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From Marcia's Minding Ag's Business Blog

How Deep Is Corn's Abyss?

It's been a favorite quote on Twitter recently that $7 corn covered up problems and $3.50 corn exposed them. Bloated cost of production must be Problem #1.

No wonder there's a large abyss between projected revenues and costs for 2016 crops--and the gap isn't likely to improve much before 2018. That's a story line that Purdue, the University of Illinois, the University of Missouri's FAPRI and other forecasters have been warning since this summer. But at DTN's Ag Summit last week, speakers clarified how severe that capital drain could be.

Farm Credit Services of America Senior Vice President Tim Koch jolted a pre-event workshop with what's at stake. Just last year, Farm Credit lenders advised corn growers to keep $250/acre of working capital on reserve. Oxygen seemed to be sucked out of the room as rookie farmers gasped at that figure. But in FCS America's latest analysis, typical Iowa corn growers lost $100/acre in 2014 and could face cumulative $400/acre working capital losses for the 2015-2017 crops, based on $3.50 cash corn and expenses stuck at bloated 2015 levels. High yields may deflect some of that damage in 2015, Koch added, but not the overall trend.

The Farm Credit lender also noted that in normal market equilibrium, the top end of producers are profitable and growing, the average are hanging in there, and the bottom end are losing money and exiting the industry, as Texas A&M economist Danny Klinefelter likes to observe. "Business success and survival depend on continuous improvement at a pace necessary to stay in the front half of thepack," Klinefelter has said.

"But for the past seven years, we've not been in equilibrium. High cost producers have survived and thrived," Koch said. "Now that economics are realigning, we could be out of equilibrium for two to five years on the other side. We'll be waiting for the expense side to get back in line."

Staying power will be a problem for 20% highest cost farm operators, added Bob Craven, director of the University of Minnesota's Center for Farm Financial Management. In his southern Minnesota database, high cost producers needed $5.45/bu. corn to breakeven in 2014, versus $3.84 for the most efficient group. The problem is that highest cost 20% operators lack the working capital reserves to weather a multi-year storm. Instead of the 30% working capital/gross revenue standard preferred by most lenders, their working capital had eroded to only 19% at the start of 2015. That likely leaves a cushion too small to meet bank regulatory standards by 2017.

"We're in the 'whoa' zone of the roller coaster ride," Craven said, just reaching the pinnacle and peeking at the downhill run. He expects the high cost corn growers to lose $240-$230/acre in 2016, based on average yields and current Dec 2016 corn futures. And that's with moderate rents close to $226/acre, not some wild bids of $350 and up.

Barring some drastic shift, such as refinancing equipment to free up cash or slashing input costs for 2016, "about one more year will wrap it up for most of those [high-cost] folks," said Craven.

The bottom line for farm operators is to cut wherever possible without affecting yields. Rent reductions alone can't fix it, but operators will need to challenge seed and fertilizer suppliers and realign equipment expenses, Craven said.

As Koch stressed, "survivors will be the ones who can navigate costs."

Next post: Farmers at the Ag Summit share the last word on how they're beefing up 2016 margins.

Follow Marcia Taylor on [Twitter@MarciaZTaylor]

Posted by Marcia Zarley Taylor at 5:00 PM CST 12/15/15

Comments (1)

Guess we will find out if the world needs 20 percent of American farmers expense won't go down enough. Efficient ones won't last at those losses a steady load of negative talk gets old and unimaginative. Cost of production will be met eventually or collapse will occur.

Posted by andrew mohlman at 9:28 PM CST 12/15/15