

By Diana Klemme

2009 Crop: Record Yield, Record Problems?

Merchandising is more than buying and selling grain; it's about using your working capital and other assets to maximize returns for your business. Evaluate many components, including:

- Current and forward basis values on the commodities you handle
- Potential basis changes on those commodities
- Futures spreads
- Logistics, freight availability and cost
- Alternative uses of space and money
- Quality and discounts.

Some years, futures spreads are your big risk factor; other years it could be the availability and cost of credit or of freight. Discounts are often overlooked in merchandising decisions, which can be a minor mistake some years, but an expensive or disastrous mistake in others: 2010 is one of the latter.

The 2009 corn crop is showing serious problems across numerous areas. The wide range of moisture at harvest meant wide ranges of moisture came out of dryers and went into bins. Hot spots are common, and a lot of managers reported high-damage corn coming out of farm bins by early January. Some managers report clearing problem spots out of bins, only to see new hot spots surface soon afterward.

Other managers report their corn breaks up easily, creating unusual amounts of "BCFM," broken corn/foreign material. This has increased the supply of corn "screenings," with values falling to as little as 50% to 60% of corn.

Vomitoxin remains a problem in scattered areas, especially in parts of the Eastern Corn Belt, leaving ethanol plants working to make sure their DDG byproducts maintain quality for feeders. Reports are surfacing of declining hog and cattle gains from 2009 crop corn, not always from toxin issues.

Elevator managers who bought and hedged corn, counting on wide futures carries to provide substantial basis returns, may find the summer of 2010 provides unwelcome surprises instead.

Not all discounts are equal

In many markets, discounts schedules can be negotiated in a trade, just like haggling over a couple of cents on the basis, or over shipment time. Sharp merchandisers will work this to their advantage when quality is a problem. Be creative: If your problem is damage when everyone else has low test-weight, bargain for a lenient damage scale, and concede to a tough test-weight schedule, without revealing why. In some cases, you may be moving inventory directly from farm to terminal, so locking in better than market discounts can offer another bonus. You have the choice to discount the farmer on the "standard" market scale of discounts and keep the value of your negotiated discounts for your bottom line.

Discounts as basis

In problem quality years, treat your discounts as an integral part of the basis itself. If you have two potential buyers, don't accept the higher basis if it might mean more in discounts than you gain on basis. By the same token, plan ahead when holding poor-quality stocks. Generally, bad grain only gets worse over time. In some cases, the risk of added discounts on deteriorating corn quality can wipe out carries or potential basis gains, and perhaps a lot more. When you suspect or know grain in your area has quality problems, count the potential increase in discounts as a cost of holding when weighing your projected merchandising returns from basis alternatives. And err on the side of caution — assume significant quality deterioration and higher costs.

Blending/discounts

Most elevator managers understand mixing and blending within a crop year to minimize (or eliminate) discounts at sale time can contribute a lot to an elevator's bottom line if the grain was discounted properly on the inbound side. Evaluating whether to hold grain over from one crop year to the next for blending purposes is a more challenging process. When you have to hold grain over, you run a greater chance of further quality deterioration,

of futures spreads not covering your interest costs, and you may have to turn down strong basis levels through the year just because you can't make grade. And you have to factor in the proper value on the space the off-grade grain occupies if holding the stocks means not being able to handle other volume.

Consider two elevators (assume both could refill their space with soybeans or another commodity). Elevator 1 will keep the 2009 crop low-quality corn and blend it out with 2010 crop. Elevator 2 will move the corn out by spring 2010, take the discounts, and refill with soybeans, better corn, or perhaps with wheat.

Elevator 1 may make an expensive error by failing to include any merchandising return of handling soybeans through the same space the off-grade corn has to occupy for months. If merchandising both the soybeans and the corn would net more dollars on the space, move the bad corn, take the discounts, and use the space (and working capital) in other ways.

The point is, don't get caught up in *always* trying to avoid discounts. In some cases, moving the corn out may not be possible. If there's no market for a particularly poor lot of grain, you may have no choice but to hold it. But buy it right, and make sure you decide to hold it only after exploring all possible alternatives, and calculating the net dollar value of each.

The outcome

Ethanol plants, exporters and feed markets are managing quality problems through more specific and tougher grade specifications, stiffer discount schedules, and careful testing of inbound corn. The end result is that corn trading is evolving into a two- or even three-tier market. Sellers that can guarantee #2 yellow corn may get one bid, high test weight corn may earn a premium, and problem corn may be discounted steeply, separate from specific grade discounts. Nutritionists are evaluating the impact of various grades and factors and are steering buyers' decisions.

Sellers can manage this year's challenges by being proactive. Some elevators are offering premiums to farmers for specific traits, such as 2008 crop corn, or for a specific higher test weight. Many have stepped up their oversight of operations, testing bins more frequently than usual, testing *every* outbound load before



it leaves. Consider setting up a program to help farmers test bins. That serves two functions: 1) building good will, and 2) giving you an overview of the corn you'll see in the months ahead.

And in grain trading, buyers have no reason to lock in a discount schedule on a contract unless the seller negotiates it. Grain contracts can be like credit lines. The only terms you can be sure of are the ones in your written, signed agreement. ■



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