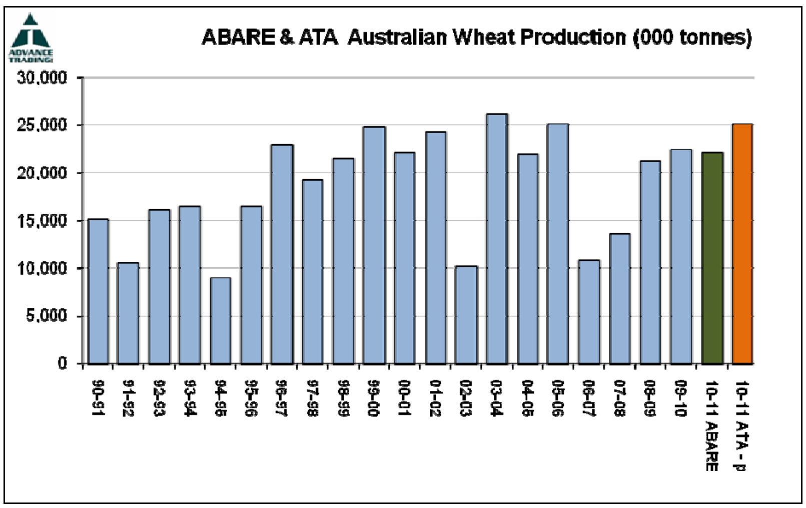
Wheat Market Update

3rd September 2010

This article will provide some insight into the local wheat market as we enter the important spring growth phase for the 2010/11 crop. It will focus on three aspects and importantly it discusses the cost of deferring grain sales into next year i.e cost of carry :

1. Australian crop size
2. East coast exports
3. Possible market dynamics including cost of carry.

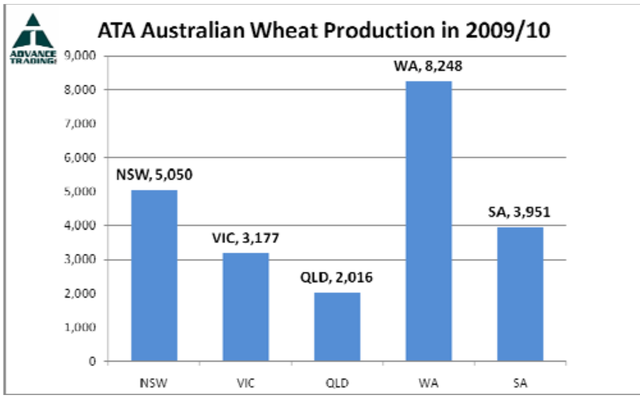
Crop Size



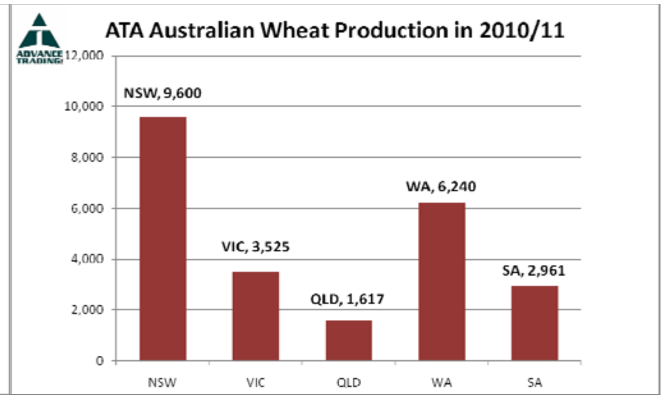
The current wheat crop outlook in the east coast is exceptional. Advance Trading analysis of historical data, and its evaluation of current conditions; indicate that on current crop conditions and an average spring, east coast wheat production could reach as high as 14-14.5mmt. This would be an increase of 4mmt or 38% on last year.

ABARE has Australian production set at 22mmt which, at this stage, looks likely to be well below actual production. It is envisaged that ABARE will revise this number up to around 23-24MMT when they release the next crop outlook paper.

The charts below highlights the significant change of wheat inventory for each State measured between the two seasons. NSW is expected to grow up to 40% of the crop, well above last year's 22%. WA on the other hand, is expected to produce only 25% of the Australian crop, down from last year's 37%. These percentages may change leading up to harvest. As a result of the increase in the East Coast yields, and the current demand for wheat on the world market, wheat exports will be ramped up to capacity on the east coast in 2010/11 season.



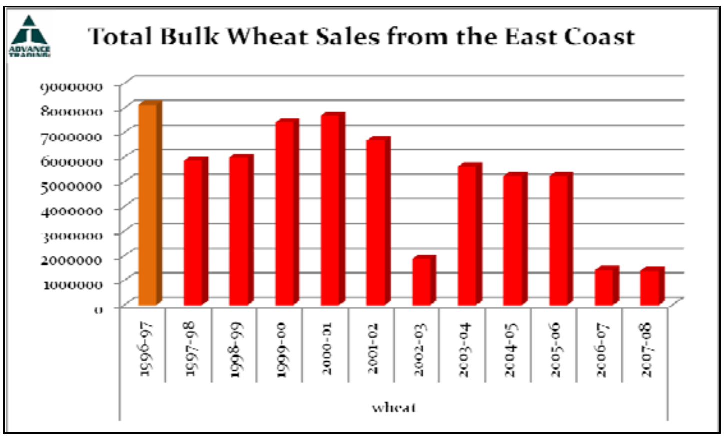
(units: 000's tonnes)



(units: 000's tonnes)

East coast exports

The chart below highlights total bulk export shipments from the east coast (NSW, Vic and QLD) in the past 12 years. The maximum amount previously shipped from bulk facilities is around 8mmt (as seen in 1996/97 season). Both road and rail will be fully utilized to accommodate the predicted volumes into port facilities.



Possible market dynamics including cost of carry

The question that everyone is asking – how will the market accommodate the large surplus of wheat on the east coast in 2010/11? The only way the market can accommodate the expected surplus on the east coast is to "carry" it or store and sell later. But as we are all aware to carry grain until it is sold costs money.

The cost to carry grain is indiscriminate. If you are a Producer, Trader, Pool Manger or Consumer, it will cost you roughly the same, and as can be seen from the table below the cost to carry grain next year is approximately $3.44t PER MONTH and that is without ANY price protection hedging.

Therefore, if a producer intends to carry wheat well into 2011, they need to be sure to protect the harvest price, PLUS the cost of carry. It is not a good economic decision to carry wheat for 6 months and then receive a flat price that is the same or less than the price of wheat at harvest. Carrying grain requires the price of the grain to include the cost of storage, the cost of hedging, and opportunity for profit.

If a producer was to carry grain for 6 months, then arguably it would cost a minimum of $20.64/mt ($3.44/mt x 6 months on current exchange rates). Therefore to be pricing grain for June 2011 you would need to add a minimum of $20.64 to harvest prices.

If there is any benefit in retaining stock in the bulk handling system or farm we will need to see the local market move out to full carry, by that we must assume that we will achieve a "basis" appreciation of US$0.83c/bu ($3.44/mt) each month to cover cost of storage and interest.

Storage Cost - Carry

ASX Milling Wheat = $291/mt

Storage +		**$1.35/mth**
Interest +	**@ 8%apr**	**$1.94/mth**
Insurance & Quality	**?**	**$0.15/mth**
Total		**$3.44/mth**

Another major cost that is incurred by holding grain includes hedging the stock, and the potential for margin calls. This is all determined by the type of hedging instrument that is facilitated.

Wheat will be offered up to the market place looking for a home at harvest, which will lead to a softening in domestic cash prices (ie"basis") and wider carries (greater storage costs). A portion of the crop will be sold at harvest by growers for cash.

With such a large wheat crop, Advance expects domestic buyers and millers will only buy hand to mouth as they need the inventory. If there is carry in the market leading up to harvest (deferred prices are greater than the nearby price), domestic millers will not wish to lock-in and pay for the storage and only buy inventory as they need the stock i.e they will likely shy away from locking in forward purchases too far ahead.

Exporters will only be interested in acquiring which can be exported over the period up to the next northern hemisphere harvest (ie: July 2011). So what happens to the rest of the crop? Some will be delivered into wheat pools, some stored on farm, and the rest warehoused. In all these cases, either directly or indirectly, the grain grower will hold the majority of ownership of the crop and pay for the cost of storage until the crop is absorbed, used by the market. The questions remain - will growers position themselves to effectively manage price risk to pick up the cost of carry through an improvement in the "basis" over the next 12-18 months? What will happen to prices if we see a big northern hemisphere crop next year and another above average Australian crop? Will growers be holding grain into a falling market?

Effectively managing forward price risk and carry, whilst giving growers a payment stream at key times throughout the year, are the key roles of a pool manager.