The Incredible Shrinking Margin

By Diana Klemme

"I'm taking my soybeans down the road this year — their bid is a nickel higher than yours most days anymore, and their moisture discounts are better, too."

Sound familiar? Managers always dread when farmers say they're going elsewhere — whatever the reason. Sometimes a customer does leave because of price; that farmer is commonly known as a "transaction customer." This customer typically has little loyalty and always has an eye for the better deal, and may come and go with the crop years. A "relationship customer," on the other hand, may consider such "cruising" a waste of time and looks more at the big picture. He recognizes service and remembers when you stayed open late for his last load at harvest. Chasing transaction customers with higher bids or easier discounts may provide a small boost in volume but at the expense of overall revenue. Bidding up cuts your margin on all the other bushels you'd have bought anyway! It's time for a reality check

Your handling costs rise with commodity prices: A ½% handling loss on soybeans costs 6 to 7¢/bushel. A 1% moisture discount on $6 corn costs 12¢/bushel at many processors. Soybean crushers discount moisture at 1.5% to 1.75% of contract price each ½%, figured to the 1/10%. That's as much as a 23¢/bushel hit on 13.1% moisture soybeans at current prices.

Procedures or mistakes in grading inbound receipts can chew up revenue in a hurry. Some elevators may not discount a load of soybeans that test just over 13% moisture if that farmer's other loads for the day were below 13%, for example. But a destination test on your outbound load might contain a spot of those 13+% soybeans that ding you for a hefty discount. Moisture discounts on corn are also costly this year — 15.6% corn could cost you 2% of contract price — that's 14¢ on $7 corn.

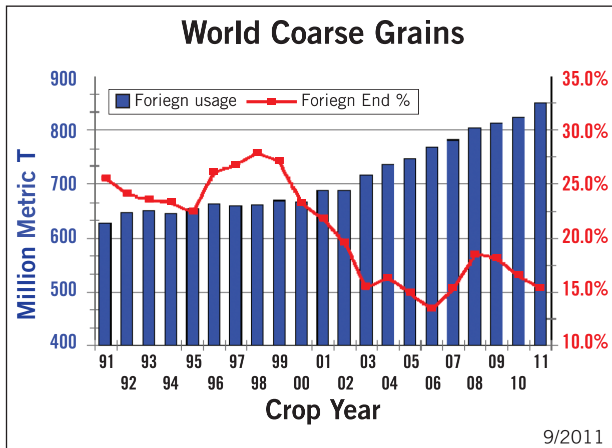
This is the year to analyze your actual handling costs and reconsider how you set your bids and to be sure your staff is properly trained on grading procedures. That 10¢ per bushel "back to back" margin that worked in the past on soybeans seems woefully short in 2011. And 5¢/bushel on corn or 8¢ on wheat won't go far. Basis appreciation and skillful "mix and blend" can help on the revenue side, but even those don't guarantee a profitable year. Be realistic about your costs and set aside those fears of losing customers if you lower your bids a little. Now's a good time to widen those margins; farmers are seeing record or near record prices, and their 2011 income is already high.

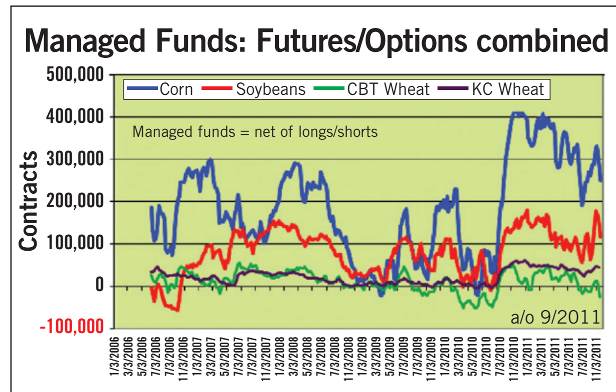
USDA monthly farm prices set record highs late in the 2010 crop, and August 2011 prices were 19 to 32% higher than the previous records set for harvesttime on corn and soybeans, and almost tied the highs on wheat. (Note: Monthly soybean prices topped $13 in the summer of 2008, but elevators typically were handling small quantities at that point)

	Record high monthly average in:			
	September	October	August 2011	2011 change
Corn	$5.01 ('08)	$4.32 ('10)	$6.62	+32%
Soybeans	$10.80 ('08)	$10.20 ('10)	$12.90	+19%
	June	July	August 2011	
All wheat	$7.62 ('08)	$7.15 ('08)	$7.56	(.8%)

Market volatility is another reason to widen margins and give yourself a bigger cushion. Futures price swings are big and fast these days. It's easy to buy a few loads and lose 5 to 10¢ in soybeans in the brief time before you can get them hedged. (The theory that you'll average out with some winners and some losers never seems to hold up in practice.) Even a small mistake on your Daily Position Report can be costly if not caught quickly when corn's over $6. Markets can, and will, sell off

Diana Klemme is a longtime contributor to *Feed & Grain.* Contact her at Grain Service Corporation, Atlanta, GA, by calling (800) 845-7103 or e-mail at diana@grainservice.com.





SOURCE: CFTC WEEKLY COMMITMENT OF TRADERS REPORT

of course, and it's possible short-term price tops have been made. But matched with a 10% correction these days makes for a hefty swing. It's prudent to assume high prices are here to stay — regardless of whether they go any higher — and to plan around high costs *and* volatility.

The U.S. and global balance sheets are tight in the major ag commodities with foreign coarse grain usage rising despite high prices and stocks declining. This chart of total foreign coarse grain consumption excludes imports/exports — this is net consumption. Within the total usage of coarse grains, foreign *feed* consumption has been rising steadily despite high prices and plentiful wheat supplies. Foreign feed usage will post a record high 534M metric tons this year, 63% of total foreign disappearance of coarse grains. The global soybean S&D is tight, but slightly more comfortable than for corn or coarse grains. Soybean futures, however, are relatively low compared to corn, at a price ratio of under 2:1.

The heat-ravaged U.S. corn crop is forcing US corn disappearance to decline by around 500 metric bushels, through both reduced exports and feed use, and our ending stocks/use ratio will still be the lowest since 1996. The pressure will be on to ensure acreage here and abroad in 2012 crop and to keep the brakes on demand growth. Low prices won't do that.

Some will argue a global slide back into recession will reduce demand, but history doesn't support that. This chart of foreign coarse grain consumption shows that despite the severe 2008 economic downturn, demand continued to rise. Consumers may change their menus, but they still eat, and animals are no different. The demand growth in China accounts for a large percentage of total foreign demand growth, which points to steadily rising imports of corn in the years ahead, as well as soybean imports, with the United States one of the few exporters of size. The only question may be the pace of China's rising imports and their notoriously clever, but crafty, buying patterns may well add to futures market volatility.

Another factor to consider is the role of "Big Money" (speculative or investment capital) in U.S. commodity futures. Index funds were targeted in recent years as a major factor in rising prices and volatility, but perhaps surprisingly, data doesn't support that. Index fund longs in corn and wheat have been relatively flat for nearly two years, with soybean longs peaking in early 2011. Some of the swings in Big Money net positions have come from the Managed Funds sector, where their positions can be net long or short. Managed funds can shift quickly, for fundamental, technical, or any other reason, fueled at times by volume from computer trading models. The changes in "Managed Funds" net positions since early 2010 have been dramatic and swift — especially in corn — which has been reflected in volatile, dynamic price swings. (One interesting aspect has been the shift from net-long to net-short in fund holdings in Chicago wheat, exchanging Chicago for modest longs in KC wheat.)

The combined impact of active speculative money in ag futures, along with tight S&Ds and rising global demand for coarse grains, wheat and soybeans, may be volatility and high prices that will be our companions more often than not for the next few years. Take steps to ensure that *your* business doesn't fall prey to high costs and "The Incredible Shrinking Margin" syndrome. ■