August 2018, Volume 23, Number 3

THE FARMER'S EDGE

Hurley & Associates
Agri-Marketing Centers

Rail Transportation Update

By Tom Williamson

Railroad service overall has improved in the last six to eight months. Trains held for power and/or crews have diminished substantially as Class One railroads pulled locomotives out of storage and hired and trained additional engineers to replace employees terminated in 2017. Total Class I freight railroad employment was 147,000 in May 2018, up 1,041 over April 2018 but still down 2,032 from May 2017. The gain of 1,041 employees in May from April was the biggest one-month gain since April 2015. However, when comparing second quarter 2018 to second quarter 2017, velocity and terminal dwell were significantly worse y/y for the rails with CSX's sharp improvement being a notable exception. Velocity unfavorably declined 4.7% y/y in the quarter while terminal dwell unfavorably increased 5.9% y/y. These operating metrics are rough proxies for rail service, and the data support the consensus view that rail service is not likely to get to normal level (2016 levels) until sometime next year.

Rail shipments have surged with U.S. railroads originating 1,159,973 intermodal containers and trailers in June 2018, up 6.3% over June 2017. Average weekly intermodal volume in June 2018 was 289,993 units, easily the most for any month in history. Additionally, U.S. railroads originated 1,080,769 carloads (see chart 1) in June 2018, up 2.0%, or 21,098 carloads, over June 2017. Total carloads in the first half of the year were up 1.3% over the first half of 2017. Carload growth has been broad-based with petroleum products up 19.7% in June, thanks to growing oil production and tight pipeline capacity. Carloads of crushed stone, sand, and gravel are setting new records due to demand for frac sand and strong construction markets. 2018 will probably be a record year for chemical carloads too.

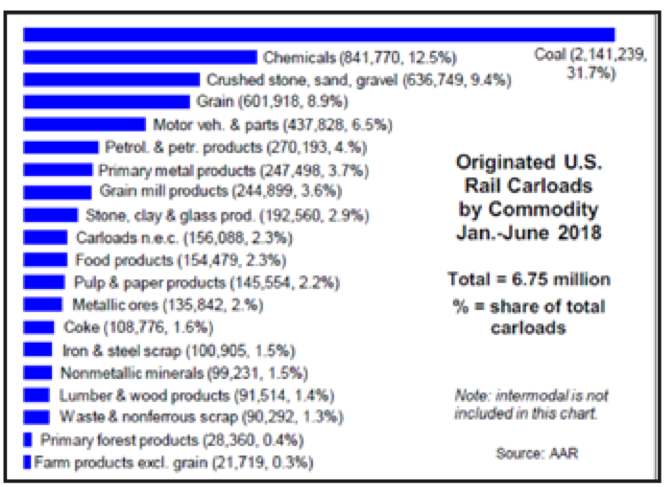


Chart 1

GRAIN CARLOADINGS: U.S. railroads originated

continued on page 2

HURLEY & ASSOCIATES
SERVING AGRICULTURAL PRODUCERS SINCE 1988
CELEBRATING 30 YEARS

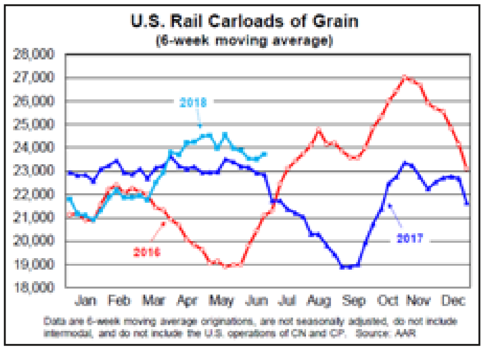
IN THIS ISSUE:

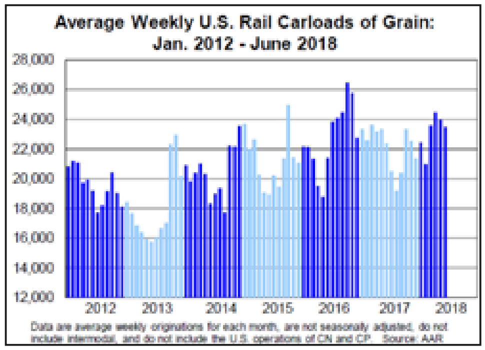
1-2 Rail Transportation Update
3, 5 Are You Getting the Right Income Signals?
4 Consultant Spotlight: Lynn Weeks
4, 7 Tariff Talk Roils Ag Markets
6 Understanding Cash Flows

Rail Transportation Update

By Tom Williamson

Continued from page 1





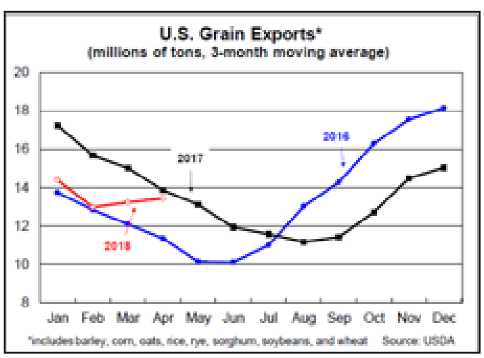
Charts 2 and 3.

93,970 carloads of grain in June 2018 up 5.0%, or 4,515 carloads, over June 2017 (see charts 2 and 3) and the fourth straight month-to-month increase. Weekly average grain carloads in June 2018 were 23,493, the highest weekly average for grain for June since 1995. For the first half of 2018, grain carloads of 601,918 were up 0.3% (1,612 carloads) over the first half of 2017; up 10.7% (58,153 carloads) over the first half of 2016; and the highest first half total since 2008. Total U.S. grain exports through the first four months of 2018 were down 6.7% see (charts 4 and 5), including a 10.3% decline in soybean exports and a 21.5% decline in wheat exports.

U.S. Grain Exports by Type of Grain
(millions of tons)

	2013	2014	2015	2016	2017	Jan-April 2017	Jan-April 2018
Corn	26.3	54.5	49.0	61.5	58.1	24.2	24.0
Rice	4.2	3.7	4.3	4.3	4.3	1.7	1.2
Sorghum	2.3	7.9	10.8	7.5	6.2	2.6	3.4
Soybeans	43.4	54.6	53.1	63.6	61.2	18.9	17.0
Wheat	36.2	28.0	23.4	26.4	30.1	10.2	8.0
Other	0.6	0.8	0.8	0.6	0.7	0.2	0.2
Total	113.0	149.7	141.4	163.9	160.6	57.7	53.9

Source: USDA



Charts 4 and 5.

PETROLEUM AND PETROLEUM PRODUCTS: U.S. originated carloads of petroleum and petroleum products rose 19.7%, or 7,411 carloads, in June 2018 over June 2017 (see charts 6 and 7). In the first half of 2018, this category accounted for 4.0% of U.S. carload volume, down from a peak of 5.3% in 2014. Crude oil accounted for approximately 25% of this category in the first half of 2018 but it accounted for well over half of this category back in 2014. North Dakota continues to be the epicenter of U.S. crude oil by rail originations.

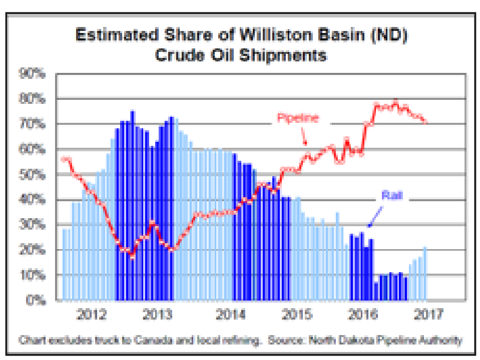


Chart 6.

STONE AND FRAC SAND: Another monthly record for carloads of **crushed** stone, sand, and gravel which totaled 109,106 in June 2018, **up 7.1%, or 7,276 carloads**, over last June. Year-to-date carloads through June were 636,749, up 8.4%, or 49,504 carloads, over last year and far more than in any first half of the year. In the first half of 2018, this category accounted for 9.4% of total U.S. non-intermodal carloads, its largest share ever and ahead of all commodity categories except coal and chemicals.

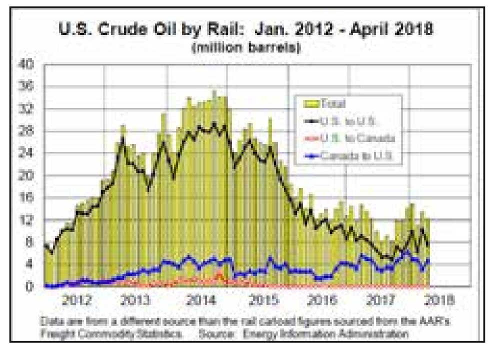


Chart 7.

Railroads continue to focus on cost cutting and productivity improvements resulting in service failures. Their desire to lower operating ratios instead of improving service metrics and a lack of sufficient highly trained railroaders is slowing the rails' progress on returning rail service to levels that are acceptable to most rail shippers.

Are You Getting the Right Income Signals?

By Pauline Van Nurden

Every farmer completes at least one income statement annually, whether you realize it or not. The Schedule F tax return is essentially a cash basis income statement. But, is this cash based statement the best measure of business performance and profitability for the year?

Let's first off consider Schedule F's ability to paint a farm's financial picture. Farmers have the ability to file cash based tax statements. This right provides tremendous flexibility in managing taxable income through things like prepaying expenses, deferring income, and fast depreciation. This right is within the letter of the law, but likely makes all businesses look as though they have similar performance, as the common goal is to mitigate taxable income. Herein lies the major flaw of cash based income statements, the timing of cash can be managed to swing profitability.

So what is a better option? Accrual or accrual adjusted income statements paint a better picture of business performance. Preparing an accrual or accrual adjusted income statement matches all revenues and expenses to the year, whether the cash transaction has happened or not. An accrual based accounting system uses account receivables and account payables to record transactions as they occur, not when cash is exchanged. Some farms utilize accrual accounting systems, but they are more complex and time consuming. An alternative is to make accrual adjustments at the end of the accounting period to reflect changes in inventory. This methodology values all items produced during the accounting period with the costs incurred for production. Both systems arrive at the "matching principle," where all revenues and expenses are recorded during the period, no matter when cash is exchanged.

Let's take a look at this in practice. Two farms show $25,000 in net farm income on their cash based Schedule F tax return. It appears as though both had mediocre years, right? Since each ended the year showing $25,000 in "profits"?

	Farm A	Farm B
Cash Revenues	$500,000	$500,000
Cash Expenses	- 475,000	- 475,000
Net Cash Income	$ 25,000	$ 25,000

When we consider inventory at the beginning of the year versus the end of the year for each farm, we reveal the full picture.

	Farm A	Farm B
Cash Revenues	$500,000	$500,000
Cash Expenses	- 475,000	- 475,000
Net Cash Income	$ 25,000	$ 25,000
Inventory Change	+100,000	-100,000
Depreciation	- 30,000	- 30,000
Net Farm Income	$155,000	($105,000)

The full story. Because of a bumper crop, Farmer A has more grain in the bin at the end of the year as compared to the beginning of the year and he has even prepaid expenses for next year to keep taxes in check. He brought in more total income this year, when we match the revenue and expenses to the correct year. Farmer B, on the other hand, essentially sold 2 years of grain this year – the grain in inventory at the beginning of the year and all of this year's crop production in the fall – and has prepaid no inputs for next year. This was all done in order to avoid an operating loss on taxes. Farmer B had a difficult year, that will be even tougher next year, as he is already working through his liquid reserves.

By factoring in accrual adjustments Farm A actually had $260,000 more profits than Farm B! Hopefully this simple example better explains why using accrual adjustments to calculate net farm income is important to best evaluate profitability and financial efficiency for each year. Accrual adjusted net farm income reflects the full value of production for the year, minus the costs incurred to produce it.

Does this mater to you and your farm? Let's take a look at the difference between cash and accrual net farm income in the FINBIN* database for the past 20 years. For the average farm, there has not been a significant difference between cash and accrual income annually. And, typically accrual profitability has been higher than cash. Why? High income farms are pushing income into future years. The graph below charts cash versus accrual net income on average, for all farms in the FINBIN database annually.

continued on page 5

Tariff Talk Roils Ag Markets

By John A. Johnson

Anyone who has not been under a rock for the past six months realizes that front page economic news almost every day concerns President Trump's threats and subsequent actions concerning tariffs imposed on imports into the U.S. These actions have been met with various amounts of resistance, especially from the Chinese, who have replied with threats of their own as to amounts and timing of retaliatory actions, such as the placing of tariffs of their own for imported goods into their country.

The President has also taken our nearby neighbors, namely Canada and Mexico, to task for what he deems to be unfair trade practices. Our heretofore agreement with these neighbors, NAFTA (North American Free Trade Alliance), has been upset and the parties involved have wavered between retaliation and/or more negotiations to try to get some form of the agreement back into place. At the time of this writing, Mexico and the U.S. seem to be on the verge of some agreement, and Canada has expressed interest in being added to the talks in an effort to be included in any final treaty.

Our relations with the European Union have been under scrutiny as some of the member countries feel that they have been disadvantaged by the new position of our government concerning trade. Much midnight oil has been burned by trade negotiators on each side of these various trade talks, and our discussions with the EU have been no exception.

The long and short of the struggle over tariffs and trade hardly affects any segment of our economy as much as it does our agricultural producers, particularly livestock and soybeans. These two categories affect almost all of us involved in agriculture. The very super-productive nature of our farmers and feeders makes us very export dependent. Our producers have the capacity and technological know-how to produce much more food and fiber than we can consume domestically.

Consequently, our trade partners realize how vulnerable our agricultural producers are to interruptions in trade. This most vital industry is the life, blood, and backbone of our country and we cannot allow financial devastation to cast it into disarray, and our trade partners know it well. That explains the targeting of certain commodities by China, the EU, and our heretofore NAFTA trading partners. The

continued on page 7

Consultant Spotlight:
LYNN WEEKS

What do you most enjoy about your job?
I love mentoring and watching someone grow and learn within the company between interns and mentees. I also enjoy building relationships with farmers and advocates and being a valuable part of their operations knowing they appreciate us being there for them.

How did you get started in your career?
I grew up on a farm and enjoyed farming, but circumstances didn't allow me to continue farming. I began working at a grain elevator, but I wanted to be more fulfilling to producers, and my job at Hurley & Associates allows me to do that.

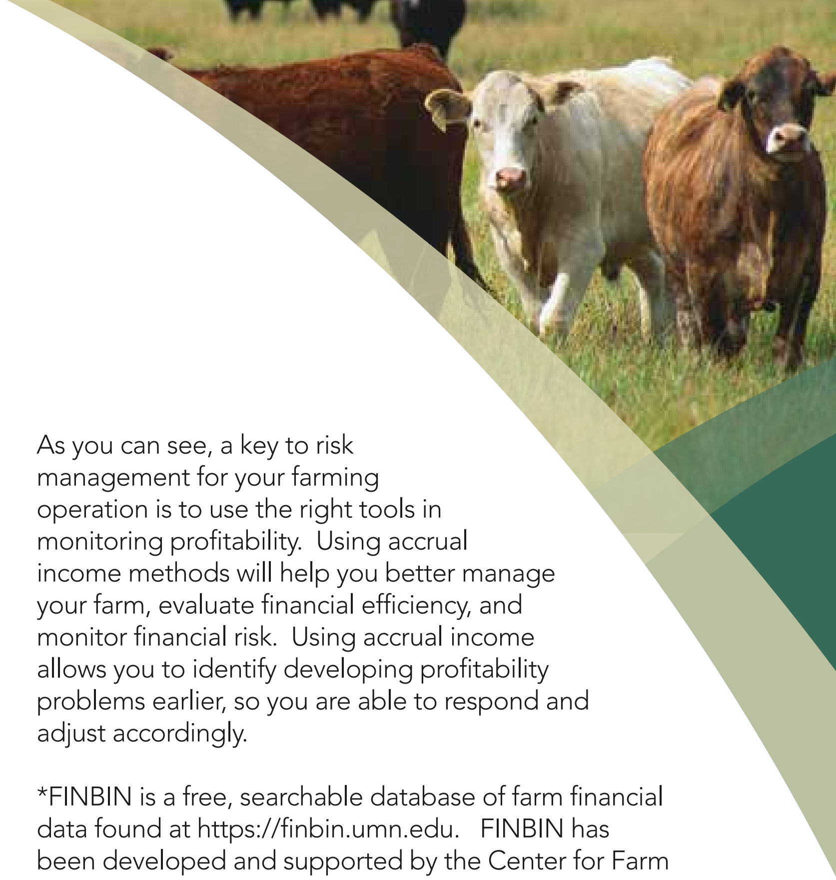
What are you most passionate about when it comes to serving our clients?
Knowing that I have a place in our clients' farming operations to secure a place for their farm to grow for generations to come is what I am most passionate about.

What would be your ideal vacation?
Hunting in Africa or getting away from the distraction of technology.

Lynn grew up on a farm in southeast Missouri and continues to remain active in it. He graduated from Southeast Missouri State University. In addition to working on the family farm, Lynn has work experience as a Grain Merchandiser, an Elevator Manager, and as the St. Johns Levee Maintenance Supervisor.

Lynn became acquainted with Hurley and Associates when he worked as a Grain Merchandiser and was impressed with their level of service to clients. He was particularly impressed that Hurley and Associates individualizes risk management marketing to each farmer's needs. Lynn's knowledge in marketing, finance, and the general workings of a farm assists in his ability to help producers understand and manage their risk.

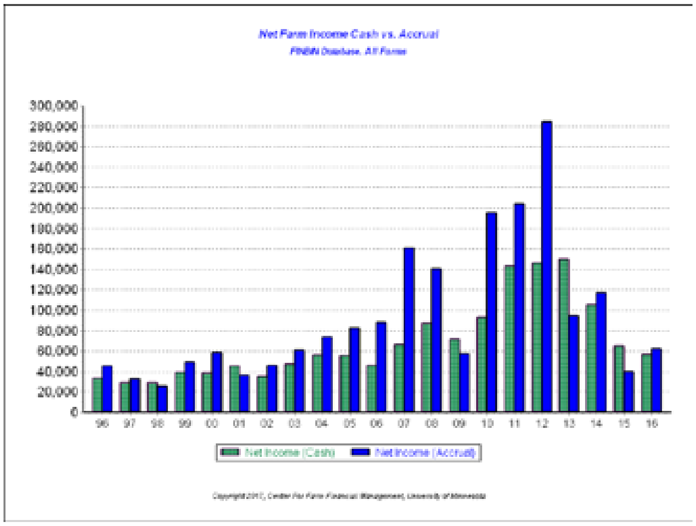
Lynn currently lives in New Madrid, MO with his wife and children. He enjoys many other outdoor activities with his family.



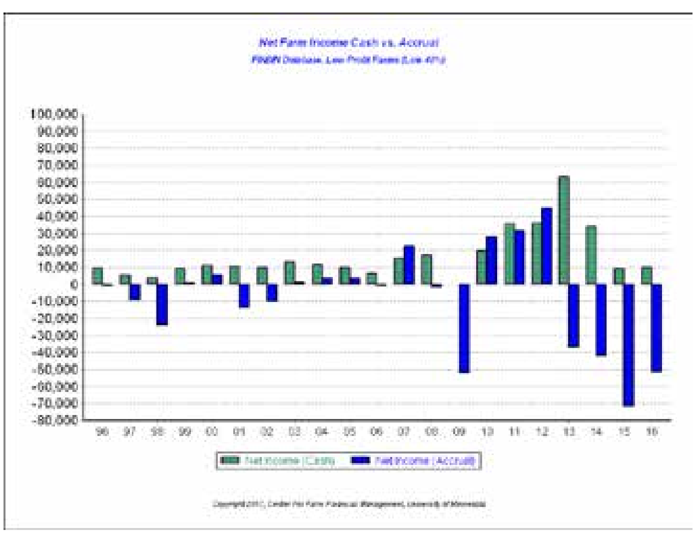
Are You Getting the Right Income Signals?

By Pauline Van Nurden

Continued from page 3



Unfortunately, not all farms are average or above average each year. So, how does the story change when we look at lower profitability farms over this same time period? Just as we saw with our example farm, lower income farms have to liquidate inventories to meet their obligations. They aren't pushing income ahead to future years and they aren't prepaying expenses for the coming year to manage taxes. In the graph below we see cash net income is greater than accrual net income in 18 of the 20 years. Yikes! For these farms, cash based income statements are giving the wrong profitability signals.



As you can see, a key to risk management for your farming operation is to use the right tools in monitoring profitability. Using accrual income methods will help you better manage your farm, evaluate financial efficiency, and monitor financial risk. Using accrual income allows you to identify developing profitability problems earlier, so you are able to respond and adjust accordingly.

*FINBIN is a free, searchable database of farm financial data found at https://finbin.umn.edu. FINBIN has been developed and supported by the Center for Farm Financial Management at the University of Minnesota. The FINBIN database provides readily accessible benchmark farm financial information for producers and agricultural professionals. The database is provided by partnering farm business management programs in 10 states. A note of thanks to these partnering programs and producers that make FINBIN available.

Pauline has worked in several areas of agricultural education and finance, including farm business management instruction, agricultural lending, and Extension education. She currently is an Extension Economist for the Center for Farm Financial Management at the University of Minnesota. Pauline's interests include farm business analysis, farm financial management, and assisting farmers in meeting their operational and personal goals. Pauline grew up on dairy farm in SE MN and now has a hobby farm with her family.

Understanding Cash Flows

By Lynn Weeks

Cash flow is revenue coming in and expenses going out. It is understanding how much money is coming in as revenue and how much is going out as expenditures. This is an important record-keeping practice needed for your farm and is crucial to running a successful farming operation. A detailed cash flow statement can help you analyze your costs of production and the potential for improved profit opportunities.

WHAT GOES INTO A CASH FLOW?

Expenses - Any expense the farming operation is responsible for, "it takes money to make money" as the saying goes. Included in this are things like:

1) Costs of production, seed, chemicals, and fertilizer. Whatever it takes to put the crop in and get the crop out.
2) Capital payments, combines, tractors, planters, and trucks
3) Cost of living expenses
4) Others: college, etc.

Expected Revenue is calculated by establishing a market plan, which will be discussed below. This will include any money that is made to support the farm. Some examples of revenue sources are:

1) Sale of farm products, such as grain or cattle
2) Custom work, such as custom planting, harvesting, and trucking
3) Government payments money that is received

We have developed a market plan that establishes price target action areas that will give us an estimated revenue projection. The last thing we want to do is underestimate production and expenses, or budget for prices that are unachievable. Knowing your break evens on each commodity is key to executing when target opportunities are presented. What if the cash flow is tight and we need all the potential that the market will give? There are marketing tools that can be used to establish floors and still have the ability to participate in market increases and protect unsold bushels, which are also included in a market plan.

Acknowledge when payments are due. This will help you when making marketing decisions. You do not want to be forced to sell grain because a payment is due. Grain farmers typically have their income during late fall and through the winter. Generally, crop loans are due toward the end of the year, and other big expenses like capital payments can possibly be spread throughout the year. When developing a market plan, coordinate your income with when payments are due. Periodically review your income and expenses throughout the year to make sure the cash flow is still accurate, and make adjustments if needed. Evaluate expenses every month, quarterly or twice a year.

There are also other things that can be done to improve the bottom line by increasing income or by cutting costs. Each operation will have to think about what changes can be made to their operation. Some things that can be looked at to raise revenue are increasing custom work, raising seed and gaining a premium on it, owning storage and taking advantage of carry and basis opportunities.

Some ways to reduce expenses may be utilizing a seed program that lowers seed costs. Lease payments on equipment instead of purchasing, and take advantage of pre-pay programs. Each operation will have to analyze their own costs to find out where expenses can be reduced.

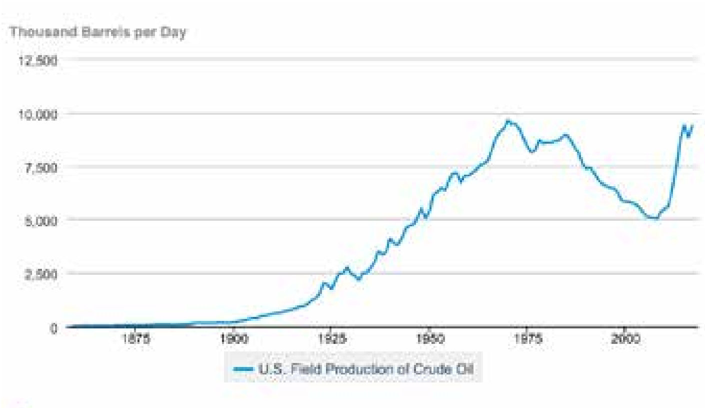
Cash flow is crucial to running a successful farm business. Advanced preparation is key to success. If making loan payments is a struggle, or if you are being forced to sell grain because a bill is due, it may be time to take a hard look at your own cash flow and use numbers that are realistic to your operation. This will take time and effort; developing an initial cash flow can be challenging. Communication with your lender is very important. By planning where you want to go financially and setting targets based on your farm cash requirements, you can increase your chances of reaching your profit potential.

Tariff Talk Roils Ag Markets

By John A. Johnson
Continued from page 4

Trump administration has announced a $12 billion program that is basically designed to keep our farmers in business until all the benefits of the current negotiations are finalized and implemented. Of course, that money is not enough to cover all the market losses that have occurred since these tariff problems arose, but it is a great start.

Elsewhere in our economy, the administration recently approved a route for the Keystone pipeline to be built from Canada to Oklahoma, down through North and South Dakota, Nebraska, Kansas and on down to Oklahoma. We have already become a major petroleum exporter, and we are getting geared up to sell Natural Gas to Europe via super tankers carrying the gas in a highly pressurized, liquid form. U.S. crude production has recently topped some 10 million barrels per day, the largest since the 1970's, and the Canadian oil will only add to the importance and volume of our oil exports.



While we are on the subject of petroleum, two developments have appeared and will come to bear on the world's energy situation in the next few months, one way or another. President Trump has announced that he is willing to meet with the government of Iran, in his words: "any time and any place," according to recent news reports. This has lessened some of the world's tensions as the Iranians would be capable of being huge suppliers of crude to the world's market. On the other hand, Venezuela announced that it has basically lost the ability to function as a country, with desolation so great that food, gasoline, repair parts and all other goods necessary for life in a functioning economy are not available at any price to purchase in their country. The economic infrastructure has completely collapsed – the final result of an experiment in complete socialism.

"Agriculture is the most healthful, most useful and most noble employment of man."

– George Washington

HURLEY & ASSOCIATES

Agri-Marketing Centers

415 E. Marshall
PO Box 471
Charleston, MO 63834

Phone: (573) 683-3371
Toll Free: 1-800-524-0342
Fax: 573-683-4407
email: mail@hurleyandassociates.com
www.hurleyandassociates.com

While the information contained in this newsletter is derived from sources which are believed to be accurate and timely, there may be inadvertent factual inaccuracies or typographical and other errors, and the information is not warranted or guaranteed for accuracy or completeness. Any opinions expressed herein are subject to change or correction without notice and Hurley & Associates Agri-Marketing Centers of Charleston, Inc. and its affiliates disclaim all liability for errors or omissions in these materials, and disclaims all liability for the use or interpretation by others of information contained in this newsletter. This material should be construed as the solicitation of trading strategies and/or services provided by Hurley & Associates, Inc. noted in this newsletter. We believe positions are unique to each person's risk-bearing ability, marketing strategy, and crop conditions, and therefore, Hurley & Associates Agri-Marketing Centers of Charleston Inc. does not give blanket recommendations. Any examples given are strictly hypothetical and no representation is being made that any person will or is likely to achieve profits or losses similar to those examples.

Decisions based on information contained in this newsletter are the sole responsibility of the reader, and in exchange for receiving this information, the reader agrees to hold Hurley & Associates Agri-Marketing Centers of Charleston, Inc. and/or its affiliates harmless against any claims for damages arising from any decisions that the reader makes based on such information. The risk of loss in trading commodities can be substantial, therefore, carefully consider whether such trading is suitable for you in light of your financial condition. Past performance is not indicative of future results, and there is no guarantee that your trading experience will be similar to past performance.

LOCATIONS

Grundy Center, IA
866-646-7472

Glenwood, MN
866-746-1628

Wheaton, MN
877-563-8490

Caruthersville, MO
800-597-3628

Charleston, MO
800-524-0342

Britton, SD
877-781-0058

Brookings, SD
877-212-2564

College Station, TX
877-697-8944