RISK MANAGEMENT PROFILES

Fillizar Ranches Manage Forage and Marketing Risks

Art Fillizar and his wife Leinani Aku own and operate Fillizar Ranches on one of the islands of Hawaii. Art grew up on the ranch that has been in the family for several generations. They have always been a cow-calf operation, marketing their beef mostly through local markets.

Keeping the ranch in the black is increasingly difficult with recent droughts and increasing input costs. Art and Leinani have been over their accounts numerous times in the past couple of years looking for adjustments they might make to improve ranch profitability. The list of alternatives seems to narrow down to two basic strategies: better management of existing pasture forage production and looking into other marketing options for better price risk management.

Forage Production Risk

Fillizar Ranches currently operate with about 140 cows. Historically, their cow numbers had been nearly a third more than that, but drought conditions over the past several years have forced them to cut numbers dramatically. They sell around 130 calves each year near the top of local prices.

Historically, the Fillizars have had more than adequate forage to support their cow herd. In fact, just a few years ago, they had considered holding some calves back to try grass fattening to diversify their product mix. Dry conditions have led them to not only scrap those plans, but they have had to reduce cow numbers as well.

Options the Fillizars are considering for better managing their forage production risk include: Whole Farm Revenue Protection

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(WFRP) insurance, Non-insured Crop Disaster Assistance (NAP) coverage available from the Farm Service Agency (FSA), and using the Hawaii Forage Production Estimator tool -- software allowing users to more closely manage pastures using current rainfall data.

Art contacted a crop insurance agent about the possibilities of using WFRP to cover revenue losses the ranch was experiencing. The agent explained that although the product could provide protection for a revenue stream documented with 5 years of historical records, it does not often work well for ranch operations. In livestock operations, managers usually provide supplementation or reduce animal numbers in a drought, rather than see them loose weight or experience other losses. As a result, annual ranch revenue would not often fall far enough due to a drought for an indemnity payment to be triggered.

Following up with the Farm Service Agency, Leinani learned that NAP coverage is low cost and could provide a payment for losses due to a drought. NAP coverage applies to the whole farm. This makes all farm acres eligible for disaster assistance. NAP protects against production losses of 50 percent or greater and is limited to a total payment of $100,000.

Another risk management option Art and Leinani may want to consider for the future is the Livestock Forage Disaster Program (LFP). This program was created as part of the 2008 Farm Bill to aid livestock producers in the event of drought or fire. To be eligible, a producer must have owned the livestock for at least 60 days prior to the disaster.

Qualifying loss must have taken place in a declared disaster county (in cases of drought) or a recognized major fire area. A producer must have purchased Non-insured Crop Disaster Assistance Program (NAP) coverage. Although Congress has not yet refunded the LFP program, expectations are that such funding will be included in a new Farm Bill.

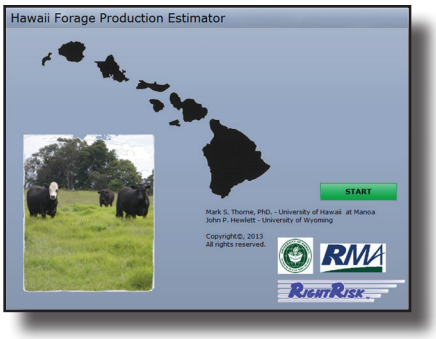
If any portion of a county where Fillizar Ranches are located received a “D2” drought declaration for at least 8 weeks during a year, the Fillizars could be eligible for a one-month indemnity payment if they meet the requirements. More severe events or drought events longer in duration would result in larger indemnity payments. In addition, if their forage losses were greater than 50 percent, the Fillizars may receive an additional payment under their NAP coverage, provided they enrolled before the sign-up date.

The last option Art and Leinani are looking into is the Hawaii Forage Production Estimator tool. This tool is a recently developed software program based upon several years of data collect by the University of Hawaii at Mānoa across three islands. Weather data from several stations was collected, as well as forage clipping observations for a minimum of three years. A University of Hawaii Cooperative Extension Service bulletin entitled “Hawaii Rainfall and Forage Production Index Project – Final Performance Report” provides further details on the project.

A software tool based on the report is now available. Known as the Hawaii Forage Production Estimator tool, the software allows users to better match pasture production with livestock harvest. The tool evaluates pasture production based on local rainfall data. Users can determine the level of livestock forage harvest while maintaining optimal range health. In addition, the tool provides estimates of forage production expected 30 or more days after noting received rainfall amounts.

Art and Leinani are planning to use the

Forage Production Estimator after attending a program offered by the University of Hawaii Extension. Their plan is to develop pasture-by-pasture estimates to develop a total forage supply picture for Fillizar Ranches over a year. They will then use the tool to modify the plan based on locally received rainfall amounts and cattle rotation over the course of the year. This should help them maintain pastures in better overall health and optimize livestock performance, even if drought conditions persist.



Market Risk

The ranch marketing strategy has been to sell to local markets for the most part. Over time, Leinani has tried working with island grocery outlets and restaurants. While these outlets can provide a higher price, the additional costs, requirements for higher quality, and need for a consistent supply create several challenges for the Fillizars' operation.

Art and Leinani had confidence when marketing along traditional lines in the past. Recent swings in market prices and increasing input costs, however, have made the price they receive for their calves even more important. Though prices have been generally higher in recent years, the Fillizars realize they likely will not remain so forever. They are looking for a better way to manage their price risks and associated swings in ranch income.

The Fillizars are not interested in trading contracts on the Board of Trade to manage price risk if they can avoid it. Art mentioned their situation to their local Extension agent and he told them they should check into the Livestock Risk Protection (LRP) product offered by the USDA Risk Management Agency (RMA) through livestock insurance agents. This insurance was only recently approved for sale in Hawaii, but has been available in other states since 2003.

Art sat down at their home computer and brought up the RMA website (www.rma.usda.gov). He learned that Livestock Risk Protection (LRP)-Feeder Cattle is an insurance product designed to protect feeder cattle producers against declining market prices. LRP-Feeder Cattle is available in 37 other states, as well as Hawaii, and may be purchased throughout the year from approved livestock insurance agents.

Producers start by submitting a one-time application for LRP-Feeder Cattle coverage. Once their application is accepted, they may purchase specific coverage endorsements for up to 1,000 head at a time. Art knew they didn't have to worry about that limit nor would they have to worry about the annual limit of 2,000 head per producer for each crop year (July 1 to June 30). Art read that producers select from a variety of coverage price levels and length of insurance coverage for each specific coverage endorsement.

He also read where it is best to match the end of the insurance period with the time feeder cattle would normally be marketed but the owner is not required to market them when the insurance period ends. That is, ownership of the feeder cattle may be retained beyond the insurance period.

Coverage is available for steers and heifers and producers may choose from two weight ranges: under 600 pounds and 600-900 pounds. Art reviewed details for LRP coverage for several insurance periods over the previous year.

Armed with this information, Art sat down with Leinani and explained how LRP-Feeder Cattle was designed to work and how they might use it to protect against declining prices in the National feeder cattle markets. They decided to contact a livestock insurance agent and submit an application for LRP-Feeder Cattle coverage.

The agent developed an example to help the Fillizars better understand how LRP might work. She suggested they assume they had purchased LRP overage in January 2012 for 60 steers weighing 700 pounds with a coverage end date of July 2012 (a 26-week policy). The expected ending value for Steers Weight 2 was $157.934 per cwt. She further assumed they had selected a coverage price of $149.83 and the total premium cost was $3.179 per cwt. Total premium for the insurance was $1,335 but, after the 13 percent subsidy from USDA, their out-of-pocket premium expense was $1,161.

In late July 2012, RMA published actual ending values of $134.18 for the example coverage. Since this was $15.65 per cwt. below the coverage price selected, Fillizar Ranches would have received an indemnity check for $6,573 from the policy.

The drop in national price was also reflected in prices for calves marketed at the local level. Island prices averaged around $120 per cwt. After subtracting premium expenses, the Fillizars would have netted $5,412 from insurance. Adding this to the revenue from selling 62 head of steers weighing a total of 43,710 pounds (705 pound average) would have given the Fillizars a total of $57,864 or $1.32 per cwt. for their crop of feeder steers.

Summary

The Fillizars are starting to feel a little more confident about their future. After reviewing their options for better managing the forage production risks they face, they find they do have some options open to them. Enrolling for NAP coverage and possibly the LFP program can provide some assistance if drought conditions persist on the ranch.

The Hawaii Forage Production Estimator tool can help the Fillizars better manage their pastures to maintain good range health and optimum animal performance even in good rainfall periods. This added management information should help to improve the performance of the ranch overall, as well as allow them to react more appropriately when conditions are changing.

Finally, Art and Leinani realize that good commodity prices are better than receiving insurance indemnity payments, but they like the protection that LRP Feeder Cattle might offer in coming years. The premium expense is something they feel they can handle in their operating budget and they plan to incorporate LRP Feeder Cattle in their future risk management strategies.

Additional Resources:

Hawaii Rangelands
http://globalrangelands.org/hawaii
RightRisk Tools
http://RightRisk.org
USDA Farm Service Agency - Hawaii
http://www.fsa.usda.gov/FSA/stateoffapp?mystate=hi
USDA Risk Management Agency
http://www.rma.usda.gov