FACT SHEET

Your quick guide to

Agricultural Option Contracts

What is an Option?

Options are a way of protecting your agribusiness against adverse commodity price movements, while still allowing you to benefit from any favourable commodity price movements. Option Contracts may be useful for producers looking to protect their revenue against declining commodity prices, or consumers looking to protect their costs against increasing commodity prices.

Why Westpac Agribusiness?

- Enjoy the support and guidance of dedicated local agribusiness bankers who get to know your business and the challenges you face.
- Get access to agribusiness products and solutions tailored for your needs.
- As Australia's first bank, we've backed the agribusiness sector for almost 200 years – weathering floods, droughts and recessions together with our customers.

Benefits

Price protection[1]
You receive protection against adverse commodity price movements through a guaranteed worst-case price.

No fixed price
You benefit from any favourable commodity price movements.

Flexibility
You determine the quantity of the commodity you want to cover, the timeframe, the option style, the currency and the price protection level that suits your needs.

Simplicity
You can make your option transactions in Australian or US dollars. By choosing Australian dollars, you eliminate the need to hedge the associated foreign currency exposures.

Risks

- Premium needs to be paid up front.
- If you terminate early there may be a cost to you as the amount you receive may be less than the original premium you outlaid.
- You are not covered for total risk, you will still carry 'basis risk' (see overleaf for details).

Quick facts

Costs	Other than the upfront premium, there are no direct fees associated with an Option Contract.
Minimum Transaction Amount	Wheat – 100 metric tonnes Sugar – 50 metric tonnes (smaller amounts and other commodities may be available on request).
Term	1 week to 3 years (longer terms may be available on request).
Settlement	An Option Contract is cash settled at maturity. No physical delivery of the underlying commodity occurs. Any amounts owing to you will be paid on the settlement date.
Early Termination	You can terminate an Option Contract early but there may be a cost to you if you do. The amount you receive may be less than the original premium you paid.

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Case study

Commodity Producer (Purchaser of Wheat Put in AUD terms)

You are a wheat producer seeking protection from falling wheat prices in 12 months' time, and you decide to hedge the price on 200 metric tonnes of wheat for this period. As you are also concerned about your exchange rate risk, you want to hedge the AUD value of your wheat sales at the same time.

Without an Option Contract

If you do nothing, the amount of AUD you'll receive when you sell your wheat in 12 months' time will depend on the market price for wheat, and the AUD/USD exchange rate at the time specified in your sale contract.

With an Option Contract

You purchase a Wheat Put Option with a notional volume of 200 metric tonnes and a maturity date of 12 months. You specify the floating reference price to be the Chicago Board of Trade (CBOT) Wheat Futures contract. You set the Strike Price at AUD 205 per tonne (AUD 30 below the current floating reference price of AUD 235). Based on these details Westpac determines the premium for your Put Option to be AUD 20.00 per tonne.[2]

There are two possible scenarios at maturity. These are:

(a) If the floating reference price is less than the AUD 205 per tonne Strike Price, Westpac will pay you the difference in AUD on the Settlement Date. This amount should compensate you for the lower price you will receive when you sell your physical wheat.

(b) If the floating reference price is greater than the AUD 205 per tonne Strike Price then no settlement occurs.

However, in this case, if you sell your wheat in the physical market at the floating reference price you will generally achieve a price that is greater than the Strike Price.

By entering into an Option Contract you've reduced the risk of adverse commodity price moves over the next 12 months. Provided you can sell your physical wheat at the floating reference price your worst-case situation will see you receive AUD 185 per tonne for your wheat net of the option premium cost. Over the same period, should wheat prices rise, you'll benefit from the favourable move.

What is not covered with an Option Contract?

You need to remember that the price you receive under the contract for the physical sale of your wheat, may not be an exact reflection of the floating reference price under your Option Contract. This could occur, for example, because the price you receive for the physical sale of your wheat takes into account matters such as transport costs, the quality of the wheat and other factors.

These fluctuations in the price that you receive are referred to as the 'basis risk' and aren't covered by an Option Contract. Any adverse slippage between the price you receive in the physical market and the floating reference price effectively decreases the fixed price you actually receive.

For more information, speak with your local Westpac Agribusiness Banker or call 1300 134 979.

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