

Searching for Profitable Margins

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AGRICULTURE IS like any other business in that producers are searching for ways to achieve profitability. Their margins, the difference between revenues and costs, depend on many factors: weather, crop yields, livestock birthing rates, production costs, demand, etc. Within agriculture, crop and livestock margins tend to be countercyclical. When crop margins are high, livestock margins are usually low and vice versa. This relationship makes sense as high crop prices create strong revenues for crop producers, but high production costs for livestock producers; and the current pricing situation shows the opposite holds as well. Low crop prices create weak revenues for crop producers and lower production costs for livestock producers.

For the hog industry, 2015 has been a mixed year, but the positives have outweighed the negatives. Figure 1 shows the projected margins for producing hogs in Iowa based on current futures prices for lean hogs, corn, and soybean meal. For the livestock margin graphs shown, the margins are computed above the major variable production costs and feed and animal acquisition costs. For the details behind the hog margin projections, see our swine margins website at www2.econ.iastate.edu/margins/swinecrush.htm. A rough rule of thumb is that Iowa hogs are profitable when the computed margins are above \$40 per head. While projected margins are below \$40 per head currently, profits are expected this summer and fall and throughout the spring and summer of 2016. While hog prices have fallen from their lofty heights of last year, hog prices are projected to hold between \$65 and

\$80 per hundredweight. Combined with lower feed costs, this results in a mostly profitable outlook over the next 18 months.

The hog industry has been in expansion mode for several months now. There were some early concerns that the industry would expand too quickly and supplies would drive prices down significantly. However, the latest USDA hog report showed the expansion was a bit smaller than anticipated, supporting a higher price picture. Also, with the passing of Memorial Day, the grilling season has started, providing support from the demand side of the market. Pork exports have also picked up recently, with the Chinese market starting to show some additional demand.

The profitability outlook for the cattle industry is also mixed, but it's not an issue of timing. The profitability picture is split by the role within the industry. Cow-calf operators are capturing high feeder cattle prices and strong profits. Finishing operations, for example, as shown in Figure 2, are paying those high feeder cattle prices and struggling to turn a profit. The figure shows the projected margins for finishing cattle in Iowa based on current futures prices for live cattle, feeder cattle, and corn. For the details behind the cattle margin projections, see our cattle margins website at www2.econ.iastate.edu/margins/cattlecrush.htm. For cattle, the rough rule of thumb is that Iowa cattle are profitable when the computed margins are above \$150 per head. As the projections indicate, profitability does not seem to be in the cards over the short term for finishing cattle. While feed costs have declined, the historical high cost of purchasing

feeder cattle is still overwhelming the margin outlook.

Over the projection period, live cattle futures are in the \$150 per hundredweight range. Those are historical strong prices. However, with feeder cattle futures over \$200 per hundredweight, the margins just aren't there. Beef supplies remain tight as beef production is lower in 2015. However, demand for beef holds strong. Retail beef prices have risen more than enough to offset the reduction in beef production. A weak spot in the beef demand picture is in the export arena. Between the strength of the US dollar, raising US beef prices worldwide, and the recent issues at US port facilities, beef exports have been reduced.

The profitability outlook for crops is similar to that for finishing cattle. Crop producers are searching for ways to reduce costs and improve margins. This is a dramatic turn from where the crop markets were just a year ago. Figure 3 tracks the projected crop margins for the 2015 corn and soybean crops in Iowa. For these crop margins, we have tracked corn and soybean futures prices, adjusted those prices to reflect Iowa cash prices for the crops, and compared those prices to estimated production costs for both crops. For 2015, the estimated production costs are \$4.41 per bushel for corn and \$10.96 per bushel for soybeans. These costs are slightly below the estimates for 2014, but the drop in crop prices has been larger. Last spring, crop prices were high enough to provide a positive margin projection. However, with the harvest of last year's record corn and soybean crops and a stalling of the growth in crop demand, crop prices have fallen and profitability disappeared.



Figure 1. Projected wean to finish crush margin, May 20, 2015

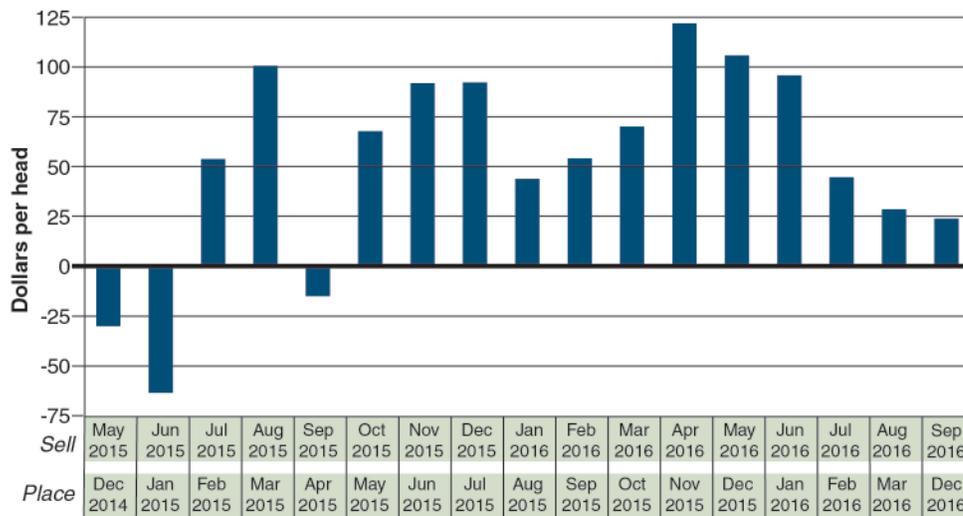


Figure 2. Projected yearling to finish crush margin, May 20, 2015

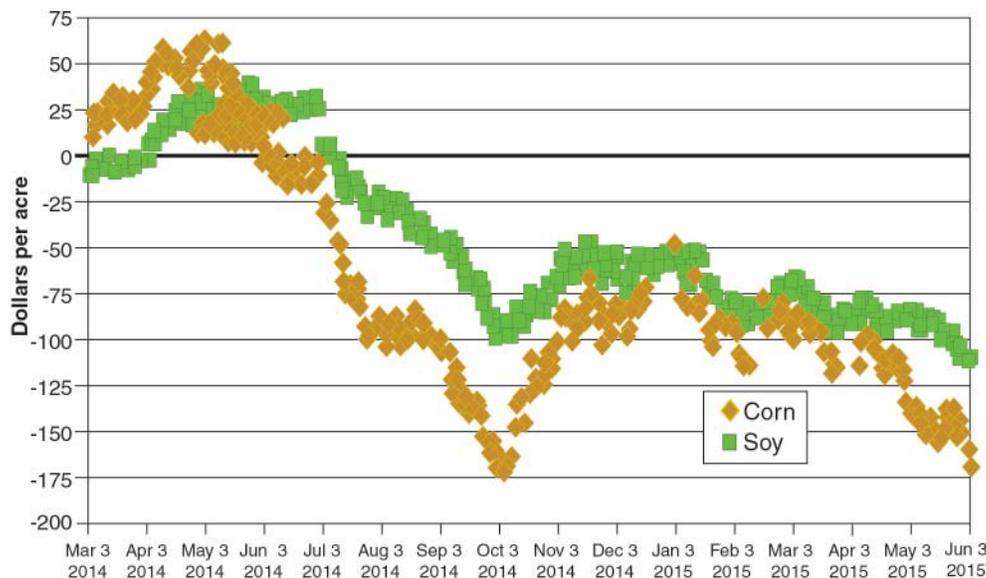


Figure 3. 2015 projected crop margins

Currently, both crops are displaying strongly negative margins, losses above \$100 per acre if trend yields are achieved in 2015. Soybean margins have held up better than corn margins as the stalling in demand has been less for that crop. Soybean exports continue to set records and domestic crush demand has been on the rise as well. Meanwhile, for corn, demand is weakening as the US dollar is wearing down on exports and the lower oil prices over the past year has reduced the incentive for ethanol production. Projected crop supplies also remain quite high. In March, farmers indicated they would plant roughly 90 million acres to corn and 85 million acres to soybeans. Given trend yields, that would result in the third largest corn crop and the second largest soybean crop ever produced, so the crop markets are also feeling the pull of another round of large crop supplies entering the markets this fall.

Putting these profitability outlooks together, the US farm sector is definitely in a consolidation mode. National net farm income peaked in 2013 at \$129 billion. The current projection for 2015 is \$73.6 billion. During the last general economic downturn, agriculture recovered quickly and had some very strong years from 2010 to 2013. Now that the general economy has slowly been improving over the past couple of years, the agricultural economy has retreated. ■