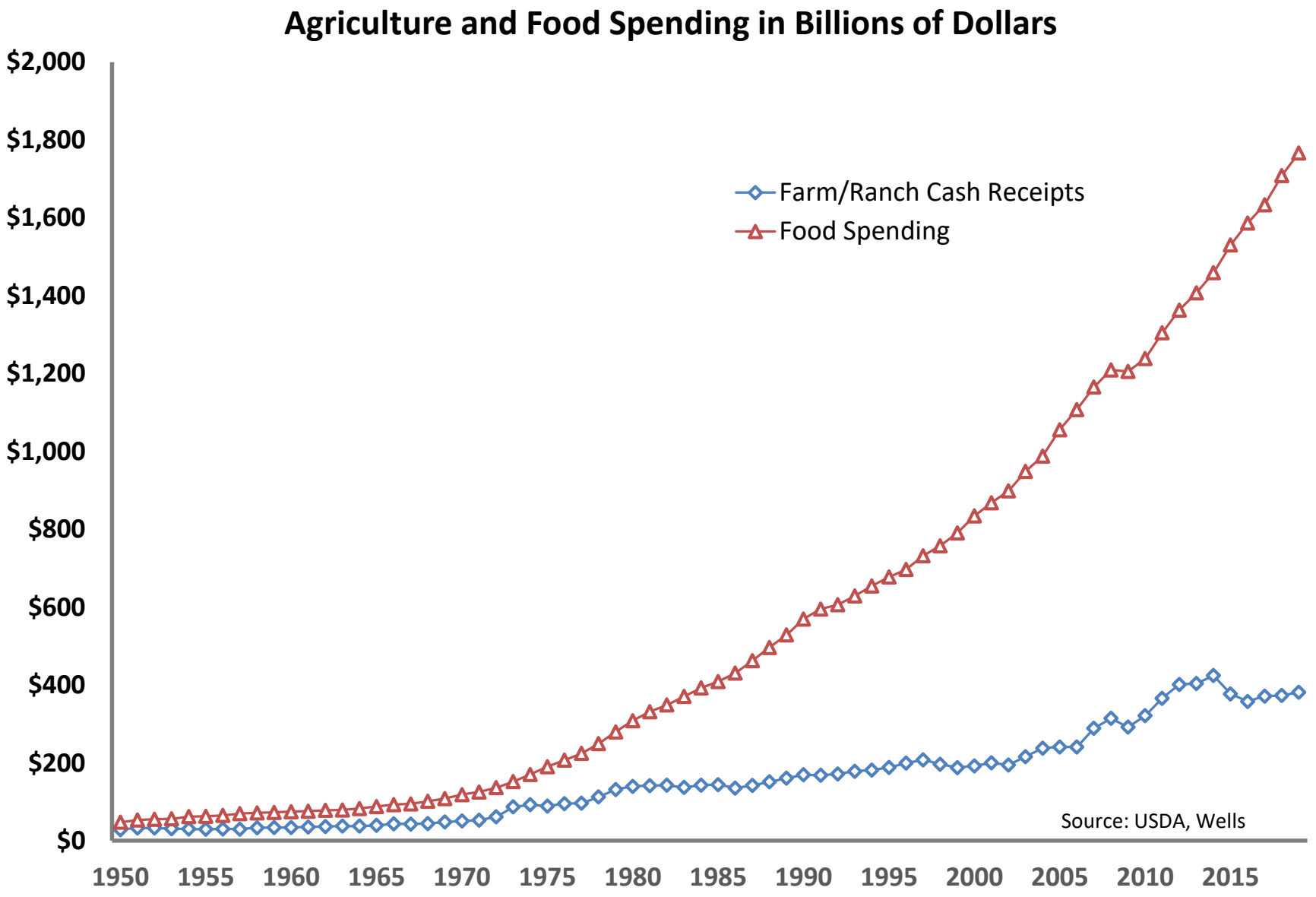


Amazon's strategy

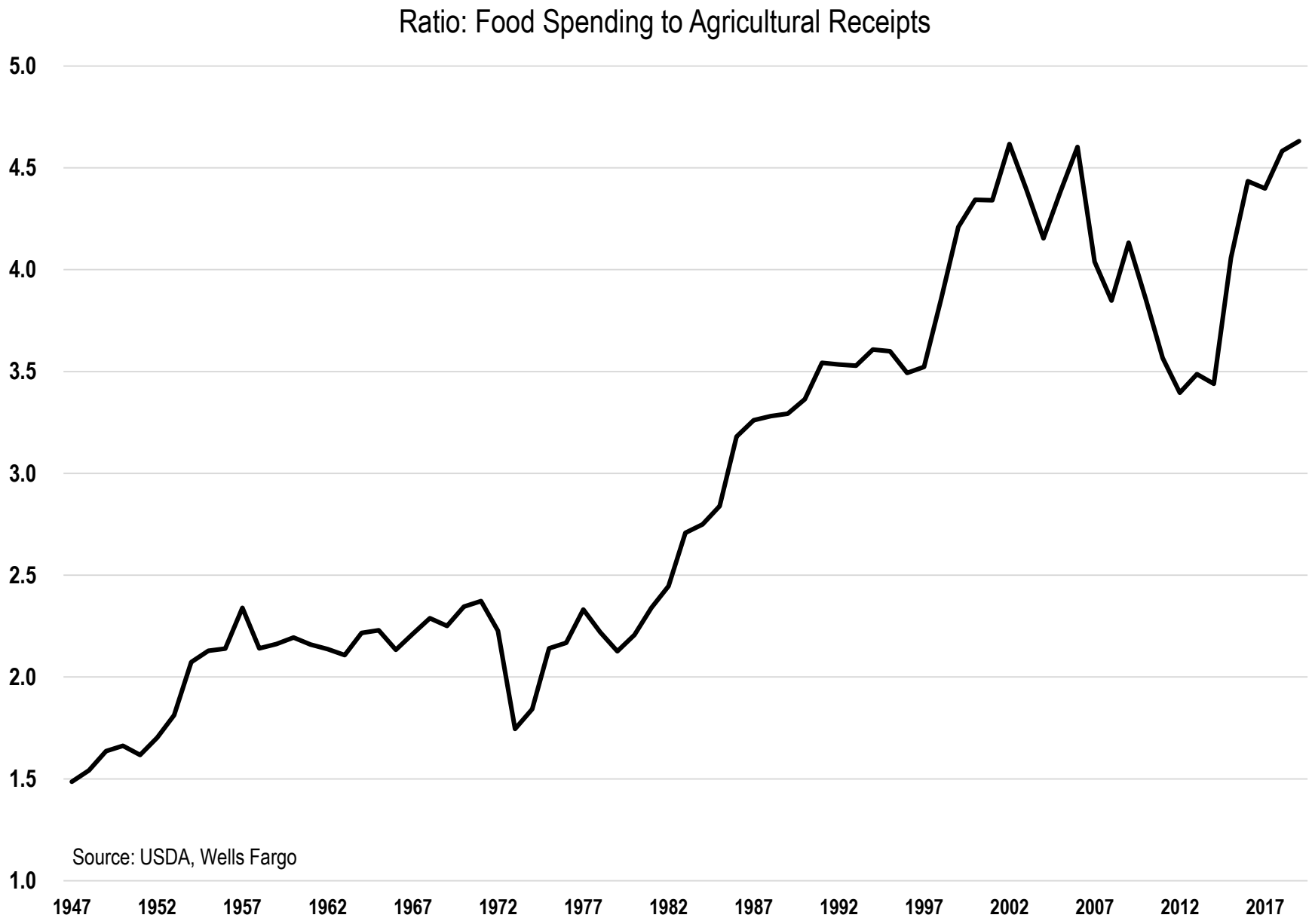


Agricultural Products are not Food

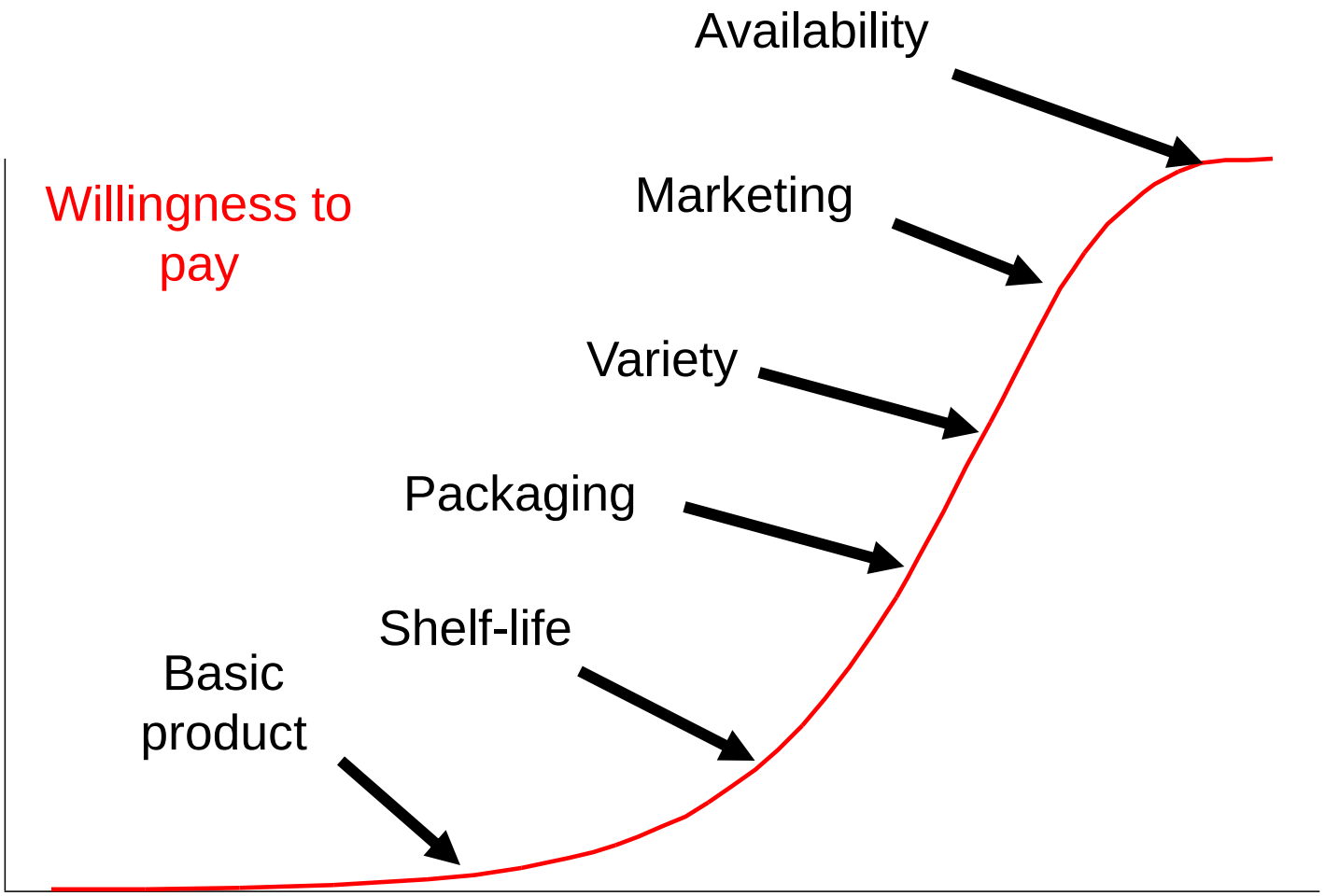
These don't run in parallel



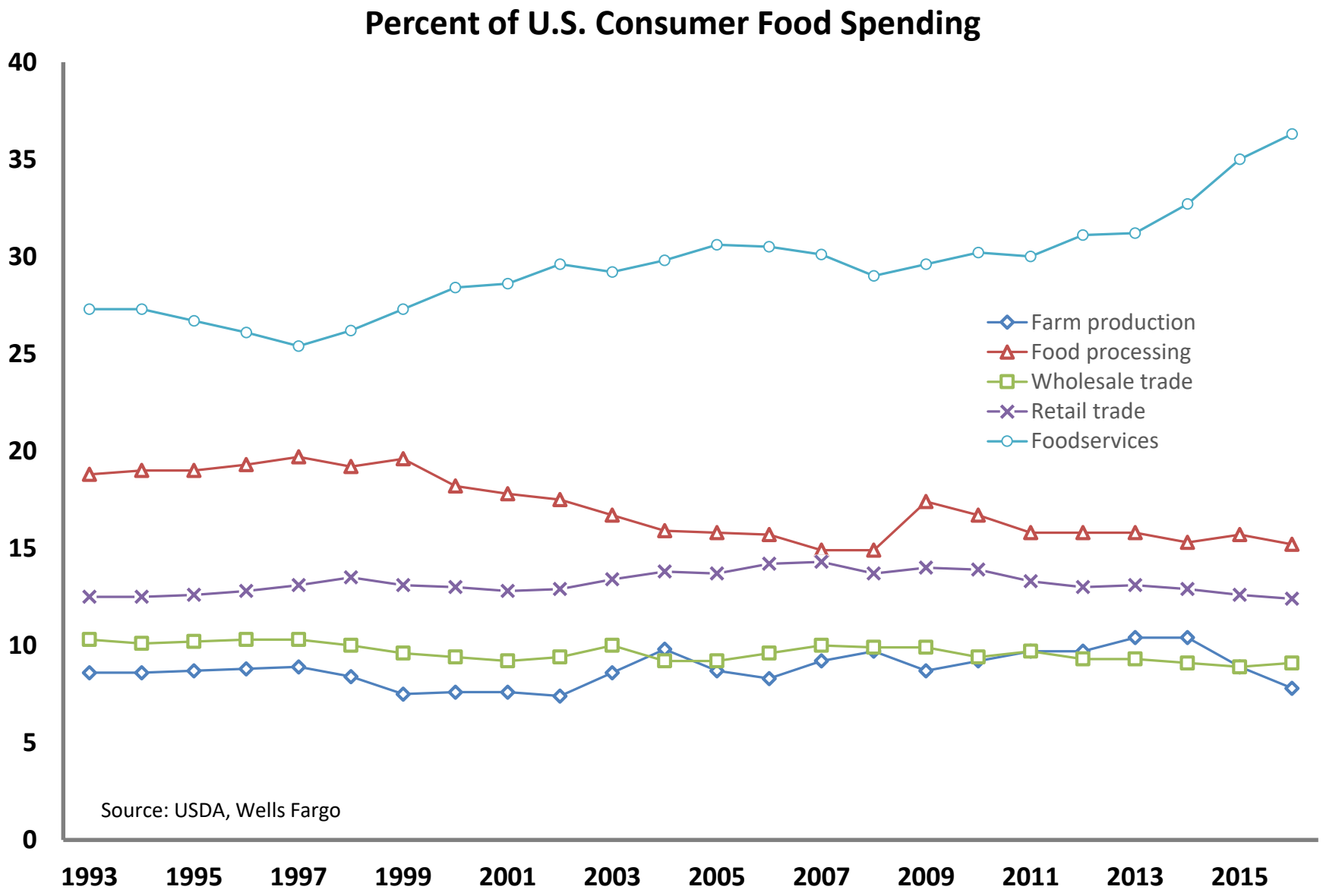
How high can this ratio go?



Value to Consumers



Ease of eating is the big dog



Show me the money!

Share of the U.S. Food dollar by category					
Category	1993-1997	1998-2002	2003-2007	2008-2012	2013-2016
Agribusiness	3.5	3.1	2.2	2.4	2.1
Farm production	8.7	7.7	8.9	9.4	9.4
Food processing	19.2	18.5	15.8	16.1	15.5
Packaging	4.2	4.1	3.6	2.9	2.5
Transportation	3.9	3.8	3.6	3.4	3.4
Wholesale trade	10.2	9.5	9.6	9.6	9.1
Retail trade	12.7	13.1	13.9	13.6	12.8
Foodservices	26.6	28.0	30.0	30.0	33.8
Energy	3.5	4.3	5.1	5.5	4.5
Finance & Insurance	3.5	3.8	3.4	3.3	3.3
Advertising	2.7	2.5	2.5	2.4	2.6
Legal & accounting	1.3	1.5	1.5	1.4	1.3

Source: USDA, Wells Fargo

What stories should we tell?

1. You can “taste the difference”
    - Variety
    - Location (even micro locale)
    - Harvest method
    - Timing
2. You can “make a difference”
3. You can “tell your friends and family”

This coffee thinks it's a wine

Did the chicken know?

Everyone needs to be a MoneyBall manager

- **Cost on the unit you get paid in**
  - Acres v. tons
  - Relative yield and cost
- **Your success is average cost**
  - Average depends on marginal
  - Everything is fixed now
  - Everything is variable tomorrow
- **Adopt and adapt is a learning process**
- **Asset discipline is yours alone**

General disclosures

The views expressed are intended for Wells Fargo customers, prospects, and other parties covering the Food and Agribusiness industry only. They present the opinions of the authors on prospective trends and related matters in food and agribusiness as of this date, and do not necessarily reflect the views of Wells Fargo & Co., its affiliates and subsidiaries. Opinions expressed are based on diverse sources that we believe to be reliable, though the information is not guaranteed and is subject to change without notice. This is not an offer to sell or the solicitation to buy Wells Fargo product or service including security or foreign exchange product.