

Post-Harvest Marketing Alternatives

Introduction

- The marketing time frame for crops can be divided into three parts – pre-harvest, harvest, and post-harvest.
- It is advantageous to consider various pricing strategies that can be used for a portion of the crop(s) after harvest.
- The willingness to price a crop before harvest lengthens the producer's marketing season and allows more opportunities to capture a desired target price.

Storing Grain (speculative storage)

- The producer needs to determine if there is an economic incentive to store, rather than just storing grain out of habit.
- To determine this, the producer first needs to know the cost associated with storing the grain (storage rates, in and out charges, shrink, interest/opportunity cost, etc.)
- Next, the producer needs to have an idea of how far cash prices might rise in the future.
- If the producer expects the cash price to increase, he must determine whether the increase will be large enough to more than offset the associated storage costs. One way this can be accomplished is by reviewing the futures prices for upcoming months along with the current futures price, local cash price, and storage costs.
- One must keep in mind that this method of comparison will never show much of a return to storage since the incentive to arbitrage the market will induce market participants to store grain whenever prices near full carry.
- Another important fact to remember is that holding unpriced grain in storage is a speculative venture. If prices decline instead of rising after harvest, the producer stands to lose two ways. First, the price received for the grain when it is sold is lower than it was at harvest. Secondly, the producer must pay the storage costs.

Advantages and Disadvantages for Storing Grain

Advantages of Storing Grain	Disadvantages of Storing Grain
Extends the marketing season	Prices may not increase enough to cover storage costs
Can take advantage of higher prices if they occur	Basis may weaken
Can take advantage of strengthening basis if it occurs	Producer is unprotected against falling prices
	Stored grain can lose quality

Table 1. Returns on Storage

It is October now	December	March	May
Futures price	\$3.90	\$4.10	\$4.20
Expected basis	0.10	0.15	0.20
Expected cash price	\$4.00	\$4.25	\$4.40
Less current cash price	\$4.00	\$4.00	\$4.00
Less storage and interest*	0.00	0.25	0.38
Returns to Storage	0.00	0.00	0.02

*Interest calculated at 10% of September cash price; storage at \$0.03/bushel/month

Replacing Cash with Futures

- Another strategy that allows the producer to take advantage of rising prices is to sell the cash grain at harvest and buy an equal amount in the futures market (long position).
- The downside to this strategy is that if the prices decline very far, margin calls will be required to maintain equity in your margin account. If you are not prepared to handle them, this could cause cash flow problems.
- There also are a couple of advantages to this strategy. The producer does not incur storage costs, and the margin needed to re-own the crop in the futures market is only a fraction of the crop's actual value, which allows the producer to use the remainder of the cash to pay off debt, reinvest in the farm, etc.

Forward Cash Contract

- With a forward cash contract, a grain elevator or feedlot offers the producer a set price for the specified delivery date.
- The underlying purpose of post-harvest forward contracting is to earn a return on one's storage investment. Producers also may use this method as a way to move income into the next year for tax purposes.

Advantages and Disadvantages of Forward Contracts

Advantages of Forward Contracts	Disadvantages of Forward Contracts
Simple to use and understand	Prevent producer from capturing higher prices (if they occur)
Eliminate risk of weakening basis	Stored grain may lose quality
Eliminate downside price risk	Obligated to pay storage and interest costs

Store Grain and Sell Futures (storage hedge)

- Storing grain and selling futures is commonly referred to as a “storage hedge.”
- The primary advantage of a storage hedge is that it locks in a general price level and reduces price risk because the hedger is short in the futures market.
- A storage hedge protects against changes in the overall level of market prices, but still allows the producer to speculate on the basis and capitalize on a strengthening basis if it should occur.
- You might consider this alternative if you are satisfied with the general price level but think you can add to that price by locking in a return on storage.

Advantages and Disadvantages of Storage Hedge

Advantages of Storage Hedge	Disadvantages of Storage Hedge
Can capitalize on strengthening basis	Susceptible to weakening basis
Extends the marketing season	Prevents producer from capturing higher prices
Protects against downside price risk	Stored grain may lose quality
	Obligated to pay storage and interest costs
	Margin calls can squeeze cash flows, especially when grain has not been sold yet.

Table 1. Placing the Hedge

	Futures Market	Cash Market
October	Sell March futures at \$4.10 and store grain	Cash price offer \$3.80
March	Buy March futures at \$3.50	Sell cash grain at \$3.60
Hedge results		
Cash grain price in March		\$3.60
+ Futures gain/loss		\$0.60
-Storage Costs		\$0.25
= Final Price		\$3.95
Return on Storage Hedge		
+ Difference in March – December		\$0.20
+ Expected basis change (Oct. – Mar.)		\$0.20
-Storage and interest cost		\$0.20
= Return on storage hedge		\$0.25

Advantages and Disadvantages of Selling at Harvest and Buying Call Option(s)

Advantages of selling at harvest and buying call option(s)	Disadvantages of selling at harvest and buying call option(s)
Can capitalize on rising prices	Call option premiums can be costly
Avoids cost of storage	Harvest time is usually when cash prices are lowest
Harvest sale makes cash available sooner	