

Feed Price Protection for Cattle Producers

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Price Risk Management

- Risk management does not always mean risk elimination nor price minimum

Objective:

Utilize strategies to limit or control the range of potential price

Price Management Alternatives

- Small purchase, short term storage
- Large purchase, long term storage
- Cash Contract
- Futures
- Options

Small Purchase, Short Storage

Feeds are purchased in small quantities to match short-run needs

Advantages

- Market highs offset lows in the long run
- Cash flow

Disadvantages

- Exposure to all market and supply risk
- “Take the good with the bad”

Large Purchase, Long Storage

Large quantities of feed are purchased and stored, supplies for longer duration

Advantages

- Supply risk and price risk are eliminated
- Seasonal price declines may be beneficial

Disadvantages

- Additional cost for storage
- Large investment, difficulty to cash flow

Cash Contract

Feed is forward priced with a contract for delivery

Advantages

- Supply risk and price risk are reduced

Disadvantages

- Supply, price subject to contract being honored

Futures Hedge

A futures contract is purchased and later sold to offset changes in the cash market

Advantages

- Price risk is reduced to only basis risk
- Best defense against increasing prices

Disadvantages

- Basis risk remains
- Margin calls

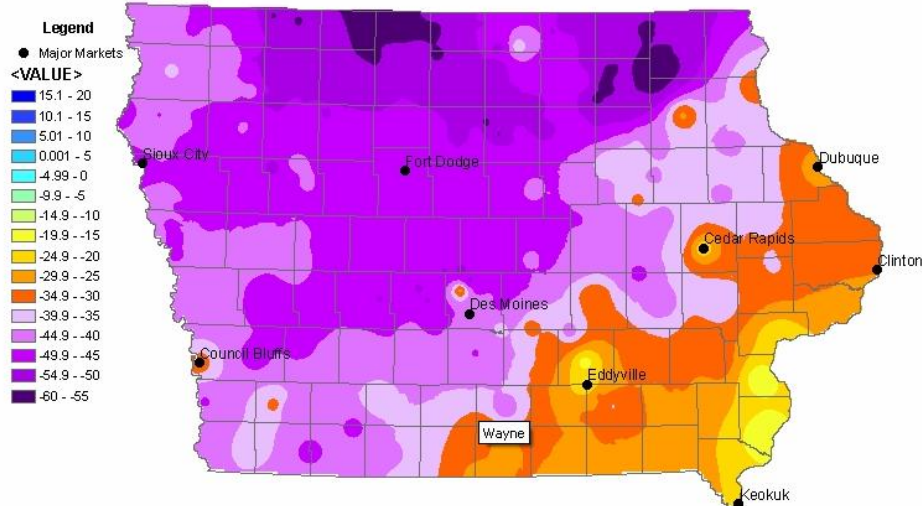
Using futures

- Basis = local cash price – futures price
OR
- Futures price + basis = local cash price
- Margin call: Money held on account to secure futures contract

Iowa Basis

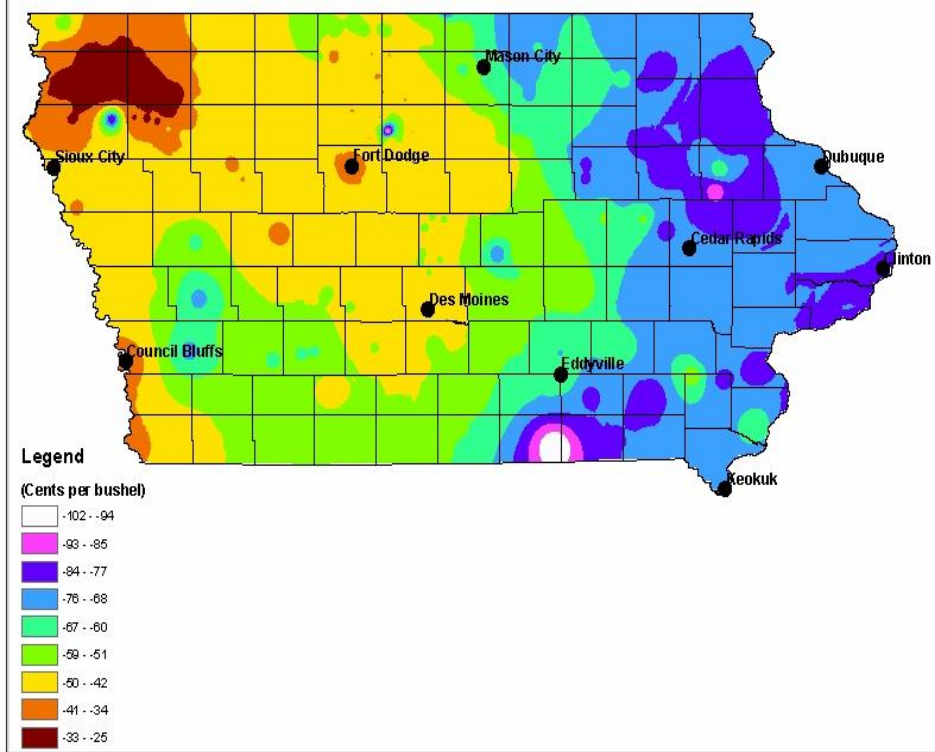
JUN 23, 2006 CORN BASIS

Basis Calculated from CBOT JUL futures Prices 228.3 cents per bushel



June 23, 2008 Corn Basis

Basis calculated from CBOT July 2008 futures price of \$7.2425 per bushel



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Options Hedge

Purchasing a Call option to lock in a price ceiling

Advantages

- Protection from higher prices
- Opportunity for lower price remains

Disadvantages

- Basis risk remains
- Up front cost of call premium

Options Combination

Call option is purchased, Put option is sold to help offset cost of call premium

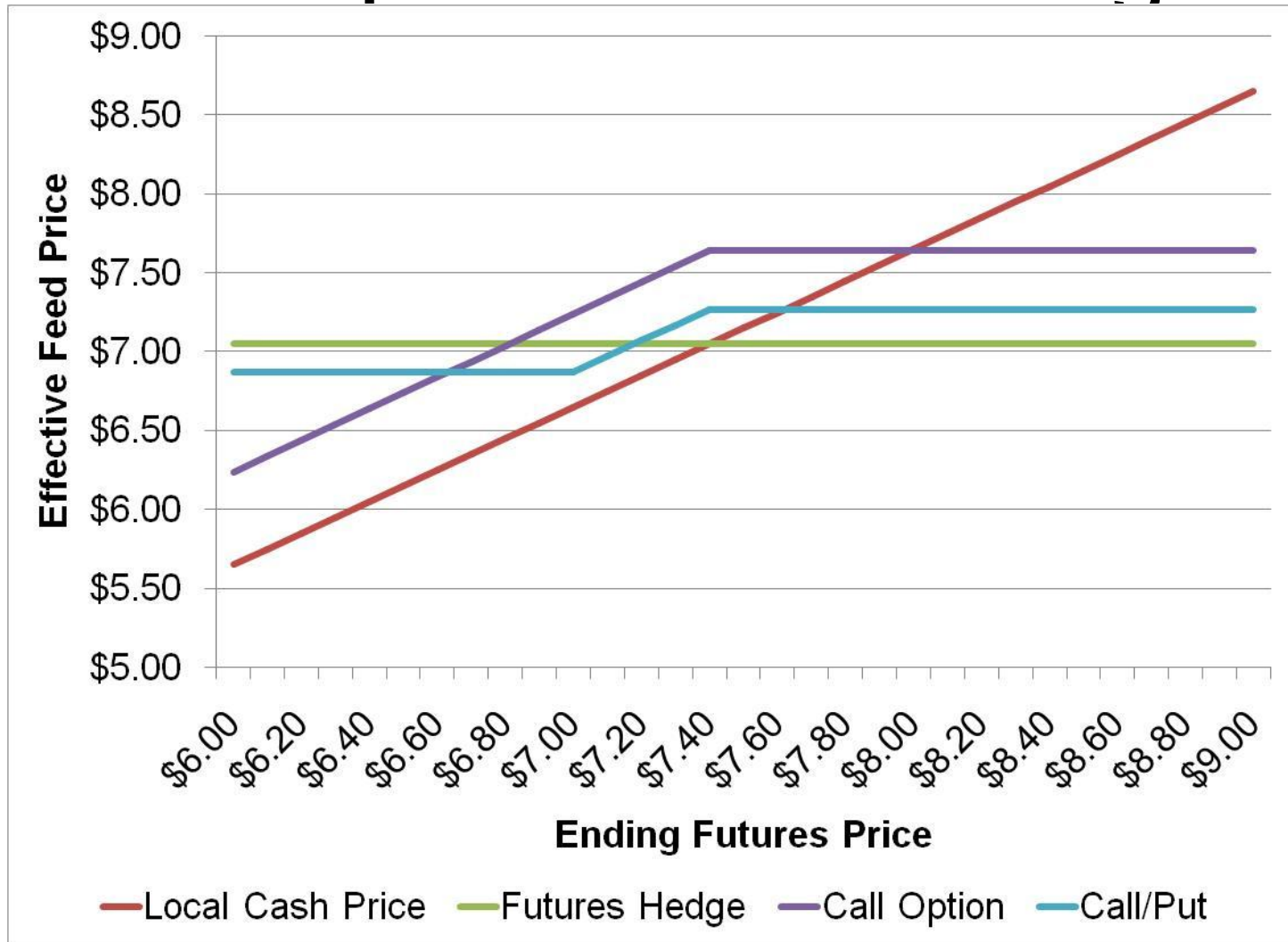
Advantages

- Cheaper than using only using only a call option

Disadvantages

- Establishes a price floor
- Potential for margin calls

Comparison of strategies



Alternative Feed Protection

- Compare the value of alternative feeds
- Other feed price protection using a corn futures/options position (i.e. DDGS)
- Seasonality or opportunities

Thank you

Questions?

www.iowabeefcenter.org