2011 Acreage Concerns

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World Concerns: FC Stone's lead analyst Doug Jackson has been a vocal leader in discussion of a 2011 acreage battle and even a multiple year acreage shortage. I sat in on his presentation last week in Ankeny IA. He admits that there are a million moving parts to the puzzle. First, I'll provide his comments by topic and then my reaction in the last part of this newsletter.

When Jackson looked at the world coarse grains sections of the last USDA WASDE report he came to the conclusion that USDA couldn't solve the balance sheet and tried to hide the problem by ignoring the facts and published an unbalanced report. The area that he referred to was the FSU-12 (Former Soviet Union) region which appears to have a need to import, contrary to reports from the region and USDA. What he saw was a reduction in feed usage for that region from 55 MMT to 45 MMT which he believes was done in order to balance the numbers. He doesn't believe that the livestock herd would be reduced that drastically to warrant a reduction in usage of that magnitude. He also recalls that USDA tends to move moderately in making adjustments and that the 13MMT reduction made to date is only the first of many adjustments that will be made and that future adjustments will also be for a reduction in the size of the FSU wheat crop.

U.S. Exports: Doug Jackson believes that there is not enough US export capacity to meet the word Wheat, Corn and Soybean needs over the next months. He is confident that nearly all of the FOB capacity (ship loading) has been booked in the US for the months of Sept, Oct, Nov and possibly into Dec. He thinks that the US rail freight system will be taxed in a way that we have not seen in the past. He thinks that virtually all the grain rail cars have been spoken for but that they will be resold at a premium to those willing to pay up at sometime this fall.

2011 Possible U.S. Acreage Scenario: FC Stone's Jackson would portray an acreage scenario similar to this for 2011 & 2010. An increase next year totaling about 8 million acres by increases of 4 million acres for both wheat and corn, and steady acres for soybeans. Then in 2012 steady corn acres and increased soybean of 3 million acres and wheat yet another 2 million acres for another 5.5 million total acres.

	USDA 06/07	USDA 07/08	USDA 08/09	Aug USDA 09/10	Aug USDA 10/11	2009-2010 Year-Year Change	Early Look 11/12	2010-2011 Year-Year Change	Early Look 12/13	2011-2012 Year-Year Change
Planted Acres										
Corn	78.3	93.6	86.0	86.5	87.9	1.4	92.0	4.1	92.5	0.5
Soybean	75.5	64.7	75.7	77.5	78.9	1.4	79.0	0.1	82.0	3.0
Wheat	57.3	60.4	63.1	59.1	54.3	-4.8	58.0	3.7	60.0	2.0
Total	211.1	218.7	224.8	223.1	221.0	-2.1	229.0	8.0	234.5	5.5

U.S. Wheat: World Wheat production is at the heart of the problem so it is a logical place to start as wheat prices have moved sharply higher over the past few weeks. Jackson believes that the US will plant 4 million acres more wheat for the 2011/12 crop year, with much of that being winter wheat that may end up being double cropped with soybeans. He would put 2010/11 exports about 300 million higher than USDA is currently using, so I have shown this as an adjustment to each of the 2010/11 scenarios below. The beginning stocks for the 2011/12 early look reflect USDA's current yield and increased demand of 300 million for the 2010 carryout. Jackson thinks that exports could increase another 400 million in 2011/12 as the countries of the world rebuild their stocks, something that he doesn't see happening in the next 12 months because of logistical problems. He would see another 2 million acres being added in 2012/12 even if with good yields.

U.S. Wheat Supply / Demand (mb)

	USDA 06/07	USDA 07/08	USDA 08/09	Aug USDA 09/10	Aug USDA 10/11	Low Yield 10/11	High Yield 10/11	Early Look 11/12	Early Look 12/13
Planted	57.3	60.4	63.1	59.1	54.3	54.3	54.3	58.0	60.0
Harvested	46.8	51	55.7	49.9	48.3	48.3	48.3	51.04	52.80
% Harvested	81.7%	84.4%	88.3%	84.5%	89.0%	89.0%	89.0%	88.00%	88.00%
Yield	38.7	40.5	44.9	44.4	46.9	43.0	48.0	46.0	46.0
Carryin	571	456	306	657	973	973	973	652	300
Production	1,811	2,067	2,500	2,216	2,265	2,077	2,319	2,348	2,429
Imports	123	113	126	118	99	99	99	11	11
Supply	2,505	2,636	2,932	2,991	3,338	3,149	3,391	3,010	2,740
Food	933	948	925	917	940	940	940	940	940
Exports	909	1,264	1,015	881	1,200	1,200	1,200	1,600	1,400
Seed	81	88	75	70	76	76	76	85	85
Feed/Residual	125	30	260	150	170	170	170	170	170
Demand	2,048	2,330	2,275	2,018	2,386	2,386	2,386	2,710	2,510
				FCStone Adj	300	300	300		
Carryout	457	306	657	973	652	463	705	300	230
CO/Use	22.3%	13.1%	28.9%	48.2%	27.3%	19.4%	29.5%	11.1%	9.2%
CO/Days Use	81	48	105	176	100	71	108	40	33
Price	$ 4.26	$ 6.41	$ 6.78	$ 4.87	$ 4.70				
range					$ 5.50				

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U.S. Corn: Jackson thinks that we will need 4 to 5 million more acres of corn over the next 2 years and depending upon this year's realized yield that 4 million acres are likely to be needed next year. He is estimating the 2010 corn crop yield at 162.5 b.p.a. as shown below in the low yield scenario. He also thinks that USDA is underestimating demand by 300 million bushels for the 2010/11 crop that has yet to be harvested, shown as a adjustment in the 2010/11 alternatives below. The beginning stocks for the early look for 2011/12 reflect USDA's current yield and increased demand of 300 million for the 2010 carryout. The 2011/12 scenario also uses 4.1 million more acres and his total estimated demand of 13,990 which is equal to production. A hiccup in yield would create an excruciatingly painful logistical problem with low carryout numbers. If this year's yield is as Jackson suspects at 162.5 then the carry in for 2011/12 would be down 203 million to 809 million and then 2011/12 carry out is reduced to 823 million causing the excruciatingly painful logistical distribution problems.

U.S. Corn Supply / Demand (mb)

	USDA 06/07	USDA 07/08	USDA 08/09	Aug USDA 09/10	Aug USDA 10/11	Low Yield 10/11	High Yield 10/11	Early Look 11/12	Early Look 12/13
Planted	78.3	93.6	86.0	86.5	87.9	87.9	87.9	92.0	92.5
Harvested	70.6	86.5	78.6	79.6	81.00	81.00	81.00	84.81	85.27
% Harvested	90.2%	92.4%	91.4%	92.0%	92.18%	92.2%	92.2%	92.18%	92.18%
Yield	149.1	151.1	153.9	164.7	165.0	162.5	167.5	165.0	167.5
Carryin	1,967	1,304	1,624	1,673	1,426	1,426	1,426	1,012	1,026
Production	10,535	13,074	12,092	13,110	13,365	13,163	13,568	13,993	14,282
Imports	13	18	13	8	11	11	11	11	11
Supply	12,515	14,396	13,729	14,791	14,802	14,599	15,004	15,016	15,319
Feed	5,598	6,002	5,246	5,525	5,350	5,350	5,350	5,500	5,500
Seed, Food, Ind	3,488	4,345	4,953	5,865	6,090	6,090	6,090	6,090	6,090
Ethanol Use	2,117	3,000	3,677	4,500	4,700	4,700	4,700	4,700	4,700
Exports	2,125	2,425	1,858	1,975	2,050	2,050	2,050	2,400	2,700
Demand	11,211	12,772	12,056	13,365	13,490	13,490	13,490	13,990	14,290
				FC Stone Adj	300	300	300		
Carryout	1,304	1,624	1,673	1,426	1,012	809	1,214	1,026	1,029
CO/Use	11.6%	12.7%	13.9%	10.7%	7.5%	6.0%	9.0%	7.3%	7.2%
CO/Days Use	42	46	51	39	27	22	33	27	26
Price	$ 3.04	$ 4.20	$ 4.06	$ 3.50	$ 3.50				
range				$ 3.60	$ 4.10				

U.S. Soybean: Jackson points out that historically USDA underestimates soy exports by about 200 million each year, and usually makes adjustments to align carry out to actual. The three scenarios show Jackson expectation as a 200 million bushel adjustment downward and reduced carryout. He thinks yields could be close to USDA's 44 b.p.a. and leads him to the conclusion that with 1,600 million exports in 2011/12 we would need 79 million acres at a good 43.5 yield to maintain adequate US supplies. The as demand increases in 2012/13 an additional 2 million acres are needed to maintain a reasonable but snug 228 million ending stocks. (continued next page)

U.S. Soybean Supply / Demand (mb)

	USDA 06/07	USDA 07/08	USDA 08/09	Aug USDA 09/10	Aug USDA 10/11	Low Yield 10/11	High Yield 10/11	Early Look 11/12	Early Look 12/13
Planted	75.5	64.7	75.7	77.5	78.9	78.9	78.9	79.0	82.0
Harvested	74.6	62.8	74.6	76.3	78.0	78.0	78.0	78.13	81.10
% Harvested	98.8%	97.1%	98.6%	98.5%	98.93%	98.9%	98.9%	98.90%	98.90%
Yield	42.7	41.7	39.7	44.0	44.0	42.0	46.0	43.5	43.0
Carryin	449	574	205	138	160	160	160	160	200
Production	3,187	2,676	2,967	3,359	3,433	3,277	3,589	3,399	3,487
Imports	10	10	13	15	10	10	10	11	11
Supply	3,646	3,260	3,185	3,512	3,603	3,447	3,759	3,570	3,698
Crush	1,806	1,802	1,662	1,750	1,650	1,650	1,650	1,700	1,700
Exports	1,118	1,150	1,283	1,470	1,435	1,435	1,435	1,600	1,700
Seed	78	94	95	92	88	88	88	92	92
Residual	70	9	6	40	70	70	70	70	70
Demand	3,072	3,055	3,047	3,352	3,243	3,243	3,243	3,370	3,470
				FC Stone Adj	200	200	200		
Carryout	574	205	138	160	160	4	316	200	228
CO/Use	18.7%	6.7%	4.5%	4.8%	4.9%	0.1%	9.8%	5.9%	6.6%
CO/Days Use	68	25	17	17	18	0	36	22	24
Price	$ 6.43	$ 10.15	$ 9.97	$ 9.60	$ 8.50				
range					$ 10.00				

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When Jackson looks at the entire world soy complex he talks of increased demand of 13 MMT every year into the fore seeable future. Interesting that 13 MMT is about 400 million bushels and coincidentally nearly the same amount as this year's FSU wheat crop failure due to drought. Jackson believes that the Western Hemisphere will need to add 6 million new soybean acres every year to meet demand as the Chinese and other Asian lifestyles improve. As he looks at the soybean table for the three major producers (U.S., Brazil and Argentina) he sees 2011 as becoming the second tightest carryout ever. He states that a reduced crop in the U.S. or South America makes for very tight supplies and a need for higher prices to reduce usage.

FC Stone Price Outlook: Jackson sees current world wheat stocks as adequate and current prices around $7.00 futures as adequately high given the unexpected need to re-align supplies with users. He believes that wheat stocks in Australia, Canada, and the United States can supply the needs of the world. He states end users in European & Black Sea region have been scrambling to re-book imports and freight and this has put the wheat market on edge. He doesn't believe that there are quality issues with the current crop such as those that help spike prices drastically higher in the past. He believes that prices have already attracted the 4 million additional acres of wheat for next year.

Jackson talks about comfortable corn ending stocks of one billion bushels and a perceived need to attract an additional 4 million acres next year if 2010 realized yields are below USDA's current estimate of 165 b.p.a.. He thinks that the anticipated tightness of world corn ending stocks has the market nervous and is the reason that corn prices must go higher. He made the statement last Monday that, " Maybe corn goes down 15 cents between now and harvest." He clearly is very bullish corn and says that corn has become the price leader using $5.50 futures corn prices as a reasonable target and talked about unforeseen values if the 2010 crop yield is well below 165 b.p.a. He doesn't think EPA will provide a signal as to the expanded ethanol blend until mid September at the earliest and noted that the trade is looking for this announcement in Sept. He said that the market will have concerns over the ethanol blenders credit renewal starting in November if it hasn't occurred by then, a reaction caused by the failure of the Bio-Diesel credit renewal. He anticipates a lowering and phase out of the blenders credit and doesn't foresee that being detrimental to ethanol prices to the plants as long as a mandate stays in place, citing that the blenders have recently kept most of the credit and have not passed that portion on to the plants.

When asked what happens if the U.S. has a 1988 type drought he said without hesitating that EPA and USDA would mandate a prorated curtailment of ethanol production to preserve feed stocks for the livestock herd. Then Jackson said that they didn't intervene when we had $8 corn prices so he wondered at what price they would make that type of a decision, believing that in a worst case scenario they would be forced to do so.

Jackson states that U.S. soybean supplies are currently large enough to keep us away from rationing prices, unless the 2010 yields drop a couple of bushels per acre below the current estimate of 44 b.p.a.. He thinks that $5.50 corn futures would provide opportunities for $12.00 soybean futures as markets try to properly allocate acres among Wheat, Corn, and Soybeans. Strong cotton prices will further tighten acres that are available. The interesting thing about world soybeans is that every six months we get a very good fresh look at a new supply & demand scenario as the U.S. and South American crops are harvested. If the U.S. is unable to supply enough acres then Brazil and Argentina are incentivized to add acres to meet demand.

My Take: It appears that the Wheat acre expansion by 3.5 to 4 million acres or more appears to be all but a done deal. My contacts in the far east corn belt tell me that their region reduced winter wheat planting by about 2 million acres last year below normal due to a late harvest making it impossible to plant. They tell me that it appears that the eastern corn belt will add 3.5 to 4 million acres of winter wheat next year. All the normal seed supplies have been sold and they are cleaning bin run wheat for seed. Much of that region will normally grow 160 bushel corn so the possibility of double crop soybeans with the ability for forward sell wheat at great prices makes this a very attractive scenario. Areas of the far northern spring wheat region just harvested 80+ bushel farm average and are planning to increase wheat acres some next year. As they forward contract those acres are tied up and it becomes much less likely that they plant corn.

Corn is often the preferred crop over soybeans in much of the heart of the corn belt as profitability is easier to project for corn than it is for soybeans even with soybean prices near $10.00 futures. If the national corn yield fall much below 165 then we will likely see opportunities for $5.00+ corn futures. USDA is currently projecting the corn crop at 165 b.p.a based on harvested acres. They are using a 92.2% harvested to planted ratio, which equates to a whole farm yield of about 152 bushel per acre. This is where I get somewhat cautious about a yield projection as I consider the current genetics of corn and how troubled a crop would need to be to yield only 152 b.p.a. across all planted acres. While some analysts believe that USDA has likely reported the highest surveyed yield of the year and I do not have a survey to refute the thoughts that the yield could go lower or higher, I would be very cautious to believe that this crop isn't a new record as crop conditions have been rated very high all year. While early corn yield estimates are disappointing, most of those areas where a early harvest is taking place have had issues all along and are not a surprise. More isolated problems exist in corn almost every year as compared to soybeans and that is why the harvested to planted ratio for corn is only about 92% while the soybean ratio for planted to harvested acres is most often about 98%.

On the demand side of corn, it seems that feed usage could once again start to move upward as the entire livestock sector is experiencing profitability and usage could meet levels of 2006/07 at 5.5 billion bushels. Just maintaining ethanol use at the current 4.7 billion would appear to be conservative as new ethanol construction could take another 250-400 million bushels as they come online. If that takes place and other operations don't slow production then estimates usage could be too low. It is difficult to project 100% plant utilization unless the U.S. economy improves taking gasoline usage upward. To achieve 100% plant capacity the U.S. would need to export ethanol into the world market. EPA could encourage additional usage by allowing a higher blend rate for newer cars but consumer education is a problem so a

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rapid ramp up of usage would not be expected unless blenders and retailers have high enough margins to actively promote usage. I don't look for ethanol usage to exceed 4.7 billion bushel by much unless conditions change. It appears that the world is looking at the U.S. for additional feed grain supplies beside just wheat and corn is the alternative. Corn exports may be front loaded again this year and a projected 2.0 billion of exports could be too low. If we increase corn exports by 400 million bushel more demand in 2011/12 we need to add 4 million more acres to keep a comfortable but somewhat sung billion bushel carry out.

The projected U.S. Soybean carryout this fall is about 160 million. Some analysts believe that USDA will ultimately state this number lower or ratchet up 2010/11 export expectations instead. If the realized US 2010 soybean yield is much below 43 b.p.a then we tighten up 2010/11 carryout to uncomfortable levels when we could possibly have less available acres for soybeans during the 2011/12 crop year. If corn makes a run to $5.00 futures or higher before soybean prices react then we could see acres get locked into corn as forward sales are made. Once that happens we have fewer free acres to allocate to soybeans next year and the realm of $12.00+ soybeans becomes plausible as acreage allocation concerns become a front burner topic. If 2010 yields are equal to or above 44 b.p.a. then we only need to maintain the current acres of 79 million next year to keep comfortable projection for 2011/12 carry out.

My conclusion: It appears that we are headed to a time frame of re-allocating tight acres primarily as a result of wheat tying up 4+ million acres for next year early on. Allocating corn acres next year are a concern to the market at a time when world feed grain supplies have tightened due to drought in the FSU. Realized corn yields will be important, look for USDA to make adjustments every month as harvest progresses. The trade will be more cautious of locking into a final yield until late in the season, but sharp price reactions to lower yields are more likely this fall. The only time in history when December Corn futures have posted a price above $4.00 on October 1st was in 2008 at $4.84 as prices were retreating from the summer high of $7.96. Disappointing yields could provide the second opportunity of $4.00 corn on October 1st, however harvest price declines of greater than 10% are the norm and would then take values below $4.00. It appears that Soybeans would be an area that could give up a few acres next year, if South America increases acres adequately. However, a disappointing U.S. yield this fall would heighten concerns and could cause much higher values this winter. The soybean market will be the market that will most likely struggle to move to higher values. While, the trades concern over sub $8.00 bean futures as been all but eliminated because of the tightening of supplies of the other major crops, of concern to me is that a large 46 bushel yield could once again pressure prices during harvest but it is much less likely to cause a $2.00 price drop today.

Goals: Profitability remains the one major goal regardless of price outlook. If we take a long term view of realizing a return of 15% on our yearly capital invested in growing a crop we can double our farms available capital every 5 years. For example, if it takes $640 to grow a corn crop and we can net $100 per acre profit after all variable and fixed costs including debt service and family living we have obtained a return of about 15%. If achieved annually without a hiccup we would double the operations capital in 5 years.

To illustrate thus concept further, consider that a 25 year old farmer starting with just 300 acres could grow to 600 acres at age 30 without expanding any existing credit needs in terms of total dollars. By age 35 the farm size could be 1,200 acres, by age 40 it could grow to 2,400 acres and at age 45 the farm would be at 4,800 acres. If continuing the trend on to age 50 the operation would have the capital to farm 9,600 acres with an annual credit line in terms of total dollars equal to what was needed at age 25 when farming just 300 acres.

One thing that is important with this scenario is that no major hiccups occur, that is why we often are willing to accept a reasonable return that projects to be about 15% or $100 per acre. While it is true that an operation that is cash flush has much more room to accept risk and gamble by waiting on the market, it may be just as prudent, long term, for them to accept reasonable profitability levels and market the crop accordingly.

Regardless of risk tolerance, cost analysis is important and that is why we have developed the Position Management program we use as it allows for a sensitivity analysis coupled with profitability tracking. It allows us to have a complete understanding of the current market position impact on the operation with just a glance and at any time.