Compeer Financial ACA

June 3, 2022

Ratings Score Snapshot

SACP: bbb+			Support: 0		Additional factors: 0
Anchor	bbb+		ALAC support	0	Issuer credit rating
Business position	Moderate	-1	GRE support	0	BBB+/Positive/--
Capital and earnings	Very strong	+2	Group support	0	
Risk position	Moderate	-1	Sovereign support	0	
Funding	Adequate	0			
Liquidity	Adequate				
CRA adjustment		0			

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

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Credit Highlights

Overview

Key strengths	Key risks
Very strong risk-adjusted capital ratio	Concentrated lending to agricultural sector given its charter
Access to favorably priced funding through Agribank	Somewhat limited geographic footprint, though nationwide footprint continues to grow
Solid record of profitability and credit risk management	Exposure to cyclical commodity prices and unpredictable agricultural conditions

Compeer Financial ACA's capital and earnings continue to be a source of strength for the association. Despite strong loan growth over the past two years, the association has maintained very strong capital levels. Although regulatory capital ratios and the S&P Global Ratings risk-adjusted capital (RAC) ratio have declined slightly as of Dec. 31, 2021, Compeer has issued preferred stock and subordinated debt during this period of rapid growth, which provided additional capital stability. We expect the association's RAC ratio to remain above 15% over the next several years. In addition, Compeer consistently generates strong earnings due to its good operating efficiency, low loan loss provisions, and stable net interest margin (NIM), and its typical payout ratio of 40%-45% allows for capital accretion as the association continues to grow.

As an agricultural credit association (ACA), Compeer is concentrated in agricultural lending and its Farm Credit System (FCS) defined territory, but it has a good track record of credit quality. As a borrower-owned cooperative lending association within the FCS, Compeer is required to lend to agricultural producers and processers, rural borrowers, and related agribusinesses, which presents higher industry concentration risk compared with regional banks, in our view. The association has a designated territory serving counties in Illinois, Wisconsin, and Minnesota. However, as Compeer grows its nationwide business units, its geographic diversification continues to improve. As of Dec. 31, 2021, over 40% of Compeer's loan portfolio is outside of its designated lending territory. In addition, Compeer has consistently demonstrated low credit losses and relatively low levels of adversely classified assets relative to capital, which partially offsets the concentration risk.

Compeer benefits from its relationship with Agribank to readily access funding. As an ACA, Compeer's primary funding source is its line of credit with FCS bank, AgriBank. Compeer is able to match-fund its loans with its low-cost borrowings, which neutralizes interest rate risk and helps the association maintain a very stable net interest margin (NIM). While we view the association's on-balance-sheet liquidity as thin, it is higher than similar peers, and we do not expect Compeer will lose access to its available funding from AgriBank.

Outlook

The positive outlook on Compeer reflects our expectation that we could raise the rating in the next two years if the association continues its good financial performance while maintaining its conservative risk profile. In particular, we expect Compeer to maintain a very strong RAC ratio above 15%, stable asset quality metrics with low credit losses, and steady asset growth.

Downside scenario

We could revise our outlook on Compeer to stable if we expect the association to pursue more aggressive financial strategies--like aggressive loan growth that could materially pressure capital levels--particularly if the RAC ratio falls below 15% on a sustained basis. Additionally, we could revise the outlook to stable if the association loosens underwriting standards that leads to weaker credit performance.

Upside scenario

We could raise the ratings over the next 24 months if the association continues demonstrating a low risk appetite by maintaining a very strong RAC ratio, good asset quality metrics, steady asset growth, and generating consistent earnings.

Anchor

Our starting point--or anchor--for our rating on Compeer is 'bb+', in line with that for other U.S. companies that we rate under our nonbank financial institutions criteria. Because of Compeer's public policy role, access to government-related entity (GRE) funding, and regulated status, we raise its anchor to 'bbb+', three notches above our anchor for other finance companies and equal to that of U.S. banks. This is to account for the Farm Credit Administration's regulatory oversight, the company's favorable funding through its position in the FCS, and its strong competitive position.

Business Position

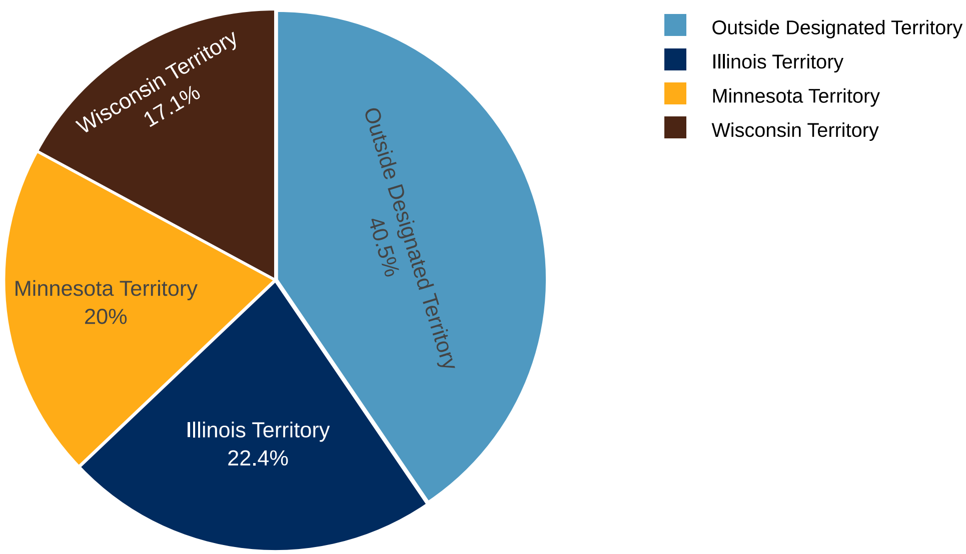
Geographic and industry lending concentration

Our view of Compeer's business position is based on its solid market position as an agricultural lender within the FCS. Its concentration in agricultural loans, with large exposures to cash grains, dairy, swine, and farm real estate, however, somewhat constrains the business position.

With $27.7 billion in assets as of March 31, 2022, Compeer is structured as a cooperative and owned by the client stockholders (nearly 73,000 member-owners) to whom it provides loans and other services. The association operates its retail operations through 43 office locations, serving 144 counties in Illinois, Minnesota, and Wisconsin. Lending to a number of less correlated agricultural sectors helps mitigate its concentration in the agricultural sector, and Compeer continues to diversify geographically through its Capital Markets Group (CMG) and its Agri-Access Program.

Compeer Financial ACA Loans By Geography

Dec. 31, 2021



Source: S&P Global Ratings.

We expect the CMG and Agri-Access will continue to fuel Compeer's growth and diversity. As of Dec. 31, 2021, just over 40% of the loan portfolio is outside of the association’s designated territory. CMG focuses on generating revenue and loan volume for the financial benefit of three participating associations in the Agribank District, which include Compeer. The business arrangement provides additional means for diversifying each participant's portfolio, helps reduce concentration risk, and positions the participants for continued growth.

In agreements with certain financial institutions, Compeer also provides correspondent lending programs under the trade name Agri-Access. Agri-Access focuses primarily on purchasing participations in agricultural real estate loans and leases. It also services loan portfolios for other institutional investors. These financial services firms are dispersed throughout the U.S.

Compeer's net interest income represents 65% of revenue, and noninterest income sources, such as patronage income and other fee income, provide solid revenue diversification. We expect net interest income to benefit modestly as loan growth continues. However, we expect net farm income to decrease marginally in 2022 due to less U.S. government direct payments than in 2021. Should weather and trade challenges continue in the grain industry in 2022, most agricultural producers still have sufficient equity to provide flexibility if needed. Although land tends to be the greatest fixed asset of most grain farm operations, we do not view it as a major area of risk for Compeer because of the company's strong collateral positions, even in declining scenarios.

Capital And Earnings

Consistently robust capital and earnings

We expect manageable growth and good profitability will support Compeer's RAC ratio and help maintain its capital and earnings, though profitability could come under pressure if less government aid for the agricultural sector leads to higher provision expenses. However, due to the cyclical nature of agricultural lending, Compeer tends to maintain strong capital to absorb losses.

Compeer's RAC ratio was 15.5% (we consider above 15% very strong) at year-end 2021--down about 27 basis points (bps) from year-end 2020. Strong loan growth in 2021 was the primary cause of the reduced capital. Loan growth was partially offset by preferred stock and subordinated debt issuances in 2021, which bolstered regulatory capital and remain well above the regulatory minimums. As of March 31, 2022, the Tier 1 capital ratio declined to 13.8% from 14.3% at year-end 2020, and the total capital ratio fell to 14.8% from 15.2% over the same period.

Compeer benefits from a low-cost structure with operating expenses to operating revenue of 41% (by our calculation), materially lower than that of the average U.S. regional bank. Similarly, the company's profitability, measured by its 2021 return on average assets of 1.92%, compares favorably to most rated U.S. regional banks. In 2022, we expect growth in net interest income as loans continue to grow, but we expect the NIM to remain generally stable because Compeer is match-funded with Agribank, which neutralizes most of its asset-liability sensitivity to changing market rates.

Patronage distributions are paid in two forms. Due to strong earnings in 2021, Compeer's board approved a $5 million increase in patronage, which will result in a total payout of $202 million in 2022. In addition, the association has in place an allocated equity redemption plan. Generally, this plan annually retires allocated equities designated with an intent to distribute an equal amount over 10 years. Total capital distributions (including preferred dividends) to net income was flat at 43% in 2021. We expect the payout ratio to remain at a similar level for 2022.

In a stress test mandated by the FCA, Compeer's common equity Tier 1 ratio would decline by approximately 470 bps over a three-year period under a hypothetical severe stress scenario, though remain above the regulatory minimum. The stress test produced for the FCA incorporates an agricultural element, which the Dodd-Frank Act Stress Test (DFAST) does not.

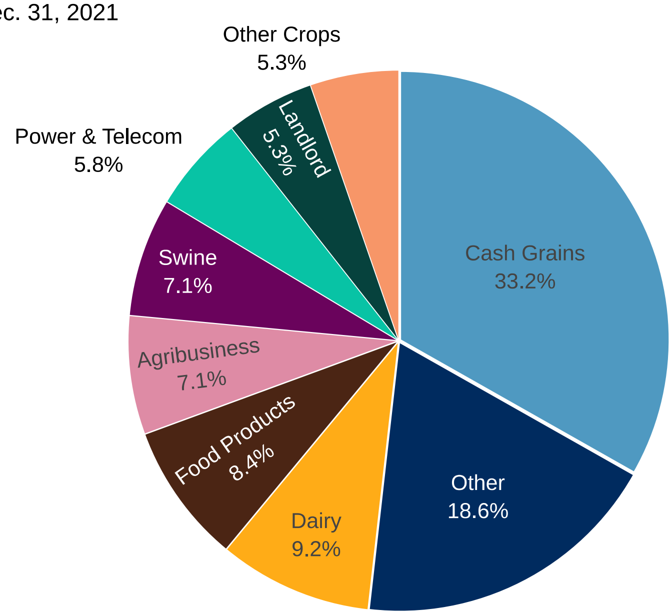
Risk Position

Concentrated in agricultural lending but consistently low loan losses

Compeer's loan portfolio is highly concentrated in agricultural loans, though concentrations in specific commodities are not outsized and individual client exposure remains relatively low. Compeer's net charge-off ratio remained low at 0.04% in 2021. We expect credit metrics to remain stable as Compeer continues to operate with conservative underwriting standards.

Compeer Financial Loans By Industry

As of Dec. 31, 2021



Source: S&P Global Ratings

Portfolio quality remains strong in and outside Compeer's territory. Adversely classified assets decreased by the end of 2021 and the overall credit quality improved, resulting in a $15 million annual reversal of provision expense. We expect nonaccrual and adverse assets will remain manageable in 2022.

The ratio of adjusted nonperforming assets to customer loans and other real estate declined to 57 bps in 2021 from 67 bps the previous year. The ratio of reserves to nonperforming loans, at 45%, was weaker than that of similarly rated financial institutions, though credit losses at Compeer have been minimal and less volatile over the past decade.

We view Compeer's lending practices as prudent, as reflected in the association's very low loan losses. However, we believe a significant drop in commodity prices and farmland values would stress the asset quality of Compeer's portfolio and lead to higher losses and weaker earnings. Conservative loan-to-value ratios, however, have generally mitigated any shocks to agricultural commodity prices. The company's conservatism is reflected in prudent underwriting parameters at loan origination. For instance, while the FCA allows real estate mortgage loans up to 85% of appraised value, Compeer's underwriting standards generally limit lending to no more than 65% of value.

Funding And Liquidity

Concentrated wholesale funding, offset by very stable access to GRE funding

The association is a nondepository financial institution. Therefore, its primary funding source is a wholesale credit agreement with AgriBank, one of the four FCS wholesale funding banks. The $27 billion line of credit with AgriBank is renewable every three years ($21.9 billion was advanced as of Dec. 31, 2021). In 2021, the association has used capital markets for supplemental funds via preferred stock and subordinated debt, but it relies overwhelmingly on AgriBank. Our calculation of Compeer's stable funding ratio is

73%, indicative of a shortfall in matched funding for term assets, but this ratio is limited by Compeer's required funding from AgriBank.

We believe these low-cost funds reflect the implicit government support the FCS receives as a GRE and the joint and several support shared among AgriBank and its three counterparts. As part of its cooperative structure, and to preserve this funding advantage, AgriBank requires Compeer to maintain an investment equal to 2.55% of the average quarterly balance of its notes payable, with an additional amount required on the association's growth in excess of targeted growth, if the geographic area is also growing above a targeted growth rate. In addition, Compeer's agreement with AgriBank incorporates covenants related to performance, credit quality, and capital levels, such that should these deteriorate, the cost of Compeer's funding would increase.

We view Compeer's on-balance-sheet liquidity as limited, with a very modest investment portfolio ($1.1 billion) made up primarily of government-guaranteed securities. The company's broad liquid assets do not cover short-term wholesale funding, at 0.15x. The shortfall largely owes to Compeer's small securities portfolio and the funding structure of farm credit associations. Nevertheless, we view liquidity as adequate because Compeer has an additional $5.1 billion in unused borrowing capacity, and we see little risk that Compeer would lose access to AgriBank funding.

Support

While the rating incorporates the ongoing funding benefits that the association receives as a member of a GRE, we believe there is a low likelihood that the U.S. federal government would provide extraordinary support directly to Compeer in the event of financial distress. Our assessment is that Compeer's individual role is of limited importance to the federal government. In addition, we view Compeer as having a limited link to the government. Its members privately own Compeer, and the government has no history of providing extraordinary government support directly to associations like it. Therefore, the issuer credit rating does not incorporate any uplift for extraordinary government support.

Additional Rating Factors

None.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	**S-1**	S-2	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1 -5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Social factors are a positive consideration in our credit rating analysis of Compeer. As an association in the Farm Credit System, Compeer benefits from low-cost funding, which helps it support rural communities and agriculture. Moreover, its cooperative structure prioritizes access and benefits for its member-owners and leads it to maintain strong risk-adjusted capital with less focus on short-term profitability.

Group Structure, Rated Subsidiaries, And Hybrids

We view Compeer Financial FLCA and Compeer Financial PCA as core subsidiaries to the parent, Compeer Financial ACA. We expect Compeer to support both Compeer FLCA and Compeer PCA under all foreseeable circumstances, if needed. We rate Compeer's hybrid securities, including its subordinated debt and preferred stock, relative to its group stand-alone credit profile (SACP) to reflect the possibility these instruments could face nonpayment risk before more senior instruments. As such, we rate the subordinated debt issued by the core subsidiaries 'BBB' (one notch below the group SACP for contractual subordination) and Compeer's preferred stock 'BB+'(three notches below the group SACP for risk of deferral and coupon nonpayment).

Key Statistics

Compeer Financial, ACA Business Positions

Mil. $	2021	2020	2019	2018	2017
Total assets	27,009	24,942	22,184	20,754	19,545
Gross receivables	24,515	22,637	19,931	18,772	17,779
Operating revenues	--	--	--	--	--
Net income after extraordinaries	--	--	--	--	--
% Change in operating revenue	7.29	10.41	5.10	95.54	25.78
Net interest margin (%)	2.23	2.34	2.36	2.47	1.73

Compeer Financial, ACA Capital And Earnings

	2021	2020	2019	2018	2017
S&P Global Ratings RAC ratio before diversification (%)	--	--	--	--	--
Debt/ATE (x)	4.93	4.95	4.60	4.59	4.59
Adjusted common equity/total adjusted capital (%)	95.47	97.53	97.38	97.23	97.08
Total equity double leverage (%)	N.M.	N.M.	N.M.	N.M.	N.M.
Noninterest expenses/operating revenues (%)	40.80	39.10	39.82	38.44	39.31
Net interest income/operating revenues (%)	64.55	65.87	66.78	69.16	67.75
Fee income/operating revenues (%)	13.46	12.08	10.20	9.48	9.50
Return on average assets (%)	1.92	1.87	1.85	2.00	1.34
Core earnings/average managed assets (%)	1.88	1.84	1.82	1.97	1.30
Common + preferred dividends/net income (%)	31.89	34.48	46.48	50.30	27.21

N.M.--Not meaningful.

Compeer Financial, ACA Risk Position

	2021	2020	2019	2018	2017
Growth in gross receivables (%) (YoY)	8.30	13.57	6.18	5.59	116.39
Nonperforming assets/receivables + other real estate owned (%)	0.32	0.28	0.44	0.39	0.24
Net charge-offs/average gross receivables (%)	0.04	0.08	0.01	0.02	0.01

Compeer Financial, ACA Risk Position

New loan loss provisions/average gross receivables (%)	(0.06)	0.13	0.11	0.08	0.08
Loan loss reserves/gross receivables (%)	0.26	0.39	0.39	0.32	0.27
Loan loss reserves/gross nonperforming assets (%)	45.25	58.42	47.19	44.80	53.36

Compeer Financial, ACA Funding And Liquidity

	2021	2020	2019	2018	2017
Stable funding ratio (%)	73.44	73.67	74.43	74.03	18.25
Liquidity coverage metric (x)	N.M.	N.M.	N.M.	N.M.	N.M.
Deposits to Total Financial Liabilities (%)	--	--	--	--	--
Secured debt/debt + deposits (%)	100.00	100.00	100.00	100.00	100.00
Unencumbered assets/unsecured debt (%)	N.M.	N.M.	N.M.	N.M.	N.M.

N.M.--Not meaningful.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- ESG Credit Indicator Report Card: U.S., Canadian, And EMEA Nonbank Finance Companies, May 18, 2022
- Compeer Financial ACA Outlook Revised To Positive On Good Credit Performance And Very Strong Capital; Ratings Affirmed, April 14, 2022
- Federal Farm Credit Banks And Associations And Bank Of North Dakota Ratings Affirmed Under Revised Criteria, Dec. 15, 2021
- Agribank FCB, Dec. 8, 2021
- Federal Farm Credit Banks, Oct. 15, 2021

RatingsDetail

Ratings Detail (as of June 06, 2022)*

Compeer Financial, ACA	
Issuer Credit Rating	BBB+/Positive/--
Preferred Stock	BB+
Issuer Credit Ratings History	
14-Apr-2022	BBB+/Positive/--
05-Jun-2018	BBB+/Stable/--
19-Jul-2017	BBB/Positive/--
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
Compeer Financial, FLCA	
Issuer Credit Rating	BBB+/Positive/--
Subordinated	BBB
Compeer Financial PCA	
Issuer Credit Rating	BBB+/Positive/--
Subordinated	BBB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.