• *Report on Fats and Oils*

How Cheap Is Cheap?

The recent rash of mergers, changes in ownership, shifts in company emphasis among soybean processors has literally changed the face of the industry. This calls attention to the general lack of profitability within the group. Low profit levels are not uncommon for firms processing raw agricultural materials into semi-finished products (meat packers are another sad example), but for a long time bean processing had been immune. Many agricultural processors have attempted to get out of the financial woods by offsetting the lack of first-step profit by switching to higher-margin finished goods. Corn processors have gone into margarine, mayonnaise, and shoe polish. Meat packers are producing deodorant soap, tennis balls, and complete frozen dinners. Flour millers are mixing baking mixes with solar balloons. Grain millers are fattening up on liquid-diet foods. Among soybean processors the final products include everything from lethicin to plastics to shortening to oven-ready broilers.

So far, at least, the soybean industry has seen more integration than diversification. The problem at this point (especially for those crushers who are not so diversified or integrated) is to assess whether the integrated/diversified crushers have become reconciled to low or invisible margins at the purely crushing step (Figure 1). For if they have, the single-line producer may well be in for some hard times. The multiple-line crushers now include just about all the big strong ones. Integrated operations are even more important to the profit level than simply diversified ones as an integrated operation is hard to shut down because of low profit at one point in the line.

European crush capacity is expanding all time. This adds demand to beans and substracts demand from products. Traders as well as crushers must assess the possibility of permanently-tight margins. For many years alert traders have kept track of the crush margin as an aid to decision making. For instance, when one is bullish on beans and the margin is poor, one buys the two products instead of beans. No matter which way the whole market goes, the two products in total should do better than beans. Of course, the key word here is what constitutes "poor," and this is what may eventually have to be revised. A similar judgment must be made when deciding at what level to put on reverse-conversion spreads.

Board conversion is, of course, not the same as true conversion. Bean futures are in-store Chicago whereas futures are basis Decatur. Cash conversion is, in effect, Decatur for all three. The difference is important, not only from the standpoint of timing but also because of the location difference of the beans. The latter is what tends to make the futures operation successful. Chicago is a domestic storage point for beans, an expert collection center, and a futures market. The importance of all three results in Chicago cash beans and consequently futures moving over downstate prices by a sufficient amount to attract enough beans to Chicago to protect all three functions. This usually happens at harvest time when downstate bean prices are depressed by selling from farmers who do not have or cannot obtain storage. At the same time nearby futures months of beans are depressed as Chicago elevators struggle to obtain the carrying margins without which they will not accumulate beans.

This is all right for the crusher if nearby products are relatively as depressed as beans. However, particularly when nearby margins are tight, there will be a tendency for products to show nearby premiums. This causes deferred conversion to be worse than nearby and gives the spreader his opportunity. Aggravating the whole problem for the crusher is that he practically has to buy the beans when the basis is cheap to avoid missing the run. At the same time speculative buying enthusiasm in beans is about at its peak as historically beans tend to make an intermediate low around harvest time. Later on in the season (say January-February) the board-conversion spread is frequently forced out, as futures conversion and cash conversion more closely approach each other, because the downstate basis has to rise to shut off the flow of beans to Chicago. Besides the basis everywhere gradually improves as the beans get under cover and strong holders replace weak holders.

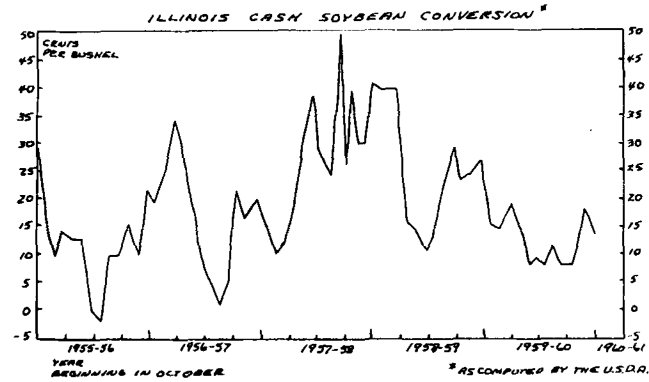

Fig. 1. Assuming out-of-pocket costs of 13 to 17¢ and total cost somewhat "over 20¢," it is apparent that "over 20" is seen infrequently and out-of-pocket only part of the time. Even so, crushing capacity grows and grows. (This season it is estimated at 525 million bushels compared with 400 million bushels crush.) Even the moderately inefficient plant is being squeezed. Note how poorly this season is starting by comparing the current October with prior years!

Over-capacity forces crushers to compete with each other and with exporters for available beans instead of the sellers competing with each other to secure the crusher bids. This is when the crusher is pinched, and "shut-down talk" starts. This helps a little. About the same time the longs in bean futures start to liquidate, which can be quite a help. Eventually bean export business tapers off. Of course, one basic question left unanswered so far is, why don't all traders buy oil and meal when they are underpriced compared to beans and thus keep the differences in line? This is due to confidence in the loan as a floor for beans and only fair confidence in the ability of crushers to improve margins, increasing importance of exports in the bean price structure, familiarity of the great bulk of traders with beans, and a feeling that the government is more interested in getting high prices to the farmer than fair margins for the crusher. This year, as usual, there has been a good deal of "reverse conversion" put on. It is too early to tell yet how this will turn out except that January board conversion is much better than it was. May still looks bad for the crusher, *i.e.,* he is working very cheaply. The question is how cheap is cheap?

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• *35 Years Ago*

In the October 1925 issue of the Journal of Oil and Fats Industries, Curtis and Tompkins, San Francisco, Calif., discussed the packaging of olive oil in a paper entitled "Color Changes in Olive Oil." They reported color changes of the oil when packed in tin as against conditions when packed in glass and exposed to light.

H. J. Morrison, newly elected president of the American Oil Chemists' Society, was presented with a gavel at the annual banquet of the society, in New Orleans, May 6, 1924, by H. B. Battle, Montgomery, Ala., retiring 14th president. In his article "Presentation of a Gavel at the 15th Annual Banquet of the A.O.C.S." he shows a picture of the gavel and gives the history of the walnut handle.

Givaudan-Delawanna Inc., New York, announces Sandela GD, a polycyclic alcohol with the characteristics of natural sandalwood oil at one-third the cost.