Farmer's Corner

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Marketing Your Grain in the Present Tense

This may be the Golden Era of row-crop farming. There are some of the best prices available for grain in history. Without a doubt, these ARE the best prices that have ever been available when there was not a big grain shortage.

As with any business with tremendous opportunity, that opportunity comes with an equal amount of risk. Risk and reward have always gone hand in hand. In years past, grain prices were not near as rewarding as they are now, but the risk was much less.

Another factor to deal with in this new price environment is volatility. Price limit moves have become almost commonplace in the futures market. For instance, when grain is $3 per bushel and its value changes by 1%, the price moves 3 cents. When that same grain is $9 per bushel and its value changes by 1%, the price moves 9 cents. While the percentages are still the same, these price swings represent significantly different impacts to the bottom line of a farming operation.

Of course, it isn't all sunshine, lollipops and rainbows. Input prices are skyrocketing as well. Basis levels are lower than usual. All of the factors of this current environment can cause mass hysteria if they are all left up in the air. The only way to deal with this sort of environment is to have a calm, simple, level-headed approach focused on the facts available in the present.

High Grain Prices

Everyone reading this is aware that we are in a period of extremely high grain prices. What makes the present day prices so unique is the fact that they are available in a time where there is a robust supply of grain in the marketplace. What's the proof? Well, not only are great prices available for today's grain, but those prices are available for multiple years in the future. In the past when there have been high prices, the new crop prices available were substantially less.

However, today's market structure is allowing the unique opportunity to lock in these extraordinarily high prices for 2 or 3 years into the future. Sure, the new crop prices aren't quite as high as the prices for today's grain in many cases, but the new crop prices are still at historically high levels. As a matter of fact, history shows that some of the most profitable times to sell new crop bushels have been during a time when the nearby bushels were priced higher. *(See charts on following page)*

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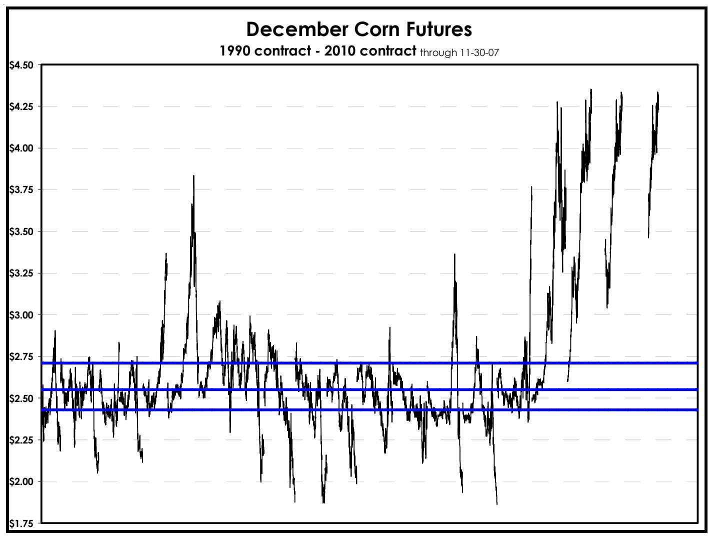

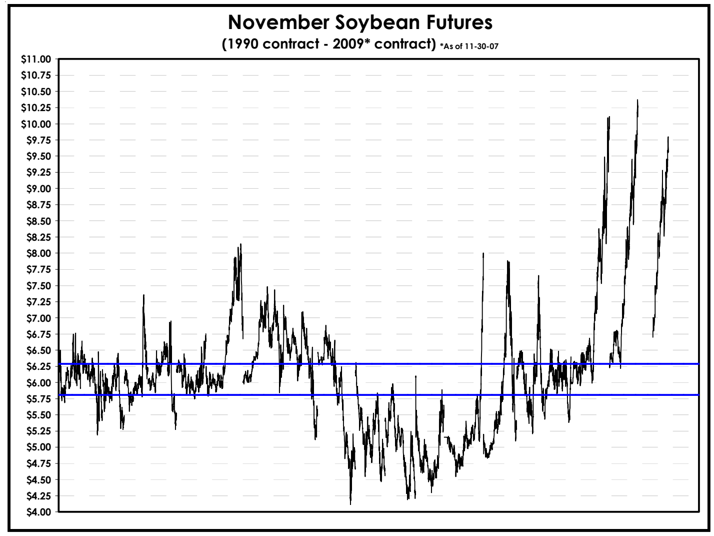

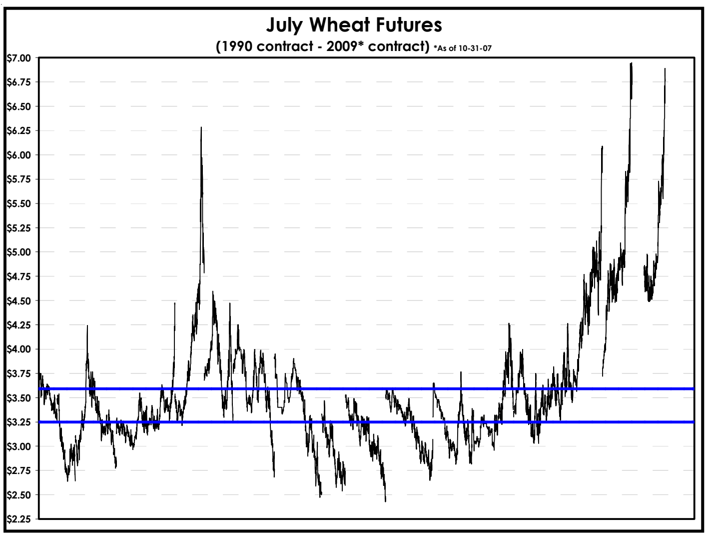

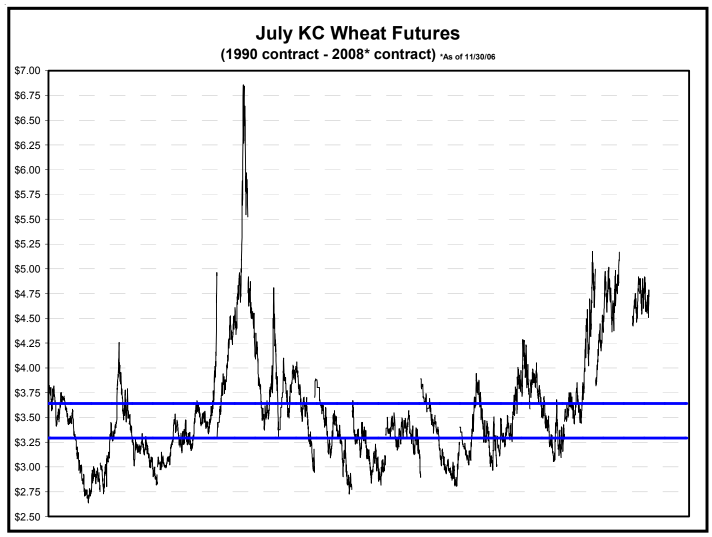

Risk

There is no such thing as a font too big to display the amount of risk currently in the production agriculture business. The risks themselves are the same as they have always been in the farming business, but now carry much more magnitude than they ever have before.

As far as grain prices are concerned, there are really two big risks: 1) Sell the grain, but the price continues to rise, or 2) Wait to sell the grain, and the price drops. No one wants either one of these things to happen to them, but the fear of risk #1 keeps them from taking action and throws them directly in the way of risk #2. No matter how you handle the situation, you have to be at risk of one of the two. So, the only way to avoid the wrong option is to know where prices are going to go. Unfortunately, anyone who knows that information doesn't need to farm or do anything else for that matter. If pricing decisions are put off and left to chance, that field of grain outside can turn into a giant roulette wheel. What always happens in that situation? In the long run, the house always wins. That's why the best option is to separate the production agriculture business from the price prediction business.

So why is the risk greater in magnitude than it has ever been before? Two words: Loan Rate. In the past few years, if you delayed your pricing decision and prices went down, you got the loan rate for your grain. In that situation, you didn't have a good year, but there was always next year. In today's environment, everything is different… except for the loan rate. So, there is a much bigger difference between current prices and the loan rate. This changes the risk from one dollar or less per bushel to multiple dollars per bushel. The main difference is that if you don't sell your grain and prices return to the loan rate, not only have you had a bad year, but with inputs prices as high as they are, you may have had your last year.

The most reasonable way to approach such an overwhelming amount of risk is to deal with what is available in the present and make decisions based on that information and not based on speculation of what prices may do in the future. Ultimately, the goal of any business is to make a profit consistently over a long period of time. Profit is simply the amount of money you take in above and beyond what you spend. So, sit down with your local elevator operator and figure out what your costs are versus what is available to you if you were to lock in today's prices. Even with the higher input costs you are faced with, you may see that great profits are still available to you.

With the current magnitude of risk now in the farming business, it is now essential to take some of these profits off the table now while they are there. Sure, there is a chance that prices go up after you sell, but the risk of losing your business if prices go down is one that isn't worth taking. The profits are on the table for the taking. Don't let greed keep you from having a profitable business for many years to come. If you still just can't live with the thought of prices going up after you sell, speak with your local elevator operator about locking in a minimum price for your grain that will allow you to participate in higher prices if they come about.

Remove Your Barriers

It's easy to paint a rosy picture of how great prices are in the current environment, but there are obviously plenty of new challenges that have come about in this environment as well. No one can ignore the extreme increases in input costs. Fertilizer, seed, chemical, and fuel have all made farming operations more expensive to run. Therefore, crop loans are bigger than ever which means the interest you are paying to the bank is quite a bit more than in years past.

How do you handle such a large obstacle? Again, there is a calm, simple, level-headed approach needed. While some costs have doubled, your overall costs have not doubled although it is easy to sometimes misinterpret it that way. Many may see that their fuel and fertilizer costs have doubled, so they think they need double the price for their grain. This cannot be further from the truth. When you sit down and spread all your costs over your entire operation, then you have a better idea of your cost increases as well as what prices are needed for your grain. Get all your costs into a figure per acre and/or per bushel.

For example, corn is one of the most input intensive crops grown. If you break down your costs on a per bushel average, costs have increased about 40 – 50 cents per bushel. This means to make the same amount of profit next year as you did this year; you would need to sell a cash price of 40 – 50 cents higher per bushel. In many cases, you can sell even better than that right now.

Another big concern lately is how low the basis has gotten. The truth is that your cash price has gotten higher. A free market system will find the appropriate price for a commodity in any given market. Lately, more speculative funds have flooded into the market in Chicago which has run this market up more than the markets out in the rest of the country. The big mistake is to overlook the fact that the cash price in your market is higher even if the basis may be different.

Historically, the highest cash prices available have usually occurred when basis was low and vice versa. Focusing on getting a high basis is a good way to get a low cash price. Receiving 50 cents under 4 dollars is better than receiving 20 cents under 3 dollars. In the end, the cash price is what makes the difference to your business. So, your take home price is what you should focus on above all else.

What Price Volatility Can Do

The Coffee Shop

With prices moving so much on a day to day basis, it can sometimes be misleading just how big an effect this has on your business. For example, say you were to invest $1.00 into a volatile market and keep it there for 2 years. In the first year, your investment grows by 50%. In the second year, since it is a volatile market, your investment loses 40%.

How did you come out? Well, most would say you made 10% or at least you averaged a 10% return. But what does the math say? A 50% return on $1.00 in your first year would give you $1.50. If you kept that $1.50 in the volatile market for another year and lost 40%, that would be a 60 cent loss. So, you would be left with $0.90! You would actually have less money than you started with despite the fact that you averaged a 10% return on your investment.

Everyone can agree that the grain market today can be called nothing less than volatile. Do everything you can to get out of the way of that volatility because the risk sometimes outweighs the rewards. Start selling your grain today!