



SOUTHERN

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GRDC™ GROWNOTES™



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GRAINS RESEARCH
& DEVELOPMENT
CORPORATION

WHEAT

SECTION 15

MARKETING

SELLING PRINCIPLES | SOUTHERN WHEAT – MARKET DYNAMICS AND
EXECUTION

SECTION 15

Marketing

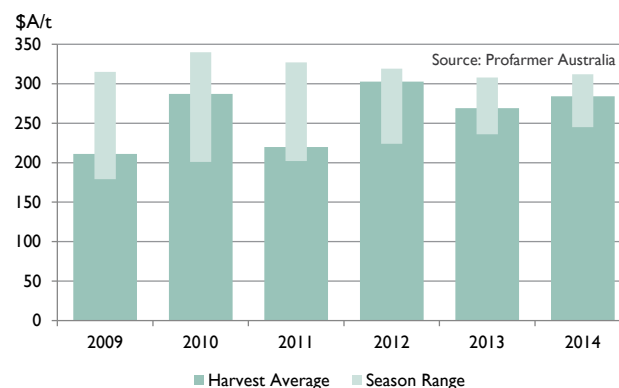
The final step in generating farm income is converting the tonnes of grain produced per hectare into dollars at the farm gate. This section provides best in-class marketing guidelines for managing price variability to protect income and cash flow.

15.1 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 factors that are difficult to quantify in order to establish the target price and then working towards achieving that target price.

These factors 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 (Figure 1).

The skills that growers have developed to manage variability and costs can be used to manage and overcome price uncertainty.



Note to figure:
Pt Adelaide APW1 wheat prices have varied A\$60-\$140/t over the past 6 years (25-65% variability). For a property producing 2,000 tonne of wheat this means \$120,000-\$280,000 difference in income depending on price management skill.

Figure 1: Annual price variation (season average and range) for Port Adelaide Australian Premium White 1 (APW1) wheat.

15.1.1 Be prepared

Being prepared and having a selling plan are essential for managing uncertainty. The steps involved are forming a selling strategy, and having 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 depends more on external market factors including:

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

The key selling principles when considering sales during the growing season are described in Figure 2.



Figure 2: Grower commodity selling-principles timeline.

15.1.2 Establishing 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 of a cropping enterprise, and how the risks may be quantified during the production cycle, are described in Figure 3.

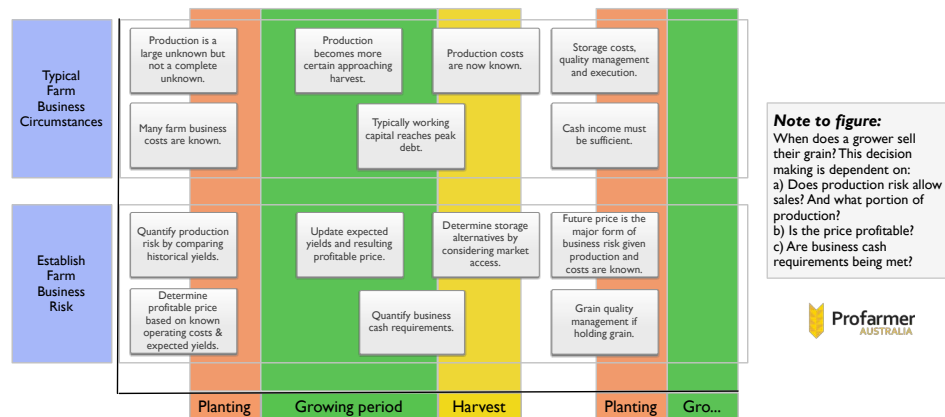


Figure 3: Typical farm business circumstances and risk.

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.' Do not increase business risk by over-committing production.

Establish a production risk profile (Figure 4) by:

- collating historical average yields for each crop type and a below-average and above-average range
- assessing the likelihood of achieving average based on recent seasonal conditions and seasonal outlook
- revising production outlooks as the season progresses

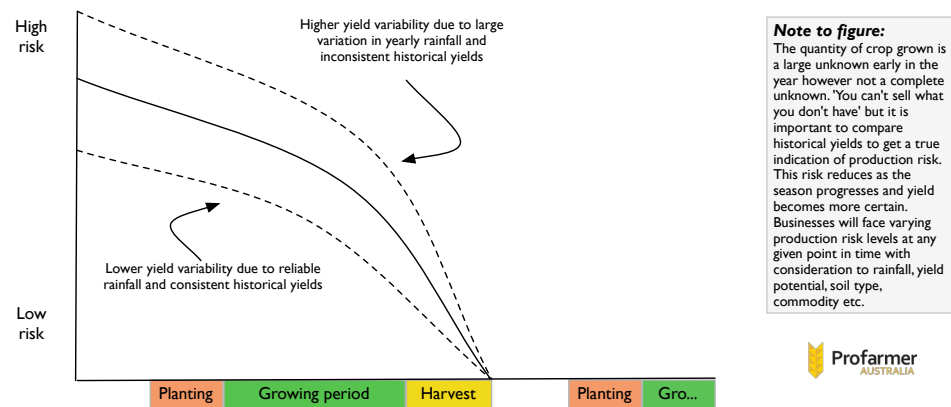


Figure 4: Typical production risk profile of a farm operation.

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 that the price is profitable.

Steps to calculate an estimated profitable price based on total cost of production and a range of yield scenarios are provided in Figure 5.

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	\$724,000
Per Tonne Equivalent (Total costs + Estimated production)	\$212 /t
Per tonne costs	
Levies	\$3 /t
Cartage	\$12 /t
Freight to Port	\$22 /t
Total per tonne costs	\$37 /t
Cost of production Port track equiv	\$248.70
Target profit (ie 20%)	\$50.00
Target price (port equiv)	\$298.70

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 Krause "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 5: Steps to calculate an estimated profitable price for wheat.

The GRDC manual '[Farming the business](#)' also provides a cost-of-production template and tips on skills required for grain selling, as opposed to grain marketing.¹

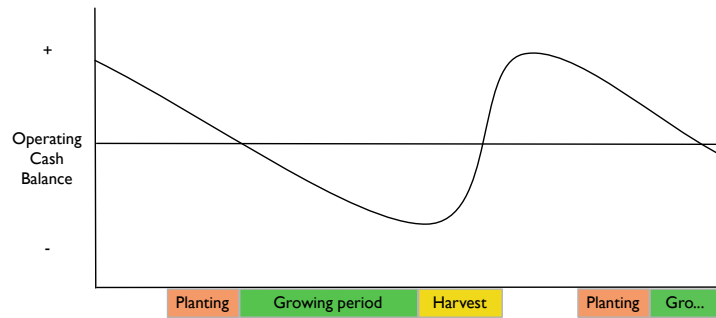
Income requirements

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 in Figure 6. 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. Figure 7 demonstrates how managing sales can change the farm's cash balance.

¹ M Krause (2014) Farming the business. Sowing for your future. GRDC, <http://www.grdc.com.au/FarmingTheBusiness>

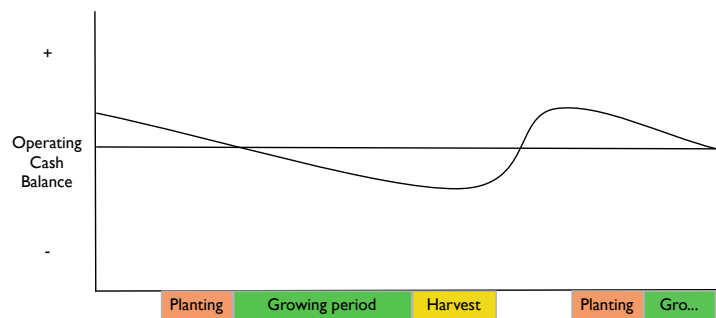


Note to figure:
The chart illustrates the operating cash flow of a typical farm assuming a heavy reliance on cash sales at harvest. Costs are incurred during the season to grow the crop, resulting in peak operating debt levels at or near harvest. Hence at harvest there is often a cash injection required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



In this scenario peak cash surplus starts higher and peak cash debt is lower

Figure 6: Typical farm operating cash balance, assuming harvest cash sales.



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.



In this scenario peak cash surplus starts lower and peak cash debt is higher

Figure 7: Typical farm operating cash balance, with cash sales spread throughout the year.

Summary

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

This is the second part of the selling strategy.

Methods of price management

The pricing methods for products provide varying levels of price-risk coverage (Table 1).

Table 1: Pricing methods and their use for various crops

Description	Wheat	Barley	Canola	Oats	Lupins	Field peas	Chick peas
Fixed price products	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash	Cash	Cash	Cash
Floor price products	Options on futures, floor price pools	Options on futures	Options on futures	none	none	none	none
Floating price products	Pools	Pools	Pools	Pools	Pools	Pools	Pools

Figure 8 provides a summary of when different methods of price management are suited for the majority of farm businesses.

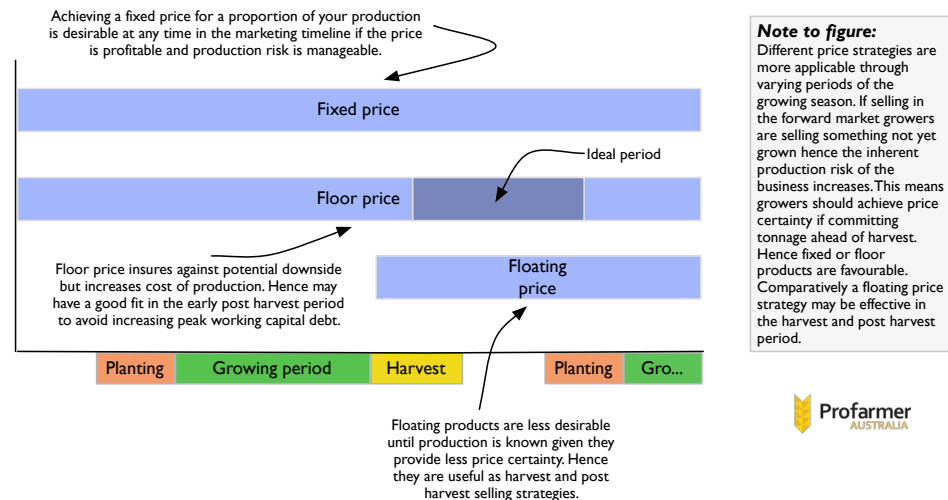


Figure 8: Price strategy timeline through the growing season.

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) (Figure 9). It provides some certainty around expected revenue from a sale because 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.

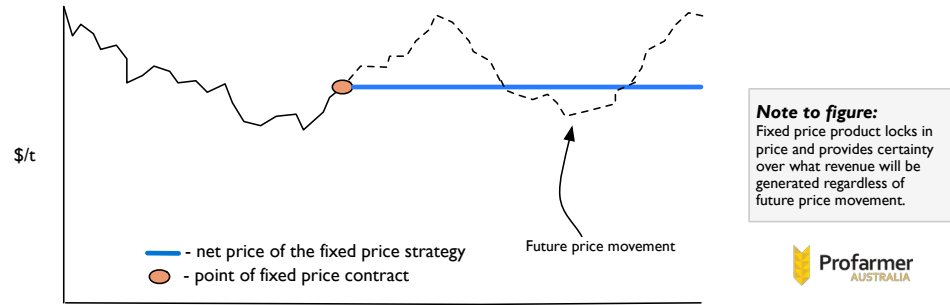


Figure 9: Fixed-price strategy.

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 while capturing any upside (Figure 10). The disadvantage is that the price ‘insurance’ has a cost, which adds to the farm business cost of production.

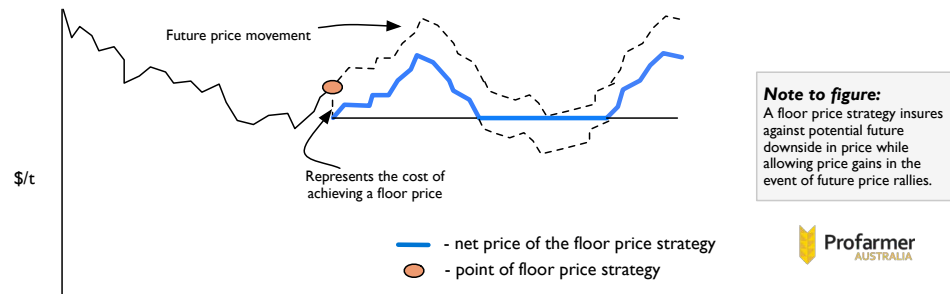


Figure 10: Floor-price strategy.

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 (Figure 11). Floating-price products provide the least price certainty and are best suited for use at or after harvest rather than pre-harvest.

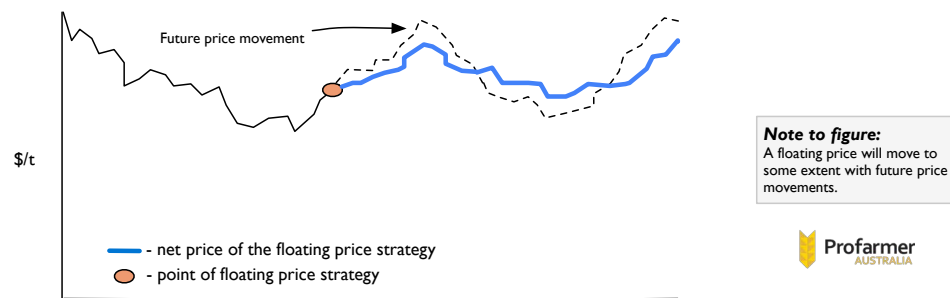


Figure 11: Floating-price strategy.

Summary

Fixed-price strategies include physical cash sales or futures products and provide the most price certainty; however, 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; however, they cost more.

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

15.1.4 Ensuring access to markets

Once the selling strategy is organised, the storage and delivery of commodities must be planned 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 12).

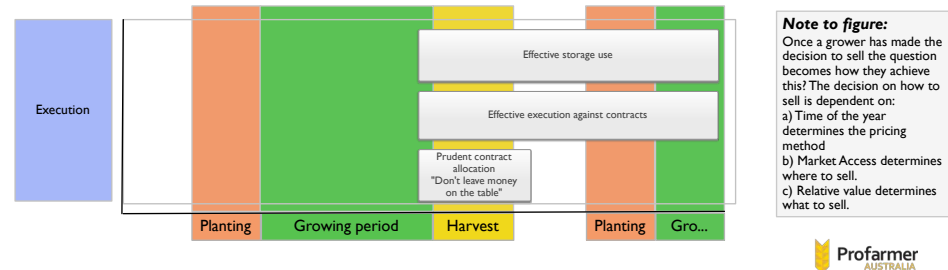


Figure 12: Effective storage decisions.

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 (Figure 13).

Principle: 'Harvest is the first priority.' Getting the crop into 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. feedlot, 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 that the grower may have to suffer the cost of taking the load elsewhere, while 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 that 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.

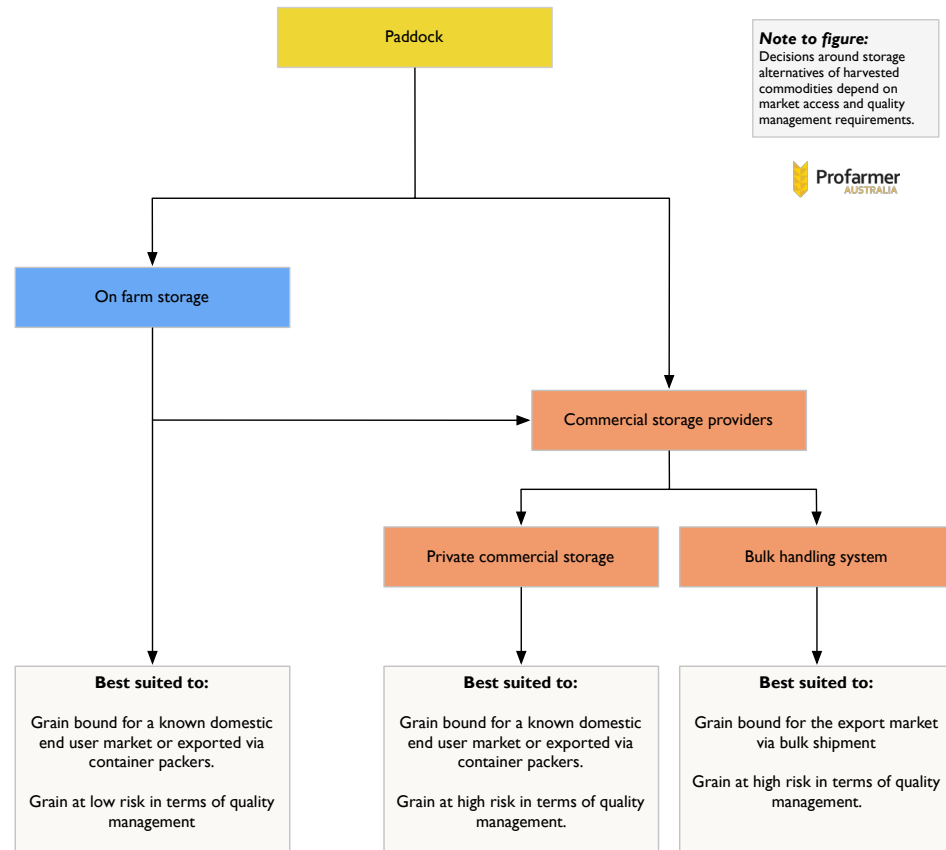


Figure 13: Grain storage decision-making.

For more information about on-farm storage alternatives and economics, refer to [GrowNotes Wheat Southern Region. Section 13. Grain storage.](#)

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 per month are typically \$3–4/t, consisting of:

- monthly storage fee charged by a commercial provider (typically ~\$1.50–2.00/t); and
- monthly interest associated with having wealth tied up in grain rather than cash or against debt (~\$1.50–2.00/t, 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 was offered at harvest. The cost of carry applies to storing grain on-farm because there is a cost of capital invested in the farm storage plus the interest component. A reasonable assumption is \$3–4/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 grain and selling it after harvest is part of the selling strategy (Figure 14).

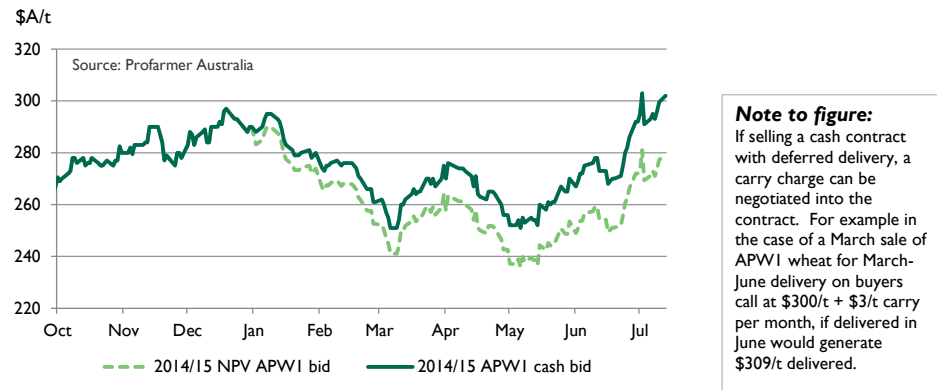


Figure 14: Port Adelaide Australian Premium White 1 (APW1) wheat cash v. net present value (NPV).

Summary

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

15.1.5 Executing tonnes into cash

Below are 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; and 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 interests first by not having conflicts of interest and by 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 that utilise exchanges such as CBOT (Chicago Board of Trade) can add significant value.

For current financial members of Grain Trade Australia, including buyers, independent information providers, brokers, agents, and banks providing over-the-counter grain derivative products (swaps), go to: <http://www.graintrade.org.au/membership>.

For a list of commodity futures brokers, go to: <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 (Figure 15):

- **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. Therefore, 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
Contract No: _____
Name: _____
Company: _____
Address: _____
Buyer ABN: _____
NGR No: _____

SELLER
Contract No: _____
Name: _____
Company: _____
Address: _____
Seller ABN: _____
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: _____ (Refer to the relevant Rules and Regulations for details)

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 shall be recorded 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? 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 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: _____ PRINT NAME
Buyer's Signature: _____
Date: _____

Seller's Name: _____ PRINT NAME
Seller's Signature: _____
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 15: Typical cash contracting as per Grain Trade Australia standards.

The price point within a cash contract will depend on where the transfer of grain title will occur along the supply chain. Figure 16 shows 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.

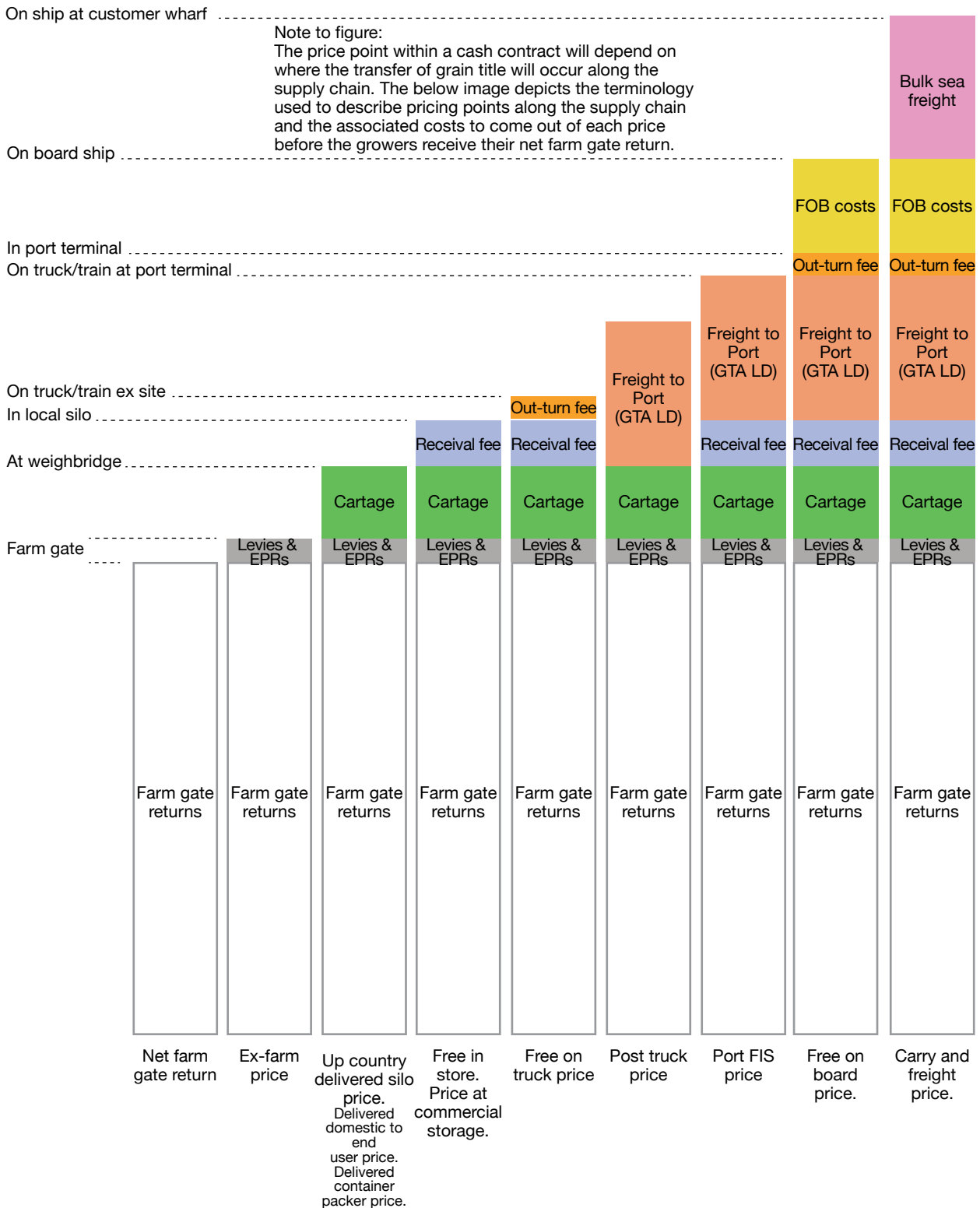


Figure 16: Costs and pricing points throughout the supply chain.

More information

[GTA Guide to taking out contracts](#)

[GTA Contracts and vendor declarations](#)

[GTA Trading standards](#)

[GrainTransact Resource Centre](#)

[GrainFlow Network](#)

[Emerald Grain customer and grower logins](#)

[Clear Grain Exchange terms and conditions](#)

[Clear Grain Exchange—getting started](#)

Cash sales generally occur through three methods:

1. **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 is available for all commodities.
2. **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 transferring the grain online to the buyer. The availability of this depends on location and commodity.
3. **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.' Selling for an extra \$5/t is not a good deal if you do not get payment.

Counterparty risk management includes the following principles:

- Deal only with known and trusted counterparties.
- Conduct a credit check (banks will do this) before dealing with a buyer you are unsure of.
- Sell only 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 whereby the grower maintains title of grain until payment is received from the buyer, and then title and payment are settled simultaneously.

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

More information

[GTA Grain contracts—managing counterparty risk](#)

[Clear Grain Exchange title transfer model](#)

[GrainGrowers Guide to managing contract risk](#)

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

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 while 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. Do not sell the cheaper commodity for a discount.

An example based on a wheat and barley production system is provided in Figure 17.

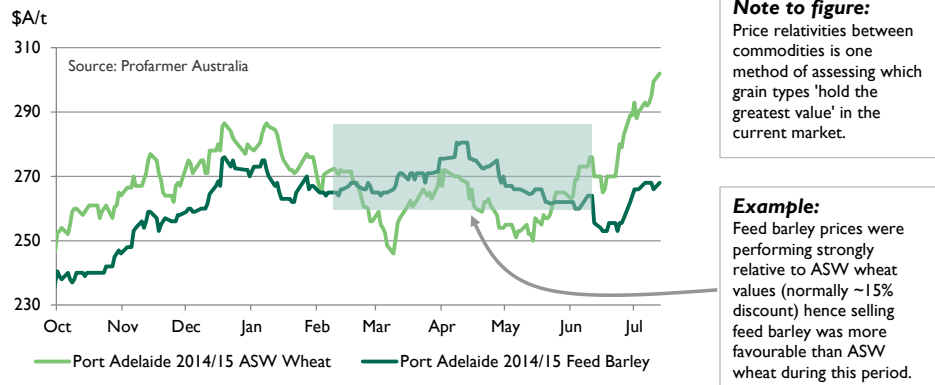


Figure 17: Port Adelaide Australian Standard White (ASW) wheat v. feed barley (AU\$/t).

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 18).

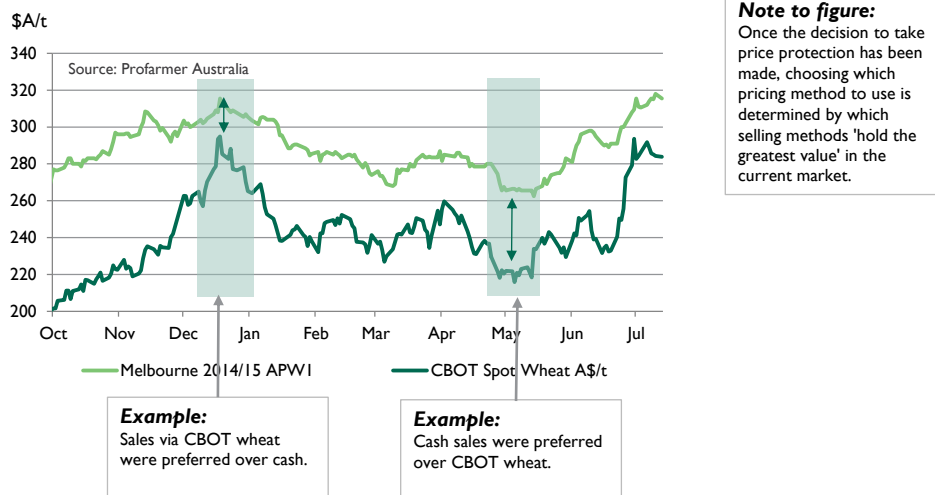


Figure 18: 2014–15 Melbourne Australian Premium White 1 (APW1) wheat v. Chicago Board of Trade (CBOT) wheat (AU\$/t).

Contract allocation

Contract allocation means choosing which contracts to allocate your grain against at delivery time. Different contracts will have different characteristics (price, premiums–discounts, oil bonuses, etc.), and optimising your allocation reflects immediately on your bottom line (Figure 19).

Principle: ‘Don’t leave money on the table.’ Contract allocation decisions do not take long, and can be worth thousands of dollars to your bottom line.

To achieve the best average wheat price, growers should allocate:

- lower grades of wheat to contracts with the lowest discounts; and
- higher grades of wheat to contracts with the highest premiums.

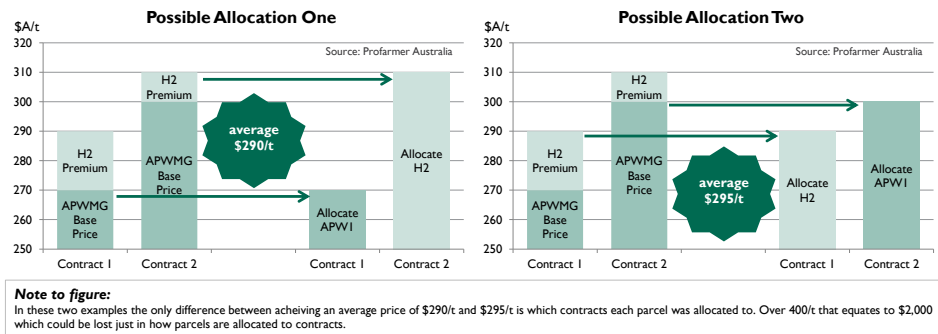


Figure 19: Examples of contract allocation of grain.

Read market signals

The appetite of buyers to purchase 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 should stand aside from the market when buyers are not as 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:

1. 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 at \$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.
2. 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.

Summary

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 to prevent selling at a discount

15.2 Southern wheat—market dynamics and execution

15.2.1 Price determinants for southern wheat

Australia is a relatively small player in terms of world grain production, with ~3.5% of global wheat production. However, in terms of world trade, Australia is a major player, exporting ~60–75% of the national wheat crop, which accounts for ~15% of global wheat trade.

Given this dynamic, Australian farm-gate prices are heavily influenced by global price volatility. This makes offshore markets such as CBOT useful indicators of where Australian wheat prices will trade.

In South Australia, ~85% of annual production is exported; however, in Victoria the domestic market (including containers) consumes 80–100% of the state’s average annual wheat crop (3.0 Mt). As a result, wheat prices in Victoria and southern New South Wales can trade at large premiums to global values in the event of below-average production given there can be little exportable surplus (Figure 20). Typically, Victoria relies on ‘importing’ up to 1.0 Mt annually from southern NSW.

When southern Australia has a large crop, local wheat values should largely correlate to global prices. Hence, the timing of harvest in major exporting and importing countries is a considerable influence on wheat prices in South Australia, Victoria and southern New South Wales. Figure 21 highlights some of the seasonal factors influencing global wheat prices throughout each year.

Prices can be compared with historic values by consulting decile charts (Figure 22).

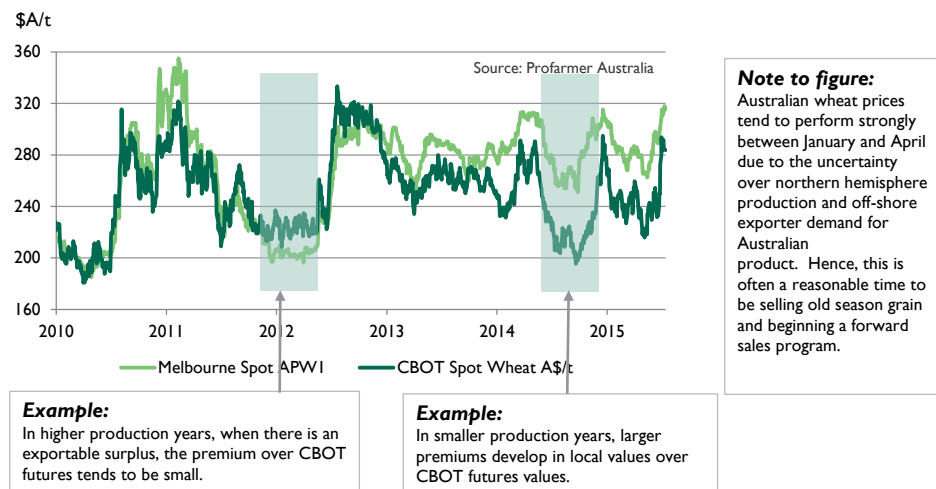


Figure 20: 2010–15 Melbourne Australian Premium White 1 (APW1) wheat v. Chicago Board of Trade (CBOT) wheat (AU\$/t).

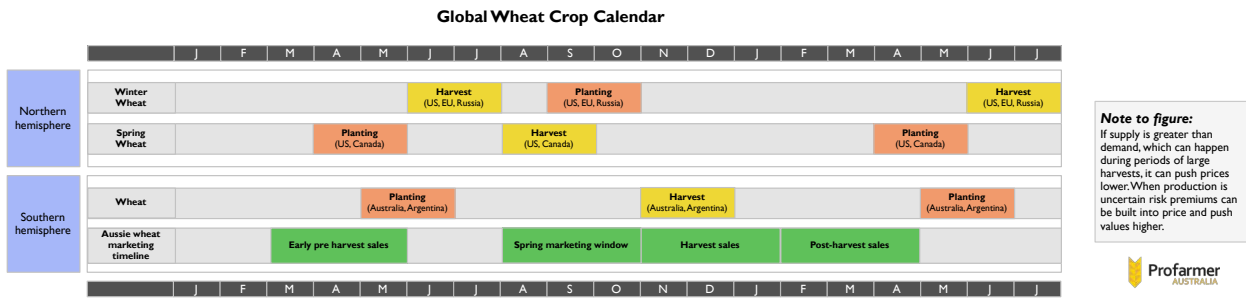


Figure 21: 2010–15 Melbourne Australian Premium White 1 (APW1) wheat v. Chicago Board of Trade (CBOT) wheat (AU\$/t).

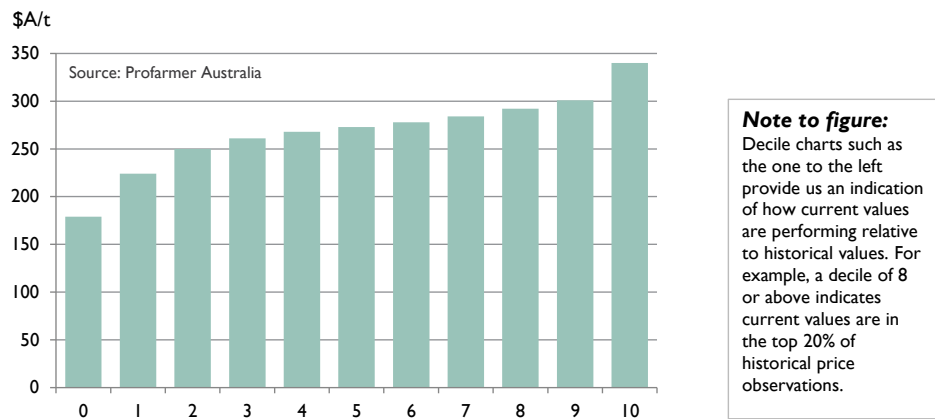


Figure 22: Decile chart illustrating the price distribution for Port Adelaide Australian Premium White 1 (APW1) wheat.

15.2.2 Ensuring market access for southern wheat

For wheat grades likely to be exported in bulk for human consumption, a bulk handling system is often the most cost-effective pathway to get grain to offshore customers. The bulk storage provider should gain scale efficiencies when moving the bulk commodity grades such as APW1, ASW1, H₂, and H1 in seasons when there is a considerable surplus.

South-eastern Australia also has a prominent domestic wheat market that can generate premiums to the bulk export markets and provide a return to on-farm storage for growers well positioned to service this demand. As a result, private commercial and on-farm storage should play a significant role in the storage decisions of Victorian and southern New South Wales wheat growers to access domestic end-user and container markets.

The level of wheat exports in containers from Victoria is regularly >1.0 Mt (Figure 23). The container trade can provide price premiums for specific grades because a container can access niche offshore markets. At times, off-spec grades such as high-protein or high-screenings loads may provide better returns through this channel than through the centralised BHC (bulk handling company) channel where stricter commodity standards may apply.

Supply-chain flow options are illustrated in Figure 24.

	Victoria		South Australia		National Total	
	Implied tonnes	% of production	Implied tonnes	% of production	Implied tonnes	% of production
Bulk	1.9 Mt	52%	4.4 Mt	91%	16.72 Mt	65%
Container	1.5 Mt	41%	0.7 Mt	14%	2.28 Mt	9%
Domestic Use	1.1 Mt	31%	0.1 Mt	2%	6.67 Mt	25%

Source: Australian Crop Forecasters

Figure 23: Market destinations for wheat—southern Australian and national 5-year averages.

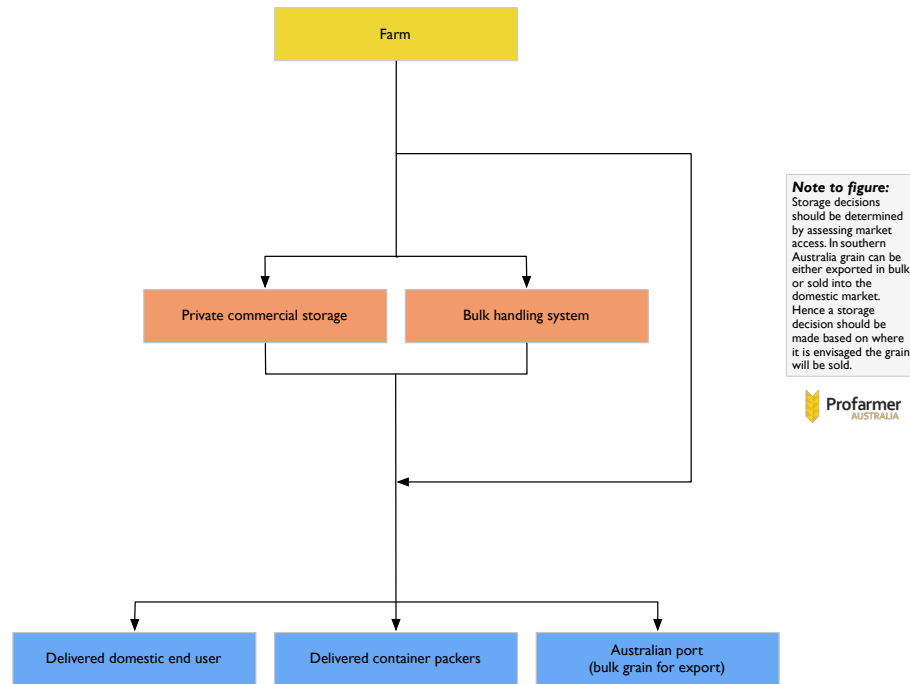


Figure 24: Australian supply-chain flow for wheat.

15.2.3 Executing tonnes into cash for southern wheat

Knowing where the wheat crop is likely to end up will help to refine a grower’s selling and logistics decisions. Broadly, there are two customer types:

- Customer type A. These customers require consistent supply of reliable quality at regular intervals regardless of the stage of the year.
- Customer type B. These customers buy opportunistically based on price and are able to manage the quality inconsistency associated with switching suppliers more regularly.

This buyer behaviour drives the supply chain to operate at two levels. First, a consistent monthly tonnage to suit the type A customer, and secondly a surge capacity to suit the type B customer. As a result, appetite to accumulate Australian wheat often peaks during and shortly after harvest as the surge demand kicks in to make the most of more abundant supply, as well as cost savings by shipping immediately post-harvest (Figure 25).

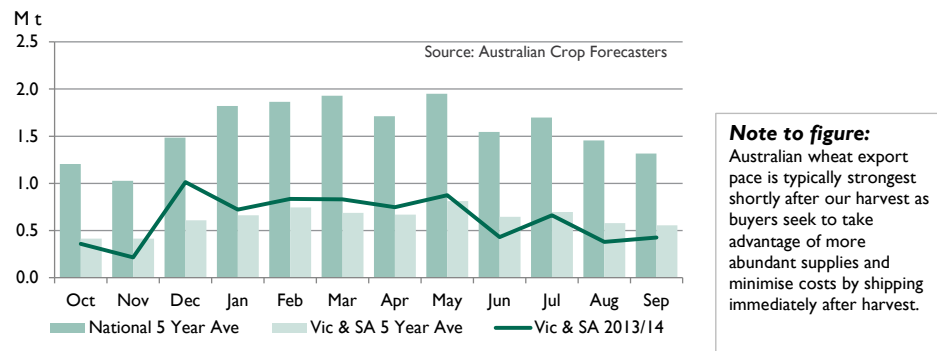


Figure 25: Monthly export pace of wheat.

What does this mean for a southern wheat grower? Demand is generally strongest for wheat during the harvest period, when type A and type B customers are both active in the market; hence, the number of buyers bidding for wheat increases. Because of the extra bid liquidity at harvest, most grower selling strategies should encompass some harvest sales.

The key to executing harvest sales effectively is to determine which grades to sell and which grades to hold. Some wheat grades, such as high-protein (H1, H₂), generally trade at stronger levels during harvest. This is because consumers of these grades require consistent quality, and often quantity, so they tend to accumulate their requirements pre-harvest and at harvest to ensure their supply while it is available. This appetite tends to push up the price premium for these grades over base APW1, making them a more attractive harvest sell. These grades are a higher risk to be holding for post-harvest sales, because once the buyers have their requirements covered, prices tend to move toward APW1 levels as buyers begin to drop out of the market (Figure 26).

Lower grades such as ASW1 and AGP1 tend to be more heavily discounted at harvest, with the grade-spread closing up after harvest as many feed users continue to buy on an as-needs basis. This makes such wheat grades a lower risk and more desirable to hold for post-harvest sales.

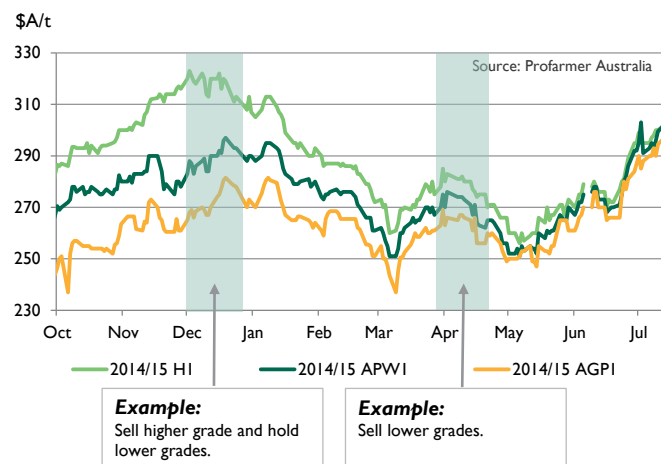


Figure 26: Monthly prices of Port Adelaide Australian Hard 1 (H1) v. Australian Premium White 1 (APW1) v. Australian General Purpose 1 (AGP1) (AU\$/t).

15.2.4 Risk-management tools available for southern wheat

An Australian cash price has three components: futures, foreign exchange, and basis (Figure 27). Each component affects price. A higher futures and basis and a lower exchange rate will create a higher Australian grain price.

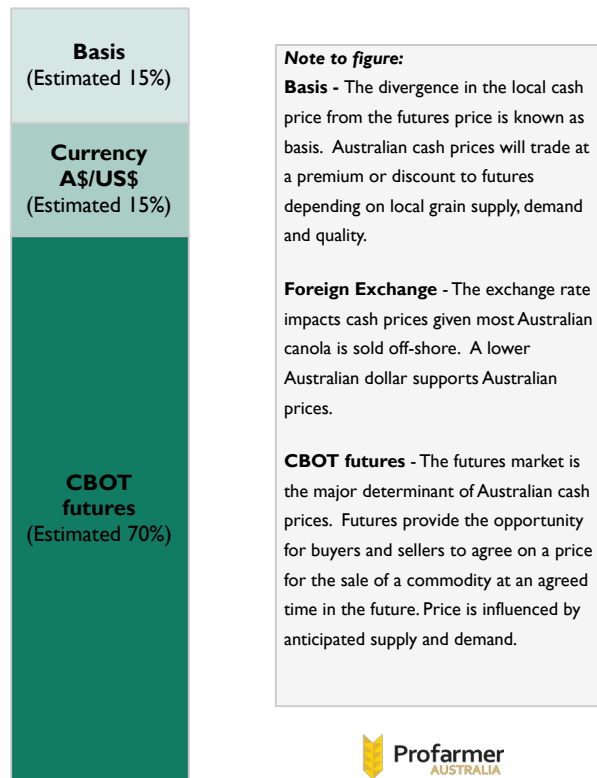


Figure 27: Components of pricing.

Table 2 outlines products available to manage southern Australian wheat prices; the major difference in products is the ability to manage the individual components of price.

Table 2: Advantages and disadvantages of the products available to manage wheat prices

	Description	Advantages	Disadvantages
Spot cash contracts	Futures, foreign exchange, basis all locked at time of contracting	<ul style="list-style-type: none"> Simple to use. Locks in all components of price. Cash is received almost immediately (within payment terms). 	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> Simple to use. Locks in all components of price (no uncovered price risk). No storage costs. Cash income is a known ahead of harvest 	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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. 	<ul style="list-style-type: none"> 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 in line 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	<ul style="list-style-type: none"> 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. 	<ul style="list-style-type: none"> 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 in line 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	<ul style="list-style-type: none"> 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. 	<ul style="list-style-type: none"> 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.

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?](#)