

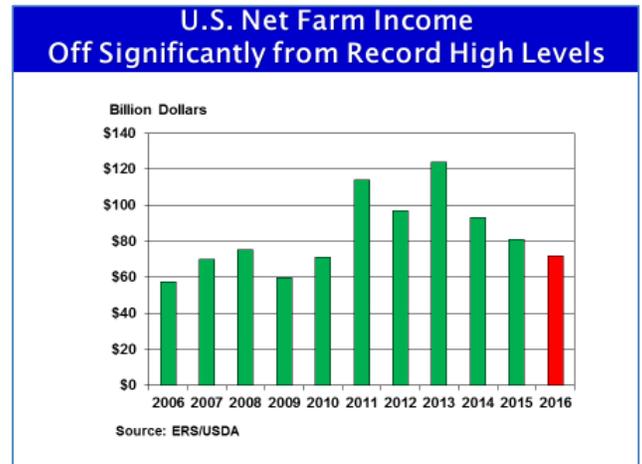
2016 – 2017 Kentucky Agricultural Economic Situation and Outlook

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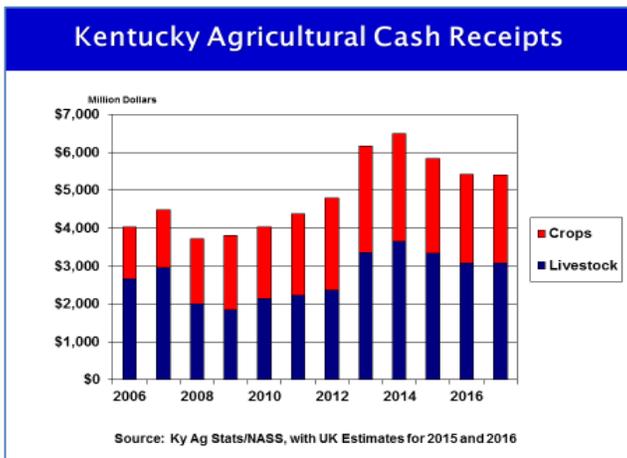
U.S. Agricultural Economy

The U.S. agricultural economy continued to struggle in 2016 as prices and incomes fell for the third straight year following an unprecedented sustained period of growth during the 2007-2013 period. The USDA is projecting 2016 net farm income to total \$67 billion, down 17% from 2015 and 46% off the record high established in 2013. Given yields trending up, lower production expenses, and higher government payments, the downturn in the ag economy is due solely to significantly lower prices as the markets react to mounting global supplies and depressed/stagnant demand. U.S. agricultural exports have declined from record high levels in response to a strengthening U.S. dollar, sluggish economic growth overseas, and abundant supplies. Land values and crop rents appear to be slowly adjusting to the declining ag economy. Despite the sharp downturn in the U.S. ag economy, lenders are reporting that the financial position of U.S. agriculture as a whole is still relatively strong following a period of extraordinarily high income levels. However, concerns are mounting for some high debt/younger farming operations given current cash flow/working capital issues and the continued depressed outlook for most U.S. agricultural sectors.



Kentucky's Agricultural Economy

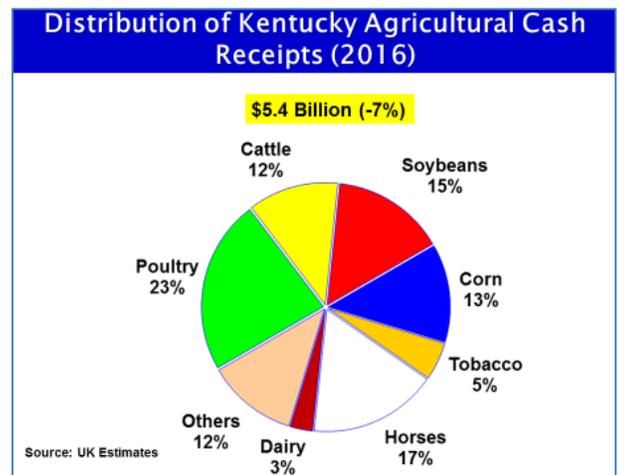
Kentucky agricultural cash receipts set a record \$6.5 billion in 2014 before retreating to \$5.8 billion in 2015. UK's Department of Agricultural Economics is projecting that Kentucky ag sales will fall to \$5.4 billion in 2016, off 7% from 2015 and 17% from our 2014 record. Kentucky's top two major ag enterprises had decent years as poultry rebounded from the effects of avian influenza, while the equine sector had another stable year. Most of the decline in Kentucky ag sales for 2016 can be attributed to rapidly falling cattle receipts which fell by more than 30% in response to mounting beef, poultry, and pork supplies. Grain receipts were mixed as soybean sales increased while corn and wheat sales declined. Tobacco receipts slumped to their lowest post-buyout level due primarily to unfavorable weather and curing conditions. Poultry remained Kentucky's number one ag enterprise, accounting for 23% of projected 2016 sales, followed by equine (17%), soybeans (15%), corn (13%) and cattle (12%). For 2017, assuming a normal growing season, Kentucky ag cash receipts are expected to stabilize with modest gains in poultry, hogs, horses, and tobacco offsetting expected losses in grains, dairy, and cattle.



Kentucky's net farm income peaked at \$2.97 billion in 2013 before slipping to \$1.7 billion in 2014 and 2015. Kentucky net farm income is expected to dip to less than \$1.5 billion in 2016, potentially its lowest level since 2010. A significant decline in cash receipts the past couple of years plus the ending of the tobacco buyout payments in 2014 have been the major reasons behind the rapid fall in Kentucky's net farm income since it peaked at nearly \$3 billion in 2013. Looking into 2017, profitability in the grain sector will

once again be tested given projected prices and slowly adjusting land rents. Increasing livestock/meat inventories will continue to challenge beef returns. The equine and poultry industries are expected to have solid years. Tobacco returns should improve assuming better yields and quality. Look for a continued growing demand for local produce and value-added agriculture.

Assuming no major supply/demand shocks, net farm income for Kentucky farmers may show signs of stabilizing in 2017 as the global markets work off excess supplies and global economies begin to show modest growth which should help to stem the downward spiral in commodity prices. Production expenses are projected to be fairly stable, but government payments may be lower given the structure of the current farm bill. Issues to monitor in 2017 will be the value of the U.S. dollar, energy prices, interest rate changes, 2018 farm bill discussions, additional buyer/seller concentration in ag markets, and potential changes in labor and trade policy. The big winners in the current depressed ag economy are consumers as prices for many food items were stable to lower in 2016 and food price inflation is expected to remain below historical levels in 2017.



Cattle

- Calf values are down roughly 50% from 2014 highs, with efficient operations likely covering cash costs and breeding stock depreciation, but resulting in little to no return to capital, land, and management.
- Recent prices have likely slowed expansion, but beef cow numbers will likely be up again in 2017.
- Look for price improvement in the spring of 2017, but a significant drop from spring to fall given mounting meat supplies.
- Fall 2017 could be the bottom of this price cycle.

Poultry

- Avian Influenza significantly impacted 2015 export values and bird values which also likely impacted the rate of turnover and replacement in KY operations.
- Receipts should be back on track in 2016 and growth appears to be continuing in 2017.

Equine/Hay

- Horse receipts have been flat for several years, rebounding from the depressed market during the 2009-2012 period.
- September yearling sales were down around 3%, but early November breeding stock sales were solid before slumping at the end when mid to lower quality horses were placed on the market.
- Equine sales and receipts are likely to be steady for 2017.
- Alfalfa hay production is down for 2016 with prices slightly higher for higher quality hay. Grass hay production is likely steady with prices a bit lower. The wet spring and dry fall impacted quality and quantity across the state.

Hogs

- Year-over-year prices were down about 10% in 2016, with the largest differences in the beginning and end of the year.
- USDA Hogs and Pigs report suggested significant growth in hog numbers in KY for 2016.
- Fourth quarter hog slaughter has pushed slaughter capacity and drastically impacted hog prices.
- Price improvement is likely in 2017 as some new plants begin operations and growth in KY hog numbers is likely to continue.

Dairy

- KY mailbox dairy prices for 2016 were down 12 to 13% from 2015 levels.
- The first significant payments were made from MPP-Dairy program this past summer, but most KY dairy producers chose very low coverage levels and did not receive any payments.
- Some improvement in prices occurred in the second half of 2016 and is likely to continue into 2017.

Corn

- Record U.S. corn yield and production is projected to increase total supply by 1.625 billion bushels to a record supply over 17 billion bushels.
- 2015-16 exports finished 265 million bushels above April 2016 estimates due to unexpected South American production problems.
- 2016-17 corn exports are projected above 2015. Export window is likely to close once South America harvests a trend or above trend-yield.
- Price potential in second half of the marketing year may face headwinds.

Soybeans

- Record U.S. soybean yield and production is projected to increase total supply by 1.625 billion bushels to a record supply over 4.58 billion bushels
- 2015-16 exports finished 265 million bushels above October 2015 estimates due to unexpected South American production problems.
- 2016-17 soybean exports are projected above 2015. Export window is likely to close once South America harvests a trend or above trend-yield.
- Price potential in second half of the marketing year may face headwinds.

Wheat

- Record U.S. wheat yield offset a 3.4 million acre reduction in harvested area. 2016 US wheat supply is projected to increase 448 million bushels from previous year.
- 2016-17 wheat exports projected 200 million bushels above 2015-16 marketing year, but still 200 million bushels below 2013.
- Ending stocks have been building each year since the 2012 drought. 2016-17 ending stocks are projected at about a 184-day supply of wheat in the bins on June 1, 2017. This will limit price potential until stocks fall.

Tobacco

- Unfavorable growing and curing conditions will likely cause the KY value of tobacco production to fall below \$300 million in 2016 – its lowest level in the post-buyout era.
- Improved yields may enable burley production to rebound modestly in 2017, but declining cigarette sales and slumping export demand will limit contract volume adjustments.
- Continued but slower growth in the smokeless tobacco market coupled with a smaller than desired 2016 crop will provide support for the dark tobacco sector in 2017.

Horticulture

- Excessive summer rain in 2016 resulted in modest decreases in produce sales to around \$38 million.
- Strong local demand should bode well for produce markets again in 2017.
- Stronger greenhouse sales should offset slower nursery sales and reach about the same \$96 million observed in 2015. Growth in 2017 will be driven by the regional housing market and retail economy.

Forestry

- The forestry sector declined 4.8% from \$14.6 billion in 2015 to an estimated \$13.9 billion in 2016. The reduction was anticipated with the collapse of the Verso pulp and paper mill in Wickliffe resulting in a loss of over \$430 million in 2016.
- Lackluster markets for the majority of hardwood lumber species continue to put a drag on the sector as well as demand for products such as railway ties. A slight dip in wood exports stopped a strong positive trend starting in 2011.
- White oak stave logs used for bourbon barrels bucked the overall trend for most wood commodities, increasing almost 8% in delivered mill price with a statewide average of \$1,252 per thousand board feet. A seller's market will continue into 2017.

