Margin Management Since 1999

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Volume 1, Issue 1 February, 2014

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A New Publication Designed For Producers Looking to Better Manage Forward Profit Margins

Dear Ag Industry Associate,

Welcome to the inaugural issue of *Margin Manager,* a new publication focused on the forward profit margins of crop and livestock producers. It is hard to believe that five years have already passed since our first *Margin Watch* report was released. We set out to write *Margin Watch* as a means of informing the various industries we work with about the risk and opportunities that exist, as well as how and why margins were changing over time.

The *Margin Watch* report continues to serve that purpose, and you will find the latest editions in the pages to follow which highlight the current profit margin profiles of the crop, hog, dairy and beef cattle industries. In addition to those reports, here you will find many other valuable additions to this publication.

Leveraging 15 Years of Experience

Through feedback from our educational seminars, interviews and testimonials, we have received a wealth of information on how the margin approach has changed people's thinking and perception of risk.

We want to share these insights with you so that you may better understand what margin management is, how it works and what it allows people to do. In addition, you will find educational topics that highlight specific focal points of the margin management process, as well as articles that share specific stories about margin management in action.

It is our hope that you will come away with a deeper appreciation for why we are passionate about this approach to managing risk, and how it can benefit you and your business.

Sincerely

Chip Whalen

Managing Editor, Chip Whalen is the Vice President of Education and Research for CIH, a leader in Margin Management. Over the past 15 years, Mr. Whalen has lectured extensively throughout the country, introducing agricultural lenders, producers and industry associates to the margin approach to risk management. He has also written articles for many leading agricultural publications.

How is the futures market used to project profit margins?

Starting with Price Discovery

Very simply, your profit margin is your revenue minus your expenses. In order to figure out what this is in a future time period, you will need to estimate your input costs and your sales value. In some cases, this will be pretty straightforward.

For example, if you have locked in a cost or can determine an expense with reasonable accuracy such as for land, this will be known. Other costs however or the sale value of your product will be more a function of market dynamics in a deferred time period which are largely unknown.

The futures market is referred to as a price discovery mechanism in that buyers and sellers from all over the world actively place bids and make offers to buy or sell contracts on underlying commodities such as corn, soybeans, wheat, hogs, milk and cattle in future time periods. While the price discovered today on these commodities for delivery or settlement in a future time period may change, the futures market provides a means for these buyers and sellers to discover the value of these commodities daily.

Also, because a wide range of buyers and sellers are participating in this open auction process, the market is said to be an unbiased estimator of the forward price expectation.If you are buying or selling agricultural commodities tied to these futures contracts such as corn for example to feed hogs or cattle, the futures price can serve as a proxy for the anticipated cost or revenue for your operation.

It does not matter whether or not the futures price is correct about the eventual value that will prevail in the spot market. What matters more is the price can serve as a reference for your anticipated costs or revenues in that these prices are unbiased and coming from an active, dynamic market. How the prices the futures market discovers relates to the prices you pay or receive for the commodities you buy and sell in your local market is a function of how these values correlate to one another.

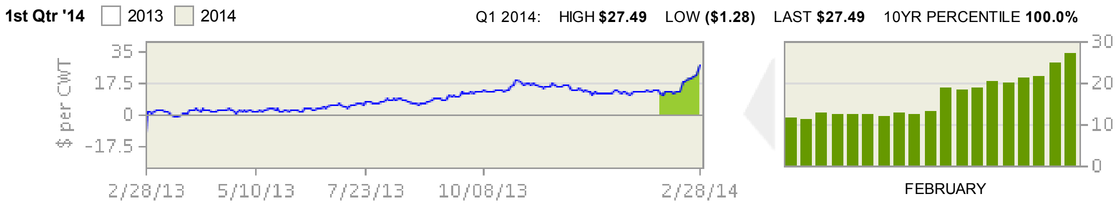
> "If you can determine that there is a strong correlation for prices you pay and receive in your local market to futures prices on the exchange, then the futures market can be used to model your revenues and expenses."

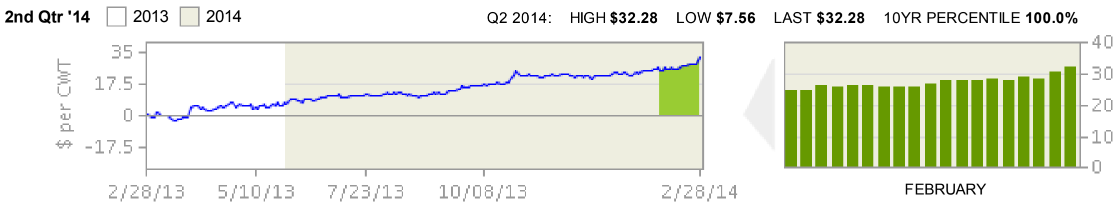
The Power of Strong Correlations

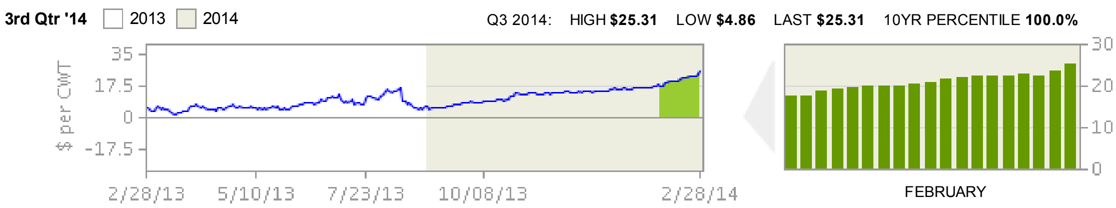
Correlation is a degree of association between two or more factors – in this case, a cash price in your local market to a futures price on an organized exchange. If you can determine that there is a strong correlation for prices you pay and receive in your local market to futures prices on the exchange, then the futures market can be used to model your revenues and expenses. In this way, the price discovery role of the futures market becomes a margin discovery tool by extension, and allows you to effectively model your profitability in a forward time period.

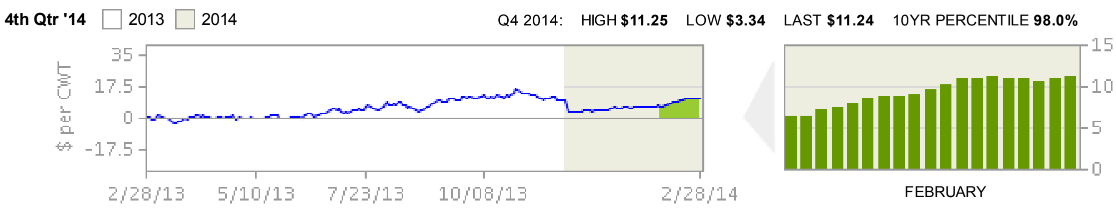
While other considerations need to be built into a profit margin model that accurately reflect your unique operation and local cash market dynamics, the futures market will be a central part of modeling forward profitability.

Hog margins continued to soar over the last half of February as hogs rose sharply during the past two weeks – up over $12.00/cwt. in the spot April contract alone. While both corn and soybean meal rose as well during the period, the strength in hogs more than made up for increased expenses on the feed side. Margins made new all-time highs in both nearby Q2 and Q3, while they remain near the 95th percentile in Q4 and the 90th percentile in Q1 of 2015. The hog market continues to draw support from surging cash prices with packers bidding up for hogs. This comes despite the fact that hog slaughter totals year-to-date are very similar to last year, and pork production is actually up 4.3% year-over-year during the six-week period between January 18 and February 22 when factoring in the higher slaughter weights of animals coming to market. While spot demand for pork is obviously strong, there remains concern over future supplies in Q2 and beyond given the latest AASV data that showed 310 positive new cases of PEDv for the week ending February 16 with past weekly data revised higher as well. PEDv cases have more than doubled since mid-December and are up several fold since last summer which is keeping firm support in deferred contracts. Meanwhile, the unrest in Ukraine with Russia occupying the Crimea has caused corn prices to spike due to concern about potential grain supply disruption out of the Black Sea. The issue also raises questions over recent news that Russia will commence purchases of U.S. pork after March 10 given the negative response from the U.S. over Russia's actions in the region. Our consultants have been actively monitoring hog positions with clients to evaluate margins within the context of the open market. It may make sense in some cases to add flexibility back to hogs at a cost given the current uncertainty with the next USDA Hogs & Pigs report still weeks away.









The Hog Margin calculation assumes that 73 lbs of soybean meal and 4.87 bushels of corn are required to produce 100 lean hog lbs. Additional assumed costs include $40 per cwt for other feed and non-feed expenses.

Three Questions With Dairyman, Steve Whitesides

Below you'll find a brief excerpt from a conversation between Margin Manager contributor, Brendan Dorais and Idaho dairyman, Steve Whitesides. To view the entire conversation, please visit www.cihedging.com/testimonials.

BD: What's the most difficult task in your operation?

SW: I'd say the volatility that we go through in pricing ... I remember when milk prices would move a dime or quarter and that was fairly big moves. Today you can limit a dollar up one day and be down fifty cents the next day so there's a lot of volatility that we deal with ... so you not only have to do a good job of producing the the milk product and crops but you have to do a good job marketing. You could lose out and not be profitable just on the fact that you lost out on marketing.

BD: Do you set alerts for margin targets?

SW: We do. We'll hit that 75% alerts. We watch those and it's interesting to see what made the alert trigger, whether it was on the commodites side, the feed or if it was the milk side. Because sometimes you'll see milk hasn't moved much or the commodities backed off, so that's where your margins come into it. By watching those margins I think that's where your opportunities come in. Because if you're just watching one side of it, you're not always seeing the whole picture.

BD: What does CIH Dairy Margin Consulting bring to the table?

SW: They bring us different ways to hedge. It might be selling the futures or it might be a three-way position, or a two-way position. And I think the discipline of having a weekly phone call is good too. In previous experience we would call as the market moved one way or

"By watching those margins I think that's where your opportunities come in. Because if you're just watching one side of it, you're not always seeing the whole picture."

SW (Cont'd): another. But I think we've gained knowledge. It's almost like going to school on a weekly basis for your marketing as you talk about the things that are taking place in the markets and how the commodities have moved. Or how milk has moved and you look at those positions and say okay how do you want to hedge that. CIH recognizes what we're comfortable with too.

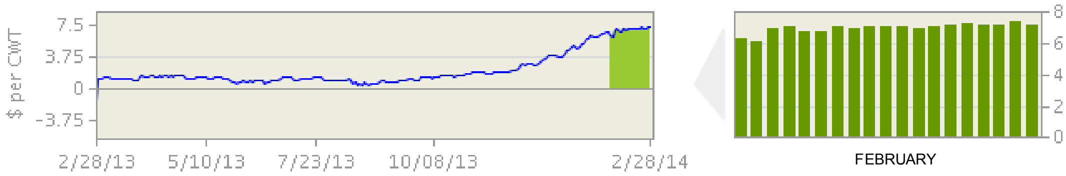
To watch the entire interview with Steve please visit:
www.cihedging.com/testimonials.

CIH will be conducting a full slate of educational programs in 2014. Learn more:
www.cihedging.com/education.

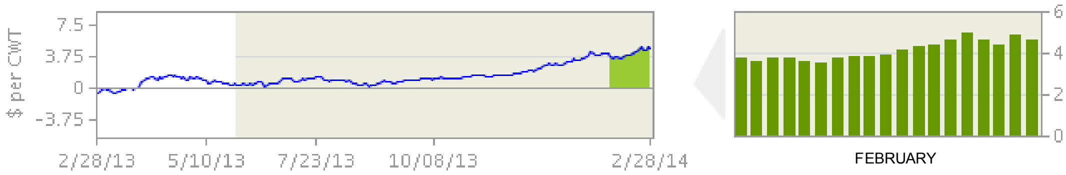
Dairy Margin Watch: February

Dairy margins strengthened over the second half of February, with higher milk prices more than offsetting increased feed costs. Nearby margins in spot Q1 and Q2 essentially remain at the 100th percentile of the past 10 years, while deferred margins in Q3 and Q4 are at the 94th and 89th percentiles, respectively. As expected, higher milk prices appear to be encouraging increased milk production, with the latest report from the USDA showing January milk production of 17.3 billion pounds – up 2.8% from December and 0.9% above last year. Cheese prices remain very strong, with block cheddar on the CME spot market on its second-longest run in the past 10 years above $2.00/lb. There is some concern however moving forward that high prices for both cheese and beef could negatively impact demand moving into the grilling season (if the U.S. ever thaws out). Unrest in Ukraine meanwhile has added some risk premium back to grain prices, although the main grain export terminals in the Black Sea are far removed from the Crimean flashpoint. USDA will update their next monthly WASDE for the corn and soybean markets on March 10. At the end of the month, USDA will provide both the Prospective Plantings report for 2014 as well as March 1 quarterly grain stocks. Our consultants are actively monitoring existing margins with clients in the context of the open market to evaluate merits of adding flexibility back to milk hedges given the underlying strength of the market. At the same time, extending coverage further out as far as Q1 of 2015 continues to make sense given the historically strong margin opportunities that are currently available.

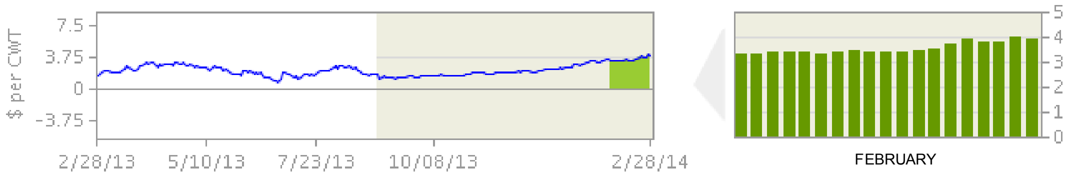
1st Qtr '14 2013 2014 Q1 2014: HIGH **$7.39** LOW **$0.39** LAST **$7.24** 10YR PERCENTILE **99.9%**



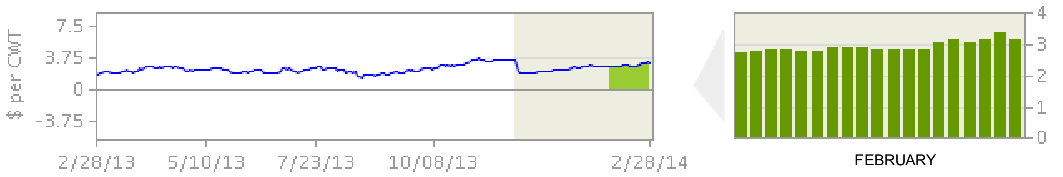
2nd Qtr '14 2013 2014 Q2 2014: HIGH **$5.03** LOW **$0.27** LAST **$4.67** 10YR PERCENTILE **99.8%**



3rd Qtr '14 2013 2014 Q3 2014: HIGH **$4.07** LOW **$1.24** LAST **$3.97** 10YR PERCENTILE **94.3%**



4th Qtr '14 2013 2014 Q4 2014: HIGH **$3.36** LOW **$1.99** LAST **$3.20** 10YR PERCENTILE **89.2%**



The Dairy Margin calculation assumes, using a feed price correlation model, that for a typical dairy 62.4 lbs of corn (or equivalent) and 7.34 lbs of meal (or equivalent) are required to produce 100 lbs of milk (includes dry cows, excludes heifers not yet fresh). Additional assumed costs include $0.90/cwt for other, non-correlating feeds, $2.65/cwt for corn and meal basis, and $7.00/cwt for non-feed expenses. Milk basis is $0.75/cwt and non-milk revenue is $1.00/cwt.

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Beef Margin Watch: February

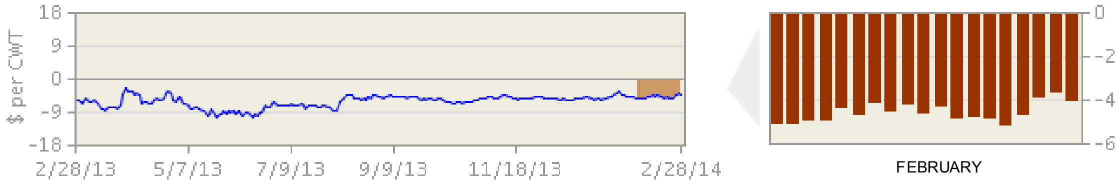
Beef margins strengthened in the second half of February, although they remain negative for all but the spot April marketing period. Both cattle prices and feed costs increased over the past two weeks, although the value of fat cattle has improved by more than the costs of feeders and corn during the period. Grain prices have added risk premium recently following the unrest in Ukraine, with Russian troops moving into the Crimea and raising concerns with the international community. While the main grain ports in the Black Sea are far removed from the Crimean flashpoint, the situation has raised a degree of uncertainty the market is clearly uncomfortable with. Cattle prices continue drawing support from the extremely cold weather across the Central U.S., and current feedlot supplies which are causing packers to bid up in the spot market. Meanwhile, supplies of imported beef are also down year-over-year which is also adding support to the market. While our consultants continue monitoring forward profit margin opportunities with clients, they are also considering adjustments in existing positions. Adding flexibility back to corn hedges appears increasingly attractive following the recent price strength.

Live Cattle Marketing Periods:

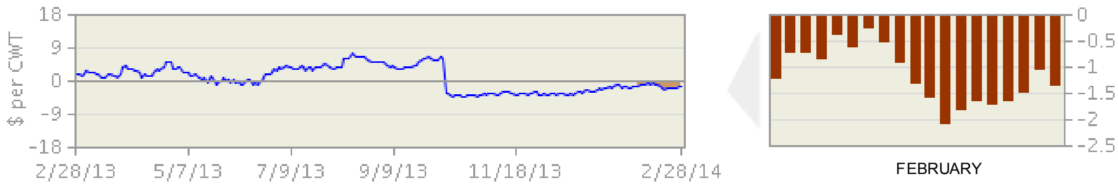
Apr '14 2013 2014 Apr 2014: HIGH **$14.81** LOW **($7.79)** LAST **$14.81** 10YR PERCENTILE **100.0%**

Jun '14 2013 2014 Jun 2014: HIGH **$0.75** LOW **($12.86)** LAST **($0.27)** 10YR PERCENTILE **93.2%**

Aug '14 2013 2014 Aug 2014: HIGH **($2.24)** LOW **($10.30)** LAST **($4.00)** 10YR PERCENTILE **76.4%**



Oct '14 2013 2014 Oct 2014: HIGH **$7.64** LOW **($3.95)** LAST **($1.37)** 10YR PERCENTILE **65.7%**



Dec '14 2013 2014 Dec 2014: HIGH **$13.61** LOW **($4.04)** LAST **($1.56)** 10YR PERCENTILE **73.5%**

Three Questions With Cattleman, Russ Keast

Below you'll find a brief excerpt from a conversation between Margin Manager contributor, Michael Shawver and cattleman, Russ Keast. The two caught up at CIH's training center, where Russ was attending a Strategic Position Management seminar. To view the entire conversation, please visit www.cihedging.com/testimonials.

MS: Tell us what attracted you to the margin approach.

RK: Seeing the presentation of data, and the percentile of where you're at today as compared to where you've been at three, five, ten years in the past. You can look at margin easily for different time periods going back three, five, ten years. Who's ever seen that? Nobody. And I've been doing this since 1980.

MS: To fully implement the margin approach to marketing cattle, do you need a different mindset?

RK: You can go months and months and months with negative margins. Losses. Knowing that, you refine your thought process. When you look at a positive margin in the future, yeah it could be more positive, but that's a lot better than getting ground into the dirt by a 200-300 dollar a head loss. We've seen many of those. At 30-40-50 dollar margin, we take that, put it in the bank and move onto the next day ... In the feedlot business, it's not the once every five years having home runs. Because the other times will destroy you. It's the slow hare that wins the race.

MS: How important is the education component to the margin approach?

RK: It's very important. I never stop learning. Taking this Strategic Position

> "In the feedlot business, it's not the once every five years having home runs. Because the other times will destroy you. It's the slow tortoise that wins the race. "

RK (cont'd): Management class, it was a great session, learned a lot about the flexibility and when to use the flexibility in the different types of contracts and hedging. The simulation is very powerful, brings it to life... It's very fascinating how you can change the delta and slide up and down with the amount of risk you want to accept. I didn't think adjustments were needed but you can see after this class that adjustments really can make or break a position. Knowing this is very helpful.

To hear the entire interview with Russ please visit:
www.cihedging.com/testimonials.

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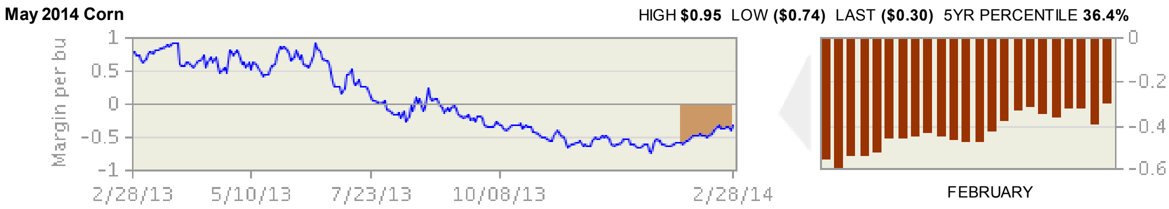
Corn Margin Watch: February

Corn margins have improved over the last part of February in part due to stronger demand as well as basis appreciation. U.S. exporters have continued to commit bushels for future delivery having sold roughly 89% of the current USDA forecast. While forward sales remain strong, the pace of shipments continues to lag what is needed to meet the USDA estimate. Currently, exporters have shipped 43% of the forecast compared to 48% on average for this point in the year. Regarding the coming new crop supplies, the USDA released its annual 10-year outlook and sees corn plantings this coming year near 92 million acres with yields around 165 bushels per acre and increasing ending stocks. It is important to note that these are macroeconomic expectations and not an official estimate from the agency. The take-away from the report is that the USDA expects domestic supplies to grow further as expected production exceeds expected demand. Revenue Protection insurance for new crop is pegged at $4.61 this year $1.04 below last year's insurance level. On the global front, South American harvest has continued smoothly and expectations for a sizable crop remain. The market has shifted its focus to the happenings in Ukraine as the conflict within the country has escalated. The USDA currently estimates corn exports from Ukraine at 18.5 million metric tons. It has been reported that exporters have rushed to sell supplies recently in all likelihood to generate cash. A continuation of this conflict would put future exports in jeopardy. Nearby margins are now at the 36th percentile of the last five years, while deferred 2014 margins are now at the 37th percentile. Our consultants are working with clients discussing margin protection of these forward values, particularly for deferred margins that are near breakeven. Some of our clients continue to hold protection strategies that create a range of protection to lower prices while also establishing a ceiling above where they would be willing to sell, as both domestic and global supplies are more than adequate to meet current demand.



The estimated yield for the 2014 crop is 166 bushels per acre and the non-land operating cost is $583 per acre. Land cost for 2014 is estimated at $240 per acre [1]. Basis for the 2014 crop is estimated at $0.02 per bushel.

The estimated yield for the 2015 crop is 184 bushels per acre and the estimated operating cost is $547 per acre. Land cost for 2015 is estimated at $240 per acre [1]. Basis for the 2015 crop is estimated at $-0.18 per bushel.

[1] The Corn Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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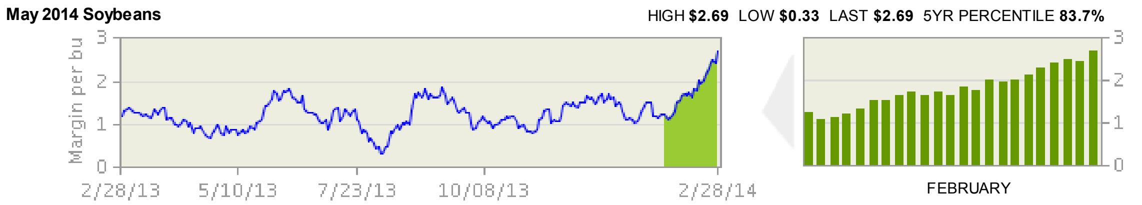
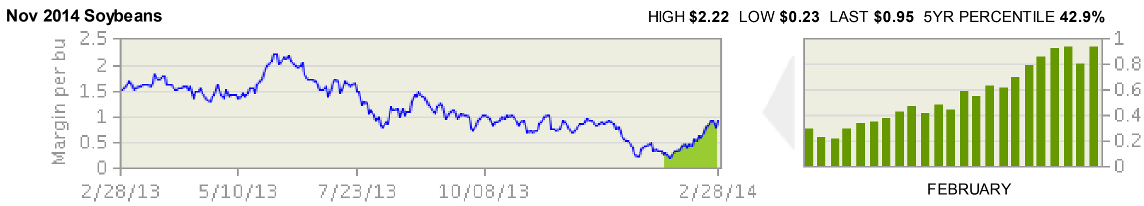
Soybeans Margin Watch: February

Soybean margins have increased modestly over the last half of February as export demand remained stout. Exporters have committed 106% of the USDA's 1.51 billion bushel export estimate with six months remaining in the crop year. Shipments are also well ahead of the pace needed to meet the USDA's estimate with 88% of that forecast already shipped. The market has begun to focus on Chinese demand of late as crush margins there have been collapsing. Soybean meal prices in China continue to fall on oversupply and weakening demand leaving crushers with negative margins. Given the weakness in China, the market continues to brace itself for potential export cancellations as well as the possibility for China to push back the timing for future shipments which presently has only occurred to a small degree. Regarding the coming new crop, the USDA released its annual 10-year outlook and expects soybean plantings to approach 80 million acres with yields around 45 bushels per acre resulting in higher expected ending stocks. This outlook is an unofficial estimate from the USDA but does provide the marketplace with a baseline for the future. Revenue Protection insurance levels have been set at $11.36 this year which would keep most producers above breakeven. On the global front, Brazilian harvest is estimated to be over 40% complete as of March 1, with harvest results showing better yields this year as expected. South American export offers are roughly $1.00 per bushel below U.S. offers and represents significant competition to the U.S. market going forward. Nearby margins are now at the 83rd percentile of the last five years and deferred 2014 margins are now at the 42nd percentile. Our consultants are actively working with clients discussing margin protection of these forward values, particularly for nearby margins that were recently near average. Many of our clients are looking to make adjustments to protection strategies that add delta to their position to capitalize on the higher market as future demand prospects are diminishing.



The estimated yield for the 2014 crop is 49 bushels per acre and the non-land operating cost is $330 per acre. Land cost for 2014 is estimated at $240 per acre [1]*. Basis for the 2014 crop is estimated at $0.18 per bushel.*

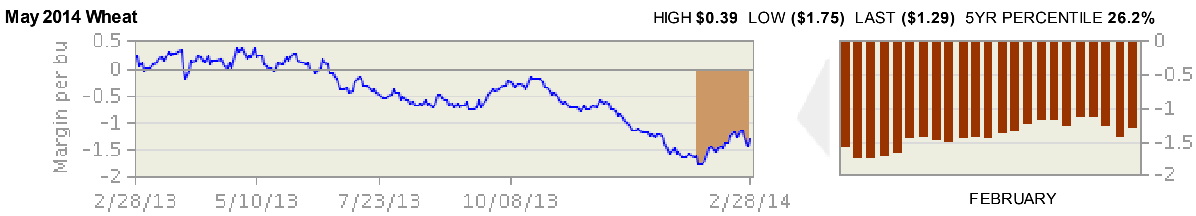


The estimated yield for the 2015 crop is 53 bushels per acre and the estimated operating cost is $319 per acre. Land cost for 2015 is estimated at $240 per acre [1]*. Basis for the 2015 crop is estimated at $-0.2 per bushel.*

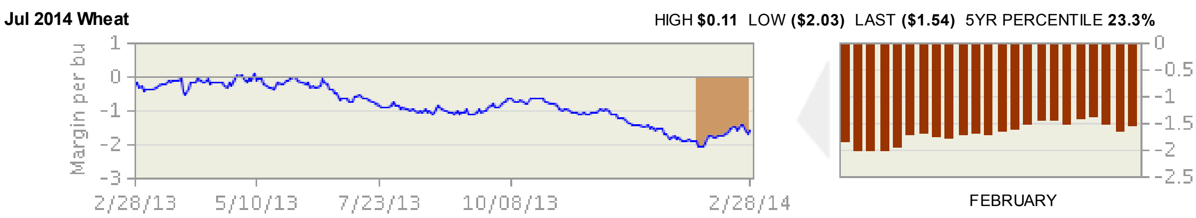
[1] *The Soybeans Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.*

Wheat Margin Watch: February

Wheat margins have weakened over the last two weeks of February giving back some gains posted earlier in the month. Domestically, demand has remained firm for exports as international competition has waned to a degree. Export sales and shipments remain above the pace to meet the USDA estimate with three months remaining in the crop year. The domestic winter crop will exit dormancy shortly with spring weather eyed. Winter wheat crop conditions were last reported at the end of November showing 62% of the crop in good-to-excellent condition, well ahead of what would be average at 53%. Conditions going forward will hinge on spring moisture. Losses in production due to winterkill will become apparent once the crop is fully out of dormancy. On the global front, the recent unrest in Ukraine has the marketplace on edge with many questions as to the future for Ukraine as a viable exporter. The main grain export ports are located in the western part of the country which is not currently occupied by any foreign military forces. Any further escalation to the conflict will add further uncertainty and will likely force potential importers to seek supplies from more reliable sources. As spring approaches, logistical snarls will begin to sort out for Canada which has been hit hard this winter. Transportation routes will become passable with last year's record production then able to get to the global marketplace. Nearby margins are now at the 26th percentile of the last five years. Deferred 2014 margins are now at the 23rd percentile. Our consultants are working with clients discussing these forward margins, particularly nearby margins that not too long ago were approaching the 10th percentile. Some of our clients that hold protection strategies continue to consider adjustments to that protection that would add delta to the strategy to capitalize on the higher market as the world remains well supplied.



The estimated yield for the 2014 crop is 67 bushels per acre and the non-land operating cost is $360 per acre. Land cost for 2014 is estimated at $150 per acre [1]. Basis for the 2014 crop is estimated at $0.3 per bushel.



The estimated yield for the 2015 crop is 65 bushels per acre and the estimated operating cost is $339 per acre. Land cost for 2015 is estimated at $150 per acre [1]. Basis for the 2015 crop is estimated at $-0.1 per bushel.

[1] The Wheat Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.