

ASX Grain Futures & Options

Put Options: helping Australia's grain growers manage price risk without production risk

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About ASX



The ASX Limited group of companies, known as the Australian Securities Exchange (ASX), includes the combined operations of the Australian Stock Exchange and SFE Corporation (Sydney Futures Exchange) which merged in July 2006.

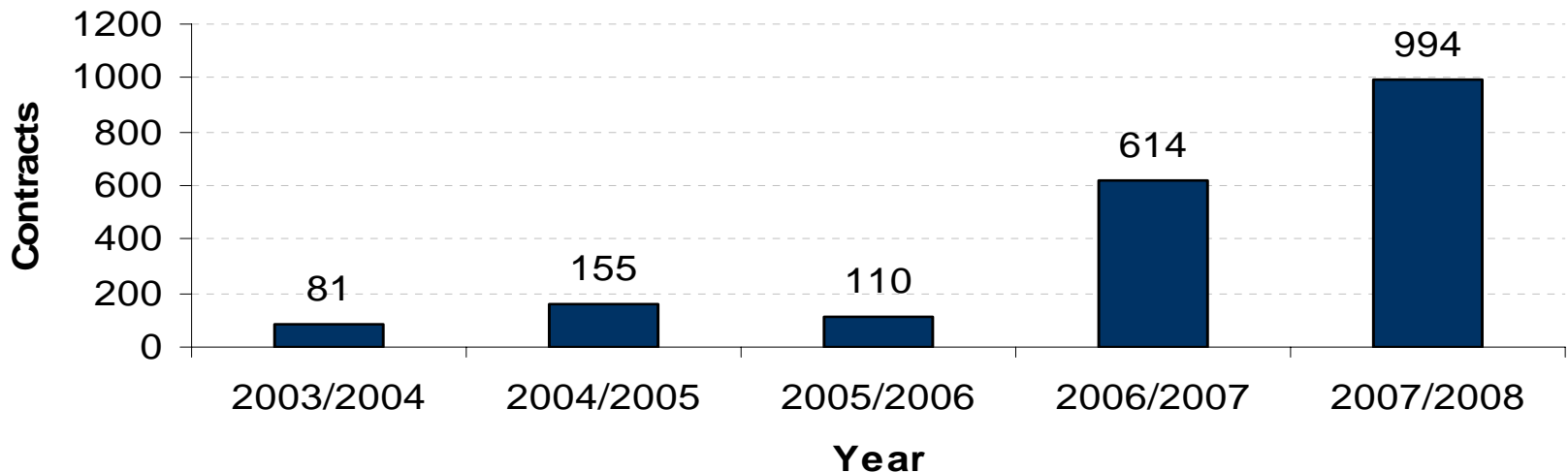
ASX operates Australia's major financial markets for equities and derivatives, and provides listing, trading, risk management, clearing, settlement, depository and market data services for domestic and global customers.

ASX Grain Futures & Options is a price discovery and risk management facility that can be utilised by all participants in Australia's grain industry.

A growing market



ASX Grain Futures and Options
Average Daily Volume
as at end October 2007



At just under 20,000 tonnes, the average daily volume for 2007/2008 represents improved opportunity for growers to participate in the market and hedge their price risk. ASX is working to improve the accessibility of the put option market for growers.

What is the problem?



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Tragically, Season 2007 did not finish the way it started and the market consequences have been severe. The poor season in Australia has followed poor crops and difficult harvests in the Northern Hemisphere. The global supply and demand equation for wheat is very tight. As a result, prices are trading at record levels and market activity has been volatile.

To add salt to the wound, many growers with forward contracts have had to 'wash out' contracts because of crop failure. When a contract is 'washed out' it is bought back at the prevailing market price. Regardless of whether the forward contract is physically delivered or cash settled, the seller has a forward commitment and a risk if the underlying crop fails. The cost of getting out of the contract is unknown at the time of contracting.

What is a Put Option?



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A Put Option refers to the right to sell a futures contract at a certain price on or before a certain time in the future.

When you *put* your ute on the market – you are trying to *sell* it.

When you *buy a Put* option you are *buying the right to sell* the futures contract at a certain price on or before a certain time in the future.

Buying Put Options essentially insures the price of the commodity against a market downturn.

No production risk



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Put Options protect growers from falling commodity prices with no production obligation.

When you insure your car, you reserve the right but not the obligation to have an accident in the next twelve months.

Similar to insurance, when you buy a put option you reserve the right, not the obligation, to sell at a certain price. Importantly, because you are buying a right, and not an obligation you are protecting the value of your crop but;

- if the market trades higher you are free to take advantage of the better prices, and
- if you do suffer crop failure there is no obligation to deliver and there is no requirement to 'wash out' the contract.

Known risk investment



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When you buy the put option, like insurance, you pay what is called a premium. The premium is what the strategy costs, so you know the money you are putting at risk.

The value of the premium varies with supply and demand. It is determined by a number of factors which include, the value of the underlying futures contract, the time to expiry for the option and the volatility of the market.

If you suffer crop failure, you have no obligation to the market.

You can either look to sell back the bought option in the market or let it lapse worthless or exercise if it is in the money and trade out of the futures market.

Put Option explained



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You are interested in establishing a 'Floor Price' for your wheat at \$260 NSW Track for next season. What is it you are looking for?

Order	Month	Year	Commodity	Strike / Exercise Price	Type	Premium
Buy	January	2009	Milling Wheat (AWM)	\$290	Put	\$30
Buy the right.	Underlying futures contract to which the right refers.			The price at which you reserve the right.	The right to sell.	The cost of the strategy.

If the right to sell at \$290 is bought for \$30, the Floor Price achieved equals \$260 (\$290 - \$30).

Recent trades



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In excess of 7000 tonnes of wheat for next season were recently hedged through the Milling Wheat Put Option market for January 2009. The strike price that traded was the \$290 strike. The premium paid for the option ranged between \$30 and \$35. The floor price established is between \$255 & \$260 NSW Track.

- There is no production risk.
- There is freedom to enjoy higher prices should they occur.

Month	Year	Commodity	Strike / Exercise Price	Type	Premium
January	2009	Milling Wheat (AWM)	\$290	Put	\$30 - \$35

Further information



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