



## IRRIGATION RESEARCH & EXTENSION COMMITTEE

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FOR IRRIGATION CROPPERS

### Price risk management

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As most growers would recognise there has been great price volatility within grain markets in the past twelve to eighteen months. Prices in the international market place are now at near record levels. These massive movements in price are sometimes difficult to comprehend and many growers have great difficulty in understanding why prices move in such a manner, let alone how to set in place a strategy to manage these big swings in price.

Many of the previous generation suggest back in their day grain marketing was simple and it was. Grain quality was based on fair average quality and there was one price set as per a national pool. Until these recent events grain prices have generally been stuck in a range that paralleled 1960s and 1970s values, while input and general business operating costs have moved with the times, meaning margins are continually being squeezed.

Price transparency and subsequent price discovery have been one of the major developments in grain marketing. The IT revolution has meant it's very simple now to know what the price for wheat is in Chicago in the USA, Matiff in France, even now in Australia through the ASX. You can log onto the internet and know instantly what value wheat is trading at. So now that growers have confidence in knowing what value wheat is, the next step is to put in place a plan to establish a price that meets individual requirements.

## Marketing - The Basics

Many growers when you mention price risk management think forward contracting, futures, currency, basis, swaps, options, loan pools etc. Risk management can include using all these products, but the first step in any program should be about putting the basics in place. Geographical location will underline most of your marketing decisions from the outset. Growers on the Eyre Peninsula of SA will have a very different set of parameter to growers situated on the Darling Downs in Qld, in terms of buyers and markets available. Understanding your locality should be the nuts and bolts of your marketing plan. It should dictate what type and variety of crops you grow and what markets are being targeted.

Why would you grow a malting barley variety if you knew that you were looking to sell the bulk of that crop into a feedlot or dairy market? It may also be that instead of growing a hard wheat variety, which will drive your input program in the pursuit of a high protein, a higher yielding lower protein feed grade wheat may be more suitable. The livestock market is only ever going to pay flat price and their key quality parameters are based on low screenings and energy values.

## Drawing Arcs and Freight spreads

Many growers are moving to build private storage and tap into the expanding East coast domestic consumer market. Before you make such a significant investment, do your homework. Does on farm storage fit in with your overall marketing strategy? Again geography will dictate a number of issues. If you are in a hard wheat area and you are planning to store hard wheat on farm, who are you selling to? Again if it is a livestock consumer are you really getting true value for your grain? If you are storing grain and marketing it as hard wheat are the consumers prepared to pay for that quality ie protein, moisture and screenings.

## Know your rail and road freight spreads

Growers in a region like Murrayville will know that the rail freight rates to Port have been in the vicinity of \$25-26. The average road freight from farm to depot is around \$8-10 so the net freight component back to farm gate is going to be around \$35. Storage and handling of grain whether it be through the bulk storage system or privately is approximately the same, around \$10-14. The road freight leg from farm gate to end users may be \$40-45 depending on volumes, back loading opportunities etc. So as a grower in that region you really need to weigh up the value of storing on farm grain unless you have a clear strategy of selling your crop into a market that is going to achieve a better net result.

In a normal production year East coast grain will still be in surplus to domestic demand. This year current supply numbers on wheat and barley on current yield estimates equate to around 17million mt. Domestic

demand for same grain east coast total as it stands this year is approximately 10million mt. Even with the touted expansion of ethanol, the numbers as they currently stand mean grain prices will still be driven by export parity numbers.

End users on the East coast know what parity value is and know exactly how much over that value they have to pay to secure grain supplies. In tight / drought years as we have just been through, values will move at lot closer to import parity values and up country pricing becomes the benchmark. When making your marketing plans are you factoring in a grain surplus to domestic demand or a deficit? We historically have more surplus years than deficits therefore should plan for such outcomes.

## Life cycle of the crop

It's a given now that you can market one individual crop over a period of 10-36 months and longer. This may mean forward contracting as far out as the 2009/2010 season or conversely you can market grain in the post harvest period into pools that can run for 12-18 months and store grain theoretically for as long as you like.

The philosophy on risk management can be as simple or as complicated as you like. Before you even begin to plan cropping program there should be a clear mindset as to where you are going.

An integral part of your risk management strategy should be know your individual crop gross margins and have a clear view of the target prices required to achieve sustainable return. Grain marketing can be an emotional exercise if you let it. Human nature dictates that we are always chasing that bit more, that better price. Picking the top of the market has proven over time to be a fruitless exercise. Knowing your costs, setting your targets at achievable levels and taking the emotion out of your marketing are keys to better risk management strategies.

If you are comfortable with forward contracting through the growing season then there are a couple key factors to take into account. The rule of thumb is to do no more than 30% of what *you* would consider a Safe Anticipated Tonnage. There are numerous contracting options now available to growers to price part of the crop; some have higher risk profiles than others. From fixed price multi grades to derivative style contracts there is a vast array of products to now choose. A good grain merchant should understand your business and your risk profile and be able to tailor product(s) to suit your needs.

As we move through the cycle of the crop there are more opportunities to set price, further sales are possible closer to harvest, some contracting options that were of value a long way out from harvest may become less relevant as we move closer to harvest.

The post harvest period also brings another set of contracting option to the fore. Many growers will not sell until crops are stripped and in storage, the window of opportunity is still wide open in the post harvest period to price grain. Grain held in storage has costs in the form of interest and warehouse costs. Carry changes based on today's sales equate to around \$2.60/mt/month plus physical cost of receiving and out turning grain. You have to continually question the logic of why you are storing grain, what is the potential upside versus the downside in price. Essentially growers storing will be trying to achieve higher prices, have stockfeed needs covered and possibly financial/ taxation issues to negate.

Price risk management and marketing means different things to different people. Within our business at Australian Grain Accumulation we have a somewhat dynamic relationship in that our owners are also our customers. As part of this business structure we have the mindset of treating growers as suppliers to these customers, rather than just producers of a commodity.

An integral part of our business is matching our customer's needs with that of what our suppliers require. Whilst price is nearly always near the top of suppliers list of requirements it may be that other services offered are just as important. Our ability to match supplier's risk profile with a strategy that will enable growers to achieve their overall targets is a key driver of our business. A key platform to our business is what we call a Value Proposition which is about providing recognised long term value to Australian growers.