Impact of international wheat price increases on competitiveness of HQCF

Andrew Sergeant
Agribusiness Advisor
Accord Associates LLP
Milling wheat prices – 1999-2011


Wheat, US, (Hard Red Wheat) price chart

04/04/2011 Rising wheat prices and HQCF's competitiveness
Grains index similar to wheat
http://www.mongabay.com/images/commodities/charts/chart-index_grains.html

Grains Index price chart

04/04/2011 Rising wheat prices and HQCF's competitiveness
Why is the international price of wheat important for C:AVA???

- C:AVA countries target a number of markets
  - Maize starch replacement is the first target for flash dryers in Malawi ... 2nd target is as a wheat flour substitute. TZ starts with the retail market and then competes with wheat
  - In all other countries, the main market is as a wheat flour substitute ... in some instances a 100% replacement (Ghana plywood) – but generally a 5 to 30% partial substitution in biscuit and bread industries
  - Therefore, HQCF should be priced against its main competition ... wheat flour
  - So a theory could be if the price of wheat flour increases so should HQCF
### The impact of higher international wheat prices in Malawi ... the theory

<table>
<thead>
<tr>
<th>Step</th>
<th>Nov-09</th>
<th>Mar-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wheat grain C&amp;F Indian Ocean port</td>
<td>240</td>
<td>340</td>
</tr>
<tr>
<td>Freight to Malawi</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Port charges</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Grain handling</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Administration &amp; other costs</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Cost of grain delivered to mill</td>
<td>375</td>
<td>475</td>
</tr>
<tr>
<td>Assume 75% processing efficiency</td>
<td>500</td>
<td>633</td>
</tr>
<tr>
<td>Processing costs</td>
<td>65</td>
<td>65</td>
</tr>
<tr>
<td>Cost of wheat flour ex-mill</td>
<td>565</td>
<td>698</td>
</tr>
<tr>
<td>Miller's margin</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>Selling price</td>
<td>625</td>
<td>758</td>
</tr>
</tbody>
</table>

- In Oct 2009 – wheat prices ex-Nacala were $240/t .... and wheat flour price was $625/t
- March 2011, probably near to $340/t
- If other cost assumptions remain the same, then wheat flour prices should be $758/t

**Is this happening in practice????**
What is the reality in Malawi???

- Current price of wheat flour MK114,000/t at MK152 to US$ is ....... $750/t !!!!!!
  - Very close to calculated cost
  - However, if a shadow exchange rate of MK180 to US$ is used the current price of wheat flour equates to $633/t

- But across all C:AVA countries, a $100/t increase in the international price of wheat should lead to a $130/t increase in price of local wheat flour ..... everything else being equal
And in other C:AVA countries

- Nigeria
  - Price of wheat flour increased from $620/t (Feb 10) to $690/t (March 11) ... a 11% rise

- Ghana
  - Feb 10 – wheat was $300/t at Tema - flour price $740/t
  - Mar 11 – wheat at $300 to 336 – flour price $933/t (a 26% rise)
  - “Millers have significant stocks of wheat”. Probably bought when prices were lower

- Tanzania
  - Very limited data
Uganda – 18% hike in wheat flour prices from Sept 10 to March 11

- Wheat flour up from $676 to $800/t
- In April 2009, wheat flour prices were $566/t
- Between April 09 to Mar 11, wheat flour prices up by 40% - or $234/t
- “Small bakers paying through the nose”
- Could these data change strategy for marketing of HQCF???
What does higher international wheat prices mean for HQCF???

- One theory
  - Higher wheat prices have led to higher wheat flour prices in C:AVA countries .. by about by 10 to 26%
  - If HQCF is a substitute for wheat flour, then it should be more valuable ... is this reflected in prices???
  - Has the ratio of wheat flour to HQCF prices been affected by the increases in international wheat price?

04/04/2011 Rising wheat prices and HQCF's competitiveness
HQCF ratios

- Nigeria –
  - March 11 - wheat flour $690/t; HQCF $427/t, gives an HQCF ratio of 62%
  - In Feb 10 – HQCF ratio was 86 to 123%
  - In Aug 10 – HQCF ratio was 83%
  - Therefore, HQCF prices have not kept up with rising wheat prices.

- Ghana –
  - In March 11 - wheat flour $933/t; HQCF $500/t, ie HQCF ratio of 54%
  - In Feb 10 – HQCF ratio was 58%
  - In Aug 10 – HQCF ratio was 64%
  - Therefore, HQCF prices have not kept up with rising wheat prices and ratios are low.
HQCF ratios - 2

- Uganda –
  - No time series of data
  - March 2011 wheat flour is $800/t, HQCF is $434/t – the ratio is 54%
  - Therefore, some way from the 75 to 80% target

- Malawi –
  - No time series of data
  - March 2011 wheat flour $750/t;
  - *Therefore, target for HQCF prices should be $560/t if a ratio of 75% is assumed.*
What does higher international wheat prices mean for HQCF? - 2

- Second theory
  - Users of wheat flour can use HQCF to buffer against international price volatility – if the price of HQCF processors negotiate a stable, but attractive price.
  - Perhaps HQCF processors do not want to rely on volatility of wheat prices, but would like a stable price.
  - So why not enter a fixed price contract that will help the buyer reduce volatility, but give the processor a better average price?????? It might be another reason wheat flour users to be attracted to HQCF
Negotiate a price for HQCF based on long term average wheat price

- If a straight line is put thru the data – then 2011 price might be $260/t
- Calculate local wheat flour prices on this basis
- Negotiate an HQCF price of 80% of this????
- The maths may need to be refined; but is the idea sound????
How much is HQCF worth to end-users???

- Take biscuit manufacturers in Uganda and Malawi – using today’s assumptions
  - Riham bought 112t of HQCF last year – it probably added in the region of $30 to 35,000 to their bottom line.
  - If Universal buy 1,000t of HQCF/year, it would make a saving of $200,000/year
- This is why HQCF should be interesting to end-users in these two countries
The question - should HQCF prices reflect volatility of wheat prices???

- Not too sure what is the best answer – in fact the best option may differ in each country, but
  - There are at least two strategic options and either strategy may improve things - but there might not be a ‘right’ answer for all
  - This question might not be completely solved, but perhaps a better solution can be identified which will make processors more money; but may be not perfect
- However, what we can do is think about this, discuss it and above all collect more data to gain a better understanding to improve the negotiating position.
Whether we believe HQCF should reflect changes in international wheat prices or not – we need to collect and analyse data on local wheat flour prices.
The next steps ...

- Need a better understanding between international wheat prices and the local wheat flour prices in each C:AVA country.
  - All CMs to revisit the first part of the benchmarking data (or slide 8 of this pp).
- Must keep better records of local wheat flour prices
  - All CMs should include this data in all reports to C:AVA management.
  - Report on ratio between HQCF and wheat flour prices
- When we have more comprehensive data, we need further discussion to determine best pricing strategy
The next steps ... 2

- HQCF processors need to be better trained to negotiate more effectively.
- CAVA country staff need to help support processors to determine the best strategy for each buyer.
Thank you