

ASX Grain Futures & Options

Ethanol – what is uncertain and how do we manage this?

Grains Week 2006

Canberra

Thursday 6th April 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, growing 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 consistent 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

ASX Grain Futures Contracts

Track Market

- Australian **Sorghum** Brisbane / Newcastle
- Australian **Milling Wheat** Newcastle & Port Kembla
- Australian **Feed Wheat** Newcastle & Port Kembla
- Australian **Feed Barley** Geelong & Portland & NSW
- Australian **Canola** Geelong, Portland & Port Adelaide & NSW

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SWAPS?

- A market made around an existing futures exchange.
- Currently offered on North American markets
 - CBOT, KCBT, WCE
- Primarily reflects Supply/Demand fundamentals in North America – not Australia
- The ASX is the Australian equivalent of CBOT, KCBT, WCE, not a swap provider.

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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 (EFP)

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

Stockfeed Miller ABC hedged (bought) 10,000 tonnes of Feed Barley using ASX Jan 07. The Goulburn Valley Mill buys grain on a 'delivered mill' basis therefore delivery against the ASX position up country FIS bulk handler is not desired. When the Mill wishes to buy the physical there is a need to unwind the open hedge.

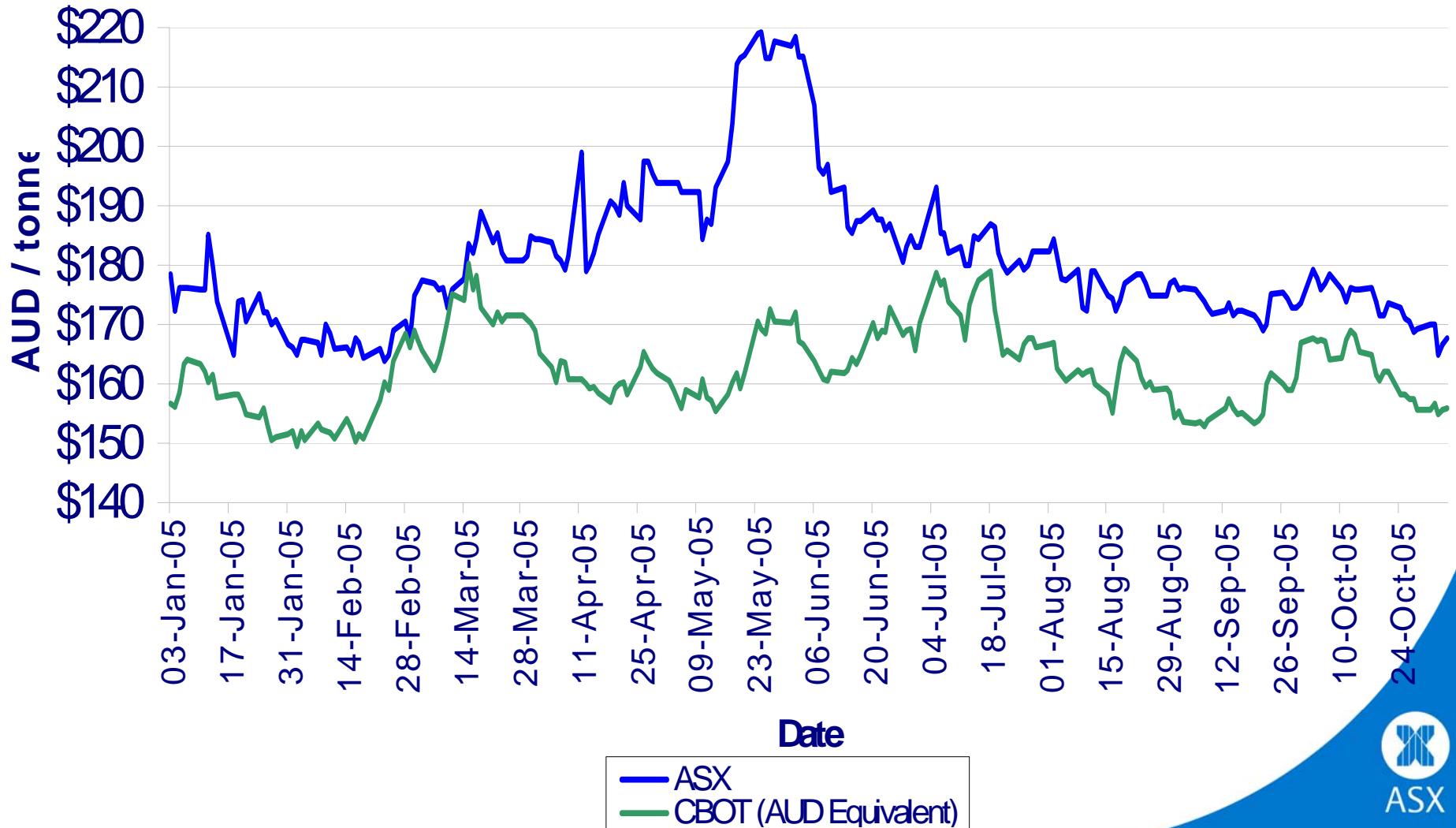
The Mill's broker is instructed to get offers for barley "delivered mill" as well as a bid to buy ASX Feed Barley Jan 07. Once the deal is agreed, the Mill has bought physical barley and has unwound the ASX hedge.

Greater Hedge Correlation

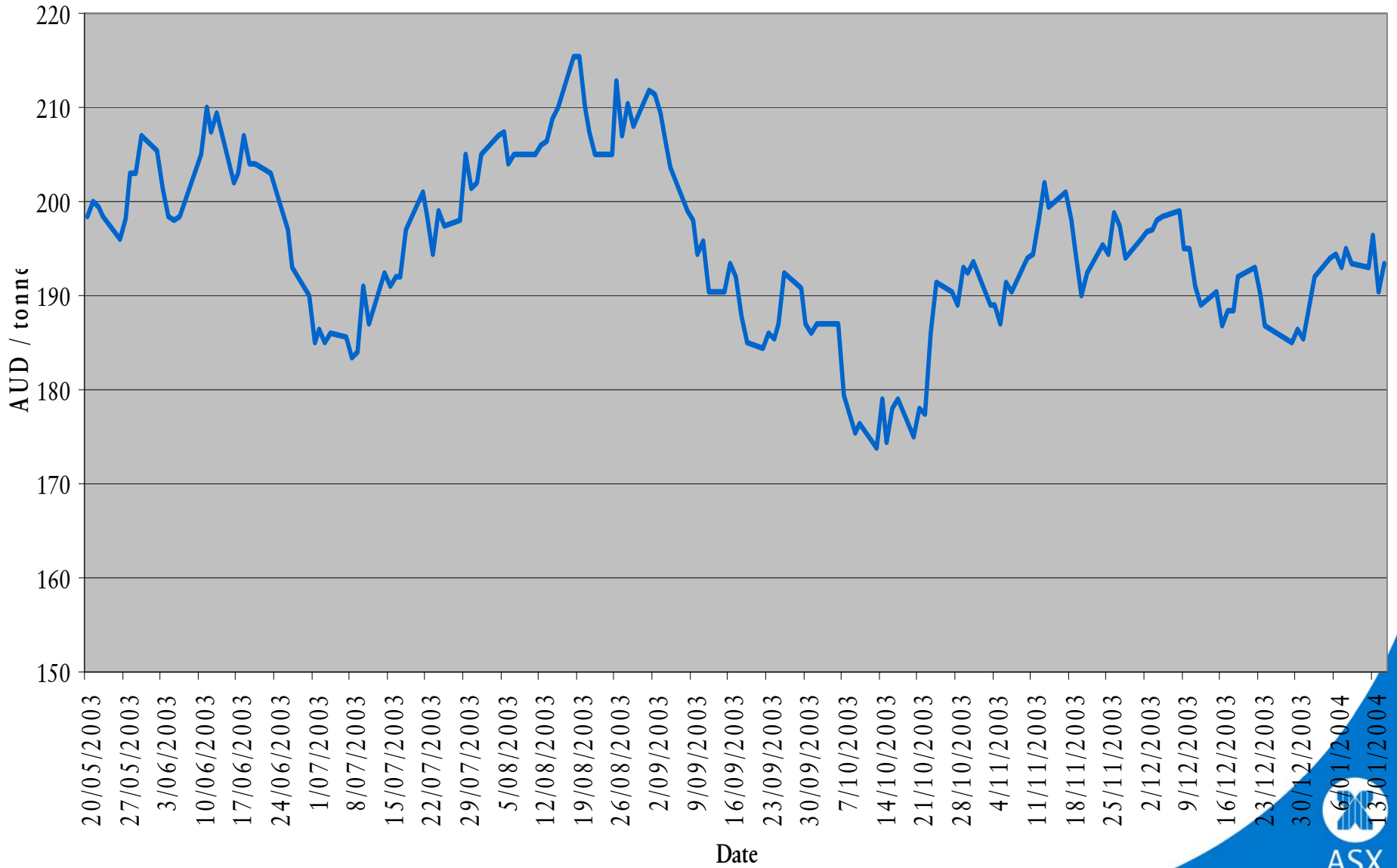
- Basis risk, the risk that the futures market does not behave in a manner similar to the physical market, is reduced the closer the futures market can match the physical.
- ASX is a domestic market that reflects local supply and demand.
- Basis risk is reduced, hedge correlation is improved.

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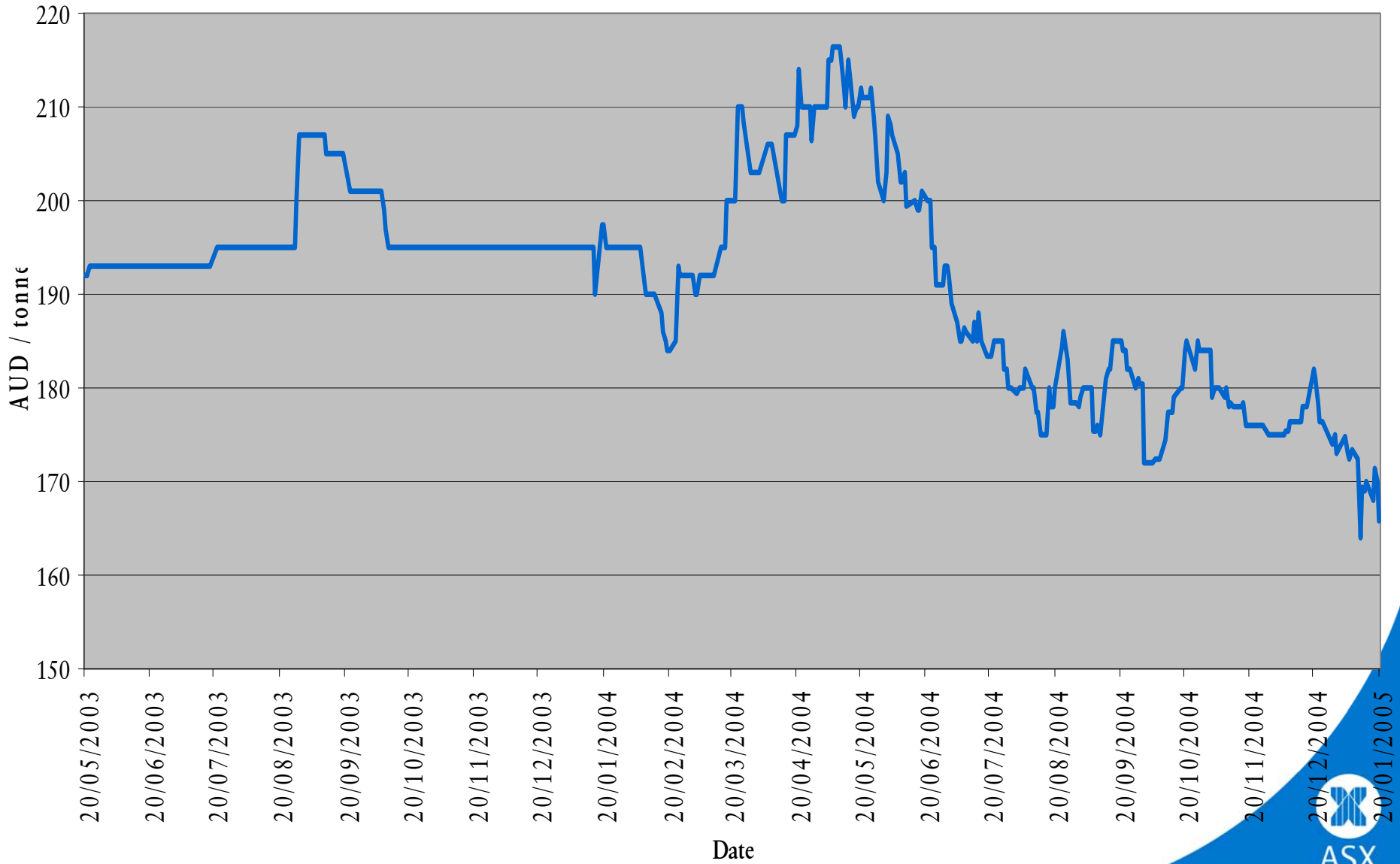
The weather impact on the domestic wheat price.
ASX January 06 Milling Wheat versus CBOT December 05 Wheat
(in Australian Dollars)



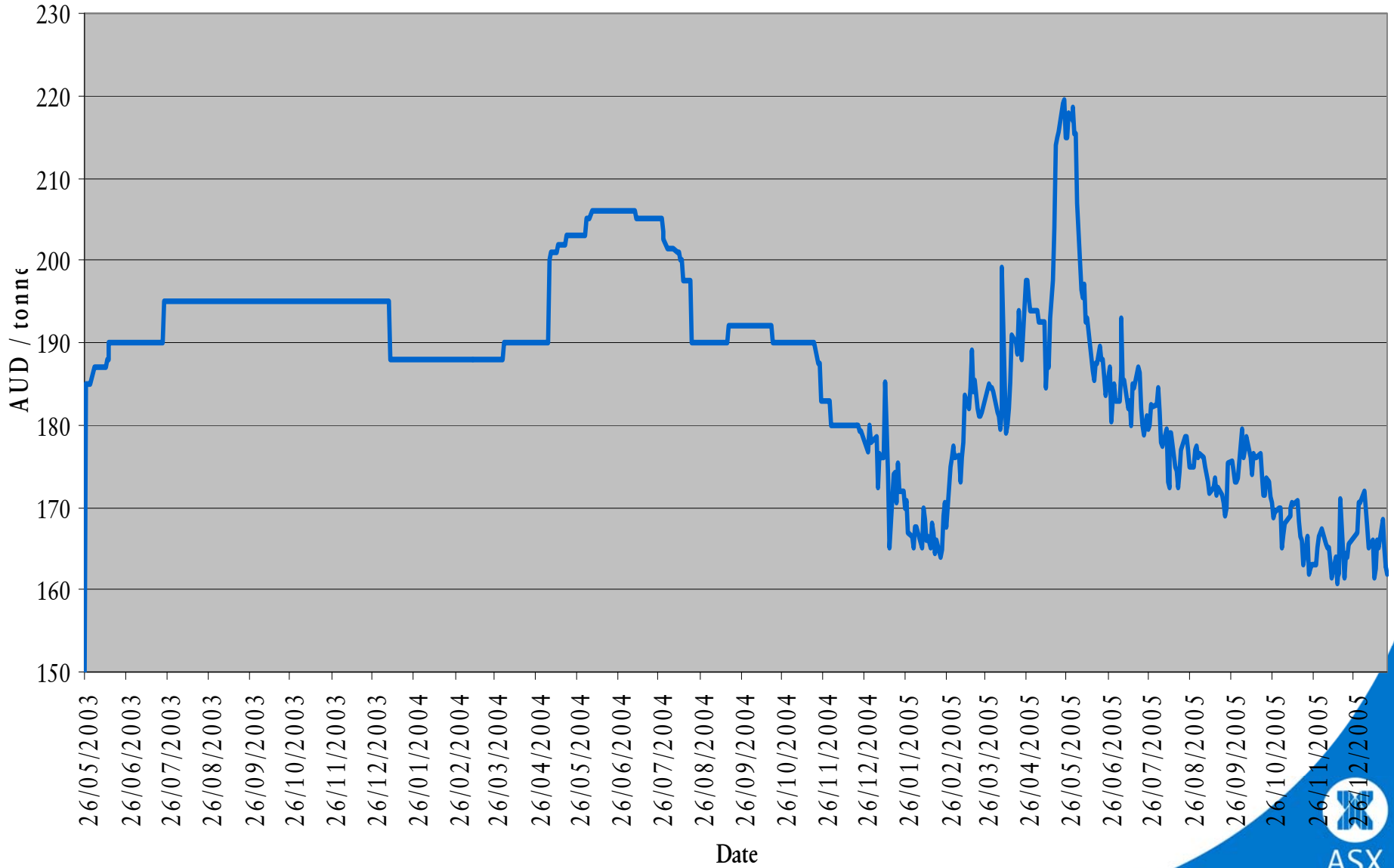
ASX Milling Wheat January 04 Contract



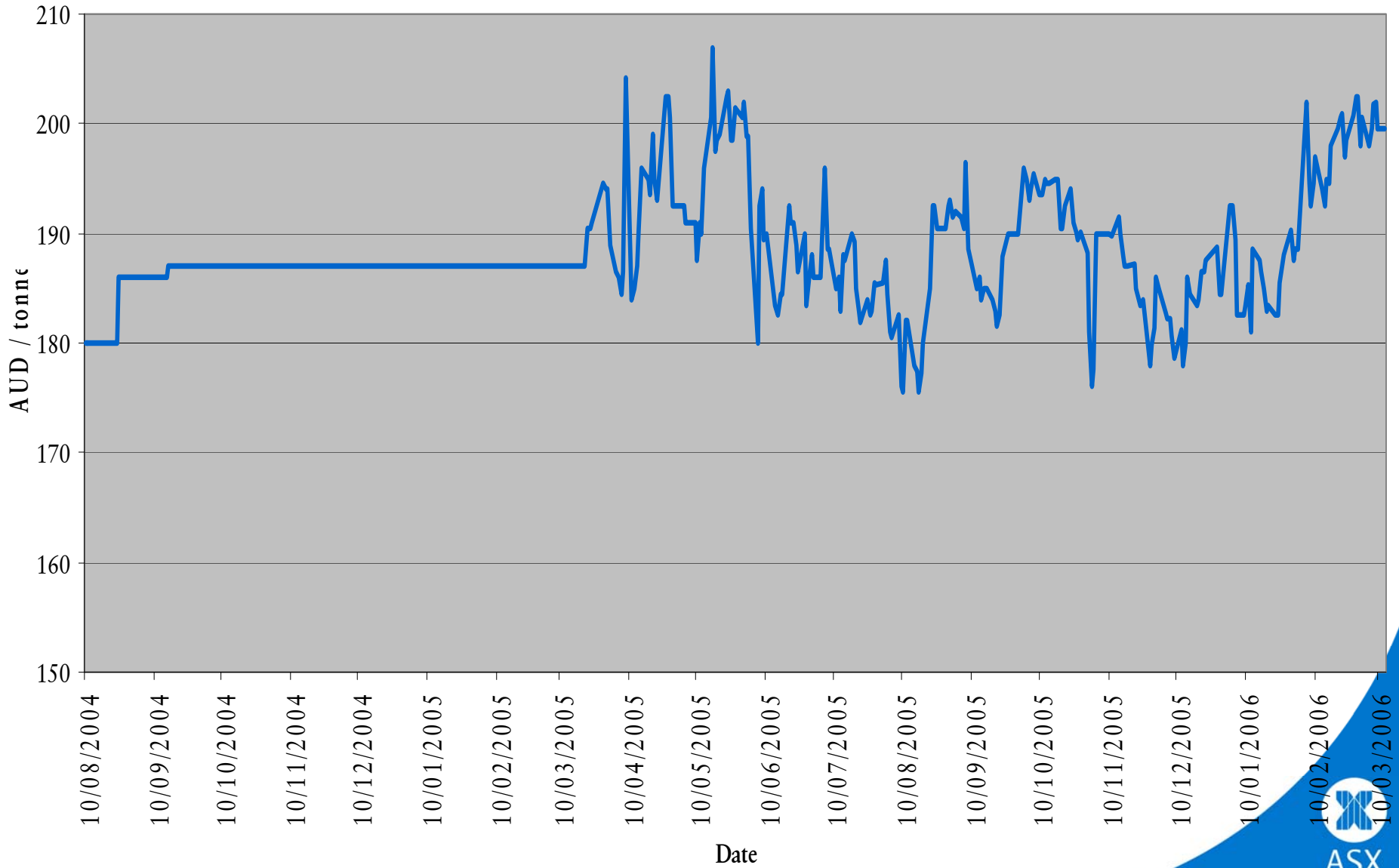
ASX Milling Wheat January 05 Contract



ASX Milling Wheat January 06 Contract



ASX Milling Wheat January 07 Contract



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.

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

Why use ASX Put Options?

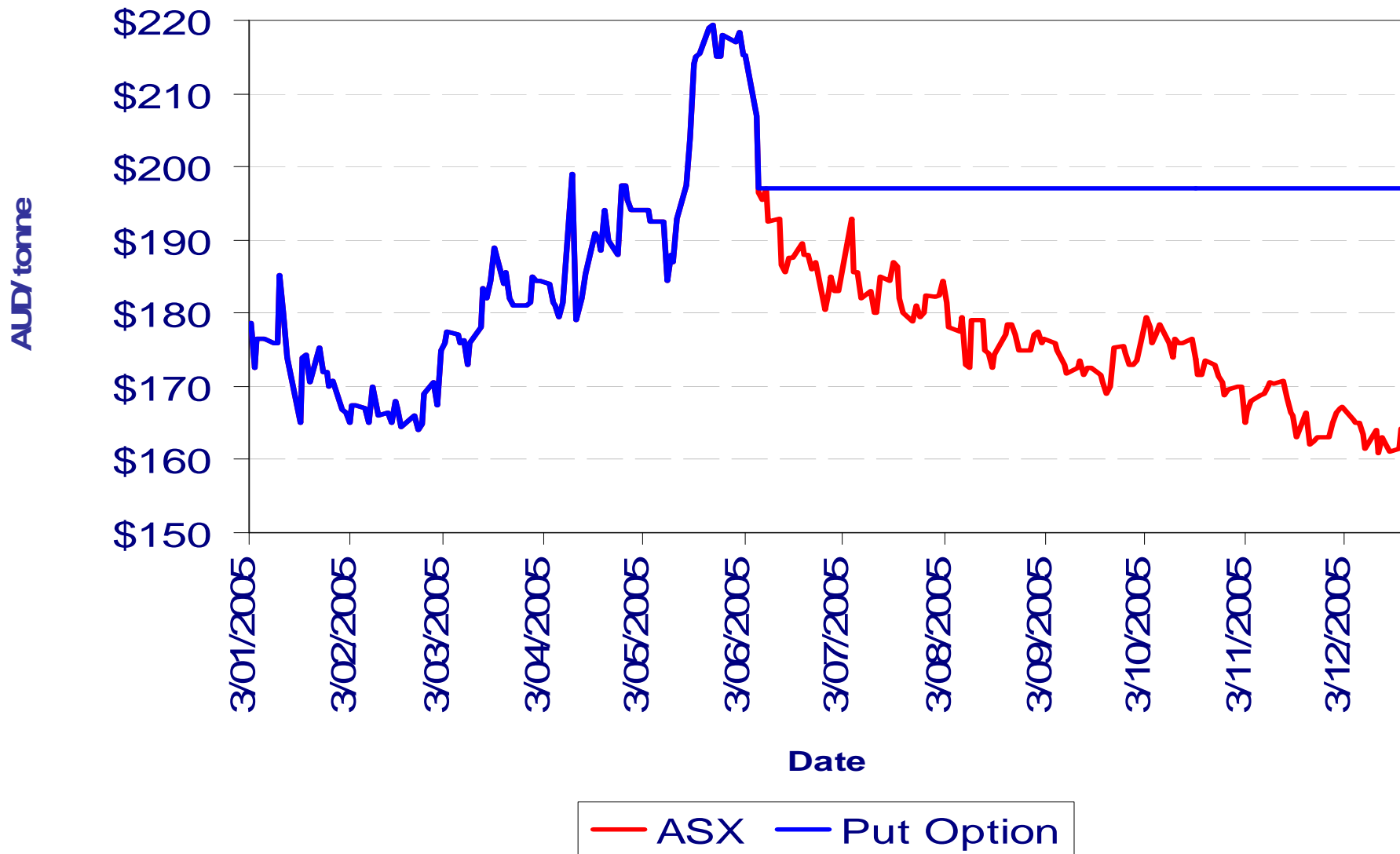
- Key Benefits of ASX Put Options for growers;
 - Protection from lower prices – minimum price
 - Ability to enjoy upside in price should it occur
 - Limited risk = premium
 - Gives your business time to decide on other marketing alternatives.
 - No production obligation, if there is no crop there is no obligation to actually deliver the grain hedged on ASX.
 - May guarantee a physical marketing alternative.

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Put Option

Jan 06 ASX Milling Wheat

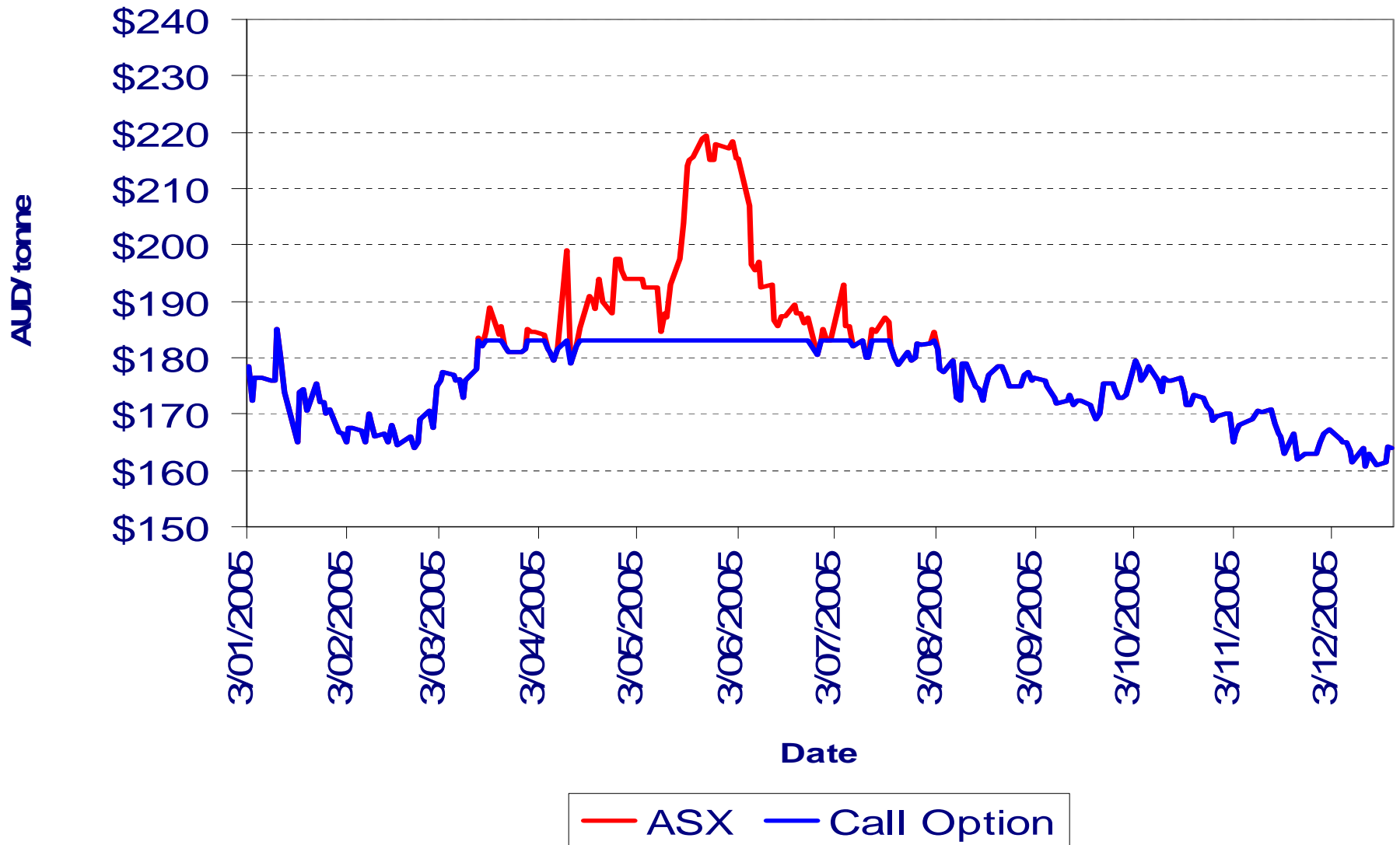
\$215 Put purchased for \$18 = \$197 Floor



Call Option

Jan 06 ASX Milling Wheat

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



Feed Grain – average price idea

1. Does an “Average Price for All” respect market signals?
2. Why should businesses be limited to receiving only an “Average Price”?

Providing a Win Win Win Scenario

- Growers can remove their exposure to price troughs – yet retain the ability to benefit from higher prices should they occur
- Consumers can remove their exposure to price peaks – and retain the ability to benefit from lower prices should they occur
- Both camps can minimise risk, maximise opportunity and because there is no production or consumption obligation create flexibility.

Further information

www.asx.com.au/grainfutures

Email Updates

Workshops

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.
- Ethanol will provide a new marketing alternative, but without ASX the above issues could hinder sustainable growth and industry development.
- Forward planning is imperative to achieve successful risk management. If you wait until a crisis occurs the horse will have already bolted!