

Managing Volatility in Livestock Commodities

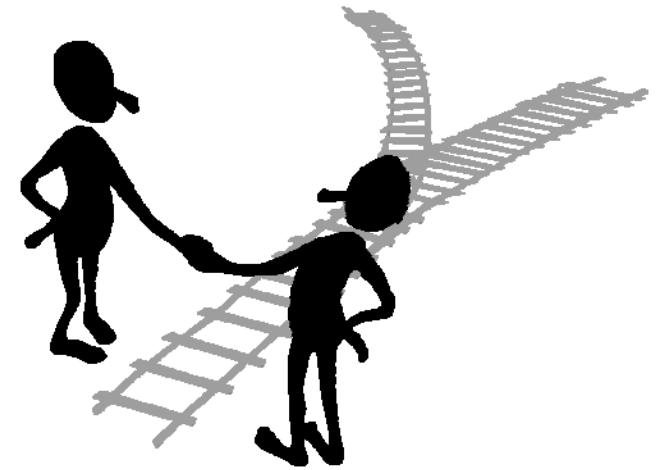
John P. Hewlett

Ranch/Farm Management Specialist,
University of Wyoming



Where Do We Want to Go?

- Reduced Risk?
 - Reduced volatility = greater certainty
 - Lower risk = lower returns



Where Do We Want to Go?

- Reduced Risk?
 - Lower volatility = greater certainty
 - Lower risk = lower returns
- Manage the risk(s) we are willing to accept at levels we are comfortable with



Where Do We Want to Go?

Risk Management Strategies

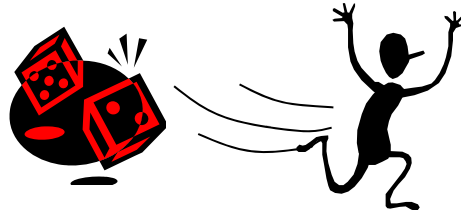
- Assume the risk
- Avoid the risk
- Reduce the risk
- Transfer the risk



Where Do We Want to Go?

Types of Risk Preference

- Risk Averse



- Risk Neutral



- Risk Loving



How Do We Get There?

- Better risk management
 - Evaluate risk(s)
 - Develop strategy
 - Use available tools



How Do We Get There?

Tools Available

- Insurance
- Disaster Assistance Programs
- Risk Analysis



How Do We Get There?

Tools Available

- **Insurance**
 - Price insurance
 - Margin insurance
 - Forage insurance
 - Revenue insurance
 - Non-insured Disaster Assistance Program
- Disaster Assistance Programs
- Risk Analysis



How Do We Get There?

Price Insurance

- Livestock Risk Protection (LRP)
 - Designed to insure against declining market prices.
 - Producers may select from a variety of coverage levels and insurance periods that match the time the commodity would normally be marketed.



How Do We Get There?

Price Insurance cont.

- **Livestock Risk Protection (LRP)**
 - Feeder cattle
 - Calves, steers, heifers, predominantly Brahman, and predominantly dairy cattle
 - Under 600 pounds or 600-900 pounds
 - **37 States** - Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming



How Do We Get There?

Price Insurance cont.

- Livestock Risk Protection (LRP)

- Fed cattle

- Steers and heifers 1,000 to 1,400 pounds
 - Up to 2,000 head per SCE
 - No more than 4,000 head per producer for each crop year

- **37 States** - Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming



How Do We Get There?

Price Insurance cont.

- **Livestock Risk Protection (LRP)**
 - Swine
 - Up to 10,000 head of hogs per SCE
 - No more than 32,000 head per producer for each crop year
 - **37 States** - Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming



How Do We Get There?

Price Insurance cont.

- Livestock Risk Protection (LRP)
 - Lamb
 - Between 50 and 150 pounds
 - Up to 2,000 head per SCE
 - No more than 28,000 head per producer for each crop year
 - **28 States** - Arizona, California, Colorado, Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, New Mexico, Nevada, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming



How Do We Get There?

Margin Insurance

- Livestock Gross Margin (LGM)
 - Provides protection against the loss of gross margin (market value of livestock minus feeder cattle and feed costs)
 - LGM uses futures prices to determine the expected gross margin and the actual gross margin



How Do We Get There?

Margin Insurance cont.

- **Livestock Gross Margin - Cattle**
 - 11-month insurance period
 - Only cattle sold for commercial or private slaughter primarily intended for human consumption
 - **20 States** - Colorado, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, South Dakota, Texas, Utah, West Virginia, Wisconsin and Wyoming



How Do We Get There?

Margin Insurance cont.

- Livestock Gross Margin - Swine
 - 6-month insurance period
 - Only swine sold for commercial or private slaughter primarily intended for human consumption
 - 20 States - Colorado, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, South Dakota, Texas, Utah, West Virginia, Wisconsin and Wyoming



How Do We Get There?

Margin Insurance cont.

- Livestock Gross Margin - Dairy
 - Gross margin LGM-Dairy (market value of milk minus feed costs)
 - 11-month insurance period
 - Only milk sold for commercial or private sale primarily intended for final human consumption from dairy cattle
 - 48 States - Contiguous 48 states



How Do We Get There?

Forage Insurance

- Forage Seeding and Forage Production
Insurance
 - Covers losses of plantings of perennial alfalfa, perennial grasses, or a mixture thereof intended for harvest
 - Does not cover harvest by grazing
 - Does not cover over-aged stands



How Do We Get There?

Forage Insurance cont.

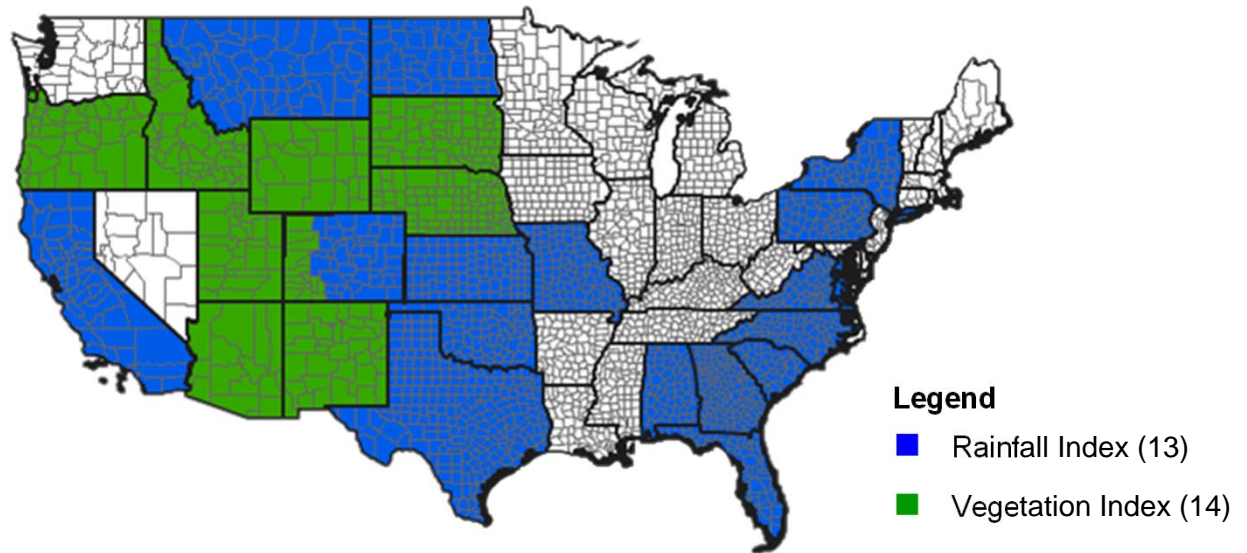
- Vegetation Index and Rainfall Index - Pasture, Rangeland, Forage Pilot Insurance Program (PRF)
 - Designed to give forage and livestock producers insurance protection for losses of forage produced for grazing or harvested for hay
 - Covers a specific geographical area known as a grid
 - Coverage based on experience of the entire grid. NOT based on individual farms, ranches, or specific weather stations



How Do We Get There?

Forage Insurance cont.

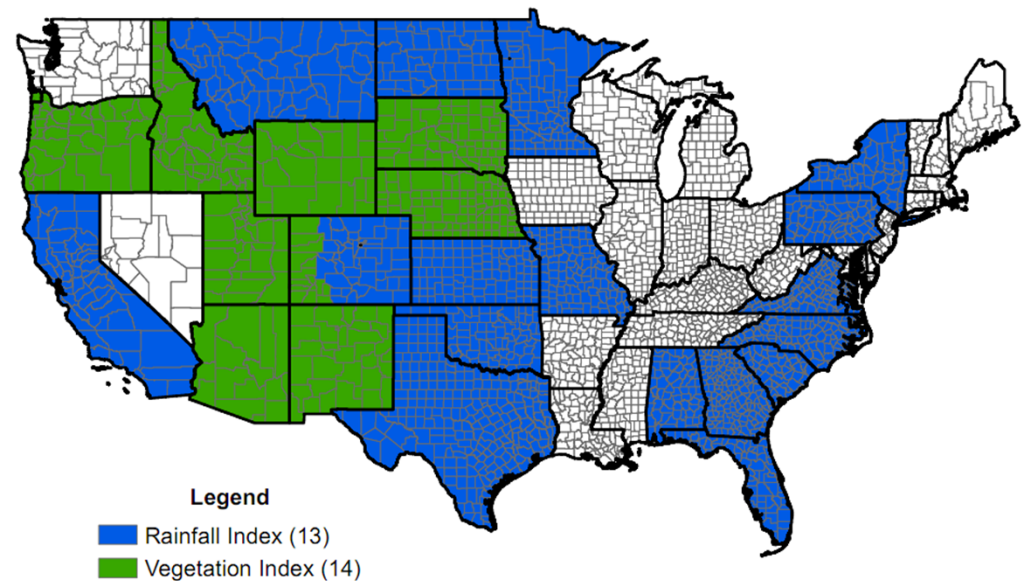
- Vegetation Index and Rainfall Index - PRF
 - Available in six regions across the country to test performance in various climates, soils, and weather conditions



How Do We Get There?

Forage Insurance cont.

- Apiculture pilot insurance program
 - Provides a safety net for beekeepers' primary income sources – honey, pollen collection, wax, and breeding stock



How Do We Get There?

Revenue Insurance

- Adjusted Gross Revenue (AGR) and Adjusted Gross Revenue Lite (AGR-Lite)
 - Provide protection against low revenue due to unavoidable natural disasters and market fluctuations that affect income during the insurance year
 - Cover most farm-raised crops, animals, and animal products are eligible for protection



How Do We Get There?

Revenue Insurance cont.

- **Adjusted Gross Revenue (AGR)**
 - **18 States** - California (selected counties), Connecticut, Delaware, Florida (selected counties), Idaho (selected counties), Maine, Maryland (selected counties), Massachusetts, Michigan (selected counties), New Hampshire, New Jersey, New York (selected counties), Oregon (selected counties), Pennsylvania (selected counties), Rhode Island, Vermont, Virginia (selected counties), and Washington (selected counties)



How Do We Get There?

Revenue Insurance

- Adjusted Gross Revenue Lite (AGR-Lite)
 - 35 States - Alabama, Alaska (selected counties), Arizona, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Kansas, Maine, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York (selected counties), North Carolina, Oregon, Pennsylvania (except Philadelphia County), Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming



How Do We Get There?

Non-insured Disaster Assistance Program (NAP)

- Available if there is no RMA actuarial offering for the commodity in the county
- Offered by the Farm Service Agency (FSA)
- Covers crops that are non-insurable, including crops grown for food, fiber, and livestock feed
- Covers low yields, loss of inventory, or prevented planting losses



How Do We Get There?

Tools Available

- Insurance
- **Disaster Assistance Programs**
 - Supplemental Revenue Assistance (SURE)
 - Livestock Forage Disaster Program (LFP)
 - Livestock Indemnity Program (LIP)
 - Emergency Livestock Assistance Program (ELAP)
- Risk Analysis



How Do We Get There?

SURE Program

- Provides disaster assistance to farms/ranches:
 - In a county where a disaster is declared by the Secretary of Agriculture, or
 - In a county adjacent to a declared county, or
 - Have experienced a farm wide crop loss in excess of 50 percent of expected production
- To be eligible, producers must buy crop insurance or Non-insured Disaster Assistance Program (NAP) for all acres of economically significant crops
- An eligible farm/ranch disaster payment is linked to the dollar amount of crop insurance coverage the farm obtains

How Do We Get There?

Livestock Forage Disaster Program (LFP)

- Provides compensation to eligible livestock producers who have suffered grazing losses due to qualifying **drought** or **fire**
- To be eligible, producers must purchase rangeland insurance or Non-insured Disaster Assistance Program (NAP) for all forage acres



How Do We Get There?

Livestock Indemnity Program (LIP)

- Provides payments to eligible livestock owners and contract growers for livestock death losses in excess of normal mortality due to adverse weather
- Does NOT have a risk management purchase requirement for program benefit eligibility
- Payments are based on eligible losses due to adverse weather conditions



How Do We Get There?

ELAP Program

- ELAP covers losses NOT covered under other disaster assistance programs: SURE, LFP, or LIP
- Payments are limited to \$100,000 per year per person or legal entity, a combined limit with SURE, LFP, and LIP



How Do We Get There?

ELAP Program cont.

- Covered losses include:
 - **Grazing losses** due to adverse weather or eligible loss conditions
 - **Loss of forage or feedstuffs raised** by livestock producers
 - **Cost of transporting additional feed** to eligible livestock
 - **Costs of purchasing additional feed** above normal quantities
 - **Payments for death loss** above normal mortality rates
 - Loss of feed intended for honeybees or farm-raised fish.
 - Honeybee colony or hive losses due to **colony collapse disorder**
 - Losses due to fish deaths from weather or eligible loss conditions
 - Livestock, honeybee or farm-raised fish losses that are not related to adverse weather or eligible loss conditions

How Do We Get There?

ELAP Program cont.

- ELAP has a risk management purchase requirement:
 - To be eligible for ELAP payments, producers on a farm or ranch must purchase insurance for each insurable crop excluding grazing land.
 - For non-insurable crops, producers must purchase NAP coverage when available, except grazing lands.
 - Persons without insurance or NAP coverage may be exempt from the risk management purchase requirement if they are socially disadvantaged, limited resource, or a beginning farmer or rancher



How Do We Get There?

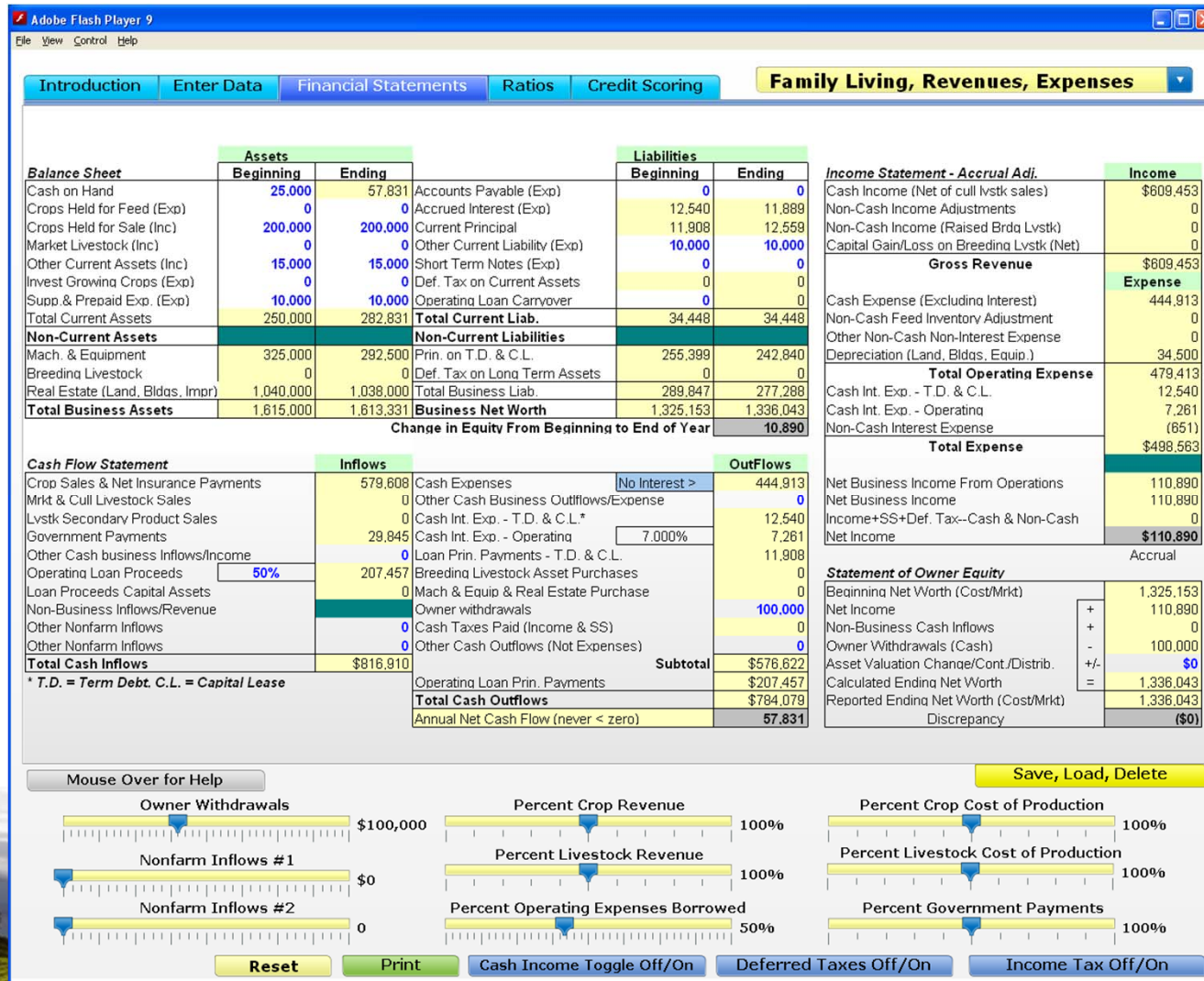
Tools Available

- Insurance
- Disaster Assistance Programs
- **Risk Analysis**
 - Financial Analysis
 - Price Risk Analysis
 - Price and Production Risk Analysis



How Do We Get There?

Financial Analysis: RDFinancial



- Ag In Uncertain Times - “Determining Financial Health (RDFinancial)” webinar offered on November 18, 2009
- <http://FarmManagement.org/AgInUncertainTimes>
- Click on Recordings in the right sidebar

How Do We Get There?

Price Risk Analysis: Futures, Options, LRP Comparison

Adobe Flash Player 9

File View Control Help

Introduction Futures Options LRP **Summary Results** Cost Of Production **Save, Load, Delete a Scenario**

Conditions at Time of Purchase	Futures	Put Option	LRP	Cash
Futures Price; Options Strike Price; LRP Coverage	\$115.55	\$114.00	\$121.50	
Expected Basis Entered by User	\$6.00	\$6.00		
Brokerage and Other Misc Costs	\$0.30	\$0.30	\$0.18	
Margin Call Transaction Costs, \$/Cwt	\$0.00			
Net Predicted Cash/Floor Price	\$121.25	\$115.15	\$117.39	
Percent Hedged or With Price Protection	87.0%	87.0%	100.0%	

Conditions at Time of Sale/Exercise/Offset For Futures/Options/Insurance	Futures	Put Option	LRP	Cash
Futures Price at Sale/Exercise/Offset	\$115.00	\$115.00		
Cash Settlement Index Value Termination/Sale/Offset			\$115.00	
Profit/Loss on Futures/Options OR LRP Indemnity, if any	\$0.55	-4.55	\$2.39	

Cash Conditions at Time of Sale	Futures	Put Option	LRP	Cash
Cash Price at Sale Time	\$121.00	\$121.00	\$121.00	\$121.00
Net Price Received @ Sale (Cash - Brokerage-Trading\$ +/- Hedge P/L, Adj % Coverage)	\$121.22	\$116.78	\$123.21	\$121.00
Cost of Production Per Cwt (CowCalf/Feeder)	\$105.00	\$105.00	\$105.00	\$105.00
Net Income Received Per Cwt of Production	\$16.22	\$11.78	\$18.21	\$16.00

	@ Purchase
Current Futures Price-Initial Postion	\$115.55
Put Option Strike Price at Purchase	\$114.00
Put Option Premium @ Strike Price	\$4.55
Expected Basis at Sale Time	\$6.00
LRP Coverage Price Level Selected	\$121.50
Coverage Rate for LRP Coverage Price	0.038859
RMA Premium for Coverage Level	\$4.7212

Check Current LRP Coverage Levels at the RMA Web Site

Check Current Futures/Options Prices on the Web

Click to toggle graphic/table display

These three values MUST be changed together for correct results.

Number of animals considered	100
Expected Average Cwt at time of Sale	5.75
LRP Ownership Share of these cattle	100%
Number of Feeder Contracts Needed	1.15
Number of Feeder Contracts Purchased	1
Percent Hedged	86.96%

	@ Sale
Futures Price @ Sale/Offset Time	\$115.00
Local Cash Price at Sale Time	\$121.00
Actual Basis at Sale Time	\$6.00
CME Cash Settlement Index @Sale/Offset	\$115.00
Total Cost of Production Cow Calf	\$105.00

Print **Reset**

MouseOver for Help Off/On

- Farm Management Wiki tool “Futures, Options, LRP Comparison”
- <http://FarmManagement.org/Wiki>
- Click on Contents > Tools > “Futures Options LRP Comparison”

How Do We Get There?

Price Risk Analysis: Futures, Options, LRP Comparison cont.

Futures Assumptions

Adobe Flash Player 9

File View Control Help

Introduction **Futures** Options LRP Summary Results Cost Of Production **Save, Load, Delete a Scenario**

Check Current Futures and Options Prices on the Web

View MT Historic Steer Basis Data Off/On **View MT Historic Heifer Basis Data Off/On**

Conditions When Hedge is Placed \$/Cwt	
Futures Price, Initial Position	\$115.55
Expect Basis at Sale Time	\$6.00
Brokerage & Interest \$/Cwt.	\$0.30
Net Predicted Cash/Floor Price	\$121.25
Cost of Production Per Cwt	\$105.00
Estimated Net Income Per Cwt	\$16.25

X axis graph increment value

Projected Cash Price Given Basis

The graph plots Projected Cash Price (Y-axis, \$112.00 to \$126.00) against Expected Basis (X-axis, \$2.00 to \$10.00). A red vertical line is drawn at \$6.00. A callout box indicates 'Basis Weaker Than Expected'.

Conditions When Hedge is lifted/offset \$/Cwt	
Cash Price @ Sale Time	\$121.00
Futures Price @ Offset Time	\$115.00
Actual Basis at Sale Time	\$6.00
Margin Call Transaction Cost/Cwt	\$0.00
Gain/Loss--Futures Excl. Trading \$	\$0.55
Net Price On Contracted Cwt	\$121.25
Cost of Production \$/Cwt	\$105.00
Net Inc. @ Sale-Total	\$16.25
Net Inc. Futures Only Adj. for Trading	\$0.25
Net Inc. Cash Only	\$16.00
Percent hedged	87.0%
Net Price Adjusted for % Hedged	\$121.22

This block does not control the graph

Number of Animals	100
Expected Average Cwt/Animal	5.75
Contracts to Cover Production	1.15
No. Contracts Purchased	1.00

Print **Reset**



How Do We Get There?

Price Risk Analysis: Futures, Options, LRP Comparison cont.

Options Assumptions

Adobe Flash Player 9

Introduction Futures Options LRP Summary Results Cost Of Production **Save, Load, Delete a Scenario**

Put Call **Check Current Futures and Options Prices on the Web**

Conditions When Options Purchased		Conditions When Option Exercised/Offset		S/Cwt
Buy Put Options		Futures @ Exercise/Offset		\$115.00
Selected Strike Price	\$114.00	Cash Price at Sale Time		\$121.00
Premium	\$4.55	Actual Basis at Sale Time		\$6.00
Futures Price @ Purchase	\$115.55	Interest and Brokerage/\$Cwt		\$0.30
Expected Basis @ Sale	\$6.00	Profit/Loss on Put Contract		-\$4.55
Interest and Brokerage \$/Cwt.	\$0.30	Net Price Received-Per Contract Cwt		\$116.15
Net Expected Cash/Floor Price	\$115.15	Total Cost of Production		\$105.00
Expected Cost of Production	\$105.00	Net Income Received Per Contract Cwt		\$11.15
Estimated Net Income \$/Cwt	\$10.15	Percent hedged		86.96%
		Net Price Adjusted for % Hedged		\$116.78

Buy Put Option
Protection From Falling Prices

Estimated Cash & Cash Plus Option

Futures Price

Option Only

Estimated Cash

Cash + Option

This block does not control graph

Number of Animals	100
Expected Average Cwt/Animal	5.75
Contracts To Cover Prod.	1.15
No. Contracts Purchased	1
% Coverage (Hedge/Options)	86.96%

Print Reset



How Do We Get There?

Price Risk Analysis: Futures, Options, LRP Comparison cont.

LRP Assumptions

Adobe Flash Player 9

Introduction Futures Options **LRP** Summary Results Cost Of Production **Save, Load, Delete a Scenario**

View LRP Table/Graph Toggle **Check Current LRP Coverage Levels at the RMA Web Site**

Number of Head You wish to insure (must be less than 2,000 per entity) **100**
 Target weight at the time of sale; Enter in Cwt (800 lbs = 8.0) **5.75**
 LRP Ownership Share of these cattle **100%**

The Information In The Box Below Comes From RMA

State	Montana
County	All Counties
Endorsement Length (Weeks)	26
RMA Commodity Code/Description	0801 FEEDER CATTLE
RMA Type Code/Description	809 STEERS WEIGHT 1
RMA Practice Code/Description	997 NO PRACTICE SPECIFIED
Crop Year	2010
Expected Ending Value	\$126.614
RMA Coverage Price Selected	\$121.500
RMA Coverage Level Provided	0.95960
RMA "Rate" by Commodity/Type/Practice	0.038859
Premium Cost Per CWT	\$4.7212
End Date of Endorsement Length	10/29/2010

Actual Ending Local Cash Price Received **DOES NOT Affect Outcome of LRP Insurance**
 Local Cash Price Received When Sold **\$121.00**

Valid Entries are: 13, 17, 21, 26, 30, 34, 39, 43, 47, 52

Important help Message

Insured Value	\$69,862.50
Total Premiums	\$2,714.79
Premium Subsidy	\$352.95
Total Producer Premium	\$2,361.84
Total Producer Premium Per Cwt.	\$4.11
Total Indemnity	\$3,737.50
Indemnity Net of Premium Costs	\$1,375.66
Indemnity Per Cwt (Net of Producer Premium)	\$2.39
Floor Price Per Cwt With LRP Coverage	\$117.39
Indemnity Per Head (Net of Producer Premium)	\$13.76
Actual Cash Revenue Including Any Indemnity	\$70,951
Actual Cash Revenue Per Cwt. Including Indemnity	\$123.21
Net Income Per Cwt. Received With LRP Coverage	\$18.21

Ending Value-Cash Settlement Index **\$115.00**

Enter or change ALL values within the "rust colored" box above to assure accurate results for an LRP coverage level. See "Important Help Message" button.

Print **Reset**



How Do We Get There?

Price Risk Analysis: Futures, Options, LRP Comparison cont.

Summary Results

Adobe Flash Player 9

File View Control Help

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Print **Reset**

MouseOver for Help Off/On



How Do We Get There?

Price Risk Analysis: Cull Cow Marketing and Feeding Alternatives

Cull Cow Feeding Calculator and Price Forecaster

This calculator is designed to predict cull cow prices 1-6 months into the future. The price prediction is based on historical seasonal price relationships and historical relationships between cull cow grades. The price prediction is also based on the body condition score and expected market class for the cows. Enter data in the clear cells and the calculator will calculate the grey cells. Average daily gain can be negative on some rations. After entering feeding costs on the next screen, the calculator will determine your expected net return from feeding and calculate an expected break-even selling price.

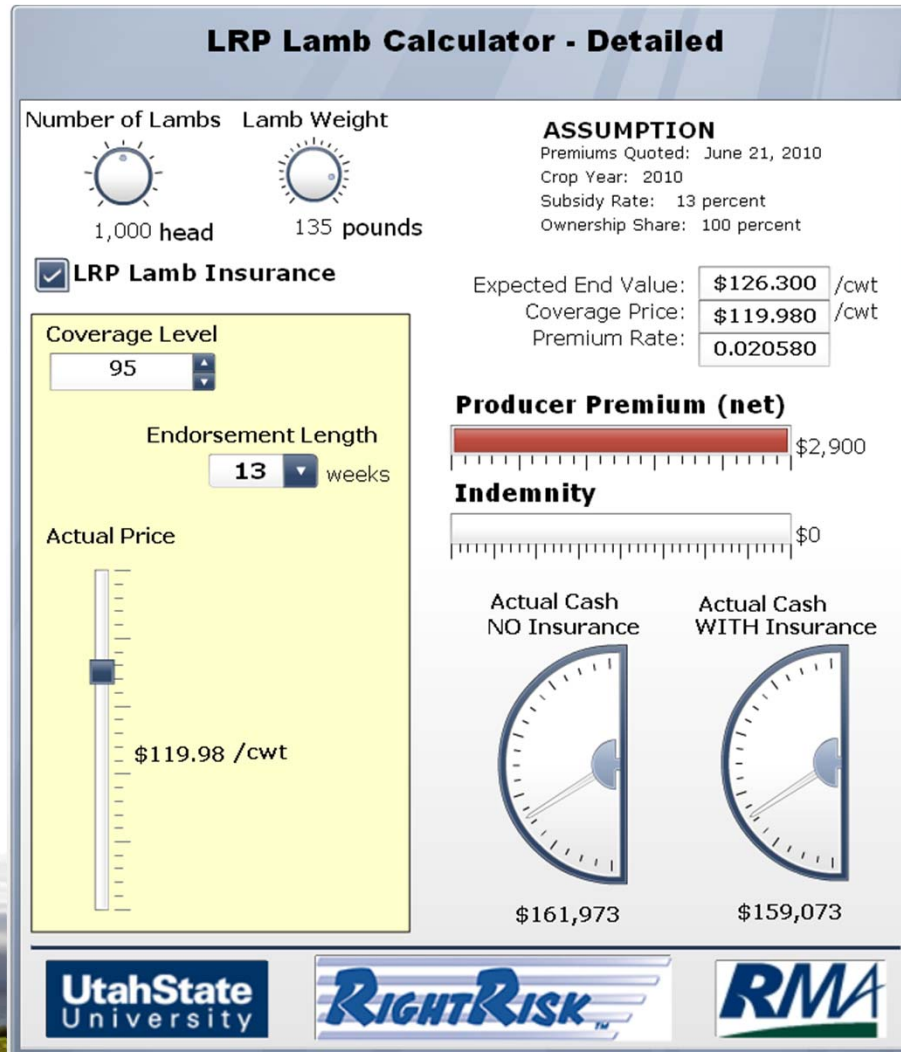
Present Date (mm/dd)	<input type="text" value="12/8"/>
Present BCS of Cull Cows	<input type="text" value="3.0"/>
Estimated Cow Weight (lbs.)	<input type="text"/>
Present Market Price for a Cutter/Lean 85%-90% Lean(\$/cwt)	<input type="text"/>
Estimated Value Today (\$/head)	<input type="text" value="0.00"/>
Number of Days on Feed	<input type="text"/>
Expected Avg Daily Gain (lbs.)	<input type="text"/>
Expected Final Weight (lbs.)	<input type="text" value="0"/>
Expected Sale Date (mm/dd)	<input type="text" value="12/8"/>
Expected BCS of Cull Cows	<input type="checkbox"/> No Commercial Market <input type="text" value="3.0"/>
Expected Market Price for a Cutter/Lean 85%-90% Lean(\$/cwt)	<input type="text" value="0.00"/>
Estimated Value at end of feeding (\$/head)	<input type="text" value="0.00"/>

- Farm Management Wiki tool “Cull Cow Marketing”
- <http://FarmManagement.org/Wiki>
- Click on Contents > Tools > “Cull Cow Marketing”



How Do We Get There?

Price Risk Analysis: LRP Lamb



- Farm Management Wiki tool “LRP Lamb”
- <http://FarmManagement.org/Wiki>
- Click on Contents > Tools > “LRP Lamb”

How Do We Get There?

Price and Production Risk Analysis: Risk Navigator tools

RIGHTRISK.ORG - Windows Internet Explorer

http://rightrisk.org/

RIGHTRISK.ORG

Risk Navigator

STRATEGIC RISK MANAGEMENT

- Home
- About SRMP
- Textbook
- Toolbox
- Example Farm
- Ag Survivor
- Instructors
- Conferences
- Sponsors

RightRisk
www.RightRisk.org

RMA

Home | About | Textbook | Toolbox | Example Farm | Ag Survivor | Instructors | Conferences | Sponsors

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Risk Navigator SRM

Unknown Zone (Mixed)

100%

- Farm Management Wiki tool “Risk Navigator”
- <http://FarmManagement.org/Wiki>
- Click on Contents > Tools > “Risk Navigator”

How Do We Get There?

Price and Production Risk Analysis: Risk Navigator tools

RIGHTRISK.ORG - Windows Internet Explorer

http://rightrisk.org/

RIGHTRISK.ORG

Risk Navigator

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RightRisk
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RMA

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Risk Navigator SRM

Unknown Zone (Mixed)

100%

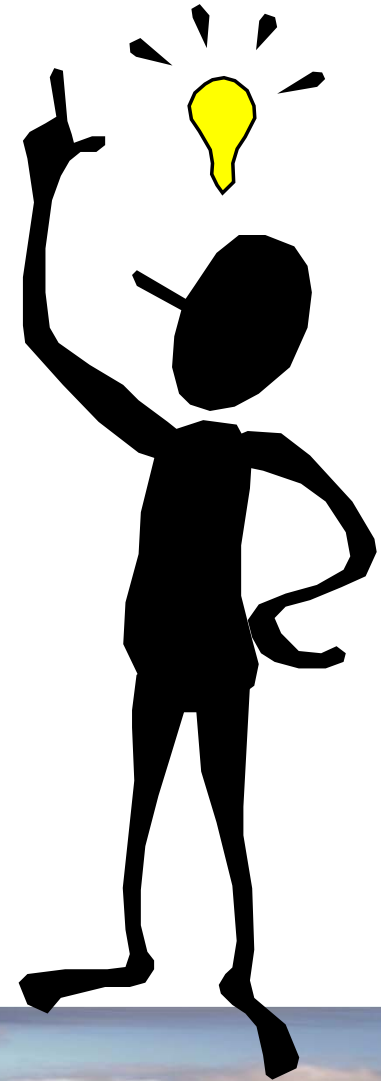
- Risk Profiler
- Stochastic Budget Generator
- Risk Ranker
- Risk Influence Calculator
- Value At Risk
- *Over 40 tools in all. . .*

Managing Volatility in Livestock Commodities

How Do We Get There?

Tools Available

- Insurance
- Disaster Assistance Programs
- Risk Analysis



QUESTIONS?

RIGHT RISK[™]

 UNIVERSITY
OF WYOMING