

# ASX Grain Futures & Options

Improving grain price risk management

Pan Pacific Pork Expo 2006

Gold Coast

4<sup>th</sup> to 6<sup>th</sup> May 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 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](http://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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# Your risk management market

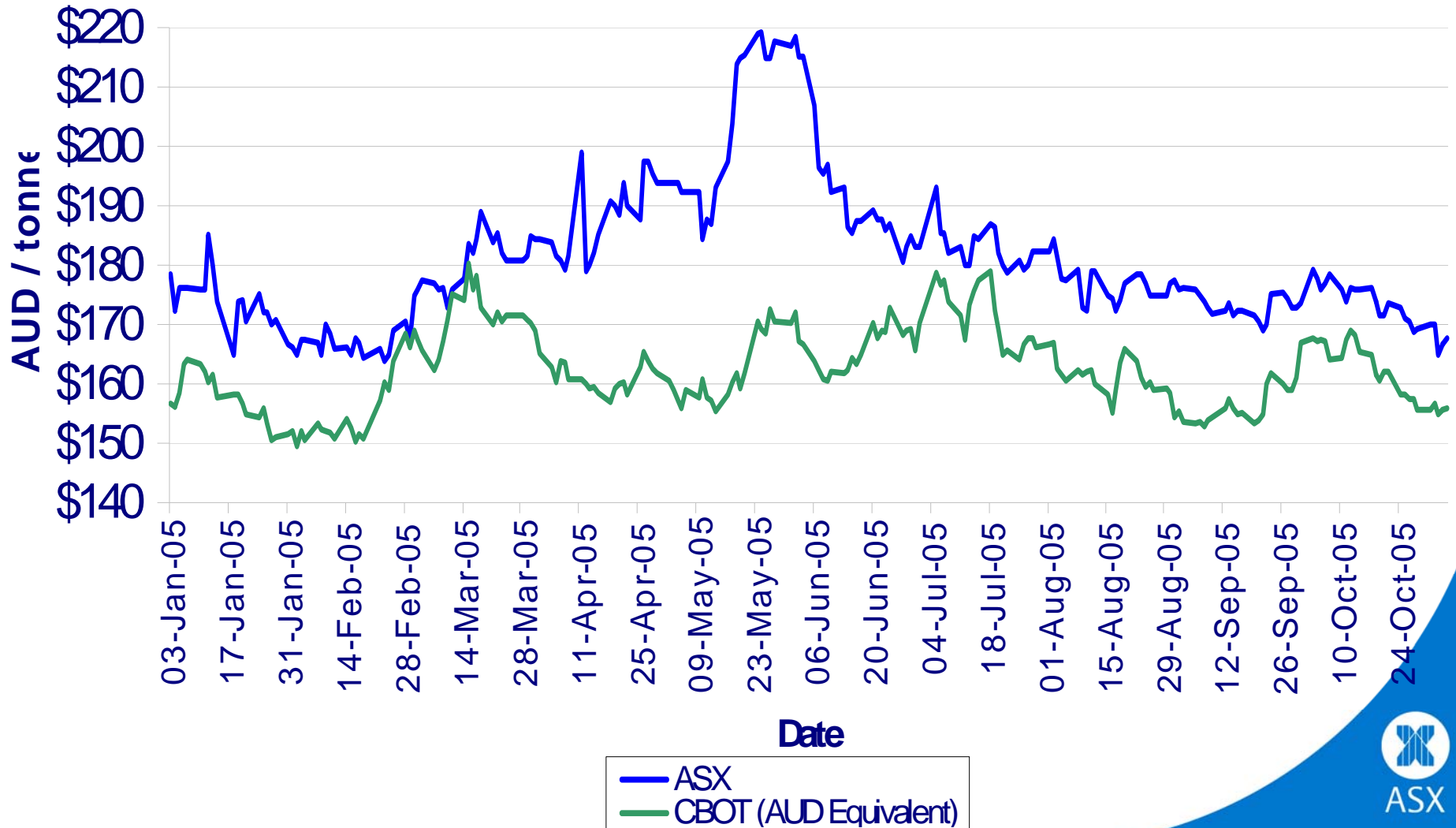
<b>Feature</b>	<b>Benefit</b>
Priced in AUD/tonne	No foreign exchange risk
Australian Clearing House – clears and settles all trades	Reduced counter party credit risk
Tradable Instruments	Physical delivery/consumption not necessary
Reflects Local Supply & Demand	Greater hedge correlation (reduced basis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

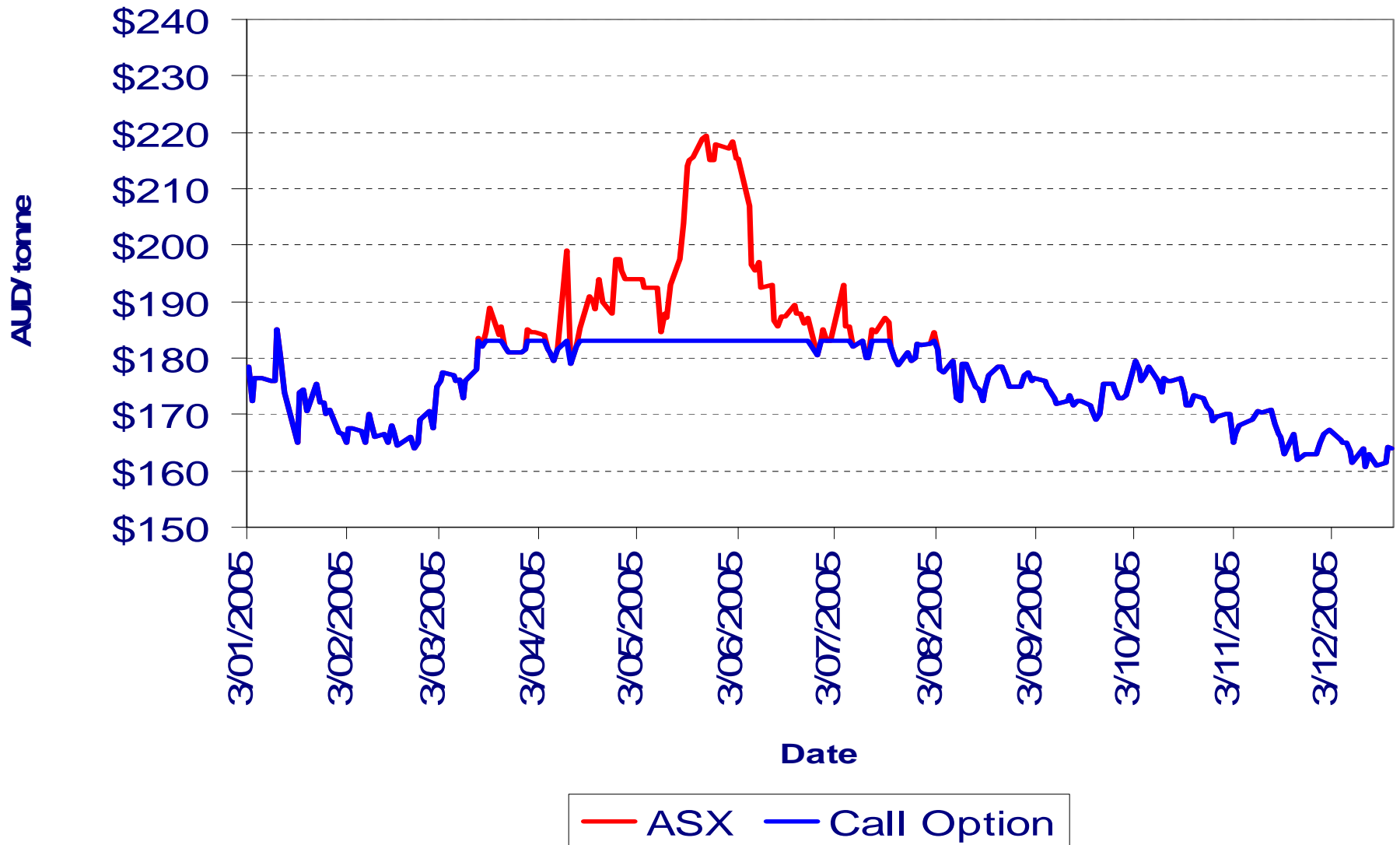
- Key Benefits of ASX Call Options for consumers;
  - Protection from higher prices – maximum price
  - Ability to enjoy downside in price should it occur
  - Limited risk = premium
  - Gives your business time to decide on other marketing alternatives.
  - No consumption obligation, if another grain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

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# Call Option

## Jan 06 ASX Milling Wheat

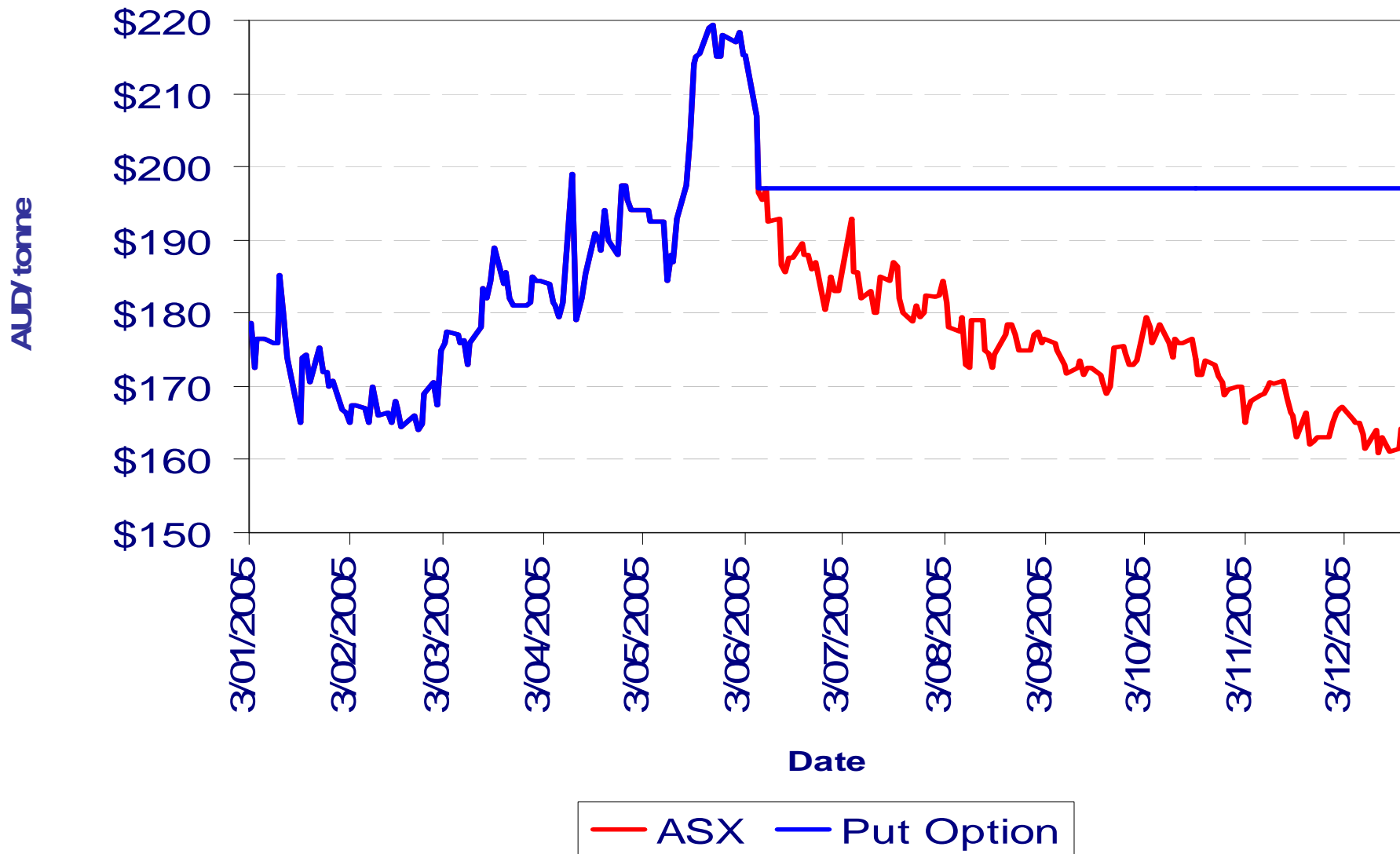
\$175 Call purchased for \$8 = \$183 Ceiling



# Put Option

## Jan 06 ASX Milling Wheat

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



# 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

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

# 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!

# Further information

[www.asx.com.au/grainfutures](http://www.asx.com.au/grainfutures)

## Email Updates