Farmer's Corner

"Helping The Producer Sell Better"

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Spring Fever

Balancing Risk & Opportunity in a Volatile Market

It's spring fever. That is what the name of it is. And when you've got it, you want - oh, you don't quite know what it is you do want, but it just fairly makes your heart ache, you want it so!

~ Mark Twain

Spring is the time of year when production agriculture begins to focus on its potential. The 2011 crop seems to present more potential than just about any crop in recent memory. But as in any year, there are risks, and in a year with great potential the risk may be great too. With higher grain prices come higher input costs and higher land costs, coupled with the ever present weather risk. The challenge in a year like this is not only managing the production but a greater level of risk as well.

The world has changed enough that a casual approach to marketing risk is probably not survivable as it may have been in years past. When the potential to sell some of the highest prices you've ever seen is on the table, it comes with great risk. High prices create high costs, and that's fine until prices drop and inputs don't. The opportunity for profitable farm returns creates competition for inputs and land. When high inputs and land cost are locked in but the high price that created them is not, the risk of a negative return is greater than usual.

How have risks changed?

Ten years ago, production was the biggest risk, followed by price risk. Crop Insurance and high prices have removed some of that risk, elevating inputs and land cost as our primary focus on the risk management front. So, ten years ago our focus on risk might have been ordered:

1. Production
2. Price
3. Inputs
4. Controlling the Land

Today, that order may be reversed:

1. Controlling the Land
2. Input Costs
3. Price
4. Production

Putting all the focus on one of these risks without attention to all the others could be devastating to your farming business.

We certainly could build scenarios of disaster. Buying inputs without selling and having prices drop below breakeven is one; forward contracting without any inputs purchased could be another. The combinations of risk are endless when one aspect of the business is attended to and another is left for later. <u>However, the potential is extraordinary if the risks are all managed to together</u>.

VOLATILITY – The Two Edged Sword

Instability and unpredictability are the new norm. The market place is much bigger. Production is more widespread, new demand is exploding, and there is lots of speculative money in the grain market. The information flow is quicker than ever, all leading to huge volatility.

Logic sometimes is fleeting when we are bombarded with so much news, good or bad! Good ideas are questioned until time erodes the benefits. The age old principles of sound financial management still hold in today's environment.

When margins get good, great and historically bigger than you've experienced take advantage of them by locking in some sales. While you do that, remember that above average margins don't last forever, so don't make long term commitments based on the assumption that an extraordinary margin will be available for years into the future.

With higher profits and cash flow, you might consider lowering your cost of production by paying down debt, investing in efficiencies and upgrading yields.

Low interest rates are attractive but long term, building working capital and lowering overall debt is the best insurance against hard times. Building equity allows you to gauge your rate of growth and the size of your operation as conditions warrant.

Coffee Shop

When making cookies here in the coffee shop if we leave out one ingredient, we just can't sell the darn things. Do it enough and our business shrinks. Farming is the same. Fail to manage just one segment of the process carefully, and we're cooked instead of the cookies.