

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 Pool Return Outlook (PRO) spreads during the crop year should also be watched to determine trends. 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 | | |
|---------------|------------------|------------------|--------|
| | No. 1 CWRS 13.5% | No. 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 | | |
|---------------|------------------|------------------|--------|
| | No. 1 CWRS 13.5% | No. 3 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:

| | No. 1 CWRS 14.0% | No. 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 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 before the adjustment payment and leave the No. 1 CWRS 14.0 per cent protein in the pool.