

Decisive Marketing

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Difficult Production and Marketing Decisions

In recent months, economic worries, dollar value, energy prices and other outside factors have played a major role in the downward direction of the corn and soybean markets. “Demand destruction” from last year’s high prices, more than adequate corn carryover and expectations for increasing soybean production have also contributed to lower prices. High production costs and dry weather in the Great Plains cause expectations for narrow profit margins and uncertainty about 2009 crop production. These factors combine to make farmer’s marketing and final production decisions difficult.

Will acreage shifts occur? The FAPRI March 2009 baseline projections show relatively small changes in planted acreage compared to 2008. Expected corn acreage of 86.3 million acres compares to last year’s 86.0 million acres and soybean plantings at 75.1 million acres are near last year’s 75.7 million acres. The USDA’s February Outlook Forum offered similar planting estimates of 86.0 million acres of corn and somewhat higher soybean acreage of 77.0 million acres.

Several private market advisory services are anticipating more of a shift in acres. The financial risks associated with the high cost of corn production, along with weather and production risks, have caused many analysts to believe that 2009 corn acres will be reduced and soybean acreage increased significantly from last year’s plantings. One private firm projects that corn acreage will drop to 81.4 million acres and soybean plantings will increase to 81.5 million acres. Many analysts doubt that this much of an acreage shift will occur. But, if it occurs, this could lead to much tighter corn and increased soybean carryovers for 2009-10. With high production costs and narrow profit margins, any price reactions (up or down) to changing supplies produces significant market and financial risks for crop production.

“Know your production costs!” Grain marketing advisors have always stressed this and it is more important than ever this year.

Obviously it costs more to produce corn than it does to grow soybeans. This is illustrated by the FAPRI “2009 Crop Budgets” (located under the “Farmer’s Corner” tab at www.fapri.missouri.edu). These budgets are based on expected production of 155 bpa corn and 55 bpa soybeans on operator owned land. Some of the costs are:

	<u>Corn</u>	<u>Soybean</u>
• Operating Costs per acre	\$314.96	\$186.43
• Total Costs per acre	\$502.91	\$355.58
• Total Cost per bushel	\$3.24	\$7.11

If the Land is cash rented, operating costs increase for the farm operator. For example, using \$150 per acre cash rent, the costs are:

	<u>Corn</u>	<u>Soybean</u>
• Operating Costs per acre	\$470.21	\$341.68
• Total Costs per acre	\$536.16	\$389.33
• Total Cost per bushel	\$3.46	\$7.79

The difference in operating costs between corn and soybean production is \$128.53. The actual cash flow difference may be even greater. The budgets assume fertilizer costs for soybean production based on crop nutrient removal rates, but producers may reduce cash outlays by not applying fertilizer in the year soybeans are grown. There has been a wide range of quoted fertilizer prices as well and, depending upon dealer inventory cost or what producers are willing to pay, will have a large impact on corn production costs. It is also important to note that other input costs, production practices, yields and cash rents vary considerably and the budgets should be adjusted to fit the situation for a given farm. The “Crop Budget Generator” spreadsheet available at: www.fapri.missouri.edu can aid in this task.

Should production plans be adjusted? Using the budgeted cost examples, current new crop cash bids offered at locations across Missouri offer a profit margin for producing corn. The past week’s soybean price increases have produced new crop cash bids that offer a profit margin on soybeans grown on owned land, but margins are very narrow on cash rented land in some parts of the state. While this leans toward supporting a decision for staying with corn, the financial risk remains a concern.

For those with crop revenue insurance coverage, depending upon coverage level, it appears that the revenue guarantees may cover most of operating cost risk for corn and soybean production on owned or cash rented land. With this protection, the somewhat higher margins offered by new crop corn bids may suggest staying with corn, especially if total US planted acres decline. For those without revenue crop insurance, the lower financial risk may tip the scales toward more soybean acres.

Pricing decisions are even more difficult. When to sell? At what prices to make sales? How much to sell? And how should sales be made?

With the limited upside price potential expected by most analysts, it will be important to set price targets or use pricing strategies that capture prices above breakeven price levels when they are offered. There are still about 17 months to sell 2009 production and so it is still early in the marketing year. But some of the better pricing opportunities often occur early in the growing season. The corn and soybean markets have been slow to begin a seasonal spring rally, but both have now rallied from their early March lows. If the rally continues, this suggests being prepared to capture pricing opportunities as the planting season approaches. The fact that current new crop bids already offer some profit also should not be ignored, especially ahead of possible surprises in the USDA’s Prospective Plantings report.

The uncertain outlook suggests spreading sales. Those with crop insurance can more comfortably spread sales for quantities that are guaranteed by the insurance policy. Without crop insurance, the when, how much and at what price decisions are more risky. However, capturing potentially profitable prices by spreading sales of an amount that is likely to be produced, regardless of the growing season, can be a good decision.

A variety of sales methods can be used. Remember, many market strategies don’t eliminate risk they just try to manage it. It is very important to understand how the strategy works and any risks associated with it. Pre-harvest new crop cash sales (forward contracting) offer a relatively simple method of capturing current or any higher new crop cash bids. However, this incurs a delivery obligation, in some cases locks-in a weak basis and may carry a counter-party risk if a grain buyer fails. Purchasing put options offers a low risk alternative, but current option premium costs wipe out all or most of the current narrow profit margins. A more complicated option spread strategy to reduce net premium costs may be needed in order to effectively use options. Futures hedges would also lock-in profitable prices, but it is important to be prepared for the cash flow impact of margin calls. Margin calls could become large if summer weather produces volatile market prices.

Any of these sales methods or strategies will work, just understand the risks, know production costs and make sales to capture profitable prices in a high risk environment. When spreading sales it is likely that some sales will turn out to be disappointing, but it reduces risk. The profit margins may be much narrower than last year and decisions are not easy, but it is still possible to have a profitable year,