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Beef, Sep 16 (Twin Falls)

Lenders - Sep 17-18 (Chicago)

Hog, Dec 9-10 (Chicago)

Crop, Dec 17-18 (Chicago)

Dear Ag Industry Associate,

The forward margins for hog and dairy producers continue to present phenomenal opportunities to protect profitability well into 2015, while those of crop and beef cattle producers are looking more challenging for the upcoming year. The different outlooks for these industries illustrate the importance of having a plan to address opportunities when they present themselves. This issue of *Margin Manager* addresses the importance of having a good plan in place, and how sticking to that plan can breed success over the long term.

We have discussed the topic of having a margin management plan in previous issues, but this month we studied a group of clients who shared success stories with us following their plans over the past several years. Our feature article, "What Margin Management Makes Possible," tells the story of these producers who were able to achieve long-term goals through careful planning and execution of a margin management plan.

In executing a plan, many of our clients find that having a strong team in place to reinforce the goals and objectives is critical to success. We sat down with senior hog consultants, David Ward and Gavin McPherson, to talk about the critical role lenders play in margin management and some of the tools CIH has created to help producers manage margins.

As always, the latest *Margin Watch* projections for the crop, beef, hog and dairy industries are included as we track how profitability has changed over the month, and the factors driving those changes.

Sincerely,

Chip Whalen
Managing Editor
V.P. Of Education & Research
CIH

Managing Editor, Chip Whalen is the Vice President of Education and Research for CIH, a leader in Margin Management. He teaches margin seminars throughout the country and can be reached at cwhalen@cihedging.com

Futures and options trading involves the risk of loss.

A Conversation with Hog Margin Consultants, David Ward and Gavin McPherson

This interview was conducted by Brendan Dorais, Vice President of Business Development, CIH.

Q: You've helped hog producers manage profit margins for over ten years. Tell me how you've seen the role of the producer's lender change.

A: The role of the lender has changed as the risk to the producer has changed. 10-15 years ago packers were offering cost plus or window contracts. For most producers, this was a large part of their risk management plan. As those contracts went away more risk management fell on the producers shoulders. Over the last 5 years hog production has become increasingly capital intensive. Building and operational costs have increased, with the drought in 2012 feed prices have increased and only recently have come down, and with PED there is added human resource and transportation costs to keep the inventory you have to market. All of this has led to needing more capital to run and build a business and relying more on a good lender to understand and fund it.

Q: Given the critical role of the lender in a margin management plan, at what point in the planning process do you recommend producers involve their lender?

A: One of our first activities with a client is to help them identify how much price risk they are exposed to in corn, soybean meal, distillers and hogs. We then work with our clients to build a margin management policy. Generally, the policy consists of profit margin levels that trigger coverage using pre-approved contracting methods and strategies that can go out as far as 18 months into the future. Once the client has reached this point with CIH, it is time to describe that plan to the lender. We work closely with the client to help the lender understand the plan and provide the lender with regular updates. We strongly encourage regular reviews of the margin management plan with the lender. Many times we find that the more informed the lender is kept on a regular basis on how the client is protecting strong forwards margins the more comfort they have on supporting not only the margining of that position but also the growth initiatives the client has in their operation.

> ***CIH understands the importance of the "team concept" and has invested heavily in building tools that were specifically designed to foster this collaboration … to make things transparent … to facilitate communication.***

Q: To what extent does the lender stay involved in your relationship with the producer?

A: As much as the producer would like. CIH understands the importance of the "team concept" and has invested heavily in building tools that were specifically designed to foster this collaboration…to make things transparent…to facilitate communication. In some cases, clients have asked to create a view only login for lenders to the client's website so they can keep a very

close track of what is going on. In most cases, however, it will be a quarterly or annual meeting with the lender to specifically address current and forward positions and goals for risk management into the future.

Q: Give me an example of a helpful tool created by CIH.

A: One powerful tool is the Capital Monitor. It monitors a producer's capital outlay of exchange-traded positions, which you can stress-test with hypothetical changes in the market. For example, given my current position what if feed came down 10% while hog went up 10%, what would my capital requirement be? Also what if I added 15% to my position and then that happened. It allows both the client and lender to test what if scenarios so everyone is informed on potential increases or decreases in markets and how that may affect an operation's margins and their capital requirements. These are all tools that work towards keeping everyone informed.

Q: Tell us about a recent success story regarding a new margin management client and their lender?

A: This summer we had a relatively new client protecting a small percentage of their operation's margin and wanted to add more margin protection. They didn't believe their lender would support a larger loan for them because of hedge losses on existing positions due to the strong cash markets we were experiencing. Our first step was to have a meeting with the client and their lender to review the margin management plan and show the lender the coverage the client would like at add at the current, very attractive margins. To the client's surprise, the lender was quite pleased to see the forward opportunities and encouraged the client to continue adding coverage as planned.

Q: What do lenders expect of margin management clients and CIH?

The Capital Monitor tool allows both the client and lender to test what if scenarios so everyone is informed on potential increases or decreases in markets and how that may affect an operations margins and their capital requirements.

A: They want their clients and CIH to: A) Maintain a margin management approach; keep feed coverage in balance with hog coverage. B) Work to develop a plan that ideally, and incrementally, increases coverage as margins improve. C.) Remain objective, follow through with the plan, and make the planned adjustments as needed. Over time, lenders want to see their clients and CIH stay true to the margin management plan.

Interested in learning how CIH can help your operation make better risk managment decisions?

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Hog Margin Watch: August

Margins recovered since the middle of the month following a bounce in the hog market while feed costs held relatively steady over the second half of August. From a historical perspective, hog finishing margins continue to exist at very strong levels of profitability – at or above the 90th percentile of the previous 10 years through the first half of 2015. Most of the margin improvement in the past two weeks has occurred in more deferred slots, on ideas that hog futures have become oversold. The CME Lean Hog index continued to decline however through the end of the month, dropping another $17.56/cwt. or 15% since mid-August. The index finished the month out down $29.05/cwt. or 23% since the end of July. USDA Cold Storage data revealed total pork in freezers at the end of July equaled 529.2 million pounds, down 1.5% from June and 2.7% lower than last year but 6.8% higher than the five-year average. Pork belly inventories of 64.7 million pounds were 129% higher than last year and 93% higher than the five-year average. Almost one-third of the decline in the cutout value recently is due to weakness in bellies. Corn and meal prices meanwhile have held relatively steady since the middle of the month, although there has been particular strength in spot soymeal prices. A lack of availability of old-crop soybeans and a slowing domestic crush pace heading into harvest has combined to significantly limit soybean meal supplies in the cash market. Pro Farmer completed their annual crop tour pegging corn yield and production at 169.3 bushels per acre and 14.093 billion bushels, respectively. The soybean crop was pegged at a yield of 45.35 bushels per acre with production estimated at 3.812 billion bushels. Our clients have been scaling into more deferred coverage following the improvement in forward margins using flexible strategies that will benefit from further margin improvement. Recent adjustments to add flexibility back to existing hog hedges has also proved timely after the bounce.

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.

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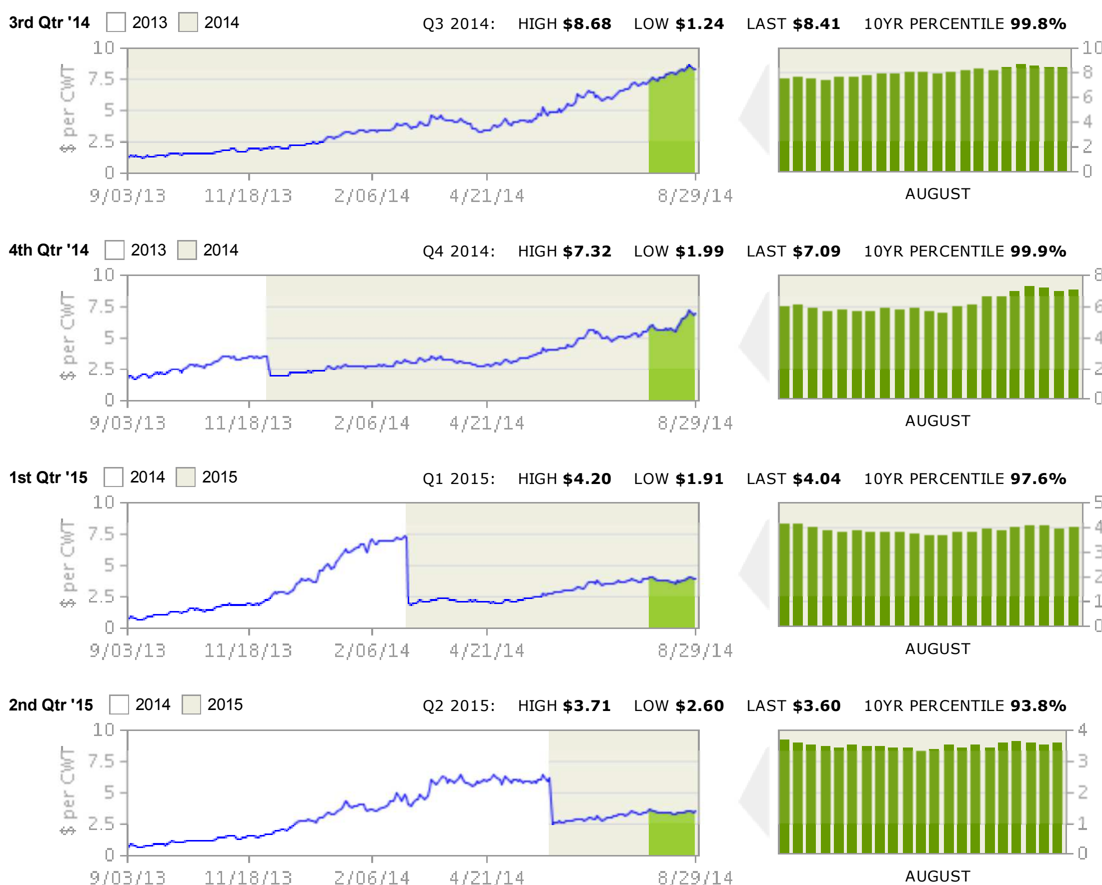
Dairy Margin Watch: August

Dairy margins improved since the middle of August, particularly in Q4, following a surge in milk prices as feed costs held relatively steady over the past 2 weeks. From a historical perspective, margins continue to exist well above the 90th percentile of the previous 10 years through the first half of 2015. Milk prices have advanced despite a bearish milk production report that is signaling expansion. July milk production totaled 16.4 billion pounds, up 4.0% from last year with June revised production of 16.2 billion pounds up 2.3% from last year. The revised figure was up 50 million pounds or 0.3% from the preliminary estimate. Production per cow averaged 1,911 pounds during July, up 61 pounds from last year and the highest production per cow for the month of July since the series began in 2003. The number of milk cows on farms in the 23 major states was 8.58 million head, 56,000 more than last year and up 6,000 head from June. The monthly Cold Storage report revealed friendly data for butter in particular, with stocks at 170.2 million pounds – down 42.4% from 2013. Cheese stocks were unchanged from June at 1.06 billion pounds, but down 7.9% from last year. Pro Farmer finished their annual summer crop tour, pegging the U.S. corn crop at 14.093 billion bushels with a yield of 169.3 bushels per acre. Soybean production was pegged at 3.812 billion bushels with a yield estimate of 45.35 bushels per acre. The corn estimate is above the current USDA projection while the soybean figure is nearly identical. Most traders and analysts expect USDA to raise both estimates in the September WASDE. Our clients continue to favor flexible strategies in deferred periods to build margin protection into 2015. The use of flexible strategies on existing positions has proven effective, particularly in Q4 following a sharp improvement in milk prices over the past few weeks.



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: August

Beef margins were mixed since the middle of August, improving in nearby marketing periods but deteriorating in deferred slots. A surge in cattle futures helped nearby periods where feeder costs have already been realized, while higher feeder cattle prices in deferred periods more than offset higher live cattle prices, with feed costs steady over the past two weeks. Margins remain negative from the April marketing period forward, presenting a challenging environment for cattle feedlots contemplating fall placements. Fundamental data for the beef market has been mixed recently, with the monthly Cattle on Feed report slightly bearish but the Cold Storage figures supportive. USDA August 1 Cattle on Feed inventory was reported at 9.837 million head, down 1.9% from last year versus the average estimate anticipating a 2.5% drop from 2013. July placements were down 7.4% versus expectations of a 9.4% decline, and there was a continuation of the recent trend of lighter weight placements which will extend the marketing window on those animals. Meanwhile, beef inventories in Cold Storage were reported at 366.5 million pounds, down 21% from last year and the lowest July inventory level since 2001. Moving forward, the surge this year in beef imports from Australia and New Zealand is unlikely to continue which should help support beef prices given the current inventory levels. Corn prices have stabilized recently after a steady drop over the past few months. Pro Farmer completed their annual crop tour, pegging corn production at 14.093 billion bushels with a yield of 169.3 bushels per acre. The figure is above the current USDA forecast, although there are widespread expectations for that estimate to grow in upcoming WASDE reports given early harvest results. Our clients continue to carefully evaluate placement opportunities given negative forward margins, while actively managing existing positions. Recent adjustments to add flexibility back to cattle hedges has proven timely following the increase in price. Strengthening corn hedges also continues to look attractive in the current environment.

Live Cattle Marketing Periods:

Oct '14 2013 2014 — Oct 2014: HIGH **$22.65** LOW **($5.17)** LAST **$14.21** 10YR PERCENTILE **98.9%**

AUGUST

Dec '14 2013 2014 — Dec 2014: HIGH **$13.61** LOW **($4.04)** LAST **$3.90** 10YR PERCENTILE **94.6%**

AUGUST

Feb '15 2014 2015 — Feb 2015: HIGH **$23.63** LOW **($2.95)** LAST **$4.55** 10YR PERCENTILE **91.1%**

AUGUST

Apr '15 2014 2015 — Apr 2015: HIGH **$16.34** LOW **($6.11)** LAST **($3.86)** 10YR PERCENTILE **31.0%**

AUGUST

Jun '15 2014 2015 — Jun 2015: HIGH **$7.24** LOW **($11.61)** LAST **($9.91)** 10YR PERCENTILE **12.5%**

AUGUST

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The Beef Margin calculation uses Feeder Cattle futures to price inbound animals and assumes each will consume 55 bushels of corn and cost approximately $250 per head (for other feed and non-feed expenses) to gain 550 pounds and reach a market weight of 1,250 pounds.

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Fort Morgan, CO - Oct 7
Garden City, KS - Oct 28
West Point, NE - Nov 18

Learn more: www.cihedging.com

What a Margin Management Plan Makes Possible

In previous articles, we discussed the topic of having a Margin Management Plan and how it can provide a roadmap or give direction to achieving profitability within an organization. We also discussed basic components of a plan and how one might be constructed and implemented. One of the items that perhaps didn't get as much attention in those two articles though is what a margin management plan makes possible.

We recently reviewed some margin management plans our clients had written that included very specific longer-term goals to help them gain greater control over their operations. By developing a consistent approach to managing forward margins, these producers were rewarded by viewing annual profitability targets as stepping stones to accomplishing future goals. In this article, we will share with you some success stories of producers who have employed a Margin Management Policy over the years and what their plan has allowed them to accomplish today.

"By developing a consistent approach to managing forward margins, these producers were rewarded by viewing annual profitability targets as stepping stones to accomplishing future goals."

A pork producer in the Upper Midwest committed to a longer term goal of expanding their production through additional sow ownership. They developed a margin management plan to achieve set profitability targets in order to start building equity for their expansion plans. As equity built in the operation following a few good years of profitability, the company began talks of expanding and doubling their production. The plan had been approved by ownership and required additional capital from the company's lender to get the project underway. Discussions with the lender began in late 2011 when the company disclosed their forward hedge positions that represented future profits for the organization at historically strong levels for all of 2012 production. As the year progressed and discussions continued with the lender, the profitability of hog producers on the open market changed dramatically, going from a historically strong level to an extremely poor situation that represented large losses. Still hedged, the operation showed its lender how their 2012 year would pan out. In addition, they also had the ability to show what the profitability on the proposed expansion production would look like for the initial farrowings, as well as their plan on managing that forward risk. The consistency of positive margins in previous years coupled with a well-defined plan gave the lender confidence to outlay capital for expansion during one of the worst times of profitability for a hog producer in the last 20 years, and as a result, they are now reaping large returns on that additional production today.

Another pork producer in the Western Corn Belt had been working through a margin management plan determining how profitability would be protected over the years. This producer was at a competitive disadvantage relative to his peers given that the operation had to purchase weaned pigs on the open market as they did not own sows. This added to the operation's costs and resulted in tighter margins. The producer modified his margin management plan to achieve multiple goals, but principally wanted to gain greater control of the bottom line by owning their pig supply. Over three

Futures and options trading involves the risk of loss.

years of wild profitability swings on the open market, the operation achieved steady returns following their margin management plan and eventually was able to purchase enough sows to reach the same output that they had been producing the previous three years. With the main goal accomplished, the producer modified his margin management plan to focus on growing the sow herd and expanding production. Over the past five years, this operation has taken control of their pig supply and has also doubled their previous production, achieving two separate long-term goals the company had defined as strategically important.

As a third example, a dairy producer had been new to using futures and options as contracting tools, but understood the importance of having a plan and setting targets to protect profitability. This was particularly evident to the producer following the devastating negative margins suffered in the open market during 2009 into early 2010. This operation had issues in the past sourcing feed for the dairy herd and wanted to alleviate that burden. After some time educating himself on futures and options through his consultant, the dairy producer incorporated strategies in the company's margin management plan that allowed for flexibility to participate in better margins over time. Posting performance bonds and meeting margin calls were things this operation could not support, so using a combination of cash contracts along with options that complimented those positions allowed the producer to retain flexibility in their pricing. Challenging as it was to spend money on option premium, the dairy executed this new plan while continuing the operation's typical cash transactions. The flexibility proved useful as margins began a period of volatility, and having the ability to manage the option positions over time resulted in better margins than initial expectations. Today, the dairy now owns enough crop ground to feed the operation's herd and also has excess to sell on the open market.

Well-defined, long-term goals and consistency in managing forward margins are the common threads among all three of these success stories. Regardless of the operation's goal or industry, a structured, disciplined approach to managing profitability can be the most powerful tool a producer has to attain the goals it sets out to achieve. Building a margin management plan that visualizes each year as a building block to achieving these goals has contributed to the success and growth in these operations over time. What are your goals and how will you set out to achieve them? What is your plan?

Watch Videos of Actual Producers discussing their real-life experience with the margin approach.

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Corn Margin Watch: August

Corn margins have deteriorated slightly since the middle of August as larger supply expectations re-enter trade discussions. The Annual Pro Farmer crop tour recently reported its estimates for this year's corn crop citing record yields for many areas of the Midwest. The Tour's national corn yield estimate came in at 169.3 bushels per acre compared to the USDA's current estimate of 167.4. The total production estimate was reported at 14.093 billion bushels, 61 million bushels above the USDA's current projection. Market participants have stated the results still seem slightly undercounted, but closer to what reality may be come harvest. Weather has continued to cooperate this year with crop conditions remaining relatively stable despite a seasonal tendency for conditions to deteriorate. Without an early end to the growing season through frost or freeze, this year's corn crop is on pace to attain a new record production level. On the demand side, a final ruling from the EPA on the biofuels mandate is forthcoming and should be announced by the beginning of October. Presently, ethanol margins remain profitable and provide an economic incentive to produce. Export sales for new crop remain strong as commitments for 2014/15 delivery presently stand at 392 million bushels or 23% of the USDA export expectations this year. The pace is slightly above the 10-year average for this point in the crop year. Nearby corn margins are currently at the 3rd percentile of the last five years while deferred 2014 corn margins are at the 11th percentile. Our consultants are working with clients discussing margin protection of these forward values, and continue to maintain flexibility with strategy alternatives. Given that the market has stabilized at lower levels, some of our clients continue to consider adjustments to current coverage that would create a range of protection to lower prices with consideration to crop insurance levels while preserving the opportunity for margins to improve in the event prices move higher.

The estimated yield for the 2014 crop is 180 bushels per acre and the non-land operating cost is $612 per acre. Land cost for 2014 is estimated at $243 per acre [1]. Basis for the 2014 crop is estimated at $-0.27 per bushel.

The estimated yield for the 2015 crop is 180 bushels per acre and the estimated operating cost is $612 per acre. Land cost for 2015 is estimated at $243 per acre [1]. Basis for the 2015 crop is estimated at $-0.27 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: August

Soybean margins have lost ground since the middle of August as market participants brace for increased production estimates. Recently, results from the Annual Pro Farmer crop tour were reported to be in-line with current USDA forecasts. The Tour's estimate for national yields came in at 45.35 bushels per acre with national production pegged at 3.812 billion bushels. Both figures are slightly below the USDA's expectation but still represent a record output. Without an early end to the growing season through frost or freeze, this year's soybean crop is on pace to attain a new record production level. Market prices for old-crop product have been wild over the past two weeks. End users have scrambled to secure dwindling stocks to fulfill nearby needs while trying to stay patient on extending coverage due to the expectation of large supplies come harvest which portends lower cash prices. Basis values throughout the country have increased substantially due to this old-crop competition, particularly for soybean meal, but basis is expected to stabilize at more seasonal levels as the new crop hits the combine. On the demand side, new crop export sales on an absolute basis are record large amounting to 764 million bushels sold presently, 40 million bushels above last year's total at this time. This represents 46% of the current USDA forecast to begin the marketing year compared to 27% on average. Soybean meal sales for the new crop position are also record large with commitments totaling 4.9 million metric tons, 42% of the USDA estimate compared to 11% on average. Nearby margins are now at the 18th percentile of the last five years while deferred 2015 soybean margins are now at the 20th percentile. Our consultants are working with clients to manage these forward profit margins. Given that New-Crop margins have continued to fall on increased supply worries, some of our clients are considering flexible margin protection strategies on any new coverage as well as adjustments to current protection strategies that would provide protection to all lower prices while retaining the flexibility to participate in higher margins should prices improve.

The estimated yield for the 2014 crop is 52 bushels per acre and the non-land operating cost is $364 per acre. Land cost for 2014 is estimated at $243 per acre [1]. Basis for the 2014 crop is estimated at $-0.2 per bushel.

The estimated yield for the 2015 crop is 52 bushels per acre and the estimated operating cost is $364 per acre. Land cost for 2015 is estimated at $243 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.

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Wheat margins have increased modestly again since the middle of August mainly due to increased geopolitical tensions. Black Sea tensions remain but have had little-to-no impact on global trade to date. The international news has domestic wheat prices moving in a wide range at lower levels. The marketplace has focused on Russia continuing to ship out record tonnages of wheat while also monitoring the potential for war disrupting that order. Outside of that region, world weather remains relatively ideal. Global crops are viewed as near-perfect with some concerning areas of Eastern Australia that lacks moisture and pockets of Argentina that are witnessing excess rainfall and cooler-than-normal temperatures. Domestically, prices remain subdued as adequate supplies currently meet demand projections. Adding to price pressures of late has been expectations on winter wheat seedings. Winter seedings this year are expected to be 1-1.5 million acres larger than last year for both winter varieties. Increased soil moisture across the Southern Plains is the main reason for the expectation. Drought conditions in some of the areas in Nebraska, Kansas and Oklahoma have improved substantially while other areas only modestly which validates a larger planting expectation. Nearby wheat margins are now at the 15th percentile of the past five years with deferred 2014 wheat margins now at the 18th percentile. Our consultants continue working with clients to protect these forward margins with flexible strategies that will allow for potential margin improvement over time. Given the recent stabilization in futures' prices and the continued rumblings of international conflict, some of our clients continue to consider adjustments to current protection strategies that would protect a range of lower prices while still preserving the opportunity to participate in higher prices should the market rebound.

The estimated yield for the 2014 crop is 67 bushels per acre and the non-land operating cost is $366 per acre. Land cost for 2014 is estimated at $163 per acre [1]. Basis for the 2014 crop is estimated at $-0.4 per bushel.

The estimated yield for the 2015 crop is 67 bushels per acre and the estimated operating cost is $366 per acre. Land cost for 2015 is estimated at $163 per acre [1]. Basis for the 2015 crop is estimated at $-0.15 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.

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