

Home-Grown Cereals Authority

Cereals Industry Forum HGCA

Price Risk Management A Case study

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Pricing and Risk – The Role of Futures & Options

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Buy Nov 06 CALL option - 1st Nov 05 possible outcomes

Nov 06 futures @ £73/t

Ex-farm Forward sale	Nov-06 Futures	Option		NET PRICE
		+ Profit	- Premium	
70	100	27	3.0	94
70	90	17	3.0	84
70	80	7	3.0	74
70	70	0	3.0	67
70	60	0	3.0	67
70	50	0	3.0	67

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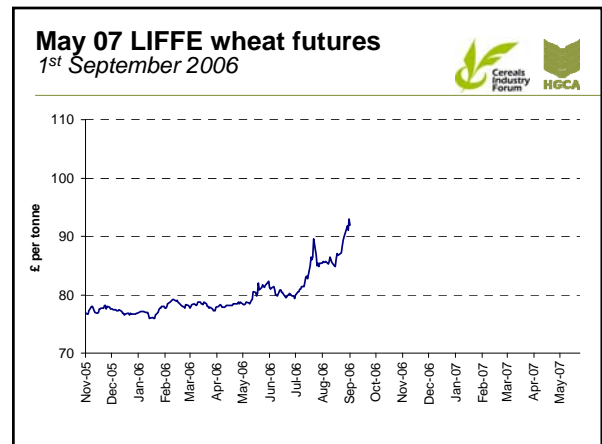
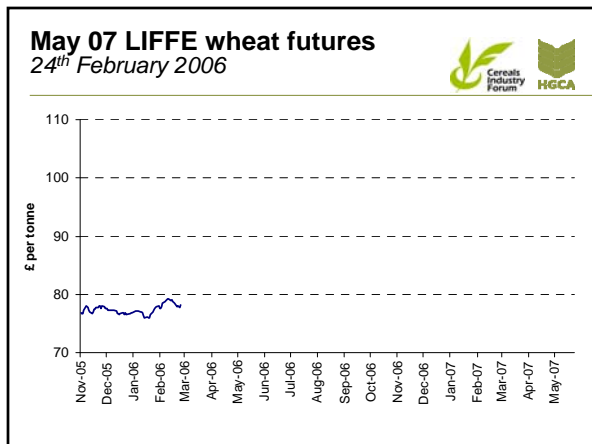
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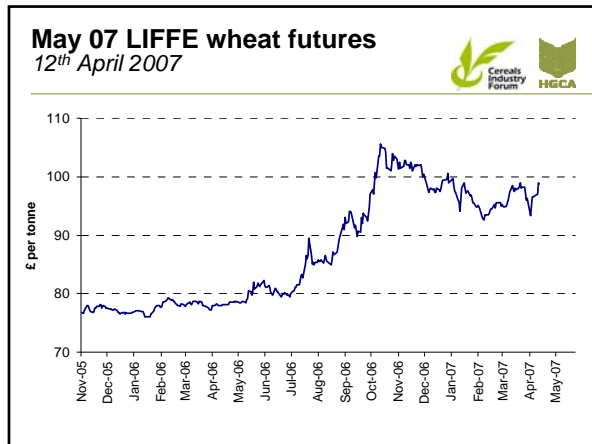
Profile - Steve Hammond (Harvest 2006) White House farm, Knapton, Norfolk

Tonnage: 900t (worst scenario), potential for 1,200t
Previous year: £60 - £70/t ex-farm
Goal: Wants £100/t May 07
Price at time of commitment: £76.50/t
Market view: Bullish / 'It can't go down!'
Risk view: Min price higher than last year's high

Decision

1. Sell 400 tonnes @£76.50/t
2. Buy May 07 Call Option £79 strike, £4.50 premium = £72 ex-farm minimum price
3. Balance 500 tonne leave open





Profile - Steve Hammond (Harvest 2006)

White House farm, Knapton, Norfolk

Decision pre-harvest- based on 900t

1. Sell 400 tonnes @£76.50/t
2. Buy May 07 Call Option £79 strike, £4.50 premium = £72 ex-farm minimum price
3. 500t balance: leave open

Outcome post-harvest- 1,200t produced

30 Oct 06: Sold 200t @ £100/t for April 07 (not 1,200t)
 Dec – Mar 07: Sold 270t @ £90/t (storage/ logistical sales)
 April 07: Exercise Call option @ £99/t (Near expiry) = £15.50/t profit to add to £72/t min price
 May/June 07: Sold balance 330t @ £100/t

Average price: 900t = £94.22/t 1,200t = £95.66/t

Profile - Steve Hammond (Harvest 2006)

White House farm, Knapton, Norfolk

400t x £15.50 option profit = £6,200

£6,200 divide by 900 tonnes budget production = £6.89

£6.89 divide by 40 pence HGCA levy = 17.2 years worth of levy!

Steve put 900 tonnes into a 2007 option.
 Current HGCA information profit = 225 years of levy plus the 17.2 from 2006

Buy Nov 07 Put option - 23rd Oct 06

possible outcomes

Nov 07 futures @ £83/t

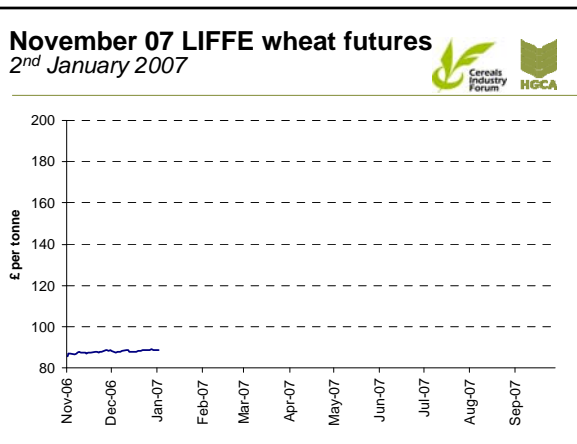
Futures	Ex-farm less-£3 Basis	Option + Profit	Option - Premium	= NET PRICE
110	107	0	4.5	102.5
100	97	0	4.5	92.5
90	87	0	4.5	82.5
80	77	3	4.5	75.5
70	67	13	4.5	75.5
60	57	23	4.5	75.5

Profile – Chris Harrison (Harvest 2007)

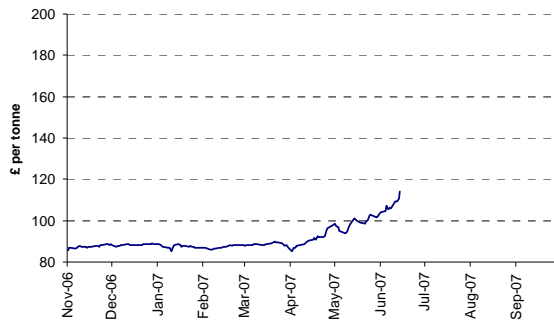
Hall Farm, Trimmingham, Norfolk

Tonnage: 800 tonnes 'our share'
Previous year: £70 - £100 ex-farm
Goal: Get the market right
Price at time of commitment: £85.50 ex-farm Nov 07
Market view: Expect prices to improve
Risk view: Better values than 06, want to secure a base income

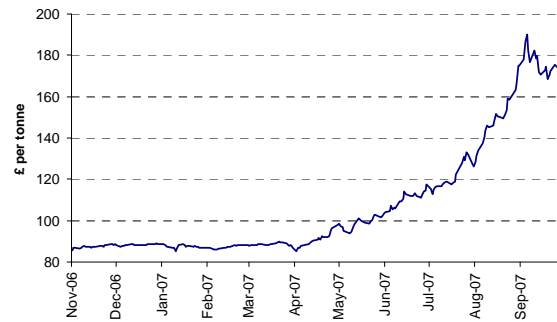
Decision
 Use out of the money Put options with a smaller premium as a 'just in case' minimum price



November 07 LIFFE wheat futures 14th June 2007



November 07 LIFFE wheat futures this is volatility!



Profile – Chris Harrison (Harvest 2007) Hall Farm, Trimmingham, Norfolk



Decision

Use out of the money Put options with a smaller premium as a 'just in case' minimum price

Outcome (so far)

14 June 07: Fixed 200 tonnes @ £110.25
Less £4.10 premium = £106.15

Balance unsold: Value May 08 = £183/t ex-farm or
Nov 07 = £170/t
May need to move some wheat
pre-Christmas

Plan: Sell some and buy May Call option

Profile – Chris Harrison (Harvest 2007) Hall Farm, Trimmingham, Norfolk



200t x £20.65 increased profit
= £4,130

600t x £85.00 increased profit
= £51,000

£55,130 divide by 800 tonnes
= £68.91

£68.91 divide by 40 pence HGCA levy
= 172.3 years worth of levy!

November 08 Call option it's your Call!



Nov 08 futures @ £130/t
Option premium = £14.50/t

Ex-farm Forward sale	Nov-08 Futures	Option		NET PRICE
		+ Profit	- Premium	
127	200	70	14.5	182.5
127	180	50	14.5	162.5
127	160	30	14.5	142.5
127	140	10	14.5	122.5
127	120	0	14.5	112.5
127	100	0	14.5	112.5
127	80	0	14.5	112.5

Summary

Wake up from your trance!



£112.50 Ex Farm Nov 08 Minimum Price

The market can not be accurately predicted, nobody is bigger than the market.

Price risk management workshops 2007/08 HGCA

- Cover your levy charges for the next 200 years.

Thank you

