

ASX Grain Futures & Options

Thinking Risk – Hedging Locally

Australasian Milling Conference

Gold Coast

Wednesday 27th March 2006



ASX
AUSTRALIAN STOCK EXCHANGE

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Our Aim

- To help you improve the risk management activities of your business.
- To ensure industries reliant on Australian Grain are protected from the adverse impacts of variable supply or demand due to economic or environmental reasons and minimise the boom/bust cycle.

Setting the scene

- Drought in 2002 – severe supply reduction, price behaviour highlighted to major consumers the risk involved in not getting forward cover
- Growers – hesitant to forward sell physical tonnages have adopted non deliverable products such as swaps or are not hedging at all
- Trade – counterparty credit risk reducing the limits for smaller traders with larger grain companies
- Result – partly dysfunctional market, volatility outbreaks, greater need to plan ahead and incorporate ASX as a hedging tool

ASX Vision

- The Australian East Coast is becoming a domestic market especially for feed grain.
- The drought in 2002 highlighted why a domestic price risk management facility is needed.
- Consumers, Growers and Trade can all utilise the ASX market and ensure beneficial price protection and contribute to a functional market dynamic.
- Through active hedging activity, futures exchanges can attract speculative activity and further enhance the liquidity of the market. This benefits everyone. e.g. SAFEX
- The industry has the ability to take greater control over the prices they pay or get paid and avoid the boom/bust cycle.

What is the role of ASX?

- To provide a transparent pricing facility through which both price discovery and the transfer of price risk can occur.
- The ASX provides the tools, it does not have a pricing or market making role. The industry determines the prices that trade.
- The ASX Grain Futures market is different to the previous contracts on the Sydney Futures Exchange.

www.asx.com.au/grainfutures

Yes, but...

- Education / Knowledge
 - Traders, management, accounting staff
 - ASX workshops – explain concepts
- Time
 - “I don’t have the time”
 - Hedging can give you time to decide

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Exchange for Physical Trades

- An off market trade that allows a physical trade in conjunction with the exchange of a reversing derivatives position.
- **KEY BENEFIT** – allows larger hedges to be unwound without having to access the market and suffer price slippage.

Example

Feedlot ABC hedged 10,000 tonnes of Sorghum using ASX March 07. The Feedlot buys Sorghum on a 'delivered' basis, taking delivery against the ASX position is not desired. When the Feedlot buyer wishes to buy the physical there is a need to unwind the open hedge.

The broker is instructed to get offers from traders to deliver sorghum to the feedlot as well as a bid to buy ASX March 07. Once the deal is agreed, the Feedlot has bought physical sorghum and sold ASX sorghum equal to the hedge size.

Your risk management market

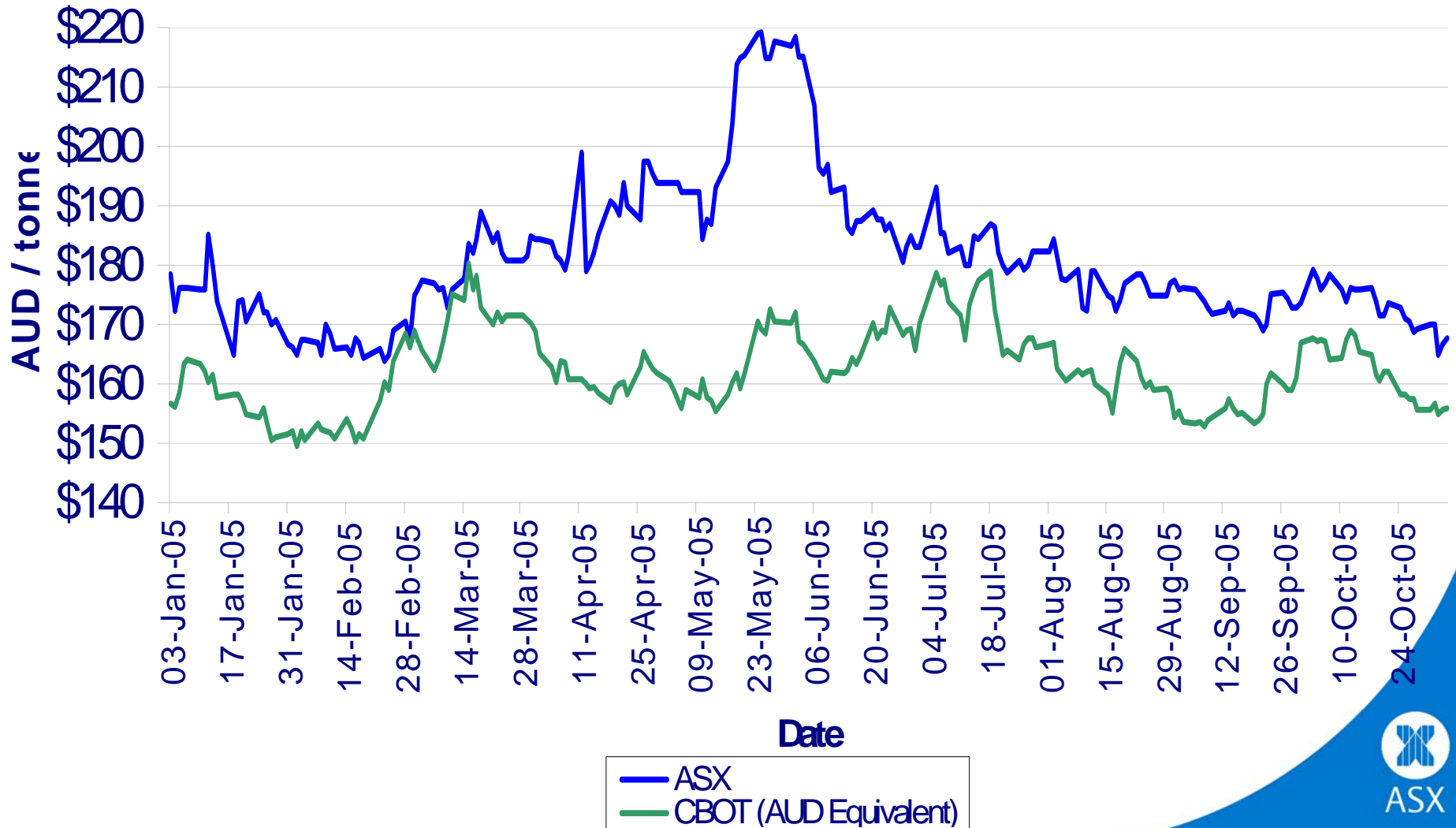
Feature	Benefit
Priced in AUD/tonne	No foreign exchange risk
Australian Clearing House – clears and settles all trades	Reduced counter party credit risk
Tradable Instruments	Physical delivery/consumption not necessary
Reflects Local Supply & Demand	Greater hedge correlation (reduced basis risk)
Planned Hedging	Greater time to decide

Greater Hedge Correlation

- Basis risk, the risk that the futures market does not behave in a manner similar to the physical market, is reduced the closer the futures market can match the physical.
- ASX is a domestic market that reflects local supply and demand.
- Basis risk is reduced, hedge correlation is improved.

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The weather impact on the domestic wheat price.
ASX January 06 Milling Wheat versus CBOT December 05 Wheat
(in Australian Dollars)



ASX Grain Options

- An Option is a contract between two parties giving the Buyer the right, *but not the obligation*, either to buy or to sell the underlying ASX Grain Future at a set price, on or before a predetermined date.
- Two types of option
 - Put – the right to sell the future
 - Call – the right to buy the future
- Like futures, options can be bought and sold. However, unlike futures, they have very different risk profiles.

Why use ASX Call Options?

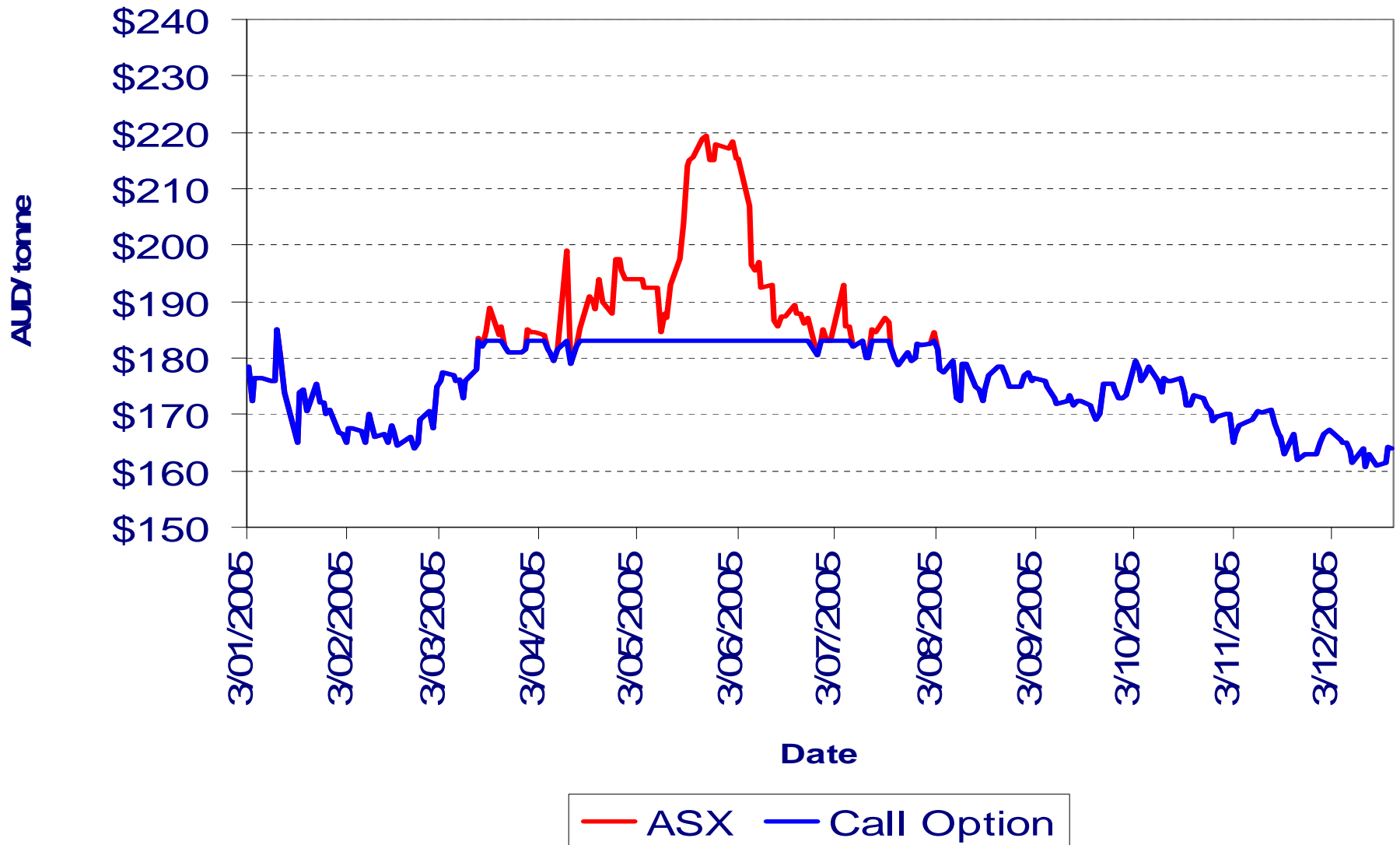
- Key Benefits of ASX Call Options for consumers;
 - Protection from higher prices – maximum price
 - Ability to enjoy downside in price should it occur
 - Gives your business time to decide on other marketing alternatives.
 - No consumption obligation, if another grain is better value in the ration mix then this grain can be utilised as there is no obligation to actually buy the commodity hedged on ASX.
 - May guarantee a physical grain supply.

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Call Option

Jan 06 ASX Milling Wheat

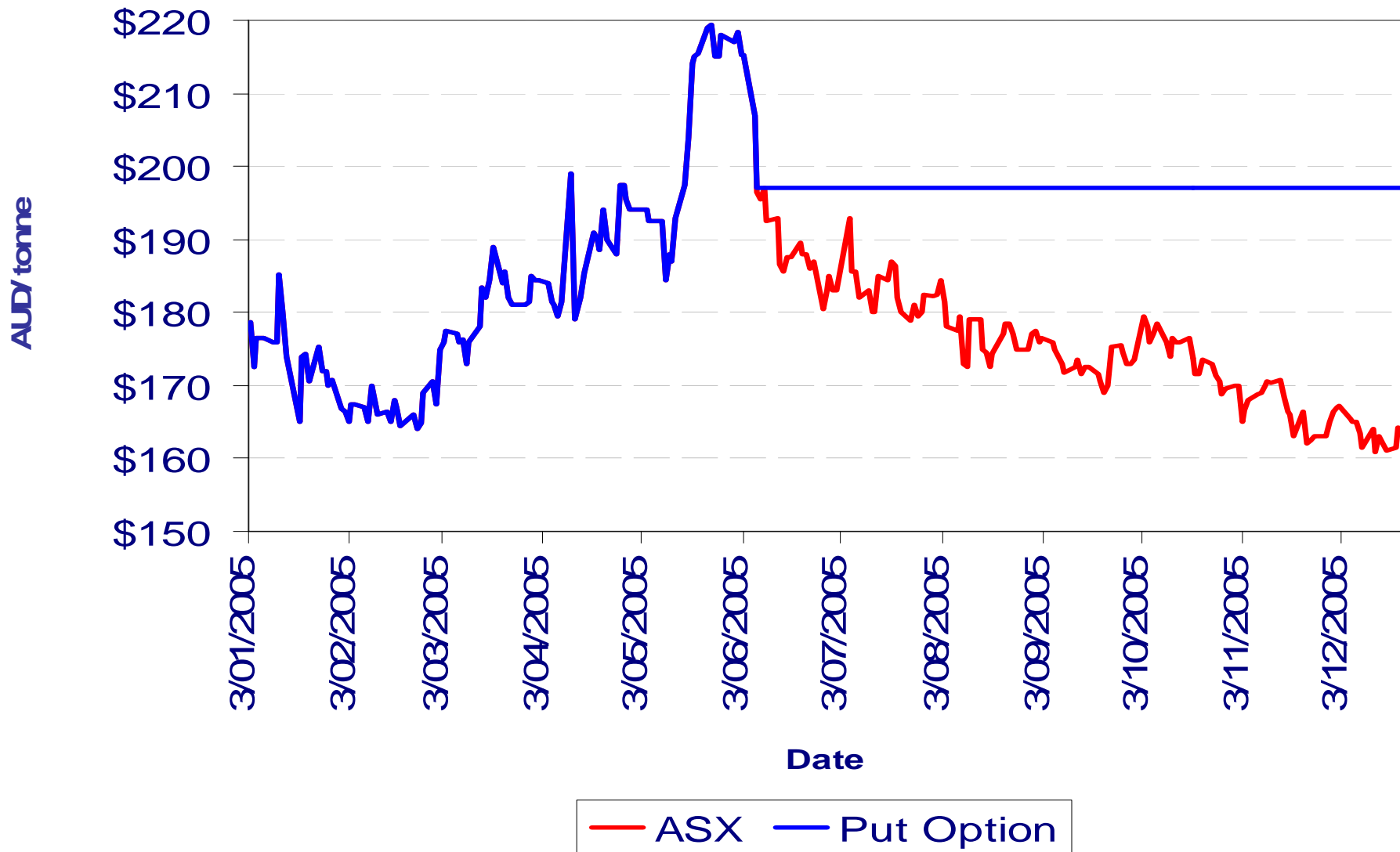
\$175 Call purchased for \$8 = \$183 Ceiling



Put Option

Jan 06 ASX Milling Wheat

\$215 Put purchased for \$18 = \$197 Floor



Further information

www.asx.com.au/grainfutures

Email Updates

Take home message

- The lessons of price risk, counterparty credit risk, production risk, foreign exchange risk and basis risk have been experienced.
- ASX Grain Futures & Options are the tools to minimise these risks.
- Forward planning is imperative to achieve successful risk management.
- If you wait until a crisis occurs the horse will have already bolted!