

March 30th, 2010
1 – 2 pm Central Time



Future Swine Profitability: Importance of Implementing a Sound Risk Management Program

Bret Oelke, Ag Business Management, Univ. of Minnesota

This presentation will review the volatility and change in the hog profitability cycle observed the past 2+ years, and how developing and implementing a sound risk management program that accounts for input costs as well as revenue will greatly improve cash flow and sustainability moving forward.

Brought to you by:



Mission Statements

- Personal
 - “To search for and develop opportunities that allow our customers to achieve their goals”
- University of Minnesota Extension
 - “Connecting community needs with University resources”

This is a conversation not a lecture, please ask questions and comment as you please.

Objectives

- Brief introduction
- Provide a historical perspective to costs and prices
- Define and explore the elements of risk management plans
- Explain how risk management plans can be implemented

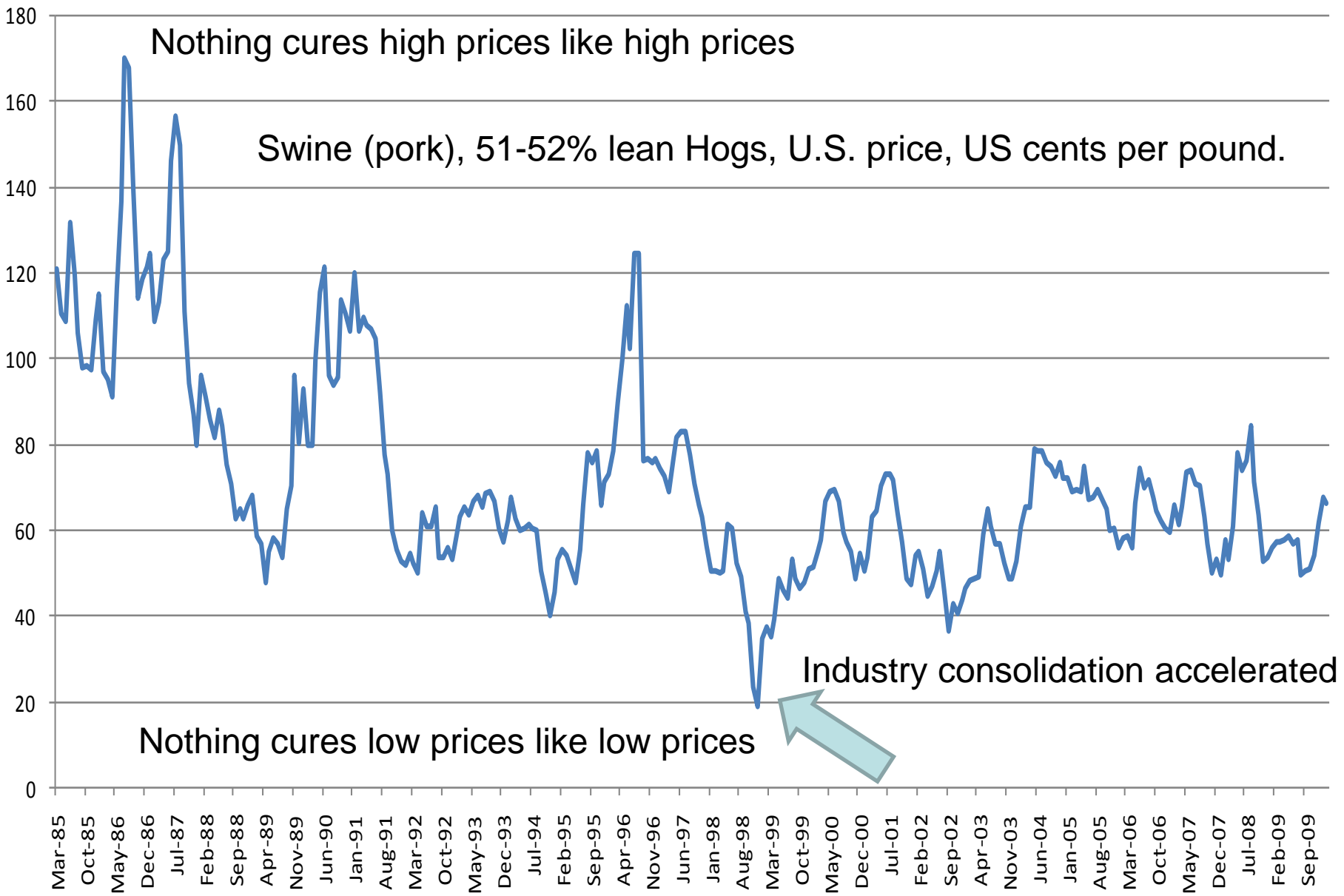
Agricultural Business Management Team

- Eight members
- Program areas and products
 - Risk management, marketing (Winning the Game, Marketing and Management Groups), business management, asset transfer (FTEP), young farmers, couples education (Building a Winning Team), Ag energy, Ag lender workshops and training.

Historical Price Perspective

- CME hog price chart to follow runs from January of 1985 through February of 2010
- Early prices are adjusted to reflect lean hog futures
- Earlier prices appear to be more volatile, with bigger swings in price
- Is this a reflection of farmer farrowers/feeders?

Swine (pork) - Monthly Price - Commodity Prices Value

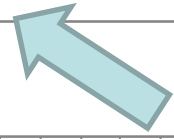


Nothing cures high prices like high prices

Swine (pork), 51-52% lean Hogs, U.S. price, US cents per pound.

Nothing cures low prices like low prices

Industry consolidation accelerated



Price thoughts

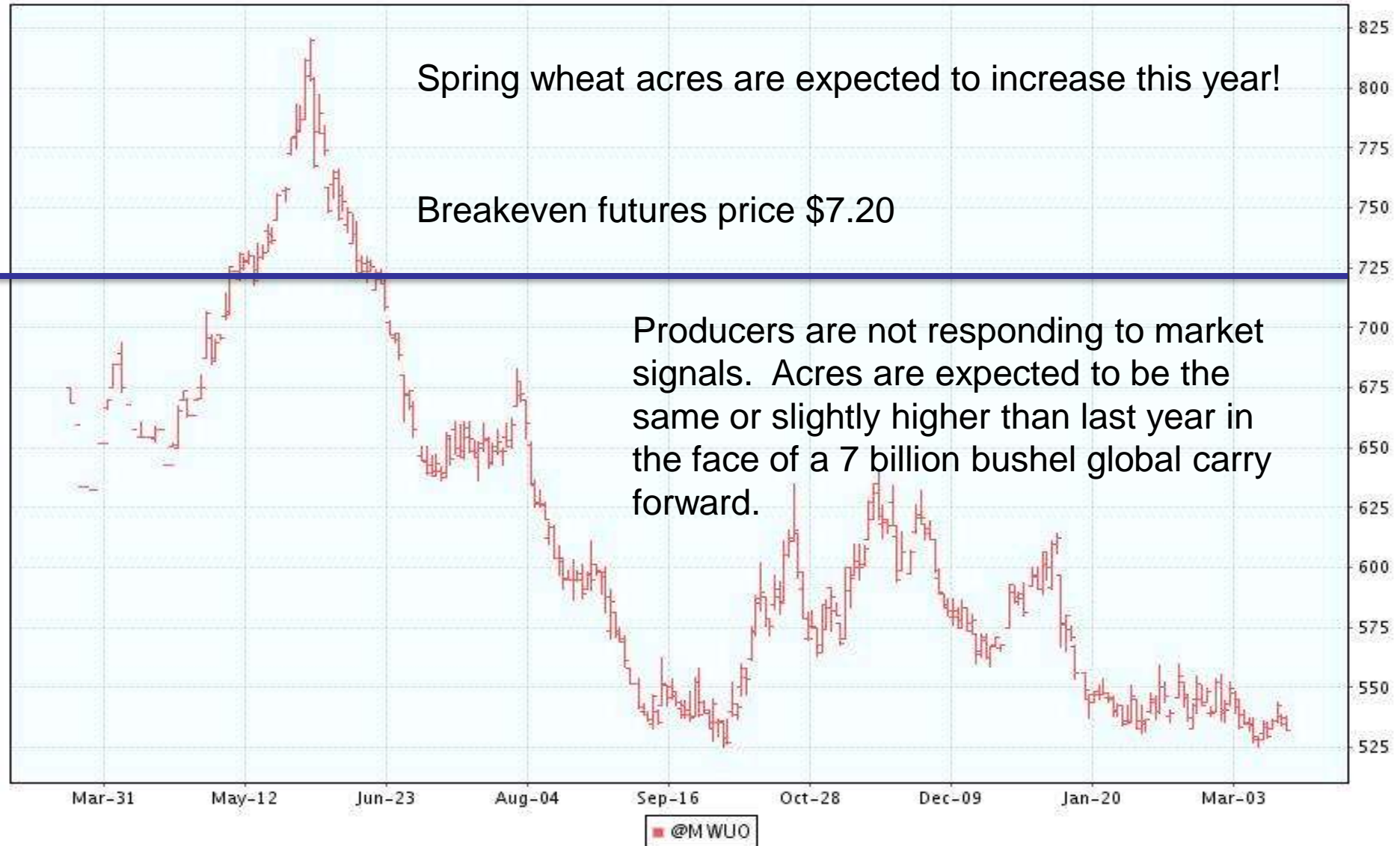
- When there are many participants in many segments in a market (both buyers and sellers) you have a more “responsive” pricing model. In other words, you have more exits and entries to the production system and participants normally respond to market signals more quickly. This is especially true when entry and exit costs are low.
- The following slide is an example of not responding to market signals

Spring Wheat September 2010

Spring wheat acres are expected to increase this year!

Breakeven futures price \$7.20

Producers are not responding to market signals. Acres are expected to be the same or slightly higher than last year in the face of a 7 billion bushel global carry forward.



Price thoughts

- When there are fewer participants in a market and their investment is higher (high cost to enter and/or exit) the industry becomes slower to react to market signals.
- This results in narrower trading ranges and a disruption in the historical price cycle (longer periods of profitability and unprofitability).
- Were “systems” playing chicken when pork became unprofitable?

Historical Cost Perspective

- Corn and soybean meal prices are also from January 1985 through February 2010
- Prices are US dollars per metric ton (2200 lbs)
- Prices early in the charts reflect price movement based on supply
- Prices more recently reflect price movement based more on demand and “outside” factors

Corn - Monthly Price - Commodity Prices Value

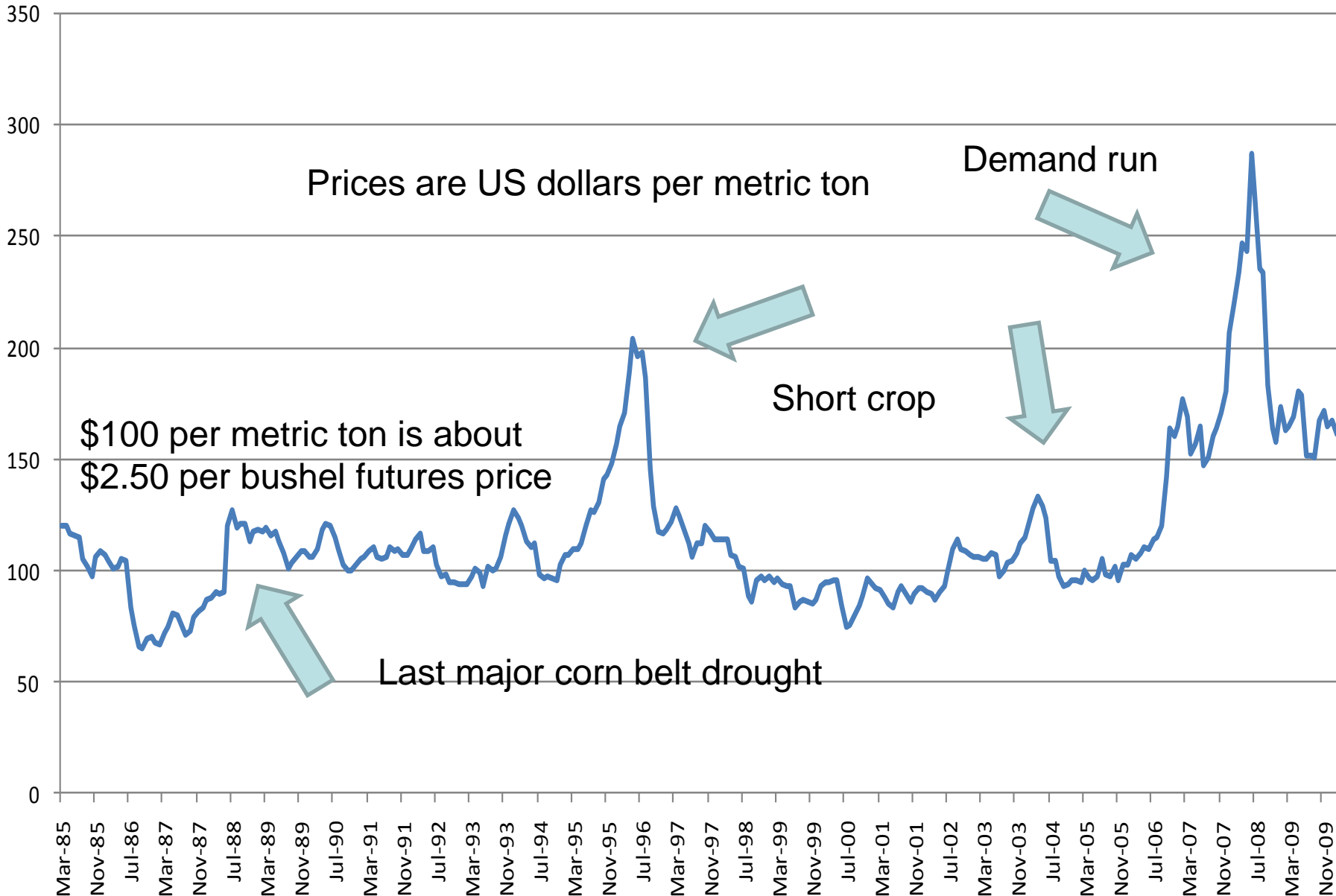
Prices are US dollars per metric ton

Demand run

Short crop

Last major corn belt drought

\$100 per metric ton is about
\$2.50 per bushel futures price



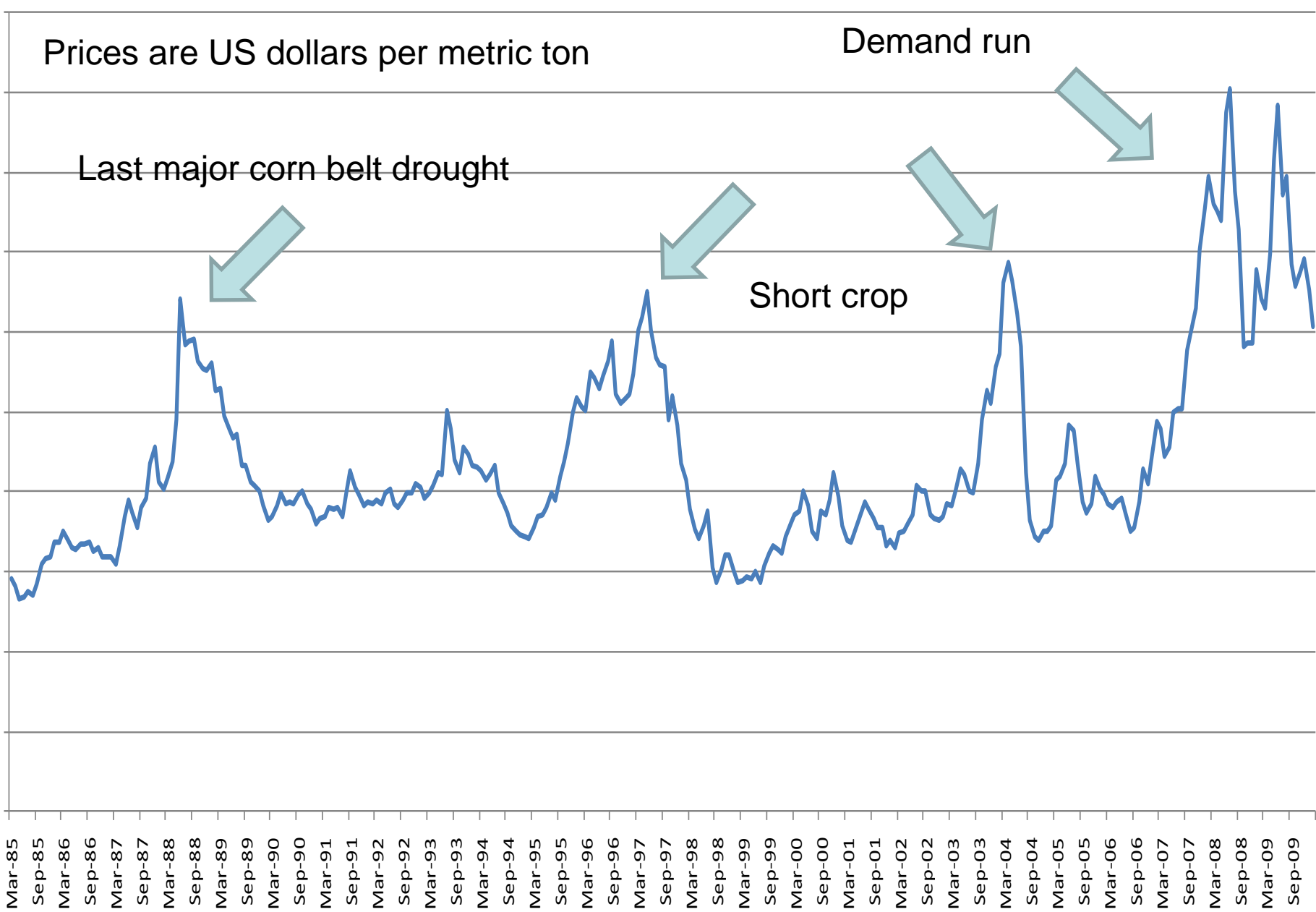
Soybean Meal - Monthly Price - Commodity Prices Value

Prices are US dollars per metric ton

Demand run

Last major corn belt drought

Short crop



Cost thoughts

- Historically, grain and oilseed prices were relatively low and stable unless supplies were threatened due to growing conditions
- Regardless of intent, farm policy kept prices low and stable. “Safety nets” kept many grain farmers in business.
- Low and stable prices helped fuel livestock industry consolidation in regions that were importers of grain and protein.

Cost thoughts

- As recently as September of 2006 cash corn prices in Minnesota were less than \$1.50 per bushel. In the central valley of California, corn was selling to commercial dairies at just over \$2.00 per bushel at that time.
- Farm policy allowed producers to “ignore” cost of production and allowed users of corn to purchase at less than the cost of production.
- Midwestern producers adopted the large scale dairy model and the South Eastern Hog production model.

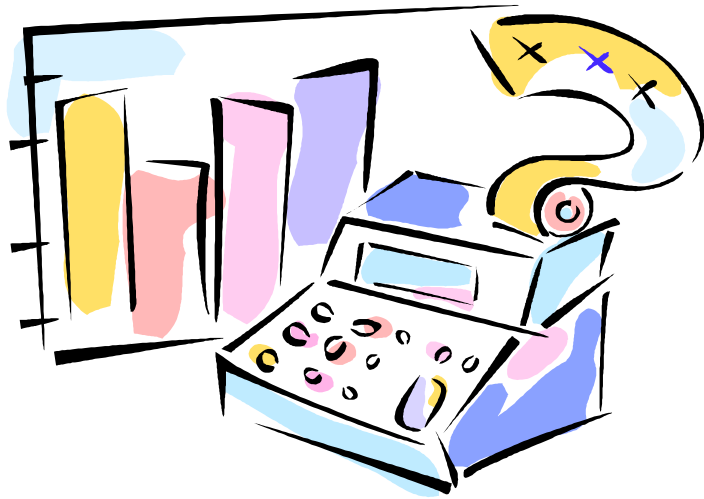
Planning for risk management

- Risk Management Philosophy
 - Improve average margins (profit)
 - Avoid mistakes
 - Generate enough income to meet personal and professional goals
 - Achieve and maintain long term profitability

Components of a risk management plan

1. Financial Situation and Goals
2. Setting Price and/or Profit Objectives
3. Market Outlook and Expectations
4. Production Risk Tools
5. Price Risk Tools
6. Price and Date Objectives
7. Strategies

Components of a Risk Management Plan



- Setting Price Objectives
 - Breakeven Price
 - Profit Objectives
 - Sensitivity Analysis
 - “What if”

Components of a risk management plan

- It is crucial to know your cost of production, accurate business and production records are key.
- Producers need to know what tools they can use to hedge price and cost risk
- Access to capital to finance risk management is necessary.
- Sometimes limiting losses is the best that can be done with non-storable commodities (pork, milk, beef)

Components of a Risk Management Plan

- Market Outlook and Expectations
 - Assess Market Situations for both inputs and outputs
 - Determine Price Probabilities
 - Understand Seasonality
 - Observe Technical Indicators

Market Outlook and Expectations

Nearby Futures Trading Range,
Chicago Board of Trade Corn



Corn Year	Calendar High	Calendar Low	Cal. Year Range	% Change from High
1990	\$ 3.02	\$ 2.16	\$ 0.86	28.48%
1991	\$ 2.66	\$ 2.33	\$ 0.33	12.41%
1992	\$ 2.74	\$ 2.05	\$ 0.69	25.18%
1993	\$ 3.07	\$ 2.10	\$ 0.97	31.60%
1994	\$ 3.12	\$ 2.10	\$ 1.02	32.69%
1995	\$ 3.71	\$ 2.30	\$ 1.41	38.01%
1996	\$ 5.55	\$ 2.58	\$ 2.97	53.51%
1997	\$ 3.20	\$ 2.40	\$ 0.80	25.00%
1998	\$ 2.84	\$ 1.85	\$ 0.99	34.86%
1999	\$ 2.34	\$ 1.77	\$ 0.57	24.36%
2000	\$ 2.50	\$ 1.74	\$ 0.76	30.40%
2001	\$ 2.31	\$ 1.84	\$ 0.47	20.35%
2002	\$ 2.86	\$ 1.92	\$ 0.94	32.87%
2003	\$ 2.62	\$ 2.05	\$ 0.57	21.76%
2004	\$ 3.35	\$ 1.91	\$ 1.44	42.99%
2005	\$ 2.63	\$ 1.86	\$ 0.77	29.28%
2006	\$ 3.78	\$ 2.04	\$ 1.74	46.03%
2007	\$ 4.57	\$ 3.10	\$ 1.47	32.17%
2008	\$ 7.63	\$ 2.90	\$ 4.73	61.97%
2009	\$ 4.29	\$ 3.37	\$ 0.92	21.45%

Market Outlook and Expectations

Nearby Futures Trading Range, Chicago Board of Trade Corn

Corn	Calendar High	Calendar Low	Cal. Year Range	
Median	\$ 3.02	\$ 2.05	\$ 0.94	31.60%
Average	\$ 3.39	\$ 2.16	\$ 1.24	32.84%
Post 96 Ave	\$ 3.39	\$ 2.12	\$ 1.27	33.50%
Smallest	\$ 2.31	\$ 1.74	\$ 0.33	12.41%
Highest	\$ 7.63	\$ 3.10	\$ 4.73	61.97%

Market Outlook and Expectations

Nearby Futures Trading Range,
Chicago Board of Trade
Soybeans



Soybeans Year	Calendar High	Calendar Low	Cal. Year Range	% Change from High
1990	\$ 6.55	\$ 5.52	\$ 1.03	15.73%
1991	\$ 6.38	\$ 5.14	\$ 1.24	19.44%
1992	\$ 6.37	\$ 5.25	\$ 1.12	17.58%
1993	\$ 7.55	\$ 5.62	\$ 1.93	25.56%
1994	\$ 7.33	\$ 5.27	\$ 2.06	28.10%
1995	\$ 6.89	\$ 5.45	\$ 1.44	20.90%
1996	\$ 8.56	\$ 6.60	\$ 1.96	22.90%
1997	\$ 9.04	\$ 6.20	\$ 2.84	31.42%
1998	\$ 6.94	\$ 5.12	\$ 1.82	26.22%
1999	\$ 5.57	\$ 4.02	\$ 1.55	27.83%
2000	\$ 5.71	\$ 4.34	\$ 1.37	23.99%
2001	\$ 5.38	\$ 4.20	\$ 1.18	21.93%
2002	\$ 6.25	\$ 4.16	\$ 2.09	33.44%
2003	\$ 8.02	\$ 5.32	\$ 2.70	33.67%
2004	\$ 10.64	\$ 5.01	\$ 5.63	52.91%
2005	\$ 7.52	\$ 4.99	\$ 2.53	33.64%
2006	\$ 6.93	\$ 5.27	\$ 1.66	23.95%
2007	\$ 12.30	\$ 6.47	\$ 5.83	47.40%
2008	\$ 16.60	\$ 7.77	\$ 8.83	53.19%
2009	\$ 10.47	\$ 8.43	\$ 2.04	19.45%

Market Outlook and Expectations

Nearby Futures Trading Range, Chicago Board of Trade Soybeans

Soybeans	Calendar High	Calendar Low	Cal. Year Range	
Median	\$ 6.94	\$ 5.27	\$ 1.93	26.22%
Average	\$ 7.44	\$ 5.22	\$ 2.22	28.15%
Post 96 Ave	\$ 7.66	\$ 5.01	\$ 2.65	32.40%
Smallest	\$ 5.38	\$ 4.02	\$ 1.03	15.73%
Highest	\$ 12.30	\$ 6.60	\$ 5.83	52.91%

Market outlook and expectations

USDA Hogs & Pigs Report

Hog Supplies Bullish

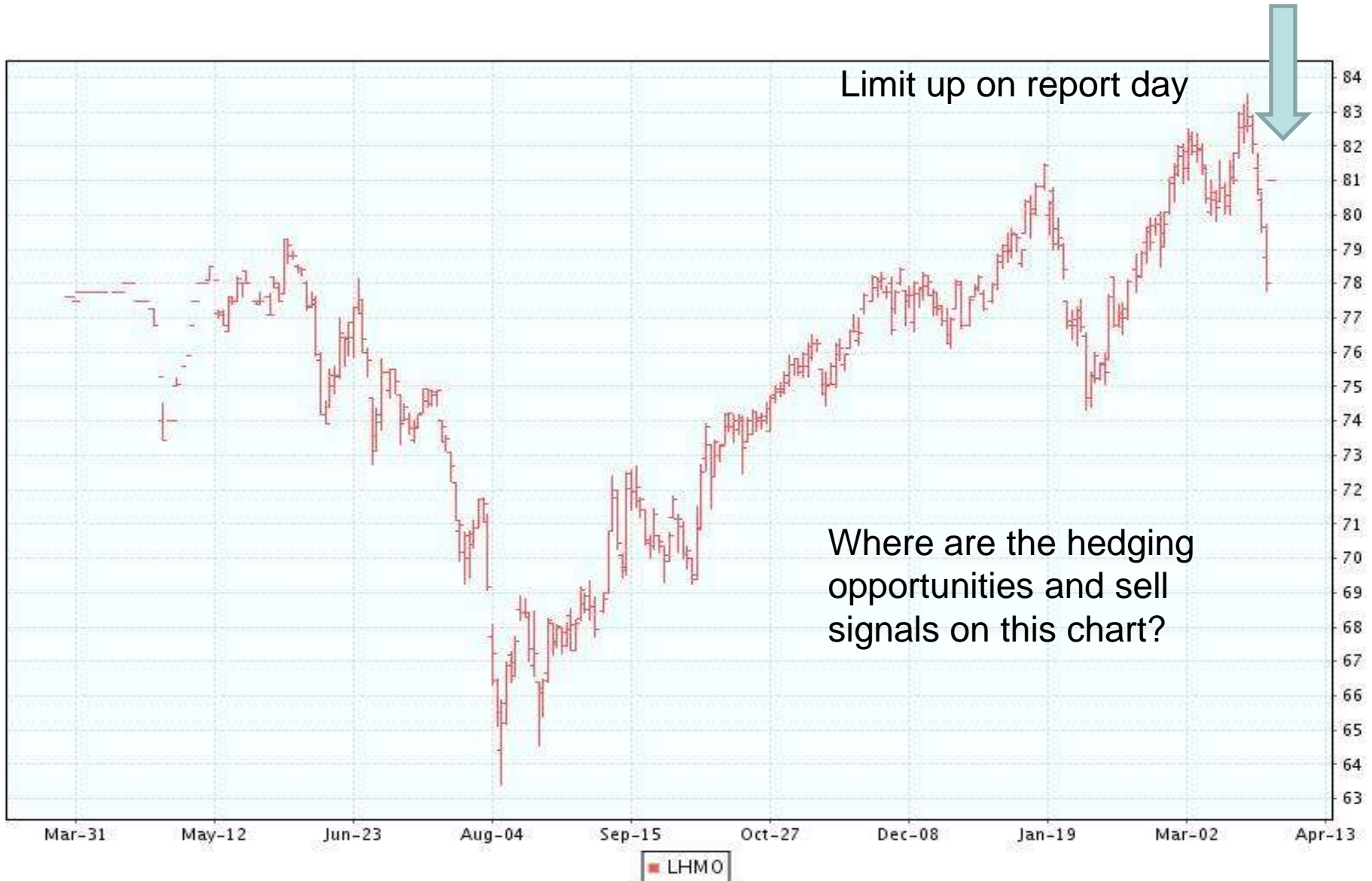
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Hogs & Pigs Report

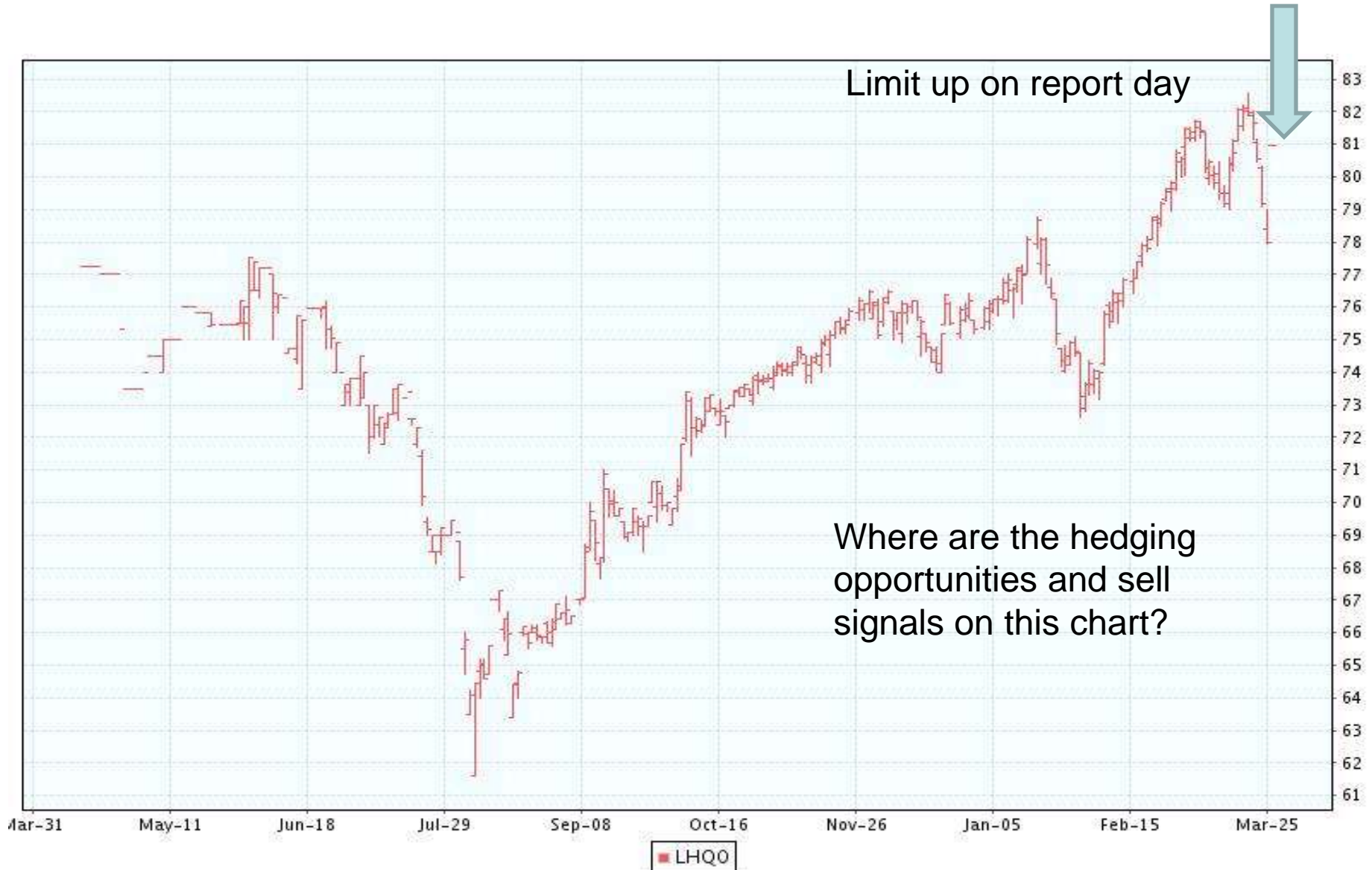
	USDA Actual	Average Guess	Guess Range
All Hogs March 1	97.0	99.0%	98.0-100.0%
Kept for Breeding	96.0	97.5%	97.0-98.0%
Kept for Marketing	97.0	99.0%	98.0-100.0%
Weight Breakdown:			
180# Plus	99.0	98.5%	97.5-100.0%
120-179#	98.0	99.0%	98.0-99.5%
50-119#	97.0	99.0%	98.5-100.0%
Under 50#	96.0	99.0%	98.0-100.0%
Farrowings/Intentions:			
Dec-Feb	96.0	98.0%	97.0-99.0%
Mar-May	96.0	98.0%	96.0-98.0%
Jun-Aug	98.0	98.5%	97.5-100.0%
Winter Pig Crop	98.0	99.5%	98.0-100.0%
Dec-Feb Pigs Per Litter	101.0	101.0%	99.0-102.0%

The Hogs & Pigs report released this afternoon is bullish with all categories falling below trade expectations. The trade should especially be impressed with the larger than expected cutback in breeding herd. Look for lean hog futures to be sharply higher on Monday based on this bullish supply news.

June 2010 CME lean hog chart



August 2010 CME lean hog chart



Seasonality

- On average, the March to May time period offers good forward pricing opportunities for grain and oilseed growers. There are pricing opportunities for users of grain and protein products during this time frame.



Technical Indicators

- Trend following tools
 - Simple moving averages (I use 4 and 9 day)
 - Indicate changes in trends
- Non-trending markets
 - Fast stochastic
 - Overbought and oversold indicators

These tools allow disciplined flexibility in the plan

Components of a Risk Management Plan

- Price Risk Tools
 - Exchange Contracts
 - Futures Contracts
 - Options
- Price Risk Tools
 - Feed and Packer Contracts
 - Forward Contracts
 - Basis Contracts
 - Minimum Price Contracts
 - Maximum price contracts

Components of a risk management plan

- Price and Date Objectives
 - Cash Flow Needs (less important in a livestock production system)
 - Cost of production and cost of inputs
 - Seasonality of both inputs and outputs
 - Minimum Prices
 - Price Risk Tools

Components of a risk management plan

- Strategies
 - Incremental Sales and purchases
 - Use of Livestock Risk Protection Insurance (LRP) when available and appropriate
 - Mix and Combinations of Tools
 - Cash, futures, options

Developing a risk management plan

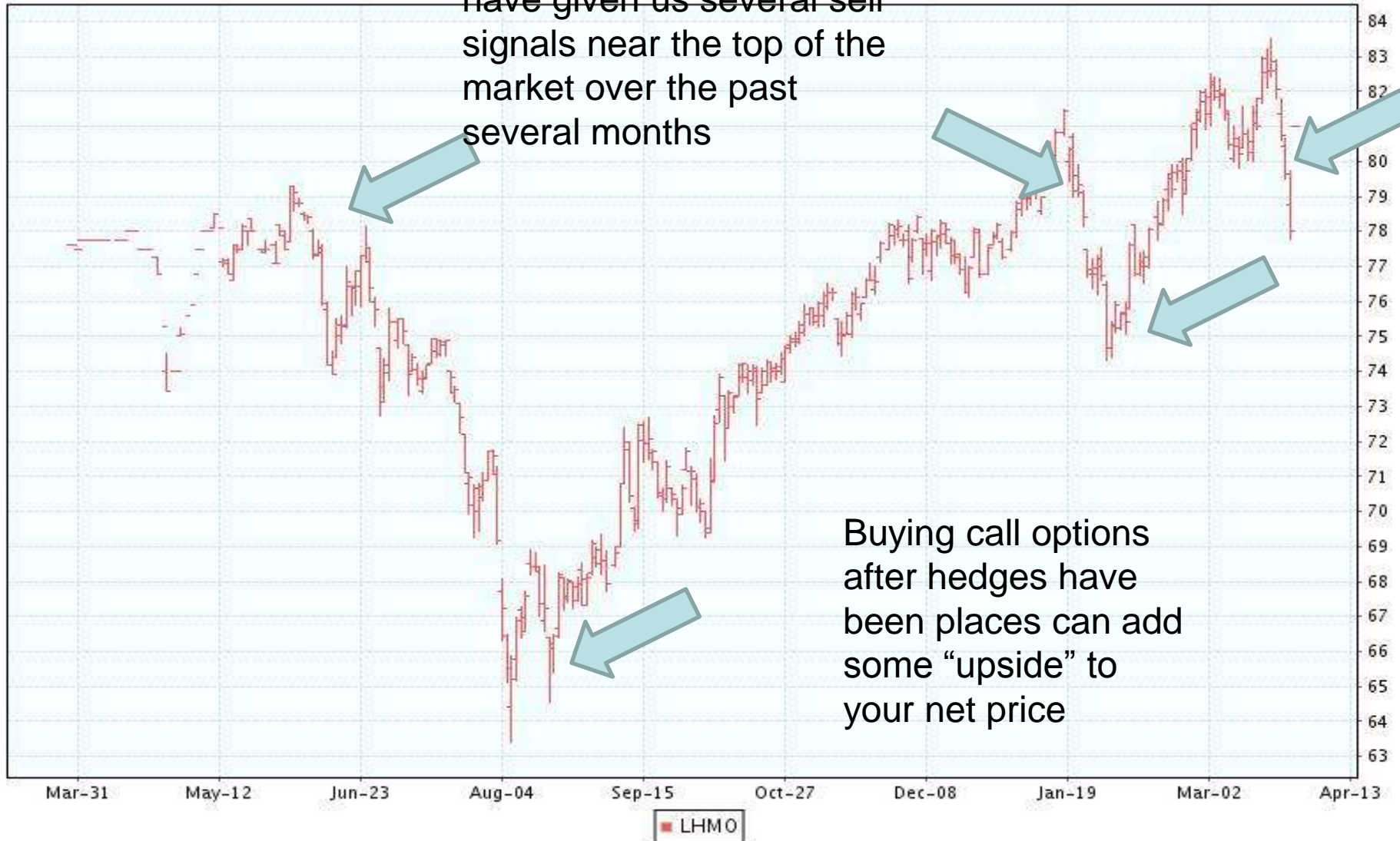
- Evaluate the Plan
 - Both During and After the Marketing Year (Management Review)
 - What worked and what didn't
 - Continue to expand alternatives
 - Use plans to remove some of the emotion

Risk management plan development

- For outputs
- Use price targets as a guide
- If the market trends down
 - Make sales at price targets as we move down through them
- If the market trades sideways
 - Use stochastic to make sales at the top of the trading range
- If the market trends up again
 - Defer sales until moving averages cross again

Hedging opportunities

Simple moving averages have given us several sell signals near the top of the market over the past several months

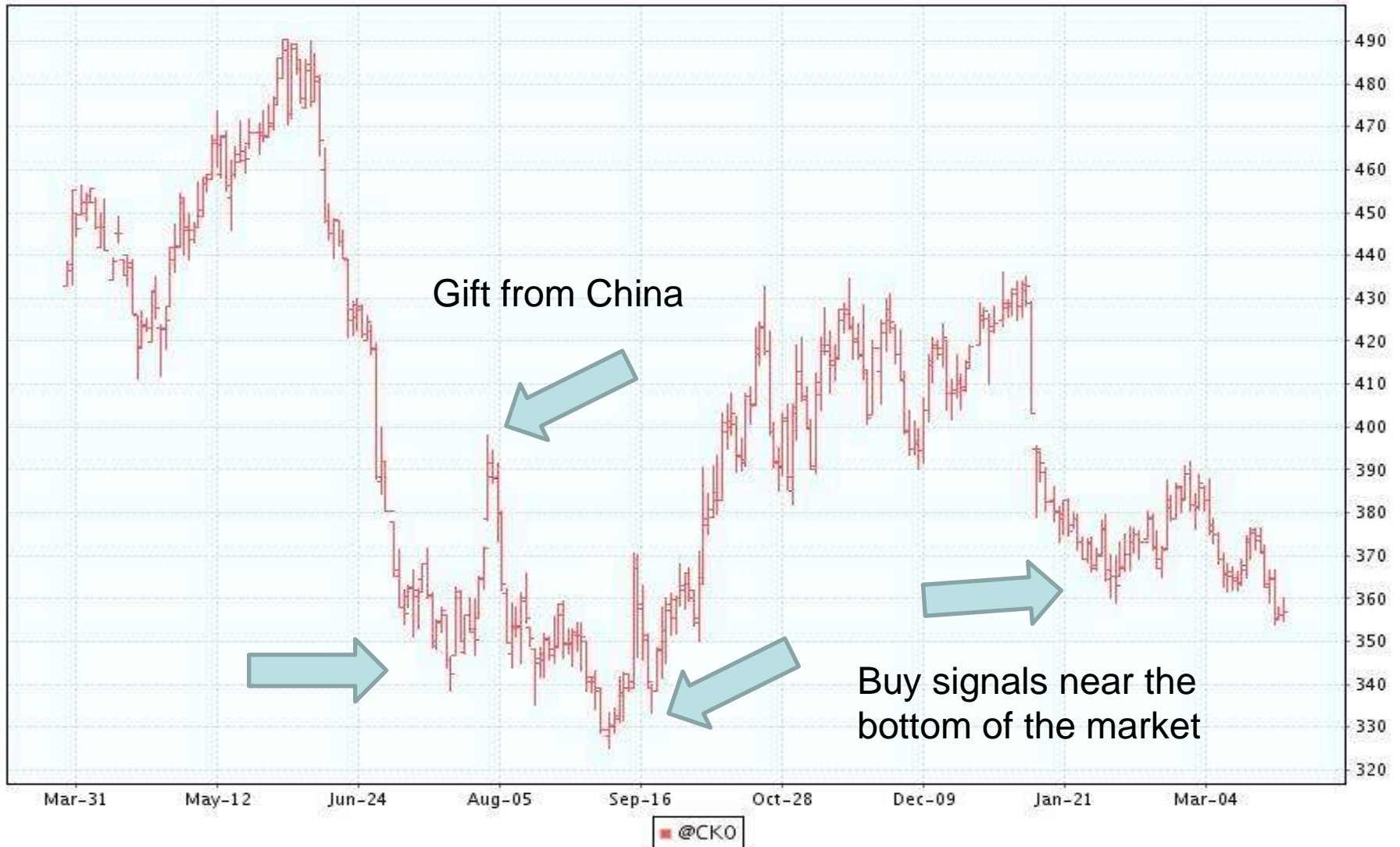


Buying call options after hedges have been places can add some "upside" to your net price

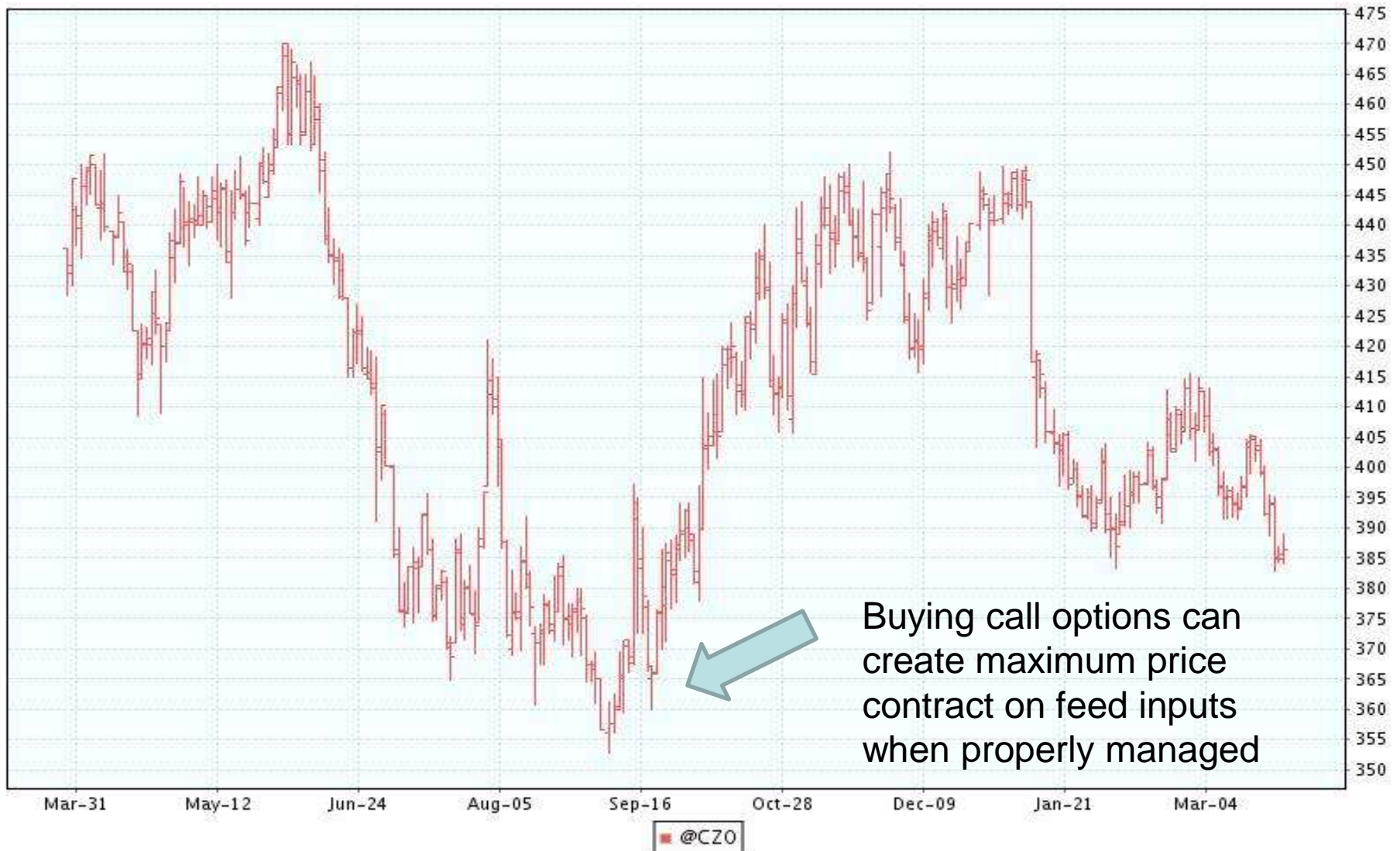
Risk management plan development

- For inputs
- Use price targets as a guide
- If the market trends down
 - Defer purchases (except for the percentage you always buy at spot prices) until moving averages cross over.
- If the market trades sideways
 - Use stochastic to make purchases at the bottom of the trading range
- If the market trends up again
 - Make purchases at price targets as we move through them

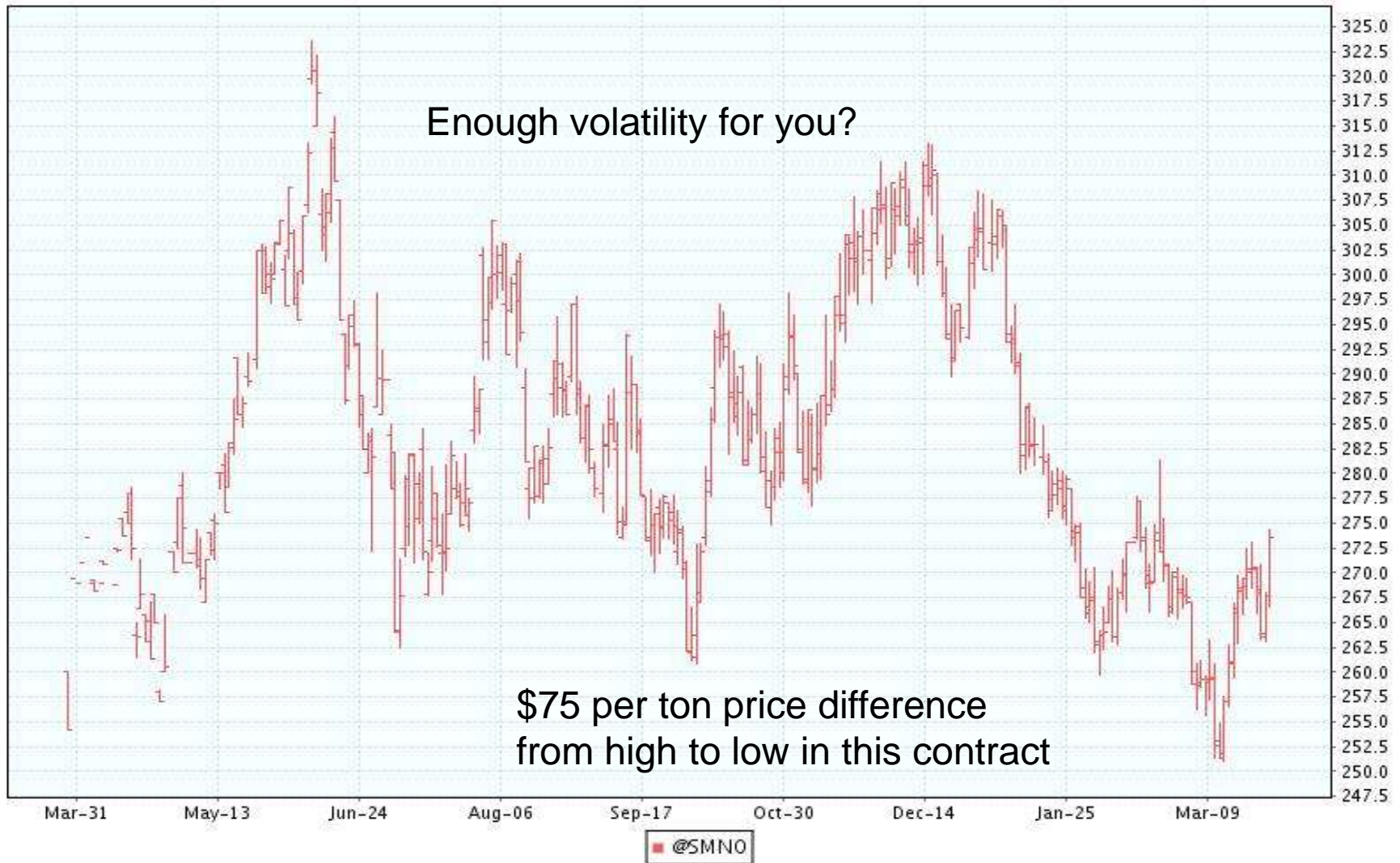
May 2010 CME corn chart



December 2010 CME corn chart

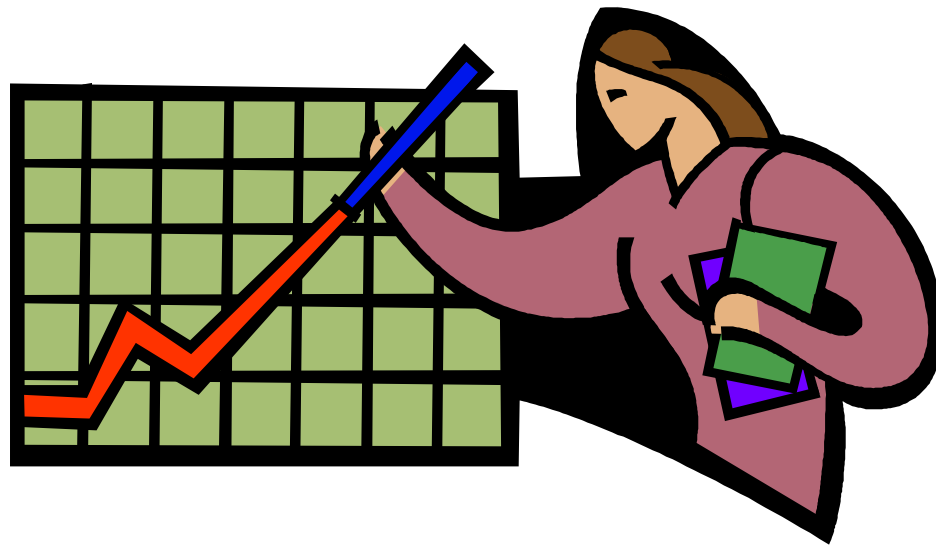


July 2010 CME soybean meal chart



Risk management plans

- Implement the Plan!!!!!!!!!!



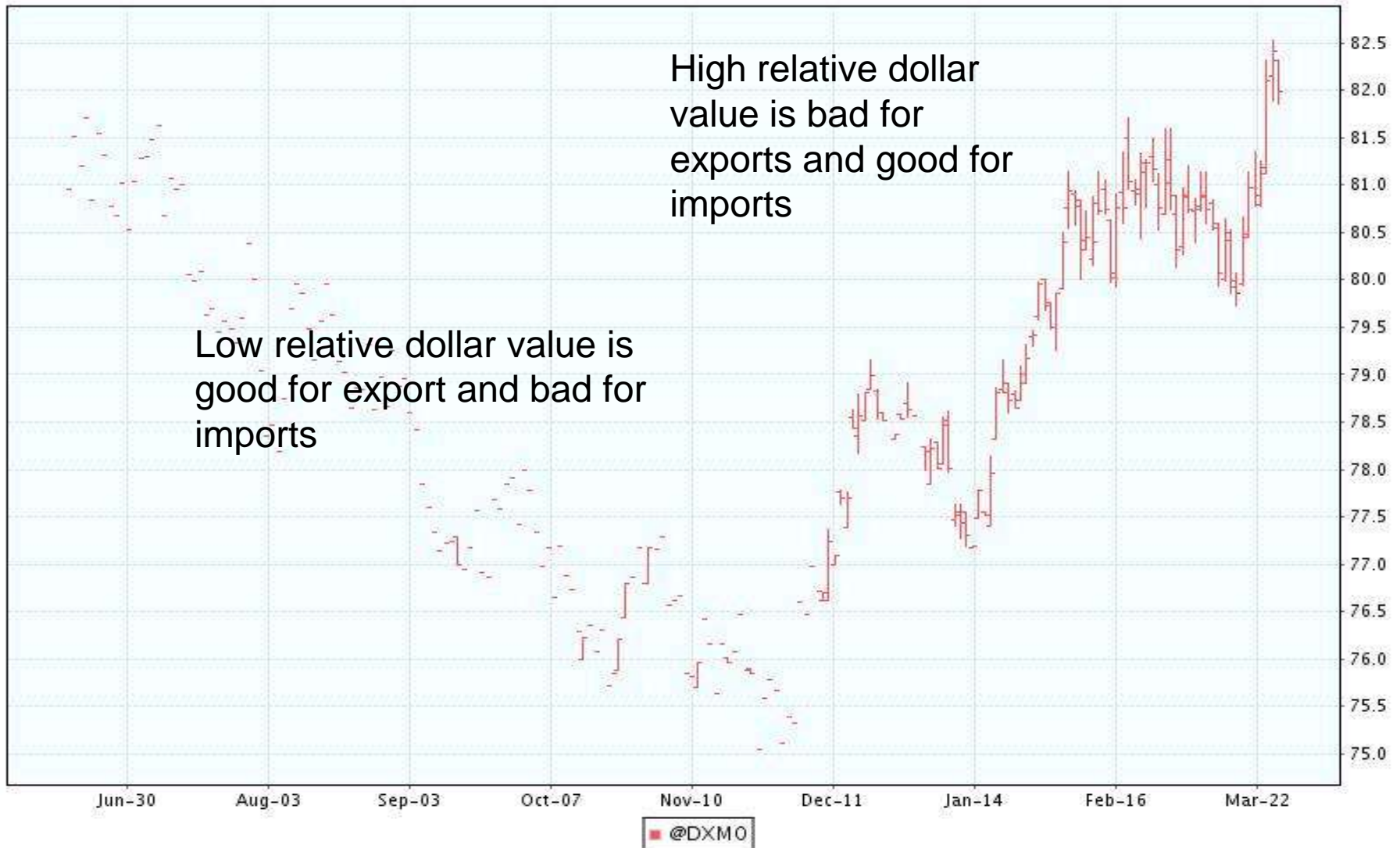
Final thoughts on risk management planning

- Understand futures and basis seasonality and patterns
- Incremental sales and purchases can be looked at as “mistake” management
- Use simple technical tools to take some of the emotion out of hedging inputs and outputs
- Growers under contract can do some things to enhance profitability
 - Energy costs, average pricing of inputs and/or outputs
 - It all depends on the system and how you are paid for what you provide

Final thoughts on risk management planning

- Risk management should be financed separately from production
- Outside markets have become more important in price movement and profitability
 - Currency values
 - Funds
 - Energy
 - Government policy and actions

Nearby dollar index chart



Nearby heating oil (diesel) chart



Thank You!

Bret Oelke

oelke002@umn.edu

218.770.2428

