SOUTHERN
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GRDC™ GROWNOTES™

GRDC
GRAINS RESEARCH & DEVELOPMENT CORPORATION

TRITICALE

SECTION 15

MARKETING

SOUTHERN FEED GRAINS: MARKET DYNAMICS AND EXECUTION | REFERENCES

Marketing

The final step in generating farm income is converting the tonnes produced into dollars at the farm gate. This section provides best in class marketing guidelines for managing price variability to protect income and cash flow.

15.1 Southern feed grains: market dynamics and execution

15.1.1 Price determinants for feed grains in southern markets

Stockfeed markets are the biggest consumers of grain domestically. While South Australian markets are export oriented, strong livestock industries in Victoria draw grain into the domestic market. The consumption of grain for domestic stockfeed in southern Australia is equivalent to approximately 40% of the total winter crop produced in SA and Victoria.

Victoria traditionally draws grain in from NSW to support domestic stockfeed markets, as well to meet its bulk and container export programs. Southern Australia accounts for approximately 35% of national stockfeed use. The biggest stockfeed market in southern Australia is the dairy industry, which comprises 40% of the demand for stockfeed in these markets. About 90% of this demand is from Victoria.

In SA, the greatest demand is from the poultry industry, at 50% of South Australia's feed-grain demand (*v.* 25% in Victoria). Poultry accounts for ~30% of feed demand across southern Australia.

The poultry industry (for eggs and for chicken meat) has seen continued growth, with strong growth expected to continue, especially in South Australia. It is driven by the availability of land and feed grains, and a more favourable regulatory environment.

Similar factors are also driving growth in the production of pig meat in South Australia. The pig industry is the third largest consumer of feed grains across southern Australia, representing 13% of demand. It is the second largest consumer in South Australia, at nearly 25%.

The other major source of demand for stockfeed in southern markets is Tasmania, with grain being exported from Victoria for the dairy and aquaculture industries.

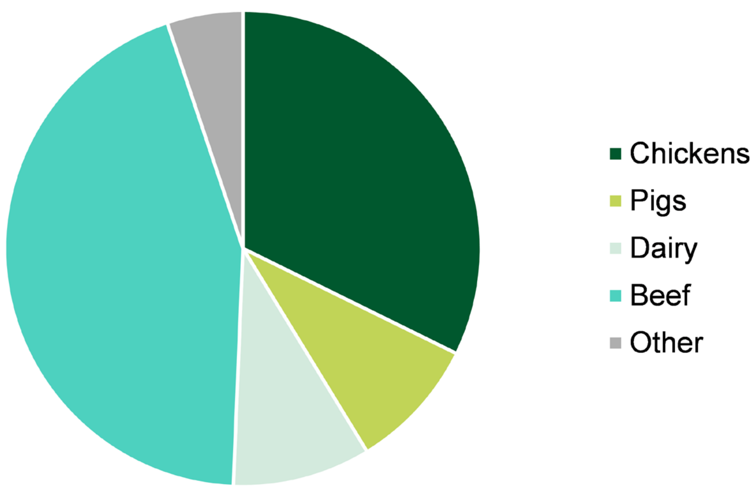

Figure 1: *Sources of demand for stock feed in southern Australia.*

The key drivers of prices for feed grains in southern markets include:

- The rate of exports, and the remaining supply of feed grains for domestic markets.
- Commodity prices in the consuming industry (i.e. meat prices).
- Trends in the dairy industry (i.e. milk price).
- Consumption trends in domestic livestock markets.
- Livestock health.
- Seasonality and the supply of pasture and fodder *v*. grain.
- Imports of alternate feed sources (i.e. soybean meal).
- Prices of competing feed grains.

Demand for grain from stockfeed markets tends to be steady throughout the year. However, knowing there is strong competition from the export market, some buyers will seek to secure their requirements shortly after harvest, when the supply of grain is more certain.

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15.1.2 Converting tonnes into cash

When it comes to accessing domestic stockfeed markets, there are three ways this can be approached:

- Sale to a feed miller or manufacturer.
- Sale directly to a farm or other end-user.
- Sale to a trader or merchant who on-sells the grain to the stockfeed market.

Principle: Always keep written records.

Thorough record keeping is everyone's responsibility, not just the buyer's.

Each organisation will differ in:

- its professionalism;
- how it manages grain requirements and purchases; and
- its documentation and record keeping.

Hence it is prudent when making sales into any market to be vigilant in maintaining your own records of contracts, even when they are executed by phone. It is strongly advised that the seller keeps a written record of the particulars of the contract, including price, quantity, quality, and delivery and payment terms, to protect themselves in the event of a dispute with the counterparty over the details of the sale agreement.

It is even better practice to send a confirmation of contract to the buyer in the event that they don't provide one to you, and even if they do. Grain Trade Australia provides standard contract documents which can be completed by either party and returned to the buyer by email as confirmation of a verbal contract (Figure 2). This way, any misunderstandings that may have taken place on the phone can be quickly identified and rectified while the conversation is still fresh in the minds of both parties.

How to sell for cash

Like any market transaction, a cash–grain transaction occurs when a bid by the buyer is matched by an offer from the seller. Cash contracts are made up of the following components, with each component requiring risk to be managed:

- Price—future price is largely unpredictable, so devising a selling plan to put current prices into the context of the farm business is critical to managing price risk.

- Quantity and quality—when entering a cash contract you are committing to deliver the nominated amount of grain at the quality specified, so production and quality risk must be managed.
- Delivery terms—the timing of the title transfer from the grower to the buyer is agreed at the time of contracting. If the contract requires delivery directly to end-users, the seller must manage operations to ensure delivery within the contracted period.
- Payment terms—in Australia, the traditional method of contracting requires title on the grain to be transferred ahead of payment, so counterparty risk must be managed.

Grain Trade Australia is the industry body ensuring the efficient facilitation of commercial activities across the grain supply chain. This includes contract trade and dispute resolution rules. All wheat contracts in Australia should refer to GTA trade and dispute resolution rules.

Quantity (tonnage) and quality (bin grade) determine the actuals of your commitment. Production and execution risk must be managed.

Price is negotiable at time of contracting.
Price basis or price point is important as it determines where in the supply chain the transaction will occur and so what costs will come out of the price before the growers net return.

Timing of delivery (title transfer) is agreed upon at time of contracting. Hence growers negotiate execution and storage risk they may have to manage.

Whilst the majority of transactions are on the premise that title of grain is transferred ahead of payment this is negotiable. Managing counterparty risk is critical.

GTA Contract No.3

CONTRACT CONFIRMATION

GTA Trade Rules and Dispute Resolution Rules apply to this contract

GRAIN TRADE AUSTRALIA

This Contract is confirmation between:

BUYER	SELLER
Contract No:	Contract No:
Name:	Name:
Company:	Company:
Address:	Address:
Buyer ABN:	Seller ABN:
NGR No:	NGR No:

The Buyer and Seller agree to transact this Contract subject to the following Terms and Conditions:

Commodity:	GTA Commodity Reference:
Grade:	Inspection: (Origin – Destination)
Quantity:	Tolerance: (Refer over)
Packaging:	Weights: (Origin – Destination)
Price:	Excl/Inc/Free GST
Price Basis:	

Delivery/Shipment Period:
(Delivered, Shipped, Free In Store, Free On Board, Ex-Farm, etc.)
Delivery Point and Conveyance:
(Road, Rail, Delivered Container Terminal, Freight, Rated Basing Point, Loading Weight requirements if applicable)

Payment Terms: The buyer agrees to pay the seller within . In the absence of a declaration, payment will be 30 days end of week of delivery.

Levies and Statutory Charges: Any industry, statutory or government levies which are not included in the price shall be deducted as required by law.

Disclosures: Is any of the crop referred to in this contract subject to a mortgage, Encumbrance or lien and/or Plant Breeders Rights and/or EPR liabilities and/or registered or unregistered Security Interest? ☐NO ☐YES (Please ☐ appropriate box) If "yes" please provide details:

Other Special Terms and Conditions:

All Contract Terms and Conditions as set out above and on the reverse of this page form part of this Contract. Terms and Conditions written on the face of this Contract Confirmation shall overrule all printed Terms and Conditions on the reverse with which they conflict to the extent of the inconsistency. This Contract comprises the entire agreement between Buyer and Seller with respect to the subject matter of this Contract.

Recipient Created Tax Invoice (RCTI).
To assist with the processing of the Goods and Services Tax compliance, the buyer may prepare, for the seller, a Recipient Created Tax Invoice (RCTI). If the seller requires this service they are required to sign this authorisation.

☐ Please issue a RCTI (Please ☐)

Incorporation of GTA Trade & Dispute Resolution Rules:
This contract expressly incorporates the GTA Trade Rules in force at the time of this contract and Dispute Resolution Rules in force at the commencement of the arbitration, under which any dispute, controversy or claim arising out of, relating to or in connection with this contract, including any question regarding its existence, validity or termination, shall be resolved by arbitration.

Buyer's Name: PRINT NAME	Seller's Name: PRINT NAME
Buyer's Signature:	Seller's Signature:
Date:	Date:

This Contract has been executed and this form serves as confirmation and should be signed and a copy returned to the buyer/seller immediately. 2014 Edition

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Figure 2: *Typical cash contract of Grain Trade Australia.*

Counterparty risk

Most sales involve transferring the title of the grain prior to being paid. The risk of a counterparty defaulting when selling grain is very real and must be managed. Conducting business in a commercial and professional manner minimises this risk.

Principle: Seller beware.

Know your counterparty.

Counterparty risk management includes:

- Dealing only with known and trusted counterparties.
- Conducting a credit check (banks will do this) before dealing with a buyer they are unsure of.
- Selling only a small amount of grain to unknown counterparties.
- Considering credit insurance or a letter of credit from the buyer.
- Never delivering a second load of grain if payment has not been received for the first.
- Not parting with the title before payment, or requesting and receiving a cash deposit of part of the value ahead of delivery. Payment terms are negotiated at time of contracting.

Above all, act commercially to ensure that the time invested in implementing a selling strategy is not wasted by the poor management of counterparty risk. Achieving $5/t more on paper and not getting paid is a disastrous outcome.

Read market signals

The appetite of buyers for a particular commodity will differ over time, depending on market circumstances. Ideally, growers should aim to sell their commodity when buyer appetite is strong, and stand aside from the market when buyers are not very interested.

Principle: Sell when there is buyer appetite.

When buyers are chasing grain, growers have more market power to demand the price they want.

Buyer appetite can be monitored by:

- The number of buyers at or near the best bid in a public bid line-up. If there are many buyers, it could indicate that buyer appetite is strong. However, if one buyer is offering $5/t above the next best bid, it may mean that cash prices are susceptible to falling $5/t as soon as that buyer satisfies their appetite.
- Monitoring actual trades against public indicative bids. When trades are occurring above indicative public bids it may indicate strong appetite from merchants and the ability for growers to offer their grain at price premiums to public bids.

Know the specifications of your grain

A grower who knows the specifications of their grain can set more realistic sales goals and source appropriate markets more quickly.

Principle: Know your specs.

Grades don’t always convey quality.

Feed grades of grain, as defined by bulk-handler receival standards, can have very broad quality specifications. For the lowest grades, there is often no minimum tolerance on screenings or protein; hence, no two parcels are the same.

The important factor for the stockfeed market is not what grade the grain is, but what proportion of energy and protein the grain contains, as these ultimately determine conversion into meat or other animal products. Hence, growers who have their grain tested and know its specifications will know exactly what the value of the grain will be in the production system.

Without this information, the buyer may base their pricing on the minimum specification or likely worst-case scenario, to protect themselves in the event that they receive grain of the lowest quality allowable in the grade specification. However, if a buyer knows why the grain was downgraded and the specifications of that load of grain, they may pay a premium, because they will know the exact quality the seller is offering.

15.1.3 Ensuring access to markets

Planning on where to store the commodity after harvest is important in ensuring access to the market that is likely to yield the highest return.

In South Australia, the predominant animal industries of pigs and poultry are highly intensive and tend to be geographically concentrated. Hence, proximity to these markets can be an important determinant of market access. In a practical sense, some growers may not have access to markets, because large distances between production and demand make the cost of transport so high that it cancels out potential profits.

In Victoria, the dominant dairy market is concentrated in Gippsland, the Western Districts and the Goulburn Valley. Here, too, proximity to the market must be considered as part of any marketing plan to access demand from the stockfeed industry.

The market for feed grains into Tasmania is often serviced by feed manufacturers and traders who export the grain by truck and ferry from Melbourne.

Storage and logistics

The return on investment from grain handling and storage expenses is optimised when storage is considered in light of market access, so as to maximise returns as well as harvest logistics.

Storage alternatives include variations of bulk handling, private off-farm storage, and on-farm storage. Delivery and quality management are key considerations in deciding where to store the commodity (Figure 3).

Commodities destined for the domestic end-user market (e.g. feedlot, processor, or container packer), may be more suited to on-farm or private storage, to increase delivery flexibility.

Storing commodities on the farm requires prudent quality management to ensure that the grain is delivered to the agreed specifications. If not well planned and carried out, it can expose the business to high risk. Penalties for out-of-specification grain arriving at a buyer's weighbridge can be expensive, as the buyer has no obligation to accept it. This means the grower may have to incur the cost of taking the load elsewhere, and may also have to find a new buyer.

On-farm storage also requires prudent delivery management to ensure that they buyer receives the commodities on time and with appropriate weighbridge and sampling tickets.

Principle: Storage is all about market access.

Storage decisions depend on quality management and expected markets.

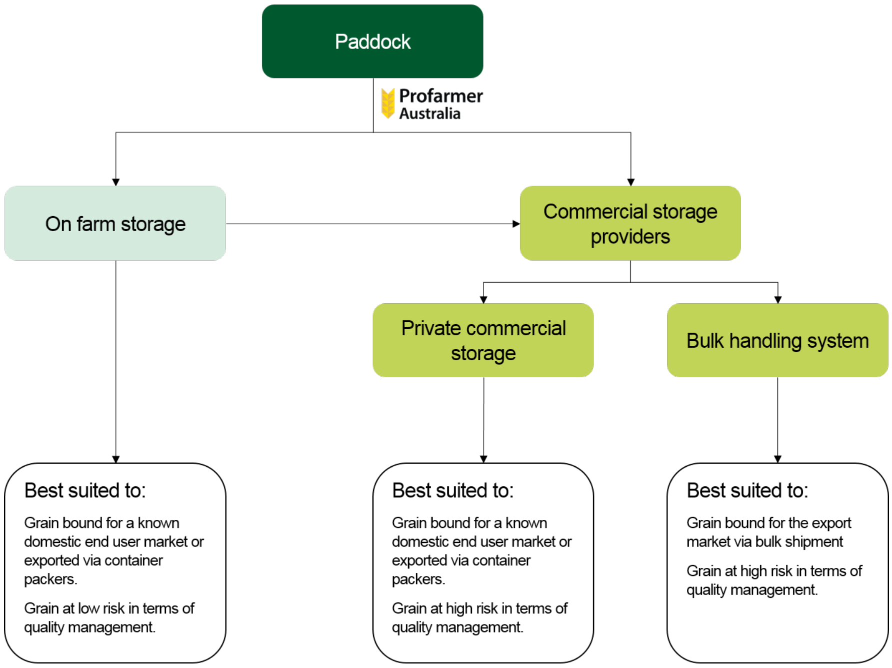

Figure 3: *Grain storage decision making: the storage chosen depends on the market growers want to access.*

Separate delivery and pricing

Principle: Separate the delivery decision from the pricing decision.

Organised stockfeed buyers who have a clear outlook as to what their grain requirements will be across the season may seek to purchase their grain in advance of delivery; i.e. they may purchase grain in March for delivery between May and July. This provides the seller with the opportunity to obtain price certainty immediately, even though delivery may not take place for months.

The benefit of this is that a seller can capture strong value when it presents, even though it may not be a convenient time to arrange delivery. Or the seller can create cash-flow certainty for a known future commitment at today's price.

Cost of carrying grain

Storing grain to access sales opportunities post-harvest invokes a cost to 'carry', or hold, the grain. Price targets for carried grain need to account for the cost of carrying it. Carrying costs for canola are typically $4–5/t per month and consist of:

1. Monthly storage fee charged by a commercial provider, typically ~$1.50–2.00/t
2. Monthly interest associated with having wealth tied up in grain rather than available as cash or to pay off debt, ~$2.50–$3.00/t, depending on the price of the commodity and interest rates.

The price of carried grain therefore needs to be $4–5/t per month higher than the price offered at harvest.

The cost of carrying also applies to grain stored on the farm, as there is the cost of the capital invested in the farm storage plus the interest component to cover. A reasonable assumption is a cost of $4–5/t per month for on-farm storage.

Principle: Carrying grain is not free.

The cost of carrying grain needs to be accounted for if holding if for sale after harvest is part of the selling strategy.

Principles revisited

1. Always keep written records: thorough record keeping is everyone's responsibility, not just the buyer's.
2. Seller beware: know your counterparty.
3. Sell when there is buyer appetite: when buyers are chasing grain, growers have more market power to demand the price they want.
4. Know your specs: grades don't always convey quality.
5. Storage is all about market access: storage decisions depend on quality management and expected markets.
6. Separate the delivery decision from the pricing decision.
7. Carrying grain is not free: the cost of carrying grain needs to be accounted for if holding for sale after harvest is part of the selling strategy.

15.2 References

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