

The Western Corn Belt: 'Fuel Speed Ahead'

Demand for ethanol looks solid for years to come, and that comes on top of higher feed usage and rising corn exports.



Ethanol plants have sprung up like fast food restaurants. They've become a common sight and more plants are under construction. Thanks to federal subsidies and ethanol being the main choice as a fuel oxygenate, demand for ethanol looks solid for years to come. And the rising price of gasoline and ethanol and falling corn price have produced very positive margins, helping many plants this summer.

	7 states Corn Production	Total U.S. corn use for ethanol	Total U.S. corn feed usage
1998	6.44 billion bu.	.525 billion bu.*	5.468 billion bu.
2004 crop	7.222 billion bu.	1.3 billion bu.	5.850 billion bu.
Change	+780 million bu.	+775 million bu.	+382 million bu.

**most of the ethanol production at that time was outside the WCB*

states add to the story. Illinois, Iowa, Wisconsin, Minnesota, South Dakota, North Dakota, and Nebraska accounted

seven states will be approximately 3.2 billion gallons, which would require approximately 1.1 to 1.3 billion bushels of corn. Demand for corn for ethanol in the WCB is rising as fast (or faster) than production in that area! This new demand comes on top of higher overall feed usage and rising corn exports. (Note: cattle numbers are down slightly vs. 1998). Think of the potential impact when a crop problem arises in the WCB or in years ahead as ethanol production climbs further!



Ethanol production capacity, existing and under construction in the Western Corn Belt, will be approximately 3.2 billion gallons, which would require approximately 1.1 to 1.3 billion bushels of corn.

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Source: Renewable Fuels Association
www.ethanolrfa.org

This map shows the concentration of existing ethanol plants in the United States and plants under construction and leaves no doubt they are impacting corn merchandising in the Western Corn Belt.

Production numbers for seven major Western Corn Belt (WCB)

for 66% of U.S. corn production in 1998 and will represent approximately 67% in the 2004 crop.

According to the Renewable Fuels Association (www.ethanolrfa.org), ethanol production capacity (existing and under construction, August 2004) for these

U.S. corn to the Pacific Rim

But corn exports off the Pacific Northwest are also rising again, from 166 million bushels for 2002/03 crop, to 360+ million bushels for 2003/04. With China's sharply reduced ability to export corn now due to declining stocks, the United States will resume a greater role in supplying the Pacific Rim. China could even need to import U.S. corn to supply their



rapidly expanding meat sector. That bodes well for PNW vessel loadings.

These factors are reshaping grain flows and logistics in the Western Corn Belt and will affect WCB grain merchandising opportunities. Grain facilities in the WCB that can't load rail have watched as

ever-larger unit trains chugged west to California and PNW markets, or to the feedlots of the Plains and Texas, taking market share with them. Now the tide is turning; the WCB ethanol plants must originate corn. The resulting tug of war between the trend to ever-bigger long-haul unit trains and the rising local demand is helping to level the playing field for grain elevators and terminals in the Western Corn belt. Truck-only facilities are no longer disadvantaged! Who thought that older truck-houses with lots of storage capacity in big flats could find a new niche?

Expansion will affect basis

Growth in WCB demand is diminishing the West's place as a cheap-basis source of corn.

It's simplistic and wrong to think the rise in ethanol production will make the corn basis rise by a certain number of cents per bushel. But the expansion of ethanol will clearly affect basis. Ethanol plants typically have

minimal storage capacity and need a regular and dependable supply of corn. Many cannot depend on producers to supply 100% of their corn needs and must turn to commercial sources. Some of the buyers are also not as basis-sensitive or savvy as major grain exporters are. These issues play right to the strength of truck facilities or to small unit-trains (assuming the ethanol plant can unload rail): the ability to react quickly and to be a regular and reliable supplier who can bring offers when buyers are ready.

Basis at harvest may still drop to cheap levels whenever the WCB corn crop exceeds immediate demand and/or available space. The rising local demand will have its greatest impact in the months when supplies grow tight — usually spring or summer, but anytime farm selling drops off. Then demand for corn could push the basis to "higher highs" to keep the available corn from "escaping" to other markets. The net result for country elevator hedgers can be wider overall returns to space.

Total corn demand may not reach its full potential for awhile; some of the WCB ethanol plants are under construction. Factor the changes into 2004 crop merchandising plans, however. WCB feed demand is projected to remain high; U.S. calf and cattle numbers in Nebraska, Kansas and Iowa are higher than last year, for example. Expect steady corn demand throughout the crop year. Don't underestimate summer 2005 WCB basis. It firmed this summer as farmers resisted falling

prices, with some locations paying +5 to +20 September futures for corn. The WCB could easily see a repeat of this whenever WCB production falls short or when farm selling grinds to a halt. But when supplies are plentiful, basis can (and will) fall hard — at least for awhile.

Basis impact will typically be greatest in the most remote areas, in the Dakotas and Minnesota for example, where it's very expensive to originate corn "upstream" from other areas. This happened in Minnesota this summer where the soybean basis soared to +140 November while crush plants in the Eastern Corn Belt were able to originate soybeans at +100 November or cheaper, and the Gulf was around +70 November. The combination of new soy crushing plants, good crush margins, and an aphid-ravaged 2003 crop drained northern soybean supplies extremely low by early summer and forced the soybean basis extremely high. A sign of things to come in corn?

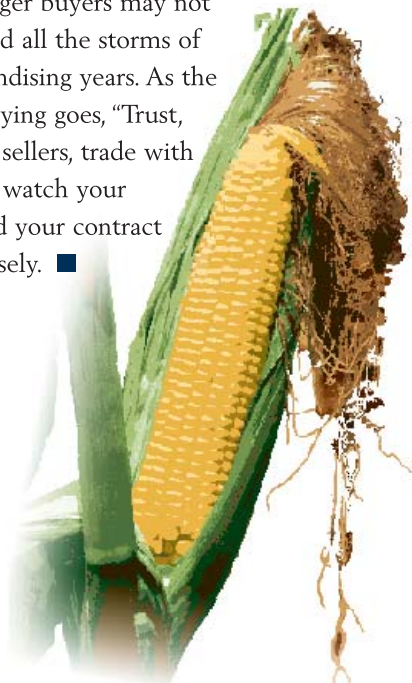
End users in other regions will be affected as well. Feedlot buyers in the Southern Plains may find it harder to originate corn, and cheap corn won't be as plentiful to head to the Central United States or the Gulf. And the rising production of DDGs (Distillers Dried Grains with Solubles) from ethanol production will displace some corn demand at feedlots.

The challenges

Perhaps the most challenging aspect will be that the corn demand for ethanol is diffused;

the corn goes to a lot of small/medium-size plants rather than a few major processors. A lot of the corn goes direct through supply agreements from farmers to the plant. And basis values are less transparent; many plants don't even publish bids on the news services, for example. The commercial trade doesn't talk (as much) about what's trading at these plants. But the plants quietly are consuming nearly 1 billion bushels and could approach 1.3 billion within a few years.

Most ethanol plants are small to medium-size businesses and don't have deep financial resources. Some younger buyers may not have weathered all the storms of rough merchandising years. As the old political saying goes, "Trust, but verify." As sellers, trade with the plants but watch your receivables and your contract terms very closely. ■



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