

Virtual farming, is it an option?

Drilling crops for the sake of it can be a pointless exercise, says **Jeremy Cole**

According to the all seeing eye of DEFRA, some 25% of this year's wheat crop remains undrilled. A similar amount of oilseed rape looks likely to be re-drilled too, mostly in the Midlands and West. The crops are literally under the weather. The weather is still wet and cold and the only way to get a crop drilled at present is to set the alarm clock for very early morning drilling on the frost.

But hang on a cotton-picking moment: is it sensible to be clawing about in the twilight hours, with night vision goggles, relying on a satellite to produce nice straight lines near the main road? Is it too late and the land in a too unsuitable condition to be drilling at all?

Some of my progressive clients have been discussing the use of a financial hedging tool on the acreage that has not been drilled. That land destined for late or mauled in second wheat crops, or re-drilling after failed OSR crops, would be better off left undrilled. Give the land a breather and save time and cash by not cultivating, drilling, fertilising, spraying this left over percentage of the farm. Reduce the business cash-flow and storage requirements.

The theory is that you don't have to have a crop in the field to make money from market movements. It's the same principle of the funds, they don't make money from owning

the physical commodities. They don't have mines, they don't have fields, but they still make money from gold, silver, copper and agri-commodities.

Farmers in the UK make a living from trading in the crop market too, except generally they are playing with a physical crop. The farmer however relies on larger price movements to make money as the costs of producing wheat, as an example, are high; approximately £175-200 variable costs per acre and a similar amount for fixed costs.

The funds buy futures and options for a mere fraction of this outlay. Futures may cost them £1/t to set up, so a £1 rise is 100% profit. A £1 rise on the £180t wheat in your shed is 0.55%. That's why a fund of £1m buys 1mt of futures, whereas it only buys 5,555t of physical wheat. This is called leverage.

UK Wheat is trading at present, in mid-January, £180/t ex farm for November 2013. So £400/acre to produce the wheat crop at 3-4t/acre yield, gives a gross output of £540-720. This makes a profit, before rent and finance, of £140-320/acre. According to Churchgate, an agricultural accountant's latest figures for 2011 harvest, net farm income (including the SFP) ranged from the bottom 25% of their clients at £50, to £185/acre for the top 25%. The top 10% achieved £240/acre. Take off the £90/acre SFP and eek, not looking so rosy.

This is, therefore, not really all fine and dandy at 3-4t/a but what is the wheat crop likely to yield if drilled at this time? In these less than ideal conditions perhaps a sub-3t/a

yield is more probable?

So, how would the use of a hedging tool work versus drilling a crop? A Call Option basically gives the buyer the right to sell at any higher future price than today's prevailing futures prices and claim the difference during the life of the option.

All very similar to taking out insurance. The insured only claims if there has been an accident and even then only if the insured wishes to do so. It is a right, but not an obligation to do something.

At present that premium is approx 9% of the value of a tonne of wheat, which is £16/t. This means the wheat market will have to rise from now until mid October (when a November 2013 option expires) to claim any money back. For the farmer to claim and make a net gain from the insurance, the rise would therefore have to be more than £16/t. If the market does not rise at all, the premium is forfeited, as per any insurance. No crash, no claim.

This means that if the wheat market stays the same or falls, the non-drilling farmer would have lost £16/t from the Call option (£40-50/acre if the yield expectation from the likely under-performing crop in question was 2.5-3t). However, the savings made by not cultivating, drilling, fertilising, spraying, lower cash-flow and storage requirements etc, would be considerably greater, approx. £200/acre. The drilling farmer, would have paid the £200/acre and additionally achieved a lower price for the eventual crop too – a double whammy.

If the market rises, and the drilling farmer must have presumably felt it must or he would not have drilled it otherwise, a benefit is made. A net benefit if the rise was over the premium cost, £16 or 9%. A £20 rise would return a net £4/t extra, a £30 rise would return a net of £14 extra. All that for no physical effort at all. Time, money and angst are saved from the farmer's point of view. The field is fallow, rested and ready for cultivating and drilling at the right time in the autumn.

This 'insurance' must be put into context. Any non-drilling farmers choosing this path are taking the view that if the market moves up significantly, over 10%, they want to be in the game. They are not worried about a small rise, as they would have lost significant sums by drilling the crop. They are applying a maximum cost to that acreage of land to help maintain or increase the overall net farm income for the year.

Just drilling for drilling's sake, on a small percentage of their acreage seems a pointless exercise to them, and I tend to agree. Do your own sums.



Even in good conditions growers should decide whether or not to drill



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