Western Australia Hedging & Basis

MarketCheck

JULY 2016

AGENDA

A. Introduction

B. Hedging performance analysis

C. Why hedging works in WA

A. Introduction

1. Forward Contracts still widely used despite underperformance vs hedging.

   - Misuse of hedging products (swaps) in 07-08 one reason for this
   - Misunderstood belief that forward contracts are less risky than hedging

2. Misunderstanding holding/carrying unhedged post-harvest is a viable strategy.

   - Long term data in all markets proves this does not work (as the carry kills you)
   - Average price but below avg return

A. Introduction

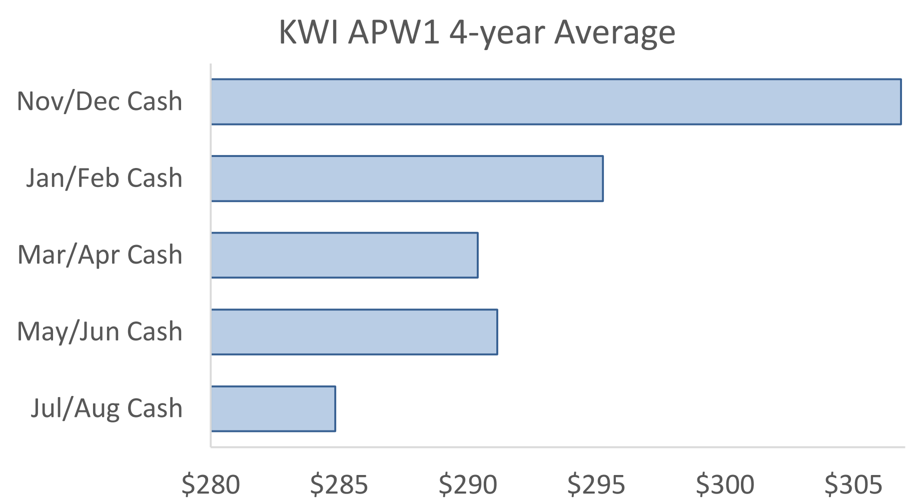
3. Still a misconception hedging is only a pre-harvest tool.

   - Majority of bank swaps are used pre-harvest
   - Sales pitch/market commentary has facilitated this
   - Growers are slowly coming to terms with hedging post-harvest

4. Misconception that hedging post-harvest only works on the East Coast.

B. Hedging post-harvest in WA

- Harvest cash the biggest winner at first glance.



Assumptions:

- *All returns are NPV'd to harvest*
- *Ie net of carry*

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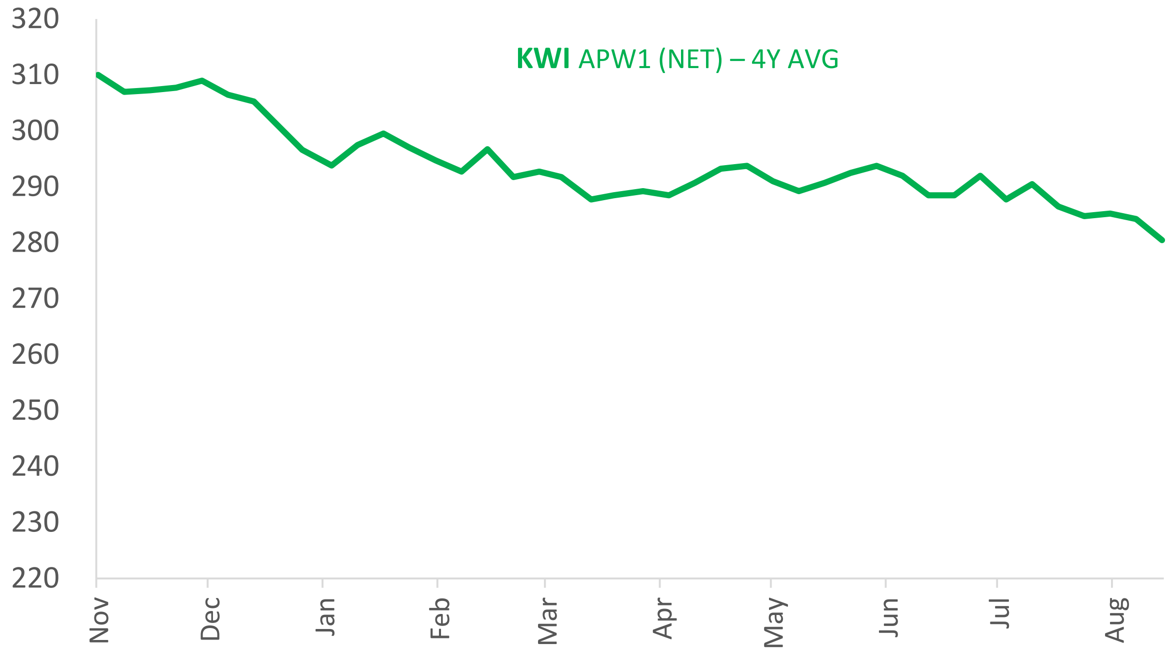

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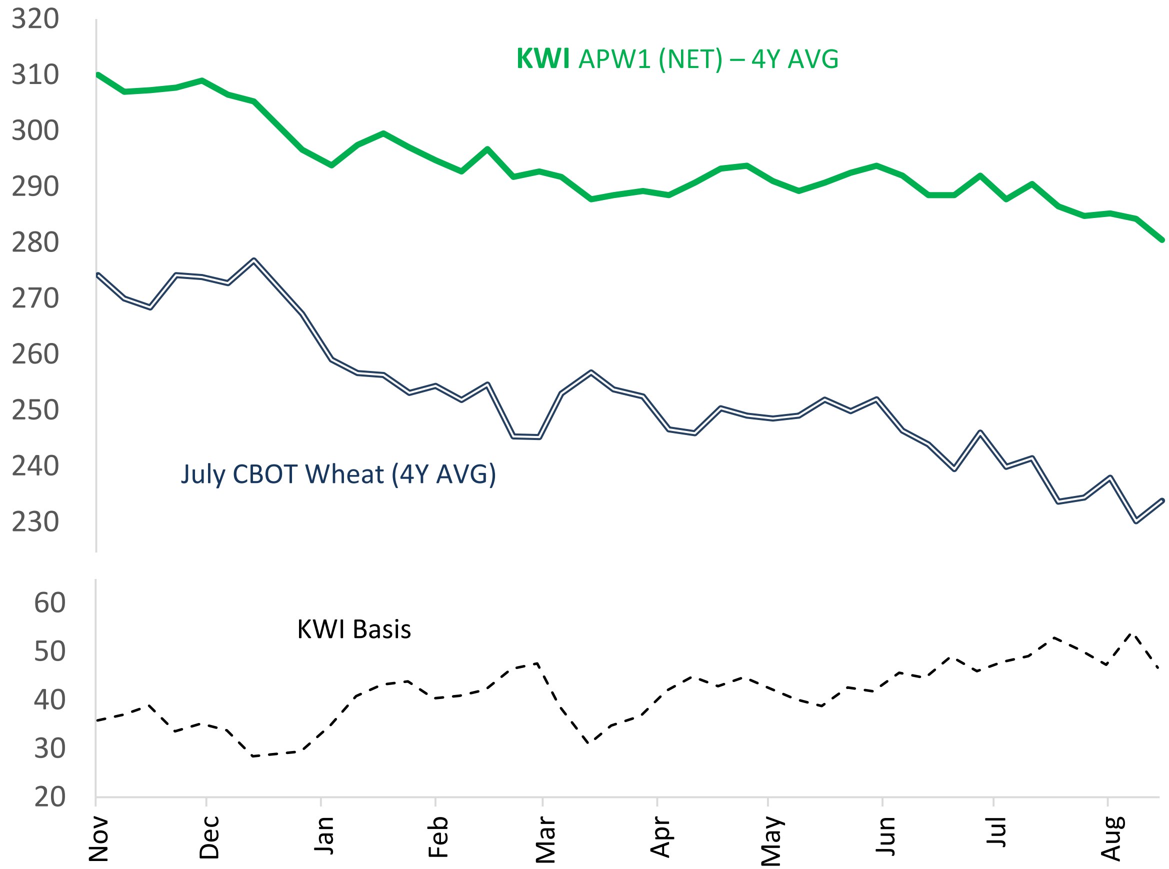
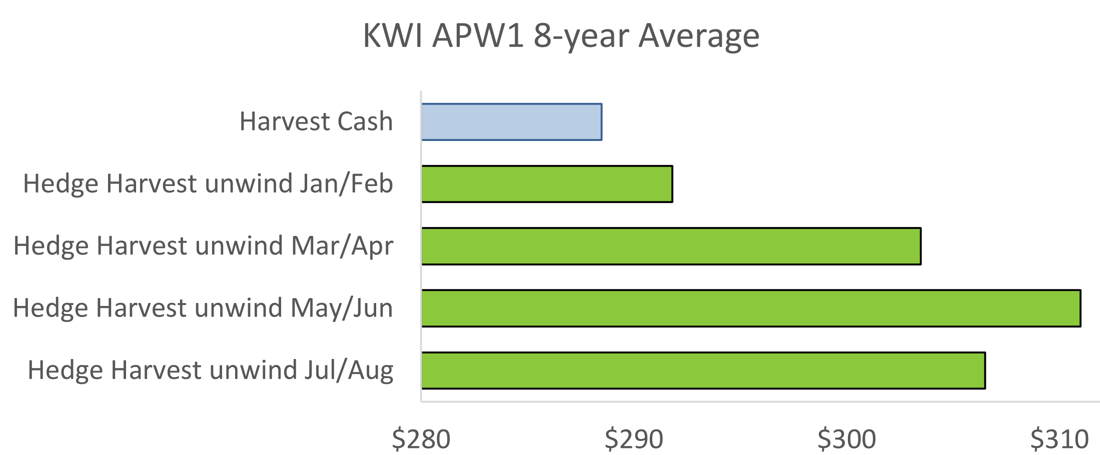
- Harvest = highest flat price but weakest <u>relative</u> price (weakest basis)



B. Hedging post-harvest in WA

- Growers have left money on the table if they've give away their position at harvest
- WA post-harvest hedging has performed better than the East Coast!

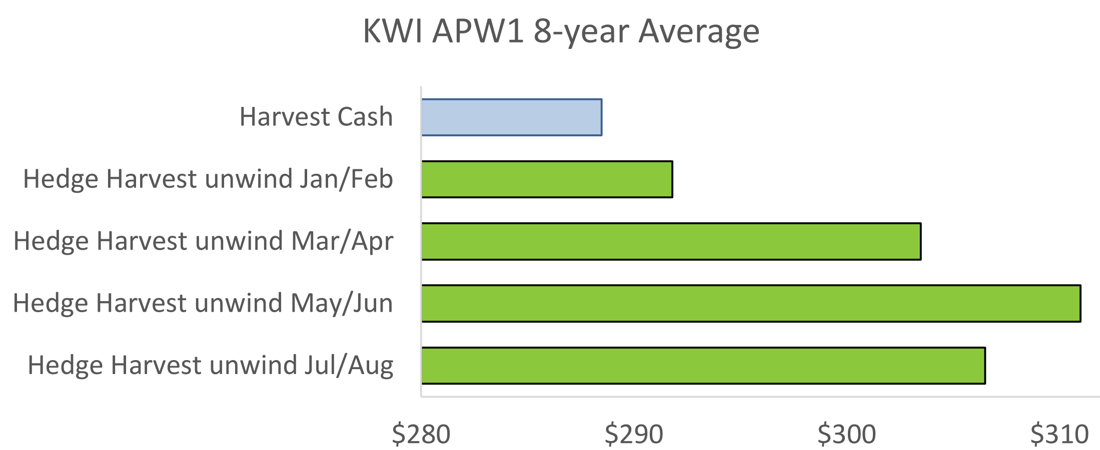


Assumptions:

- *Harvest cash = avg Kwinana FIS Nov-Dec*
- *Post-harvest is hedge (with July) during Nov-Dec, then unwind jan/feb etc*
- *All returns NPV'd to harvest*

B. Hedging post-harvest in WA

- Analysis based on blindly following a strategy – any discretion removed from the equation
- Hedging at harvest/unwinding Mar-Jun has added an average of $18.50/mt per year vs harvest cash
- For 10kt farmer this is $1.5M added to bottom line profit over 8 years



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C. Why hedging post-harvest works in WA

- The trade don’t have the balance sheet to buy it all at harvest
- ~10MMT p/a export capacity secured through LTA’s (Long Term Agreements)
- Additional 6MMT p/a offered as first-in-first-serve
- Produces an over-commitment, creating a supply deficit
- Buyers have to compete harder post-harvest

D. Conclusion

- Hedging works pre-harvest and post-harvest, Australia wide
- Hedging should be part of every grower's marketing plan, year-round