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Report on 2nd Meeting held 11 December 2007
GRAIN MARKETING STRATEGY

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TOP TIPS FROM MEETING

Options are not the same as Futures Contracts. You can use options to protect the price of unsold grain or capture market rises after a sale has been made. The worst case scenario is that you lose the price of buying the option – currently around £11/tonne. In the best case scenario you secure a price which gives you a profit and you protect yourself from any sharp drop in the market price.

1. INTRODUCTION

A good turnout of around 42 farmers, members of the trade, and others from the agricultural sector attended the meeting at Carmyllie Hall.

Programme;

- Hugh Black updated the group on what had been happening on-farm since the last meeting (see **Appendix 1**)
- Hugh then described last years grain marketing
- Martyn Worden, HGCA Risk Management Trainer gave a description of futures, options and risk management
- Ian Keith of Frontier Agriculture Ltd gave a malting barley market outlook, followed by Alistair Reekie looking at outlook for Oilseed rape.
- Attendees then split into four groups. Two looked at marketing strategy for the old crop still in store, while the other two worked on a marketing strategy for the 2008 crop.

2. CONCLUSIONS FOR GRAIN MARKETING STRATEGY

The overall conclusions from the workshop could be summarised as follows;

- Volatility is the new certainty in grain markets. This is because we are no longer insulated from the world market. That world market is undergoing major fluctuations in supply (due to weather, biofuels) and demand (the China and India effect). That makes it worth considering risk management tools such as Options.
- Domestic grain markets are finely balanced. For example Scottish malting barley availability in 2008 is forecast at 758,000 tonnes and demand is forecast at 750,000 tonnes. Exportable surpluses have disappeared (Scottish spring barley area has fallen from peak of 260,000 Ha to 220,000 Ha, while malting capacity has increased recently by 100,000 tonnes).
- **To set your marketing strategy you first of all need some guiding principles;**
 - Know your cost of production per tonne for each crop. That at least sets your minimum price target.
 - Be clear about your business resources – what storage do you have, can you shift big tonnages quickly?
 - What is your risk profile? This is both a personal issue (how much are you willing to take) and a business issue (how much can it take). A general business principle is that you should avoid having both high

financial risk (e.g. a high level of debt) and high business risk (e.g. relying 100% on the spot market). However, the key point is to decide where you want to stand on risk.

- The Group had different views although majority agreed to sell a percentage forward with a balance to market later but no agreement how much (20%, 30%, 40% or more?)
- Understand as much about the market as you can. You cannot be a market expert, but you have to form a view.
- Make use of a range of marketing tools to achieve your objective & risk profile. Includes; fixed price contracts, min. price contracts, pools, futures, options, and spot markets.
- Use someone as a regular source of market advice whom you can use to bounce off ideas and develop understanding over a long period of time.
- Finally, don't forget to assess crop quality and quantity. How does it meet market specification?

3. BACKBOATH GRAIN MARKETING 2007/08

See Hugh's summary sheet at **Appendix 2** which includes tonnages sold and prices achieved to date.

Key Points;

- Wheat; 346t sold, still 734t to sell. Crop Marketing Group pool (group of producers, regular teleconference) achieved worst price last year (£92/t), but looking like £145/t this year. Big question is marketing of what is left in store.
- Malting Barley; All sold. Half tied to contract at £120/t, but other half on contract to Simpsons Malt at £120/t which they opened up to £150/t and then due to very low Nitrogens increased to £206/t. As result sold 400t of next years crop to them at £170/t with poss low N bonus.
- Feed barley; 114 t sold to neighbour. Most still to sell. Had offer of £150/t for export. Other quote of £162.50 for January delivery.
- Oilseed rape; all to United Oilseeds at £167/t (good oil bonus).

Have not had a very clearly defined strategy. Like spread of buyers to keep options. Have masses of storage so tend to hold on to most of the crop and make selling judgements on a month by month basis. Mainly spot selling, except for malting barley.

4. PRICING AND RISK – THE ROLE OF FUTURES AND OPTIONS

See Martyn Worden's full presentation at **Appendix 3**.

Key Points;

- We have increasing volatility in grain markets. Why? We are not insulated from the world market. In a world market there are many factors at play all of which are difficult to predict. Supply is volatile due to extreme weather events and diversion of grains to biofuels. Demand is volatile due mainly to growth in Asia. Futures and Options are means to manage price risk.
- Futures contracts are a legally binding obligation to supply a given quantity at the contract price. Tend to only be used by the trade because they have high set up costs and margin calls (cash required daily to fund the difference

between the contract price and the current price) and because they can require physical delivery.

- Farmers sensible use of futures; an indicator of likely prices in the future.
- Options are a much more realistic option for farmers. These are a right to buy or sell a futures contract, but not an obligation. The price is fixed regardless of where the futures price sits when you exercise the option. They are therefore a form of price insurance.
- The worst case scenario is that you lose the price of buying the option – currently around £11/tonne. In the best case scenario you secure a price which gives you a profit and you protect yourself from any sharp drop in the market price.
- You can use options to protect the price of unsold grain or capture market rises after a sale has been made.

5. MALTING BARLEY MARKET OUTLOOK

See Ian Keith's (Frontier Agriculture Ltd) full presentation at **Appendix 4**.

Key Points;

- 2007/08; lowest barley crop for 25 years. Scottish SB area fallen from peak of 260,000 Ha to 220,000 Ha. Expect there to be no exportable surplus. UK exportable surplus expected around 250,000t – this used to be the size of the Scottish surplus. Most regions of Europe in deficit. Scandinavian surplus only just allowed for overall balanced market. Hence price response.
- Outlook 2008/09; Distillers never been so positive. Forecasting to operate at full production for next 5 to 10 years. Expansion of Scottish malting capacity (Simpsons, Berwick and Greencore, Buckie). But more area available for SB and tight supply of inputs. Outcome likely to be a finely balanced market, so high contract prices from maltsters to secure supply and likely to tweak specification to get what they need.
- But uncertainty and volatility are the norm. Strategie Grains forecast EU surplus of 1Mt under one scenario for 2008, which could allow maltsters to find some supplies abroad. Over 50% of Scottish barley is used for feed. Problems in the pig sector and reductions in cattle and sheep numbers will have some impact on how much is switched to malting, but this impact more likely to work through in 2009??

6. OILSEEDS OUTLOOK

See Alistair Reekie's presentation at the back of Ian Keith's at Appendix 4.

Key Points;

- OSR futures price up by £6/t since last meeting. Why? Demand, competition for acres, exchange rate moving in our favour (against Euro).
- Some negatives for OSR – being displaced in biodiesel by cheaper oils, pressure on biodiesel plants given uneconomic cost of inputs (Greenergy plant shifting to palm/soya oil, Immingham plant mothballed). But sheer demand in east for vegetable oils is driving prices higher; vegetable oil prices increasing faster than mineral oil price.

7. GROUP WORK – DEVELOPING A MARKETING STRATEGY FOR BACKBOATH

Marketing Strategy for Old Crop (730t wheat, 320t barley, 160t rape).

Group 1 feedback;

- Sell 75% of the wheat now. Good price available (£185/t). Makes a good margin and avoids further risk in a volatile market. Sell the rest progressively over the season.
- Sell feed barley forward now (£162/t?). Store and deliver later.

Group 2 feedback;

- Wheat; sell third now, third mid March, third speculative when price rises with target of £200/t. Ideal target would be £200/t overall!
- Need to shift some now as £1/t price rise is not good enough to justify storing it all.
- Barley; Track the feed barley discount to feed wheat and use that as driver of when to market – looking to close the gap. If got good volume to sell (300t) then probably looking to Jan/Feb window.

Marketing Strategy for New Crop (2008 harvest)

Group 3 feedback;

- Wheat; 250t cash and carry basis (£145/t). Take option on 400t to fix price. Gamble the rest – pick spot price over season.
- Spring Barley; All sold on contract at close to £185/t. Gives good harvest cashflow.
- Winter barley; Malting variety Pearl on contract. Feed Oct/Nov uplift at around £110/t.
- Rape; stick to pool selling – likely best return. Can now store.

Group 4 feedback;

- Wheat; 400t now cash and carry, 400t buy option for £140/t, cost £15/t, guarantee at least £125/t, 400t sit on and wait.
- Spring barley; 50% on £185/t contract, 50% sit on and see what happens to price.
- Winter barley; 120t neighbours feed (important relationship), 130t wait and see.
- Rape; insignificant in overall business, so don't complicate by storing – uplift at harvest and price some other time.
- Judge rise per month versus cost per month
- Don't base selling on cashflow – likely to not be most profitable option.

Overall observations;

Huge discussion on how and when to sell – everyone has different view. Need a set of principles or a structure to guide decisions? **See Conclusions at start of report.**

Most groups advocate spreading risk. Take some profit where can see price available gives a margin even if modest, fix price of another proportion of the crop to protect downside, but not limit upside, then hold the rest and be speculative hoping for big price spike.

Some groups also advocating a focus on the key crops (wheat at Backboath) and less attention or simpler approach for the minority crops (rape). One manager cannot keep an eye on everything. It's the old 80:20 rule.

Backboath is fairly highly geared. The consequences of a bad marketing decision might be worse than for a business with little debt. That suggests a degree of price fixing through contracts and hedging to guarantee some margin is prudent. However, the business has excellent storage and the partners are not scared of risk, so an element of speculation is not inappropriate.

APPENDICES

Appendix 1. What's happened on-farm since the last meeting?

- 300-400t of Osprey ware tatties to Bartletts (hope for £150 - £180/t)
- McCain Pipers; 70t to Israel £170/t on contract.
- Saxon SE2 seed for Signet £145/t pool system. All Saxon in ambient storage this year. Start grading tomorrow. Keen to shift some out of ambient stores.
- Graded off some Shepody seed. Worried about blight. Graded off ready to sell. 25t brock not very clean, away £22/t to Ring.
- Finished applying hen pen and dung. Ploughed down. Target 125 ac ploughed by Xmas.
- Bought new forklift. No correlation with SFP received last week.

Appendix 2. Backboath Crop Marketing 2007/08

WHEAT	Production 2007	1,080
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Varieties:

SALES

Date	Buyer	Tonnage	Delivery date	Price	
11/10/2007	MSP Ltd (Simpsons Malt)	116		101	11,716
Not lifted	Frontier	30		183	5,490
winter	Grainfarmer's Marketing Pool	200		145	29,000
					0
					0
					0
	sub-total	346			46,206
	Balance to sell	<u>734</u>		Av price	134

MALTING BARLEY	Production 2007	390
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Varieties:

SALES

Date	Buyer	Tonnage	Delivery date	Price	
03/10/2007	MSP Ltd (Simpsons Malt)	200		206	41,200
09/11/2007	Grainfarmers	190		120	22,800
					0
					0
					0
					0
	sub-total	390			64,000
	Balance to sell	<u>0</u>		Av price	164

FEED BARLEY	Production 2007	440
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Varieties:

SALES

Date	Buyer	Tonnage	Delivery date	Price	
Harvest	Local Farmer	116		114	13,224
					0
					0
					0
					0
	sub-total	116			13,224
	Balance to sell	<u>324</u>		Av price	114

OSR	Production 2007	227
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Varieties:

SALES

Date	Buyer	Tonnage	Delivery date	Price	
11/11/2007	United Oilseeds	60		9786.15	
	sub-total	60			
	Balance to sell	<u>167</u>		Av price	

Appendix 3. Pricing and Risk – The Role of Futures and Options. Martyn Worden, HGCA Risk Management Trainer.

Appendix 4. Market Outlook for Barley. Ian Keith, Frontier Agriculture Ltd.