

Risk Management

For Ranchers
TSCRA
3/19/2010

How do I Practice Risk Management?

You already do.

Ranchers use a number of management practices to decrease risk.

- Fertility test bulls
- Feed Mineral
- Pregnancy test cows
- Vaccinate against disease

Manage Your Price Risk

- Decreasing the risk of low prices at sales time is one of the major risk reducing practices that a ranch can use.
- Unfortunately, it is one of the least used!

Manage Your Price Risk

- There are a number of tools that can be used to decrease risk at any time,
- Futures markets
- Options Markets
- Forward contracting

Manage Your Price Risk

- Each of these tools involve establishing a price for calves at some time other than your normal sales day.
- Each of these tools requires study of the market during the course of the year.
- Each of these tools can be used incorrectly.

Manage Your Price Risk

- The first step in using any risk management tools is:
- Define your risk. Calculate a breakeven price. Until you know where the breakeven price is, it is difficult to manage risk.
- You must decide what costs should be included in your own breakeven.

Manage Your Price Risk

- Once you have calculated a breakeven price, you can begin to evaluate the risk management tools.
- We know that prices move up and down throughout the year due to:
 - Supply of calves
 - Cost of grain
 - Price of fed cattle
 - Etc.

Manage Your Price Risk

- Risk management is selling your calves when the price is sufficiently above the breakeven price to give you a profit.
- A calf crop should be for sale every day of their lives and sold when the price is right not when the time is right.
 - This may occur the day after they are born
 - It will usually not be the day they are weaned

Manage Your Price Risk

- Futures market:
 - This is a paper trading market at the Chicago Mercantile exchange that allows hedgers (ranchers) to price their calves and speculators to bet on what direction calf prices are going.
 - Using the futures market can only be done through the use of a commodity broker.
 - The broker can be of great service to a rancher if the broker is experienced in the cattle business.

Manage Your Price Risk

- Futures market:
 - The quantity that can be hedged is a 50,000 lb group of feeder cattle on each contract. Depending on when you sell your calves and their weight you can calculate how many contracts you might require.
 - By selling the contract when it is near or at the price you need to make a sufficient profit and buying it back when you actually sell the calves, you can remove price risk.

Manage Your Price Risk

- Options market:
 - The option markets are futures markets on the futures market.
 - The contracts are either **Puts** or **Calls**.
 - A put entitles you to sell a futures contract at some point in the future at a price you set today.
 - A call entitles you to buy a futures contract at some point in the future at a price you set today.

Manage Your Price Risk

- Options market:
 - The options allow you a "just in case" type of risk management.
 - The options function like any type of insurance.
 - You pay a premium
 - The premium is determined by how long you want protection and how much protection you need.
 - The amount of protection is determined by your breakeven and your profit objectives.

Manage Your Price Risk

- Options market:
 - You need to use a knowledgeable broker to advise you as you operate within the options market.
 - The contract size is the same for options as it is for the futures market.

Manage Your Price Risk

- Forward Contracting:
 - This tool will allow you to price calves prior to weaning with a prospective buyer.
 - Most feed yards have forward contracting programs.
 - You must be able to sell in truckload quantities
 - A previous relationship with the buyer makes it easier to set up this tool.

Manage Your Price Risk

- Forward contracting:
 - The setting of the prices works the same as in the futures and options market.
 - Breakeven first
 - Watch the market
 - Make contact with the potential contractor before you are ready to set the price.
 - Act when the time is right.

Manage Your Price Risk

- There are tools that can be used to reduce risk sometimes.
- Retained ownership
 - The conditions must be **right**:
 - The price of fed steers in the futures market
 - The cost of gain in the feed yard
 - This combination must yield a higher price for feeder cattle than the currently available price.

Manage Your Price Risk

- Summary:
- There are several tools available to decrease price risk on calves.
 - They require:
 - Homework
 - Study
 - Preparation
 - Discipline
- Risk Management is no different than any other tool we have learned to use to defray risk. We just have to use it.