Crop Insurance Requires Flexibility

The mood swing in farm country stems from an abrupt change in the weather and a reversal in the prevailing price trend. It's naive to believe crop insurance will negate sins of inadequate planning or marketing. Flexibility has always been key in my marketing plan—and it's even more so this year.

Such price appreciation, like what we saw in mid-June, can become a two-edged sword as we deal with the implications of crop revenue insurance, says Jamie Wasemiller, resident insurance expert at Gulke Group. Traditionally, the plan is to use the February average as a guide and price up to the percentage of chosen coverage. Using cash forward contracts versus futures is where the rub comes, Wasemiller notes. Cash contracts reduce flexibility, which is why we limited them to 15% in 2012 while using futures on as much as 85% for 2012 and 40% for 2013.

Technical buy signals on June 18 prompted me to advise clients to exit all grain hedges and (go long) futures on at least 50% to 80% of personal corn production shortfall. Markets moved quickly, and it was $5.60 on average before the plan was completed. Buying puts or selling calls could have been a disaster and was not part of my strategy. Reacting quickly and keeping it simple while buying time and information works best.

Breakdown in Marketing. To further illustrate the importance of flexibility coupled with limiting cash sales and using futures, see the following two examples:

No. 1: Cash contracts on 80% of an actual production history of 162 bu. (129.6 bu.) at $5.68 grosses $736. Half of that crop equals 81 bu., which means buying 48 bu. at perhaps $8 minus $5.68, or $111 per acre. With a fall harvest price of $8, the shortfall of 48 bu. totals a $384 insurance payout, reduced by $111 to $273 net plus the 81 bu. sold earlier at $5.68 ($460). Total gross sales equal $733, less $700 per acre cost of production, for a net profit of $33 per acre.

No. 2: In the extreme case of zero yield, a payout of $1,032 is reduced by covering the total 129.6 bu. buyback at $2.32 ($8 minus $5.68), or $300. Less cost of production at $700, that leaves only a $32 profit. In this case, it might have been best to have done nothing and wait out the growing season to sell in October, when price and yield meet their ultimate point.

December Corn

> *Several days of 95° or higher temperatures and 40 mph winds in mid-June altered yield prospects, which rippled into the market, requiring quick action by farmers .*

Using the first example with 50% coverage, 15% (19 bu.) sold at a gross of $109 plus an insurance payout of $384, plus selling the balance of 62 bu. (81 bu. minus 19 bu.) at $8 ($496) produces a gross of $880 or $180 net profit per acre after $700 expenses. That profit point is respectable in anyone's book and worth the time spent to understand and use futures and recognize when to be flexible. Think before you are offered the provision to "roll" unfilled contracts into December 2013, as it could cost you a lot.

If this year is like similar supply shortages, prices will top at about the time government reaction goes overboard or the psychological impact pushes farmers to exit cash contracts, only to realize the fall harvest price might be much less than they expect as a result of reduced demand. Timing enhanced by flexibility was critical in mid-June and will be likewise for marketing 2012 and 2013 crops. ■

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