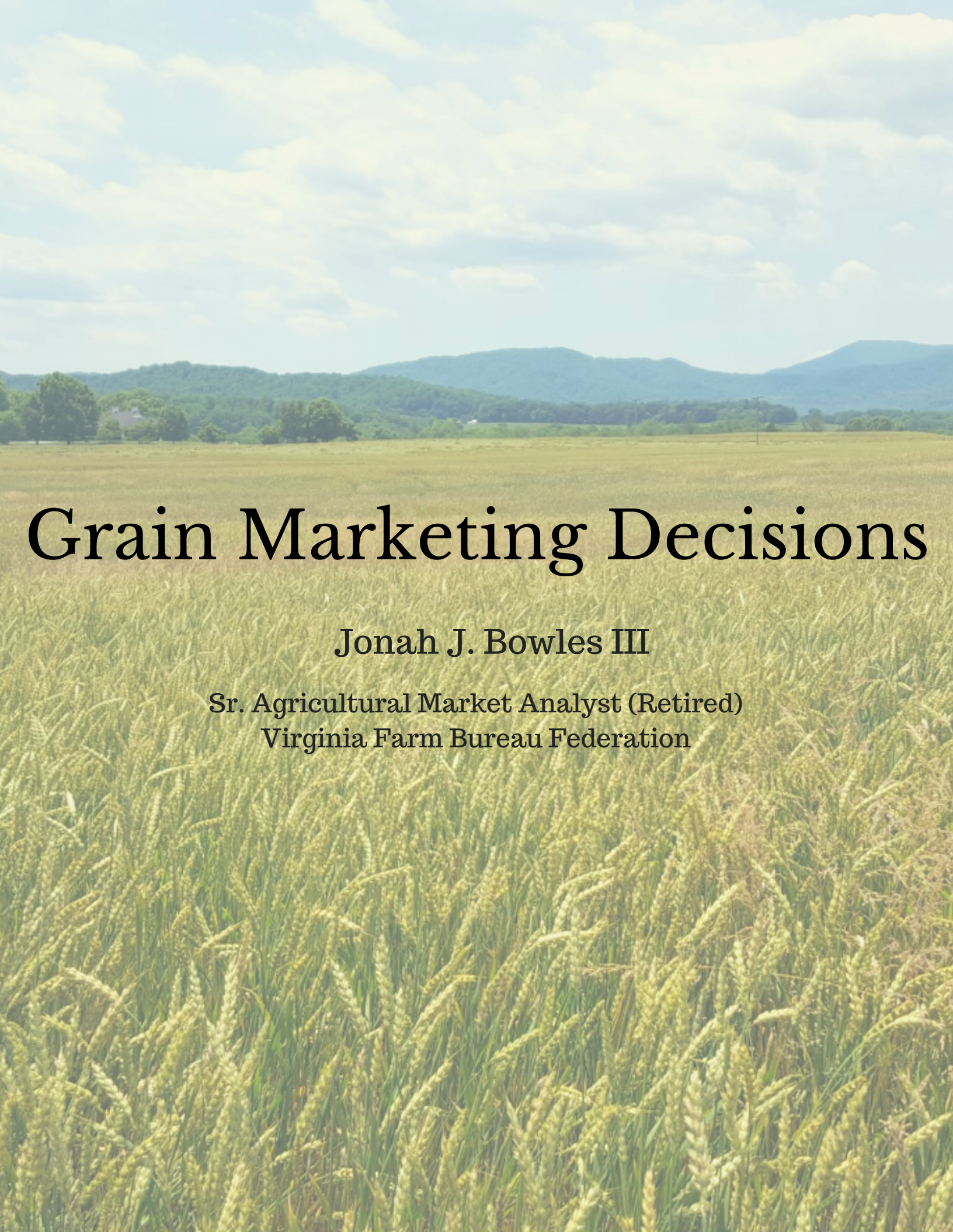

Grain Marketing Decisions

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This booklet intends to be a guideline to help with your marketing decisions. It allows you to look at your production and the markets you choose to utilize for selling your crop and then better understand what the advantages and disadvantages are for each. For some of you there will be new strategies that you may not have considered before.

This booklet does not show how to get the highest price when you sell your crop – that would involve taking on more risk than you currently have. What it does try to do is show you some marketing strategies that, when used properly, can help make your production year profitable every year.

These marketing methods are actions that can be taken when various conditions exist. However, you must be able to identify those conditions and you must also be willing and able to act in order for this guide to be of any value to you. Now is the time to begin formulating a marketing plan for this crop year and also for next crop year. Every day that passes is a possible marketing opportunity lost forever.

Historically, the markets offer acceptable pricing situations every year before harvest time. For December 2016 Corn, the current contract, a high of $4.89 was made in September 2015 – over one year prior to the expiration of the contract. Don't wait for the "homerun" – be ready to take an acceptable profit. If the market throws you a fastball right down the middle and you want to put a homerun swing on it, go right ahead, but know what you will do if you pop it up.

If you enter into harvest and have not had the opportunity to price your crop with an acceptable profit, then there must be a "plan b". This booklet will also give you alternatives for those situations.

Remember three things about your marketing plan –

1. The plan should be driven by profit, not the amount of profit.
2. The sooner you sell your crop, the better off you will be.
3. Know your cost of storage – seldom does the market pay storage in an up-trending market.

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Good Price

Market Headed Higher

Good Basis

Pays to store	(1+5), 2,3,4,5,6,8
Does not pay to store	(1+5), 2,3,4,5

Low Basis

Pays to store	1,4,5,8,10
Does not pay to store	1,4,5

Market Headed Lower

Good Basis

Pays to store	1,2,4,5,7,8,10,11
Does not pay to store	2,4,5,7,10

Low Basis

Pays to store	1,4,6,7,8,9,10,11
Does not pay to store	1,4,6,7,9,11

Low Price

Market Headed Higher

Good Basis

Pays to store	4,5,6,7,8,11
Does not pay to store	4,5,6,7,9,11

Low Basis

Pays to store	1,4,6,7,8,10,11
Does not pay to store	1,4,6,7,9,11

Market Headed Lower

Good Basis

Pays to store	(1+5) 2,3,4,7,11
Does not pay to store	(1+5), 2,3,4,11

Low Basis

Pays to store	1,4,7,11
Does not pay to store	1,4,7,11

Hedge using Futures

The primary reason for using futures over the cash market is that you like the board price or are concerned that prices will move lower, but are not satisfied with the local basis. Futures give you the ability to lift a hedge if you absolutely change your mind about market direction or if your production is not what you had originally thought. But, be very careful that this flexibility in marketing does not lead to speculation. You are trying to eliminate risk, not create more.

Examples of a production hedge for Corn –

Chicago Board of Trade price for December Corn	$3.50
Local basis	-$0.25
Normal local basis	-$0.10

Action you take -

Call your broker and tell him to sell a December Corn future at $3.50. You must already have an account open. Your broker will report the fill to you and then require that you place a cash deposit for margin, and maintain that amount in the account.

You now have the opportunity to shop for a better basis or wait for a better basis to materialize. Understand that the basis is also at risk, so you must make your decisions on the direction that you expect the local price to go relative to the Chicago Board of Trade price.

If an acceptable basis is realized, then you can either
Agree on a basis contract with your grain dealer and hold the hedge, or
Agree on a cash forward contract with your grain dealer and at the same time remove the hedge with the broker.

Remember – With this form of risk management you are subject to margin calls.

Cash Sale with Your Grain Dealer

This method is the traditional "sell out of the field" at harvest. When the Chicago Board of Trade price and the local basis are both at levels that are profitable with a good return, then there is little reason to hold on to the crop and risk any decline. Your storage facilities should only be used to improve deliverable grade and to facilitate delivery schedules.

Perceived market direction and production risk can determine how much of the crop will be priced at current levels, but being aggressive with such positive factors is a good idea

Additional sales can be made at higher prices with Good till Cancelled (GTC) Limit orders, or at lower levels with GTC Stop Loss orders. But watch storage costs if deciding to store part of the crop while waiting for higher prices – STORAGE NORMALLY DOES NOT OFFER A POSITIVE RETURN!!

Example of market situation suggesting cash sales –

Chicago Board of Trade price for December Corn	$3.50
Local basis	+$0.15
Normal local basis	-$0.10

Action you take –

Call your grain dealer and tell him to price your corn for current delivery and then make necessary arrangements to have it delivered. As long as the local basis remains strong, have your grain dealer price additional sales at agreed upon levels, whether above or below the market.

Because the grain dealer has contracted the other side of your sale, you are obligated to deliver the quantity of corn at the agreed upon date. You will not be subject to a margin call and will not need the services of a commodity broker when only using cash sales.

Forward Contracting Grain

This marketing method is done with your grain dealer and the use of a commodity broker is not necessary. The pricing is for a crop not yet ready for delivery, i.e. it is still in the tank for grade improvement, it is still in the field or it hasn't even been planted yet.

You would use forward contracts when the Chicago Board of Trade price AND the local basis combine to present an acceptable price for delivery at a time in the future, which closely corresponds to harvest.

Fundamental factors such as growing conditions and supply/demand statistics, which might suggest market price direction and production, can help determine what percentage of the anticipated crop to price at this time. But being aggressive with such positive factors is a good idea. Additional sales can be made at higher prices with Good till Cancelled (GTC) Limit orders or at lower levels with GTC Stop Loss orders.

Example of a marketing situation suggesting forward contracting –

It is now February and you are planning to plant 100 acres of corn. Your historical yield is 120 bushels suggesting a crop of 12,000 bushels.

Chicago Board of Trade price for December Corn	$3.50
Basis offered for new crop corn	+$0.15
Normal local basis at harvest	-$0.10

Action you would take –

Call your grain dealer and tell him to price a portion of your corn for delivery at harvest. As long as the local basis remains strong, have your grain dealer sell additional quantities at agreed upon levels, whether above the market at more attractive prices or below the market to prevent losses.

Because the grain dealer has contracted the other side of your sale, you are obligated to deliver the quantity of corn at the agreed upon date. You will not be subject to a margin call and will not need the services of a commodity broker when forward contracting grain.

Guaranteed Minimum Price Contract

This marketing method allows you to manage price risk by setting a bottom price for your production yet allows you to participate in price increases. Your grain dealer can offer the contract, in which case the basis is also protected. Or your commodity broker can offer it, whereby the basis is left out of the contract. How you feel about your local basis will determine which contract to use.

Guaranteed Minimum Price Contracts (GMPC's) can be considered when –

1. The current price is a good price, but you would like a higher price without risking the present pricing opportunity.
2. The current price is not an acceptable price and you are concerned about prices going lower, but would like the opportunity to benefit if prices do go higher.
3. You have priced your production, but would like upside potential without continued risk.
4. You have priced your entire anticipated production and would like protection against a short crop.

GMPC's involve purchasing options on the underlying grain futures contract and can be placed either before the production has been priced, or in addition to the pricing of your production. If the option is in addition to cash or forward contracting, the grain dealer can adjust your cash price to include the cost of the option – you put up nothing for the strategy. If the option is purchased through a commodity broker, then you pay only the option premium, priced in cents per bushel. There is no margin call once the grain option has been purchased.

An option can best be described as an insurance policy against risk. Like any other insurance policy, if it is needed then you should be glad you bought it. If it is not needed, then you should be glad you did not need it – life insurance being the most demonstrated example. Either way, the premium you pay for the option (insurance) is all that is at risk.

Basis Contract

The difference between the local cash price for corn and the Chicago Board of Trade price for corn is called your local basis. The basis is a measure of your local supply and demand fundamentals relative to those for Chicago delivery. While the Board of Trade prices are often difficult to forecast, your local fundamentals are usually easier to understand and project. Basis contracts are handled through your local grain dealer – it is not necessary to have a commodity broker.

Basis, being one component of your local price, can be traded with your grain dealer without locking in the complete price for delivery. The further out you request a basis the more difficult the local fundamentals may be to forecast. For this reason, distant basis contracts may not be as attractive as nearer basis contracts.

A basis contract does not cost you anything – in most cases you can get pre-paid a percentage of the value of the crop. Understand that you may be subjected to a margin call if the price of grain drops and if you have already received payment. You also must price your grain by an agreed upon date.

Examples of when you might want to consider contracting your basis –

1. The price for corn is not good, but your local basis is above the normal level for this time of year.
2. You have already hedged on the futures market at an attractive level, but wanted to wait for a better basis, which is now available.
3. You do not want to store your crop, would like to maintain price control of your crop, but would like some payment now.

Action you would take –

Let your grain dealer know that you want to deliver your crop versus a basis contract and then agree to lock in the Board price by a certain date with a GTC order.

Delayed Pricing Contract

This marketing strategy is done with your grain dealer. It involves delivering your crop, but not pricing the crop and not receiving a check for the value of the crop. This method can be beneficial, yet should only be done with a financially strong grain dealer with whom you have a time-tested relationship.

The Delayed Pricing (DP) contract is similar to the Basis contract in that you are given the opportunity to deliver your crop and not be subjected to storage costs while still maintaining price control. The difference with the DP contract is that the basis is not set and you will not receive any value of the crop at the time of delivery. The grain dealer is also not obligated to hold the crop until you price it – he can sell it or deliver it against his existing contracts. It becomes very obvious that you must feel comfortable that he will be in a position to pay you for your crop once you price it as you will have only his word that he will fulfill his obligation to you. Because the grain dealer must hedge his risk when offering this contract, the duration of the contract will normally be defined when the agreement is made.

Examples of when you might want to consider DP contracts -

1. You want to maintain price and basis control without being subjected to storage costs.
2. You want to maintain price and basis control and you don't have on-farm storage.
3. You want to maintain price and basis control, have on-farm storage, but don't want to risk losing grade during storage.
4. You would like the pricing and income for the crop to occur in the next tax year.

Action you would take in pricing with a DP contract –

Contact your grain dealer and let him know that you have a quantity of grain to deliver on a DP contract. You will then discuss the duration of the contract and you will be allowed to set the price anytime during that time period. A suggestion is to let him know at this time the price you would be satisfied with and tell him to price when it becomes available with a GTC order.

Good Till Cancelled Order

A Good till Cancelled (GTC) order can be placed with your grain dealer or a commodity broker. It merely means that you ask him to take an action whenever that opportunity presents itself, and continue doing so until your instructions are completed or you cancel the instruction.

The GTC order can be a standing instruction that remains unfilled for awhile – and it could be forgotten. The risk if this happens is that you might price your production twice. Your grain dealer or broker should help you with this, but the ultimate responsibility remains with you to remember that the GTC order was placed.

A good marketing plan will always utilize GTC orders. They allow you to go about your everyday business without having to watch the market so you won't miss a pricing opportunity. GTC orders can be placed at different levels above the market to take advantage of a rising market, or can be placed at different levels below the market to place a floor on a falling market.

While GTC orders are good until cancelled, they will still have an effective "life" as they will be associated with a futures contract on the Chicago Board of Trade, which will have an expiration date. This is true whether you place the order with your grain dealer or with a commodity broker. Also, understand that before the grain dealer or broker accepts your GTC instructions, they must be acceptable to the exchange where they will ultimately be placed – with the exception of a GTC basis contract.

Examples of when you might want to consider GTC orders –

1. Your crop is not priced and the market does not offer an attractive pricing opportunity at this time.
2. You have a basis contract, but the Board price is not attractive at this time.
3. You have priced a portion of your crop and would like additional sales at higher levels.
4. You have concern about prices and would like to establish a floor if the market drops significantly anytime in the future.
5. Your decision to plant a particular crop next year can depend on your ability to achieve a price before planting.
6. Any other time there is an instruction you would like to give your grain dealer or broker that is to be repeated daily until you tell him otherwise.

On-Farm Storage

This marketing tool can be a very useful one when used properly. It does not involve either the grain dealer or the commodity broker – you are in total control of your crop and when it will be sold.

Storage can be a used for increasing profitability. It allows for grade improvement of a crop with drying and cleaning, etc. Storage also gives the farmer flexibility in delivering his crop on his schedule – not just because it is being harvested. On-farm storage allows the livestock producer to maintain ownership of his crop so his feed requirements can be satisfied or to purchase larger quantities of feed at a more attractive price.

The availability of on-farm storage can also be a detriment to a good marketing plan. Very seldom does the market provide a "carry charge" in the pricing structure to pay to store a crop any length of time. When the market does pay full carry, you should ask why. The reason is probably because it is a commodity that is difficult to store and places the grade at considerable risk or the nearby price is so low due to large harvest supplies. Remember – storing a crop can increase your price risk.

Examples of when you might want to consider on-farm storage –

1. You want to improve the grade of your crop, e.g. drying.
2. You want to transport your crop after harvest, not during.
3. The market pays to store the crop and you have the ability to maintain grade during storage.
4. You raise livestock and store feed that has been grown or purchased.
5. You are paid to store a crop for someone else.

Storage with Futures

This method of marketing requires the services of a commodity broker and does not involve the grain dealer. It is one of the very few cases where a farmer who grows a crop would also buy futures contracts.

Buying futures can offer the farmer price control without the expenses of storing a crop in on-farm storage. The purchase of futures to create the position should only be done after the actual crop has been priced with, and maybe even delivered to, the grain dealer.

The amount of the crop that you purchase on futures will be determined by how aggressive you would have been in storing the crop. At no time do you want to purchase futures that exceed the amount which you have sold in the cash market – this will only places you in the position of increased risk.

Purchasing futures to replace a crop that has been sold in the cash market has three primary advantages over on-farm storage –

1. Your basis is no longer at risk; it was set with the cash sale.
2. You have lower storage costs – there are still carry charges in the futures markets, but they are normally much lower.
3. You have the flexibility to change your mind with changing fundamentals without having delivery considerations.

Examples of when you might want to use futures to store the crop-

1. You have forward contracted a price for your crop and decide you want to regain price control.
2. You have priced and delivered your crop and decide you want to regain price control.
3. You would like to store your crop, but see that carry charges make it disadvantageous.
4. You are concerned about losing grade by storing your crop, yet want to maintain price control.

Beware - futures trading can provide very flexible marketing strategies – but can easily lead to speculation and dramatically increased risks.

Compare Basis Gain Potential vs. Storage Costs

This marketing consideration does not involve your grain dealer or a commodity broker, except for the gathering of information necessary in making the decision. Basically, the question becomes "How much basis appreciation can you expect to gain over a period of time versus how much will it cost you to store the crop while you look for that improvement in basis?" This assumes that you have already managed price risk, you are only looking at basis and storage costs.

Instead of looking at this as another marketing strategy that you may or may not employ, look at it as a necessary consideration anytime you think about using your on-farm storage and why you are using it. Both of these factors by themselves might be reason to make marketing decisions, but together they will present a much greater argument in favor of or not in favor of using on-farm storage.

Knowing what your net cost of storage will be for a given time will allow you to decide whether or not the possible basis appreciation will be worth the effort to store. Understand that you might lose storage costs and experience a continued deterioration in basis, whereby you compound your problems.

Stop Loss Orders

This type of order can be given to your grain dealer or to a commodity broker. The purpose of this order is to allow the market to gain on the upside, but to stop losses if the market turns lower. This order can be either a day order or a GTC order.

Two examples of the use of this strategy are –

The market is at an attractive level with all indications that it should continue higher. You would like a higher price, the higher the better, but you don't want to risk the profits you currently have available to you.
The market is not at a profitable level and it does not look as though there is much of an opportunity for a sizeable rally. You would like to take a chance on the possibility of a better price in the near future and are willing to risk a little more on the downside for this chance.

Action you would take with a Stop Loss order –

Determine a point below the current market at which you would no longer feel comfortable that the price has rally potential, or a point at which you no longer want price exposure. Call your grain dealer or broker and tell him to place a sell order that will execute if the market drops enough to reach that point on the downside. This order can be either a day order or can be placed GTC. If the market does go higher, raise your Stop order accordingly. At some point, the market will turn enough to sell your crop, but you hope it will be at a price higher than the current market.

A Stop Loss order cannot guarantee that you will sell your crop at your stop level – a Stop Loss order becomes a market order when that price is touched or exceeded. Example – Corn closed at $3.50 and your Stop was $3.45. If the market opens the next day at $3.40, your Stop order becomes a market order to sell Corn at the $3.40 level, the first price trade at or below your $3.45 Stop.

Glossary

Basis – The difference between the local cash price of a commodity and the price of a related future contract.

Call option – An option that gives the option buyer the right to purchase (go "long") the underlying futures contract at the strike price on or before the expiration date.

Futures contract – A contract traded on a futures exchange for the delivery of a specified commodity at a future time. The contract specifies the item to be delivered and the terms and conditions of delivery.

Hedge – The buying or selling of futures contracts and/or options contracts for protection against the possibility of a price change in the physical commodity.

Long – A position established by purchasing a futures contract or an options contract.

Margin – An amount of money deposited to ensure fulfillment of a futures contract at a future date.

Margin call – A call made by a brokerage firm to a market participant to deposit additional funds into one's margin account to bring it up to the required level. The reason for additional funds can be the result of a losing market position or an increase in the required margin.

Put option – An option that gives the option buyer the right to sell (go "short") the underlying futures contract at the strike price on or before the expiration date.

Short – The position created by the sale of a futures contract or option.

Speculator – A market participant who buys and sells futures and/or options in hopes of making a profit – adding liquidity to the market.

Strike Price – The price at which the holder of a call (put) may choose to exercise his right to purchase (sell) the underlying futures contract.