Challenges of Buying Feed

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Buying feed has become one of the biggest challenges faced by feed operators across the country. It is the single biggest cost in operating a dairy or feed yard. The market volatility seen in the past decade has been phenomenal. Corn alone surged approximately 40 % in less than a month, soybeans hit record highs, while wheat followed suit. Much can be attributed to the rate at which information travels along with expanded trading limits. Most of you have seen images of the Chicago Board of Trade (**CBOT**) open pits, or maybe you have been there to see it firsthand, where emotions run high as traders stacked into tiered pits shout and throw hand gestures to buy and sell commodities that are delivered to the pit by runners. If you have not seen it or can't visualize what I am talking about, it won't be long before you will have to visit a museum to get the details. The open outcry system is becoming a thing of the past.

On August 1st, 2006, the Chicago Mercantile Exchange (**CME**) introduced electronic trading of agricultural futures contracts, and electronic trading took place alongside the open outcry system. The point-and-click trading took like wild fire, it is said that within 6 mo electronic trading of futures contracts accounted for 50 % of the total trade volume (Bandyopadhay et al., 2008).

This is not the only consolidation that is going on within the industry. A global race for grain control is putting more and more of the cereal grains in fewer and fewer hands. At times the major grain companies in the world are referred to as the "ABCD" of the industry – ADM, Bunge, Cargill, and Louis Dryfus. A recent acquisition between Gavilon and DeBruce Grain has put Gavilon in the pack. However, that does not look like it is going to last long. Japan's powerhouse Marubeni is waiting for final approval to push a $5.6 B purchase through that would swallow up the Gavilon Group. The DeBruce acquisition by Gavilon made it the second largest elevation system in the US. This is not the only multi-billion dollar business deal that was approve this year; European giant Glencore International inked a deal worth $6.1 B for Viterra, which accounts for approximately 45 % of Western Canada's grain handling capacity and is the leader in South Australia in storage capacity. These major grain companies account for 75 % of the global grain marketing.

WHAT IS DRIVING CONSOLIDATION

When asked this question of the CEO and chairman of Bunge, Mr. Weisser told the Wall Street Journal that "the market has shown it necessary to have large companies with a significant geographical spread and strong balance sheet" (Berry, 2012). These large companies feel the need to spread to different parts of the world as we see the grain supplies tighten. These companies have offices across the globe and are just as worried about the markets in China as they are with the ones in their back yard.

This global consolidation has both pros and cons for the average producer. Dennis Kyllo founder of Commodities Plus saw this trend way before its time. In the late 1990s

Kyllo had had enough of the feed industry. He felt his relationship with dairymen and feed yards were being leveraged to get more volume and increase revenue. Many of the companies he worked for did not see the importance of maintaining a relationship with dairymen and focused more time fostering relationships with other grain trading companies.

He felt that the internet had proven that people and companies were willing to sell to anyone as long as they were credit worthy. He vocalized his opinions and was told he was crazy by his peers and leaders within the grain industry.

When Kyllo left a high position of a major grain trading firm to start Commodities Plus, he was told he would never get the big boys to sell direct to the dairy and feedlot industry. In that, a new concept was born, and through luck or foresight most of the big grain companies are now willing to sell directly to a dairy or feed yard as long as they qualify for credit.

We have not arrived at this point without consolidation in the dairy and feed yards as well. The USDA reports "between 1970 and 2006, the number of farms with dairy cows fell steadily and sharply, from 648,000 operations in 1970 to 75,000 in 2006, or an 88 % decline (ERS, 2009).

WHAT CAN WE MAKE OF ALL OF THIS CONSOLIDATION?

What happens when a market matures? We can see this in all of the livestock industries-beef, pork, poultry, and now dairy; profit margins become razor thin. The same is true in the grain handling and trading industry. These slim margins force speculation, manipulation, and the need to be flexible and explore all options.

WHY IS THIS IMPORTANT TO INDEPENDENT NUTRITIONIST AND NUTRITION GROUPS?

As nutritionists you are judged on milk production and overall animal health. In theory you are paid to efficiently turn nutrient inputs into healthy milk production. *How many of you feel that you get to focus 100 % of your time and energy on just animal health and milk production*? None of us want to fall into the category of "*jack-of-all-trades master of none*". For this reason we need to help promote organizational management that puts responsibilities on the shoulders of those that are going to dedicate the time to master the responsibilities for which they are culpable.

The reality is over all animal health and milk production is a huge responsibility. If you are being affective in today's environment, you are trying to maximize nutrient density by testing forages to determine their nutrient content and sorting for target rationing.

You are balancing rations for heifers, dry cows, and milking cows. You are more than likely breaking the milk cows out and building target rations to get maximum results within groups.

As if that is not enough, a ration that is balanced perfectly is only as good as the success of the overall implementation of the feed program that you have laid out. This being the case, your time is also required to oversee and manage parts of the feeding programs on each individual dairy.

At the end of all of this, how many of you find it frustrating to finally have built a ration that you are comfortable with and have spent the time implementing only to have to come back and start all over because the markets have changed and there is a new *hot buy* that your customer is chasing? While we talk about being flexible in the markets to take advantage of opportunities, I am not suggesting that we believe in chasing the trends. We at Commodities Plus understand that there is an intrinsic value to stability. Often times the volatility in the markets requires us to be creative in our purchases, such as buying basis or backing into a value that comes from an understanding of how commodity spreads from one market to another. I won't go into great detail on how value is determined but feel it important to point out that buying for dairies in 10 states helps us to stay ahead of the trend and many times tips us off to get coverage of a commodity before it goes out of style or prices itself out of the ration and falls back into the nutritionist's lap to deal with. I think that we can all agree if someone was managing the feed contracts for accurate take out and strategic planning it would make life much simpler and you could do a better job doing what you do best, efficiently turning nutrient inputs into healthy milk production!!!

This would be easy in a constant environment; the problem is we don't operate in a constant environment. Quite the opposite in fact, as stated earlier the environment that surrounds us today has never seen changes come quicker. There is more managed money than ever being thrown at the markets to cause them to change. From 1980 to 2004, managed money has increased by almost 140 %, and this does not depict the hedge funds or proprietary trading of major investment banks (Goldman Sachs Research, 2009). People tend to invest in hard assets during times of uncertainty and economic uncertainty.

IF MILKING COWS WERE EASY, EVERYONE WOULD DO IT

I'm sure that you have heard this before but I am going to say it again because I believe it pertains to the overall task. I was told by my grandfather when I was young that "if it was easy, it was probably not worth working for". And throughout life I have learned that in the middle of difficulty lies opportunity. So, it is up to us to find that opportunity in the midst of an ever changing environment.

I have seen in the past 14 yr dairymen and feed yards overlook constant evaluation of the cost-effectiveness of their feeding programs. Not because they are poor managers or bad businessmen, but because they got busy making sure cows were being bred, bills were being paid, or environmental issues were being addressed. The fact is dairymen and feed yard operators have to wear many hats and manage countless rolls. It has been my observation that the successful ones surround themselves with smart, capable people like nutritionist, veterinarians, feed buyers, accountants, and lawyers that can work together collectively to focus on maximum profitability. The adage *it takes a village to raise a child* can be applied to running a dairy or feed yard today in the sense that it takes a team to be successful.

If the world around us is going to consolidate in an effort to tighten their targeted approach to control the information that is available to make feed purchasing decisions, we must circle the wagons and be prepared. If you've ever watched the discovery channel you might recall the hunting methods of a predator as it stalks its prey. When danger is sensed in the case of a herd of musk-ox, the group will come together and form a circle in an effort to show strength, stability, and unity.

The target now becomes the ones outside of the herd, unprotected and independent from the group. There is safety provided in numbers. Make no mistake, the information that is being delivered is being consolidated to help paint a story that makes individuals easier targets to sell to. It is becoming ever more important to have accurate information to base your decisions on when you are hearing numbers that are quoted. For example two-thirds of all distillers grains produced today are "*low fat*".

This year we had major issues with aflatoxin in the corn crop. Corn gluten feed had a two tiered pricing structure. When the low fat distillers market is weak and the corn gluten market is strong, we have seen low fat distillers represented as corn gluten. We now have regular canola and high fat canola. The list goes on-and-on, the point is we need to work together so that the nutritional specifications you are basing your formulations on are being met so that the performance you are judged on is not flawed!

Consolidation is happening all around us. You can see it in the airline industry, you can see it in the railroad industry with unit train rates, and you can see it throughout this presentation, it is happening in the feed industry.

We need to embrace it. We live in exciting times with great opportunities in front of us. And when I think about what I was asked to speak about today, "*Challenges of Buying Feed*", my hope is that I have painted a picture of teamwork, because buying feed is not what it used to be. Long-term contracts are harder to come by; credit issues are a major factor to take into consideration when contracting feed, getting what you paid for is vital! Price is not the only consideration on which to base a purchase. We must be calculated in what, when, how, and who we buy our feed from; while leveraging the best value and use of credit for the dairy to meet its needs. I believe that the answer to the question "How do we face the "*challenges of buying feed"* in an environment that is constantly changing?" is: it is a full-time job that can be the difference between being profitable or not. Make sure it is someone's full-time responsibility.

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