

Risky business more perilous

By HOLLY SPANGLER

ELEVATOR manager Jerry Rowe isn't asking for sympathy. He'd just like a little understanding.

At Heritage Grain Co-op in Dalton City, Rowe is managing his way through unprecedented times in the grain buying business. As commodity prices have skyrocketed and have stayed high for so long, elevators across Illinois are racking up millions in margin calls

Key Points

- Illinois grain elevators face cash crunch from margin calls.
- Officials maintain most elevators are financially OK.
- Farmers can sell direct on the CBOT, but face massive risk.

and interest costs. Many have lines of credit three to four times their normal financing. Everyone from grain giants to independent mom-and-pop elevators are scaling back, refusing to buy grain beyond 2008, or even beyond 60 days.

Although no one blames any recent elevator failures on the situation, it's clear that elevator managers like Rowe are in a cash crunch.

Trickle-down effect

"The industry is learning that we have to have more margins," Rowe explains. "We can't, in these scenarios, run on the margins that we have in the past. Unfortunately, that probably means the farmer has to pay the bill."

When farmers lose the marketing tools they've been used to having and making money with — forward contracting, hedge-to-arrive contracts, etc. — they lose out on potentially huge profits.

To some degree, it's been a trickle-down effect, Rowe explains. When major players like Cargill, ADM and Bunge stop offering new-crop cash markets, independents have no cash market in which to hedge contracts. Then the elevators have to adjust their policies.

So what's a producer to do? Arlan Suderman, *Prairie Farmer* market analyst, says about the only option farmers have to capture further-out high prices

CASH CRUNCH: "Our bankers understand our positions in the grain markets," says Jerry Rowe, manager of Heritage Grain Cooperative in Dalton City. "The banks realize that if they would start cutting people off, the cascading effect of people having to move positions would mean tremendous losses, both to local elevators and banks."

is to sell directly on the Chicago Board of Trade. However, they are then subject to the same margin call rules that elevators live under. If the price goes up, as it well could if there's even a perception of a weather scare this summer, then the farmer has to have money in the bank to cover the margin.

For example, say a producer sells 50,000 bushels of corn at \$6 on a March 2009 contract. If corn prices would jump to \$10 this summer in a weather scare, that's a \$4 difference. The producer needs \$200,000 sitting in reserves. And don't forget the interest.

"Your lender has to be on board with what you're doing," Suderman warns, pointing to the tremendous risk involved. In fact, Suderman likes to tell any farmer who's considering hedging on the futures market that three people have to understand and agree with the plan: the producer, the producer's spouse and the producer's banker.

"If any of those three can't sleep at night, don't do it!"

Healthy elevators?

As for those producers who will stick with local sales, Suderman says they might consider asking for a letter of credit from the elevator if they're signing a deferred payment contract simply



PHOTO BY MIKE WILSON

They said it

"When the commercials quit bidding for future months' deliveries, the country elevators do, too. It's a trickle-down effect. They will trade cash grain but pull back on future purchases due to the cost of maintaining the hedges."



Tom Jennings, Illinois Department of Agriculture acting director

"Producers need to understand the terms of contracts and make sure they sign the contract."

If you have a problem, contact the elevator immediately. If you wait six or eight weeks, it causes real problems, and even more so with today's volatility."

Jeff Adkisson, Grain and Feed Association of Illinois

"I don't think we'll see a lot of farmers making their own margin calls. The potential risk is very high, especially if they're making margin calls on a crop that's still growing in the fields."



Arlan Suderman, *Prairie Farmer*

"Two years ago, we had an operating line of credit of \$9 million. This year it's \$35 million. It has just been a severe

cash drain."
Jerry Rowe, Heritage Grain Cooperative, Dalton City

Grateful for grain fund

IN the wake of three elevator failures during the past year, the balance of Illinois' Grain Insurance Fund has dropped from \$7.3 million down to \$3.6 million. Tom Jennings, Illinois Department of Agriculture acting director, says the failures were not directly related to the margin call situation.

Jennings isn't worried, though he admits those were pretty dramatic hits. "In terms of financial wherewithal in Illinois, I firmly believe that it is a very solid financial base," he says, adding that the books he sees every day show elevators are still making money — record profits, even.

Since 1983, Illinois producers have enjoyed a healthy grain insurance fund, which was established to protect producers and lenders in the event of an elevator failure. Jennings touts Illinois' fund as the best in the country, with higher limits and more contractual coverage. Yet every so often, folks outside the state begin talking about a national grain fund, as Jennings suspects will happen at this summer's July meeting of Midwest directors of agriculture.

And that, it would seem, does make Jennings a little nervous. "All the different indemnity fund proposals that we've seen have provided less coverage to producers than what they already enjoy in Illinois. Our people have come to expect what our fund offers. We're not in favor of anything that offers less coverage than what we already have."

to protect themselves should the elevator get in over its head. It's not likely to happen, but considering the amount of risk elevators are facing, it wouldn't take long for a previously healthy elevator to find

itself in trouble, he says.

Rowe, who also serves as secretary of the Grain and Feed Association of Illinois, doesn't believe the industry will see elevators collapsing in the coming months, though there

A new normal or back to the old days?

AS grain buyers and farmers adjust to the volatility-charged market situation — and the reduction in available marketing tools — one question comes to mind: When will it all go back to normal?

Don't hold your breath, say both marketing experts and elevator managers. Arlan Suderman, *Prairie Farmer* market analyst, says we'll see limits on forward pricing tools until the market settles

into long-term equilibrium. As long as volatility leaves elevators and their financiers at risk, there's a limit to the tools they can offer.

"Once everything settles into equilibrium, those tools will come back," he explains. "Unfortunately, that's probably a couple years away."

Jerry Rowe, manager of Heritage Grain Cooperative in Dalton City, foresees a situation where he might be buying grain for a 10- to 12-month period,

instead of only through January 2009, as is their current policy. "That scale may keep moving forward, a month at a time," he explains. "If we get into a position where the market stabilizes and actually moves down, then maybe those windows will broaden out. But if we have a crop scare, the windows will narrow."

Rowe also believes we may be seeing a total structural change in basis levels. "Farmers need to be aware that elevators

are going to have to take a wider margin. They don't have a choice if they're going to try to keep up with this."

Some easing could occur when uncertainties over the general economy subside. Suderman explains that plenty of money exists in the system, and in fact, federal reserves are up 15% to 16% over one year ago. However, lenders are reluctant right now, given the credit crunch, to let go of that money. Once the economy "gets its feet back under it," he says, there may be more available credit to ease the situation.