

PHYSICAL SUGAR SALE



Previous Price Management Fact Sheets explained how the futures market is used to hedge sugar prices at a time and price level to suit the party (buyer or seller) undertaking the hedge.

Sugar prices hedged as a consequence of a grower's individual pooling and pricing decisions determine approximately 99% of the Sugar Price that is used in a grower's cane price formula.

It was also explained that futures contracts need to be 'closed out' in a particular way with a physical sugar buyer, using the 'Against Actual' (AA) procedure, to ensure a perfect hedge is achieved.

This Fact Sheet will demonstrate how the close out process is linked with the physical sale contract.

For Australian exports, a typical raw sugar sale will be a 'CNF' or 'CIF' based sale to an end user of the raw sugar (i.e. a sugar refiner). The key markets supplied by Australia include Indonesia, Malaysia, Korea, Japan, New Zealand and USA.

A CNF sale means 'Cost and Freight'. A CNF sale is where the seller of raw sugar will load the contract tonnage onto a vessel which it has chartered and ship the cargo to the buyer's port in the destination country. A CIF (Cost, Insurance and Freight) contract differs only in that the seller pays cargo insurance as well.

An alternative sale method is a 'FOB' (Free on Board) sale where the seller only has to load the cargo onto a vessel provided by the buyer. Very few, if any, sales of Australian raw sugar are made this way, as our industry has focused on delivering to refiner customers in order to better capture the value flowing from consistent, good quality sugar, and timely and efficient movement of sugar from our bulk sugar terminals.

Let's look at a typical raw sugar sale to a refiner in Indonesia, which we will call Indo Refining Pte. The sale contract terms could look like this:

Buyer	Indo Refining Pte
Quantity	30,000 metric tonnes (MT)
Ship to	Ciwandan, Indonesia
Shipment period	1–10 April 2015
Price	AAs for 590 lots March 2015 ICE#11 futures plus US\$14.50 Physical Premium plus Polarisation Premium per tonne*
Freight	US\$19.00 per tonne
Polarisation	Maximum pol 99.00 degrees
Other quality items	Typical Queensland raw sugar

Shipment period

The sale will require the seller to charter a vessel to present to load from a Queensland Bulk Sugar Terminal during the period 1–10 April 2015 and then to sail to Indonesia. Assuming a typical loading time of approximately 24 hours and a voyage time for this journey of about 12 days, the arrival time in Ciwandan is scheduled to fall somewhere in the window from 14–23 April 2015.

Quantity

The contract is a 'futures-based' contract covered by 590 lots, equivalent to 29,973.416 MT (i.e. 590 x 50.8024 tonnes), that is, almost the 30,000 MT contract quantity. This slight mismatch in the hedged lots versus the physical tonnage does not cause any issue because the buyer will pay for the full cargo based on the AA strike price.

Physical premium

The contract price includes a Physical Premium of US\$14.50 per tonne, which the seller has negotiated with the buyer. The premium is determined by examining what competing sellers would ask to win this contract for April arrival in Indonesia.

In this example, let's assume Guatemala is considered as the most likely competition and it is estimated that Guatemala can deliver raw sugar to Indonesia at ICE#11 plus US\$32 per tonne for that arrival period. This estimation is based on market knowledge that, as a result of supply and demand, Guatemalan raw sugar is available in the traded market for that shipment period at a US\$2 premium (or about US0.10 c/lb) to the ICE#11 March15 futures contract. With freight to Indonesia estimated at US\$30 per tonne, Guatemalan sugar can therefore effectively land in Indonesia at ICE#11 March15 futures plus US\$32 per tonne after taking into account the prevailing Physical Premium and freight cost.

With that market intelligence in mind, a marketer selling Australian sugar will aim to extract a superior price to ICE#11 March15 futures plus US\$32 per tonne, particularly given our reputation for consistent quality and on-time delivery. For the sake of this example, let's assume that for Australian sugar a price of ICE#11 March15 futures plus US\$33.50 per tonne can be negotiated with the refiner.

Knowing sea freight from Queensland to Indonesia is around US\$19 per tonne, the Physical Premium for Australian sugar is effectively US\$14.50 per tonne (i.e. US\$33.50 minus US\$19).

Strike price

Once the contract is agreed, the next step is to set a date to register the 590 lots of ICE#11 March 2015 AA's. This is usually at a date close to the expiry of the position, simply to allow as much time as possible for buyer and seller to execute their own respective hedging activities. In our example, a date of 23 February 2015 would be typical and the parties would agree to register 590 lots of futures via the AA procedure at the prevailing ICE#11 market price on that date, say for this example, US\$16.00 c/lb. This will close out 590 lots of both the buyer's and seller's March 2015 hedging.

Polarisation premium

Assume the vessel loads on time on 5 April and the average analysis of the loaded sugar determines a polarisation of 98.94 degrees. This means the cargo is due a Polarisation Premium of 3.69%* of the base sugar price.

Contract price

The actual US\$ contract price for the physical sugar can now be determined:

AA price at US 16.00 c/lb x 22.046	\$352.74
Plus Physical Premium	\$14.50
Equals base price =	\$367.24
Plus Polarisation Premium @ 3.69% of base price	\$13.55
Plus freight	\$19.00
Equals CNF contract price	\$399.79 per MT

To receive payment for the cargo, the seller needs to present a range of documents to the buyer's bank. Once the loaded sugar sample is analysed (usually within 24 hours of loading) the seller can present a complete set of electronic documents to the bank requesting payment for the total cargo value of 30,000 tonnes x US\$399.79 per tonne or US\$11,993,700.

* Please see Price Management Fact Sheet # 3 for an explanation of the International Polarisation Scale and how it is used to calculate the Polarisation Premium. In this example, for a polarisation of 98.94 degrees the premium is calculated as 1.5% + 1.25% + 0.94% = 3.69%.



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