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THE FARMER'S EDGE

Hurley & Associates
Agri-Marketing Centers

Pricing Commodities

By Kurt Ehnle

Welcome to the world of selling agricultural commodities. Pull up a chair and stay awhile.

Pricing your production has always been an important endeavor but when times are tough and margins thin it becomes even more critical. We use the term "Sales" to measure our pricing activities. Sales can be defined as *the exchange of goods, services, or property for money.* The word "Sales" often appears on the Income Statement as Sales of Corn, Sales of Soybeans, Sales of Hogs, etc.

Sales is the life blood of the business. If the business is short on Sales it's weak. And, without Sales the business is soon dead. So, since Sales are so vital, it would behoove the astute business owner to not play games and take unnecessary risks with the market. Additionally, considering any type of premium for specific types of grain or certain qualities of livestock production would in like manner add to Sales. Often the initial reaction for producers who are presented with an opportunity to grow or produce a product with a premium is "I don't want to bother"…but maybe you should stop a minute and consider what a "little bother" might add to Sales and mean to the bottom line. Maybe you don't want to bother and that's your choice. So if you pass, someone else will jump at the chance if it's a win – win deal.

To get a handle on just how well (or poorly) we are doing with selling our production we need to consider the operation's Inventory and what that means. Inventory is commonly thought of as *the finished goods a business accumulates before selling them to end users or buyers*. But Inventory can also describe stages of incomplete production such as varying stages of livestock development. Regardless of the business, whether it be oil and gas production, automobile manufacturing, a cattle feedlot, or grain production, all are likely to have a certain amount of Inventory. And that Inventory has only one purpose or function…to be **turned into cash** visa Sales. Thus, the relationship of Sales and Inventory is critically important.

Achieving attractive profitability consistently is virtually impossible in production agriculture unless Inventory is being converted into cash in an orderly and efficient manner. Unpriced Inventory is dead weight to the business. In a perfect setup, there would be no Inventory and all production would go directly to the buyer immediately and capital movement would be maximized. However, most businesses have some level of Inventory but the goal should be to keep it as low as possible and still maintain full production. I personally am acquainted with an equipment business that builds custom equipment on an as ordered schedule. Therefore, there is no Inventory of completed machines, only a

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SERVING AGRICULTURAL PRODUCERS SINCE 1988
CELEBRATING 30 YEARS

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certain amount of parts Inventory. The capital movement efficiency in that business is at a maximum.

Capital movement efficiency and its impact on the profitability of a business is poorly understood by many in production agriculture. Agriculture is one of the most capital intense businesses there is which begs the question as to why no one outside the Ferguson Group endeavors to discuss the effects on the financial performance of the operation. The quicker and more often you can complete the production cycle the more profit potential exits.

To measure the relationship of Sales to Inventory the calculation of Sales to Inventory & Breeding Stock @ Fair Market Value (S/I&BS@FMV) is of vital importance to the business' management team in monitoring pricing (marketing) activities. It is calculated by dividing annual Total Sales (for a 12 month period) by the dollar amount of Total Inventory & Breeding Stock at Fair Market Value on the year's closing date. In agriculture, guidelines have been established to gage the performance of the operation's selling decisions. The Ferguson Group (apparently the only source in the agriculture industry) has developed enterprise specific guidelines. Financial index performance measurements vary from $.90 for cow/calf operations, to $1.10 for cash grain producers, to $3.00 for cattle feedlots…in order to achieve 10% profit margins. Of course all financial information must adhere to Generally Accepted Accounting Principles (GAAP) or the results are not valid.

$$\frac{\text{Total Sales (Annual)}}{\text{Inventory \& Breeding Stock @ Fair Market Value}} = \text{\$.00 Index}$$

Why is there such a difference in the guidelines for the various enterprises in production agriculture? Because the production cycles vary considerably. For example, farrow-to-finish hogs produce 2.25 to 2.5 cycles per year, cash grain typically is 1 crop per year, turkeys are 3.5 cycles per year, etc. The critical factor is "how many times does your money turn". Thus, it should be obvious that the grain producer who holds grain for extended periods or even multiple years kills the S/I&BS@FMV index and profitability right along with it.

Some may question why Inventory at Fair Market Value is utilized. There are two reasons. First, Fair Market Value identifies how much cash would have been received if the Inventory had been sold on the date of the balance sheet. Secondly, 96-97% of all U.S. farms and ranches do not maintain cost accounting systems prepared according the GAAP. Since cash accounting procedures recognize all expenditures immediately upon payment, GAAP requires that zero book values be applied on farm raised products. Therefore, Fair Market Value is used. Conversely, many manufacturers that utilize **true** cost accounting systems may use Inventory at Book Value.

You may be thinking, if S/I&BS@FMV is so important then "why don't more people" monitor it on a regular basis and pay attention to the results. That is an excellent question! But the answer likely lies in the fact that it is not taught in agricultural schools and is general not understood. It is an easy calculation and the necessary numbers to make the calculations are readily available. Try it! You may very well be surprised as to what it is telling you.

Anyone owning unpriced grain in inventory is **speculating**. Pure and simple. I've seen a lot of people (advisors included) come up with fancy so called "marketing plans" and forget the basics of what it is they are supposed to be accomplishing…and that is pricing the production at a profitable level and as quickly as is prudent. Too often they are trying to hit a home run instead of just getting on base and end up striking out. Human nature is such that if we can lock in a 20% to 25% profit margin we pass it up thinking we are going to strike it rich by getting a 45% profit margin but end up with 5% after the market has went up and come back down and finally we decide to throw in the towel.

Often I see or hear of producers holding grain for extended periods of time to capture the carry in the market. Now that may be the life blood of the grain elevator and the job of the grain merchandiser but that's another business enterprise and should be treated as such. One has to do with grain production and pricing that commodity in the market. While the other has to do with hedging to capture the time value of money by trading today's price versus a greater price for a specified date in the future. The two businesses have quite different purposes, have different internal financial structures, and have different performance measurements. Thus, they should be operated as two separate enterprises. The

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Our Business is Your Business

By Karen Marshall

Before I get into the article, I wanted to acknowledge the following:

As part of our monthly company newsletter in January, our Chief Communications Officer, Peggy Raisanen, chose to mention a milestone for our business and I wanted to share it with you because we are most grateful for the opportunity to work with you and your family.

This year, Hurley & Associates will be celebrating our 30th year of business. We have been blessed beyond measure to be able to have the impact we have had for so many farm families and so many employees. In this 30th year, we want to take time to recall the mission that got us here and that will carry us through the next 30 years.

MISSION -

To help our clients realize economic stability while maintaining the dignity and value of the farm family. Through collective efforts of our employees, associates, and agri-businesses we continually strive to accomplish this mission by:

- Providing marketing risk management services.
- Helping the client reduce market risk.
- Developing a prudent marketing program tailored to the clients' specific needs, to reach practical financial goals, and to become better stewards of their finances.
- Staying informed by evaluating and keeping pace with the increasing flow of information and rapid changes in agri-business, in order to keep clients on the leading edge of agriculture.
- The application of sound Christian principles to achieve positive results for the clients' farm enterprise.
- Allowing our employees and associates to use their God given creative abilities, thereby sharing the benefits of a positive relationship with the client.

We firmly believe the future of agriculture belongs to those people with vision, for they will define and shape the future for succeeding generations. Our desire is to join in the process by offering the highest level of professional assistance and personal service to ensure the vitality and integrity of the individual and of agriculture. Each of our offices work together within a specific framework to facilitate the desired results of our mission.

Our Company Values / Principles for Positive Results: Accountability, Partnership, Service, Responsibility, Perseverance

Are you one of the many millions of people who set New Year's Resolutions? I do not use January 1 to set expectations or goals for the upcoming year. Rather acknowledge areas of improvement I need to address and set goals throughout the year. I was reading an article in the Wall Street Journal, Set the Bar High for Your 2018 Resolutions by Jason Sweig. One of the "funnier" suggestions was "If you think you're the smartest person in the room, you must not have talked to everyone in the room yet." Another was "Eat more crow. It's the most nutritious of all brain foods." Actually very good advice. What it failed to mention was the need to share those resolutions/goals with others. Write them down. Why? Accountability. Having written goals and plans keeps you more focused on what is important, limiting distractions. Thus, one of the benefits of a written market plan. A very powerful tool.

What can we expect in 2018? Our crystal ball is no clearer than it was 30 years ago. Fortunately, you do not need a crystal ball to have an effective and successful marketing and business plan. We live in a world where everybody and everything is connected. Being informed is important but to much information is simply noise. On any given day, you can find something to match your bias of the market and ignoring information that does not support your bias. The effect of this is to cloud your emotions and reduce the importance of sound business decisions.

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problem with not treating them as two separate business endeavors is the level of confusion that develops. Profits in production are distorted by losses in pricing actions, or conversely, losses in production are distorted by gains in pricing actions.

Back to S/I&BS@FMV (the relationship of sales to inventory) and what it tells us about the pricing (or marketing) activities of an operation. This index reveals precisely how efficient funds invested in Inventory & Breeding Stock are being converted into cash sales. If we are playing marketing games, taking on undue risk, holding grain for extended periods of time speculating on price improvement, etc., the index will readily point out that there is a problem and then we can identify the specific reason(s) for the poor performance.

S/I&BS@FMV identifies the positive or negative impact of pricing activities on the business. Prices in the market place certainly can have a big impact on the level of Sales generated. And, we have little influence on price discovery at the Chicago Board of Trade. However, what we do have total control of is accepting a price offer. The time to take a cookie is when they are passing the plate! Once the plate has passed, it's too late! Why didn't we take a cookie when it was offered? Was it greed and we were thinking there will surely be another plate with bigger and better cookies. Maybe or maybe not. That's why knowing your cost of production is of monumental importance…so you know when to lock in a profit.

Submitted by:
Kurt Ehnle is president of KE Precision Ag. The staff at KE Precision AG are leading experts in the field of precision planters. He is also the Principle Financial Consult at Ferguson Group (Peoria) and has been providing financial consulting to farms and ranches as well as agri-businesses for over 25 years. He may be contacted at 309-360-5412 or at keprecisionag.com or fergusongroupltd.com.

Consultant Spotlight: JACKSON WAAGE

What do you most enjoy about your job?
Being able to work hand in hand with individual producers, trying to better their operations is what I enjoy most.

How did you get started in your career?
In the summer of 2014, I was able to intern with our Hurley & Assoc. office in Brookings. Once that summer concluded, I was offered a full-time position and started in my current role as a Consultant in January 2015.

What are you most passionate about when it comes to serving our clients?
Understanding the amount of trust and responsibility the farmers place with us to so that we can work together in bettering their operation is what gets me excited every day.

What would be your ideal vacation?
My ideal vacation isn't necessarily a place, but consists of two things: warm weather and a golf course.

Jackson Waage was raised in Groton, South Dakota and enjoyed helping at the family farm run by his grandfather and uncle near Houghton, SD. He attended South Dakota State University where he studied Agricultural Economics, as well as Ag Marketing. After completing a Grain Marketing Internship at a large Co-op in Northeast South Dakota, Jackson realized how complex, yet key, creating a strong marketing plan is to the success of the family farm. He was then afforded the opportunity to intern with Hurley & Associates in 2014 where he strengthened his knowledge about farm risk management.

Jackson was hired on as a Farm Marketing Consultant with Hurley & Associates in January of 2015. His favorite part of the job is applying personalized marketing plans to each individual producer, as well as furthering clients' education in the marketing tools available. Jackson enjoys golfing, hunting, and helping out at the family farm during harvest during his free time.

U.S. Economy on a Roll

By John A Johnson

The U.S. economy is a fairly bright picture at this time. For the month of December, the short version is: 1) job openings are at record highs, 2) unemployment is at a 17-year low, 3) loans are cheap, allowing businesses to increase investment, and 4) the stock markets keep setting new peaks which enriches many American households. As a result of this confidence inspiring economic boom, consumer spending climbed 0.4% in December capping off the biggest increase in consumer buying since 2011. Household incomes rose 0.4% in December and advanced 3.1% for the full year. Demonstrating another measure of confidence in the economic situation, households drew even more heavily on their savings to fund their purchases. The savings rate fell to 2.4% in December, the lowest level since 2005.

The good economic news for the U.S. doesn't end there, President Trump recently signed the biggest corporate tax cut since 1986, also, the cuts are expected deliver some income tax relief to about 90% of U.S. households. This measure is expected to boost consumer spending even more in the coming months.

U.S. export sales are also continuing to show improvement in response to the recently falling value of the U.S. Dollar, which makes American goods even cheaper to buy for our foreign customers.

The U.S. housing market is still out of kilter concerning supply and demand. The available inventory of houses for sale in December dropped 11.4% for the month, and 10.3% for the year. It marked the 31st consecutive month in which supply was lower compared with a year ago. At the current pace of sales, it would take only 3.2 months to sell all available inventory, the lowest since NAR began tracking in 1999. That supply/demand imbalance pushed prices higher — again. The median sales price in December was $246,800, up 5.8% compared with a year ago.

The lack of available supply of houses for sale seems to have caught the nation's builders off guard, and it will take a few months to get the industry geared up for the new pace of inventory offtake.

What are the biggest hurdles to continuing our increased economic growth? Probably the threat of higher inflation and increasing interest rates. If inflation accelerates and blows past the Federal Reserve's 2% target, the central bank will raise interest rates and thus raise the cost of borrowing. The Federal Reserve Bank's preferred inflation gauge, the PCE index, will probably show a sizable increase for the month of December, but the 12-month rate is likely to remain below the 2% threshold.

The Fed itself is in transition as the new chairman takes the helm this month, but will have a statement after the February meeting, and will probably use it to set up an interest-rate hike in March.

In International economic news, the agricultural community in America is watching intently as U.S. negotiators attempt to re-write the Trans Pacific Partnership agreement, which was agreed to by the former U.S. administration, but was never ratified by the Senate, and has subsequently been repudiated by the present administration. Our Secretary of Agriculture, Mr. Sonny Perdue, has stated that he feels confident that there can be a more equitable agreement for agricultural trade worked out between the U.S. and the nations who did agree and sign on to the now-labeled Trans Pacific -11 agreement.

No discussion of the world's economy would be complete if we failed to mention the dynamic shift in the relationship of oil-producing countries and oil-consumers of the world. The United States, Mexico and Canada are on track to become some of the world's leading producers, while China, Korea and other Asian countries are on track to become the world's largest users and importers. Saudi Arabia and other OPEC nations are now scrambling to find their place in the new world order, as it pertains to producers and consumers of petroleum.

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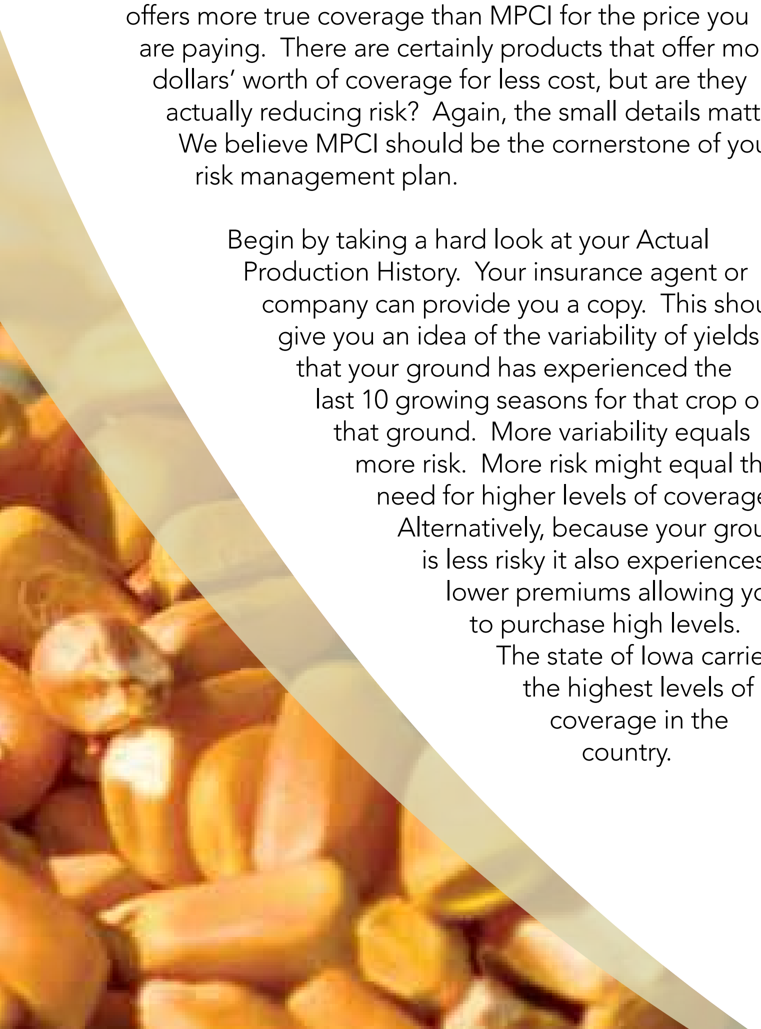
How Should I be Managing Crop Risk Through Insurance Coverage?

By Brian Fruechte

I always refuse to answer that question with, "this is what most people do." Your risk management plan for 2018 needs to be customized for your APH, geography, age, expectations, ability to withstand risk, etc. A blanket statement about what most of my clients do is irrelevant even if there's comfort in numbers. Each year there are new programs that come out whether from RMA or your AIP; however, not every new program that comes out is best, nor should they all be test driven on your farm. All of the small details inside insurance contracts matter.

The crop insurance program is designed to pay out $1 for every $1 put into it, making this program better than any private insurance you could buy anywhere. To make it even more appealing, remember that you aren't paying $1 for every $1 of coverage. Your coverage is subsidized and you are only paying a fraction of $1 for your $1 worth of coverage. For that reason, it's hard to find a product that offers more true coverage than MPCI for the price you are paying. There are certainly products that offer more dollars' worth of coverage for less cost, but are they actually reducing risk? Again, the small details matter. We believe MPCI should be the cornerstone of your risk management plan.

Begin by taking a hard look at your Actual Production History. Your insurance agent or company can provide you a copy. This should give you an idea of the variability of yields that your ground has experienced the last 10 growing seasons for that crop on that ground. More variability equals more risk. More risk might equal the need for higher levels of coverage. Alternatively, because your ground is less risky it also experiences lower premiums allowing you to purchase high levels. The state of Iowa carries the highest levels of coverage in the country.



In 2009, RMA granted a large increase in premium subsidy for the use of Enterprise Units (EU). As a result, 53% of corn acres and 52% of soybean acres in the US are now EU. I find EUs to be very beneficial and the premium is fantastic compared to Optional Units (OU). The best part about EUs is that the pricing coverage component works exactly the same way as OUs work. However, the yield coverage component does not work equivalently. The first problem, of course, is hail. The second problem that most haven't given enough consideration are those 1 or 2 fields that nearly every producer has, that perennially yield lower than the majority of the acres you farm. Maybe it's your "wet field" or your "desert field" or you already refer to it with your own colorful nickname! Economics tells us that in the short-term we can continue to farm those acres if they at least cover our variable costs. Hopefully, they are covering all or most of the fixed costs as well. If you're keeping records on a field by field basis, you know this impact already. Optional Units used to kick in and provide coverage on those specific problem fields, now with EUs they get lumped together and you likely don't have a claim. Is there a way around this problem?

RAMP was a new product offered in limited amounts for 2016. It offers coverage that works with a MPCI policy; however, the unit structures can be different! This may be an excellent option for you especially as you get more spread out geographically and are carrying EUs. We've even found that RAMP can be an "in-between" option if you are having difficulty choosing a level of coverage. You should be aware of the new products each year, but be sure you are actually gaining in the amount of risk covered or decreasing the amount of premium it takes to do the same job. Many of us have come a long way from OU structure with hail coverage all the way to whole farm units. Simply lumping more and more revenue centers together increases your risk. If you have questions about these products or any other, here's my number: 605-690-9023.

Wishing you a prosperous growing season,
Brian Fruechte
www.fruechtecrop.com

Our Business is Your Business

By Karen Marshall
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The first step in managing any business in a low price downturn is to conduct a reality check/stress test regarding the financial vulnerability your farm business is facing. It is time to sharpen your pencils. The key component of a market plan begins with a clear vision of your farm financial needs. If we are working together using your financials as a benchmark, we can build a marketing plan that manages your price risk. We want to teach not tell you about tools available to enhance your bottom line. We want to collaborate with you to develop specific strategies and steps to benefit your business. I read a statement in a report by Greg Kostal "There is an absolute need to adjust behavior to margin marketing and not price marketing." At a recent event, we were fortunate to hear a presentation by Dr. David Kohl. He defined the Four Cornerstones of Success as Planning, Strategizing, Execution and Monitoring. Opportunities are seldom labeled. You however have the ability to define your financial needs, thus capitalizing on opportunities when present, accomplished through planning, strategizing, execution and monitoring. If you have ever been to a Hurley and Associates meeting you know we fully believe in these four cornerstones for your success.

Last year was challenging with a very wet spring planting season followed by hot, dry weather in mid-summer. The implications of such would not suggest a record corn yield or the second highest soybean yield on record. Yet, amazingly, producers managed to do both. In addition, we saw record corn and soybean production from South America. Volatility in the futures market is not your enemy but your friend. It is where opportunities exist. In 2017, volatility was at historic lows, a result of commodity surpluses worldwide. Let us acknowledge that history does not necessarily repeat itself. Some things are probable but nothing is certain. Hindsight is of little value in the decision-making process. It distorts our memory for events that occurred at the time of the decision so that the actual consequence seems to have been a "foregone conclusion." We know what we know only today. Tomorrow can bring a sea of tailwinds and headwinds creating a different marketing environment. Unforeseen circumstances that are just that and impossible to predict. They can be weather related, political or economic events and numerous other factors that affect the supply and demand of commodities, and therefore prices. There are reasons to be optimistic about 2018 and when opportunities present themselves we will be there to execute your plan.

U.S. Economy on a Roll

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Venezuela, who has the largest known supply of crude oil in the world, is wallowing in near-chaos, on the verge of economic collapse as their currency is becoming almost comically de-valued. Goods of every kind for purchase are in critically short supply, even hospitals are running short of life-saving medicines. All the while, the Maduro government is frantically trying to maintain order. Theirs has become a classic study of socialism run amok.

Clearly the United States is re-taking the mantle of being the economic powerhouse of the world, as China steadily moves toward second place, with an eye to becoming the largest economy in the world at some future date. They have a very strong case for success with such a huge country and a large, highly motivated population.

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