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# Margin mayhem

By HOLLY SPANGLER

**W**HEN Jerry Rowe deadpans, "We're having capitalization issues," you get the feeling the Dalton City elevator manager is making a massive understatement.

That's because Rowe, manager of Heritage Grain Cooperative, is describing the margin call situation facing every grain buyer in the state — and country, for that matter.

Although the Illinois Department of Agriculture maintains none of the three state elevators that have filed bankruptcy in the past year did so because of this situation, solvency and cash flow are on everyone's mind. That's because elevators are racking up millions of dollars in margin calls every day, due to both high grain prices and high volatility.

### What's a margin call?

Margin calls are the difference between the price at which an elevator hedges a futures grain contract — which is usually slightly higher than what the farmer has sold it for, thanks to basis — and the current cash price on the Chicago Board of Trade.

Say a farmer forward contracted 10,000 bushels of 2008 corn at \$4 back in 2007. Now that corn's worth \$5.30 on the board (at press time). When an elevator buys a forward contract from a farmer, the elevator immediately hedges the contract by selling it on the futures market — again, usually at a slightly higher price due to basis. Until that farmer delivers the grain, the elevator must keep enough cash in reserve to offset the "margin" (close to \$1.30 per bushel in this example).

The problem for elevator managers is twofold:



PHOTO BY MAREK WILSON

**MARGIN CALL CRUSH:** At Heritage Grain Cooperative in Dalton City, Jerry Rowe is learning to manage the business differently in the wake of millions of dollars in expenses in margin calls. "You don't go out and buy '09 and '10 corn," he says.

### Key Points

- Finances tighten as elevators juggle millions in margin calls.
- Most elevators won't buy 2009 crop.
- Escalating prices and volatile markets created the situation.

First, farmers have become aggressive forward contractors, selling one and two years in advance, which means elevators have a lot of grain "on the book."

Second, prices have escalated rapidly and moved with great volatility. Rowe, for example, has 2 million bushels of corn on his books that was sold at an average price of \$3.50. Now the market's at \$5.30. That means he needs \$3.6 million sitting in reserves just for those sales. Add in 7% interest and expenses start to rack up.

For producers, the result is a loss of marketing tools. Elevators, often at the request of their lenders, won't offer new-crop bids for 2009 or 2010. Some won't even bid beyond 60 or 90 days. Others have tacked premiums onto hedge-to-arrive contracts, while others cut out HTAs completely.

Elevators, and producers, are playing in a whole new ball game, says Rowe. "We're financing old crop at levels we've never seen before. We're waiting for transportation to move, waiting to make margin calls on old and new crop, and financing inventory for a longer period of time," he says. "Two years ago, we had an operating line of credit of \$9 million. This year it's \$35 million."

■ For more on the margin call crush and advice for farmers, see Pages 4-5.

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