By Diana Klemme

# A 500-Year Flood?

*The challenge is to start preparing right now for the 2005 harvest — even though it's 10 months away. Nobody wants to be unprepared for two 500-year floods in a row.*

Mike leans on the counter and stares at the piles of corn behind the elevator. He thinks to himself, "Who'd have suspected? This was like a dog-gone 500-year flood; thank heaven harvest is over. Nobody had a clue how big these corn and soybean crops were!" He straightens up slowly and stretches wearily. "Too many hours, not enough trucks, too many problems, and not enough space. Oh well, at least I won't face the same problems as last winter — no reason for corn to go to $3 or soybeans $9," he chuckles. "And I sure doubt soybean basis will see +120 this summer!"

Mike recalls the day last January when he had stared at the financial report and tossed it on his desk, wondering what to say at the upcoming board meeting. The directors hadn't been pleased with the '03 harvest merchandising results —and there had been little improvement in the December numbers. He had wondered if his job as manager was on the line. "I sure thought we'd done well last fall," he remembers saying to himself. "We stayed open long hours, handled more grain than ever, sold basis at high numbers, and we still didn't net much on corn or soybeans." He had listed points to review with the board:

- Large harvest volume, new customers, good reports about service and unloading
- Poor railroad performance cost us some money on late shipments in Oct./Nov.
- Difficult year for soybean merchandising: Big inverses, higher and volatile prices, free DP everywhere — hard to make money. Would anybody else do better?
- Unusual basis moves
- Corn — my forward sales will give me flexibility. Long basis position is earning a return for the elevator space.
- Financing demands for inventory and hedging have been unusually large.

"But this is an unusual year," he had reassured himself last year; "or is it? What if markets don't settle down and carries don't return? Just how much risk could we face?"

Last January he had wisely decided some of those talking

Largest corn and soybean space needs

| | Sept 1 inv. | + Produc | = Volume |
|---|---|---|---|
| 1986 | 4576 | 10,168 | 14,744 |
| 1987 | 5318 | 9,069 | 14,387 |
| 2000 | 2007 | 12,673 | 14,680 |
| 2004 | 1071 | 14,891 | 15,962 |
| 2005? | 2280 | 14,067? | 16,347? |
| | | | |
| 2005: | Pltd. acres | yield | = produc |
| Corn | 82.0? | 150? | 11,324? |
| Soybeans | 73.5? | 38? | 2,743? |
| | | | |
| 2004 | | | |
| Corn | 81.0 | 160.2 | 11,741 |
| Soybeans | 75.1 | 42.6 | 3,150 |

*million bushels, million acres, 2005 scenarios are GSC numbers* points sounded more like excuses than a management plan. He presented them to the board, but followed with specific suggestions on preparing the elevator for what he thought lay ahead for spring and summer 2004. He had talked about declining world inventories, tight U.S. carryovers, and preparing for the market volatility that could develop. The board seemed skeptical about his market scenario but were impressed he was thinking two steps ahead instead of making excuses, and had unanimously agreed to his plan:

- to expand the credit line and prepare for sharply higher futures,
- set overall company risk limits on basis positions,
- to be conservative on hedging and spreads — hedge in nearby futures until/unless you can lock in sufficient carry,
- to monitor farmer contracts closely against default risk should prices rise,
- and most controversial, to widen the daily bid-margin.

That plan kept Mike on track, and the elevator had avoided many problems that other managers faced. Mike had no problem meeting 2004's staggering margin calls, and widening the bid margin had covered the interest cost. He had no problems getting farmers to deliver on low-priced contracts. And best of all, the elevator's P&L looked quite good when it was all over.

"But that was then and this is now — it's December 2004," Mike says to himself. "At least I can relax this year. Prices should stay low in 2005 and futures carries are wide in corn — there's a 42¢ Dec4/Dec5 carry; I can just keep the place full and earn the carry. We earn storage income or basis appreciation — either way it's money and it spends the same! Maybe we can even put up more bins come summer. What can go wrong?"

Mike pulls on his jacket and cap and heads out to walk around the corn piles. "But every time I get complacent I overlook something. Can't let that happen this year." He starts a mental checklist but quickly stops, realizing the answer is right in front of him. "It's the corn piles! That's the clue!" and hurries back to the office to check some numbers.

> ***"The board seemed skeptical about his market scenario but were impressed he was thinking two steps ahead instead of making excuses."***

Logging onto USDA's website, he jots down numbers, starts a spreadsheet, and soon the picture emerges. "Son of a gun," he thinks, "who'd have figured?"

**A second 500-year flood?**

Mike realized that his challenge is to start preparing right now for the 2005 harvest — even though it's 10 months away. The spreadsheet shows that assuming a "normal" '05 crop, the grain industry could face even more daunting logistics than with 2004 harvest! Mike enters more formulae using 2005 corn and soybean acreage and yield scenarios, and scans those results. He leaves wheat, sorghum and oats out of the calculations because those aren't grown in his area, and prints the results:

He notes that the fall of 2004 saw more corn and soybeans competing for space than in the peak of the CCC storage years in the mid-1980s. No wonder there are corn piles everywhere! But even if 2005 crop production falls 6%, there'll be more grain competing for available space than this season!

Mike assumes that '05 soybean acres will decline because of Asian Rust, but knows it's too early to know for sure what farmers will do. He assumes Delta and Midsouth soybean acres will decline, an area that doesn't favor corn. He pencils in a 1.6-million-acre decline in soy acres, but just a 1-million-acre rise in corn acres — primarily in Missouri, southern Illinois and Indiana, Kentucky, and eastern Iowa. Acres could differ from this, of course, but all Mike's trying to do is get a sense of potential production. He figures this year's record yields will be tough to repeat so he uses 150 bushels/acre on corn and 38 on soybeans. He notes that gaining corn acres vs soybeans means an extra 110 bushels/acre or so of volume!

**Bin-buster II**

His spreadsheet shows that with his acreage scenario, even if yields fall 10 bushels/acre on corn and nearly 5 bushels/acre on soybeans, 2005 production could be over 14 billion bushels. Elevators and farm bins would need to find space and transportation for almost half a billion more bushels than this season! Of course yields could fall more or acres might decline, and that could ease the crunch, but even if production falls to 13 billion bushels, it would still be the second largest total volume of grain on hand at harvest. If yields exceed 150 on corn or 38 on soybeans, the logistics problem will be even greater.

***"He has to ship at nearly 100% of his monthly capacity from January to September to be ready for harvest."***

Mike opens his logistics spreadsheet and enters his current inventories, his best estimates of potential to-arrive volume January-August, and his current monthly shipping capacity. He looks at the bottom line, but isn't really surprised. The corn piles outside his window were the clue. The sheet shows he has to ship at nearly 100% of his monthly capacity from January to September to be ready for harvest. If he holds company-owned inventory into the spring based on the wide carries, the elevator might not be ready or able to accommodate the 2005 harvest!

Mike turns to his legal pad and jots down more ideas and reminders. "Gonna be a long winter — I just thought the hard part was over! But at least I have a lot of time to work on this." Mike mentally ticks off his challenges:

• How to keep rail loadings on schedule when car placements are irregular?

• Buy freight early in the secondary market? USDA transportation report shows Class I car loadings up 4% in 2004 vs. 2003. Demand should increase again in 2005.

• Liquidating ownership early in a wide carry could mean losing potential revenue just to maintain the shipping schedule. Prepare the board.

• Important to get forward sales on as decent opportunities arise so we don't depend solely on the spot basis. Can't afford to miss much shipping time; that's more important than hitting the top of the basis this year.

• Monitor sale contracts that use buyer's freight. Wide carries encourage some buyers to drag their feet picking up the grain; they just sell it later at a higher basis. Negotiating carrying charges from the buyer won't help logistics!

• Continue protecting futures carrying charges on corn. We cannot ship everything short-term even if basis should rise. Move more hedges forward!

• Much of our inventory is farmer-owned. When will they start to sell?

• Find ways to encourage farm movement before late summer. Survey farmers about on-farm grain inventories.

• Talk with farmers about potential 2005 acreage changes.

• Check cost for new bins; check about leasing existing on-farm space as it becomes available. Start preparing early for '05 ground piles: tarps, fans, base.

• Remember that the whole picture could change: '05 crop could be much smaller than anticipated, South America's soybean crop could fall sharply, prices could rise. Start another "what-if" game plan and be ready to change if necessary.

Mike sees that his challenges are much different this year; managing logistics is now at the top of his list! But he has a plan, he's starting early, and he'll review his checklist regularly. Nobody wants to be unprepared for two 500-year floods in a row. ■

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