

LIVESTOCK RISK PROTECTION: EVALUATING COVERAGE WITH THE RISK SCENARIO PLANNING TOOL

Wyoming cattle producers John and Cindy Robb* in a previous installment looked into how Livestock Risk Protection (LRP) might work to limit at least some of the price risk in their operation.

They decided on a 21-week contract at 96 percent coverage for their 100 head of steer calves weighing 600 pounds. This LRP contract had a total insured value of \$77,964 and a premium cost of \$2,967.

The main question for the Robbs with this policy is its overall effectiveness. We might ask, "What is the likelihood of an indemnity payment that would cover premium costs?" A partial budget analysis can help answer the question; the Risk Scenario Planning (RSP) tool properly addresses the associated risks.

RSP Tool Setup

The RSP tool from RightRisk.org helps users evaluate the inherent risk involved in the partial budgeting process. The tool is set up like most partial budgets, with four categories (added returns, reduced costs, added costs, and reduced returns) resulting in estimated net revenue value. Instead of choosing just one value for items that may vary, such as price in this analysis, the tool allows users to examine a range of values (maximum, minimum, and most likely) and the effect on the budget bottom line.

Problems arise when using set values in the budgeting process where they do not account for variability (risk). The RSP tool helps indicate how a range of values (not just a single guess) can affect the budget decision and account for the uncertainty.

Tool Budgets and Analysis

For our example, we input data in two budget categories: added returns and added costs. Under added costs, we enter the LRP premium of \$4,945/cwt on 600 cwt (\$2,967 total).

We account for a potential indemnity payment under the added returns section. The coverage price is \$130/cwt, and we assume the index price in September will be the same (\$130/cwt). We enter the indemnity as a function of both the index price and the coverage price (coverage price minus the index price).

This will result in a positive indemnity payment only if the index price is lower than the coverage value. Expected actual calf sales and corresponding expected cash price are entered at \$130/cwt as well.

The Robbs' net return would total \$75,033 (calf sales of \$78,000 minus the LRP premium of \$2,967), assuming the expected prices at the end of the contract period and no indemnity payment. (See Partial Budget chart below.)

How do we account for uncertainty in the LRP index price and calf sales? This is where the value of the RSP tool comes into play. Suppose the Robbs forecast a maximum value of \$140/cwt and a minimum value of \$115/cwt for the ending index value. We can also factor in the uncertainty of the price received for steers in September, with a maximum of \$140/cwt and a minimum of \$120/cwt. Clicking RUN causes the tool to generate a probability distribution, based on the values we entered. The resulting graph describes the range and likelihood of net revenue outcomes, given the various possible combinations of values entered.

The distribution reveals a 50 percent probability of the strategy generating a net return of \$76,152 or less, with a maximum possible return of \$84,798 and minimum of \$70,368. (See Probability chart below.) Stated another way, there is a 50 percent probability the net return will be just over a thousand dollars higher with LRP price protection in place, as compared to the expected value without it (\$75,033).

*The Robb operation is a case study example created to demonstrate RightRisk tools and their application. No identification with actual persons (living or deceased), places, or agricultural operation is intended nor should be inferred.

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LRP Overview

- LRP is designed for livestock producers (fed and feeder cattle, swine, and lamb) to cover declines in price
- Contracts available from 70-100% of expected ending value of cattle
- Contract lengths range from 13 to 52 weeks
- Indemnities are paid where actual ending values are lower than the coverage value
- Values are set by a CME index
- Total number of insurable livestock varies by species
- Ending value has no bearing on cash price received

RISK MANAGEMENT, CASH FLOW PLANNING FOR AGRICULTURAL BUSINESSES

Wyoming Small Business Development Center (SBDC) Network advisers work with many business clients with cash flow and other financial management processes.

While that can be foreign to many folks, especially new businesses, agricultural businesses tend to be good at understanding the seasonal nature of their cash flows and the challenges that timing of revenue and expenses can create. That dynamic has been even more unpredictable given the current COVID-19 pandemic.

Closures of some meat packing plants and other market factors has led many to wonder, "What can I do to potentially reduce my risk?"

Livestock producers and row crop farmers often account for the timing difference between income and expenses by using a line of credit from a lender. The idea being to borrow money on the line to pay expenses when they are due, then pay the loan back when they sell livestock or a crop, hopefully with enough extra for some profit.

Analyze, cut unnecessary risks

While paying attention to operating expenses is always a good idea, now is an especially important time to analyze everything and see if you can cut some of those unnecessary items. You might source a less expensive option or postpone a planned purchase for another time. The bottom line is business owners must know their cost structure, and every operation is different!

As they say, cash is king, something even more important in times of greater uncertainty.

If you are a small ag business looking for ways to manage your cash flow challenges, this

may be a good time to look into using options or futures to hedge your risks for marketing cattle. If prices happen to go up in the near future and your business purchases a favorable position, you will be sitting good if prices take a tumble with economic uncertainty late in the year or going into the next year; however, I would encourage you to work with a professional if you are not familiar with this form of investing or risk management.

Consider marketing options

Planning now to make sale dates for calves flexible is another consideration. If fall calf prices are low, perhaps having a plan to keep them longer makes sense. Marketing is going to be extremely important, so watch closely. So much is influenced by the news these days, and we all have 24/7 access to breaking news such as the previously mentioned meat plant closures.

While we hope the worst of the closures is behind us, pay attention and be ready to act accordingly. Considering options ahead of time will likely be beneficial and allow movement more quickly.

Economic Injury Disaster Loans

The Small Business Administration's Economic Injury Disaster Loan (EIDL) program is another opportunity for agricultural producers to consider. While EIDLs traditionally have not been available to ag producers, an exception was made for COVID-19. EIDLs are 30-year, 3.75 percent interest loans to help with working capital needs, and payments are deferred for one year. The online application can be found at www.sba.gov. Be advised that EIDL loans are still available, but the Small Business Administration cautions that funds may soon be depleted.

These loans are underwritten and funded directly by the SBA Office of Disaster Assistance, not through a local lender. Contact your local Wyoming SBDC Network adviser to assist you through this application process and answer any questions you may have about this program. Contact information is at www.wyomingsbdc.org.

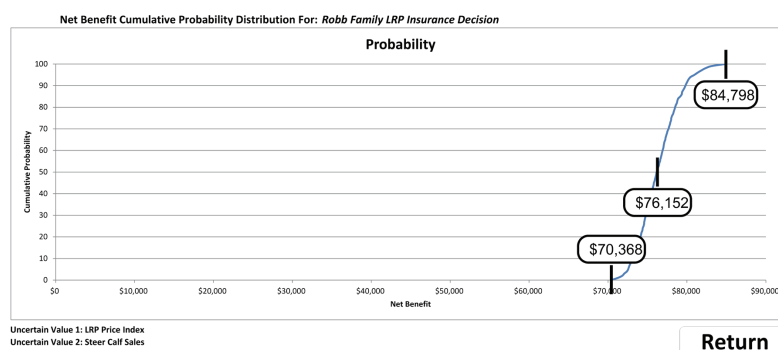
The Wyoming SBDC is waiving registration fees for webinars and webinar recordings to help entrepreneurs during the COVID-19 pandemic. Information is at www.wyomingsbdc.org/training.

Bruce Morse is the Wyoming SBDC regional director for Big Horn, Hot Springs, Park, and Washakie counties. He can be reached at (307) 754-2139 or at bmorse1@uwyo.edu.

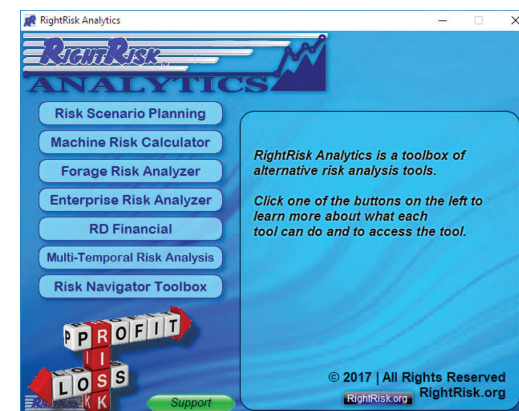
Partial Budget For: Robb Family LRP Insurance Decision			
Positive Effects		Negative Effects	
Added Returns	Quantity	Value	Total
LRP Price Index		\$ 130.00	\$ -
LRP Coverage Price		\$ 130.00	\$ -
Calf Sales (cwt.)	600	\$ 130.00	\$ 78,000.00
LRP Indemnity	600	\$ -	\$ -
Total Positive Effects			
(Added Returns + Reduced Costs)		\$ 78,000.00	
Added Costs		Quantity	Value
LRP Premium	600	\$ 4.95	\$ 2,967.00
Total Negative Effects			
(Added Costs + Reduced Returns)		\$ 2,967.00	
Net Benefit of: Robb Family LRP Insurance Decision			\$ 75,033.00

Risk Scenarios			
Uncertain Value 1		Uncertain Value 2	
Description	Cell	Description	Cell
LRP Price Index	D7	Steer Calf Sales	D10
Current Value (Most Likely)	130	Current Value (Most Likely)	130
Minimum Value	115	Minimum Value	120
Maximum Value	140	Maximum Value	140

Determining the Robbs' net return, assuming the expected prices at the end of the contract period and no indemnity payment.



Using the Risk Scenario Planning tool to determine possible net returns at various probability levels.



For further information

Livestock Risk Protection (LRP) is just one of the many risk management options available to Wyoming producers. Almost all crops and livestock have a policy that can mitigate some of the risk involved with production. Visit rma.usda.gov or a crop insurance agent for more information.

RightRisk Analytics Toolbox

The Analytics Toolbox includes the RSP tool and several other risk analytics tools covering a wide range of agricultural risk management questions and issues, including budgeting, forage leasing, machinery cost, and whole farm budgeting.

To view or download the toolbox:

- Logon to RightRisk.org.
- Under the Resources Tab, select Risk Management Tools.

DIRECT-MARKETING BEEF TO CONSUMERS COULD BOOST SAGGING PROFITS

This year has been a "different" one for folks in Wyoming, including our cattle producers.

Live cattle prices have remained lower than usual, and the profitability window has been tight, especially for smaller operations. The value of retail beef has remained strong even though live cattle prices have been somewhat disappointing.

This situation has some producers trying new things and getting creative with marketing their products. For example, instead of selling all of their calves like usual at lower prices, some producers are opting to retain ownership of a small portion of their calves. They will feed them to finished weights, have them processed, and market them directly to consumers themselves.

This process means increased costs, but capitalizing on higher profit margins for their products is also possible. Perhaps they can make up some of their profit losses this year by skipping the middle man and selling their own products directly to the consumer for a better price. This idea is not a new one, and it has its challenges, but it is possible if you have a good plan.

There are several factors to consider if you are going to sell your own beef.

Know your market and know what makes your product unique. You have to have something that convinces people your product is worth buying instead of going with a marked-down deal on a big store's meat shelves. You can find a niche they will pay for by understanding what is important to your target market. You can market your product as locally grown, exceptional quality, grass-fed,

all-natural, etc. However you decide to establish your brand, make sure it jives with what's important to your target audience.

Understand your limitations. The Wyoming Food Freedom Act allows sales of state-inspected meat directly to consumers but not to restaurants, grocery stores, or across state lines without inspection from a certified USDA facility. Retaining animals will require additional costs per animal in the form of pasture, time, and resources. Ensure the extra costs won't outweigh the potentially added value. Another priority is you will need reservations with your packer to get your beef processed. This can be more difficult than one might expect, and plans should be confirmed well in advance. Options in Wyoming are still limited.

Have a plan on how you will sell or package your beef and for what price. Will you sell it as a whole beef or divide it into halves or quarters? Or, will you sell mixed boxes of beef? Will you label the packages or how do you plan to tell your products' story? Ask yourself these questions and make sure you have a plan on how you package your products.

This process will require time and hustle to accomplish. Finding buyers should also start well before the beef is ready. Direct-sale opportunities may be limited in Wyoming, so keep the number of retained animals realistic so you can get your products sold. Also have a plan for venues to sell the product (farmers markets, social media, etc.).

Formulating a sound business plan is very important. Reference articles that detail marketing at a farmers markets and telling your products' story. Understand the do's and don'ts of direct-marketing your beef and protecting yourself from liability. Lastly, utilize your local resources. UW Extension offices and Small Business Development Centers are located throughout the state and have experienced professionals available that can help you develop your business plan for free or at a very low cost.

Plan to have lots of extra beef in your freezer if you don't do your homework. But if you can put in the effort, it could be worth it during a year like 2020!

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More enterprise resources

- This resource discusses the do's and don'ts of direct marketing your beef. — bit.ly/direct-marketing-beef
- Extensive resources for those considering food ventures. — bit.ly/food-ventures
- Value added enterprise considerations. — bit.ly/value-added-wyo