How Much Risk Is Right For You?

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LRP – Feeder Cattle

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Late summer 2011, John and Polly Harkin were preparing for another fall calving season on their Virginia farm. They were concerned about their costs of production and the perceived risk they were seeing in the marketplace. That spring, they had to pay over $1,500 per head for their usual purchase of 20 replacement heifers and they were beginning to feel uneasy about how much “skin” they had in the game. Cattle markets had been good to them lately but a sudden drop in feeder cattle prices would leave them with little chance of covering their input costs.

As in previous years, the Harkin’s had sold their 2010 calf crop in July and August of 2011 with the calves averaging 650-700 pounds. They sold one load by private treaty to a buyer from Pennsylvania and ran the rest through the local auction market over the course of several weeks. With 140 cows, the Harkin’s sell about 125 feeder cattle each year like this and regularly average in the top 30% of the market based on the market summary published for their area by the USDA Agricultural Marketing Service.

The Harkin’s felt good about the way they were marketing their cattle but they worried about the cattle markets as a whole. They had been around long enough to know that good prices don’t last forever but they had never had this much at stake in terms of their costs of production. They were looking for a little bit of price protection on the output side but didn’t want to dive into trading contracts on the Board of Trade if they could avoid it. Polly mentioned their situation to their local Virginia Cooperative Extension agent and he told them they should check into the Livestock Risk Protection product offered by the USDA Risk Management Agency (RMA) through livestock insurance agents.

Looking for Price Protection

The next morning, Polly sat down at their home computer and brought up the RMA website (www.rma.usda.gov). She found out 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 States including Virginia 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 can purchase specific coverage endorsements for up to 1,000 head at a time. Polly 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).

Polly read on the RMA website that producers select from a variety of coverage price levels and length of insurance coverage for each specific coverage endorsement. She also read where it is best to match the end of the insurance period with the time your feeder cattle would normally be marketed but you don't have to market them when the insurance period ends. That is, ownership of the feeder cattle may be retained beyond the insurance coverage period. Coverage is available for steers and heifers and producers may choose from two weight ranges: under 600 pounds and 600-900 pounds.

Polly viewed the LRP-Feeder Cattle program's coverage prices, actual ending values, and per hundredweight cost of insurance on the RMA website for several insurance periods over the previous year. Actual ending values are based on weighted average prices as reported in the Chicago Mercantile Exchange Group Feeder Cattle Index and are posted on RMA's website at the end of each insurance period.

Armed with this information, Polly sat down with John that evening and explained to him 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 their local crop insurance agent and submit an application for LRP-Feeder Cattle coverage. They committed to evaluating their coverage options for their 2011 calf crop after the first of the year for the calves they planned to sell in July/August of 2012.

First Experience

On January 26, 2012, after looking at their options and considering the market situation, the Harkins decided to purchase LRP-Feeder Cattle coverage for 60 steers weighing 700 pounds with a coverage end date of July 26, 2012 (a 26-week policy). The expected ending value for Steers Weight 2 was $157.934 per cwt. They purchased a coverage price of $149.83 and the total premium cost was $3.179 per cwt. The total premium for the insurance was $1,335 but, after the 13% subsidy from USDA was applied, their out-of-pocket premium expense was $1,161.

In late July, RMA published an actual ending value of $134.18 for the Harkins' policy coverage. Since this was $15.65 per cwt. below their coverage price, they received an indemnity check for $6,573 from their policy.

It's not all roses though. The drop in price was felt when they marketed their calves. They were hoping to top last year's average price of $126 per cwt. for their steers but were only able to average $120. However, after subtracting out their premium expense, they were able to net $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) gave the Harkins a total of $57,864 or $1.32 per cwt. for their crop of feeder steers.

The Future

John and Polly realize that good markets are better than receiving insurance indemnity payments but they like the protection that LRP-Feeder Cattle provided them in 2012. The premium expense is something they feel they can handle in their operating budget and they plan on incorporating LRP-Feeder Cattle into their future risk management plans.

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Additional Resources

USDA Risk Management Agency Livestock Policies: http://www.rma.usda.gov/livestock/.
LRP Coverage Prices, Rates, and Actual Ending Values: http://www.rma.usda.gov/tools/livestock.html.
USDA Agricultural Marketing Service market news reports: http://www.ams.usda.gov.