



NORTHERN

SEPTEMBER 2018

GRDC™ **GROWNOTES™**



GRDC™

GRAINS RESEARCH
& DEVELOPMENT
CORPORATION

CANOLA

SECTION 15

MARKETING

SELLING PRINCIPLES | NORTHERN CANOLA: MARKET DYNAMICS AND EXECUTION

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK

i MORE INFORMATION

Ground Cover Radio 117: [Quest to put health back into canola oil](#)

Clare Flakelar from Charles Sturt University discusses consumer preferences. Driving Agronomy podcast: [Canola, the Good Oil](#)

GRDC Update Paper: [Grain marketing – irrigated crops](#)

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 shows a grain selling flow chart that summarises:

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

The grower will run through a decision-making process each season, because growing and harvesting conditions, and prices for grains, change all the time. For example, in the five years to and including 2015, Newcastle canola values varied A\$90–\$170/t, a variability of 15–35% (Figure 2). For a property producing 500 tonnes of canola this means \$45,000–\$85,000 difference in income, depending on timing of sales.

The reference column refers to the section of the GrowNote where you will find the details to help in making decisions.¹

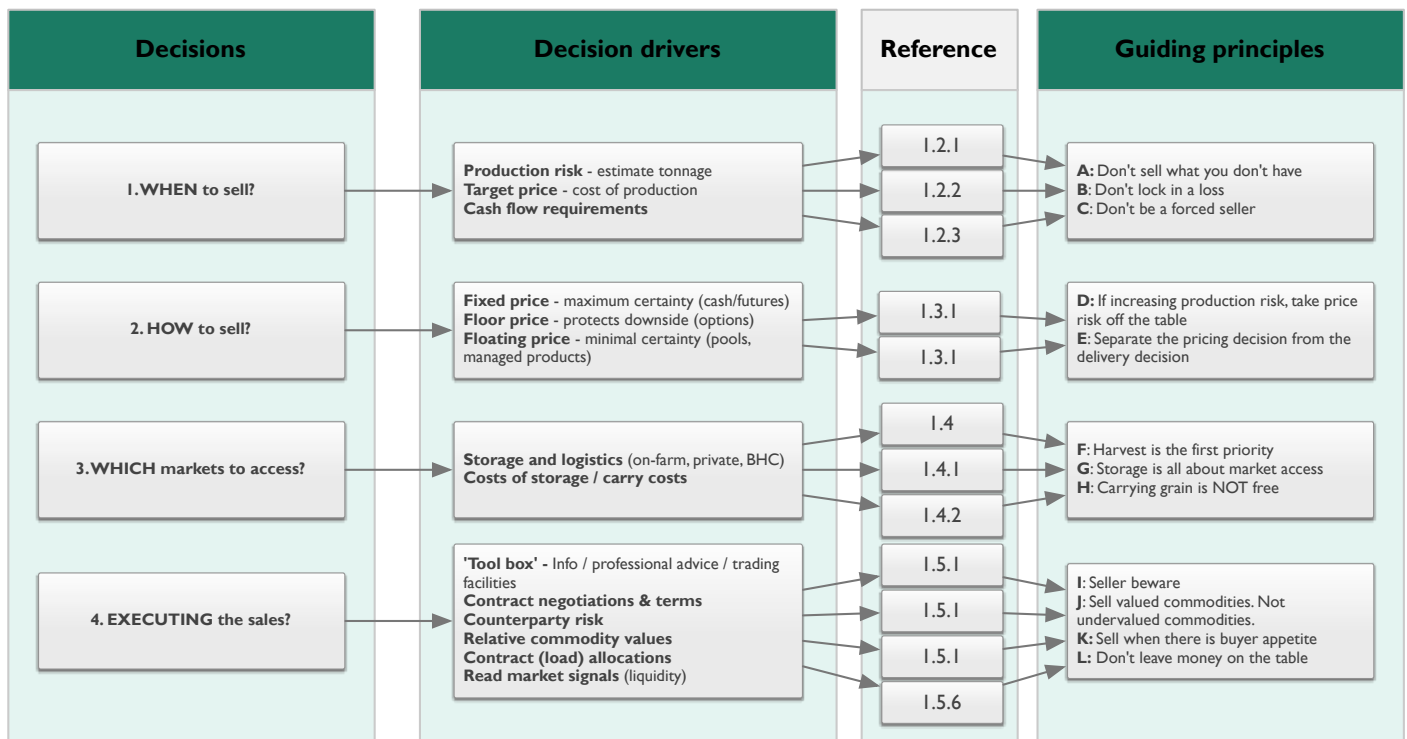


Figure 1: Grain selling flowchart.

¹ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

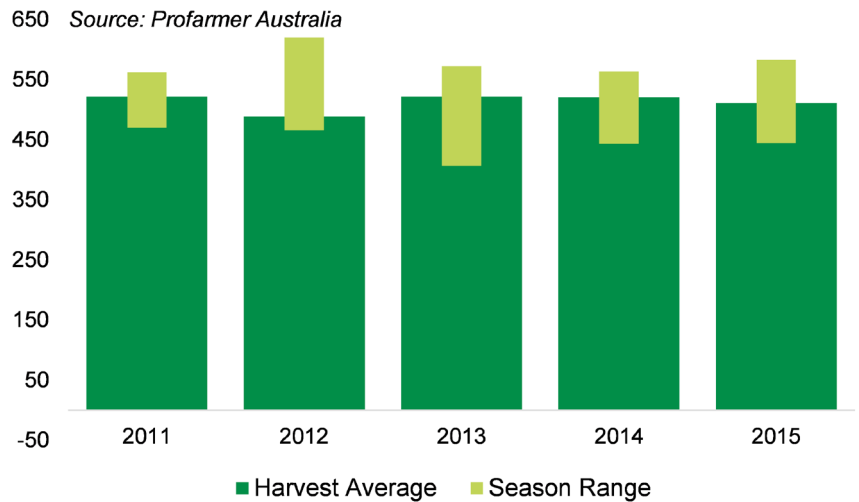


Figure 2: *Intraseasonal variance of Newcastle canola values.*

Source: Profarmer Australia

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 a target price and then work towards achieving the target price.

Unknowns include the amount of grain available to sell (production variability), the final cost of producing the grain, 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 are difficult to predict.

The skills growers have developed to manage production unknowns can also be used to manage pricing unknowns. This guide will help growers manage and overcome price uncertainty.²

15.1.1 Be prepared

Being prepared by having a selling plan is essential for managing uncertainty. The steps involved are forming a selling strategy, and forming a plan for effectively executing sales. The selling strategy consists of when and how to sell.

When to sell

Knowing when to sell requires an understanding of the farm’s internal business factors, including:

- production risk
- a target price based on the cost of production and the desired profit margin
- business cashflow requirements.

How to sell

Working out how to sell your grain is more dependent on external market factors, including:

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

² Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

The following diagram (Figure 3) lists the key principles to employ when considering sales during the growing season. Exactly when each principle comes into play is indicated in the discussion of marketing planning and timing in the rest of section 15.³



Figure 3: Timeline of grower commodity selling principles.

Source: Profarmer Australia

15.1.2 Establish the business risk profile

Establishing your business risk profile helps you determine when to sell: it allows you to develop target price ranges for each commodity, and provides confidence to sell when the opportunity arises. Typical business circumstances and how to quantify the risks during the production cycle are described below (Figure 4).

³ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

TABLE OF CONTENTS

FEEDBACK

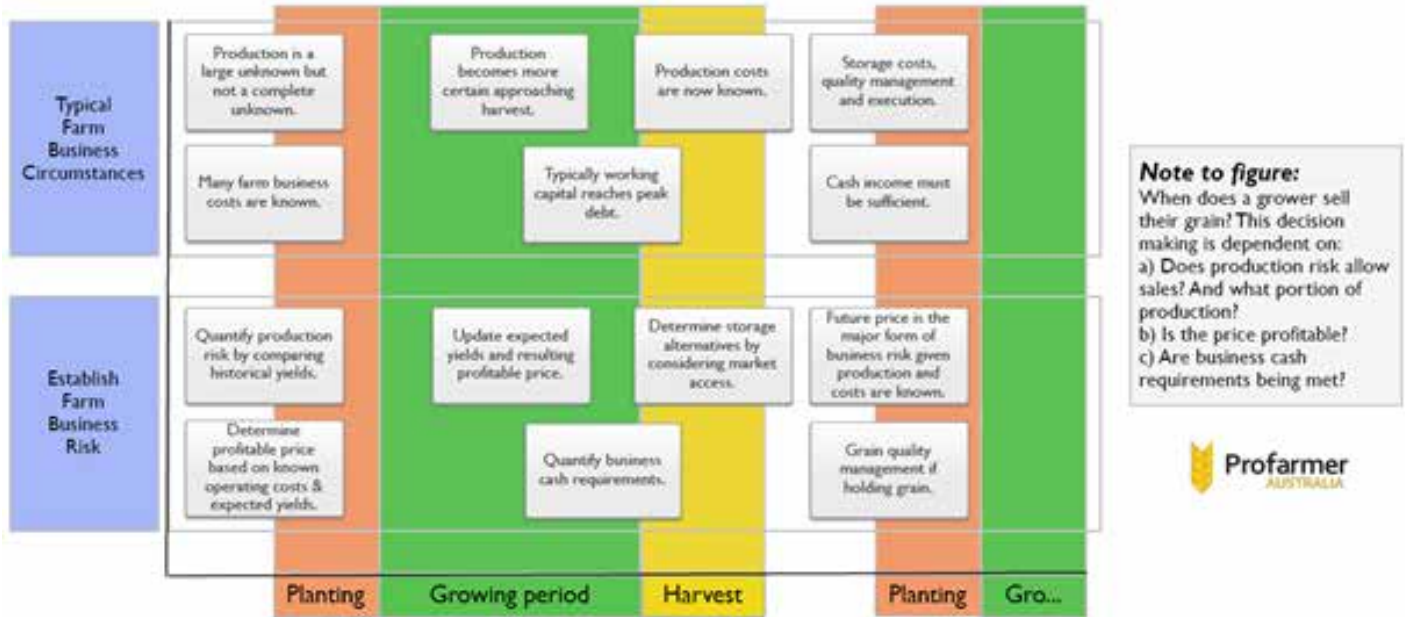


Figure 4: Typical farm business circumstances and risk.

Source: Profarmer Australia

Production risk profile of the farm

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

Principle: You can't sell what you don't have.

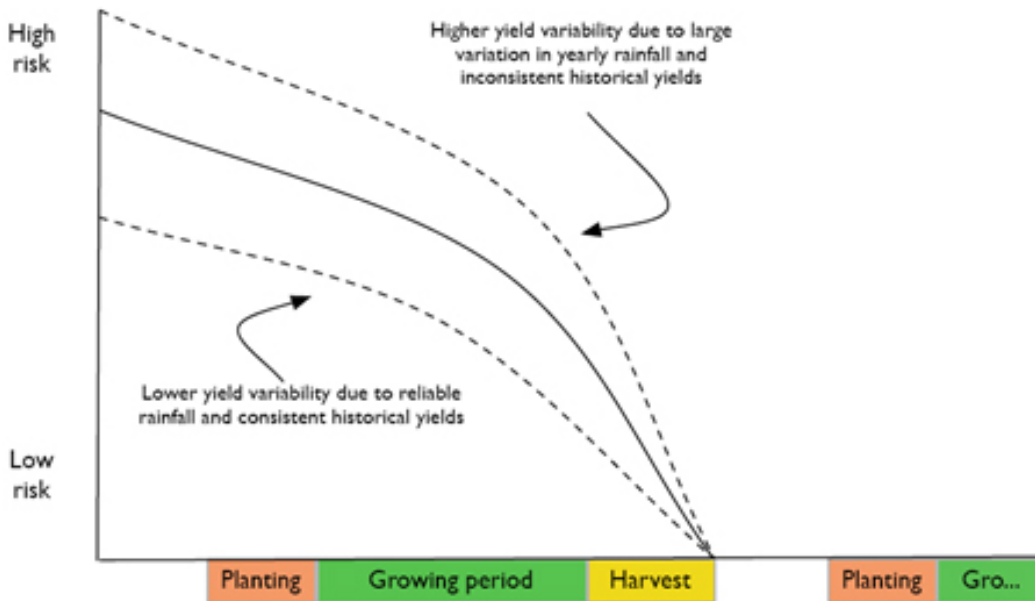
Therefore, don't increase business risk by over committing production. Establish a production risk profile (Figure 5) by:

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

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK



Note to figure:
The quantity of crop grown is a large unknown early in the year however not a complete unknown. 'You can't sell what you don't have' but it is important to compare historical yields to get a true indication of production risk. This risk reduces as the season progresses and yield becomes more certain. Businesses will face varying production risk levels at any given point in time with consideration to rainfall, yield potential, soil type, commodity etc.



Figure 5: Typical risk profile of a farm operation.

Source: Profarmer Australia

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, which means knowing all farming costs, both variable and fixed.

Principle: Don't lock in a loss.

If committing production ahead of harvest, ensure the price will be profitable. The steps needed to calculate an estimated profitable price is based on the total cost of production and a range of yield scenarios, as provided below (Figure 6).

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
Receival fee	\$11 /t
Freight to port	\$22 /t
Total per tonne costs	\$48 /t
Cost of production port FIS equiv	\$259.20
Target profit (ie 20%)	\$52.00
Target price (port FIS 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 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 × 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: An example of how to estimate the costs of production.

Source: Profarmer Australia

GRDC's manual [Farming the Business](#) also provides a cost-of-production template and tips on grain selling v. grain marketing.

Income requirements

Understanding farm business cash flow requirements and peak cash debt enables growers to time grain sales 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.

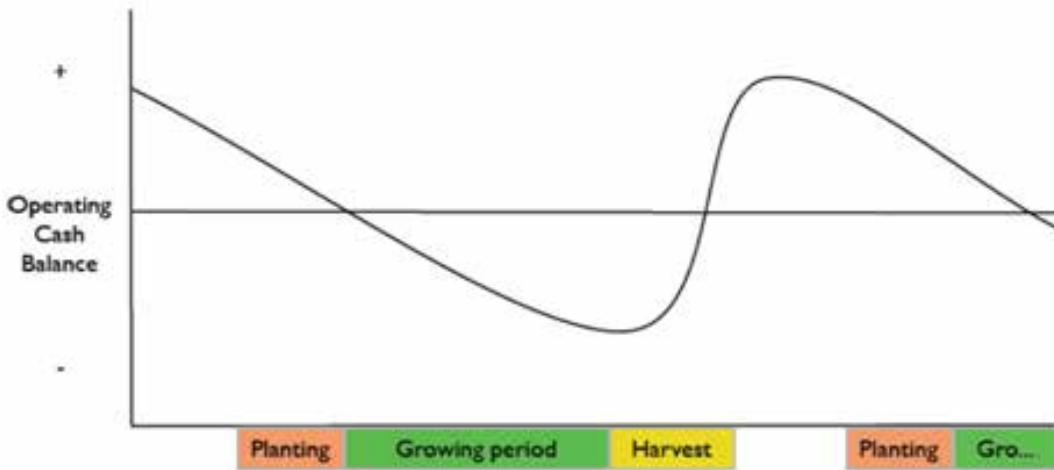
Be ahead of cash requirements to avoid selling in unfavourable markets.

Typical cash flow to grow a crop are illustrated below (Figures 7 and 8). Costs are incurred up front and during the growing season, with peak working capital debt incurred at or before harvest. Patterns will vary depending on circumstance and enterprise mix. Figure 8 demonstrates how managing sales can change the farm's cash balance.

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK



Note to figure:

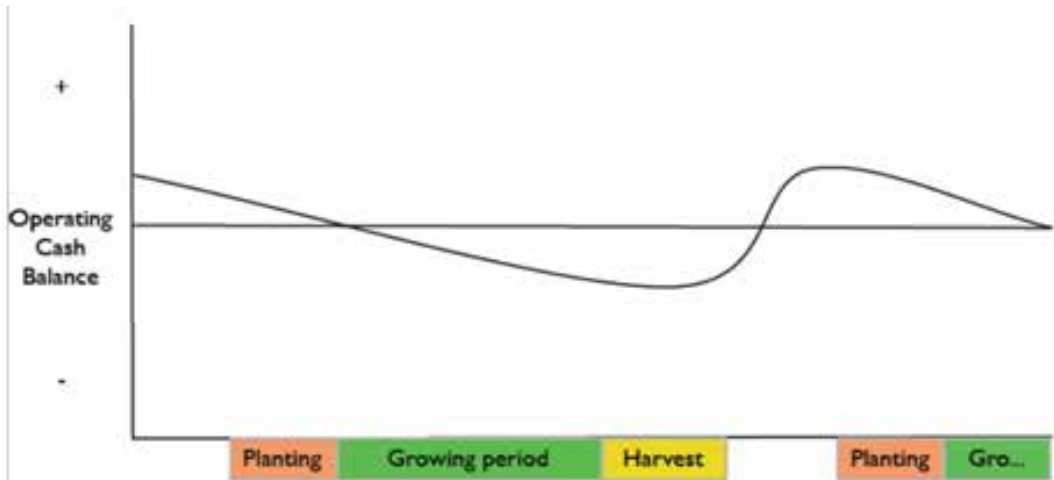
The chart illustrates the operating cash flow of a typical farm assuming a heavy reliance on cash sales at harvest. Costs are incurred during the season to grow the crop, resulting in peak operating debt levels at or near harvest. Hence at harvest there is often a cash injection required for the business. 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 7: Typical operating cash balance when relying on cash sales at harvest.

Source: Profarmer Australia



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 8: Typical operating cash balance when crop sales are spread over the year.

Source: Profarmer Australia

The 'when to sell' steps above result in an estimated production tonnage and the risk associated with producing that tonnage, a target price range for each commodity, and the time of year when cash is most needed.⁴

15.1.3 Managing your price

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

4 Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

The second part of the strategy, managing your price, addresses how to sell your crop.

Methods of price management

Pricing products provide varying levels of price risk coverage, but not all products are available for all crops (Table 1).

Table 1: Pricing methods and how they are used for different 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 9 summarises how the different methods of price management are suited to the majority of farm businesses.

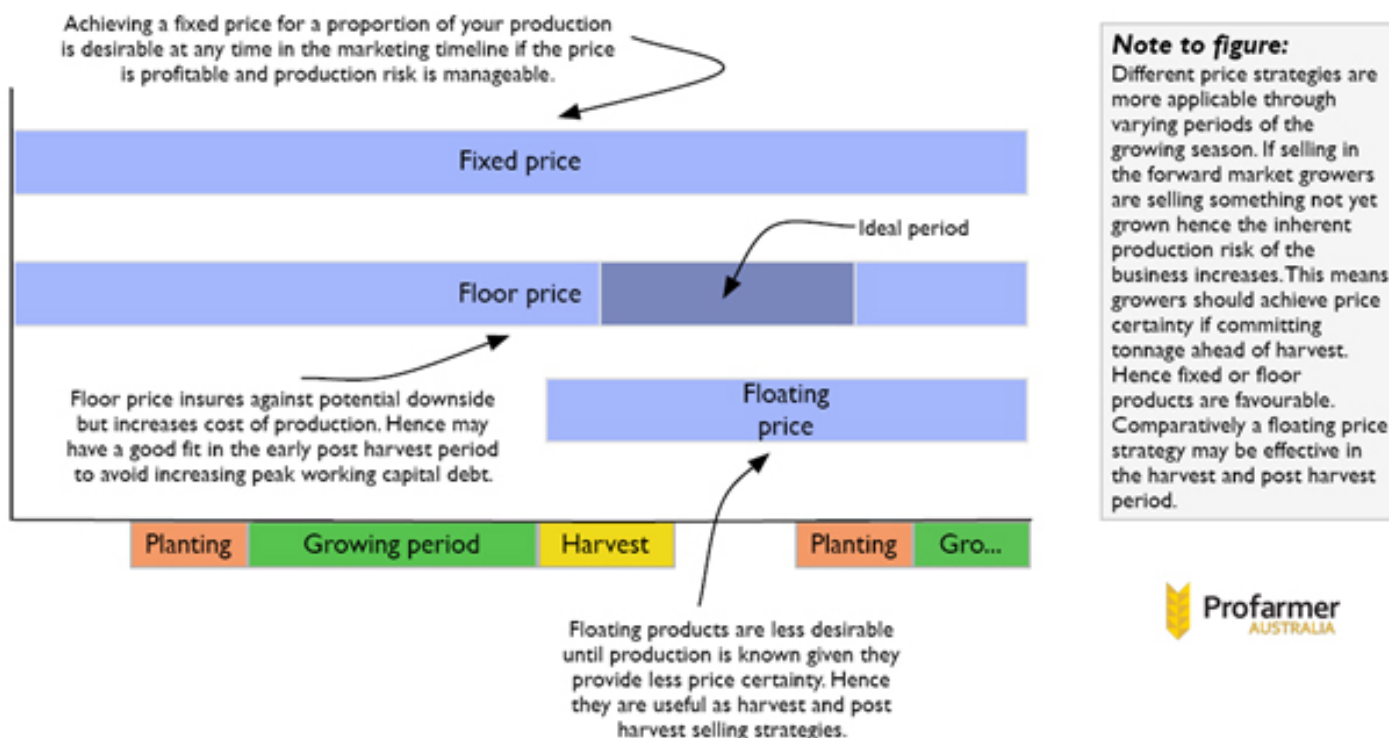


Figure 9: Price strategy timeline, summarising the suitability for most farm businesses of different methods of price management for different phases of production.

Source: Profarmer Australia

Principle: If increasing production risk, take price risk off the table.

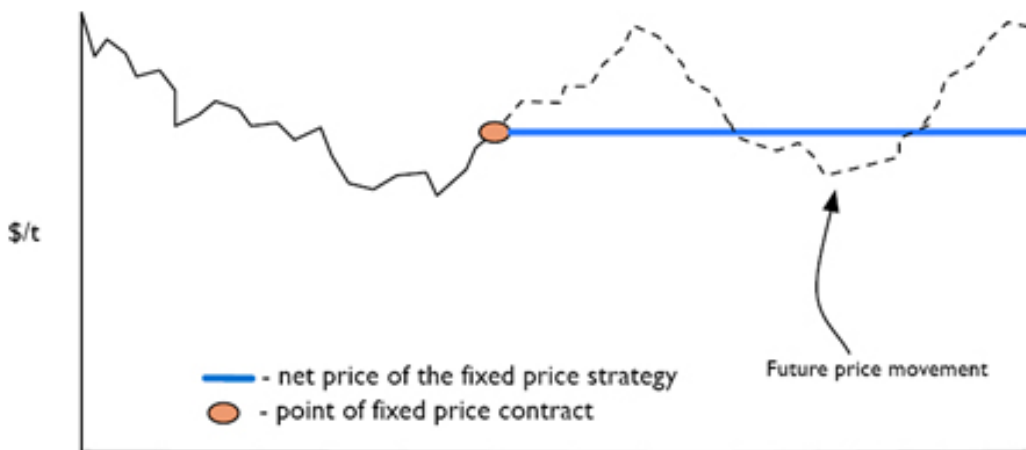
When committing to unknown production, price certainty should be achieved to avoid increasing overall business risk.

Principle: Separate the pricing decision from the delivery decision.

Most commodities can be sold at any time with delivery timeframes being 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 10). It provides some certainty around expected revenue from a sale as the price is largely a known factor, except when there is a floating component in the price, e.g. a multi-grade cash contract with floating spreads or a floating-basis component on futures positions.



Note to figure:
Fixed price product locks in price and provides certainty over what revenue will be generated regardless of future price movement.

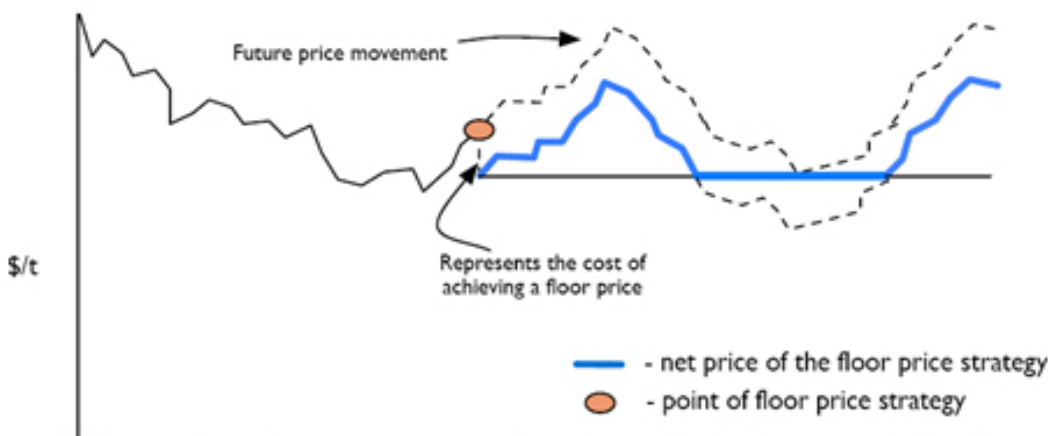


Figure 10: Fixed price strategy.

Source: Profarmer Australia

Floor price

Floor price strategies (Figure 11) can be achieved by utilising options on a relevant futures exchange (if one exists), or via a managed-sales program (i.e. a pool with a defined floor price strategy) offered by a third party. This pricing method protects against potential future price decrease while capturing any price increase. The disadvantage is that this kind of price 'insurance' has a cost, which adds to the farm's 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.

Source: Profarmer Australia

3. Floating price

Many of the pools or managed-sales programs are a floating price, where the net price received will move up and down with the future movement in price (Figure 12). Floating price products provide the least price certainty and are best suited for use at or after harvest rather than before harvest.



Figure 12: Floating price strategy.

Source: Profarmer Australia

Having considered the variables of production for the crop to be sold, and how these fit against the different pricing mechanisms, the farmer may revise their selling strategy, taking the risks associated with each mechanism into account.

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 so are best used after harvest.⁵

15.1.4 Ensuring access to markets

Once the questions of when and how to sell are sorted out, planning moves to the storage and delivery of commodities to ensure timely access to markets and execution of sales. Planning where to store the commodity is an important component of ensuring the type of access to the market that is likely to yield the highest return (Figure 13).

⁵ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

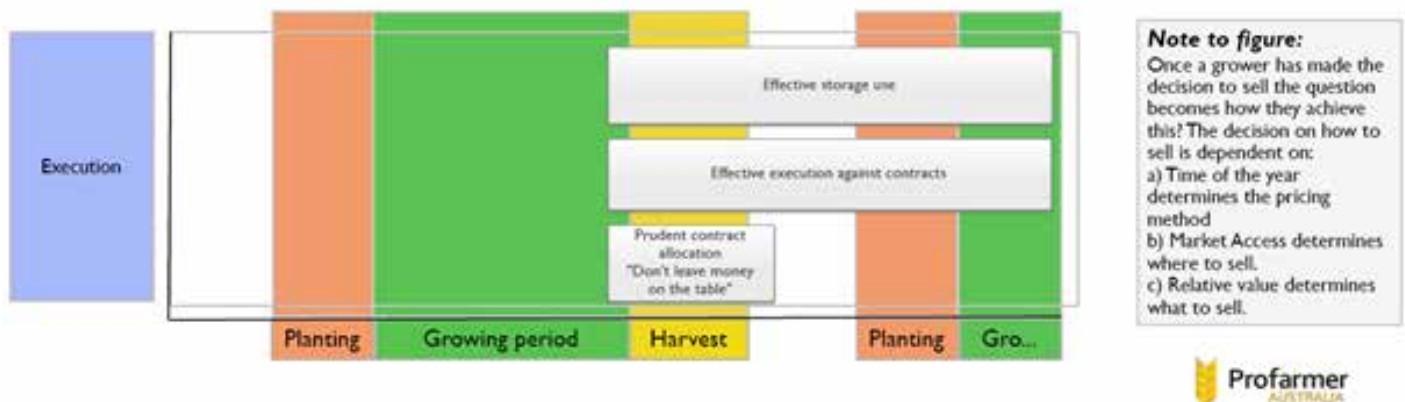


Figure 13: Storage decisions are influenced by selling decisions and the timing of all farming activities.

Source: Profarmer Australia

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 your commodity (Figure 14).

Principle: Harvest is the first priority.

During harvest, getting the crop into the bin is the most critical aspect of business success; hence storage, sale and delivery of grain should be planned well ahead of harvest to allow the grower to focus on the harvest itself.

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.

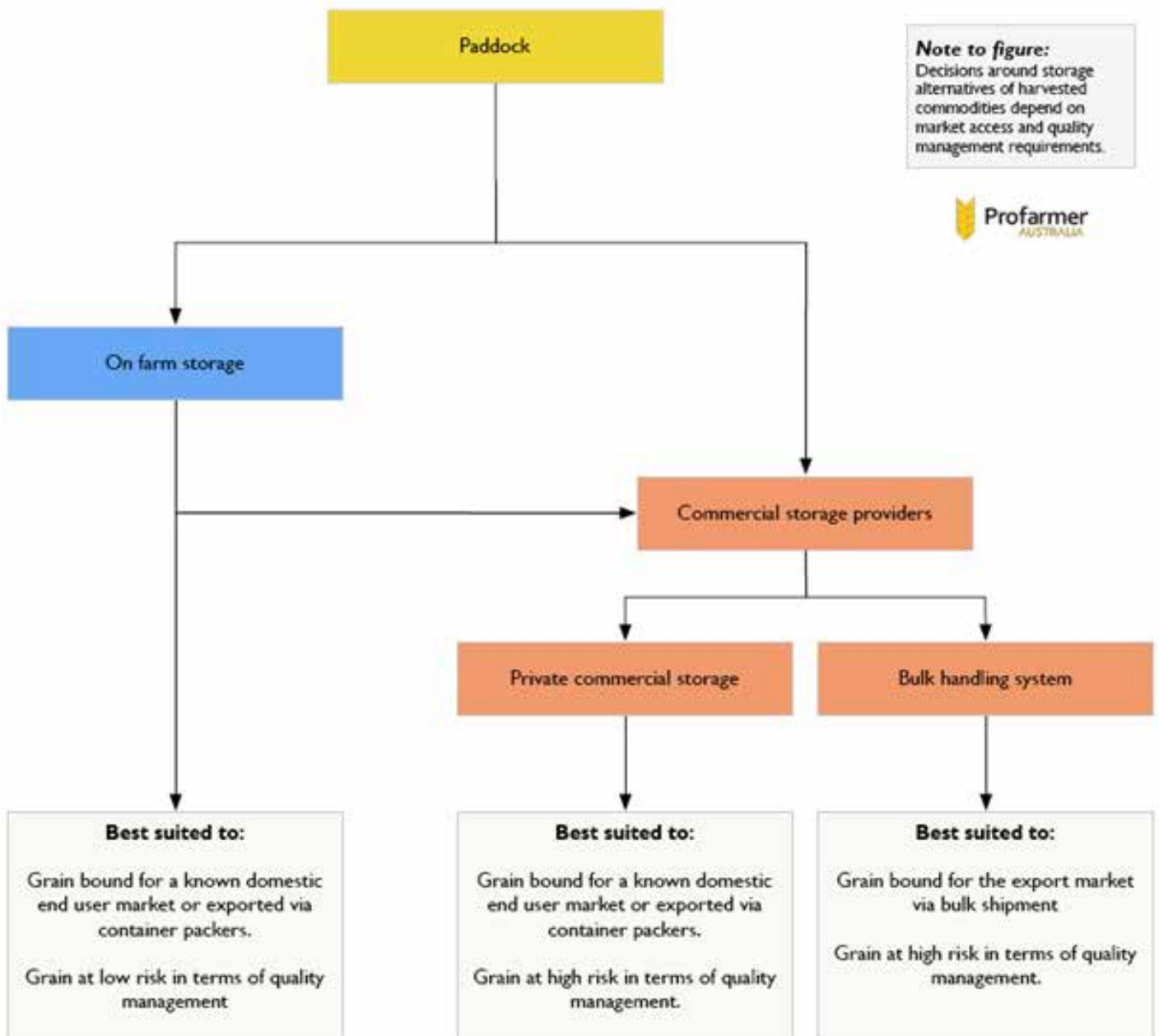
Storing commodities on the farm requires prudent quality management to ensure that the grain is delivered to the agreed specifications. If not well planned and carried out, it can expose the business to high risk. Penalties for out-of-specification grain arriving at a buyer's weighbridge can be expensive, 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 that delivery is managed to ensure that the 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.

For more information on on-farm storage alternatives and economics, see Section 13: Grain Storage.



Note to figure:
Decisions around storage alternatives of harvested commodities depend on market access and quality management requirements.



Figure 14: Grain storage decision-making.

Source: Profarmer Australia

Cost of holding 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 are typically \$3–4/t per month and consist of:

- monthly storage fee charged by a commercial provider (typically ~\$1.50–2.00/t)
- monthly interest associated with having wealth tied up in grain rather than available as cash or for paying off 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 the price offered at harvest (Figure 15).

SECTION 15 CANOLA

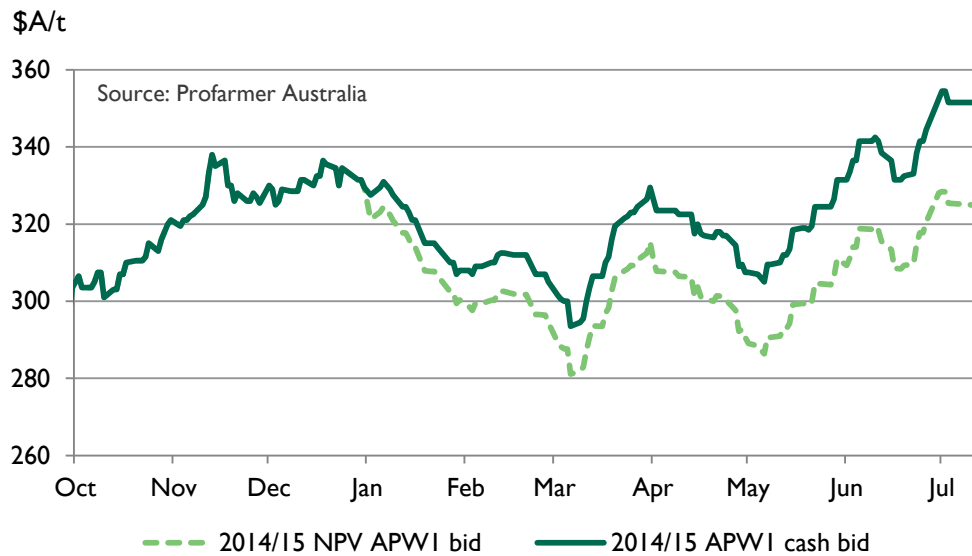
TABLE OF CONTENTS

FEEDBACK

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. A reasonable assumption is a cost of \$3–4/t per month for on-farm storage.

Principle: Carrying grain is not free.

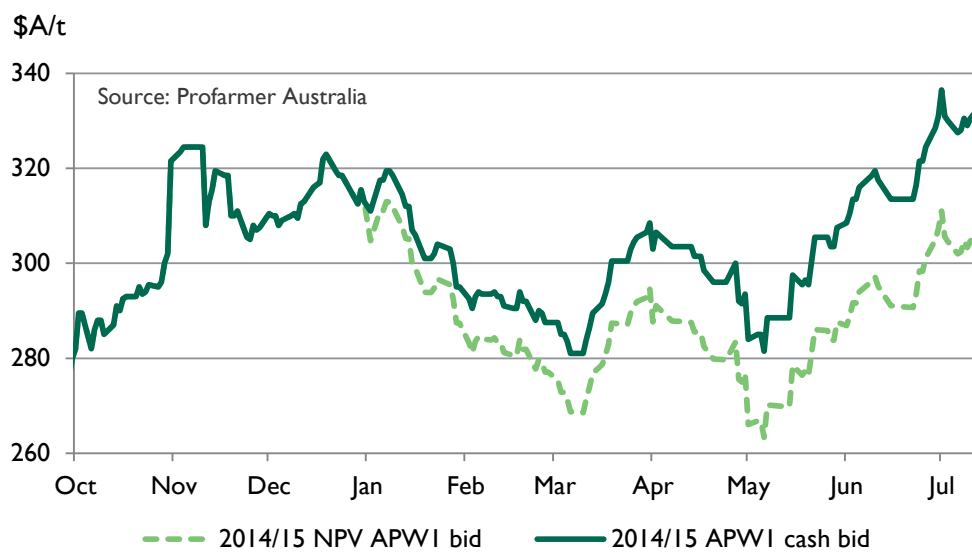
The cost of carrying grain needs to be accounted for if holding it for sale after harvest is part of the selling strategy. The usual way of doing this is to include it in the sale contract. For example, a crop sold in March for delivery in March–June on the buyer’s call at \$300/t + \$3/t per month carrying would generate an income of \$309/t if delivered in June (Figures 15 and 16).



Note to figure:
If selling a cash contract with deferred delivery, a carry charge can be negotiated into the contract. For example in the case of a March sale of APW1 wheat for March–June delivery on buyers call at \$300/t + \$3/t carry per month, if delivered in June would generate \$309/t delivered.

Figure 15: How adding a carrying charge changes the total paid in the Brisbane APW2 cash market.

Source: Profarmer Australia



Note to figure:
If selling a cash contract with deferred delivery, a carry charge can be negotiated into the contract. For example in the case of a March sale of APW1 wheat for March–June delivery on buyers call at \$300/t + \$3/t carry per month, if delivered in June would generate \$309/t delivered.

Figure 16: How adding a carrying charge changes the total paid in the Newcastle APW1 cash market. Note differences between this market and that in Figure 15.

Source: Profarmer Australia

Optimising farm gate returns involves planning the appropriate storage strategy for each commodity so as to improve market access and ensure that carrying costs are covered in the price received.⁶

15.1.5 Converting tonnes into cash

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

Set up the toolbox

Selling opportunities can be captured when they arise by assembling the necessary tools in advance. The toolbox for converting tonnes of grain into cash includes the following.

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 services 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. A better return on investment for the farm business is achieved through higher farm gate prices, which are obtained by accessing timely information, and being able to exploit the seller's greater market knowledge and greater market access.
3. Futures account and a 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 the Chicago Board of Trade (CBOT) can add significant value.

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 17):

- 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 risks must be managed.
- Delivery terms—the timing of the 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 on the grain to be transferred ahead of payment, so counterparty risk must be managed.

MORE INFORMATION

Access to buyers, brokers, agents, products and banks through [Grain Trade Australia](#)

[Commodity futures brokers](#)

ASX, [Find a futures broker](#)

6 Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK

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

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 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.

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

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 transfer this Contract subject to the following Terms and Conditions:

Commodity: _____ Grade: _____ Quantity: _____ Packaging: _____ Price: _____ Price Basis: _____ Delivery/shipment Period: _____ Delivery Point and Conveyance: _____ Payment Terms: This buyer agrees to pay the seller within _____ in the absence of a declaration, payment will be 30 days after week of delivery.

GTA Commodity Reference: _____
Inspection: _____ (Days - Declaration)
Tolerance: _____ (After use)
Weights: _____ (Days - Declaration)
Excl/Incl Free GST _____

Levies and Duties: Any industry, statutory or government levies which are not included in the price shall be provided as required by law.
Disclosure: 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 facilities 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 override 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 transaction, 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
SIOA. For GTA member use only.

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 17: Typical terms of a cash contract.

Source: Grain Trade Australia

The price point within a cash contract will depend on where the transfer of grain title will occur along the supply chain. Figure 18 depicts the terminology used to describe these points and the associated costs to come out of each price before growers receive their net return.

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK

On ship at customer wharf

Note to figure:
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 supply chain and the associated costs to come out of each price before the growers receive their net farm gate return.

On board ship

In port terminal

On truck/train at port terminal

On truck/train ex site

In local silo

At weighbridge

Farm gate

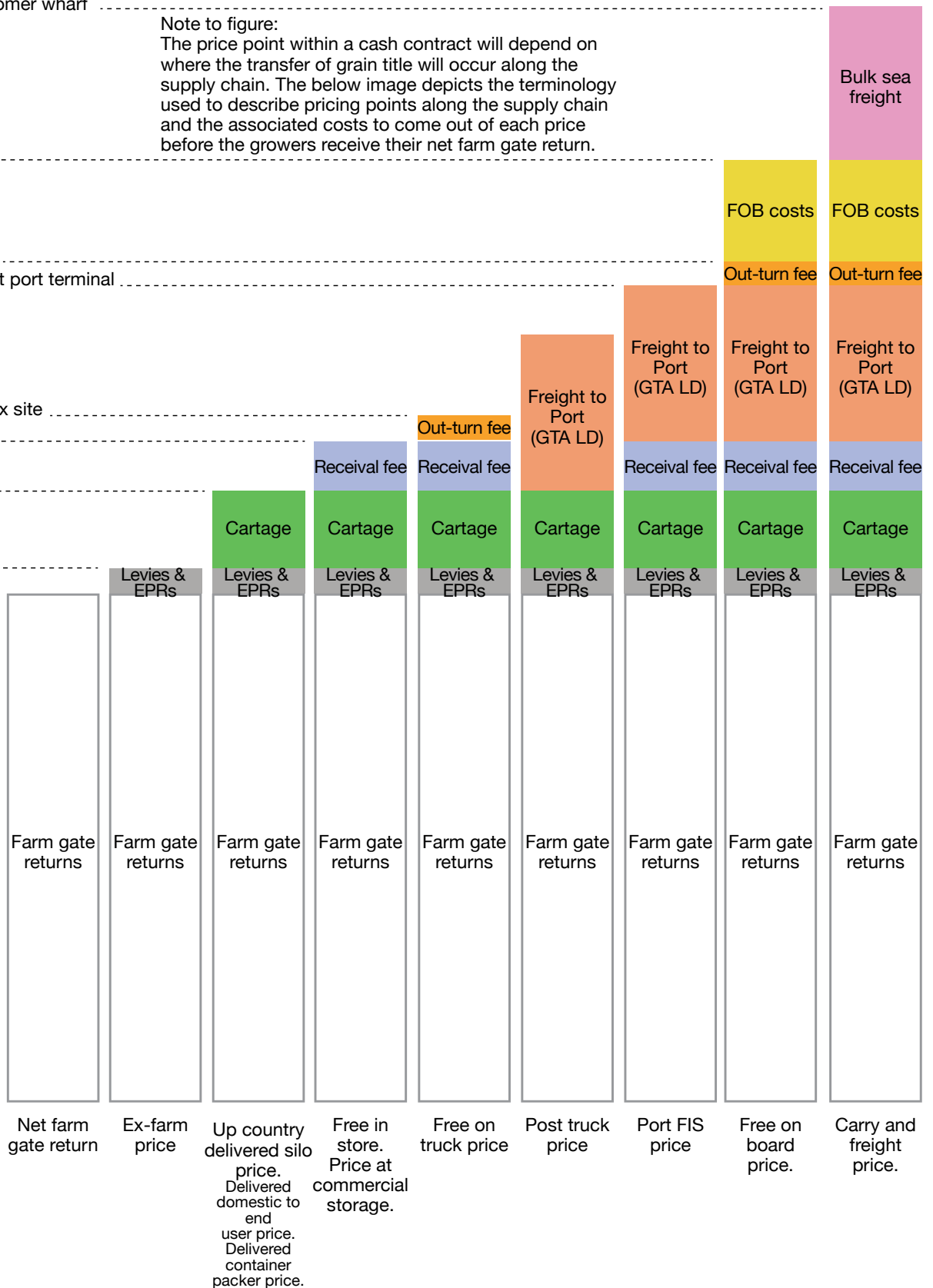


Figure 18: Cost and pricing points throughout the supply chains.

Source: Profarmer Australia

i MORE INFORMATION

[Grain Trade Australia, A guide to taking out grain contracts](#)

[Grain Trade Australia, Trading standards](#)

[GrainTransact Resource Centre](#)

[GrainFlow](#)

[Emerald Grain](#)

[Clear Grain Exchange, Getting started](#)

[Clear Grain Exchange, Terms and conditions](#)

i MORE INFORMATION

[GTA, Managing counterparty risk](#)

[Clear Grain Exchange's title transfer model](#)

[GrainGrowers, Managing risk in grain contracts](#)

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

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 is 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 option 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 offer and bid match, the particulars of the transaction are sent to a secure settlement facility, although the title on the grain does not transfer from the grower until they receive funds from the buyer. The availability of this option 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 the title on 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.

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.
- 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. Alternatively, the Clear Grain Exchange provides secure settlement whereby the grower maintains title on the grain until they receive payment, and then title and payment are settled simultaneously.

Above all, act commercially to ensure the time invested in implementing a selling strategy is not wasted by poor management of counterparty risk.

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 to hold commodities that are not well priced at any given time. That is, give preference to the commodities with the highest relative value. This achieves price protection for the overall revenue of the farm business and enables more flexibility to a grower's selling program while achieving the business goal 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.

Reviewing price relativities between two commodities is one method of assessing which grain holds the greatest value in the current market. This may be achieved

by considering flat prices, relative decile values, or performance against offshore markets. In the example below (Figure 19), for a wheat and canola production system, canola values surged in May–June and maintained strong relative value, despite softening values in late July and early August. Once confident that the price surge had become established, a grower would probably choose to hold off on sales of wheat and sell canola.

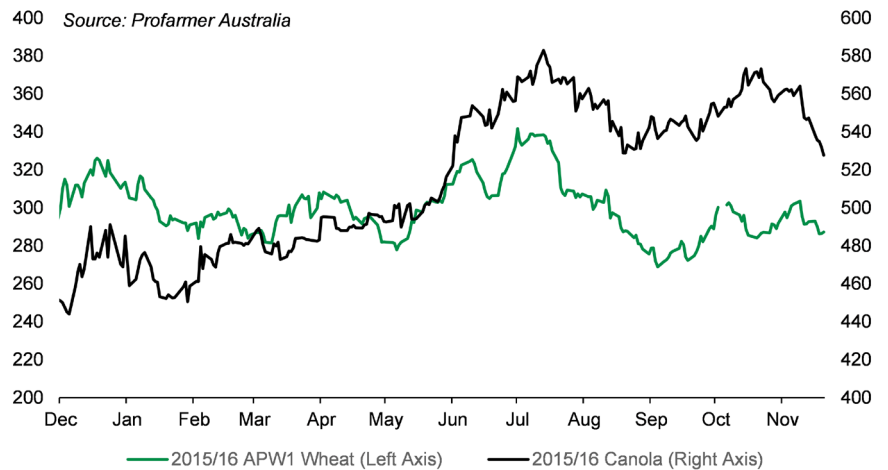


Figure 19: The Newcastle APW1 wheat v. canola values for the 2015–16 season indicate how a grower might follow both prices to decide which grain is better to sell, relative to the other.

Source: Profarmer Australia

Contract allocation means choosing which contracts to allocate your grain against come delivery time. Different contracts will have different characteristics (e.g. price, premiums-discounts, oil bonuses), and optimising your allocation reflects directly 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 price for their crop growers should:

- allocate lower grades of grain to contracts with the lowest discounts
- allocate higher grades of grain to contracts with the highest premiums (Figure 20).

The grower may have several options. For example, Figure 20 shows that the only difference between achieving an average price of \$518.4/t and \$520.7/t is which contracts each parcel is allocated to. Over an amount of 400 t, the difference in average price equates to nearly \$1,000, which could be lost just in how parcels are allocated to contracts.

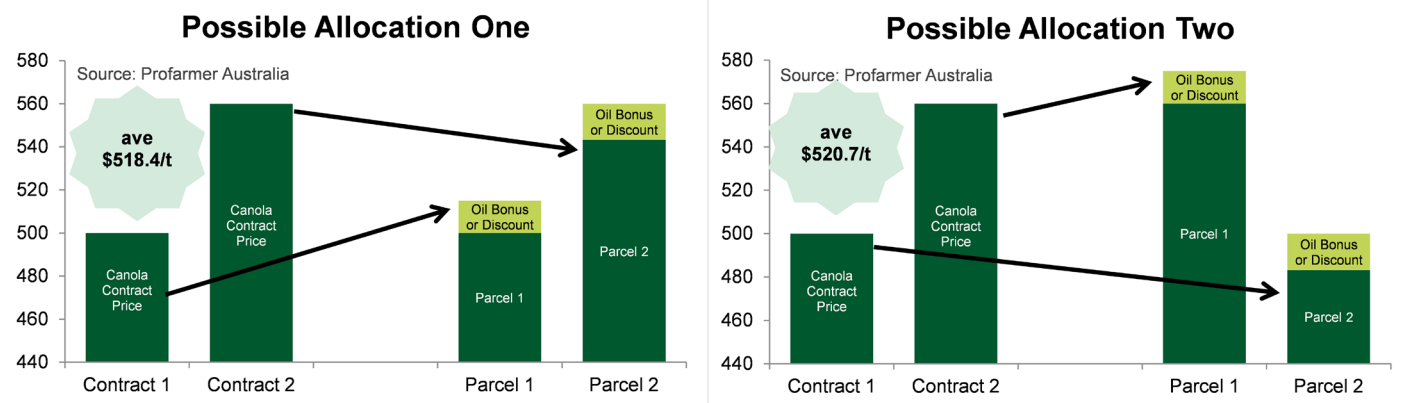


Figure 20: How canola contracts might be allocated may change according to the price offered.

Source: Profarmer Australia

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 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.

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 conducting 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.⁷

15.2 Northern canola: market dynamics and execution

15.2.1 Price determinants for northern canola

Australia is a relatively small player in terms of world oilseed production, contributing about 5% to global canola production. However in terms of world trade, Australia is a major player, exporting approximately 75% of the national canola crop, which accounts for about 23% of the global canola trade.

⁷ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK

Given this dynamic Australian farm gate prices are influenced by global price volatility. This makes off-shore markets such as the Intercontinental Exchange (ICE) canola contract and Euronext (often referred to as Matif) rapeseed useful indicators of where the Australian canola price will trade (Figure 21).

In addition, global canola values are influenced by supply and demand of other global oilseeds such as soybeans and palm oil. This is because the different oilseeds can often be substituted for each other for various uses. Global canola values and soybeans often trade in similar directions as they act as substitutes for various uses.

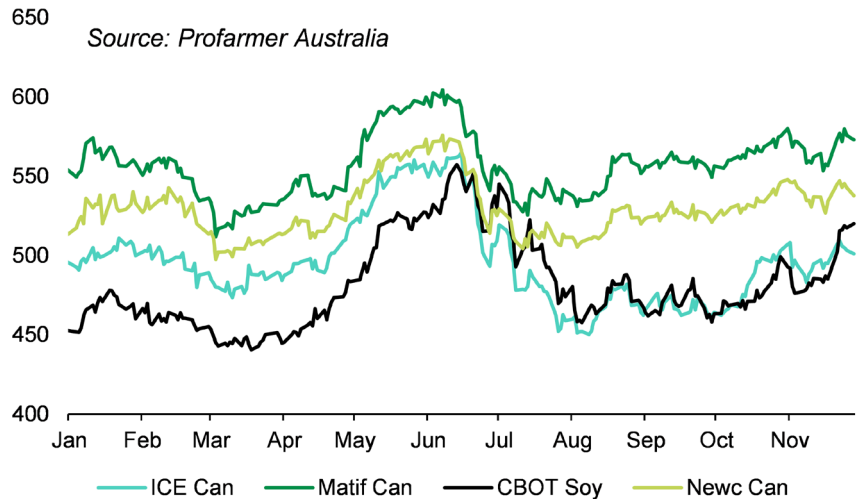


Figure 21: Newcastle 2016–17 canola values reflect the values of offshore canola futures (A\$/t).

Because of Australia’s heavy involvement in the international canola trade, it is important to understand the world production calendar for canola (Figure 22). Seasonal factors in other canola growing countries influence global canola prices throughout each year. Due to Australia’s export focus, the timing of harvest in major exporting and importing countries is a considerable influencer of prices. If supply is greater than demand, which can happen during periods of large harvests, it can push prices lower. When production is uncertain, risk premiums can be built in to price and push values higher.

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Northern Hemisphere	Canola						Harvest (EU)		Planting (EU)				
	Soybean, Canola					Planting (US, Canada, China)				Harvest (US, Canada, China)			
Southern Hemisphere	Canola					Planting (Australia)							Harvest (Australia)
	Soybean				Harvest (Argentina, Brazil)						Planting (Argentina, Brazil)		

Figure 22: World canola production calendar.

Source: Profarmer Australia

Decile charts are another useful tool for farmers wanting more confidence in setting prices for their crop. Decile charts provide an indication of how current values are

performing relative to historical value (Figure 23). For example, a decile 8 or above indicates values are in the top 20% of historical price observations.⁸

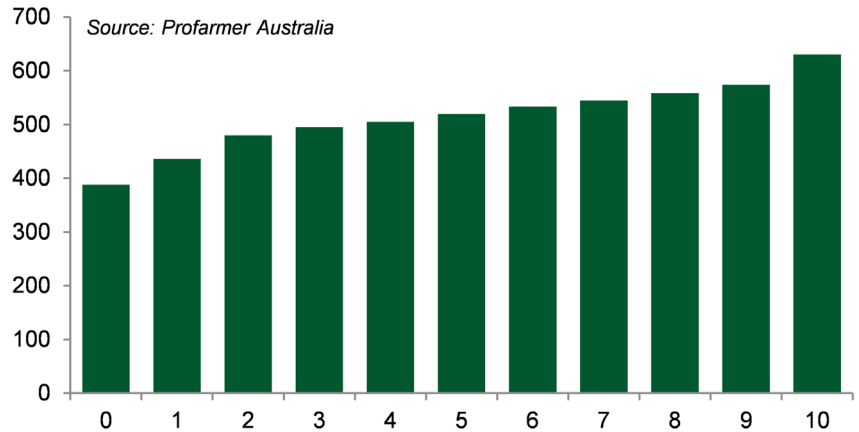


Figure 23: Newcastle canola decile. A decile 8 or above indicates values are in the top 20% of historical price observations. This occurred here from August 2009 to November 2016.

Source: Profarmer Australia

15.2.2 Ensuring market access for northern canola

A large proportion of canola grown in the northern region of Australia is exported in bulk for human consumption; hence a bulk-handling system is usually the most cost-effective pathway to get canola to off-shore customers (see Figure 24). The bulk-storage provider should gain scale efficiencies when moving the bulk commodity grade CAN1.

NSW also has a very prominent domestic canola market. This market can generate premiums to the bulk-export markets and provide a return to on-farm storage for growers well positioned to service these crushers. In addition, Victorian demand is larger than production in most years, so canola from NSW is often sold over the border to service the relatively large domestic Victorian market. As a result, private commercial and on-farm storage should play a much larger role in canola farming, as it allows growers to access valuable domestic end user markets. Northern Australia canola crushers are located at Newcastle and Manildra, and southern ones at Cootamundra, Wagga Wagga, Numurkah and Melbourne.

The level of canola exports in containers from NSW remains very low, at ~1% of production. However, this type of sale can provide price premiums for specific grades as a container can access niche off-shore markets. This particularly applies to off-spec (i.e. low oil, high admix) or genetically modified canola.⁹

Market Destinations - Canola - 5 year averages				
	New South Wales		National Total	
	Implied tonnes	% of production	Implied tonnes	% of production
Bulk	360,000	40%	2,300,000	74%
Container	6,000	2%	90,000	2%
Domestic Use	340,000	38%	750,000	24%

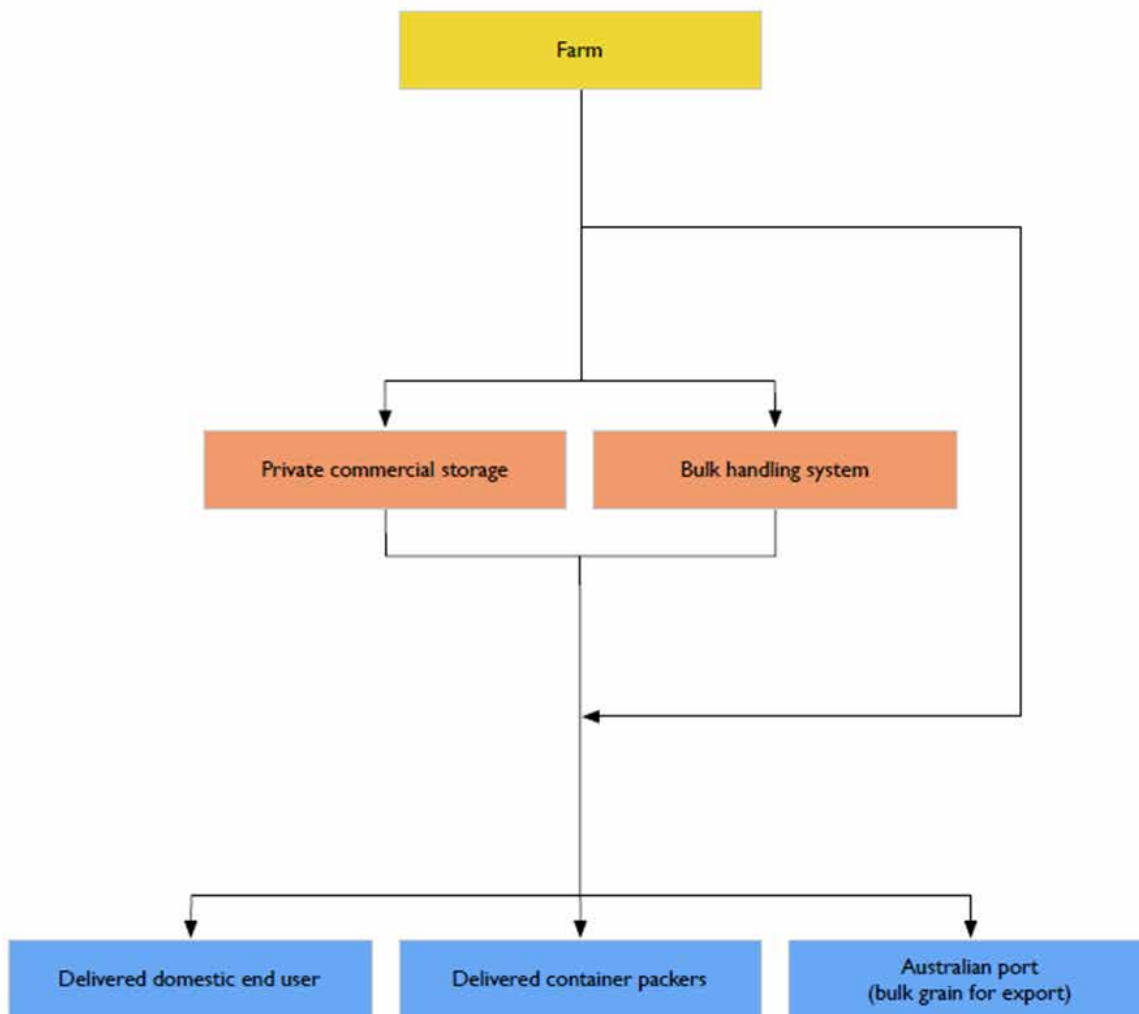
Source: Australian Crop Forecasters

Figure 24: Market destinations for NSW canola.

Source: Australian Crop Forecasters

⁸ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

⁹ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote



Note to figure:
Storage decisions should be determined by assessing market access. The large majority of northern canola is exported in bulk. Hence the bulk handling system should provide efficiencies to market. NSW also services a relatively large domestic market and private commercial and on-farm storage should provide a reasonable method to access these markets.



Figure 25: Australian supply chain flow.

Source: Profarmer Australia

15.2.3 Converting tonnes into cash for northern canola

The key to effectively executing sales is determining which grades to sell and which grades to hold. Deciding which grades to sell is about identifying which are showing best relative value, and selling those while value remains—this is the principle of selling valued commodities (Figure 26).

Niche canola grades such as genetically modified (GM) canola are often best sold during harvest or shortly after, as buyer appetite often drops away post-harvest. This is due to there being fewer buyers for GM than for conventional canola. For example, the EU, which is a major off-shore market for Australian canola, does not accept GM product. Hence once buyers with a specific use for these canola grades have filled their requirements, price discounts to conventional CAN1 can increase. The export pace for Australian canola is typically strongest shortly after our harvest as buyers seek to take advantage of more abundant supplies and minimise costs by shipping immediately after harvest (Figure 27).

Storing canola for domestic markets can provide premium returns, although it is important to monitor buyer appetite. Selling for a future delivery date with a per-month carrying cost built into the price can be effective in capturing existing market

TABLE OF CONTENTS

FEEDBACK

i MORE INFORMATION

[Oilseeds industry—delivering high quality products to local and global markets](#)

[Grain market lingo—what does it all mean?](#)

premiums, and generating a return on farm infrastructure, without running the risk of the domestic buyers adequately covering their requirements.¹⁰

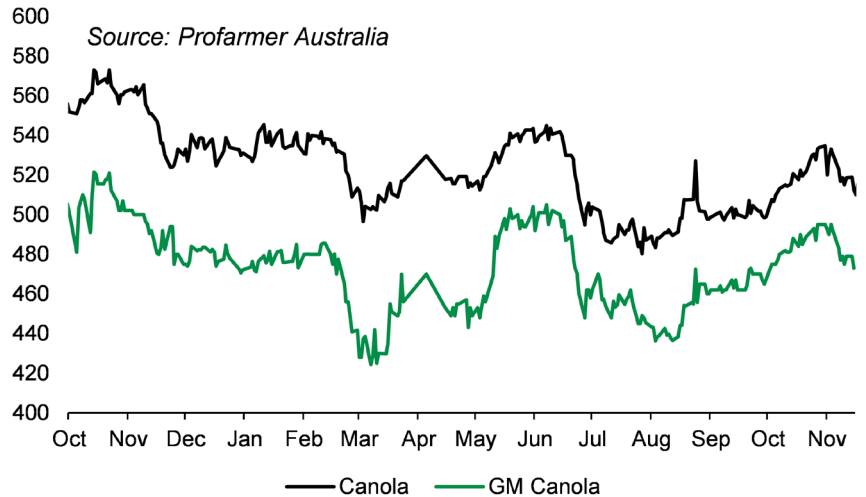


Figure 26: Melbourne 2015-16 values for conventional canola and GM canola.

Source: Profarmer Australia

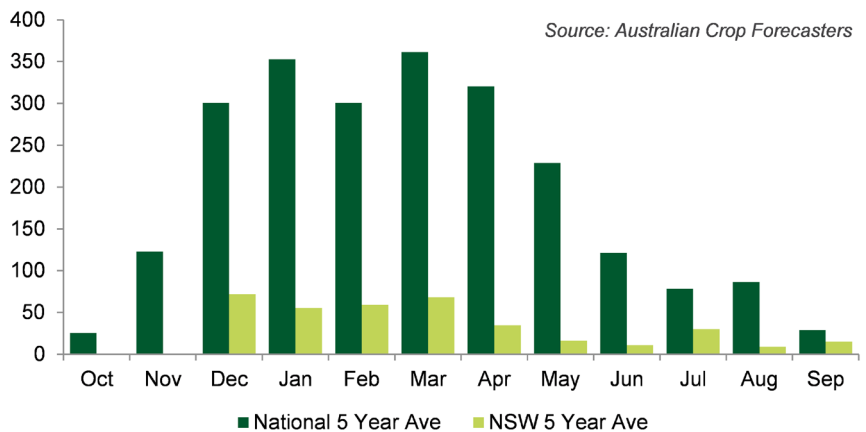


Figure 27: Monthly export pace of canola ('000 t), averaged over five years.

Source: Australian Crop Forecasters

15.2.4 Risk management tools available for northern canola

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

¹⁰ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

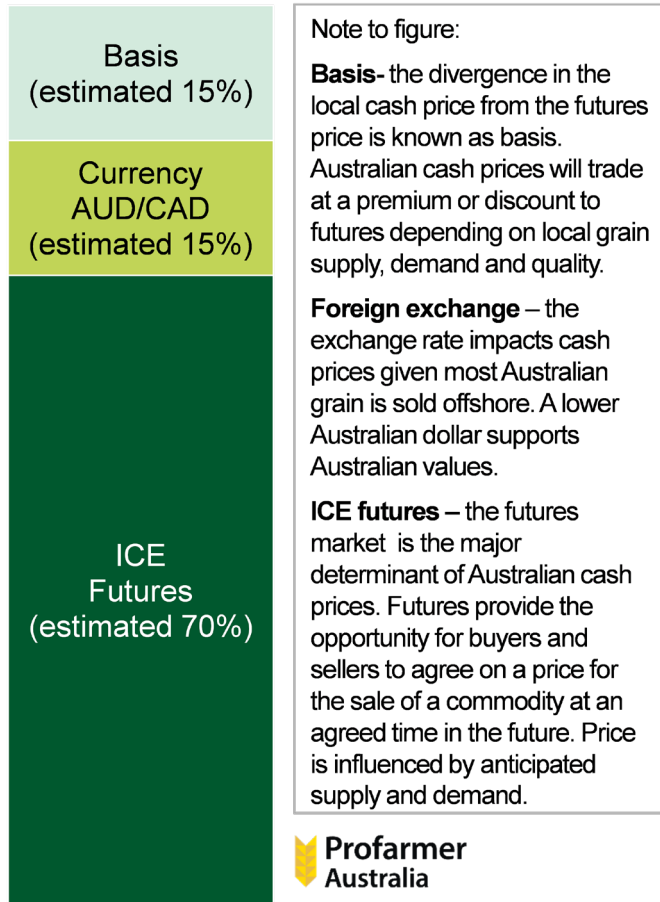


Figure 28: The components of the Australian cash price for canola.

Source: Profarmer Australia

Table 2 outlines the products available to manage canola prices. The major difference in products is the ability to manage the individual components of price. ¹¹

¹¹ Profarmer Australia (2016), Marketing Field Peas, GRDC Northern Field Pea GrowNote

SECTION 15 CANOLA

TABLE OF CONTENTS

FEEDBACK

Table 2: Price management tools available to canola growers.

	Description	Advantages	Disadvantages
Spot cash contracts	Futures, foreign exchange, basis all locked in at time of contracting	<ul style="list-style-type: none"> Price secured effectively and simply. No price risk and no production risk. Grain is converted in to cash almost immediately. 	<ul style="list-style-type: none"> Immediate grain delivery required. Sales other than at harvest require storage which incur costs. Locks away the three pricing components at the same time. Counterparty default risk must be managed.
Forward cash contracts	Futures, foreign exchange, basis all locked in at time of contracting	<ul style="list-style-type: none"> Price secured effectively and simply ahead of harvest. No price risk. No storage costs required. Cash income is known ahead of harvest. 	<ul style="list-style-type: none"> Contracts often inflexible and difficult to exit. Locks away the three pricing components at the same time. Future delivery is required resulting in increased production risk. Counterparty default risk must be managed.
Futures contracts	Futures, foreign exchange, basis are able to managed individually	<ul style="list-style-type: none"> Liquid markets enable easy entry and exit from the marketplace. Prospective grain sales can be hedged with extra flexibility. Price 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 movement, 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 market risk.
Over the counter bank swaps on futures contracts	Futures, foreign exchange, basis are able to 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. Prospective grain sales can be hedged with extra flexibility. No counterparty risk due to the bank creating the market. Day-to-day margin calls managed by the bank on behalf of the grower. 	<ul style="list-style-type: none"> Total cost of utilising product is \$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 market risk.
Options on futures contracts	Futures, foreign exchange, basis are able to managed individually	<ul style="list-style-type: none"> No counterparty risk and no daily margin calls. Price downside is protected however future price upside is possible. Liquid markets enable easy entry and exit from the marketplace. Prospective grain sales can be hedged with limited production risk. Price is based off the underlying futures with complete transparency. 	<ul style="list-style-type: none"> Options can be costly and require payment up front. The value of options erode over time as expiry approaches— depreciating asset. Options are perceived to be complicated by growers.

For more information and worked examples on how each pricing component affects wheat grain price, see the GRDC publication, [Grain market lingo: What does it all mean?](#)