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Preparing for the next generation to take over the family operation is a critical challenge facing many of our clients and the nation's agricultural producers at large. Many producers have created estate plans to address the tax implications of transferring significant farm assets like buildings, land and equipment. However, risk managers should also consider how a margin management plan can help a farm family achieve its long-term goals across generations.

When we last covered the topic of a margin management plan, we discussed how the process of defining goals and objectives in a written organized plan provides structure to an operation, allowing it to achieve some bigger long-term initiatives such as expansion, vertical integration and land acquisition. In this issue, we explore factors to consider when preparing successors to take over the critical decisions involved in margin management.

Sincerely,

Chip Whalen
Managing Editor

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Upcoming Education Events

Crop Margin Management
Chicago

July 13-14, 2016

Hog Margin Management
Chicago

August 17-18, 2016

Futures and options trading involves the risk of loss.

Make A Margin Management Succession Plan

Do you have a plan for passing on your operations? Preparing for the next generation to take over the family operation is a critical challenge facing many of our clients and the nation's agricultural producers at large.

While many producers have begun to plan for transferring their significant farm assets in the most tax-efficient way, they may not have considered some operational questions, including: How will work get done? Who will take charge of various facets of the operation? By helping address those questions, a margin management plan can play a critical role in preparing the next generation to take control helping the operation achieve its long-term goals across the generations.

A good margin management plan should take into account some key factors.

- **Define roles and responsibilities** of all who will be executing the plan. If members of your operation specialize in a certain area of the business, spelling out who will do what helps everyone understand how their work contributes to the common goal and can help coordinate efforts across the operation.
- **Identify where business knowledge lies**. Often, the principal owner or equity partner has been making all the marketing and risk management decisions, and other family members do not understand the decision-making process or the criteria on which decisions have been based. Taking futures and options positions and deciding when to contract for purchases and sales requires specialized knowledge and a different language that is typically foreign to those who haven't followed the markets for many years.
- **Share critical knowledge**. If the person who typically works in your nursery or milking parlor were to get sick, there is probably at least one other person on your farm who could fill in to ensure operations continue to run smoothly. The same should hold true for the person who makes marketing and contracting decisions for the farm. Unfortunately, bad things sometimes happen. We have seen instances where a sudden illness or

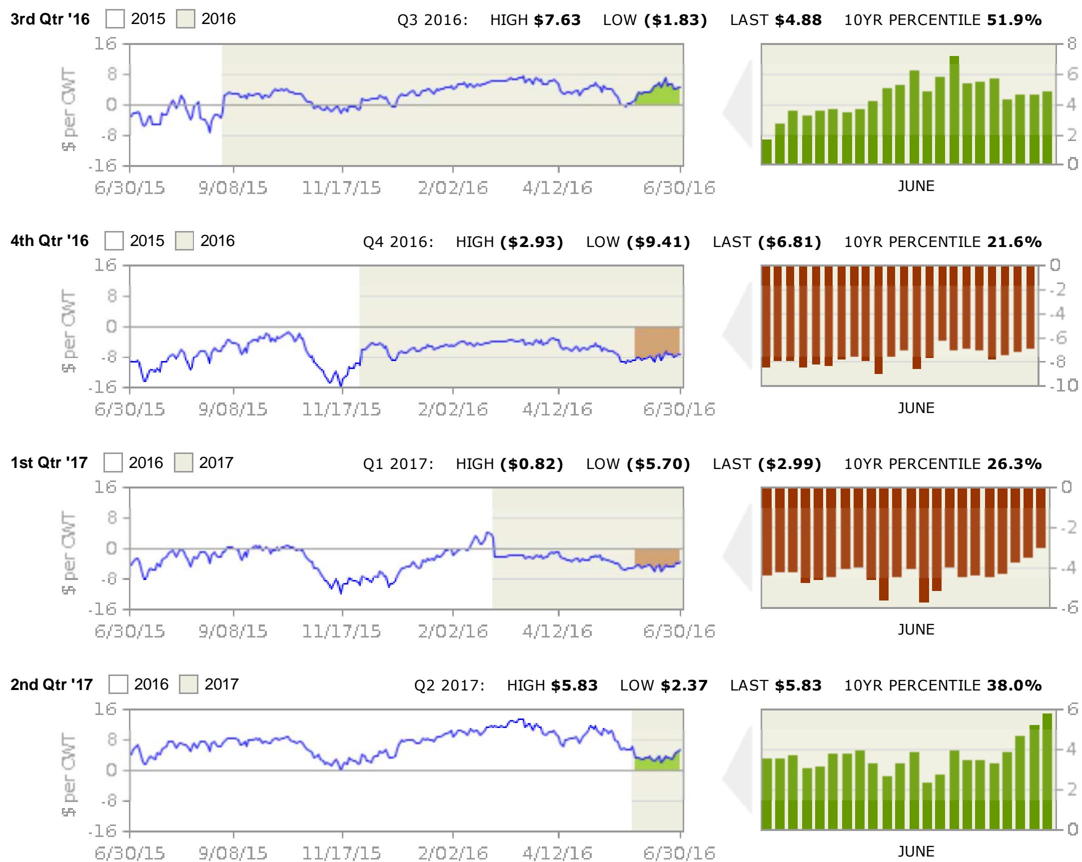
accident involving the main decision-maker leaves the rest of the family struggling to make decisions about market positions they don't understand. You can avoid generating unnecessary anxiety and confusion by educating your intended successors.

- **Get professional help.** While you may have a firm grasp on how and why you take positions, explaining this complex topic to others requires a different set of skills. Sending your intended successors to one of CIH's educational margin management seminars can help you transfer your knowledge across generations. Taught by professional educators, these comprehensive seminars provide a solid basis of understanding for the critical decisions that will impact the future profitability of the operation. Some savvy producers have brought not only their children, but also spouses or other relatives, to a seminar to learn margin management, from the basics of what the futures market is and how an option differs from a futures contract, to more complex issues – such as choosing among different contracting alternatives, funding accounts to maintain performance bonds on open positions and communicating with lenders who provide liquidity on credit lines.
- **Agree on where you disagree**. Since older farmers usually have ample equity in their operations, they may feel more comfortable riding the open market and taking on more risk than their sons and daughters. But there may be other areas where your priorities differ from your intended successors. A discussion about your operation's current risk profile is a great opportunity to identify what will stay the same and what will need to change for future generations. These important conversations can help the younger generation become more invested in the margin management process as they begin to see the connection between contracting decisions and financial performance in closing out marketing periods. We have seen margin management plans revised as a result of this added dialogue, as more input and thought is put into the decision-making process from multiple parties.

While preparing a comprehensive succession plan to efficiently transfer assets to the next generation, it is wise to think about how those assets are being managed. This includes critical decisions such as contracting to protect profit margins and how that fits in to preparing the next generation to take control. By investing the time to include this in your planning, you can ensure a smoother transition and help provide direction to those who will eventually be in charge.

Hog Margin Watch: June

Margins continued mixed through the end of the month, as nearby marketing periods weakened slightly while deferred periods improved since the middle of June. The last half of June featured sharply lower prices for both hogs and feed, spurred by key reports from USDA. First, the Quarterly Hogs and Pigs report revealed a larger pig supply than expected. In particular, the March-May pig crop at 102.55% of a year ago was 1.85% above pre-report expectations, which ranged from 99.6% to 101%. As a result, there was a notable increase in lighter-weight pigs that will be coming to market between mid-August and mid-November, putting pressure on nearby marketing periods. On the other hand, September-November farrowing intentions were reported at 98.87% of last year, which was down 1.93% from pre-report estimates, and provided support to deferred contracts. On the feed side, USDA released a quarterly inventory report of grain stocks along with revised acreage at the end of June. Corn planted area was revised up 547,000 acres from the March Planting Intentions to 94.148 million, 1.389 million above the average trade guess and also higher than the estimate range of between 92 and 94 million acres. In addition to the acreage surprise, June 1 corn stocks were estimated at 4.722 billion bushels, which was nearly 200 million above the average trade forecast and likewise outside of the estimate range of between 4.437 and 4.625 billion bushels. The figures suggest that the July WASDE report may include a sharp upward revision to both old-crop and new-crop ending stocks, which would offset the effects of any potential weather issues that might arise. Clients that had strengthened their hog hedges benefitted from those adjustments and many are currently looking to actively strengthen feed hedges following the sharp drop in corn prices.



The Hog Margin calculation assumes that 73 lbs of soybean meal and 4.87 bushels of corn are required to produce 100 lean hog lbs. Additional assumed costs include $40 per cwt for other feed and non-feed expenses.

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Dairy margins continued to strengthen over the last half of June due to a combination of higher milk prices and sharply lower feed costs. In a reversal of fortune, margins are now projected positive from negative readings earlier in the month for the spot Q3 period through the first half of 2017, with Q2 margins for next year above the 80th percentile of the previous 10 years. Strength in the spot cheese market further bolstered milk prices, with both blocks and barrels trading higher over the past two weeks. Ongoing concerns over recent heat impacting cow comfort and milk production remain supportive. USDA's latest monthly production report showed May output at 18.65 billion pounds, up 1.2% from last year, with the dairy herd revised down 4,000 head, but still the largest since December 2008. The monthly Cold Storage report continued to reflect large stocks of dairy products. Inventories of natural cheese in cold storage reached 1.25 billion pounds at the end of May, up 3.3% or 40 million pounds from April, a month when the average increase over the past five years has typically been only 17.7 million pounds. Butter stocks in cold storage totaled 324.9 million pounds, up 29.2 million from April and 22.5% from last year. USDA also released the Quarterly Grain Stocks and June acreage reports at the end of the month. Both figures were considered very bearish for corn. Planted area was revised up 547,000 acres from the March Planting Intentions to 94.148 million, which was nearly 1.4 million acres above the average trade guess and outside the range of estimates. June 1 corn stocks were pegged at 4.722 billion bushels, almost 200 million above the average trade forecast and again outside the range of estimates. Our clients have been adding protection in deferred periods following improved margins, while also making adjustments to existing positions, particularly strengthening milk and feed hedges.

The Dairy Margin calculation assumes, using a feed price correlation model, that for a typical dairy 62.4 lbs of corn (or equivalent) and 7.34 lbs of meal (or equivalent) are required to produce 100 lbs of milk (includes dry cows, excludes heifers not yet fresh). Additional assumed costs include $0.90/cwt for other, non-correlating feeds, $2.65/cwt for corn and meal basis, and $8.00/cwt for non-feed expenses. Milk basis is $0.75/cwt and non-milk revenue is $1.00/cwt.

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Beef Margin Watch: June

Beef margins improved over the last half of June as feed costs fell sharply while cattle prices held relatively steady since the middle of the month. USDA released their highly anticipated Quarterly Grain Stocks and June acreage reports, which were both considered very bearish for corn. Corn planted area was revised up 547,000 acres from the March Planting Intentions to 94.148 million. The estimate countered expectations for a decline with ideas that intended corn area got switched to soybeans following a sharp rally in that market from early April to early June. The new acreage figure was 1.389 million above the average trade guess and outside the expectation range of between 92 and 94 million acres. Meanwhile, June 1 corn stocks were pegged at 4.722 billion bushels, 194 million above the average trade forecast and likewise outside the estimate range of between 4.437 and 4.625 billion. The figures suggest that both old-crop and new-crop corn ending stocks will be revised higher in the July WASDE report and would help offset the effects of any potential weather issues that might arise. USDA's monthly Cattle on Feed report was considered neutral, as the figures were very close to industry estimates. The June 1 cattle on feed inventory rose 2.2% from last year, with placements up 9.6% from a year ago and marketings 4.9% above 2015. Beef in Cold Storage was estimated at 446.7 million pounds at the end of May, down 5.9% from last year and in line with a normal seasonal drawdown in beef stocks this time of year. Our clients have seen a significant benefit recently from reducing delta on feed hedges following the sharp drop in price, and are now looking to strengthen those positions and secure the cost savings that have accrued.

Live Cattle Marketing Periods:

Aug '16 2015 2016 — Aug 2016: HIGH **($2.49)** LOW **($17.84)** LAST **($11.89)** 10YR PERCENTILE **8.7%**

Oct '16 2015 2016 — Oct 2016: HIGH **($1.60)** LOW **($37.51)** LAST **($7.10)** 10YR PERCENTILE **15.0%**

Dec '16 2015 2016 — Dec 2016: HIGH **($1.87)** LOW **($34.83)** LAST **($2.51)** 10YR PERCENTILE **54.1%**

Feb '17 2016 2017 — Feb 2017: HIGH **($3.16)** LOW **($33.93)** LAST **($3.16)** 10YR PERCENTILE **35.8%**

Apr '17 2016 2017 Apr 2017: HIGH **($1.00)** LOW **($20.55)** LAST **($2.95)** 10YR PERCENTILE **44.0%**

Jun '17 2016 2017 Jun 2017: HIGH **$0.65** LOW **($15.72)** LAST **($5.98)** 10YR PERCENTILE **41.8%**

The Beef Margin calculation uses Feeder Cattle futures to price inbound animals and assumes each will consume 55 bushels of corn and cost approximately $250 per head (for other feed and non-feed expenses) to gain 550 pounds and reach a market weight of 1,250 pounds.

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Corn prices and margins have cascaded lower over the past two weeks. Rains and forecasts for additional moisture have severally dampened prices and many now argue all weather premiums have been wiped out of the price of corn. Additionally, the entire commodity market was shocked by passage of English voters of the referendum proposing the United Kingdom to leave the European Union, especially as many polls had been pointing to the measure's defeat. While the exit is expected to take at least a couple of years to play out, the response from the corn market was immediate. Another surprise for the corn market was the data revealed in the quarterly grain stocks and planted acreage reports. Stocks of corn as of June 1 were 4,722 million bushels, up 6% from last year, and almost 200 million bushels above the average pre-report expectations. Also, U.S. corn planted acreage was even higher than the whopping 93.601 million acres reported on the intentions report in March. At 94.148 million planted acres, this figure represents the third highest planted acreage of corn since 1944 and completely outstripped the average pre-report expectation of fewer acres planted. So far this crop year, corn conditions have been steady at elevated levels, registering at 75% in the Good/Excellent categories over the past few readings. Export inspections have continued to be vigorous, backing up very healthy global U.S. corn sales. Given the recent down move in corn, many of our clients have been working to lighten position delta moving to more flexible positions.

The estimated yield for the 2016 crop is 182 bushels per acre and the non-land operating cost is $595 per acre. Land cost for 2016 is estimated at $238 per acre [1]. Basis for the 2016 crop is estimated at $-0.1 per bushel.

The estimated yield for the 2017 crop is 184 bushels per acre and the estimated operating cost is $564 per acre. Land cost for 2017 is estimated at $228 per acre [1]. Basis for the 2017 crop is estimated at $-0.15 per bushel.

[1] The Corn Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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Soybeans Margin Watch: June

Prices and margins in soybeans remained steady these past two weeks despite market turmoil. While the referendum vote in England over the exit of the United Kingdom from the European Union put some pressure on soybean prices, the overall affect was not as dramatic as in other major commodities. Perhaps given soybeans' unique current fundamental picture, an initial kneejerk reaction was tempered following the epic vote. The alternative fundamental outlook was further reinforced mostly by the planted acreage report. Even though the reported soybean planted acreage number of 83.688 million acres is a record high estimate, it undershot the average pre-report projection of 83.969, and whispers of even greater acres seeded. Soybean stocks as of June 1 were 869 million bushels, up 39% over last year's tighter supply situation, and were higher than many had anticipated. The higher quarterly stocks of beans did little to counter the lower acreage projection. U.S. origin soybean sales and shipments have continued to fill the gaps caused by South American weather issues over the past couple of months, further supporting prices. New crop soybean conditions, while off the high-water mark, are still maintaining near record Good/Excellent ratings. Our clients are taking advantage of the soybean volatility by strengthening position delta to capitalize on margin opportunities that are significantly more favorable than just a month ago.

The estimated yield for the 2016 crop is 52 bushels per acre and the non-land operating cost is $365 per acre. Land cost for 2016 is estimated at $238 per acre [1]. Basis for the 2016 crop is estimated at $-0.16 per bushel.

The estimated yield for the 2017 crop is 53 bushels per acre and the estimated operating cost is $339 per acre. Land cost for 2017 is estimated at $228 per acre [1]. Basis for the 2017 crop is estimated at $-0.16 per bushel.

[1] The Soybeans Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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Wheat Margin Watch: June

Wheat prices and margins had a rough two weeks. Expectations of near record yields for U.S. wheat, as well as reactions to the referendum vote in England in favor of the United Kingdom to exit the European Union put wheat on the defensive. Wheat prices are currently at levels not seen in years and are approaching levels not seen in almost a decade. The quarterly stocks report offered all wheat stockpiles as of June 1 at 981 million bushels, one million bushels lower than average pre-report expectations, but 30% greater than 2015. The planted acreage report had all wheat plantings at 50.816 million acres, an increase of 1.257 million acres from the intentions report in March, and 1.084 million acres higher than the pre-report average. Total all wheat planted acreage however was almost 4 million acres less than seedings last year. Winter wheat conditions continue to excel, with 62% in the Good/Excellent categories, ahead of last year by over 20%, and the harvest is now approaching 50% complete. Our clients are responding to the sharp decline by adjusting overall coverage to flexible, lighter delta positions.

The estimated yield for the 2016 crop is 67 bushels per acre and the non-land operating cost is $358 per acre. Land cost for 2016 is estimated at $158 per acre [1]. Basis for the 2016 crop is estimated at $-0.3 per bushel.

The estimated yield for the 2017 crop is 68 bushels per acre and the estimated operating cost is $345 per acre. Land cost for 2017 is estimated at $150 per acre [1]. Basis for the 2017 crop is estimated at $-0.3 per bushel.

[1] The Wheat Margin Watch yield, land and non-land operating cost values are based upon central Illinois low productivity farmland crop estimates in the "Historic Corn, Soybean, Wheat, and Double-crop Soybeans" report published by the Department of Agricultural and Consumer Economics at the University of Illinois.

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