

Adjustment factor

As the Canadian Wheat Board (CWB) starts completing sales, it becomes necessary to adjust the basis up or down to reflect the risk to the CWB as the value between the sales position of the pool account and the current futures market changes. An adjustment factor will be applied to the basis calculation when the CWB starts recording sales into the pool. The adjustment factor is calculated as follows:

$$\text{Adjustment factor} = (\text{Averages futures \& foreign exchange on CWB sales made to date} - \text{current futures}) \times \text{percentage of pool sold}$$

The adjustment factor will be shown separately for the 2006-07 crop year.

Since the CWB buys futures when making sales, the basis adjustment factor needs to reflect the average of these futures as a percentage of the pool that is sold. This futures position will contribute to the final pool return. The basis offered to producers is adjusted to reflect the sales position of the pool account with respect to the spot futures value. The adjusted basis is calculated as follows:

$$\text{Adjusted basis} = \text{estimated pooled basis} -/+ \text{adjustment factor}$$

The effect of the adjustment factor

The adjustment factor will likely reduce the value of the adjusted basis if futures markets are increasing in value. Alternatively, the basis will likely improve if the futures are decreasing in value. Shown are two examples of the effect that the adjustment factor has on the adjusted basis.

Example of applying the adjustment factor when FUTURES VALUES ARE RISING

On October 1, the pool account is 25 per cent sold and the average futures and foreign exchange value of these completed sales is \$200 CDN per tonne. The spot futures value on this day is \$215 CDN per tonne, or \$15 per tonne HIGHER than the average.

$$\text{Adjustment factor} = (\text{Averages futures \& foreign exchange on CWB sales made to date} - \text{current futures}) \times \text{percentage of pool sold}$$

$$\text{Adjustment factor} = (\$200 \text{ per tonne} - \$215 \text{ per tonne}) \times 25\% = \text{\textbf{-\$3.75 per tonne}}$$

In this example, the basis value will be adjusted downward ▼ by \$3.75 per tonne.

$$\text{Adjusted basis} = \text{estimated pooled basis} -/+ \text{adjustment factor}$$

$$\text{\textbf{\$16.25}} = \text{\textbf{\$20.00}} - \text{\textbf{\$3.75}}$$

Note: The current futures have trended upward as compared to the average futures the CWB bought when sales were made. The **basis in this case will decrease in value** to account for these sold positions.

Example of applying the adjustment factor when FUTURES VALUES ARE FALLING

On October 1, the pool account is 25 per cent sold and the average futures and foreign exchange value of these completed sales is \$200 CDN per tonne. The spot futures value on this day is \$185 CDN per tonne, or \$15 per tonne LOWER than the average.

$$\text{Adjustment factor} = (\text{Averages futures \& foreign exchange on CWB sales made to date} - \text{current futures}) \times \text{percentage of pool sold}$$

$$\text{Adjustment factor} = (\$200 \text{ per tonne} - \$185 \text{ per tonne}) \times 25\% = \text{\textbf{+\$3.75 per tonne}}$$

In this example, the basis value will be adjusted upward ▲ by \$3.75 per tonne.

$$\text{Adjusted basis} = \text{estimated pooled basis} -/+ \text{adjustment factor}$$

$$\text{\textbf{\$23.75}} = \text{\textbf{\$20.00}} + \text{\textbf{\$3.75}}$$

Note: The current futures have trended downward as compared to the average futures the CWB bought when sales were made. The **basis in this case will increase in value** to account for these sold positions.

The adjusted basis becomes more volatile as the sign-up period progresses into the crop year due to the greater impact of the adjustment factor. This can be attributed to the percentage of the pool sold. The greater the percentage of the pool sold, the greater the potential for change to the adjusted basis.

When is the adjustment factor applied to the BPC and FPC?

The adjustment factor is applied on the date of sign-up for an FPC or BPC contract, whether a producer signs up the basis or futures portion of the BPC contract. The adjustment factor is applied to the contract, based on the date tonnage is committed to the program(s). This information will be available on the daily pricing schedules; please see the CWB website at www.cwb.ca. Below are a number of examples that run through the various scenarios for locking in prices using the futures, adjustment factor and CWB basis in FPC and BPC contracts. In the examples, the highlighted values within each stage are the ones that have been locked in. Values are for illustration purposes only.

Call the CWB at
1-800-275-4292
to arrange your
assignment.

Example 1

Action taken by producer	Futures value	Basis value	Adjustment factor	Value locked in on this date
May 30, signs BPC futures only	\$200	\$22	\$0	\$200
Aug 20, signs the basis portion	\$200	\$20	\$1	\$20
Total value of contract				\$220

Example 2

Action taken by producer	Futures value	Basis value	Adjustment factor	Value locked in on this date
May 30, signs BPC basis only	\$0	\$22	\$0	\$22
Sept 8, prices the futures portion	\$198	\$22	\$2	\$198
Total value of contract				\$220

Example 3

Action taken by producer	Futures value	Basis value	Adjustment factor	Value locked in on this date
Aug 18, signs BPC futures only	\$210	\$20	-\$2	\$208
Sept 14, signs the basis portion	\$210	\$22	-\$4	\$22
Total value of contract				\$230

Example 4

Action taken by producer	Futures value	Basis value	Adjustment factor	Value locked in on this date
Aug 15, signs BPC basis only	\$0	\$22	\$3	\$25
Sept 25, prices the futures portion	\$200	\$22	\$3	\$200
Total value of contract				\$225

Example 5

Action taken by producer	Futures value	Basis value	Adjustment factor	Value locked in on this date
*Sept 25, signs FPC	\$200	\$22	\$3	\$225

* The fixed price is calculated by adding the December 2006 futures + December 2006 basis + adjustment factor on the date the value is offered.

How are buyouts calculated?

Showing the adjustment factor separately will also change the buyout formula for BPC contracts. The new buyout calculation is as follows:

The greater of:

{(current futures + current basis + current adjustment factor) - (producer's lock in futures + producer's lock in basis + producer's lock in adjustment factor)} plus \$15.00 administration

or

(current futures - producer's lock in futures) plus \$15.00 for administration