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Grain marketing in the real world

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GRAIN MARKETING IN THE REAL WORLD

GRDC GROWER UPDATES – AUGUST 2009

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PLEASE NOTE: *These notes are provided some weeks prior to the Updates as guidance for the proceedings. Slide presentations available on the day will provide more current and detailed information – markets will remain volatile over 2009!*

KEY MESSAGE

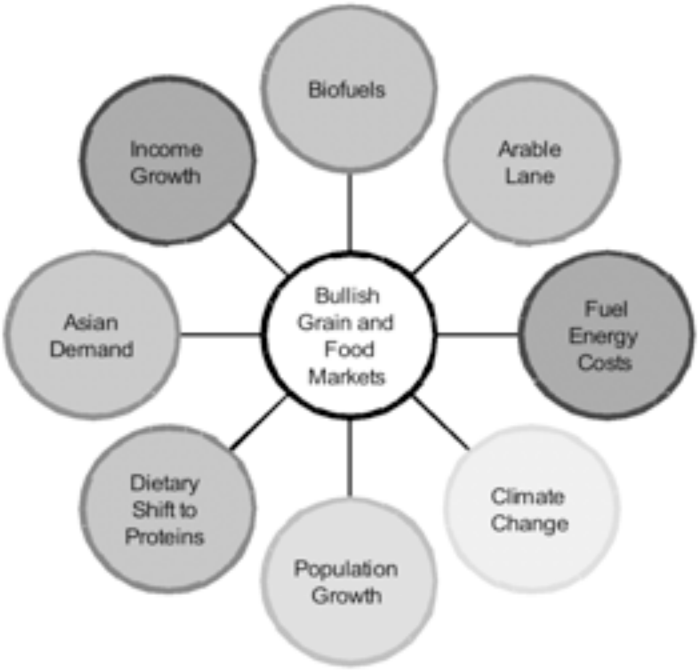
Agriculture and grains retain a sound future, despite the 30-40% drop in prices from the record 2008 levels. Growers should not expect another 2008 spike, but they should plan to capture profitable returns as they present. Deregulation of the export wheat market means it is now up to the individual farmer to have a plan to achieve this. The focus should be on "plan, don't predict".

This paper focuses on three main themes:

1. *Broad Trends in Grain and Agricultural markets.*
2. *Export wheat deregulation – what have we learnt?*
3. *What are the key influences on prices in 2009?*

1. Broad Trends in Grain and Agricultural Markets

- When talking of trends it is critical to define the time horizons we are talking about. In grain, it can look like this:-
  - Traders – from 1-30 days
  - Consumers – 30-300 days: typically look at a full year/season requirement for their plant
  - Farmers – at least a season and often a generational view (out to 20 years: what shape can I leave my farm in for my kids?)
- While world prices have halved from the record prices in 2008 (over US$10/bushel) to around US$5/bushel in early July 2009 (it was US$6/bu in early June), prices are still at historically high levels (approx US$3.50 -5/bu over the previous decade).
- From a longer term farmer perspective, food and grain looks a good business to be in. There has been a paradigm shift in global food and agricultural markets; markets that were predominantly supply driven by production surpluses in the 1990's are now increasingly demand driven.
- Supply is constrained (arable land, climate change, fuel/fertiliser costs), while demand is strong (dietary shifts, Asian demand, biofuels growth, income & population growth). A range of factors combine to make grain and food outlook positive over the next decade.



- Fuel and energy is repricing agriculture. This sets up a number of paradoxes: food vs. fuel, land protection vs. land development, environmental protection vs. the need to feed the world's people.
- Security of supply is a new risk for grain buyers to manage and timely market information is critical to managing their supply chains.
- Direct contracting of supply from producers to particular end users is likely to grow. It will not be a one-size-fits-all outcome.
- Market information to enable the matching of food/grain accumulation products to end-product and customer segments will become more important. Just as important will be the relationship building to make the supply chain sustainable and flexible for both parties.
- For the Australian grains sector, there are challenges with climate change, water management, infrastructure, etc, but fundamentally Australia's freight advantage to Asia, world class quality systems, highly mechanised and professional production systems, and stable political and legal environment make the outlook POSITIVE.

2. Export Wheat Deregulation – what have we learnt?

- Despite some predictions of doom and gloom from export wheat deregulation, to date there have been no "disasters". Around 23 exporters are accredited, with no one as yet emerging as dominant.
- Mistakes were made by some bulk-handlers who underestimated the demand of exporters to ship early.
- In some cases (mainly WA), export shipping capacity was over-booked with resultant queues of ships. The primary blockage was lack of rail capacity, not lack of export terminal capacity to load ships.
- The rain-delayed harvest, both east and west coast, proved to be a challenge for those exporters who sold forward based on early shipment of new crop. At times, we saw these "shorts" having to pay up to get grain to meet their shipping commitments.
- Growers proved to be smart owners of their stock and taking their time to sell. A high percentage of grain was either stored on-farm or warehoused, as well as some growers taking cash where they saw it attractive.
- Export customers have acted in a hand-to-mouth fashion from late 2008 and into 2009 as they feel confident about supply of grain and are prepared to watch prices stabilise. Importantly, traditional human consumption demand throughout Asia and Middle East remains sound.
- Customers have also shown a preparedness to "shop around" with Australian suppliers, so that exporters have to be price competitive to win the business. If the price is not competitive from their traditional supplier, they will switch to another supplier.

- **The primary impacts of deregulation at a farm level appear to be on:-**

Grower selling

- Spread over the full year instead of harvest period
- Major increase in cash selling and decline in pools
- Major increase in demand for grower services/information. Growth in grower brokers for price discovery and advice (at approx 1% cost)
- No evident market depression at harvest
- Growers see the price differentiation by grade and location as driven by the quality and volume required by customers. This is individual to customers and remains only so long as the customer demand is open.

On Farm Storage

- Do it well and benefit, do it poorly and lose
- Upside from blending; downside from poor hygiene
- Saving in supply chain cost to domestic consumer, but must know and manage the quantity and quality. Rejection at delivery is very costly.
- Improves harvest logistics to cope with harvest surge (speed of big headers), but may reduce your access to market post-harvest (e.g., access to price spikes of export supply chain if stored in the BHC system)

Price Volatility

- Direct world price signals every day to farm gate versus previous masking of this volatility through smoothing of pools
- Here to stay: lower world stocks and hand to mouth customer behaviour
- Individual companies take positions on specific grades and locations
- Offers a new post-harvest value add opportunity

Differential Supply Chain Costs

- Different customers have individual freight rates at different sites for different grades (e.g. could be $10+ difference between contiguous sites depending on how a rail rate for high outload/throughput may compare with a road-only site). These customer and product specific supply chains will continue to grow.

Contract Management

- Growers have to rapidly adapt to an environment where their grain marketing is governed by contracts – no longer a "best endeavours" or "she'll be right" approach.
- The Grain Trade Australia (GTA) contract is the standard and every grower must become accustomed to its terms. Contract tolerances, quality specifications, shipping terms, payment terms, counterparty risk, etc. etc. etc. It is a new world in which near enough is not good enough; it will be the contract which spells out the outcome. Growers will ignore contract management at their peril – or get someone to do it for them.

3. What are the key influences on prices for 2009?

- The run-up to record 2008 grain prices was building for several years starting with the US Govt decision in 2005 to support corn-ethanol plants (ethanol now accounts for 30% of the US corn crop). This was followed by a series of poor grain crops over 2006 and 2007. Australia had droughts in 2006 and 2007, US and EU suffered relatively poor crops in 2007 (esp. eastern Europe),
- Apart from the new ethanol demand, traditional demand for grains remained strong (rising disposable incomes in Asia and India, changing diets to more poultry, pork, dairy, beef, etc)
- The end result in 2008 was world stocks of grains and oilseeds at record lows and an explosive price situation, further fuelled by hedge fund managers who poured money into soft commodities to drive futures markets even higher.
- Analysts spoke of competition between crops (wheat, corn, oilseeds) for the available land, where each commodity had to "buy" land away from the other.
- The rest is history. Price works! - A$400 per tonne is too profitable!! Growers around the world responded by growing more grain. 2009 produced a record world wheat crop and prices tumbled by 40%.
- The global financial crisis compounded the price corrections with fund managers having to liquidate their commodity positions to meet bankers' demands for security – futures markets also tumbled.
- BUT, despite the drop from around US$9/bushel in mid-2008 to US$5-6/bushel in Jun-Jul2009 (having touched US$5/bushel in Dec 08 and early July 09), these price levels remain high relative to the last decade average in the US$3.50-5.00 per bushel range.
- Input costs appear to be undergoing a major downward price correction. Oil is now at approx US$65-70/barrel c.f. US$140/barrel in mid 2008.
- Finally, stock levels remain sensitive to any interruption to normal crop yields in 2009, so the stage is set for continued volatility.

So where does that leave us for prices from now till 2009 harvest?

- Spot old crop wheat (ASW delivered capital city) is approx A$290-300 and FB1 Barley at A$225-235. New crop (Jan 2010) is A$250-260 for ASW and A$200-210 for Feed Barley. (Note: prices at time of writing). If these prices remain, there is clearly no incentive or reward for holding grain, BUT as we know, the world does not stand still!

  The key influences on prices are expected to be from the supply side, with demand remaining steady. Therefore the main factors are (1) weather and (2) A$.

- July to September weather is critical for the US crops.

- Both corn and spring wheat acres were higher than expected in the 30 June USDA report, while soybeans were under expectations. Spring wheat (high protein) was planted late and the Canadian and Argentinean crops have suffered some damage from dry weather. The US/Canadian crops need kind weather to achieve average yields. If they get ok weather, then supplies will be ample and the price pressure will be down (which is reflected in the current bid prices for Aust new crop).

- In Australia, Aug-Oct is critical, and with the Bureau of Meteorology forecasting likelihood of return of El Nino in second half 2009, the question is whether it bites in spring time or later, and where? Until this production risk to the Australian crop is resolved, the current forward prices for Jan 2010 are not attractive to growers.

- 2009 prices for cereals can retrace back towards 2008 levels (although not expected to reach those highs), but only if we see a significant crop reduction in a major producer over the Aug-Oct period. Without such a production scare, the price pressure is likely to remain on the downside. Note: This scenario does not apply to canola, where the world balance sheet for oilseeds (esp. soybeans) remains very tight and it is difficult currently to see much downside to oilseed prices until we see production being assured over the last half of 2009. At current price levels, we would expect to see South America make a large acreage shift to soybeans from wheat and corn in the 2009-2010 season.

- Prices for the 2009-2010 Australian crop will be determined by export values unless we have the horror spring again, in which case domestic prices will move above export values.

- The A$ has now traded around US80cents for a few months. Only two months ago it was closer to US70cents – a difference of $35-40 per tonne at today's grain values!! So where the A$ sits when we come to harvest is critical. A rough rule of thumb at current prices is US1 cent equals A$3.50-4.00 per tonne.