CLOUDBREAK GRAIN MARKETING

Wheat & Barley

20th January 2023

Wheat Demand Tapers

- Better yields than expected
- Record SA and Aussie crop
- Russian exports improved significantly
- Global demand decreasing
- Potential for volatility in March?

Outlook: Ahead of harvest, CloudBreak recommended catching up on sales targeting up to 50%, as we felt yields were underestimated and foresaw strong harvest pressure with a big crop looming. Additionally, with consistent rainfall at the time, we were leaving room for to take advantage of any potential shipping shorts. Fast forward to post harvest, and yields were much larger than expected and as anticipated, growers in early zones were able to take advantage of opportunistic shipping shorts.

However, with yields surprising to the upside, even after additional sales, on average growers are still only 50% sold. This leaves a large number of unsold tonnes amid a record crop. Across the board, cash prices have been easing, as exporters are getting more comfortable with the level of cover they require to meet their short-term commitments. Also weighing on prices has been global futures trending lower amid strong Russian exports, selling pressure out of Australia and concerns over declining global demand. The AUD has also been trending higher, currently above 69c (up 3c from early Dec and 7c from October).

Whilst Russian exports remains strong, they will likely continue to keep a cap on global prices. The USDA forecasts record Russian exports 43MMT, with some analysts pegging it even higher. CloudBreak does remain skeptical of these 43MMT+ figures, as Russian Jan exports have started to slow, and Putin has reportedly demanded the creation of stable wheat reserves and mentioned he was concerned over the ferocity of their export pace. If this pace underwhelms, then this could be supportive of global prices.

In comparison to other states, SA does have the largest relative shipping capacity in relation to the amount of grain we produce, which in normal years generally allows SA to trade at a premium. However, in such a big year, SA will also face shipping capacity constraints during the Jan-June window, as buyers will focus on exporting as much as they can ahead of the Northern Hemisphere crop and our crop is too large to export all in that window.

Seasonally, wheat futures can see price strength into Feb/March as there is speculation over the uncertainty of the Northern hemisphere crop conditions. Currently US winter wheat crop conditions are struggling and will need favourable rainfall/snow cover over the next few months. As for SA cash pricing, we can also typically see a rebound into Feb/March, as grower selling slows post-harvest and buyer interest starts to resume.

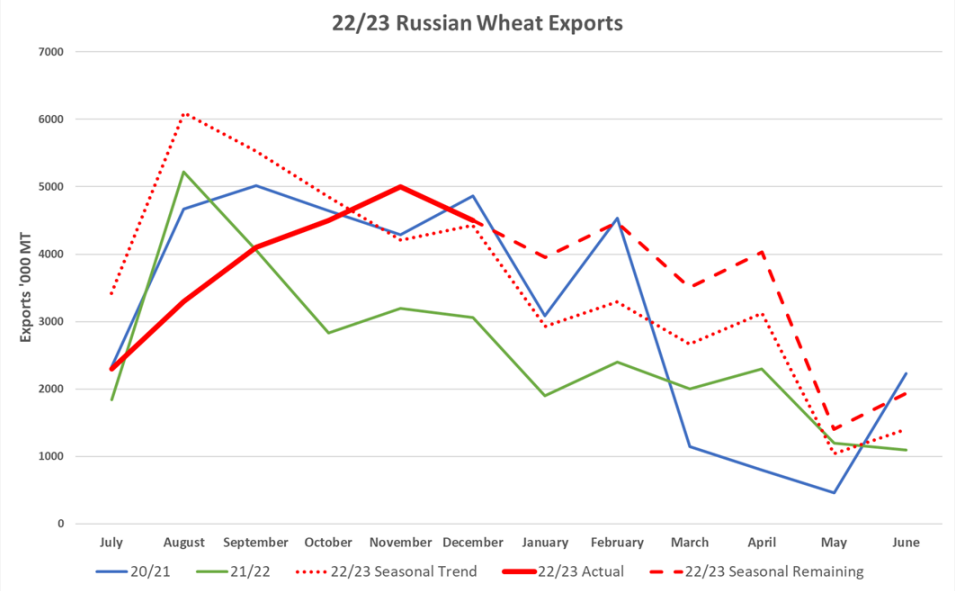
SA basis against SRW is at near neutral levels, however, against EU milling wheat and US HRW wheat futures, it's still weak at circa -100USc/bu. This does make sense though, as we've just come off a record crop, US winter wheat zones are in drought conditions and EU stocks remain very tight. As such, basis against EU milling and US HRW will likely remain weak until concerns over weather in the US and tight stocks in the EU are abated.

You have to remember we are sitting on a record crop and with it, the potential for shipping bottle necks which could reduce demand. Yes, prices have come back from their highs, however, we wouldn't hold back any growers looking to advance sales. For grower more risk seeking, you could look to target Feb/March for potential upside due as the US crop comes out of dormancy. Please note, holding a large percentage targeting this window is a high-risk strategy.

There is a case to be put forward, that if El Nino does occur, there could be potential upsets to NH spring wheat crops. However, either way we do suggest growers to have a good percentage sold by Feb/March, and historically, we do see seasonal weakness into July. Remember, if we do see NH crop issues, growers can always take advantage of this via 23/24 forward sales. Anyone holding grain will have to be wary of the AUD, which has been trending higher since October.



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Locally: After a delayed and stop start harvest, we're now made it to the tail end with most growers wrapping up for the 22/23 season. Despite exceptionally wet conditions heading into harvest, wheat quality across SA and the east coast has been much better than previously expected. As we approached harvest, grade spreads blew out in both directions as the market expected large quantities of downgraded wheat, however, once headers actually started rolling, ASW1, APW1 & H2 were the predominant grades in SA. The east coast also experienced a similar situation, with a lot more ASW1 & APW1 than expected. We note, as a percentage of the SA crop, amid bigger yields there's about twice as much ASW1 and half as much H2 compared to last year. There remains a premium for H2 or circa +20 in OH and all spreads for lower grades (ASW1 and below) have tightened significantly since the beginning of harvest. However, with significantly more ASW1 around this year, will the spreads continue to tighten? (Please see section on ASW1 spreads).

Local cash prices ahead of harvest were historically strong, with APW1 valued at circa $470 in the OH zone in mid-November. Supporting these prices was continued wet weather, leading to limited grower selling and concerns over quality, coupled with a low AUD. As such, buyers were bidding up for milling grades to help prevent being caught short (as they did last year). However, once headers started rolling in early Dec, prices fell quickly, with APW1 falling $80/mt from $470 on the 16th Nov, lading at $390 on the 7th of Dec in OH. Rain over harvest slowed the flow of grain did create some shorts ahead of Christmas, which saw APW1 make a temporary return to $425-$430. However, after 3 weeks of favourable weather, APW1 is now back trading sub $400 in the OH system. As mentioned, the spreads for lower grade wheat has improved significantly, however, in general wheat prices have continued to soften as buyers become more comfortable with their position.

Global Futures: Global wheat futures remain in a long-term downward trend, currently pressured by increasing export pace from the Black Sea (mainly Russia) and a record harvest in Australia. Additionally, with the expectation of sluggish world economic growth, the market expects wheat demand to suffer (which is currently evident, as July-Nov major exporter shipments are down 3MMT YoY).

Russian exports were sluggish in July-August amid a lack of insurance coverage and importers fearing force majeure wash outs. However, as confidence grew in the export corridor, Russian exports from September onwards picked up pace significantly and are now estimated to be back in line with the 5-year average. Russian analysis agency Sovecon estimates July-Dec Russian wheat exports at circa 23MMT (2.8MMT larger than last year) and total 22/23 season exports at 43.7MMT (USDA 43MMT). CloudBreak remains skeptical as to whether these record export figures can be met, seasonally Russian exports tend to decline from January onwards as the Southern Hemisphere crop becomes available and importing countries start to focus on their own upcoming domestic crop (which we've seen in Jan so far). Additionally, Putin has reportedly demanded the creation of stable wheat reserves and said he was concerned about the rapidly growing exports… As such, CloudBreak feels 40-41MMT is more likely (still very large though).

Still in the back of traders' minds is the poor condition of the US winter wheat crop. Whilst early crop conditions aren't a great indicator of final yields, if the crop comes out of dormancy and remains poor ahead of harvest, we could experience some strong volatility. Kansas and Nebraska (which accounts for about 30% of the US winter wheat crop) were last rated at sub 20% Good-to-Excellent, well below the same time last year, and last year was still below average. For the time being, the US has seen some needed rainfall on the forecast and the market likely won't start to truly factor in new season supply issues until the crop comes out of dormancy in March.

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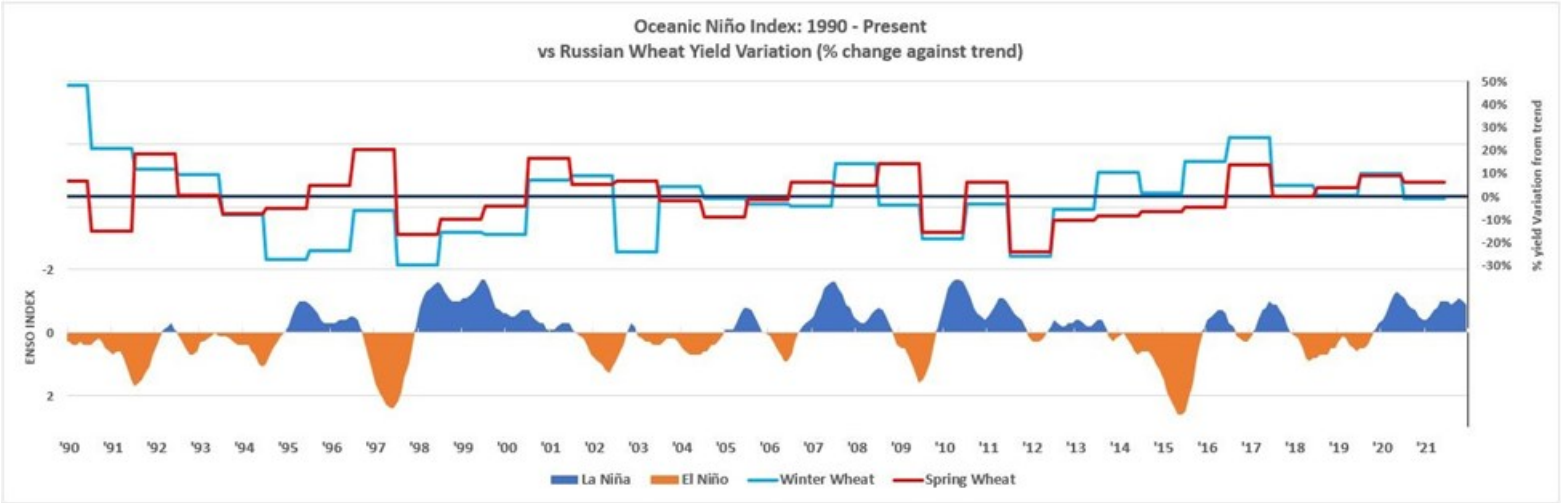
ENSO: After 3 bumper years for Australia, La Nina is expected to return to neutral levels by February and may even head towards El Nino by winter. Models currently predict a 30-40% probability of El Nino conditions developing by June-July. If this were to occur, it could result in lower rainfall across SA and the east coast at the back end of the season, which is the key period for determining yields. Whilst Australia has had ample rainfall and will likely carry in good soil moisture into seeding, a good start and winter rainfall will still be needed. Despite the potential for ENSO to turn negative (El Nino) in the last half of the year, with good carry in soil moisture, Australia could be at least on track for an average year in 23/24.

As for the Northern Hemisphere and Argentina, a neutral ENSO could be a welcome relief, especially for US winter wheat zones which have been experiencing drier conditions over the past 3 seasons. US wheat planted area for the 23/24 season is expected increase by 2.3M acres YoY (up 5%) due to strong prices during seeding. As such, a return to neutral ENSO or potentially El Nina could help solve supply issues for the winter wheat regions of the US in 23/24. However, we do note that if El Nino occurs, US spring wheat and corn crops could suffer from excessive heat/dryness, as has been observed in the past.

In previous years where Russia had droughts in their spring wheat zones, El Nino has also been present. Following record production in 22/23 and reportedly unfavourable prices, Russian farmers are unlikely to have increased planted area of wheat for the upcoming season. If El Nino does form this year, it is unlikely to have an impact on Russian winter wheat production (as it will already be reaped be El Nino conditions develop). However, it could reduce their spring wheat yields. Even though the relationship is not 1 for 1, we do note that we have seen severe droughts across the Black Sea (mainly Russia) during El Nino events. E.g., 09/10. Typically, we do see sub optimal Russian yields in El Nino years. A positive IOD is also known to negatively affect Russian rainfall.

Overall, La Nina conditions typically aren't favourable for Northern Hemisphere production, as such a return to neutral ENSO could help to normalise rainfall particularly in US winter wheat zones. If El Nino develops, we could see lower rainfall in the later half of our season and a rebound in the Argentina crop. Additionally, we may see warmer conditions across US/Canadian spring wheat zones, along with potential negative impacts on Russian spring wheat. With major exporter stocks still very tight, the market needs the Northern Hemisphere to have a favourable weather this season. Therefore, any potential supply issues caused by El Nino would create a large amount of bullish momentum for 23/24.

SA Market: Following larger area but mostly exceptional yields, the SA 22/23 wheat crop is expected to be circa 7MMT, over 2MMT higher compared to last year. Whilst the shipping stem is very full, which will provide ongoing support, buyers are going to be more comfortable accumulating post-harvest when there are plentiful stocks around. In comparison to other states, SA does have the largest relative shipping capacity in relation to the amount of grain we produce. However, we could have some shipping bottle necks, as buyers are going to be targeting the first half of 2023 ahead of NH harvest pressure. SA is estimated to have a 12MMT total grain crop, as such. we won't be able to shift all our tonnes before July as our annual shipping capacity is estimated at 12.7MMT.



Typically, Jan-Feb post-harvest can have lackluster demand, as buyers have already covered their short-term commitments and happy to step back and allow the grower to carry the grain until they need the grain in late Feb/March. This can be especially true in big years. This season has been slightly different, as we did see strong demand after Christmas (because harvest was delayed), however, buyers are now starting to get comfortable, and prices could continue lower in the short-term.

The primary questions moving forward are:

Will we see prices recover? And what are spreads likely to do?

Price recovery?: Total Australian wheat production is forecast at a record 36.6MMT by ABARES, with other estimates as high at 40MMT+. As such, growers will likely continue to see pressure from SA's massive crop coupled with large crops from other states. Currently, SA is experiencing pressure from cheaper high protein wheat coming from the east coast, as NSW and Vic have been harvesting quality that far exceeds the initially expected quality heading into harvest. As mentioned above, our fully booked shipping stem will provide ongoing support, however, in the short term we're unlikely to see a solid recovery locally unless we see strength in global prices or sizeable weakness in the AUD. With strong Russian exports continuing in the meantime, they will act as a cheap global benchmark. Seasonally, we can see a spike in wheat futures in Feb/March as the market starts to speculate over the condition of the Northern hemisphere crop as it comes out of dormancy. However, this will be dependent on rainfall over the next few months.

Grower liquidity has started to dry up, and trader elevation margins have responded as such. E.g., APW1/ASW1 margins in SA are circa AUD$30/mt (back from $80-$100 pre harvest), which is reasonable considering the record production year. There is a risk that as buyer demand wanes in this sloppy period, basis will widen and margins with it before potentially improving when buyers return in late Feb/March.

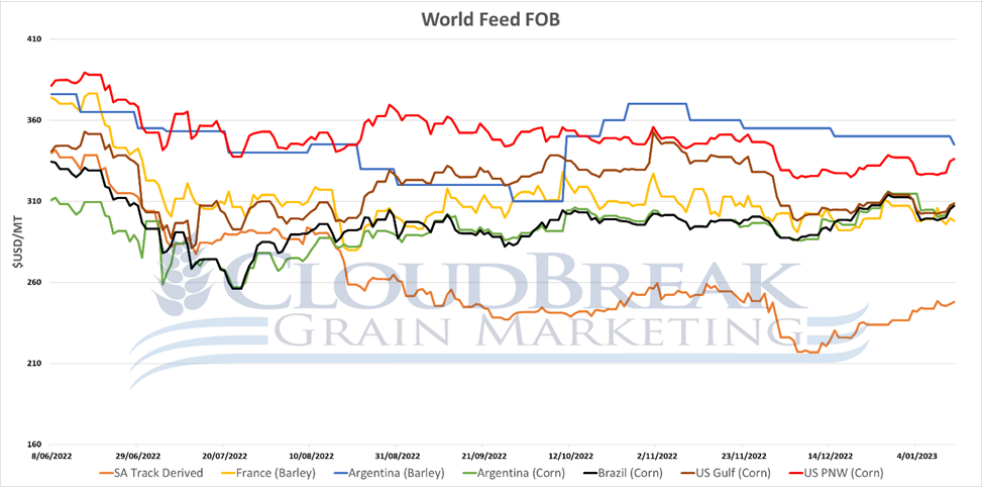
Spreads: Seasonally, high protein spreads are strongest during harvest and then start to weaken when buyers get their fill. The proportion of the SA crop that is H1/H2 this season is significantly less in comparison to last year (only around 20% vs 40% last year). As such, H1/H2 is likely to remain at a solid premium in the short-term. However, the premium has weakened since its peak during harvest of +45 to now sit at around +20 and is expected to slowly weaken as demand decreases. With H1/H2 stocks tight this year, there's likely to be minimal H2 vessels and will likely be used as a blending tool for APW1.

As for ASW1, the percentage of the SA crop in much larger this year (circa 39% this year vs. 15% last year). The spread has strengthened from -45 pre-harvest to currently sit at around -20/-25, amid solid off-shore demand and better than anticipated SA quality as a whole. We expect the primary ASW1 price pressure to come from WA, as ASW1 is priced there at only $340 FIS Kwinana basis ($50 under SA). With much more ASW1 around this year (across Australia in general), we would expect ASW1 to maintain a reasonable discount to APW1. Currently for SA this is at circa -15/-20 and seems to be in line with the FOB market (currently -$15USD).

SA wheat quality emerged significantly better than previously expected, and SFW1/AGP1 accounts for just 5-6% of the total SA crop. Therefore, the majority of it will just be blended into vessels with higher base grades. The majority of feed wheat trading out of Australia is coming from WA. Any SA trader looking to sell feed wheat into SE Asia will likely be using ASW1. Pre-harvest, SFW1/AGP1 spreads were at a monstrous -120+, however, have now strengthened considerably (currently at circa -25/-30) which reflects the current spread in the export market.

Foot in the Door with China Relations

- Second largest barley crop for SA on record
- China back on the cards?
- US corn futures testing resistance
- Malt premiums continue to grind lower
- Prices recover from harvest lows

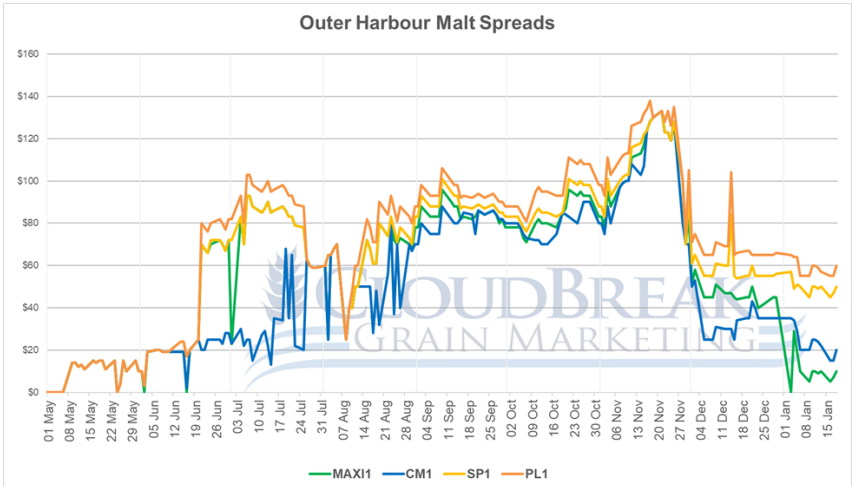


Outlook: Heading into harvest CloudBreak was recommending being at least 40% sold. During harvest growers were encouraged to sell any malt grade barley off the header to take advantage of the high premiums while they lasted, as well as making catch up sales will prices weren't yet impacted by harvest pressure. Now that harvest is mostly complete and intense selling has stopped CloudBreak estimates the average grower is approximately 45-50% sold, in part due to higher than anticipated yields. Seasonally Jan/Feb can be relatively quiet months as the buyers digest what they purchased during harvest and get comfortable with their position in the short term. Local BAR1 prices have been steady post-harvest, remaining at a decile 9 level. On the world stage, Australian barley is still extremely cheap making it a tempting target for any additional feed demand that pops up. Since August, Australian barley has traded at a significant discount to the rest of world due to our inability to sell to China and Saudi Arabia pivoting to compound feed pellets. On a comparative FOB basis, SA BAR1 has traded at a $USD50 discount to other countries. With the real possibility that China lifts trade restrictions at some point this season we could see this spread tighten. The biggest risks to holding at this stage are the large local crop pushing SA's export capacity to the limit and a rising Aussie dollar. The prospect of a record South American corn crop could also threaten Australia's markets in Asia post March/April.

For growers currently at the 50% sold level, CloudBreak recommends to keep making incremental sales while prices are stable if you are below the 50% sold level. Seasonality tells us prices continue to recover through to March where we will likely look to advance sales further. On the longer term, for those who are more risk seeking, consider holding around a quarter to a third of production to speculate on the return of China. For growers who are still holding malt, premiums are unlikely to improve for old crop supplies so look to sell malt first.

Harvest: Now that the dust has settled and things are winding down, grower selling has slowed to a trickle. Above average rainfall resulted in exceptional yields for SA growers in what will likely be the second largest barley crop for SA on record, with ABARES forecasting 2.66MMT. Prices ahead of harvest were strong, circa $340 but once headers started rolling prices quickly fell as low as $269 on an Outer Harbour basis. Further adding to the pressure on prices was the rising AUD which rallied from $0.64 to $0.68 from November to December. Prices began to recover in late December as rains slowed down harvest and generated a number of minor shipping shorts. BAR1 is currently $305 and has been mostly steady for the past three weeks.

The higher yields lead to lower protein, meaning many growers ended up with malt quality barley. Malt premiums heading into harvest were also strong, peaking at +$138/t for Planet, on fears that the wet weather would result in high black tip count and as the domestic maltsters were eager to secure supplies after being caught short last season. When harvest started quality was far better than initial fears and the abundance of malt saw premiums rapidly collapse with most premiums halving within a few days. Since then, the premium for malt has continued to grind lower as maltsters meet their requirements and the malt export



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market remains thin. This coincided with the seasonality of malt premiums which are typically strongest during early harvest and fade away once harvest is complete.

March **US corn** futures are currently seeing converging trendlines potentially forming a symmetrical triangle pattern. Prices are currently testing the upper trendline as corn rallies on the back of the latest WASDE update, Argentine weather and better than expected US exports. Corn rallied 15USc/bu following the January WASDE update which cut US production by 5.09MMT, down to 348.75MMT due to a significant reduction to harvested area. Corn area harvested was reduced by 650kha, a 2% reduction which was well below analyst forecasts. Prices saw further support from the ongoing drought in Argentina which is beginning to impact yield potential now that 89% of the crop has been planted. Only 7% of the Argentine crop is rated good to excellent and while there is rain forecast, longer term models maintain drier than average conditions. US export sales have been well behind last year's pace, with net sales so far at 22MMT compared to 41.45MMT this time last year. Lacklustre exports out of the US have been the result of much cheaper offers out of Ukraine and South America and high domestic prices in the US. However, the release of export inspection data by the USDA showed far better than expected exports, nearly double the previous weeks. This generated some optimism and triggered a wave of buying but US exports have a long way to go to catch up to the USDA's forecasts and at this stage there are no hints of fresh demand from China.

South American corn is coming into focus for feed markets as Argentina nears completion for seeding and Brazil enters the window for planting their second corn crop. Due to dry conditions, many Argentine growers opted to plant their corn later in the season in the hope's conditions would improve. As later planted corn on average yields lower than early planted corn, Argentine growers had taken a sizeable risk. However, with forecasts for the next two weeks showing above average precipitation across all growing regions in Argentina, the risk appears to have paid off. If this forecast does materialise it could break the drought and normalise yield potential. Brazilian corn production is forecast to reach a record 125MMT this season. Conditions in southern Brazil were drier than average during December, which was during the sensitive pollination stage, however temperatures were not excessive so the impact to yield should be marginal. Brazil will begin harvesting their first corn crop in February which primarily stays in the domestic market. The second export oriented Safrinha crop accounts for approximately three quarters of production and is planted in January through to March. The second crop is primarily planted in the centre/western portion where conditions have been mostly fair.

China: Australia's relationship with China has been thawing and it is now a very real possibility that the anti dumbing duties on Australian barley will be lifted at some stage this season. Relations have been improving since Prime Minister Albanese met with President Xi at the G20 summit in November. We have already seen several "unofficial" restrictions lifted on Australian commodities with Chinese companies resuming purchases of Australian coal for the first time since 2020. However, barley and wine are likely to take longer to wind back as these were official restrictions and are currently active disputes with the WTO. If the anti-dumping duties are simply reversed, it would be seen as an admission that the duties were put in place to punish Australia and not to prevent harm to Chinese growers. Australian and Chinese trade ministers are expected to meet within the next few weeks, the first such meeting since 2019. This meeting will provide a clear opportunity for Australia to advance the issue of Australian barley. It does seem like it is just a matter of time before the duties are dropped and it will be interesting to see how the market responds given the diversification in trade we've seen over the past few years.

