

This section outlines some aspects of the BPC and FPC programs in more detail by providing examples and different market scenarios that producers should be aware of when making decisions. The figures used in this section are for illustrative purposes only.

BPC sign-up

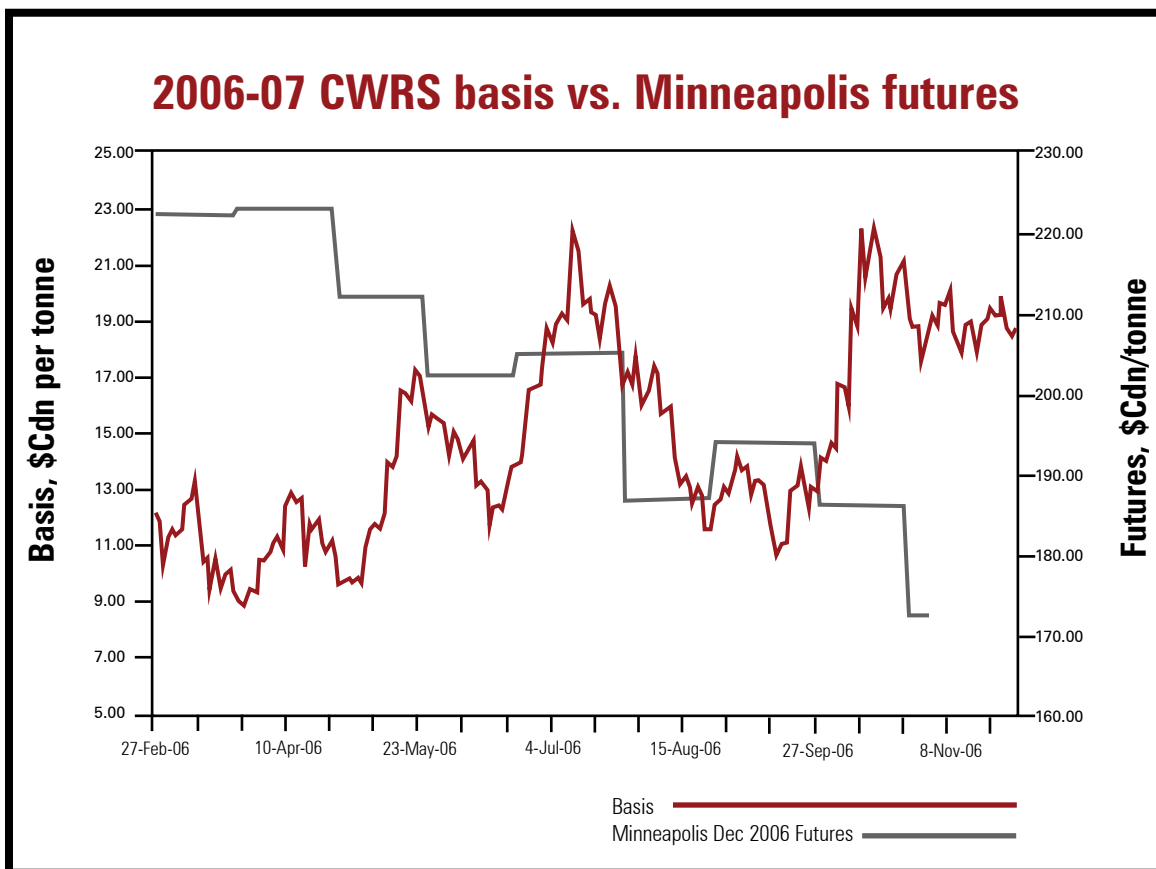
The BPC can be priced using two different approaches:

1. Lock in a basis and price the futures later or
2. Price the futures and lock in a basis later.

Which strategy to choose depends entirely on whether a market rally or downturn is expected. As the following charts show, locking the basis in first would have resulted in a better return in 2006-07 but locking the futures in first would have resulted in a better return in 2005-06.

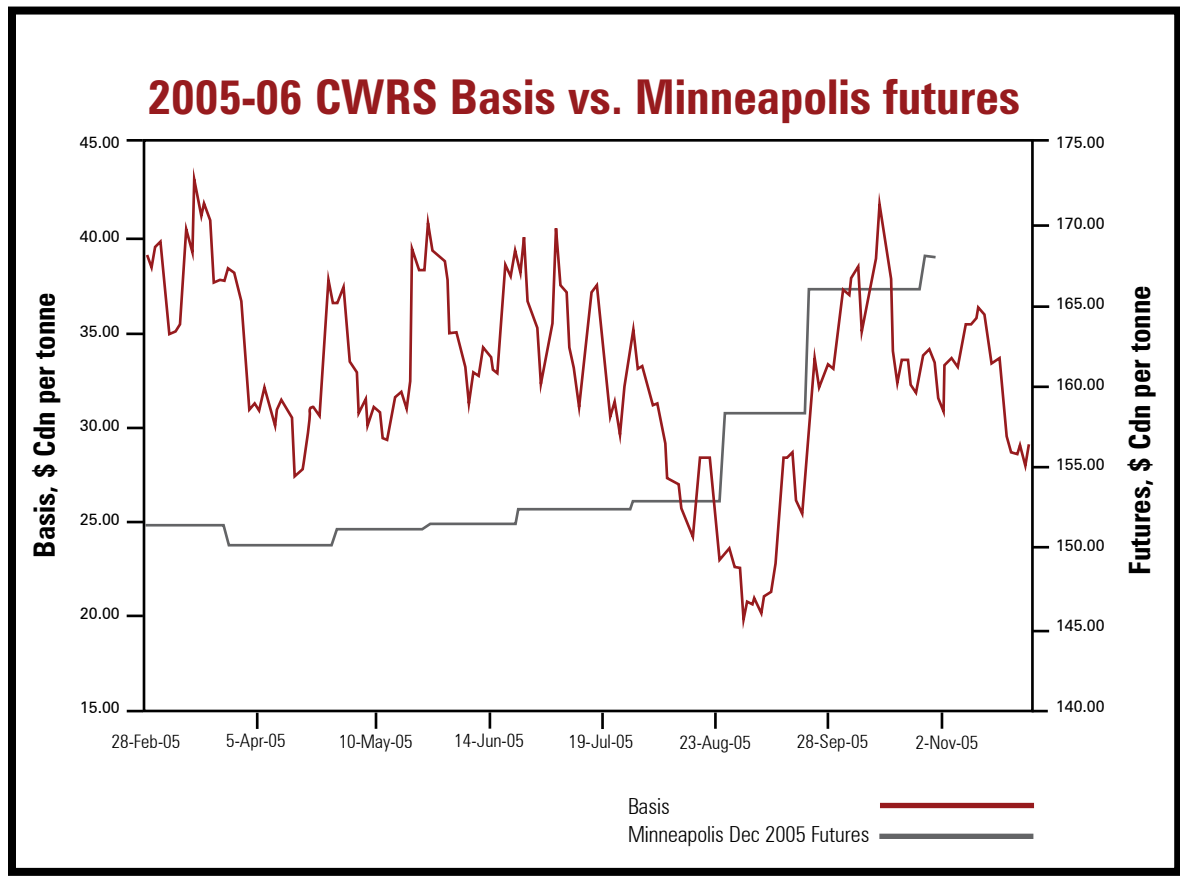
In 2006-07, the wheat futures market trended generally higher beginning in the spring, with peaks in July and October. The main driving variables were: multiple supply events (production problems in the major wheat exporter countries and the Black Sea region), increased demand from Iraq, emergence of significant and unexpected demand from India, as well as significantly increased commodity investor (speculative and index fund driven) flow of money into agricultural commodity markets.

Milling wheat FOB prices were relatively steady in the early months of the sign-up period. In May, U.S. wheat futures were rallying due to increased fund based money flows, concerns with the U.S. Hard Red Winter wheat crop, and production prospects in other major exporters. In offshore markets which represent a significant portion of export competition, milling wheat prices were slowly strengthening. This prevented the wheat PRO from moving higher in line with U.S. futures, which in turn held down the basis. The Canadian dollar gaining strength during this time period was another negative factor. In July, forecasts for reduced production in North America, Argentina, Australia and the EU-25 supported prices for mid and lower quality milling wheat. However, by fall it became clear the North American supply of milling wheat was larger and of better quality than was earlier expected.



In 2005-06, the market was relatively volatile from the start of the sign-up period until the start of the crop year. Prices peaked in early March but held within about a \$15 per tonne range until the end of July. Global wheat crops were in generally good condition during this period, offsetting concerns regarding developing dryness in the U.S. Hard Red Winter wheat belt. Volatility was mainly due to speculative activity. Prices began weakening before the start of the crop year in anticipation of a near-record large world wheat crop. The market bottomed at the end of August with Hurricane Katrina and the uncertainty following it.

From the beginning of the sign-up period to the start of the crop year, the PRO held fairly steady due to favorable world crop conditions with a resulting flat basis. Despite the outlook for large world production, the basis started rising strongly after the start of the crop year as it became clear North American supplies of high-grade, high protein milling wheat would be tight due to vomitoxin problems in the U.S. spring wheat crop and poor harvest weather in Canada. Higher U.S. grain transportation costs due to Hurricane Katrina were also bullish for export prices.



When to roll a basis

Producers have the option to roll the basis portion of an unpriced BPC to another futures month in order to extend their futures pricing deadline or to take advantage of market trends. When a basis is rolled, it will be adjusted in value by the spread between the two futures months. To receive the best adjusted basis, producers should watch the spread between futures months to determine the best time to roll.

If you are rolling to a forward month with the expectation that prices in that month will rise by more than your current futures month, the best adjusted basis is received when the spread has narrowed. If you are rolling backward with the expectation that a nearby futures month will rise by more than your current futures month, the adjusted basis is more favourable when the spread has widened.

Example

A producer locks in a December basis of \$12.31 per tonne for CWRS on March 5. On September 15, the settlement price for the December Minneapolis futures is \$209.85 per tonne and the March settled at \$214.85 per tonne. If the producer rolled the basis on that day, the adjusted basis would be \$5 per tonne less at \$7.31 per tonne due to the spread between the two futures months:

Original basis + (current basis month futures price – new basis month futures price) = rollover adjusted basis

$\$12.31 + (\$209.85 - \$214.85) = \7.31 per tonne

If the futures market were inverted with the December at \$214.85 per tonne and the March at \$209.85 per tonne, the producer's basis would improve by \$5 per tonne.

$\$12.31 + (\$214.85 - \$209.85) = \17.31 per tonne

Buyouts

Producers can initiate a buyout at any time after making the initial commitment. Market conditions at the time of buyout will determine the cost. This section outlines factors producers should consider when contemplating a buyout.

Buyout Costs are assessed on the greater of:

(Current basis + current futures + current adjustment factor) – (producer's basis + producer's futures + producer's adjustment factor)

Or

Current futures – producer's futures

The buyout calculation is the same for both the BPC and FPC, but depending on the producer's pricing commitment, only certain components of the formula apply.

BPC futures or basis only

Producers thinking of reducing or buying out of their basis or futures only BPC prior to August 1, should watch the daily pricing schedule for an opportunity to do so when the CWB's basis or the futures value is near or below their own, in order to minimize the buyout cost. Buyout costs can be limited to the \$15 administration fee if the producer's futures or basis is below the daily posted rate. The adjustment factor portion of the formula will not have any impact on the cost because the adjustment factor is set at zero until the CWB begins buying futures to hedge its sales program.

Effect of the adjustment factor

After August 1, buyout costs become increasingly influenced by the adjustment factor as the CWB's long position increases as the crop year progresses.

The impact of the adjustment factor on buyout costs is exactly the opposite to the impact on contract prices at sign-up (see page 10) because futures are being sold rather than bought. Therefore, the effect on buyout costs due to the adjustment factor is a reduction in cost if futures are rising and an increase in cost if they are falling.

Example

A producer locks in a December CWRS basis on June 29 at \$11.62 per tonne over the Minneapolis Hard Red Spring futures and an adjustment factor of \$0 per tonne. The futures market begins to rally in the summer and continues into the fall. The producer hopes the market will rise even higher and decides to roll the BPC to the July futures month in order to extend the pricing deadline until the end of June. The producer's new basis is \$10.50 per tonne over the July.

However, the futures market peaked in October and deteriorated steadily into the spring. As the June 30 pricing deadline approaches, the producer calls the CWB to buy out the BPC. The July basis deteriorated slightly to \$10 per tonne since the producer rolled his basis in June. However, since significant pool account sales were made earlier in the year at much higher prices, the adjustment factor has climbed to \$6 per tonne.

Since the producer has not locked in his futures the cost is calculated as:

(Current basis + current adjustment factor) – (producer's basis + producer's adjustment factor)

$$\begin{aligned} &= (\$10 + \$6) - (\$10.50 + \$0) \\ &= \$16 - \$10.50 \\ &= \$5.50 \text{ per tonne} \end{aligned}$$

The \$1 per tonne rollover charge is added to the buyout cost for a total of \$6.50 per tonne plus the \$15 administration fee.

FPC buyout

Buyout costs for FPCs account for changes in basis and futures from the sign-up date.

Example

On May 3 a producer locked in a CWRS FPC contract for \$212.16 per tonne. On September 15, the CWRS FPC is quoted at \$212.16 per tonne on the daily pricing schedule. The producer calls the CWB for a buyout quote and discovers there will be a cost of \$2 per tonne plus the \$15 administration fee.

Although the net prices on both days were the same, the individual components were not. When the producer signed up the FPC, the basis was \$12.31 per tonne over the Minneapolis futures price of \$199.85 per tonne. The adjustment factor was \$0 per tonne since the contract was signed prior to August 1. On September 15, when the producer called for a buyout quote, the basis was \$9.31 per tonne over the futures price of \$201.85 per tonne and the adjustment factor was \$1 per tonne.

The buyout cost was assessed at the greater of:

(Current basis + current futures + current adjustment factor) – (producer's basis + producer's futures + producer's adjustment factor)

$$\begin{aligned} &= (\$9.31 + \$201.85 + \$1) - (\$12.31 + \$199.85 + \$0) \\ &= \$212.16 - \$212.16 \\ &= \$0 \text{ per tonne} \end{aligned}$$

Or

Current futures – producer's futures

$$\begin{aligned} &= \$201.85 - \$199.85 \\ &= \$2 \text{ per tonne} \end{aligned}$$

In this instance, the producer is assessed \$2 per tonne in damages due to the short futures position loss plus the \$15 administration fee.

Initial payment spreads

When producers deliver against a BPC or FPC, they receive the initial payment for the actual grade delivered. This effectively reduces or raises their contract price by the spread between the initial price of the reference grade and the initial price of the delivered grain on the date of settlement.

If producers have a range of grades and/or proteins available to deliver against a BPC or FPC, they should watch initial payment spreads to determine which will provide them with the best return. Changes to the PRO spreads during the crop year should also be watched to determine trends for timing settlement if there is a recommendation for an adjustment payment.

If there is an adjustment payment recommendation, the PRO spreads reflected at the time of the recommendation are used to set the new initial payment rate. Knowing the trends in the PRO spreads will help producers decide which grade and/or protein to deliver and the best timing of settlement.

Example

On May 30, a producer commits 50 tonnes of CWRS to an FPC at a contract price of \$200 per tonne. The producer has 50 tonnes of No. 1 CWRS 14.0 per cent protein and 50 tonnes of No. 3 CWRS 13.8 per cent protein available for delivery and must decide which grade to apply to the FPC contract and which to apply to the pool.

In late October, the CWB recommends an increase to the initial payments. An adjustment payment is expected in the middle of November. Since deliveries against the FPC are subject to the initial price spreads on the date of delivery, the producer reviews the CWB PROs and initial prices to determine which grade to apply to the FPC. Remember, the adjusted initial prices will reflect the changes in the PRO spreads.

	Reference grade 1 CWRS 13.5%	1 CWRS 14.0%	Spread
Initial price	\$135	\$140	\$5
July PRO	\$195	\$200	\$5
October PRO	\$205	\$220	\$15

The PRO spread between No. 1 CWRS 13.5 per cent protein and No. 1 CWRS 14.0 per cent protein has improved by \$10 per tonne (\$15 - \$5) from July to October.

	Reference grade 1 CWRS 13.5%	CWRS 13.8%	Spread
Initial price	\$135	\$120	(\$15)
July PRO	\$195	\$180	(\$15)
October PRO	\$205	\$172	(\$33)

The PRO spread between No. 1 CWRS 13.5 per cent protein and No. 3 CWRS 13.8 per cent protein has deteriorated by \$18 per tonne (\$33 - \$15) from July to October.

Fundamentals suggest this trend will continue and that it will be reflected in the upcoming adjustment payments. The following table illustrates the consequences of delivering before and after the adjustment payment:

	1 CWRS 14.0%	3 CWRS 13.8%
FPC price	\$200	\$200
- Initial price of reference grade	\$135	\$135
= Additional payment	\$ 65	\$ 65
+ Initial price of delivered grade	\$140	\$120
= Net FPC price before adjustment payment	\$205	\$185
+ Change in PRO spread	\$ 10	(\$18)
= Estimated net FPC price after adjustment payment	\$215	\$167

Based on the change in PRO spreads the producer's net FPC price would increase by \$10 per tonne for No. 1 CWRS 14.0 per cent protein following the adjustment payment and decline by \$18 per tonne for the No. 3 CWRS 13.8 per cent protein. Therefore, the producer would be better off to deliver the No. 3 CWRS 13.8 per cent protein against the FPC prior to the adjustment payment and leave the No. 1 CWRS 14.0 per cent protein in the pool.