MARKETING PLUS CROP INSURANCE

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2009 Corn Strategies for Creating a Marketing Floor & Crop Insurance

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Let's take a look at couple of strategies for establishing a net effective floor price using option marketing strategies combined with the Crop Insurance Revenue Products for 2009 new crop corn. The goal is to use the crop insurance that you have purchased to provide a part of the protection.

This first example is using a bear put spread to protect most of the gap between current new crop prices and the revenue floor provided by revenue insurance. A bear put spread involves buying a put option with a strike closer to the market and selling a put option with a strike further away from the market price. Thus, the put bought will have a higher strike and have a higher premium than the put sold will have.

If you purchased revenue insurance at the 75% level with the corn base price of $4.04 you have a futures floor of $3.03 less your local basis. We are using an example of a -.35 basis which would provide a $2.68 cash floor.

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2 Way Strategy, Buy Put & Sell Put
With Crop Insurance Revenue Floor

Put Options Used		Basis	Cash Price	Net Prem Cost	Effective Price
Put Bought Strike	4.20	-0.35	3.85	0.37	3.48
Premium Paid	0.55				
Put Sold Strike	3.20	-0.35	2.85	0.37	2.48
Premium Collected	0.18				
Net Premium	0.37				

Compare Forward vs. Strategy Floor	Futures	Basis	Cash Price
Today's Forward Price	4.28	-0.60	3.68
Strategy Floor			3.48
Strategy Floor vs. Forward			-0.20

Crop Insurance Base	4.04		
Level	75%		
Crop Ins Futures Floor	3.03	-0.35	2.68
Stratgey Lower Put Floor			2.48
Strategy / Insurance Diff			0.20

	Strike	Premium	Futures Floor	Basis	Cash Price
Put Only Floor	4.20	0.55	3.65	-0.35	3.30
Put Spread / Crop Ins Upper Floor	4.20	0.37	3.83	-0.35	3.48

We show buying a 4.20 put option for a cost of $.55 and selling a 3.20 put option for a credit of $.18 for a net cost of $.37 per bushel.

The put spread strategy provides an effective upper floor of $3.48 as shown on the first line. We use the 4.20 strike minus a basis of .35 for a cash price of 3.85 less the .37 cost of the spread for an effective upper floor of $3.48 per bushel. This compared to being locked into a forward sale of $3.68 per bushel.

Using the sale of a 3.20 put limits the absolute lower floor to $2.48 as shown. We are using the 3.20 strike minus a basis of .35 for a cash price of 2.85 less the .37 cost of the spread for an effective absolute lower floor of $2.48 per bushel.

This strategy has an overlap of $.20 per bushel between the crop insurance floor of $2.68 and the strategy floor of $2.48 per bushel.

The strategy saves $.18 per bushel as compared to using a put only floor. It provides a savings of $22.28 per acre in option premium based on an A.P.H. of 165 bushels and using the strategy for your insured guarantee of 124 bushels.

In this case a bear put spread strategy works well to protect the floor on the insured bushels which is 75% of the APH and provides unlimited upside. A put option only strategy is the best way to price protects your uninsured bushels, in this example 25% of the expected production and also provides unlimited upside.

This **second example is uses an advanced 3 way option strategy** involving a bear put spread to protect most of the gap between current new

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crop prices and the revenue floor provided by revenue insurance and also selling a call option to reduce the net cost.

The second strategy results in a higher net effective price floor than the first strategy but also limits some of the potential to lock in upside to the price you would receive and has the potential for margin calls on the call option that is sold. This is a more bearish strategy than the first example and if margin calls are realized it could require more cash flow to keep in place.

Using a bear put spread buy a put option with a strike closer to the market and selling a put option with a strike further away from the market price. Thus, the put bought will have a higher strike and have a higher premium than the strike of the put sold.

If you purchased revenue insurance at the 75% level with the corn base price of $4.04 you have a futures floor of $3.03 less your local basis. We are using an example of a -.35 basis which would provide a $2.68 cash floor.

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3 Way Strategy, Buy Put & Sell Put & Sell Call With Crop Insurance Revenue Floor

Put & Call Options Used		Basis	Cash Price	Net Prem Cost	Effective Price
Put Bought Strike	4.20	-0.35	3.85	0.20	3.65
Premium Paid	0.55				
Put Sold Strike	3.20	-0.35	2.85	0.20	2.65
Premium Collected	0.18				
Call Sold Strike	6.40	-0.35	6.05	0.20	5.85
Premium Collected	0.17				
Net Premium	0.20				

Compare Forward vs. Strategy Floor	Futures	Basis	Cash Price
Today's Forward Price	4.28	-0.60	3.68
Strategy Floor			3.65
Strategy Floor vs. Forward			-0.03

Crop Insurance Base	4.04		
Level	75%		
Crop Ins Futures Floor	3.03	-0.35	2.68
Stratgey Lower Put Floor			2.65
Strategy / Insurance Diff			0.03

	Strike	Premium	Fut Floor	Basis	Cash Price
Put Only Floor	4.20	0.55	3.65	-0.35	3.30
Put Spread / Crop Ins Upper Floor	4.20	0.20	4.00	-0.35	3.65

We show buying a 4.20 put option for a cost of $.55 and selling a 3.20 put option for a credit of $.18 and selling a 6.40 call option for a credit of .17 for a net cost of $.20 per bushel.

The put spread/call strategy provides an effective upper floor of $3.65 as shown on the first line. We use the 4.20 strike minus a basis of .35 for a cash price of 3.85 less the .20 cost for an effective floor of $3.65 per bushel. This floor of $3.65 is compared to being locked into a forward sale of $3.68 per bushel.

Using the sale of a 3.20 put limits the absolute lower floor to $2.65 as shown. We are using the 3.20 strike minus a basis of .35 for a cash price of 2.85 less the .20 cost of the strategy for an effective absolute lower floor of $2.65 per bushel.

Selling the 6.40 call alone would normally limit the upside but higher cash values of the crop grown offset with the potential loss on the option if the futures are above 6.40 per bushel. However, based on producing a crop equal to your bushel guarantee the crop insurance indemnity per bushel would equal the loss on the option. Producing a crop larger than your bushel guarantee provides total combined revenue to offset the option loss.

This strategy has an overlap of $.03 per bushel between the crop insurance floor of $2.68 and the strategy floor of $2.65 per bushel.

The strategy saves $.35 per bushel as compared to using a put only floor. It provides a savings of $43.31 per acre in option premium based on an A.P.H. of 165 bushels and using the strategy for your insured guarantee of 124 bushels.

In this case a bear put spread / sell call strategy works well to protect the floor on the insured bushels which is 75% of the APH and provides upside due to the crop insurance indemnity with a higher harvest price. However, upon locking in upside by selling cash in a higher market during the growing season we could also have a cost to exit the call sold thus reducing some of the gain. The crop insurance indemnity could offset the loss revenue on the call.

A put option only strategy is the best way to price protects your uninsured bushels, in this example 25% of the expected production and provides unlimited upside.