Western Grain

Following deregulation, farmers are taking up the challenge of marketing their own grain

There's money in deregulation

Joy Angwin

As many primary producers from across the State take off a harvest that will bring mixed results in terms of both price and yield, some farmers will be celebrating another good year of very high prices.

Wheat prices will still fluctuate regardless of deregulation because the market is a global phenomenon. However, the key lies in how this market is managed by farmers.

Surprisingly, the marketing formula we use was developed by an individual who had little knowledge about the technical side of farming, but has scrutinised the buying and selling of agricultural products and questions conventional wisdom.

David Burton is the managing director of Commodity Hedging Company (CHC). His experience in commodities dates back to 1983 when he was employed by a Brisbane-based Asian futures broker.

In 1987, he joined the Cotton Marketing Board and worked there until he started his own business in 1990. The cotton industry was one of the first to be deregulated in Australia and David's job was to hedge currency and futures, in addition to educating growers on risk management.

The methods that David uses will seem complicated to most people because they involve the complex cycle timing of the well-known forecaster W.D. Gann, which David says took him several years to understand. Having dealt with farmers' businesses and hedging for more than 20 years, David was able to develop a hedging program combined with time cycles, weather forecasting and strategies to reduce risk.

When other advisers and farmers lost a combined $100 million in WA alone in 2007, David's clients received $600 a tonne. Why? With the use of time cycles, he was able to forecast the high 12 years in advance, the findings of which were published in July 1996 in *Your Trading Edge*.

Momentum in the grains industry is gathering pace and creating a situation where farmers have increasing control over prices and can boost the revenue generating capabilities of their businesses. Consequently, growers such as myself are keen to share David's success and tell our story to encourage others to explore new thinking in a deregulated market.

HISTORY

The history of how the Australian wheat industry became a monopolized entity dates back to 1915, when an Australian Wheat Board — comprising representatives from each wheat-growing state — set up a pooling scheme to assist growers.

TABLE 1: PRICE COMPARISON

Year	Average Marketing ($A/t)	AWB Pool ($A/t)
1991	307	132
1992	213	200
1993	217	165
1994	254	174
1995	301	237
1996	344	260
1997	280	212
1998	232	197
1999	200	186
2000	184	195
2001	192	232
2002	284	261
2003	316	265
2004	482	215
2005	358	197
2006	424	265
2007	830	422
2008	976	325
2009	698	258

War-time measures were beneficial to growers because they were freed from the dominance of wheat merchants and the actions of price and shipping cartels, which led to depressed prices. Growers did not have the communication methods then that they have today.

In addition, in the early 1930s, the impact of the Great Depression, government intervention and a period of rapid expansion in the industry saw world wheat prices decline significantly, and the industry entered a serious slump. Through extreme times, measures such as the ones adopted were necessary.

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From World War I to 1984, comprehensive wheat marketing legislation was enacted, which in simple terms removed producers' competition in the output market. While the industry focussed on technological innovation — improving yield and quality of the product — wheat prices were determined by the expertise of the wheat board of the time.

There was no perceived need for farmers to understand the commodity markets that determined their price, it seemed.

Dongolocking grain growers Joy and Scott Angwin market their own grain. PHOTOS: DANELLA BEVIS

In recent times, one wonders if regulation empowered farmers in any way? Were the prices achieved representative of the opportunity available through the expertise of highly paid marketing people and executives, or did both the legislation and costs diminish the returns? Did it create farmers who had dynamic business plans, or did it leave them struggling and reliant on costly consultancy to give them direction and assistance with their business?

Wheat farmers have now entered a new era where they have the opportunity to control their own marketing. When attending information workshops, growers are given a multitude of information on destination markets and international consumption projections and trends, but it is questionable if this information is relevant to the reality of what determines the price of wheat.

CHC clients primarily concentrate on three components of price: futures, currency and basis. The CBOT futures market, established in 1848, was set up to ensure there were buyers and sellers for commodities.

Since 1983, currency can be hedged, so up until two years ago farmers have been able to achieve two-thirds of their own marketing. Unfortunately, the single desk was the only means of controlling basis up until two years ago. Now there are more merchants in the marketplace, which means more competition on basis.

POOLS

David says that — price-wise — pools have never worked in any industry in Australia, and they are well behind what could have been achieved with good marketing. Table 1 explains what could have been achieved with forward hedging of currency alone and does not include picking highs and lows.

Why would grain companies want growers to participate in their pools? It is because the volumes achieved helps to divide the costs of running their businesses. When you have low volume years, as in the case of drought years such as in 2006, the costs become huge.

It is important to understand that the 'estimate' is by no means a guarantee of price. When farmers delve into their business planning and try to understand their risks, then the idea of participating in a scheme that is unsecured — such as pools — would likely cause them to look for greater guarantees (see table 2).

HEDGING

Great prices achieved by growers have been through the use of various hedging tools available to wheat growers only. It is an enviable and unique position that seems to be greatly underutilised.

The use of swaps is paramount in the programme. Making use of the time when high prices occur on the futures market and low currency, and locking these in to the highest percentages allowable to the furtherest date (three years). There is no production risk with swaps and with close monitoring of your position report, a close-out of the position can occur at any time.

David's approach is as follows: when high prices occur and a profit is assured, the hedging percentage is high. Getting paid cash in the shortest time negotiable for contracts and depositing proceeds into their own accounts sees growers making more money from astute business management than languishing over the extended payout process of pools.

The business transactions are much more transparent and easily accounted for and checked over.

In addition to swaps, options, futures and currency contracts may be employed. Growers have never been the recipients of high prices because before deregulation, AWB had a limited forward-hedging programme. So, no marketing had ever been done for farmers.

When the wheat price is high, some merchants have advised growers to not hedge because growera re told these prices will persist for years.

They create a position in the market for themselves. The market drops, the news is bad and you're told there is no foreseeable lift in demand and wheat can only be sold on the market for this amount because nobody wants it.

They then 'buy back' their positions by purchasing grain off the individual.

When it's close to harvest, manag-

Do-it-yourself grain marketing

Beaumont farmer Simon Tiller spends an average of two hours a day keeping up to speed on grain marketing.

Spending hours in front of a computer tracking the grain market, exchange rates and watching grain traders might sound like a job for your grain marketer, but according to Beaumont farmer Simon Tiller, it's helping him to know his business inside and out.

The Nuffield scholar is one of a new breed of market savvy farmers who are spending less time on the tractor and more time on marketing.

He recently attended a two-day grain marketing workshop with other farmers to learn about hedging strategies for dry and high yield years, how to use call options, margin calls, interest rate swaps and wheat pools so he can make the most of a volatile and constantly changing market.

"I spend around 20 per cent of my working week on grain marketing, which is around two hours a day finding out information on currency, basis and futures and constantly reviewing week by week our crop production to make sure we are not under or over-hedged," Simon said.

However, before hedging, Simon said a business plan was needed to identify the total input costs using a 10-year yield average to show what breakeven price is needed, making it easier when hedging.

"We try to achieve a 20 cent return on farm business investment," he said.

"Sometimes we get more than that and sometimes we get less."

While wheat prices have on average fallen by $100 a tonne in the past two years, Simon said the time he spends researching and staying abreast of the situation was worth it.

By doing nothing, and just watching the price fall, Simon said it could cost them $100 a tonne on their 10,000 tonne wheat crop.

"At end of day, the futures market is what drives our profit."

It is the biggest influence on our business, probably more so than the weather."

"It doesn't matter how much it rains from now on, wheat has gone down by $100 a tonne and that's hundreds of millions of dollars just for the Esperance shire alone, which grows 600,000 tonnes of wheat."

TABLE 2: ESTIMATED POOL PRICE OF $200

Estimated Production	Hedge (%)	Yield Increase (%)	Price Increases To ($A/t)	Final Price ($A/t)
2,000,000	100	15	250	207
2,000,000	100	15	300	213
2,000,000	100	15	350	220
2,000,000	100	15	400	226
2,000,000	75	20	250	208
2,000,000	75	20	300	217
2,000,000	75	20	350	225
2,000,000	75	20	400	233
2,000,000	50	25	250	210
2,000,000	50	25	300	220
2,000,000	50	25	350	230
2,000,000	50	25	400	240
Estimated Production	Hedge (%)	Yield Increase (%)	Price Decreases To ($A/t)	Final Price ($A/t)
2,000,000	100	15	175	197
2,000,000	100	15	150	193
2,000,000	100	15	125	190
2,000,000	100	15	100	187
2,000,000	75	20	175	196
2,000,000	75	20	150	192
2,000,000	75	20	125	188
2,000,000	75	20	100	183
2,000,000	50	25	175	195
2,000,000	50	25	150	190
2,000,000	50	25	125	185
2,000,000	50	25	100	180
Estimated Production	Hedge (%)	Yield Decrease (%)	Price Increases To ($A/t)	Final Price ($A/t)
2,000,000	100	15	250	191
2,000,000	100	15	300	182
2,000,000	100	15	350	174
2,000,000	100	15	400	165
2,000,000	75	20	250	188
2,000,000	75	20	300	175
2,000,000	75	20	350	163
2,000,000	75	20	400	150
2,000,000	50	25	250	183
2,000,000	50	25	300	167
2,000,000	50	25	350	150
2,000,000	50	25	400	133
Estimated Production	Hedge (%)	Yield Decrease (%)	Price Decreases To ($A/t)	Final Price ($A/t)
2,000,000	100	15	175	204
2,000,000	100	15	150	193
2,000,000	100	15	125	190
2,000,000	100	15	100	187
2,000,000	75	20	175	196
2,000,000	75	20	150	192
2,000,000	75	20	125	188
2,000,000	75	20	100	183
2,000,000	50	25	175	195
2,000,000	50	25	150	190
2,000,000	50	25	125	185
2,000,000	50	25	100	180

ing your own derivatives is advantageous because you can decide which merchant has the best credit rating and basis.. Farmers need to know about, and calculate, these risks.

STORAGE

Storage of grain is a hot topic this season as growers seek to address their limited margins and explore how they can add value or recover costs. David says clients who store a commodity become a 'cash speculator'. By this, he means they are forecasting that the price of the commodity will increase.

Some farmers stored in 2007 and 2008 when record prices were available. If farmers don't sell when the price is high, when will they sell?

The problem of storage is exacerbated because if you haven't sold last year's crop and stored it instead, it's unlikely you will forward-sell for future years. Therefore, you have lost the potential for profit.

History shows that the price stays lower for longer periods than it does high, so storage is working against you. If you wanted to speculate, you should have sold for cash and bought call options if you believed the price was increasing. You would be financially better off since the interest received would pay for the call option.

Growers nominate a date in the season after harvest when they sell for cash — win, lose or draw — and concentrate on planning for the new season. If price is below cost of production at the start of planting next year, growers should consider not planting.

When a farmer grows a crop and hasn't forward-sold, they become a cash speculator in the hope that prices will increase. It would be dangerous to grow because the prices could stay down for another year, or years, depending on the economic cycle.

In addition, if you have an oversupply due to weakened demand and large production but continue growing, you are creating your own demise because you will be adding more grain to world stocks.

So then, how do you take advantage of a move up in the market without growing?

You would hedge against a price rise by buying futures or call options. You would also save your machinery for high-price years, scale back on labour costs and take the opportunity to rest your soils and yourself. This year, some farmers may be thinking that it would have been wiser to not grow, given the outcome.

David says the amount of debt in the farming sector is a concern. Where risks are plenty in the form of weather and the market — to name a few — the amount of debt adds one more in the form of interest rate exposure.

The cost of paying off debt cripples many farmers. The amount of money needed to cover the taxation liability in profitable years plus the principle owed cripples many farmers.

The mindset not to pay tax by spending money on overvalued products is a bad strategy. A credit position allows for greater creativity and options in determining the price growers can achieve.

In years where there is no guarantee of a good price, the prospect of not growing at all is then available to you.

If you are not presenting a budget to the bank to satisfy their lending criteria, then you have no one to answer to in respect of your intentions with your business.

Growers need to be aware that the banks' lending criteria can change, as seen in the latest credit crisis, and their terms often change as the economy changes such as a move from low to high interest rates and a change in equity status.

SUCCESS STORY

So how are farmers hedging successfully? The story of a number of farmers who met David early in 2008 is similar to mine.

I met David at a workshop in Kulin in March 2008, talked to him at Woolorama, and decided instantly that we needed to use his grain marketing advice and we commenced three years of forward marketing for wheat and canola.

David directed us to scrutinise our business planning and to use the tools available to us in the short term to manage our grain pricing. Now, for our future, we are looking to set up better arrangements with the businesses and banks of our choosing.

We averaged a wheat price of $520 per tonne (1225 tonnes) and a canola price of $670 per tonne in 2008. This was achieved by selling swaps, buying put options and pricing grain at the correct time.

We produced 2500 tonnes of barley, which was all priced and sold before and just after harvest.

> David provides advice, but clients manage the execution of all the dealing. Clients understand the risks of the decisions they make and have strategies planned.
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> JOY ANGWIN

With 1300 tonnes of grain storage available to us, it was tempting to hold onto some grain, but we didn't and it was the right decision.

David has guided us very specifically with managing the risks of fluctuating input costs and suggested how we could 'hedge' our input costs also. Our normal barley planting programme is more than 500 hectares"

In April 2009, David advised us that it was risky to grow barley in the price climate, and because we could not hedge it planting was scaled back to 60ha. The prices were currently at the cost of production.

I believe we are taking significant steps to gain knowledge in understanding what the opportunities and risks are with grain marketing.

We need to be able to use all aspects of the hedging facilities available to us. Managing a fluctuating foreign exchange rate is integral to managing the price we receive.

CHOOSING AN ADVISER

In choosing a commodity adviser, it is vital that farmers explore their success. Has the adviser traded the commodity markets themselves, or are they working for wages? Is it the only business they conduct? What is their trading record? It will soon tell you if they are the person to assist you in your business.

In 2007, the industry lost more than $100 million because farmers didn't cut positions when they needed to. Advisers obviously weren't advising this, or keeping position reports for their clients so they could see how much they were losing as yield potential and price changed. They were unwise to sell forward in cash because they would never be able to buy their position back.

For the rural industry to progress vast changes are required when hedging commodities. Millions of dollars are lost each year because of low prices at harvest time. New methods and ideas are long overdue in the wheat industry. Seeking out new people who have this knowledge is paramount.

If you want to know more, or speak to David, go to www.schoolofgann-.com.

The return on our investment in David's consultancy has been invaluable to us as a business.

Farming is a great industry and the potential for profit is enormous, but farmers cannot afford to wait for food shortages and increasing populations to make their work worthwhile. They need to create their own prices through good advice and hard-headed business decisions.

■ Joy Angwin is a WA farmer and the opinions and information expressed in this article are her own