



SOUTHERN

AUGUST 2017

GRDC™ GROWNOTES™



GRDC™

GRAINS RESEARCH
& DEVELOPMENT
CORPORATION

DURUM

SECTION 15

MARKETING

SELLING PRINCIPLES | SOUTHERN DURUM: MARKET DYNAMICS AND
EXECUTION

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:

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

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

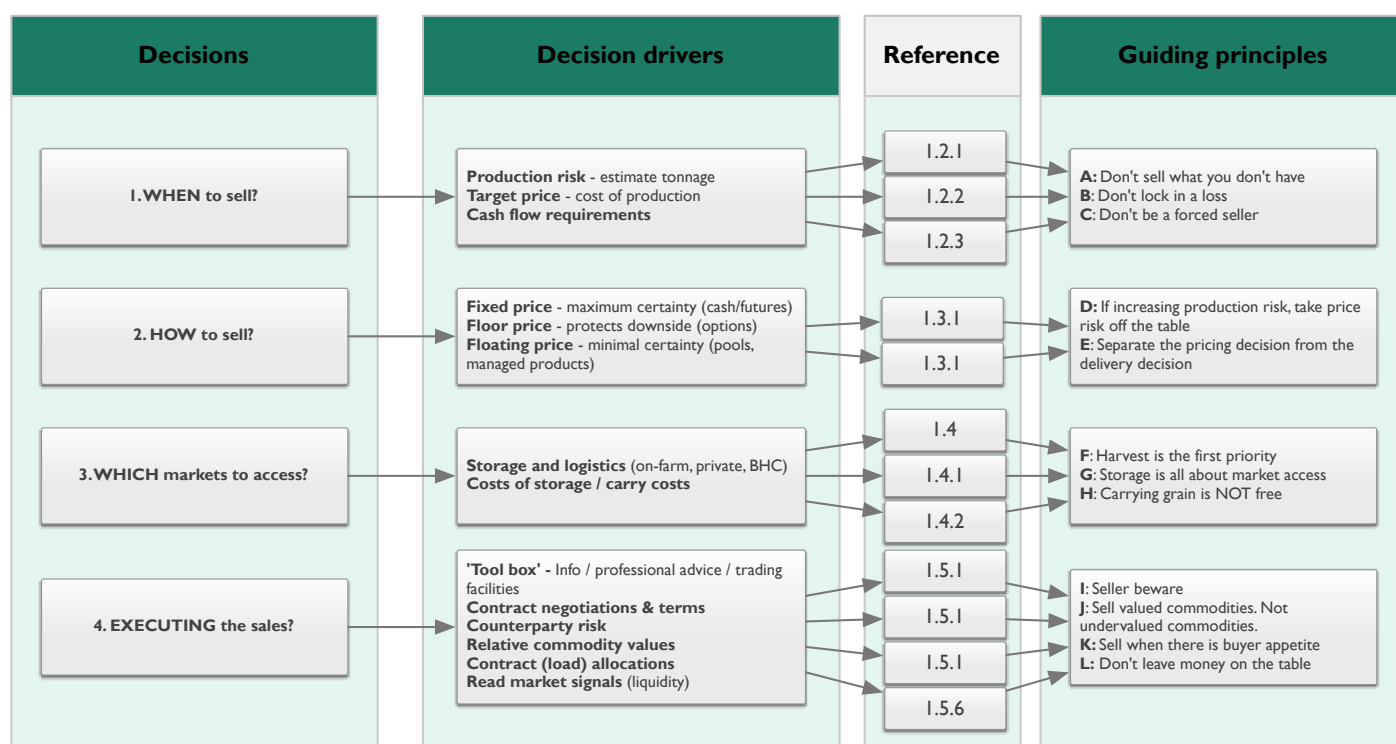


Figure 1: Grain-selling flowchart.

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 seven years to 2015, Port Adelaide durum values varied by as much as A\$310/t, (representing variability of 35–80%) (Figure 2). For a property producing 500 tonnes of durum this means \$50,000–\$155,000 difference in income, depending on the timing of sales.

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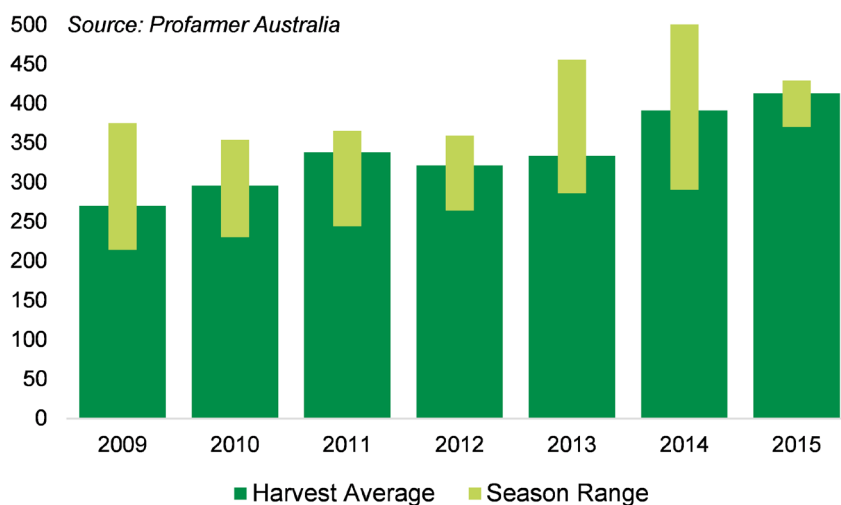
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Figure 2: Intra-season variance of Port Adelaide durum values.

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.

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

The following diagram (Figure 3) lists the key selling principles to employ when considering sales during the growing season. Exactly when each principle comes into play is indicated in the text of section 15.

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Note to figure:

The illustration demonstrates the key selling principles throughout the production cycle of a crop.

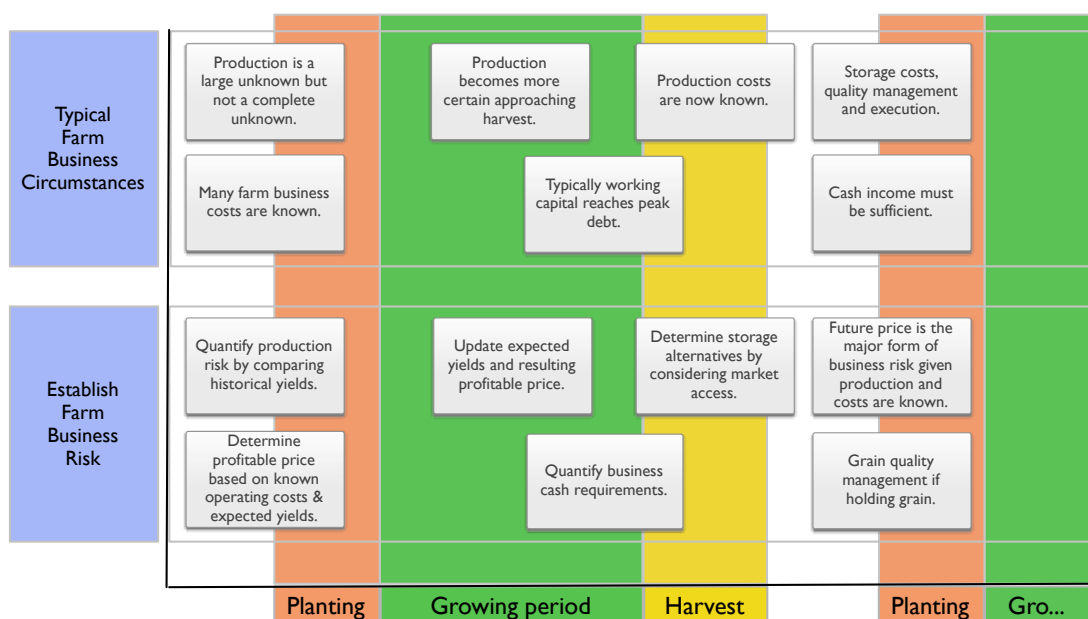


Figure 3: Timeline of grower commodity selling principles.

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).



Note to figure:

When does a grower sell their grain? This decision making is dependent on:

- Does production risk allow sales? And what portion of production?
- Is the price profitable?
- Are business cash requirements being met?



Figure 4: Typical farm business circumstances and risk.

Source: Profarmer Australia

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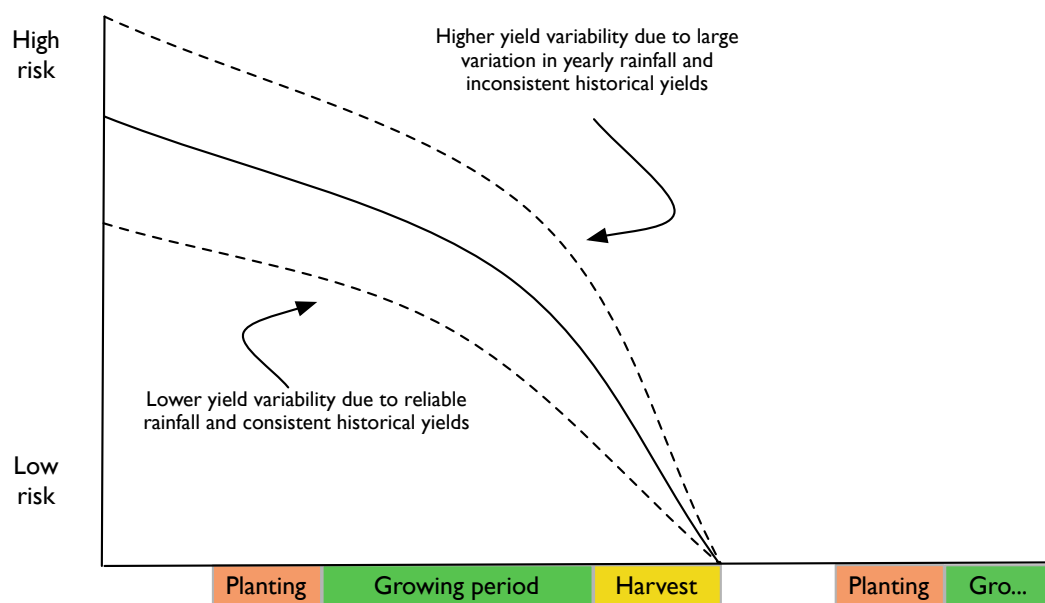
Production risk profile of the farm

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 (see 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.



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 farm 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).

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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 fees	\$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 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 x planted area.

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

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

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

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

Figure 6: An example of how to estimate the costs of production.

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

Income requirements

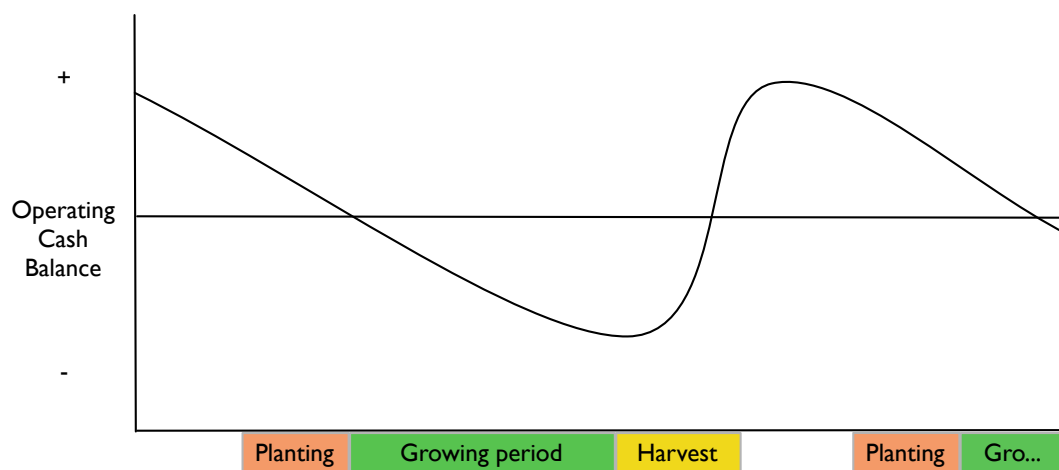
Understanding farm business cash-flow requirements and peak cash debt enables growers to time grain sales so that cash is available when required. This prevents having to sell grain below the target price to satisfy a need for cash.

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. The second figure demonstrates how managing sales can change the farm's cash balance.

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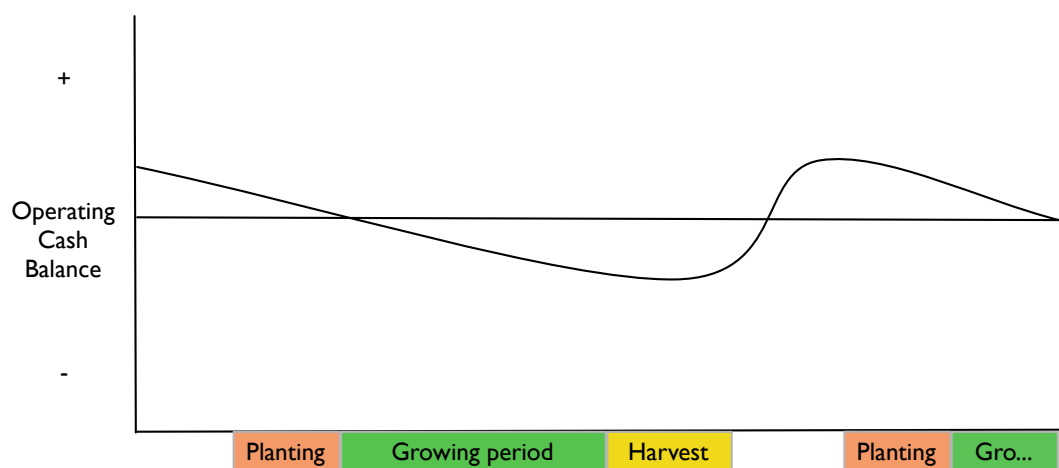
In this scenario peak cash surplus starts higher and peak cash debt is lower

Figure 7: Typical operating cash balance.

Source: Profarmer Australia

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 lower and peak cash debt is higher

Figure 8: Typical operating cash balance.

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.



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.

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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.

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 (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	Provides the most price certainty	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash, futures, bank swaps	Cash	Cash	Cash	Cash
Floor price products	Limits price downside but provides exposure to future price upside	Options on futures, floor price pools	Options on futures	Options on futures	none	none	none	none
Floating price products	Subject to both price upside and downside	Pools	Pools	Pools	Pools	Pools	Pools	Pools

Figure 9 summarises how the different methods of price management are suited to the majority of farm businesses.

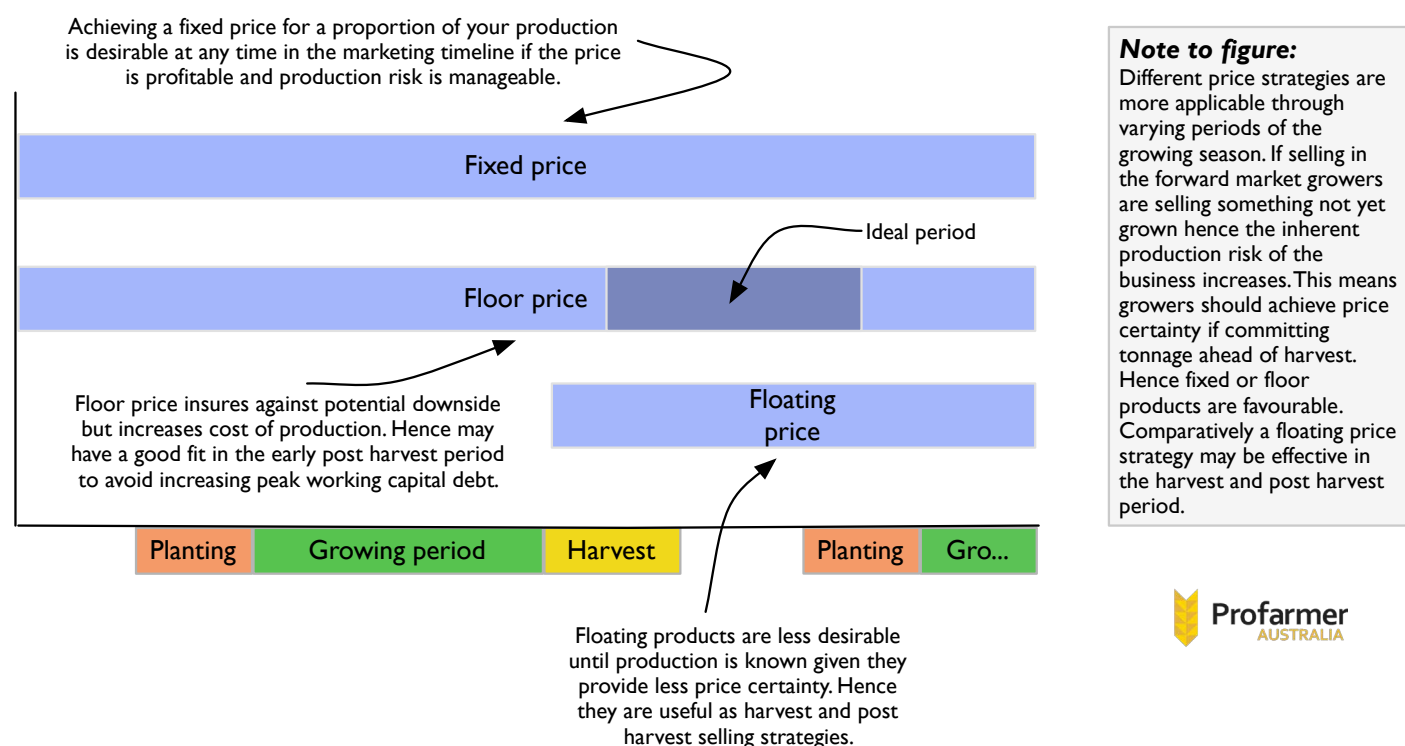


Figure 9: Price strategy timeline, summarising the suitability for most farm businesses of different methods of price management for different phases of production.

Source: Profarmer Australia

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

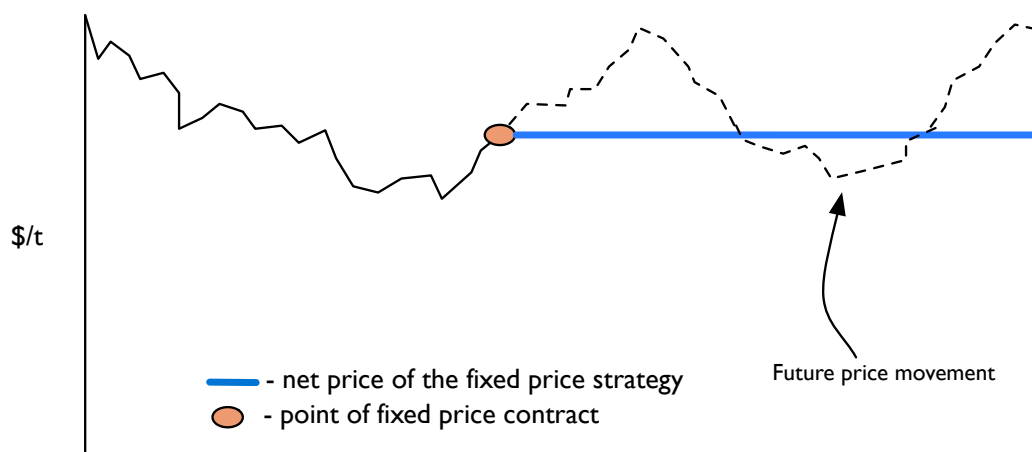
When committing to unknown production, price certainty should be achieved to avoid increasing overall business risk.

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.

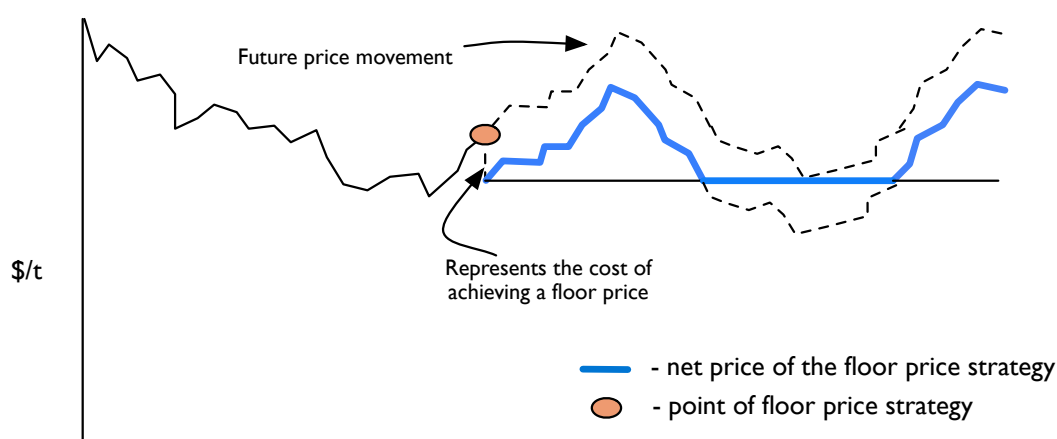


Figure 10: Fixed price strategy.

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 downside whilst capturing any upside. The disadvantage is that the 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.

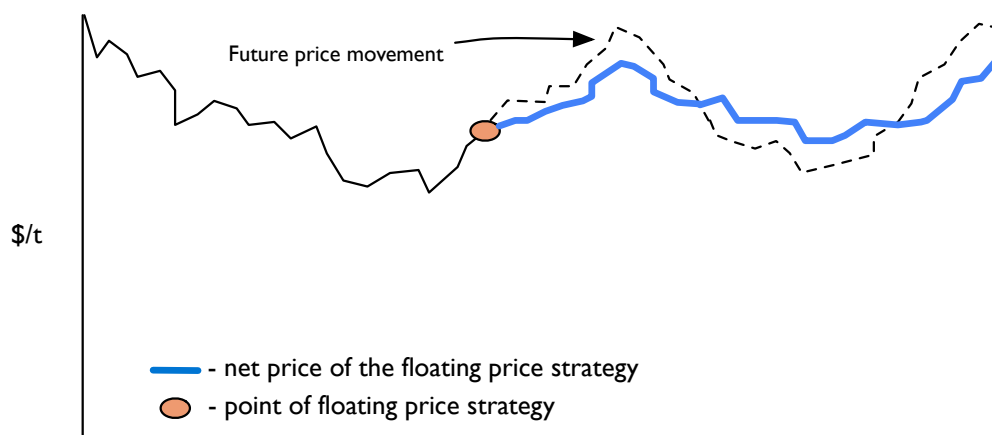
Source: Profarmer Australia

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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.



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



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 mechanism, the farmer may revise their selling strategy.

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.

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).

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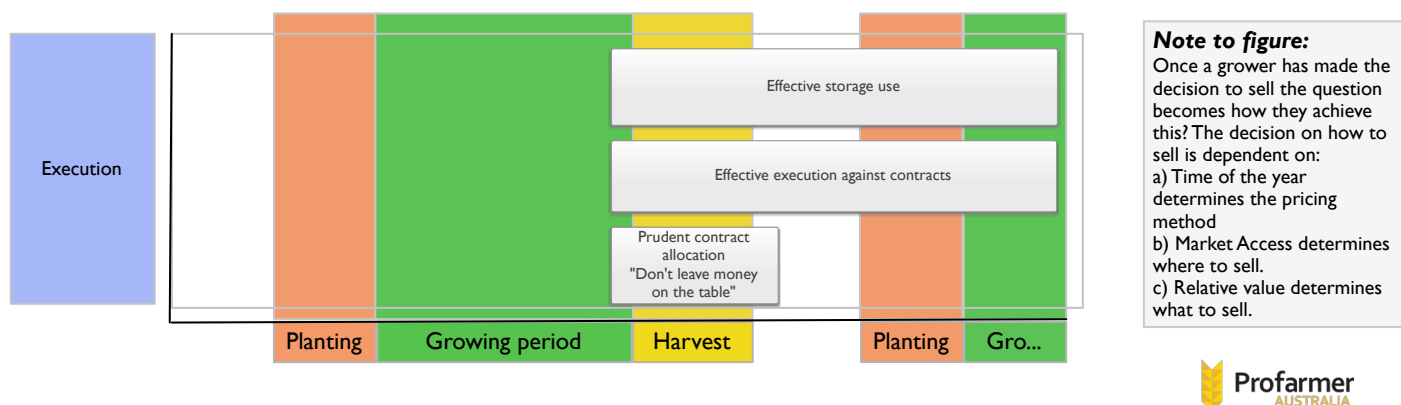
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Figure 13: How storage decisions affect selling time, and must be accommodated as part of the timing of all farming practices.

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 prudent delivery management to ensure commodities are received by the buyer 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.

MORE INFORMATION

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

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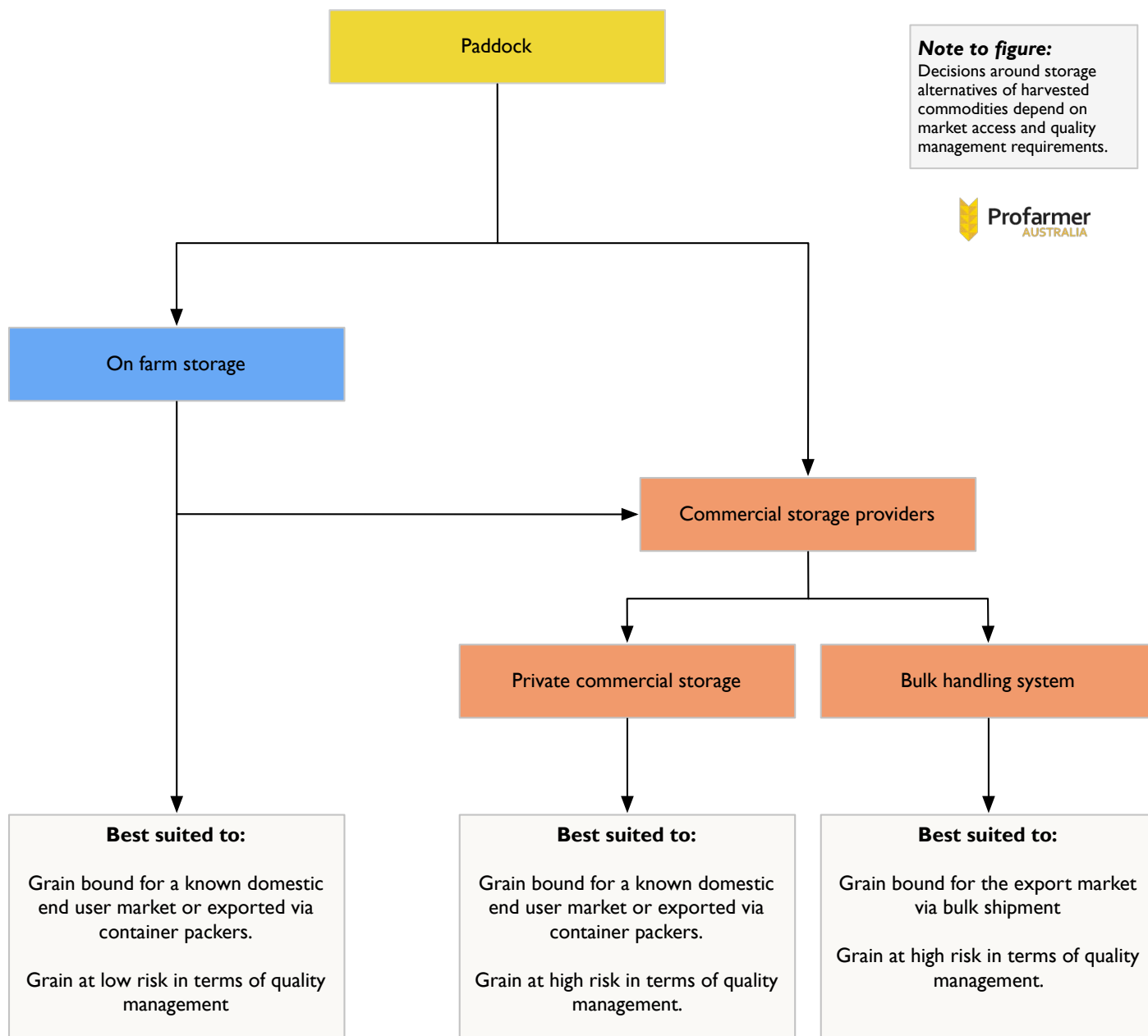
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Figure 14: Grain storage decision-making.

Source: Profarmer Australia

Cost of carrying grain

Storing grain to access sales opportunities post-harvest invokes a cost to ‘carry’, or hold, the grain (Figure 15). 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).

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

The cost of carrying also applies to grain stored on the farm, as there is the cost of the capital invested in the farm storage plus the interest component. 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.

If selling a cash contract with deferred delivery, a carrying charge can be negotiated into the contract. For example, a March sale of canola for March–June delivery on the buyers call at a price of \$300/t + \$3/t carrying per month, would generate revenue of \$309/t delivered in June.

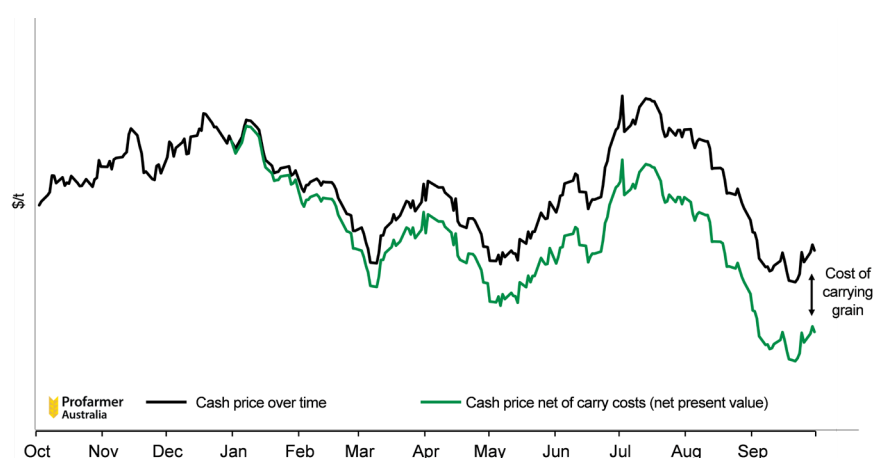


Figure 15: *Cash values v. cash adjusted for the cost of carrying.*

Source: Profarmer Australia

Optimising farm-gate returns involves planning the appropriate storage strategy for each commodity to improve market access and ensure that carrying costs are covered in pricing decisions.

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 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. A better return on investment for the farm business is achieved through higher farm-gate prices that are obtained by accessing timely information, and the seller's greater market knowledge and greater market access.

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MORE INFORMATION

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

[Commodity futures brokers](#)

ASX's [Find a futures broker](#)

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 16):

- 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 manage 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.

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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: _____

Grade: _____

Quantity: _____

Packaging: _____

Price: _____

Price Basis: _____

Delivery/shipment Period: _____

Delivery Point and Conveyance: _____

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

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

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

Other Special Terms and Conditions: _____

GTA Commodity Reference: _____

Inspection: _____ (Origin - Destination)

Tolerance: _____ (Refer over)

Weights: _____ (Origin - Destination)

Excl/Inc/Free GST _____

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

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

☐ Please issue a RCTI (Please ☐)

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

Buyer's Name: _____

Buyer's Signature: _____

Date: _____

Seller's 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 16: 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 17 depicts the terminology used to describe these points and the associated costs to come out of each price before growers receive their net return.

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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

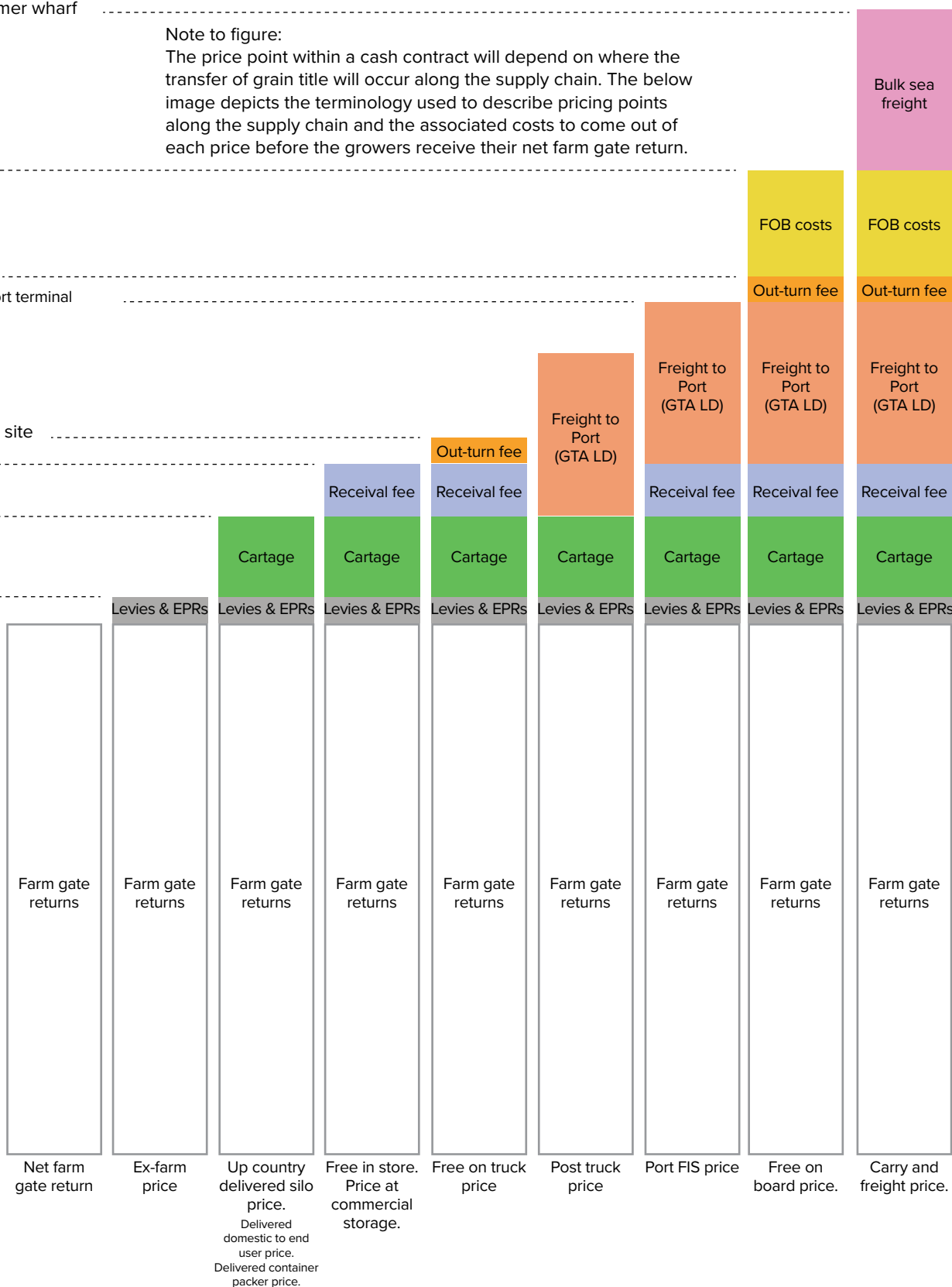


Figure 17: Cost and pricing points throughout the supply chains.

Source: Profarmer Australia

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[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](#)
[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. Achieving \$5/t more on paper and not getting paid is a disastrous outcome.

Relative values

Grain-sales revenue is optimised when selling decisions are made in the context of the whole farming business. The aim is to sell each commodity when it is priced well, and 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.

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Contract allocation

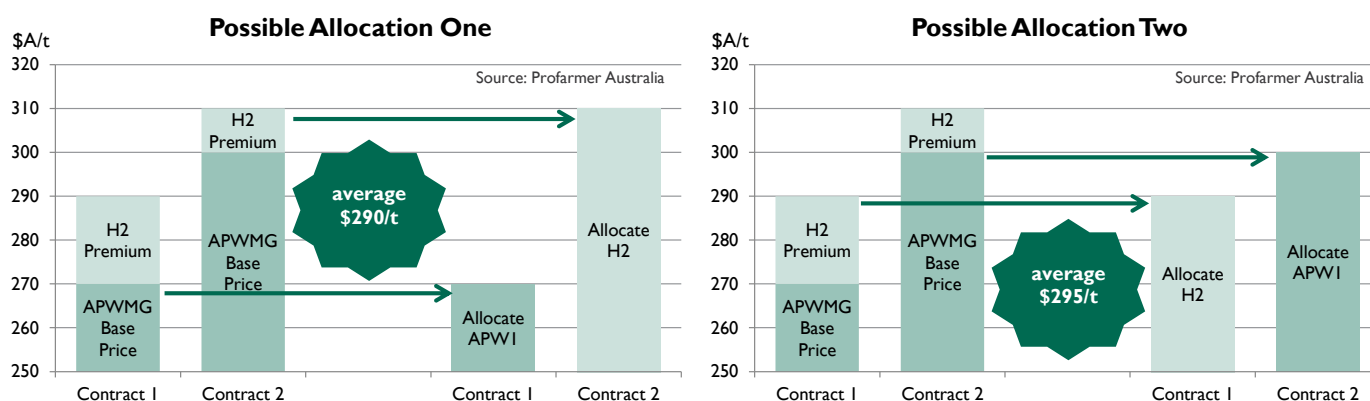
Contract allocation means choosing which contracts to allocate your grain against come delivery time. Different contracts will have different characteristics (e.g. price, premiums-discounts, oil bonuses), and optimising your allocation reflects immediately on your bottom line.

Principle: Don't leave money on the table.

Contract allocation decisions don't take long, and can be worth thousands of dollars to your bottom line.

To achieve the best average wheat price growers should:

- Allocate lower grades of wheat to contracts with the lowest discounts.
- Allocate higher grades of wheat to contracts with the highest premiums (Figure 18).



Note to figure:

In these two examples the only difference between achieving an average price of \$290/t and \$295/t is which contracts each parcel was allocated to. Over 400/t that equates to \$2,000 which could be lost just in how parcels are allocated to contracts.

Figure 18: How the crop is allocated across contracts can have an impact of earnings from the crop.

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 if 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 chart below plots actual trade prices on the Clear Grain Exchange against the best public indicative bid on the day.

The selling strategy is converted to maximum business revenue by:

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- 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.

15.2 Southern durum: market dynamics and execution

15.2.1 Price determinants for southern durum

Durum is a specialty wheat used primarily for pasta products. Due to its specialised use, demand for durum tends to be inelastic and finite, i.e. there is a relatively fixed requirement for durum year on year, and there are few substitutes for it.

The major durum-producing regions are Canada, the European Union (predominantly France and Italy), north Africa and Australia, and the major consumers are the European Union and north Africa. Australian production is split between South Australia at 40–50% and northern NSW and southern Queensland making up the remaining 50–60% of the crop. In a typical year Australia exports 60–70% of its durum production with a small number of local food manufacturers consuming the remainder (Figure 19).

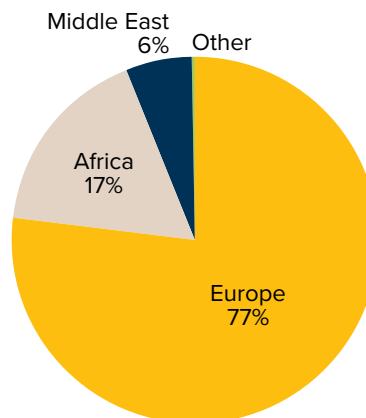


Figure 19: Export destinations for Australian durum

While durum values are influenced by the price of bread wheats such as APW1, these two wheat varieties ultimately have different markets and hence at times the price relativities between the two can separate reflecting differences in the supply and demand dynamics of each market. For example, during the 2014–15 season, untimely rains saw European Union durum production fall to historically low levels, and their import requirement rose to its highest level in five years. This coincided with weather-damaged crops in Canada and the United States, and with a smaller crop in Australia. Hence the production of durum wheat globally was not adequate to cover demand, and this resulted in a \$200/t+ premium for durum wheat in Australia over APW1 varieties, despite an ample supply of Australian bread wheats (see Figure 20).

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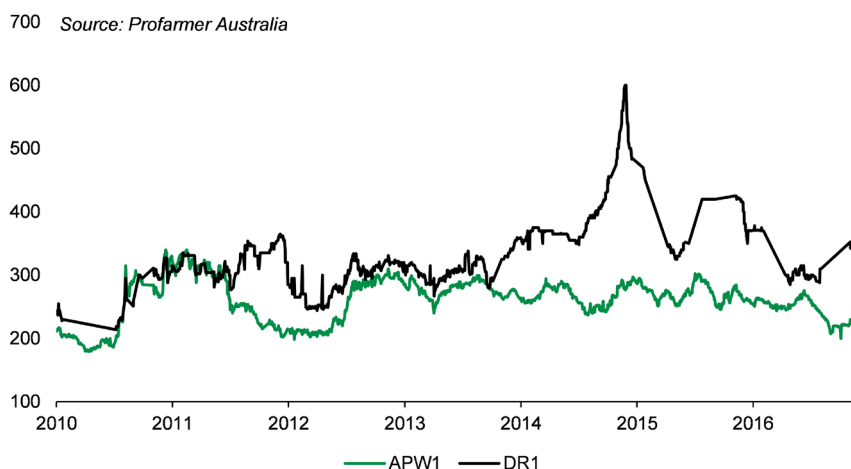
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Figure 20: Port Adelaide durum values, showing the price spike in 2014–15.

Source: Profarmer Australia

Therefore, when global durum supply fails to meet demand, durum can trade at strong premiums compared to bread wheat as the market competes to secure their demand requirements from a smaller global crop.

However, in years when global durum supply exceeds the finite demand, Australian durum values tend to be weak relative to bread wheat varieties, as Australian durum is discounted to compete for a smaller amount of international trade activity, as well as competing for alternate homes in the domestic market (e.g. stockfeed markets).

Hence a major determinant of Australian durum values is the price at which international trade is transacting. This is influenced by:

- global supply v. demand
- the quality of the global crop
- the timing of the Australian export program

15.2.2 Ensuring market access for southern durum

Due to the inelastic nature of durum demand, consumers and exporters traditionally focus their accumulation programs on the period immediately leading up to, during and after harvest, when supply is the most certain. Hence the buying appetite for durum tends to be strongest from October to January. Australian durum exports are typically strongest between January and May in each marketing year, as exporters look to move the crop shortly after the Australian harvest but ahead of the harvest of the northern hemisphere crops (Figure 21).

Over 95% of durum exports are executed via bulk-export vessels rather than container exports. This makes the bulk-handling system an effective means for managing durum destined for the export market.

Being a specialty crop, there are fewer buyers of durum wheat than other grades of wheat. This means liquidity risk is a particularly important consideration for durum growers. Liquidity risk is the risk that buyers reach their accumulation requirements and step out of the market, causing the price to fall sharply, or buyer appetite to dry up altogether.

The timing of the Australian export program is also an important consideration for ensuring market access for southern durum. With the export program typically focused on the first half of the marketing year, it is critical that sellers take this into consideration when making decisions about the timing of sales.

Holding durum later in the post-harvest period may result in a scenario where by there is no buyer appetite for the grain. For this reason, in most seasons holding

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durum later in the post-harvest period should be considered a higher risk compared with holding other grades of wheat or commodities.

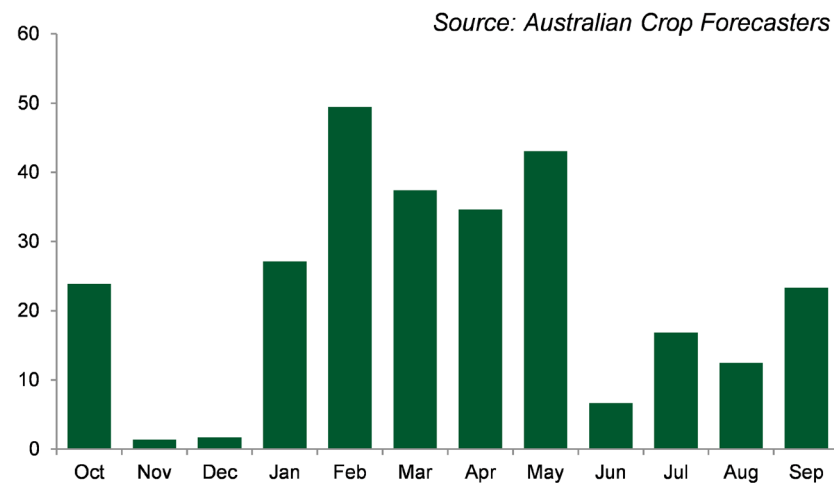


Figure 21: Average monthly export pace for Australian durum over 10 years.

Source: Australian Crop Forecasters

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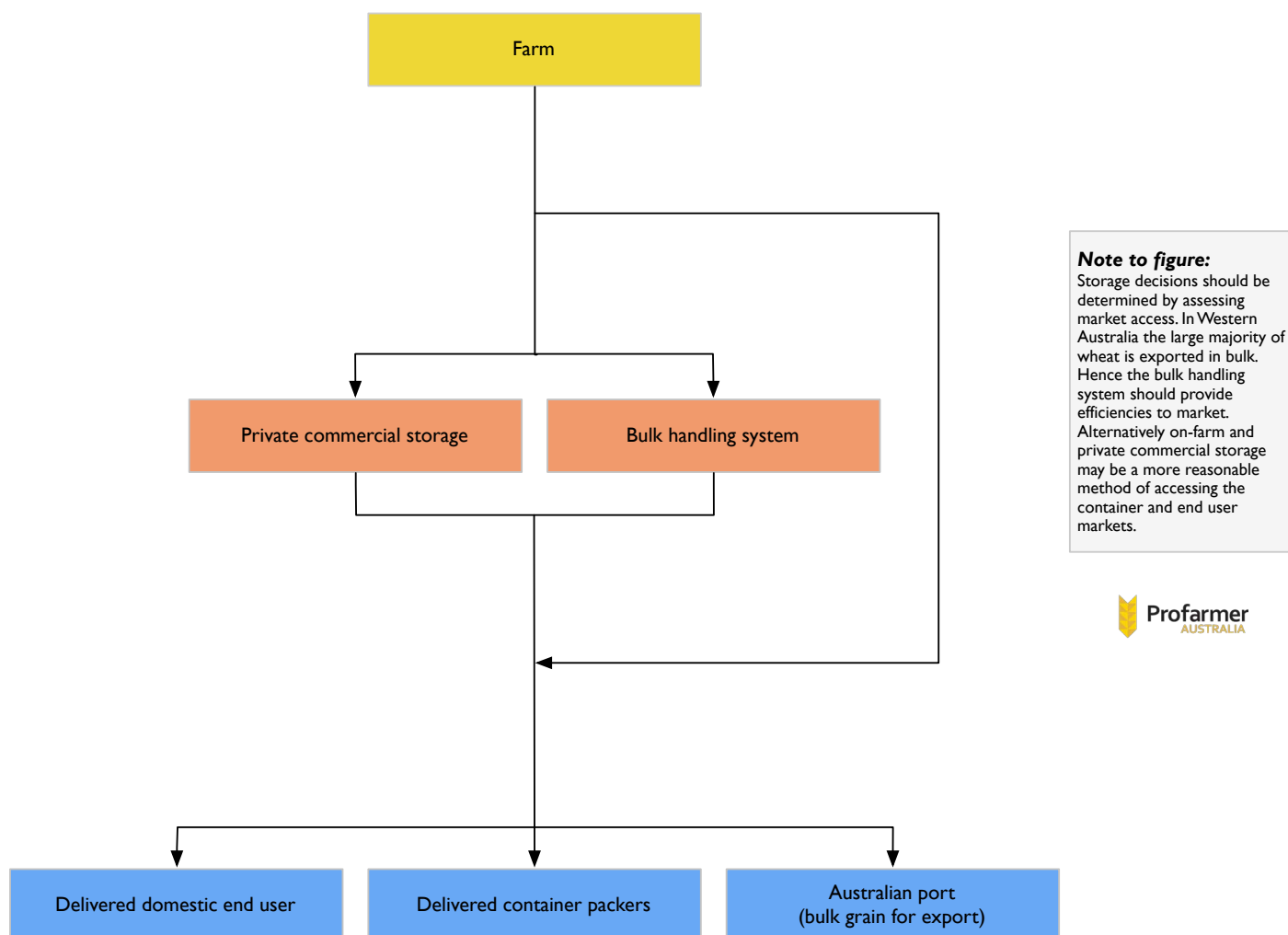
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Figure 22: Australian supply-chain flow.

Source: Profarmer Australia

15.2.3 Converting tonnes into cash for southern durum

Growers of durum have a number of avenues to convert tonnes of grain into cash.

In the forward market, an area program allows producers to commit to planting a certain area to durum and the buyer may take on some or all of the production risk. These contracts are normally offered directly by domestic users or by their agents. Area contracts can take a number of different forms so it is important when comparing these contracts that the seller considers the following risks in particular:

- Production risk—is the buyer taking on all of the production risk, or does the contract include minimum and/or maximum volume commitments?
- Quality risk—what premiums and discounts are being offered for protein, screenings and other quality parameters? Are quality discounts based on a sliding scale based on the quality produced, or set based on the bin grade delivered?

Forward durum multigrade contracts for fixed tonnages are also available. An important consideration of any forward contract is the quality that is deliverable against the contract. There are a large number of receival grades for durum from DR1 down to DRF, so it is important to consider which grade you may end up delivering and whether you are able to deliver the quality specified in your contract.

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Pricing in the durum market is not always transparent, with few buyers and a number of transactions taking place outside the public indicative bid, so it can be difficult to gauge fair market value. In periods of short supply durum can trade above the indicative public bid. Hence placing a firm offer to the market above the public indicative bid can be an effective means of achieving fair value for your durum. Considering market conditions and prices from several previous years, e.g. the last decade, may help you decide on contract terms and the price you want to achieve (see Figure 23).



Figure 23: Port Adelaide durum deciles. Deciles provide an indication of price performance relative to historical values. Decile 1 indicates values in the bottom 10% of historical observations, and a decile 9 indicates the top 10%. This chart is based on price observations from August 2009 to current.

Source: Profarmer Australia