Your Course Includes: Each Tuesday Night Jan 27, Feb 3, Feb 10, Feb 17, Feb 24

- Understanding margin risk and its causes
- Tools to control input cost risk (land lease)
- Crop insurance and government payments to decrease margin risk
- Marketing tools to decrease risk

- Combining crop insurance and marketing tools, what is the best strategy
- Bringing it all together!
What is Margin Risk?
Estimated Variable Costs/Acre: Average Quality Indiana Land (158 bu. corn; 49 beans; 70 wheat)

Rotation CORN
- 2005: $222
- 2006: $380
- 2007: $512
- 2008: $239
- 2009: $512

Rotation BEANS
- 2005: $114
- 2006: $125
- 2007: $120
- 2008: $120
- 2009: $254

Wheat
- 2005: $98
- 2006: $112
- 2007: $119
- 2008: $119
- 2009: $254

Purdue: ID-166
Margin Exposure: Unprecedented $ of Uncertainty Per Acre: Why?

Market Prices

Yields

GOVT

Input Costs

Land Lease Costs

Rapidly Changing Environment

Time Exposure
Tenant’s View of Margin Adjustment in BioFuels Era

Pre-BioFuels

Early Phase of BioFuels

Longer-Run BioFuels
$5.00 Costs in 2009--Purdue

**Government Support Line = Target Price of**

$2.60 (02 & 03) to $2.63 in (04 to 12)

**Risk Exposure**

$5.00-

$2.63 or

$2.37/bu.
Government Support Line = Target Price of $5.80 (02 to 09) to $6.00 in (10 to 12)

Soybeans

$11.00 Costs in 2009--Purdue

Risk Exposure $11.00-$6.00 or $5.00/bu.
Breakeven Analysis
Breakeven Analysis

• Price needed to pay all costs once all other income sources are accounted for

• Variable costs
  – Fertilizer, seeds, storage…
  – Costs that would not be encountered if the crop was not planted/raised.

• Fixed costs
  – Interest on machinery loans, machinery ownership costs, utilities, buildings…
  – Costs encountered even if the crops was not planted/raised
Variable Costs

- Fertilizer
- Pesticides (herbicides, fungicides…)
- Seeds
- Custom work
- Machinery repairs
- Fuel (drying and machinery)
- Hauling
- Storage
- Crop insurance
- Interest on variable cost
Fixed Costs

- Machinery ownership cost
- Labor cost
- Building
- Utilities (Electricity, gas, telephone…)
- Land use cost (land ownership cost/rent)
Example Variable Costs (corn)

- Fertilizer $/Acre $215.00
- Seed $/Acre $ 111.00
- Pesticides $/Acre $ 41.00
- Machinery fuel & repairs $/Acre $ 42.00
- Custom work & seasonal hired labor $/Acre $  - 
- Crop insurance $/Acre $ 27.00
- Interest and other expenses $/Acre $ 20.00
- Drying charge $/Acre $ 32.00
- Storage handling charge $/Acre $ 24.00
- Total variable cost $/Acre $ 512.00
Example Fixed Costs (corn)

- Machinery/building ownership cost ($/year) $150,000
- Labor cost (unpaid and hired labor) ($/year) $ 80,000
- Utilities (Electricity, gas, telephone…) ($/year) $ 3,600
- Total fixed cost (2,000 Acre) ($/Acre) $ 117
- Land use cost ($/Acre) $ 170
- TOTAL COST (variable + fixed) ($/Acre) $ 799
Calculating Breakeven Price

- Crop value (yield*price) ($/Acre) $ 799
- Government payment ($/Acre) $ 20
- Crop insurance ($/Acre) $ -
- Variable cost ($/Acre) $ 512
- Fixed cost ($/Acre) $ 117
- Land use cost ($/Acre) $ 170

$ 0
Calculating Breakeven Price

- Crop value (180 * 4.44) ($/Acre) $799
- Government payment ($/Acre) $20
- Crop insurance ($/Acre) $-
- Variable cost ($/Acre) $512
- Fixed cost ($/Acre) $117
- Land use cost ($/Acre) $170
- Net Margin $0
Breakeven price vs yield

Graphical representation
Soybeans Breakeven

• Variable cost for soybeans are $254 per acre, fixed cost $117 and land $170 per acre. Government payment $20 per acre.

• If yield is 50, breakeven price is $10.42 per bushel

• If yield is 55, breakeven price is $9.47 per bushel

• If yield is 60, breakeven price is $8.68 per bushel
Input Costs
Estimated Variable Costs/Acre: Average Quality Indiana Land (158 bu. corn; 49 beans; 70 wheat)

- **Rotation CORN**
  - 2005: $184
  - 2006: $222
  - 2007: $239
  - 2008: $380
  - 2009: $512
  - **Increase:** +59%

- **Rotation BEANS**
  - 2005: $114
  - 2006: $125
  - 2007: $120
  - 2008: $182
  - **Increase:** +52%

- **Wheat**
  - 2005: $98
  - 2006: $112
  - 2007: $119
  - **Increase:** +50%
Major Inputs for Crop Production

Fertilizers:
- N up 25% to 75% (NH₃ $950 to $1300/ton)
- P up 50% to 100% (DAP $1100 to $1400)
- K up 70% to 150% ($900 to $1250/ton)

Seeds:
- Corn 15% to 35%
- Soybeans 15% to 25%
- Wheat 15% to 40%

Pesticides: 5% to 30%

Machinery: Up 4% to 6%

Insurance: –Change with crop prices
Fertilizer Prices Estimated by Industry Representatives Last Summer

- Anhydrous Ammonia $950-1300/ton
- DAP $1100-1400
- K $900-1250
- UAN Solution, 28% $400-800

Prices paid by farmers, April, USDA National Ag Statistics
Retail Markets Adjusting to Sharp Declines in Wholesale Prices of Certain Fertilizers

USDA National Ag Statistics
Land Leases
Landowner/Producer Risk-Return Tradeoff

- Cash Rent
- Crop-share
- Flex Cash
- Custom Farm

Risk vs. Average Return graph.
Flex Rent

• FSA position

55105–55108). Accordingly, regulations will be issued to clarify that for the purpose of determining payments made with respect to the 2009 through 2012 crop years, combination or flex leases will be viewed as cash leases.
Flex Rent

• Flex rent example
  – Base rent
  – Bonus based on total revenue (yield and price)

\[ \text{Bonus} = (\text{price} \times \text{yield} - \text{trigger}) \times \text{sharetolan dlord} \]
Landowner net return versus prices
Tenant net return versus prices

Return per acre vs. Price ($/bu)

- Cash Rent
- Share Rent
- Flex Rent 1
- Flex Rent 2
Thinking about a flex lease?

- How sensitive am I to risk?
The Answer is in your Records
The Answer is in Your Records

• Precise records are critical
• They allow you:
  – Plan cash flow needs
  – Calculate breakeven prices
  – Measure the financial health of your operation
  – Provide a way to measure progress
  – Etc.
Allocate Expenses

Bank Account: PCA-Revolving Line
Ending Balance: $216,330.26

Pay to the Order of ADM Grain
Date: 01/05/2006
$110,360.80

Allocate Expenses:

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<tr>
<th>Account</th>
<th>Amount</th>
<th>Memo</th>
<th>Customer/Job</th>
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## Summarize Variable Cost by Crop

### Example Farm
### Summary Report YTD
### All Transactions

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<td>89,188.00</td>
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<td>19,463.00</td>
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<td><strong>Total Income</strong></td>
<td>89,188.00</td>
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<td>188,046.80</td>
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<td>73,364.97</td>
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<td><strong>Grain Inputs/Expenses</strong></td>
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Predict Future Cash Flow Needs From Past Needs

**Profit & Loss**

January through December 2007

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<th>Cash Basis</th>
<th>Jan 07</th>
<th>Feb 07</th>
<th>Mar 07</th>
<th>Apr 07</th>
<th>May 07</th>
<th>Jun 07</th>
<th>Jul 07</th>
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Decision Making Made Easy
Decision Making Made Easy

• Breakeven price is known
• Resources are available
• Cash flow needs are addressed
• Risk of the decision has been considered
• Decision fits the business goals and the mission statement
• Act, don’t look back, move on!
Now What?
Management Responses to Uncertainty

• Margin-Margin-Margin
• Increase financial strength
  – Reduce debt/enhance equity to deal with a downturn.
• Diversification
• Reduce time exposure
• Turn from Aggressive management to Conservative management
• Timing-Timing-Timing-Timing
Readings for Feb 3\textsuperscript{rd} on ACRE

- ACRE reading
- Crop insurance reading
Assignments

• Go to web site:
  http://www.agecon.purdue.edu/extension/programs/marginrisk.asp

• Calculate 2008 breakeven prices*

• Calculate 2009 predicted breakeven prices*

• Estimate monthly cash flow needs for 2009 by adjusting 2008 cash flows based on changes in the operation or input cost changes.

*Simple formula to calculate machinery ownership cost included in assignment
Course Website

- Login: margin
- Password: risk2009

- To email in questions, either give them to your host or send them to Corinne Alexander: cealexan@purdue.edu