

2013-2014 Agricultural Policy and Outlook Conference Series

Grain Marketing in an Era of Lower Prices

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Since 2000, global grain and oilseed demand has grown explosively.

- Number one driver: increased domestic oilseed demand in China for feed
- Number two driver: demand from the US corn ethanol industry.

Along with other sources of increased demand, these drove grain prices to record highs, and provided enough support to keep them at very high levels since 2007. This run is coming to an end:

- US corn ethanol production has leveled off, at best, as there is now enough capacity to meet all of the corn ethanol consumption mandated by the 2007 RFS
- The EPA now appears to want to lower the mandated levels of corn ethanol consumption in response to blend wall concerns
- Global grain production area has increased in response to high prices
- Developed world yields (especially corn) continue to grow.

Prices reflect that we have moved from an era of scarcity to one of adequate inventories, and prices have responded by moving lower. Another year of 160+ yields on corn and 42+ yields on soybeans will push prices even lower, potentially to 3.25-3.50/8.00-9.00. These prices are well below the cost of production on land that has been purchased or cash-rented in the past 3-4 years. Prices will only return to profitable levels if supply declines (due to acreage leaving primary row crops) or demand returns. This will likely create a significant financial strain in crop-growing areas. To prepare for this:

- Farmers should build a working capital cushion of 1-1.5 years of land charges above what they typically need to operate. Periods of low profitability are very bad times to draw equity from land, further, the equity itself will almost certainly decline.
 - Avoiding machinery and building expenditures just to take advantage of section 179 is an easy way to build capital.
 - Refinance any and all loans and mortgages into 10-year fixed rate now.
 - Hold off buying land or entering into multi-year leases. Keep your powder dry.
 - Carefully evaluate living expenses. Living expenses and operator salaries have risen rapidly in the last decade, but are unlikely to fall as fast.

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- Lenders should evaluate their credit risks in Ag very carefully.
 - Farmers that are most vulnerable are those that are large, aggressive, and cash rent the majority of their land—especially vulnerable are those with multi-year fixed leases.
 - o But lenders must worry not only about vulnerable farmers—they must worry about vendors to those farmers. In this age of consolidation, there are fewer and fewer vendors servicing the farm community. If a large operation goes bankrupt, it may affect the finances of a chemical dealer, or a small elevator, or a machinery dealership enough to cause it to fail.
- Marketing needs to focus on understanding the worst case scenario for a specific plan and comparing it to the working capital of the farm.
 - Working capital is crucial, as market conditions that exhaust the working capital of any given farm and require it to take equity from land will require many other farmers to do the same—reducing land values and making it harder to refinance land.
- For the coming year
 - Realize that the prices that we had earlier in '13 are not guaranteed to return.
 - For those storing unhedged grain, you are assuming a tremendous amount of downside risk that historically has not been very profitable.
 - Hedge corn—basis improvement will probably peak around March.
 - o I'm worried that many farmers are holding out for higher bids, and that may work to depress prices in summer of '14 as the grain supply exceeds the demand.