Farmer's Corner

"Helping The Producer Sell Better"

May/June 2008 Number 3

Spring Quick Read Issue:

Protecting Equity by Working Together

In spite of the fact that there has been a dramatic escalation in input costs, especially fertilizer, chemicals, seed, cash rents and fuel, producers are being presented with opportunities to lock in record profits. Many have begun forward contracting at levels well below current levels, but would be able to dramatically raise their averages by selling more of the 2008 crops.

Using the revenue products sold by crop insurance agents, farmers have been able to put a floor under the crop at excellent levels. These products also allow the farmer to sell ahead for harvest delivery and have the fall back of crop insurance to help pay non-delivery charges that would be incurred in the unfortunate situation of a crop failure.

The ability to safely lock in a profit, even with a dramatic increase in production costs, has led to farmers forward contracting at record volumes for most if not all major crops. This situation has led to some implications that have had a direct impact on the farmer and his ability to lock in these great prices.

What's Different?

In previous rallies, nearby prices would run up and "drag" the prices for later years up along with them. In many previous cases it wouldn't be at all unusual to see discounts of $1 - $2 or more between one crop and the next. While this would present the producer with what would probably still be profitable prices, deferred prices wouldn't be nearly as attractive as nearby prices.

The current situation is completely new and unprecedented. We saw the nearby year rally strongly, and to everyone's initial delight deferred years rallied right along with them, leading to premiums for deferred years in some cases (Only recently have we started to see some discounts to deferred years). This unique situation lead to a willingness on the part of many producers to take advantage of those prices by forward contracting for two or even three years out.

Why is This a Big Deal?

An increase in multi-year contracting has begun to strain the resources of grain buyers, both large and small. As long as the local elevator is able to resell positions as they purchase them from farmers, they can continue to buy grain for these latter delivery periods, but as more and more grain has been contracted, the industry is less willing to buy it. Many large end users have stopped offering bids for deferred grain. In fact, it is virtually impossible to forward contract '08 new crop bushels in some parts of the country.

This challenge is being widely discussed in much of the local, state and national media. It has led to a great deal of frustration on the part of farmers and the agri-businesses that serve them.

Equity at Risk!!!!!

The producer is being presented with the gift of high price. This has the effect of putting a huge amount of equity for their farming operations within their grasp! The challenge is how to capture it before it slips away.

If history has taught us anything, it's that opportunities present themselves, and then often disappear, at least for a time. The problem is that when prices do finally drop, and nobody can predict how far that will be, the cost of production never seems to drop with the same rapidity that it went up. The farmer who is unable or unwilling to capture the higher price has then allowed that equity to escape and put his farming operation at risk.

The size of this potential loss of equity is on a scale that we've never experienced. In the past, the loan rate would prevent a huge loss if the price dropped substantially. For many crops the loan rate would cover a good portion of the cost of production. The escalation in that cost of production has now reached levels where a dramatic drop in price could lead to huge losses to production agriculture and the impact of that would be disastrous.

Time to Think Outside the Box!!

Many producers and elevators are working together to come up with possible solutions to the problem by sitting down and looking at alternatives that will allow the farmer to protect the equity that is so precious. There are several different ideas on the table, but all of them are some variation on this theme: the farmer and elevator need to find a way to work together to capture this opportunity. In the past, grain buyers have gladly borne all the costs associated with forward contracting, but as more and more producers take advantage of high prices for deferred years, it will probably become necessary at some point for the producer to get involved in the financing of this opportunity. It is not yet clear what form this will take or how it will work, but all across the country grain buyers, producers, and lenders are getting together to share ideas.

The future looks bright as we continue to work alongside each other to learn and make the most of our opportunities to grow together.