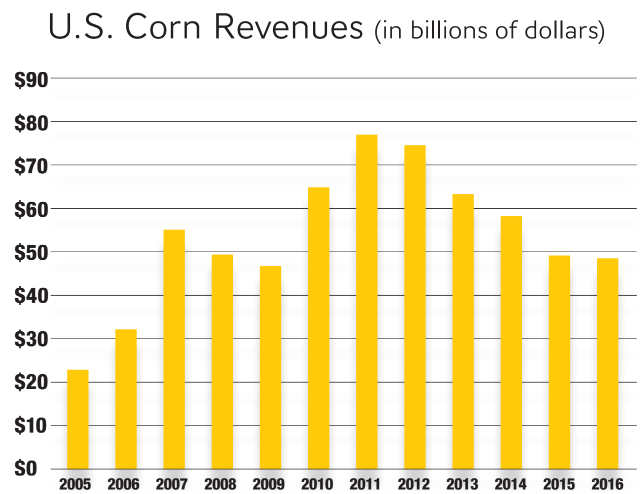
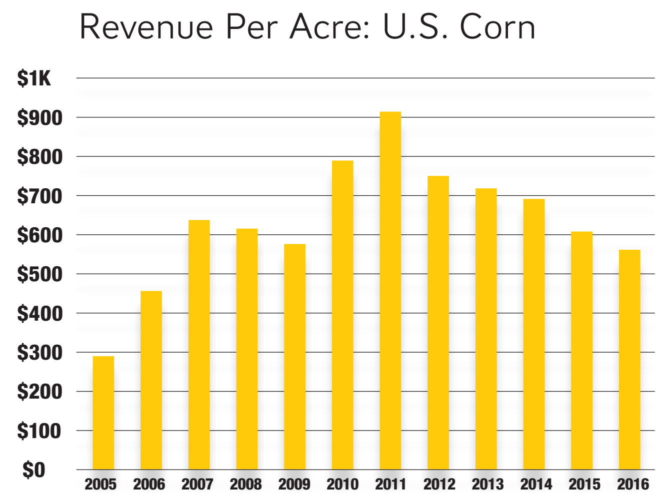
By Al Kluis





WEATHERING THE STORM

HERE'S WHAT SUCCESSFUL FARMERS DO TO SURVIVE UNTIL GOOD PRICES RETURN.

At every meeting I had during late summer and fall, someone asked this question: "When will prices get back to where I can make a profit again?"

The answer is not so easy. A lot of farmers are very frustrated after four years of lower grain prices. I stay focused on the markets. I study grain prices every day. I keep long-term weekly and monthly charts, and I'm very aware of long-term grain cycles. I've learned to look at futures prices, crop revenues, crop yields, and profits in several different ways.

For example, I look at national trends, such as total crop revenue. My team and I work with farmers to track the revenue on their farms. I've seen some farms stay profitable – even over the last several years – as crop prices and revenues fell.

So that big question we get so often really has two parts: "How have some individual farms stayed profitable over the last four years?" And, "What has to happen for the whole ag sector to get back in the black?"

PART I OF A 2-PART QUESTION

First, let's look at the farmers who have stayed profitable. How did they do it? Producers who have stayed profitable over the last four years have three characteristics in common.

1. They are low-cost producers. The biggest thing I see from one farm to the next is the difference in land cost and equipment cost per acre. The farmers who have stayed profitable sometimes pay higher cash rents, but they only rent highly productive farms. They also farm enough acres to keep their equipment cost per acre at a low price level. They use technology, but they don't always have brand-new equipment. They get their crops in on time, which usually sets them up for higher yields.

2. They consistently get good yields. The difference in input costs between the farmers who consistently get 250-bushel-per-acre corn and those who get 200-bushel-per-acre corn is about $70 per acre. That extra 50 bushels of corn per acre – even at just $3 per bushel – is an extra $80 net that goes straight to the bottom line. They do not buy the cheapest seed; they are not afraid to use fungicides. They go all-out to get the highest yield possible. They spend a lot of time walking their fields every summer.

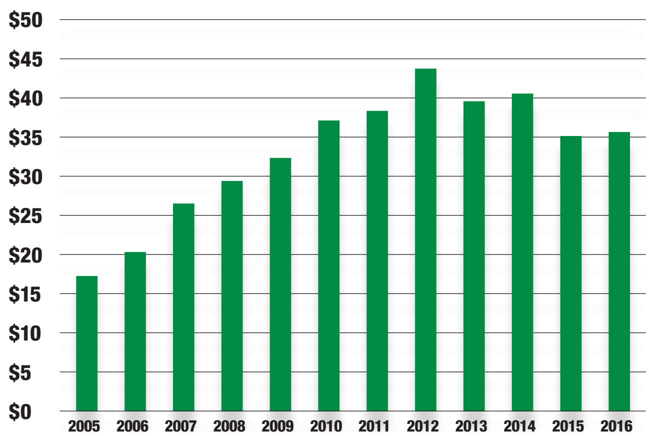
3. They are business people who work hard at marketing. These farmers have and *execute* a written marketing plan. The last two years show how important that is. In both 2015 and 2016, there was a meager three-week window to sell at a profit level. Profitable farmers sold aggressively during those three weeks. The farmers who followed my new-crop hedging recommendations are ahead over $100 per acre on new-crop corn and soybean income. For many farmers, that is the difference between a small profit or a loss this year.

The farmers who have done everything right are still only marginally profitable. Many of these farmers ▸

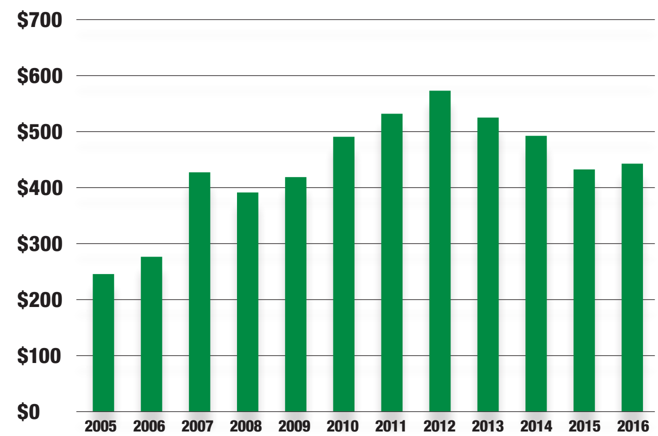
left: From 2005 to 2011, corn prices and revenue moved sharply higher. Total U.S. corn revenue went from $22 billion in 2005 to $77 billion in 2011. From that high, revenue has been falling for the last five years. My early estimate is for total 2016 corn revenue to be just $48 billion. I think this will prove to be a major long-term low in revenue and profits.

above: In 2005, the average gross income per acre of corn was $292. With that income, farmers were able to bring $20 to $40 per acre to the bottom line. The prices and revenue exploded until 2011, when gross corn revenue topped $900 per acre. Many farmers who had good yields and sold corn at $5 to $7 per bushel had bottom-line profits of $200 to $300 per acre. Revenue has been falling since then. My early estimate for the 2016 corn crop is just over $550 per acre in gross income. For the 2016 crop, this will create operating losses of about $150 per acre. The exceptions are farms with super-high 220-bushel-per-acre yield or those who sold ahead aggressively last summer.

U.S Soybean Revenues (in billions of dollars)



Revenue Per Acre: U.S. Soybeans



above: From 2005 to 2012, soybean prices and revenue rose sharply. Total U.S. soybean revenue went from $17 billion in 2005 to $44 billion in 2012. After that, revenues fell for three years to the low in 2015 at $35 billion. Because of the huge crop in 2016, my early estimate is for a slight gain in total soybean gross revenue in 2016 to $36 billion.

right: In 2005, the average gross per acre of soybeans was $238, and farmers were able to bottom-line $30 to $40 per acre. After 2005, both price and yields went higher. The average revenue per acre in 2012 hit just over $590 per acre. For farmers with good yields, this allowed many to bring $150 to $250 per acre to their farms' bottom lines. After 2012, prices started to fall. By 2015, gross income was down to $427 per acre. For 2016, my early projections are for a slight increase to $433 per acre. For most farms, grossing just $433 per acre will generate an operating loss of $70 to $120 per acre. Farmers who double-cropped soybeans after wheat or those who sold aggressively ahead last summer, may still have a profitable year.

are delaying equipment and other capital purchases. No one producing corn, soybeans, and wheat is making the profit levels that we experienced from 2009 through 2012.

It's not all bad news, however. Because of the lower prices, we are now experiencing a huge increase in demand. Because global demand continues to grow, we now need to produce a 14.4-billion-bushel corn crop in 2017 and a 4-billion-bushel soybean crop or ending stocks will start to drop.

PART 2

Now let's look at the second part of that big question: "When will good prices come back?" Here are three factors that will signal a return to higher prices, greater revenues, and better profits.

1. Continued strong and growing global demand. If anything happens that starts a trade dispute or a trade war, farmers will be in the industry sectors that will be hit the hardest. I am optimistic, though. My long-term grain charts suggest better prices by 2017 and 2018. With that forecast, I'm making the assumption that we keep exporting more grains and meats into an expanding global export market.

2. A weather problem in some part of the world. It's ironic that with three years of record grain production, farmers are struggling to make money. To get a fast turnaround, it will take a weather problem in South America or the U.S. in 2017. After four good years in a row, odds are pretty good that we will not have a fifth year of record production on both continents.

3. Total corn crop revenue needs to turn higher. I watch total corn revenue as the main indicator for grain farming profits. You can also see how cyclical corn revenue is. It was a huge run on my corn revenue chart when it took off from the 2005 low at $22 billion dollars per year to the high at $77 billion in 2011. This increased revenue pushed land rents higher and resulted in record-high land prices. Now, five years later, my estimate is that the U.S. corn revenue is down to $48 billion. With total revenue down by 32%, it stands to reason that land prices are down by 10% to 30%.

If total corn revenue can turn higher, then farm prices and farm profits will turn higher. Having charted and traded for 40 years, I know it's not a matter of *if*; it's a matter of *when*.

Until then, do what you can to keep your costs down while still getting the best yields you can. Focus on doing the best you can with your marketing. Good prices will return. SF

NOTE: Trading of futures and options has substantial financial risk of loss and is not for all investors.

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