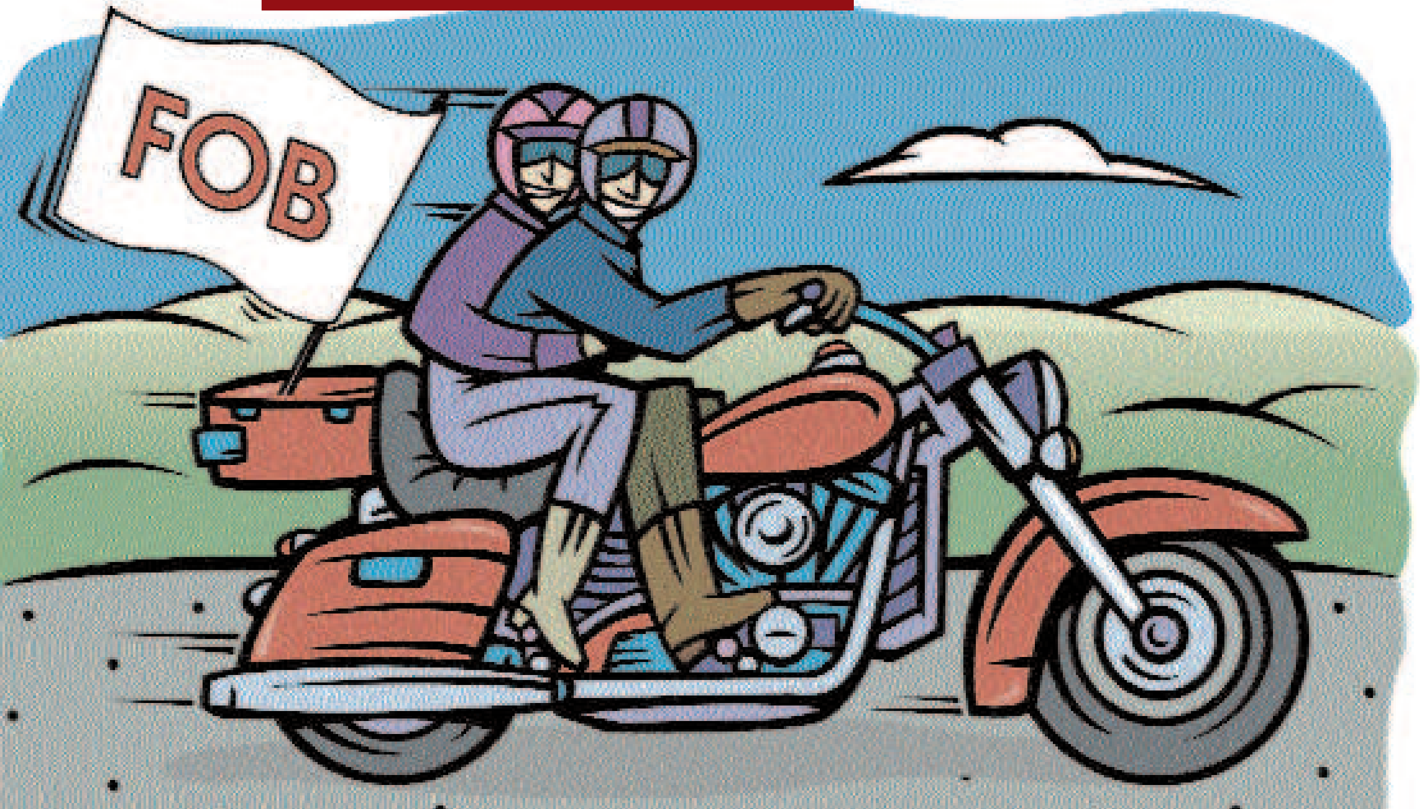

Leader of the Pack

Be the leader of the pack: Consider farm bins as extensions of your elevator

By Diana Klemme, vice president, Grain Service Corporation

Competition for on-farm grain is always fierce, and especially so when crops are small. When your elevator is the only logical destination for on-farm grain, your job is easy: Stay in contact with the farmers and be there when they're ready to sell. But many farmers can ship to a number of destinations, and processors and terminals are increasingly buying direct from farmers. Country elevator managers often wonder how to buy on-farm grain in such areas, take it directly to a third location ("Direct Ship") and still make money. Buying bushels and selling them "back to back" is the simple approach, but you'll miss a lot of grain and you won't make much per bushel. And how do you get farmers to sell to you if the terminal will buy direct from farmers at the same bid they quote to you?

Be the leader of the pack, not the follower. Think of services you can provide that the destination buyer will not or cannot. That might include splitting checks, offering additional pricing alternatives such as minimum price or unpriced basis contracts, or just that your staff is friendlier. Perhaps then you can buy the grain, but you'll still only make a tiny margin if you trade "back to back" and your farmers will view you as little more than an agent for the final destination, not a serious market force.

A better approach is to consider farm bins as extensions of your elevator. Don't assume you have to immediately sell every bushel as you buy it on-farm. Bid competitively, buy the grain and hedge it, and merchandise that basis position: Some months you'll win, sometimes you'll lose a little, but over time, a

Figure 1

Contract 1: 10,000 bu. 2.40 delivered Local Terminal 4/03
Contract 2: 10,000 bu. 2.28 FOB farm 4/03
Seller to provide trucking; call for destination
+12¢ freight if delivered to local terminal
+10¢ freight if delivered to alternate terminal

Figure 2

Example: Local terminal bid to the farmer = $2.40
Farmer A's trucking cost = $ .12
Your bid FOB Farm A: $2.29
(1¢ more than if Farmer A sells direct)

well-managed program should generate a respectable basis margin. Building an aggressive "on-farm" origination program means you'll have to manage a lot of logistics, but that's what you do with your facility, and it's where the potential profits will be. Buy and hedge as much grain as possible when basis is weak; sell as much as possible when the basis is high. Well, maybe farmers won't give you that much control over on-farm grain, but you can buy a lot of flexibility if you try.

Rather than buying "delivered terminal" and letting farmers deliver in their trucks anytime during their contract time slot, quote your bids "FOB farm." (FOB, or "free on board" means title transfers once loaded at origin with no extra charges.) Write your purchases "FOB farm" with the destination to be determined later. Buying "FOB" gives you control over exactly when the grain moves and more flexibility over where to ship it. The farmers have to call you to arrange pickup.

Many farmers own trucks and may want to haul the grain themselves. You can still buy grain FOB their farm. Use their trucks to your advantage. Write on your purchase that the farmer can haul the grain, and list rates the farmer charges for possible destinations. (The rates don't matter; you'll buy the grain on-farm net of the rate.) Now you don't have to determine the destination until delivery time. You can also agree that if the farmer's trucks aren't available, you'll arrange other freight and give your farm customer an equal amount of other hauling later as an offset (Fig.1).

Farmers can also benefit from selling "FOB farm" versus selling direct to a specific destination. You will more likely try to accommodate a farmer with a grain quality problem if the farmer gave you flexibility in the contract. You might move the grain to an alternate destination at a reduced value, or even bring it into the elevator. A farmer might be pleased with this if you can accept the off-grade grain on contract and dispose of it at a lesser penalty than at the intended destination. Remind your farm customers that when they sell grain direct to a destination, the buyer expects the grain and it's the farmer's problem if the grain is off-grade. You can offer more flexibility to the farmer and be seen as a problem solver.

Elevators are often more flexible than terminal buyers if the farmer can't get to the farm bins on schedule. Review your position and perhaps swap shipment time among farms. "Joe can't get to the bins this month? Well, maybe Sam can ship early and we'll pick up Joe's grain next month." Or you may help a farmer by arranging an alternative if the primary destination is unable to receive grain.

Setting bids for an 'on-farm' program

The more flexibility the farmer will give you in the contract, the more value the contract has to you. Be competitive (or even lead the market) when buying for deferred time slots where you can buy FOB farm, especially when the basis is weak. That gives time for the basis to create opportunities, and gives you flexibility among destinations or to adjust the shipment period.

assumes all transactions are hedged

Figure 3

		APRIL	MAY	JUNE	OCTOBER	DECEMBER	JANUARY
PURCHASES	**FOB farms**	**40,000**	**20,000**	**25,000**	**30,000**	**0**	**50,000**
	Delvd A	**10,000**	**0**	**0**	**0**	**0**	**10,000**
	Delvd B	**5,000**	**5,000**	**0**	**0**	**0**	**0**
	TOTAL	**55,000**	**25,000**	**25,000**	**30,000**		**60,000**
SALES	**Dest. A**	**5,000**	**0**	**0**	**0**	**0**	**0**
	Dest. B	**20,000**	**20,000**	**0**	**0**	**0**	**0**
	TOTAL	**25,000**	**20,000**	**0**	**0**	**0**	**0**
NET BASIS		**+30,000**	**+5,000**	**+25,000**	**+30,000**	**0**	**+60,000**

Always having competitive bids can also discourage farmers from shopping around next time (Fig. 2).

Buying grain FOB farm before harvest for January pickup is one example. Basis often firms in December on corn and soybeans, and you may want to move some of those January bushels in December, then pay the farmer in January. If you have grain bought "on farm" for January and the basis is weak or if there is a big carry, some farmers may be receptive if you offer to amend their contracts and pay them a premium to hold the grain on-farm a while longer.

Just as you don't automatically sell the basis because a farmer sells grain out of elevator storage, neither should you automatically sell the basis every time you buy grain FOB farm. Build a "Direct Ship" basis position and trade it as the basis changes. All you need is to have enough sales when it's time to ship the bushels.

Be most aggressive when basis is really cheap and lag other buyers when basis is extremely high or bids are only for quick shipment. Or sell strong basis for forward time slots and buy the grain later. However you trade it, running an aggressive Direct Ship takes time, but creates opportunities for revenue and customer service.

Your Daily Position Report is critical in running an FOB farm position (or Direct Ship). Just as you always need to know what grain you have bought "to-arrive" your elevator, you also need to know what quantity you own "FOB farm" so you can manage basis and logistics risks. A sophisticated grain program may give you the information you need, but many merchandisers run a separate spreadsheet to fine-tune their trading (Fig. 3).

Direct-ship/on-farm grain trading won't often make big basis margins so it's important to be tight on discounts and payment. Pass through discounts, weights, grades and inspection fees, and minimize paying before you receive the funds.

Changing farmers' habits won't come easily if they're used to selling only when they're ready for the grain to be picked up, or if they insist on going to one destination even when other choices are available. You may find your early efforts fall on deaf ears, or that you have to pay a higher basis to get the program going. Get most aggressive when basis is weak and let the farmers stay at least close to their comfort zone. Instead of buying grain FOB farm with multiple destination choices, buy it FOB and agree the farmer can still go to the favored destination. It may cost you some flexibility the first time or two, but you crossed the first bridge by using new contract terms: FOB farm. Over time, FOB = flexibility!

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