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Grains Report

Last week saw little movement in grains prices. Volatility decreased in anticipation of the World Agricultural Supply and Demand Estimates (WASDE) released on February 9. The WASDE report was pretty neutral for corn, beans and wheat. For corn, the 2011/2012 total domestic use remained the same, ending stocks were reduced to 801 million bushels; although industry expectations were for the ending stocks to be lowered to 791 million bushels. The stocks to use ratio was reduced to 6.3, indicating very tight ending stocks. The 801 million bushel ending stocks would give us only 23 day supply of corn, should something happen with the new crop. With the very tight ending stocks in the corn market, the small changes in the underlying fundamentals could quickly erode or spike prices.

U.S. ending stocks of corn were reduced due to lower production estimates for Argentina, which affected exports. Argentinian production was lowered by 4 million metric tons (15%). World 2011-12 coarse grain production is projected to be a record despite the reduction in the Argentina crops. However, projected world corn ending stocks remain at very tight levels.

U.S. wheat stocks were decreased in the current WASDE report due to increased exports. Wheat is basically being priced as a feed grain. This also may limit/slow upside corn price moves.

(Grains: Continued.)

	Corn				Soybeans		
	2009/2010	2010/2011	2011/12		2009/2010	2010/2011	2011/12
Beginning Stocks	1,673	1,708	1,128	**Beginning Stocks**	138	151	215
Production	13,092	12,447	12,358	**Production**	3,359	3,329	3,056
Imports	8	28	20	**Imports**	15	14	15
Total Supply	14,774	14,182	13,506	**Total Supply**	3,512	3,495	3,286
Food, Seed, Industrial	5,961	6,428	6,405	**Crushings**	1,752	1,648	1,615
Feed and Residual	5,125	4,793	4,600	**Seed**	90	87	88
Total Domestic	11,086	11,220	11,005	**Residuals**	20	43	32
Exports	1,980	1,835	1,700	**Exports**	1,499	1,501	1,275
Total Use	13,066	13,055	12,705	**Total Use**	3,361	3,280	3,011
Ending Stocks	1,708	1,128	801	**Ending Stocks**	151	215	275
Stock to Use Ratio	13.07	8.6	6.3	**Stock to Use Ratio**	4.5	6.6	9.1
Avg. Farm Price ($/bu)	3.55	5.18	5.80-6.60	**Avg. Farm Price ($/bu)**	9.59	11.30	11.10-12.30

Source: WASDE

Although corn prices have been trading mostly sideways for the last couple days, the spreads between some futures contracts have narrowed very slightly. The March/May spread narrowed ever so slightly, while the May/July spread narrowed about 2.5¢. The spread is likely to widen if there are quick spikes in price as corn purchasers will be wanting to have bushels on hand and be willing to pay a premium. High daily volatility and price variability will continue for old and new crop during the 2012 growing season.

The 2011 U.S. soybean supply and use projections were unchanged from last month. Thus ending stocks remained at 275 million bushels, even though the industry expected a slight decrease.

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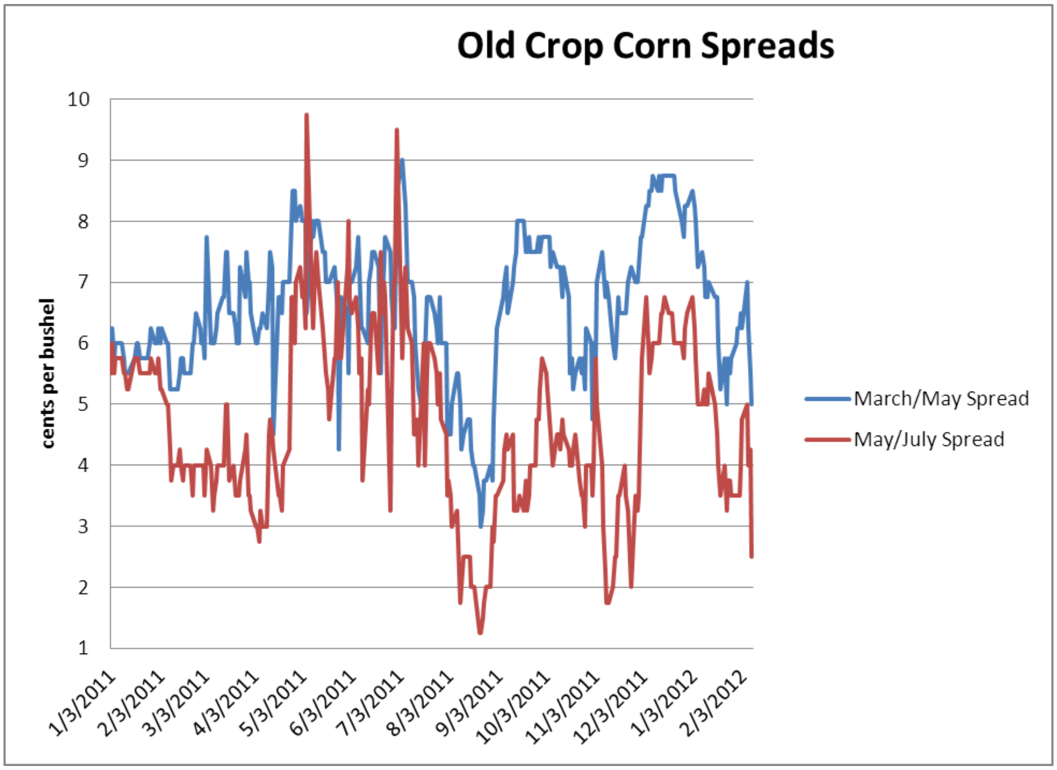


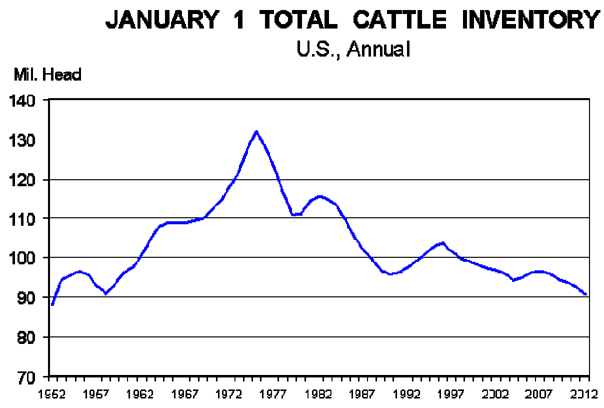
United States Cattle Inventory and Situation

On January 27, 2012, the USDA/NASS released the semi-annual *Cattle* report. Most information in the report was expected. Record setting drought in the Southern U.S. caused beef cow herd liquidation, fewer calves on cereal grain pasture, and more cattle in feedlots. However, record high feeder cattle prices stimulated interest in beef heifers, with replacements increasing enough in areas with good moisture conditions to cause a slight increase for the U.S.

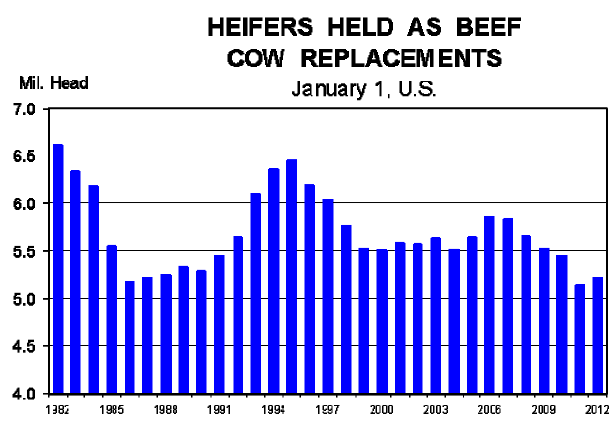
All cattle and calves in the U.S. as of January 1, 2012, totaled 90.8 million head, slightly more than 2% below the 92.7 million on January 1, 2011; however, Wisconsin was down 1.4% to 3,400,000 head. This is the lowest U.S. January 1 inventory of cattle and calves since the 88.1 million in 1952.

The number of beef cows that have calved was down over 3% from 2011, at just under 29.9 million head. Wisconsin had no change in the number of beef cows that calved or the number of milk cows that calved. The decline in U.S. numbers was not a surprise given the severe drought that has plagued the Southern Plains. Beef cow numbers declined 660,000 head (-13%) in Texas, 288,000 head (-14%) in Oklahoma, 53,000 (-11%) in New Mexico, and 51,000 (-3%) in Kansas for a decline in those major drought impacted states of 1,052,000 head. Beef cow numbers in the entire U.S. declined less than a million at 966,700. Some beef cows did move from the drought stricken area to neighboring states where moisture conditions were better. Beef cows increased 112,000 head in Nebraska, 22,000 in Colorado, and 20,000 head in Wyoming.

(Cattle: Continued.)



Beef replacement heifers over 500 lbs. in the U.S. were up 73,000 head over 2011, an increase of 1.4%. About 3.2 million of those are expected to calve in 2012. Similar to beef cows, replacement heifers declined 60,000 head (-10%) in Texas and 55,000 (-15.5%) head in Oklahoma, while replacements increased 55,000 (+18%) in Nebraska, 35,000 (+29%) in Colorado, 25,000 (+18%) in Wyoming, and 5,000 (+7.6%) in Wisconsin. Milk cow replacements were down 1% in the U.S. and 2.8% (20,000 head) in Wisconsin. Other heifers over 500 lbs. were down 2% in the U.S.



The combined total of calves under 500 lbs., and other heifers and steers over 500 lbs. outside of feedlots was 25.7 million, down about 4%. The total number of cattle on feed at 14.1M head was up almost 1% from last year.

So what does all this mean for the cattle situation and 2012 prices? Higher prices. But before the celebration begins, the entire picture must be examined.

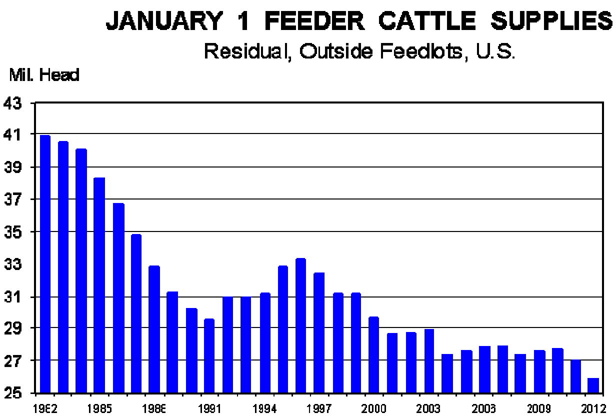
Last year at this time I wrote that there would likely not be an increase in cattle numbers in 2011 due to the high corn prices and low profit margins. I said that cattle feeders were going to have trouble keeping their bunk space filled and there would likely be some consolidation in the industry. Amazingly the cattle feeders in the U.S. have managed to keep their inventories full.

This success came at the expense of future feeder cattle supplies, as inventories were kept full on account of early placements of drought impacted calves and directly placing Mexican cattle in feedlots. Since those 2011 calves were placed on feed early, there will be fewer calves available for 2012. Combine this decrease in the carryover of number of calves from 2011 with the January 1 estimate of smaller cow numbers signaling another decline in the calf crop for 2012, we see that supplies of all market classes of cattle will continue to be historically tight.

The tight numbers are supportive of calf and feeder cattle price. The Livestock Marketing Information Center estimates that 2012 will likely bring average profits of close to $150 per head for the cow-calf producer. This is up from the $80 profit per head experienced in 2011. Note that this is an industry

(Cattle: Continued.)

average for profit and individual producers will experience differences depending on if they are a high or low cost producer. Assuming weather cooperates, these higher profits will likely lead to even greater retention of beef heifers for replacements, which will put even more pressure on feedlots and the challenges they face in procuring calves and feeder cattle.



In 2012, cattle feeders will find it challenging to procure placements due to the decline in the number of feeder cattle outside of feedlots, the decline in the 2012 calf crop, and the increase in the number of beef heifers held for replacements. Thus we will likely see declining feedlot placements in the next several months. On top of the challenges of finding placements and paying higher prices for those placements, feedlots will also not experience the same percentage of increase in finished cattle price. Even though their output price will likely be higher for 2012, their margins will be lower. In fact, feedyard margins have declined from about break-even at the beginning of the year to losses of nearly $70 per head last week.

Finished cattle prices will not increase by the same percentage because of push back on choice beef prices and the abysmal margins that packers are experiencing. LMIC estimated that the beef packer margin in December 2011 was about 3% below a year earlier. For the first three full weeks of 2012, that margin collapsed averaging 40% below 2011's. During these weeks finished cattle prices increased about $5.00 per cwt. and the wholesale boxed beef value dropped nearly $10.00 per cwt. Last week there was a slight turnaround and according to Sterling Beef Profit Tracker, beef packer margins improved more than $26 per head, but losses are still near $100 per head. Beef packer margins typically improve seasonally as spring approaches; however, packer margins are forecast to remain below 2011's at least into the summer quarter. Red ink will force packers to evaluate their plant efficiencies, likely decreasing slaughter days and eliminating the most unprofitable plants.

2012 will likely bring record prices, but only the cow-calf sector will see anything near record profits.

Below is a table showing LMIC's forecasted cattle prices for 2012.

	Live Slaughter Steer Price - 5 market average	Feeder Steer Price Southern Plains 700-800#	Feeder Steer Price Southern Plains 500-600#
2012 Quarter 1	122-124	144-147	157-162
2012 Quarter 2	125-128	145-149	158-14
2012 Quarter 3	122-126	146-152	157-165
2012 Quarter 4	125-130	143-150	153-163

If A Smaller Cattle Herd Brings Higher Prices, Why Would the Industry Want to Expand?

The January 2012 *Cattle* report provides numbers to indicate this is the smallest cattle herd since 1952. However, it should be noted that beef production totaled over 26 billion pounds in 2011, compared to about 10 billion in 1952. The beef industry produces much more beef with the same number of cattle that existed in the 1950s. The record highest beef production was the 27 billion produced in 2002. Unfortunately, genetics will make is harder to continue producing more beef with less cattle.

Smaller beef production leads to smaller beef consumption. Beef consumption is measured by adjusting beef production for international trade and freezer stocks. When this number is divided by the current population, we get per capital beef consumption of 55.3 pounds, a 3.5% decline from 2011 levels.

It is vital for the long-term health of the industry not to have beef production fall too low. With declining cattle numbers, smaller packers and feedlots will likely exit the business. This infrastructure is not easily re-developed when cattle numbers increase.

Lower cattle numbers will eventually mean lower beef production and then retailers and wholesalers will encounter challenges when attempting to procure and feature beef. Consumers will find beef prices high and substitute lower price protein products for beef, leading to continued decline of domestic beef demand. Finally, U.S. exporters will have less beef quantities. These exports have added to the higher prices experienced last year. With insufficient quantities of beef to export, U.S. beef will have a higher price, making competition from Brazil and Australia even greater.

The important issue to note is that once procurement methods change, either for domestic retailers or foreign markets, it is difficult to regain those markets. Additionally, consumers are mostly creatures of habit, and if consumption of beef gets too low and consumers have substituted in lower prices proteins, it will be difficult to get them to increase consumption just because cattle numbers have increased.