



WESTERN

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GRAINS RESEARCH
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CORPORATION

OATS

SECTION 15

MARKETING

SELLING PRINCIPLES | WESTERN OATS – MARKET DYNAMICS AND EXECUTION

SECTION 15

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.

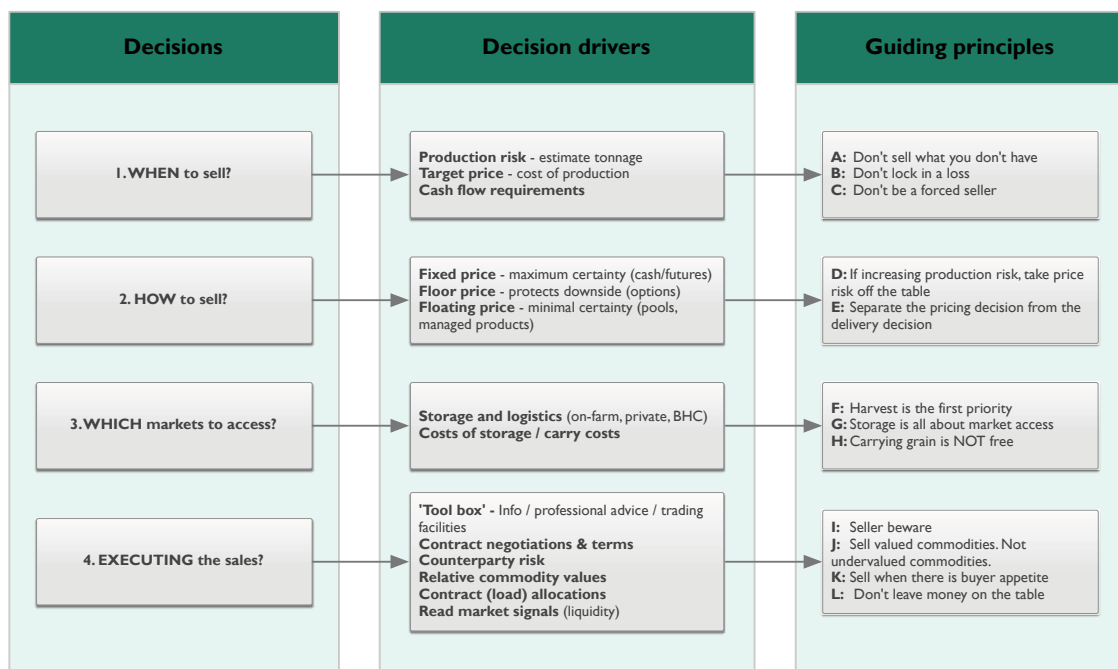
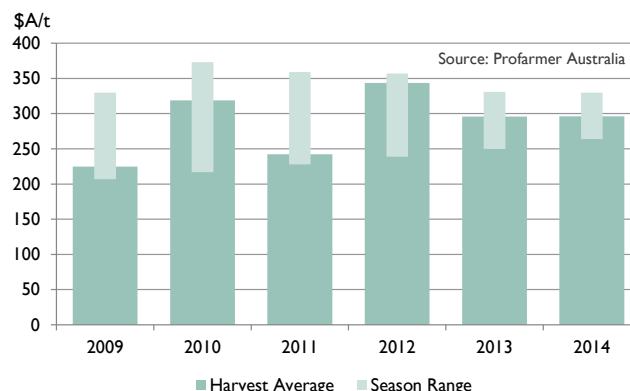


Figure 1: Grain selling flow chart.

Figure 1 shows a grain selling flow chart that summarises:

- The decisions to be made
- The drivers behind the decisions
- The guiding principles for each decision point



Note to figure:
Kwinana APW2 wheat prices have varied A\$60-\$160/t over the past 6 years (25-60% variability). For a property producing 2,000 tonne of wheat this means \$120,000-\$320,000 difference in income depending on price management skill.

Figure 2: Selling principles

15.1 Selling Principles

The aim of a selling program is to achieve a profitable average price (the target price) across the entire business. This requires managing several unknowns to establish the target price and then working towards achieving that target price.

Unknowns include the amount of grain available to sell (production variability), the final cost of that production, and the future prices that may result. Australian farm gate prices are subject to volatility caused by a range of global factors that are beyond our control and difficult to predict.

The skills growers have developed to manage production unknowns can be used to manage pricing unknowns. This guide will help growers manage and overcome price uncertainty.

15.1.1 Be prepared

Being prepared and having a selling plan is essential for managing uncertainty. The steps involved are forming a selling strategy and a plan for effective execution of sales.

A selling strategy consists of when and how to sell.

When to sell

This requires an understanding of the farm's internal business factors including:

- production risk
- a target price based on cost of production and a desired profit margin
- business cash flow requirements

How to sell?

This is more dependent on external market factors including:

- time of year determines the pricing method
- market access determines where to sell
- relative value determines what to sell

The following diagram (Figure 3) lists key selling principles when considering sales during the growing season.

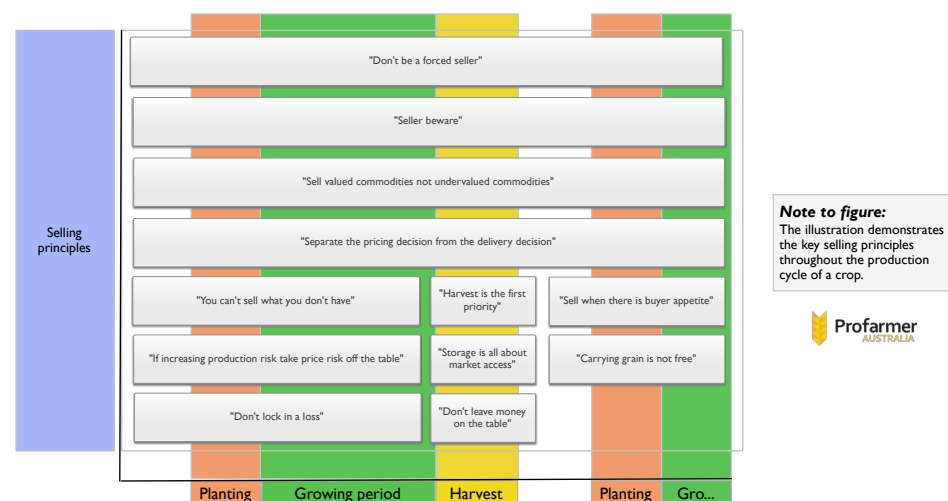


Figure 3: Grower commodity selling principles timeline.

15.1.2 Establish the business risk profile (when to sell?)

Establishing your business risk profile allows the development of target price ranges for each commodity and provides confidence to sell when the opportunity arises. Typical business circumstances and how to quantify those risks during the production cycle are described below.

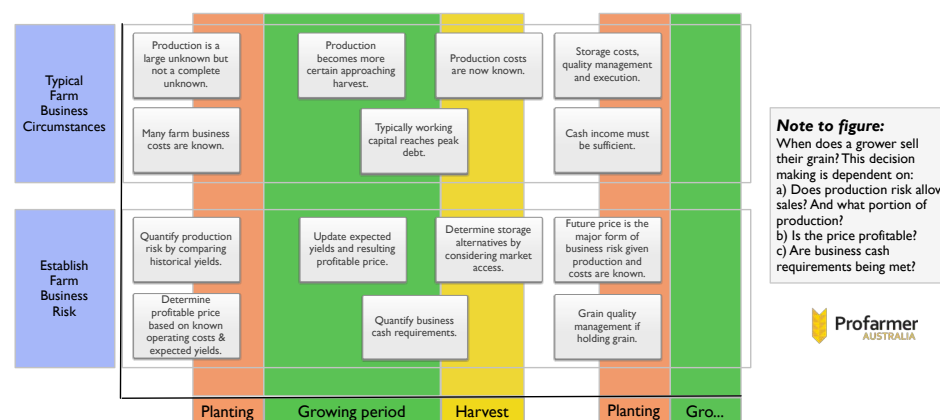


Figure 4: Typical farm business circumstances and risk.

Production risk profile of the farm

Production risk is the level of certainty around producing a crop and is influenced by location (climate and soil type), crop type, crop management, and time of the year.

Principle: “You can’t sell what you don’t have” – Don’t increase business risk by over committing production.

Establish a production risk profile by:

1. Collating historical average yields for each crop type and a below average and above average range.
2. Assess the likelihood of achieving average based on recent seasonal conditions and seasonal outlook.
3. Revising production outlooks as the season progresses.

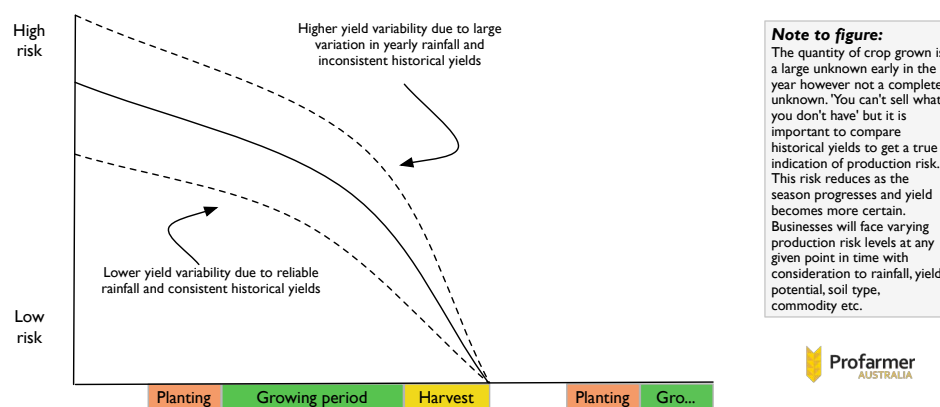


Figure 5: Typical risk profile of farm operation.

Farm costs in their entirety, variable and fixed costs (establishing a target price).

A profitable commodity target price is the cost of production per tonne plus a desired profit margin. It is essential to know the cost of production per tonne for the farm business.

Principle: “Don’t lock in a loss” – If committing production ahead of harvest, ensure the price is profitable.

Steps to calculate an estimated profitable price based on total cost of production and a range of yield scenarios is provided below.

Estimating cost of production - Wheat		
Planted Area	1,200 ha	
Estimate Yield	2.85 t/ha	
Estimated Production	3,420 t	
Fixed costs		
Insurance and General Expenses	\$100,000	
Finance	\$80,000	
Depreciation/Capital Replacement	\$70,000	
Drawings	\$60,000	
Other	\$30,000	
Variable costs		
Seed and sowing	\$48,000	
Fertiliser and application	\$156,000	
Herbicide and application	\$78,000	
Insect/fungicide and application	\$36,000	
Harvest costs	\$48,000	
Crop insurance	\$18,000	
Total fixed and variable costs	\$742,000	
Per Tonne Equivalent (Total costs + Estimated production)	\$212 /t	
Per tonne costs		
Levies	\$3 /t	
Cartage	\$12 /t	
Freight to Port	\$11 /t	
Total per tonne costs	\$22 /t	
Cost of production Port track equiv	\$259.20	
Target profit (ie 20%)	\$52.00	
Target price (port equiv)	\$311.20	

Step 1: Estimate your production potential. The more uncertain your production is, the more conservative the yield estimate should be. As yield falls, your cost of production per tonne will rise.

Step 2: Attribute your fixed farm business costs. In this instance if 1,200 ha reflects 1/3 of the farm enterprise, we have attributed 1/3 fixed costs. There are a number of methods for doing this (see M Klaus “Farming your Business”) but the most important thing is that in the end all costs are accounted for.

Step 3: Calculate all the variable costs attributed to producing that crop. This can also be expressed as \$ per ha x planted area.

Step 4: Add together fixed and variable costs and divide by estimated production

Step 5: Add on the “per tonne” costs like levies and freight.

Step 6: Add the “per tonne” costs to the fixed and variable per tonne costs calculated at step 4.

Step 7: Add a desired profit margin to arrive at the port equivalent target profitable price.

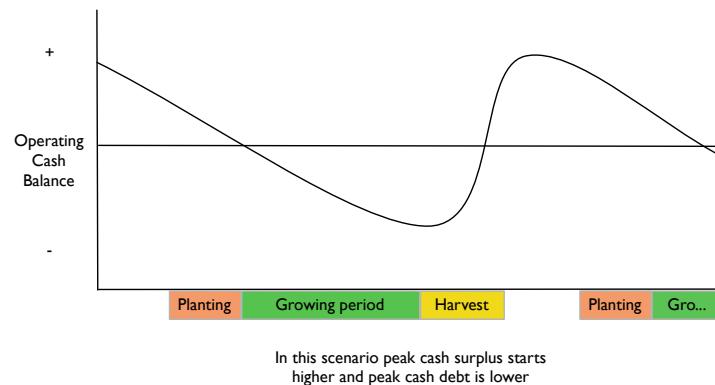
Figure 6: GRDC’s “Farming the Business Manual” also provides a cost of production template and tips on grain selling vs grain marketing. <http://www.grdc.com.au/FarmingTheBusiness>

Income requirements

Understanding farm business cash-flow requirements and peak cash debt enables grain sales to be timed so that cash is available when required. This prevents having to sell grain below the target price to satisfy a need for cash.

Principle: “Don’t be a forced seller” – Be ahead of cash requirements to avoid selling in unfavourable markets.

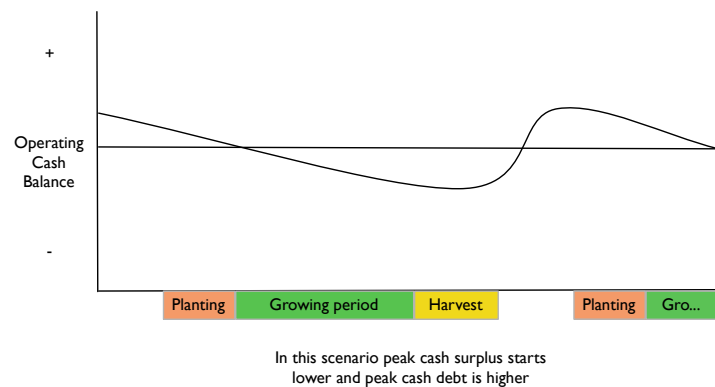
A typical cash-flow to grow a crop is illustrated below (Figures 7 and 8). Costs are incurred upfront and during the growing season with peak working capital debt incurred at or before harvest. This will vary depending on circumstance and enterprise mix. The second figure demonstrates how managing sales can change the farm’s cash balance.



Note to figure:
The chart illustrates the operating cash flow of a typical farm assuming a heavy reliance on cash sales at harvest. Costs are incurred during the season to grow the crop, resulting in peak operating debt levels at or near harvest. Hence at harvest there is often a cash injection required for the business. An effective marketing plan will ensure a grower is 'not a forced seller' in order to generate cash flow.



Figure 7: Typical operating cash balance.



Note to figure:
By spreading sales throughout the year a grower may not be as reliant on executing sales at harvest time in order to generate required cash flow for the business. This provides a greater ability to capture pricing opportunities in contrast to executing sales in order to fulfil cash requirements.



Figure 8: Typical operating cash balance.

When to sell revised

The “when to sell” steps above result in an estimated production tonnage and the risk associated with that tonnage, a target price range for each commodity, and the time of year when cash is most needed.

15.1.3 Managing your price (how to sell?)

The first part of the selling strategy answers the question “when to sell” and establishes comfort around selling a portion of the harvest.

The second part of the strategy addresses “how to sell”.

Methods of price management

Pricing products provide varying levels of price risk coverage:

Table 1: Pricing methods and how they are used for various crops

	Description	Wheat	Barley	Canola	Oats	Lupins	Field peas	Chick peas
Fixed price products	Provides the most price certainty	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash	Cash	Cash	Cash
Floor price products	Limits price downside but provides exposure to future price upside	Options on futures, floor price pools	Options on futures	Options on futures	none	none	none	none
Floating price products	Subject to both price upside and downside	Pools	Pools	Pools	Pools	Pools	Pools	Pools

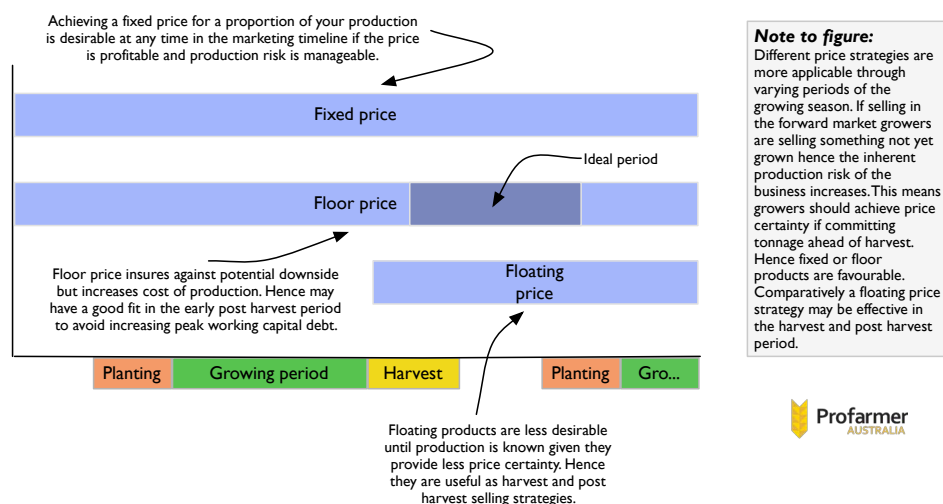


Figure 9: Summary of where different methods of price management are suited for the majority of farm businesses.

Principle: “If increasing production risk, take price risk off the table” – When committing unknown production, price certainty should be achieved to avoid increasing overall business risk.

Principle: “Separate the pricing decision from the delivery decision” – Most commodities can be sold at any time with delivery timeframes negotiable, hence price management is not determined by delivery.

Fixed price

A fixed price is achieved via cash sales and/or selling a futures position (swaps).

It provides some certainty around expected revenue from a sale as the price is largely a known except when there is a floating component in the price. For example, a multi-grade cash contract with floating spreads or a floating basis component on futures positions.

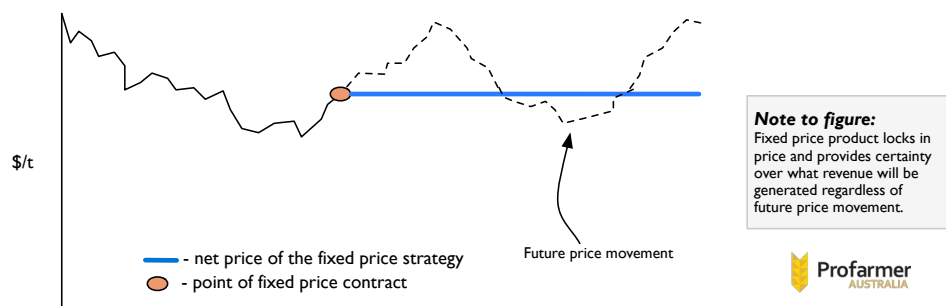
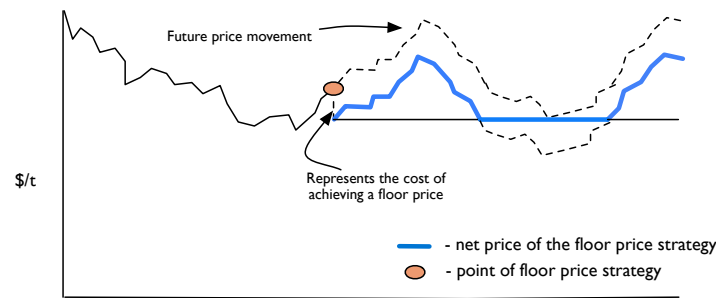


Figure 10: Fixed price strategy.

Floor price

Floor price strategies can be achieved by utilising “options” on a relevant futures exchange (if one exists), or via a managed sales program product by a third party (i.e. a pool with a defined floor price strategy). This pricing method protects against potential future downside whilst capturing any upside. The disadvantage is that the price ‘insurance’ has a cost which adds to the farm businesses’ cost of production.



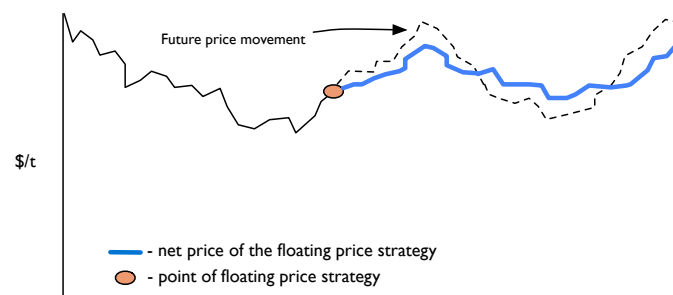
Note to figure:
A floor price strategy insures against potential future downside in price while allowing price gains in the event of future price rallies.



Figure 11: Floor price strategy.

Floating price

Many of the pools or managed sales programs are a floating price where the net price received will move both up and down with the future movement in price. Floating price products provide the least price certainty and are best suited for use at or after harvest rather than pre harvest.



Note to figure:
A floating price will move to some extent with future price movements.



Figure 12: Floating price strategy.

How to sell revised

Fixed price strategies include physical cash sales or futures products and provide the most price certainty, but production risk must be considered.

Floor price strategies include options or floor price pools. They provide a minimum price with upside potential and rely less on production certainty but cost more.

Floating price strategies provide minimal price certainty and are best used after harvest.

15.1.4 Ensuring access to markets

Once the selling strategy of when and how to sell is sorted, planning moves to storage and delivery of commodities to ensure timely access to markets and execution of sales. At some point growers need to deliver the commodity to market. Hence planning on where to store the commodity is important in ensuring access to the market that is likely to yield the highest return.

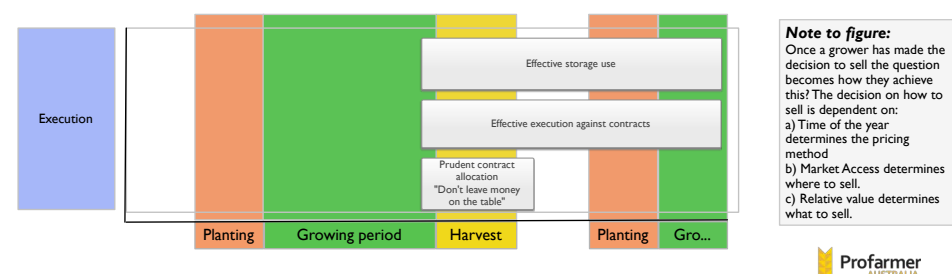


Figure 13: Effective storage decisions.

Storage and logistics

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

Storage alternatives include variations around the bulk handling system, private off farm storage, and on-farm storage. Delivery and quality management are key considerations in deciding where to store your commodity.

Principle: “Harvest is the first priority” – Getting the crop in the bin is most critical to business success during harvest, hence selling should be planned to allow focus on harvest.

Bulk export commodities requiring significant quality management are best suited to the bulk handling system. Commodities destined for the domestic end user market (e.g. feed lot, processor, or container packer), may be more suited to on-farm or private storage to increase delivery flexibility.

Storing commodities on-farm requires prudent quality management to ensure delivery at agreed specifications and can expose the business to high risk if this aspect is not well planned. Penalties for out-of-specification grain on arrival at a buyer’s weighbridge can be expensive. The buyer has no obligation to accept delivery of an out-of-specification load. This means the grower may have to incur the cost of taking the load elsewhere whilst also potentially finding a new buyer. Hence there is potential for a distressed sale which can be costly.

On-farm storage also requires prudent delivery management to ensure commodities are received by the buyer on time with appropriate weighbridge and sampling tickets.

Principle: “Storage is all about market access” – Storage decisions depend on quality management and expected markets.

For more information on on-farm storage alternatives and economics refer to GRDC Western Region - Wheat - GrowNote, Chapter 14 Grain Storage.

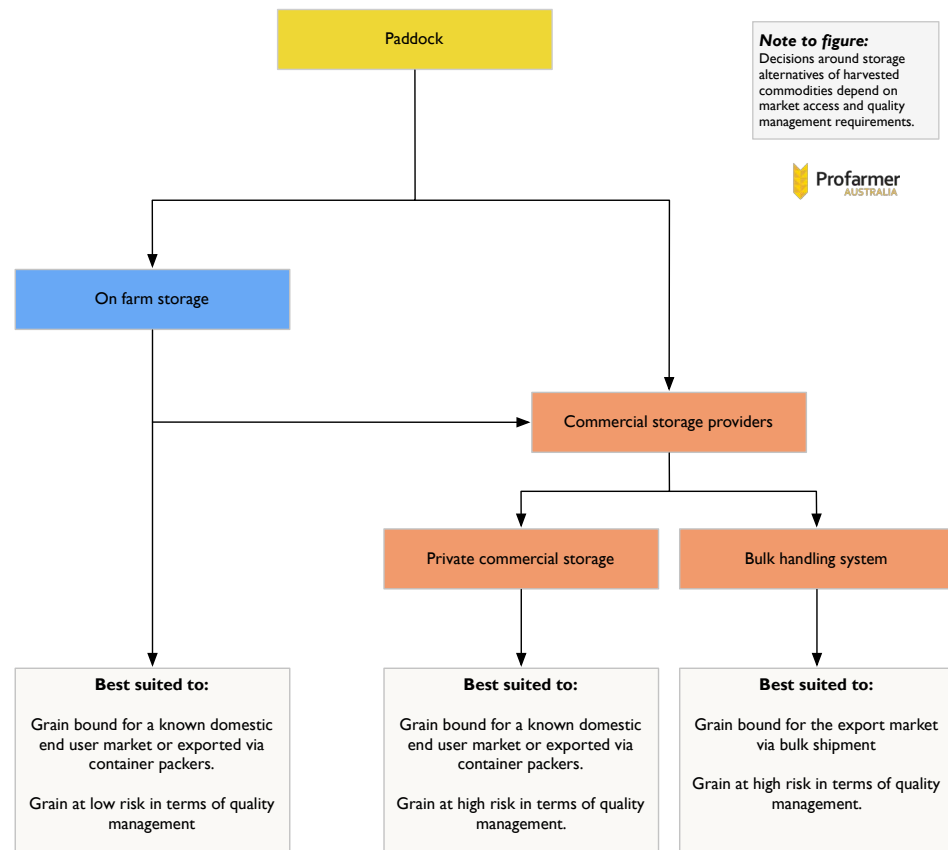


Figure 14: Grain storage decision making.

Cost of carrying grain

Storing grain to access sales opportunities post-harvest invokes a cost to “carry” grain. Price targets for carried grain need to account for the cost of carry.

Carry costs are typically \$3-4/t per month consisting of:

- monthly storage fee charged by a commercial provider (typically ~\$1.50-2.00/t per month)
- the interest associated with having wealth tied up in grain rather than cash or against debt (~\$1.50-\$2.00/t per month depending on the price of the commodity and interest rates).

The price of carried grain therefore needs to be \$3-4/t per month higher than what was offered at harvest.

The cost of carry applies to storing grain on farm as there is a cost of capital invested in the farm storage plus the interest component. \$3-4/t per month is a reasonable assumption for on farm storage.

Principle: “Carrying grain is not free” – The cost of carrying grain needs to be accounted for if holding grain and selling it after harvest is part of the selling strategy.

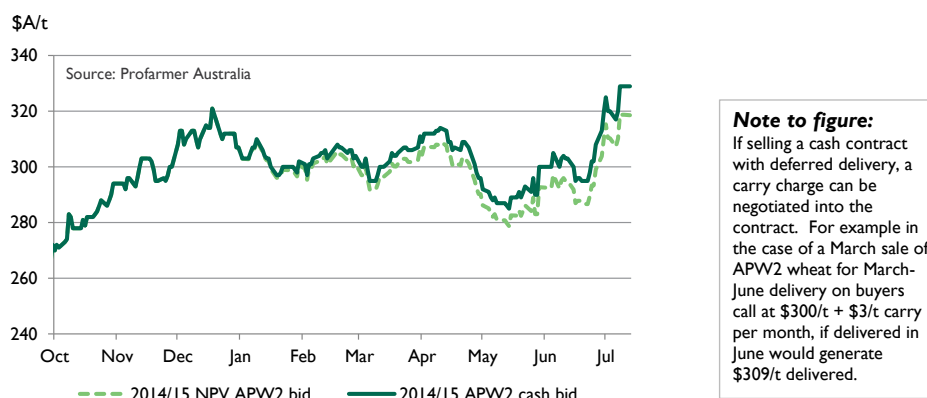


Figure 15: Kwinana APW2 cash vs NPV.

15.1.5 Ensuring market access revised

Optimising farm gate returns involves planning the appropriate storage strategy for each commodity to improve market access and cover carry costs in pricing decisions.

15.1.6 Executing tonnes into cash

This section provides guidelines for converting the selling and storage strategy into cash by effective execution of sales.

Set-up the tool box

Selling opportunities can be captured when they arise by assembling the necessary tools in advance. The toolbox includes:

1. Timely information

This is critical for awareness of selling opportunities and includes:

- market information provided by independent parties
- effective price discovery including indicative bids, firm bids, and trade prices
- other market information pertinent to the particular commodity

2. Professional services

Grain selling professional service offerings and cost structures vary considerably. An effective grain selling professional will put their clients' best interest first by not having conflicts of interest and investing time in the relationship. Return on investment for the farm business through improved farm gate prices is obtained by accessing timely information, greater market knowledge and greater market access from the professional service.

3. Futures account and bank swap facility

These accounts provide access to global futures markets. Hedging futures markets is not for everyone however strategies which utilise exchanges such as CBOT can add significant value.

References:

The link below provides current financial members of Grain Trade Australia including buyers, independent information providers, brokers, agents, and banks providing over-the-counter grain derivative products (swaps).

<http://www.graintrade.org.au/membership>

The link below provides a list of commodity futures brokers.

<http://www.asx.com.au/prices/find-a-futures-broker.htm>

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 a level of risk management:

- Price - Future price is largely unpredictable hence devising a selling plan to put current prices into the context of the farm business is critical to manage price risk.
- Quantity and quality - When entering a cash contract you are committing to delivery of the nominated amount of grain at the quality specified. Hence production and quality risk must be managed.
- Delivery terms - Timing of title transfer from the grower to the buyer is agreed at time of contracting. If this requires delivery direct to end users it relies on prudent execution management to ensure delivery within the contracted period.
- Payment terms - In Australia the traditional method of contracting requires title of grain to be transferred ahead of payment; hence counterparty risk must be managed.

GTA Contract No.3
CONTRACT CONFIRMATION
GTA Trade Rules and Dispute Resolution Rules apply to this contract

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 only)
Packaging:	Weights: (Origin - Destination)
Price:	Excl/Incl Free GST
Price Basis:	
Delivery/Shipment Period:	(Delivered, Shipped, Free In Store, Free On Board, Ex-Farm, etc.)
Delivery Point and Conveyance:	
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 Charges: Any industry, statutory or government levies which are not included in the price will be assessed 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 Breeder's Rights and/or EPR liabilities and/or registered or unregistered Security Interest? <input type="radio"/> NO <input type="radio"/> YES (Please <input type="checkbox"/> 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 declaration.
☐ 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: <small>PRINT NAME</small>	Seller's Name: <small>PRINT NAME</small>
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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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.

Figure 16: Typical cash contracting.

The price point within a cash contract will depend on where the transfer of grain title will occur along the supply chain. The below image depicts the terminology used to describe pricing points along the grain supply chain and the associated costs to come out of each price before growers receive their net farm gate return.

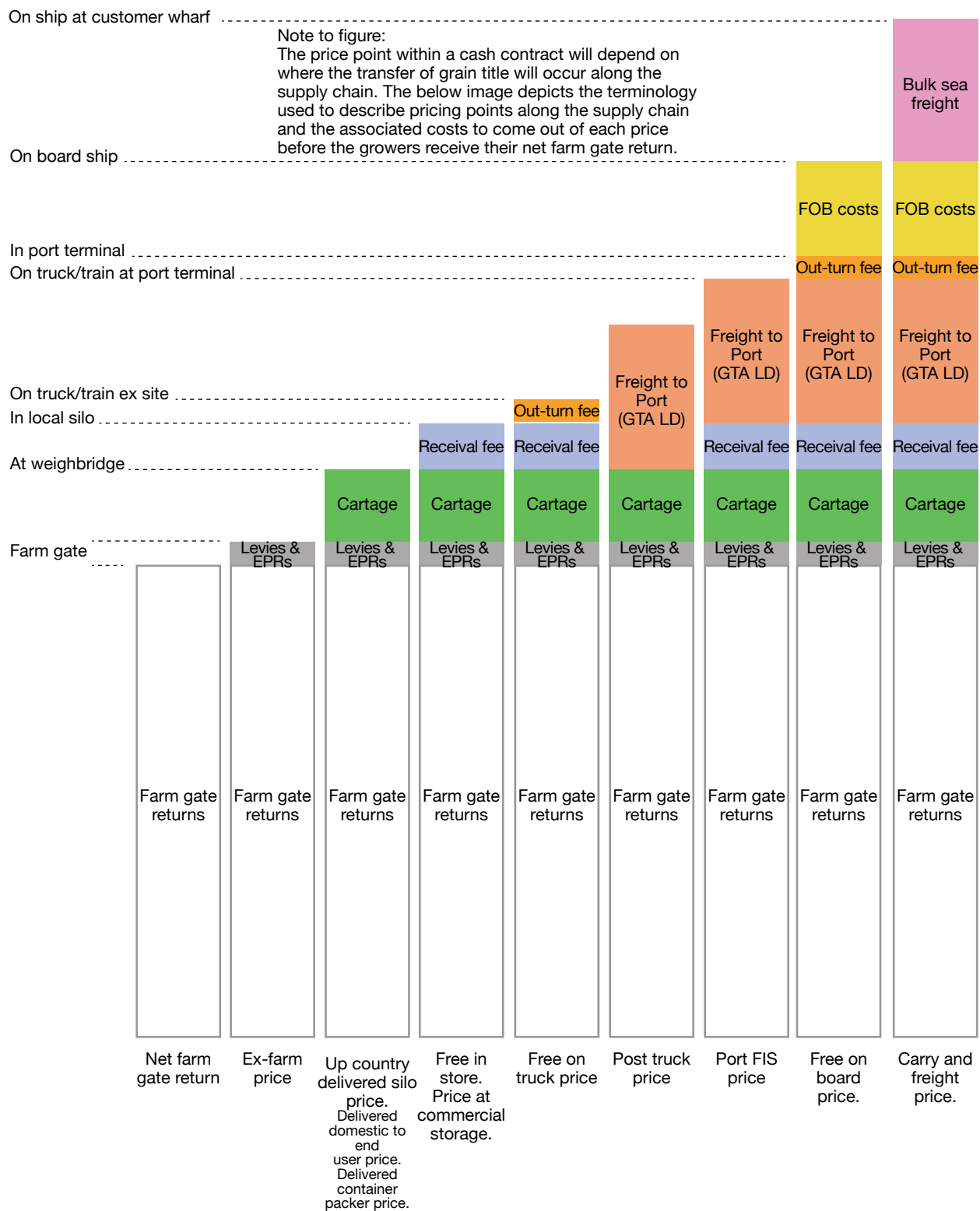


Figure 17: Cost and pricing points throughout the supply chains.

More information

http://www.australiangrainexport.com.au/docs/Grain_Contracts_Guide.pdf

<http://www.graintrade.org.au/contracts>

http://www.graintrade.org.au/commodity_standards

<http://www.graintransact.com.au>

<http://www.grainflow.com.au>

<http://emeraldgrain.com/grower-logins/>

<https://www.cleargrain.com.au/terms-and-conditions>

<https://www.cleargrain.com.au/get-started>

More information

[GTA managing counterparty risk 14/7/2014](#)

[Clear Grain Exchange title transfer model](#)

[GrainGrowers Guide to Managing Contract Risk](#)

[Counterparty risk: A producer perspective, Leo Delahunty](#)

Cash sales generally occur through three methods:

- Negotiation via personal contact - Traditionally prices are posted as a “public indicative bid”. The bid is then accepted or negotiated by a grower with the merchant or via an intermediary. This method is the most common and available for all commodities.
- Accepting a “public firm bid” - Cash prices in the form of public firm bids are posted during harvest and for warehoused grain by merchants on a site basis. Growers can sell their parcel of grain immediately by accepting the price on offer via an online facility and then transfer the grain online to the buyer. The availability of this depends on location and commodity.
- Placing an “anonymous firm offer” - Growers can place a firm offer price on a parcel of grain anonymously and expose it to the entire market of buyers who then bid on it anonymously using the Clear Grain Exchange, which is an independent online exchange. If the firm offer and firm bid match, the parcel transacts via a secure settlement facility where title of grain does not transfer from the grower until funds are received from the buyer. The availability of this depends on location and commodity. Anonymous firm offers can also be placed to buyers by an intermediary acting on behalf of the grower. If the grain sells, the buyer and seller are disclosed to each counterparty.

Counterparty risk

Most sales involve transferring title of 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” – There is not much point selling for an extra \$5/t if you don’t get paid.

Counterparty risk management includes:

- Dealing only with known and trusted counterparties.
- Conduct a credit check (banks will do this) before dealing with a buyer they are unsure of.
- Only sell a small amount of grain to unknown counterparties.
- Consider credit insurance or letter of credit from the buyer.
- Never deliver a second load of grain if payment has not been received for the first.
- Do not part with title of grain before payment or request a cash deposit of part of the value ahead of delivery. Payment terms are negotiable at time of contracting, alternatively the Clear Grain Exchange provides secure settlement where-by the grower maintains title of grain until payment is received by the buyer, and then title and payment are settled simultaneously.

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

Relative values

Grain sales revenue is optimised when selling decisions are made in the context of the whole farming business. The aim is to sell each commodity when it is priced well and hold commodities that are not well priced at any given time. That is, give preference to the commodities of the highest relative value. This achieves price protection for the overall farm business revenue and enables more flexibility to a grower’s selling program whilst achieving the business goals of reducing overall risk.

Principle: “Sell valued commodities; not undervalued commodities” – If one commodity is priced strongly relative to another, focus sales there. Don’t sell the cheaper commodity for a discount.

An example based on wheat and barley production system is provided below (Figure 18).

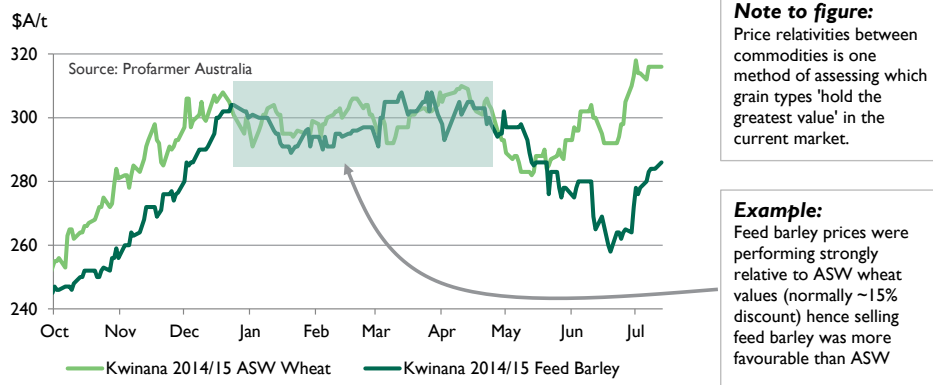


Figure 18: Kwinana ASW wheat vs feed barley.

If the decision has been made to sell wheat, CBOT wheat may be the better alternative if the futures market is showing better value than the cash market.

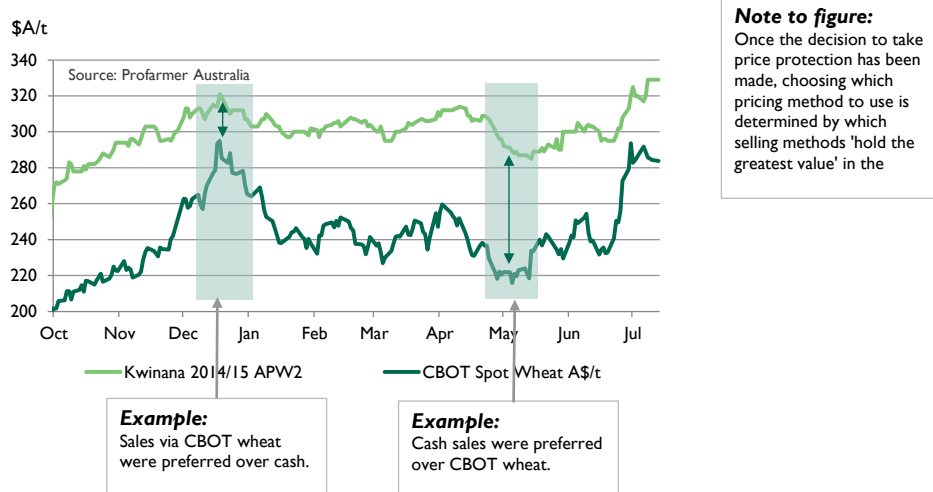


Figure 19: Kwinana APW2 vs CBOT wheat A\$/t.

Contract allocation

Contract allocation means choosing which contracts to allocate your grain against come delivery time. Different contracts will have different characteristics (price, premiums-discounts, oil bonuses, etc.), and optimising your allocation reflects immediately on your bottom line.

Principle: "Don't leave money on the table" - Contract allocation decisions don't take long, and can be worth thousands of dollars to your bottom line.

To achieve the best average wheat price growers should:

- Allocate your lower grades of wheat to contracts with the lowest discounts.
- Allocate higher grades of wheat to contracts with the highest premiums.

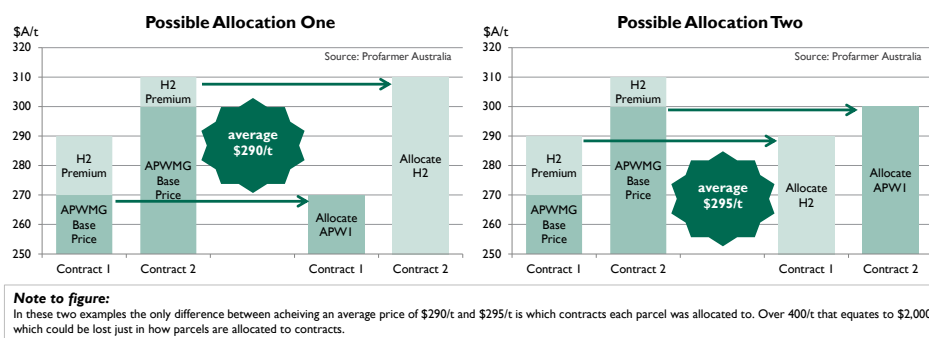


Figure 20: Possible allocation.

Read market signals

The appetite of buyers to buy 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 that interested in buying the commodity.

Principle: “Sell when there is buyer appetite” – When buyers are chasing grain, growers have more market power to demand a price when selling.

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 buyer appetite is strong. However if there is one buyer \$5/t above the next best bid, it may mean cash prices are susceptible to falling \$5/t if that buyer satisfies their buying 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.

15.1.7 Sales execution revised

The selling strategy is converted to maximum business revenue by:

- ensuring timely access to information, advice and trading facilities
- using different cash market mechanisms when appropriate
- minimising counterparty risk by effective due diligence
- understanding relative value and selling commodities when they are priced well
- thoughtful contract allocation
- reading market signals to extract value from the market or prevent selling at a discount

15.2 Western oats – market dynamics and execution

15.2.1 Price determinants for WA oats

The global oat crop is estimated at 20-23Mt each year and Australia is an important player; typically producing 1-1.5Mt annually. Australia exports about 20% of its production each season while the bulk of the crop is consumed domestically. The large majority of exported oats is used for human consumption.

WA is Australia's largest oat production state accounting for about 1/3 of the crop each season.

Given this dynamic WA farm gate prices are heavily influenced by both local and global factors. Importantly they are also influenced heavily by the supply and demand of other local feed grains such as wheat and barley. While the commodities are not necessarily

substitutable the price relativity is important in order to ensure consumer supply requirements are met each season.

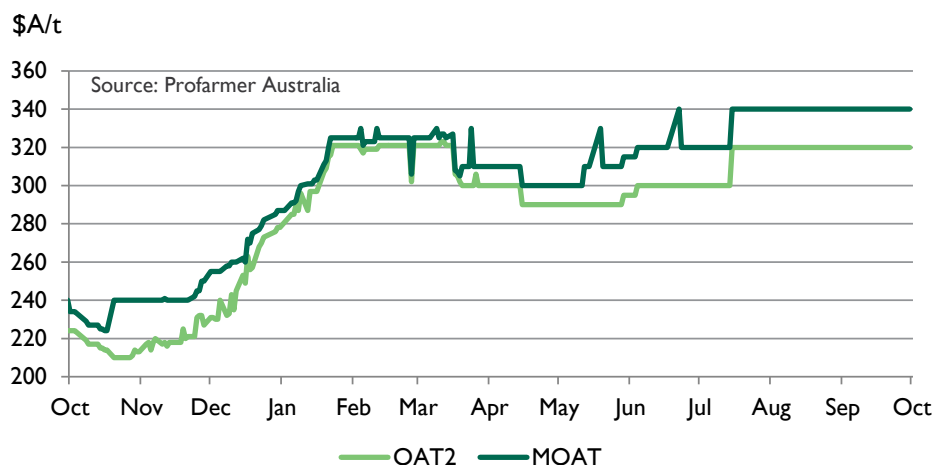


Figure 21: Kwinana MOAT vs OAT2.

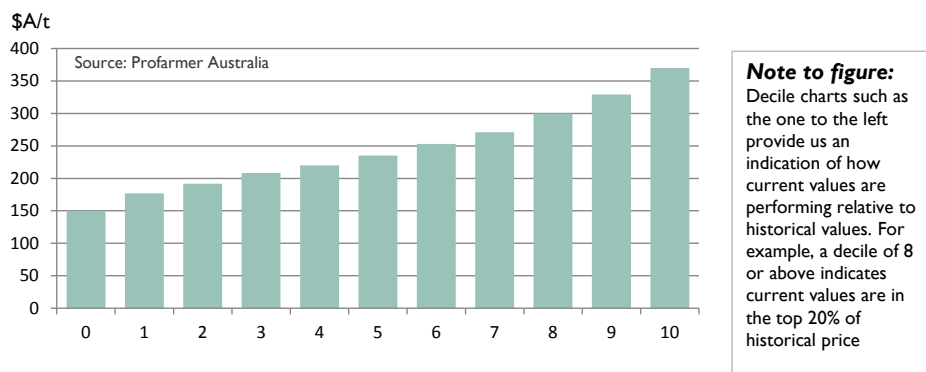


Figure 22: Kwinana MOAT decile.

15.2.2 Ensuring market access for WA oats

Domestic consumers in WA demand a majority proportion of the oat crop. Growers who are well positioned to service these markets will likely return premiums to the bulk export market. Private commercial or on-farm storage can be a more effective method of accessing the domestic consumer market.

This is particularly prudent for off-spec oats that don't meet the milling requirements. Downgraded oats will typically be consumed by the domestic feed market, hence private commercial or on-farm storage may make it easier to access.

The bulk handling system does, however, offer a reasonable alternative for accessing the export market, which is predominately for human consumption milling quality oats. The bulk of this is exported in containers and the bulk handling system can provide efficiencies to access this market.

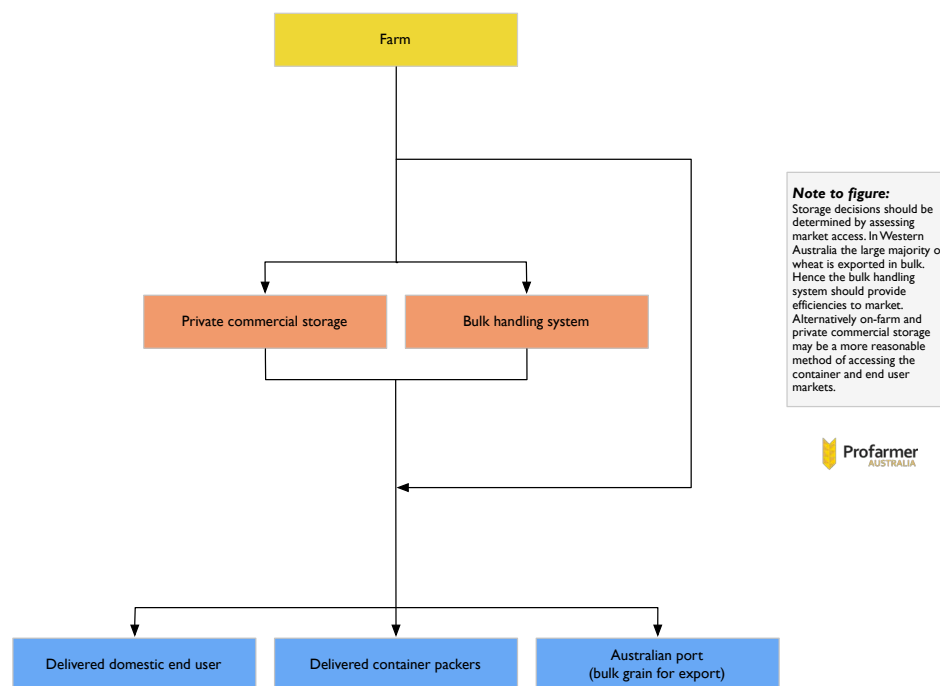


Figure 23: Australian supply chain flow.

15.2.3 Executing tonnes into cash for WA oats

Knowing where the Western Australian oat crop is likely to end-up will help refine a grower's selling and logistics decisions. Understanding whether your grain will be used for milling or feed purposes will help determine the best path to market.

For milling quality oats it is of the upmost importance to maintain grain quality given the discounts in place if the grain fails to meet milling grade standards. Milling oats are often contracted prior to production with consumers looking to lock in supply, or alternatively sold into the cash market post-harvest. Given consumers have rigid supply requirements each season, forward selling a portion of your crop may offer a premium. It is always important, however, to manage prospective sales prior to harvesting the crop against your production risk.

Comparatively, feed oats are more heavily influenced by domestic factors including the relative price of other feed grains and local feed grain supply and demand fundamentals.

Given the lack of active participants in the oat market in Western Australia, monitoring liquidity using the Grow Note to Bank Note principles minimises the risk of being exposed to sudden price drops.

15.2.4 Risk management tools available for WA oats

An Australian cash price is made up of three components - futures, foreign exchange, and basis. Each component impacts on price – a higher futures and basis and a lower exchange rate will create a higher Australian grain price.

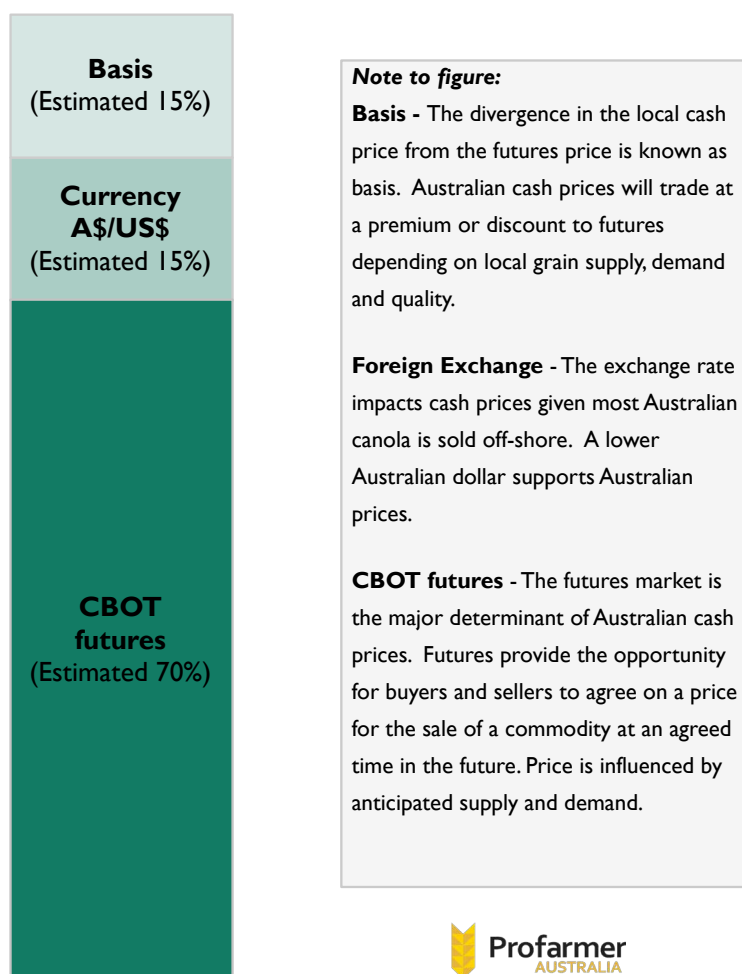


Figure 24: Pricing components.

Table 2: Products available to manage WA oats prices; the major difference in products is the ability to manage the individual components of price.

	Description	Advantages	Disadvantages
Spot cash contracts	Futures, foreign exchange, basis all locked at time of contracting	Simple to use. Locks in all components of price. Cash is received almost immediately (within payment terms).	Immediate grain delivery required. Sales after harvest require storage which incur costs. Locks away three pricing components at the same time. Risk of counterparty default between transfer and payment.
Forward cash contracts	Futures, foreign exchange, basis all locked at time of contracting	Simple to use. Locks in all components of price (no uncovered price risk). No storage costs. Cash income is a known ahead of harvest	Often inflexible and difficult to exit. Locks away the three pricing components at the same time. Future delivery is required resulting in production risk. Counterparty default risk must be managed.
Futures contracts	Futures, foreign exchange, basis are able to be managed individually	Liquid markets enable easy entry and exit from the marketplace. Locks in only some components of price, hence more flexible than cash contracts. Price determined by the market, and is completely transparent. No counterparty risk due to daily clearing of the contracts.	Requires constant management and monitoring. Margin calls occur with market movements creating cash-flow implications. Grain is required to offset the futures position, hence production risk exists. Cash prices may not move inline with futures, hence some price risk. You still have to sell the underlying physical grain.
Over-the-counter bank swaps on futures contracts	Futures, foreign exchange, basis are able to be managed individually	Based off an underlying futures market so reasonable price transparency. Liquid markets enable easy entry and exit from the marketplace. Locks in only some components of price, hence more flexible than cash contracts. Counter party risk is with the bank, hence it is low. The bank will manage some of the complexity on behalf of the grower, including day to day margin calls.	Costs vary between \$5-10/t at the providers discretion. Requires constant management and monitoring. Grain is required to offset the futures position, hence production risk exists. Cash prices may not move inline with futures, hence some price risk. You still have to sell the underlying physical grain.
Options on futures contracts	Futures, foreign exchange, basis are able to be managed individually	No counterparty risk due to daily clearing of the contracts. No margin calls. Protects against negative price moves but can provide some exposure to positive moves if they eventuate. Liquid markets enable easy entry and exit from the marketplace. Price risk can be reduced without increasing production risk. Price determined by the market, and is completely transparent.	Options can be costly and require payment upfront. The value of options erode overtime as expiry approaches - depreciating asset. Perceived to be complicated by growers. Move in option value may not completely offset move in cash markets. You still have to sell the underlying physical grain.

More information

For more information and worked examples on how each pricing component affects wheat grain price refer to the GRDC publication Grain Market Lingo – what does it all mean?

www.grdc.com.au/GrainMarketLingo