

"Shell Shocked"

Despite initial skepticism, elevators with space and capital may find StarLink-commingled corn offers a long-term profit opportunity.

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What started in September 2000 as an obscure story about some taco shells made from genetically modified corn soon stunned the grain industry. By mid-October the word "StarLink" had made network news and the front page of the *New York Times*.

StarLink is a variety of corn genetically modified to contain a gene from Bt bacteria that produces the Cry9C protein, toxic to the European corn borer. All Bt corn varieties other than StarLink are approved for both human and animal feed use. But EPA granted StarLink only limited approval, for domestic animal feed use, and subject to stringent conditions. Nationwide, around 350,000 acres were planted in 2000.

Unfortunately, things went awry and created a mess for the grain industry. A consumer advocacy group discovered some taco shells that had been pro-

duced from StarLink corn. By the time the taco story erupted, the StarLink horse was miles down the road. Some growers claimed they weren't informed of usage restrictions. Some inadvertently delivered StarLink or cross-pollinated corn to elevators without declaring it was for animal feed only.

Once the grain industry learned of the problem, it had to act quickly. Elevator man-

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agers across at least 29 states discovered they may have unknowingly received, and in many cases shipped, StarLink corn. Iowa was affected most, with around 15 to 20 million bushels grown in 2000 vs. total production of 1.75 billion bushels. Elevators need to:

- Determine which (if any) inventories might be contaminated.
- Train their staff and alert farmer customers of the problem.
- Set up inbound/outbound testing procedures — where appropriate.
- Begin documenting all StarLink-related costs or losses.

• Review (if affected) their open corn sales to see which would preclude StarLink.

• Begin to analyze merchandising implications.

Among the questions many managers asked were "Where can I sell this corn," and "Will it trade at a discount?" Talk circulated that the basis for contaminated corn could fall out of bed. Some managers initially feared there might not even be a market for StarLink corn. As early as October, one university professor ventured the opinion that hedging StarLink corn in CBOT futures might actually increase a firm's risk, citing a potential disconnect between 'clean' and contaminated corn. This same professor voiced concerns over the collateral value of warehouse receipts backed by StarLink or commingled corn. These were dramatic statements, but no substantiation was provided.

Problems are usually opportunities in work clothes, and StarLink fits the bill. StarLink corn is approved for domestic animal feed (and potentially for export for feed use). Projected 2000 crop corn usage in the United States breaks down as follows:

Feed	58 %	5.85 billion
Export	22.5%	2.28 billion
Food/ Industrial	19.5%	1.98 billion
Total	100 %	10.10 billion

Domestic feed this year will be about 119 times U.S. StarLink production (assumes approximately 49 million metric bushels grown in 2000). Early commingling increased the affected inventory substantially and some livestock operations will not buy the affected corn. But feed markets overall could still absorb the grain involved. Some basis discount is likely at times and more so in some areas than others. But overall, that basis won't completely

decouple from the value of 'clean' corn — someone always wants to buy a bargain!

Expect losses

Make no mistake; the grain industry will realize some significant losses from this mess. Some elevators have to find new markets, and some will indeed incur a loss vs. export or processor basis opportunities. Much of the loss will come from the freight costs of getting to "out of position" acceptable destinations. Other firms will incur extra freight costs on rejected shipments. Firms on all ends have had to train staff and absorb the costs and delays of testing.

Aventis has set up programs to work with producers and the commercial sector. They may compensate some firms for market and freight loss, but elevators also need to minimize their costs. Seek out alternative potential buyers, including firms you haven't traded with recently. There are companies that routinely trade paper positions, arbitrating regional basis variations. That is the kind of firm that will find markets that can receive commingled corn and then serve as a trading conduit to link users with suppliers.

How cheap can basis go?

Elevators with space and capital may find StarLink-commingled corn offers a long-term profit opportunity. First, they have to be able to segregate any affected corn and be able to comply with all applicable EPA or USDA regulations, protocols or procedures. This might entail dedicating an entire location to StarLink/commingled corn. Elevators can do this without becoming part of the official Aventis/USDA handling program. As with all opportunities, it isn't without risk. But now firms will go into this knowing what they're handling and doing it correctly.

The 'opportunity' side of the problem comes courtesy of CBOT

futures. Corn spreads already pay more than the interest cost to carry corn — clean or contaminated — into 2001 crop. The March 2001/Dec 2001 futures spread is around 22 cents as of November 2000. The interest cost to hold from Jan. 1 to Oct. 1 is only about 17 cents.

Elevators that have or acquire commingled corn and think the basis is discounted too much relative to clean corn have a backstop: Roll the short hedges forward to December 2001, and let the futures carry pay your interest cost. This gives you nearly a year to shop for sales at a lesser discount to clean corn. The ability to work a position while the market pays the holding costs greatly lessens the odds that steep basis discounts will exist for long. Savvy traders are always looking for such opportunities, in all commodities, not just StarLink corn.

There already have been (and will be more) instances where spot units test StarLink positive at a destination that can't unload them. Rerouting rejected spot shipments may result in steep basis discounts, demurrage and additional freight costs. But those also occur for reasons unrelated to StarLink. The fair benchmark is to gauge the forward-contract differential for StarLink vs. clean corn. By being patient and shopping aggressively, managers should be able to trade StarLink corn at little to no discount at times over the next year and earn the carry as well. 

Author's note: StarLink was developed by Aventis CropScience, a division of Aventis SA, a European-based corporate group with over \$41 billion in assets.

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