

NewsWatch



CASH CRUNCH: Jeff Bechard, president of AgMark LLC in Beloit, says truck and rail transportation logistics, coupled with increasing margin calls, could force grain elevators to pay more money for margin calls and interest expense.

Margin mayhem

By BILL SPIEGEL

ALTHOUGH grain elevators have committed much more money than usual to pay for margin calls this year, farmers should expect no trouble in being paid for their grain after harvest.

"If the local elevator is financially sound, farmers don't need to be worried about anything," says Mike Woolverton, a grain market economist at Kansas State University.

That doesn't mean, however, that elevator managers are not concerned about margin calls. Jeff Bechard, president of AgMark LLC in Beloit, says his elevator's cash reserves have been stretched to maintain margin accounts. "For every 5,000 bushels of wheat we hedge, we tie up \$4,500 in margin calls, and that's if the market does nothing," Bechard says.

If the futures market moves up, grain merchandisers like Bechard must offset the short futures position with margin calls.

"We don't lose money, but we tie up money until we have the grain in our possession," he explains, adding that many elevators have to borrow money to meet the margin calls.

"For every dollar we borrow, we have to have at least 15 cents of working capital. Banks are willing to loan that money because they know we'll have the grain eventually. On top of that, we have to

Key Points

- Grain elevators must maintain a margin account to offset futures contracts.
- Many elevators have to borrow money for these margin calls.
- A perfect storm of harvest logistics and high prices could slow wheat purchases.

pay interest, which we don't recoup. That eats into our margin," Bechard says. "In effect, we're being penalized for offering a marketing service in volatile markets."

Harvest pressure

The debt some grain elevators are incurring could be a burden at wheat harvest time.

"If commodity prices are high, some smaller country elevators could find it a challenge to buy a lot of wheat in a short period of time," Bechard says. "With prices high, farmers may sell more bushels at harvest than they have in the past. The risk of ownership then transfers to the country elevator."

The situation is compounded by transportation logistics, which were often a logjam last year. Grain elevators may have a difficult time finding enough trucks and trains at the pace they need to ship.

"Grain elevators don't get their money until grain is shipped," explains Dave Studebaker, general manager

of the Delphos Co-op in Delphos and Minneapolis. "If we have a big harvest, we'll get rail cars and trucks tied up. When will we get our money?"

Grain movement from country to end user, then, could exacerbate cash-flow problems.

"Transportation and market congestion could create a bigger interest equation and force elevators to obtain a larger line of credit," Bechard says. "If a farmer doesn't sell all his grain off the combine, that would help the country elevator."

Advice for farmers

If farmers are concerned about whether their local elevator can afford to buy grain, one precaution is to request a letter of credit.

"A farmer who defers payments or income becomes a general creditor to the grain company, and there's no warehouse bond to protect them," Bechard says. "You can request a letter of credit to secure that deferred income, however. If a grain company doesn't want to offer a letter of credit, don't defer payment."

A fee will be charged by the elevator's bank for a letter of credit, he adds.

Bechard doesn't anticipate any problems for farmers or grain elevators this harvest, however. "I don't want farmers to be worried, but they should be aware of challenges grain hedgers are facing," he says.

Break a contract and break the law

SUPPOSE you contracted wheat for \$5 last fall, and with every futures price increase, you're becoming a little more desperate to capitalize on these higher prices. Even the most ethical farmer might be tempted to take grain to a different elevator where the cash prices are much higher.

This scenario would not only be unethical, it would also be against the law, according to Roger McEwen, the Leonard Dolezal professor of agricultural law at Iowa State University. The U.S. legal system abounds with precedent that requires a farmer to fulfill his or her contractual obligations.

Let's say a farmer calls the elevator to contract grain at a set price. The elevator sends a written obligation to the farmer to sign and return. Even if the contract is not signed, the farmer is bound by an oral agreement, McEwen says.

The elevator holding the contract can buy "cover goods," or the same type of grain, to fill the farmer's contract. The price difference of the purchased grain versus the contracted grain may be charged to the farmer, McEwen says.