Central Region Cooperative's Grain Contract Descriptions

CASH CONTRACT
(Fixed Price Contract)

- This is the most common contract used by Minnesota elevators. The producer calls the local elevator and is quoted a cash price for a particular commodity for a nearby delivery period. If he sells his grain on a cash contract, he has locked in both the futures price and the basis, effectively transferring all price risk to the buyer. Shipment is usually "buyer's call" (whenever the elevator can take the grain) during the contract delivery period and full payment is made upon delivery.

Advantages of Cash Contract

1. Easy, no complications.
2. Cash price, quantity, and delivery are known.
3. Risk of price decrease is eliminated.
4. No service or storage charges.
5. All proceeds available on delivery.
6. Income can be deferred.

Disadvantages of Cash Contract

1. Price locked in, can't participate in a market rally.
2. Payment not received until grain is delivered.
3. Possible penalty for cancellation.

FORWARD CONTRACT
(Cash forward contract, Forward-to-Arrive)

- A forward contract is a cash contract that allows a producer to sell grain for future delivery. Although both futures and basis are set, premium and discount scales may or may not be able to be set until delivery. An example of this contract would be selling new crop grain many months before harvest if market conditions lead you to believe that prices will be lower at that time.

Advantages of Forward Contract

1. Easy, no complications.
2. Locks in price, no downside risk.
3. Can take advantage of a carry market.
4. No service charge.
5. Can defer income.

Disadvantages of Forward Contract

1. Price locked in, can't participate in a market rally.
2. No payment until delivery.
3. May not be able to lock in premium or discount scales.
4. Risk involved if production doesn't meet expectations.

PRICE LATER CONTRACT
(No Price Established, Delayed or Deferred Price Contract)

- For this type of contract, the seller delivers and transfers ownership of his grain to an elevator without setting a sales price. No futures or basis are established until the contract is priced. You will want to discuss with your elevator manager if a service charge will be applied to this contract and if there is a time period that the grain must remain unpriced or a time limit on fixing a final price. It is also important to clarify if discounts and protein scales will be locked in at delivery or time of pricing.

Advantages of Price Later Contract

1. Can ship grain immediately.
2. Can take advantage of futures and/or basis improvement.
3. Allows you to defer income.
4. It may be possible to change an NPE contract to a basis fix contract, thus stopping service charges and allowing you to receive an advance.

Disadvantages of Price Later Contract

1. Unlimited downside price risk.
2. Title of grain is transferred to the elevator.
3. No payment is made until contract is priced.
4. May have to lock in discounts and protein scales.
5. Service charges may apply

HEDGE-TO-ARRIVE
(Futures fixed contract)

- A hedge-to-arrive contract allows the producer to lock in a futures price with the elevator, leaving the basis to be set at a later time. The elevator will establish a hedge in the futures on your behalf in exchange for delivery of the cash commodity at a set time. This contract is useful if futures prices are relatively high and market conditions lead you to believe that they will weaken and/or you think there is room for improvement in basis levels.
- A hedge-to-arrive contract will be written for delivery of a specific amount of grain (usually 5,000-bushel lots, but some elevators may write one for a smaller amount), a specific

shipment period, and the set futures price. This contract will be complete when the producer sets the basis, which will determine the cash price. The basis can be set at any time but must be set prior to delivery and while the contracted futures month is still being used by traders to calculate cash price.(usually the 15th day of the month preceding contract expiration)

- Central Region Cooperative will charge the following fees for hedge-to-arrive contracts:
- All HTA's must be delivered to a Central Region Facility (no flex delivery is allowed)

Corn HTA Fees

Central Region Cooperative will enforce the following Policies for Hedge-to-Arrive Contracts.

- Current month through July 2019 option months = 3¢ HTA fee
- September 2019 through July 2020 option month = 4¢ HTA fee
- September 2020 through July 2021 option month= 6¢ HTA fee
- All fees will be deducted from the futures price on the date of contract.
- Fee to roll forward is an additional 2¢/bushel. Must be in same crop year. Crop year is December option month through September option month. Fee will be deducted from the futures price at the time of roll.

Soybeans HTA Fees

- Current month through July 2019 option months = 06¢ HTA fee
- August 2019 through July 2020 option months = 8¢ HTA fee
- August 2020 through July 2021 option month = 12¢ HTA fee
- Fee to roll forward is an additional 2¢/bushel. Must be in same crop year. Crop year is November option month through September option month. Fee will be deducted from the futures price at the time of roll.

*Basis must be set prior to first notice day of the delivery month.
*Storage will apply until delivery month and basis is fixed.

Advantages of Hedge-to-Arrive

1. Limits downside futures price risk.
2. Can take advantage of basis improvement.
3. No margin requirements to the farmer, since the elevator is carrying the position.
4. May be allowed to roll the contract to a later month in the same crop year.

Disadvantages of Hedge-to-Arrive

1. Can't participate in futures rally.

2. Downside basis risk.
3. Must monitor basis levels closely to lock them in when high.
4. Locked in to the elevator and required to deliver.
5. If grain is delivered prior to pricing basis, there may be service charges.

BASIS CONTRACT
(Basis Fix Contract)

- In this type of contract, the producer locks in a favorable basis with the elevator, leaving the futures price to be set later. Basis contracts are used successfully when the basis is at historically high levels and market conditions lead you to believe there is room for improvement in futures prices. It is important to ask your elevator manager for basis levels for more than the nearby futures month and to determine if storage costs warrant fixing the basis farther out.
- The delivery date and quantity will be negotiated with the elevator. Discounts and premiums are usually set at the time the basis is established, unless the sale is for new crop delivery.
- If the deadline comes when you must lock in the futures price, but you want to leave the option open and allow for further possible futures price increase, you may roll the basis contract into a deferred futures month. If the deferred futures market has a carry built into it (the deferred price is higher than the nearby price) your basis contract will be reduced by the amount of that carry. If the deferred futures market is in an inverse (the deferred price is lower than the nearby month), the amount of the inverse will be added to your basis contract.

Advantages of Basis Contract

1. Eliminates downside basis risk.
2. Can take advantage of potential futures price increase.
3. Can collect an advance on delivered grain without locking in the final cash price.
4. No storage costs.
5. By “rolling the basis” contract can remain unpriced for extended period of time.

Disadvantages of Basis Contract

1. Risk of futures price decrease. (If futures prices drop below the level used to calculate your advance, you may have to pay back a portion of the advance.)
2. Required to deliver grain as stated in contract.
3. Must track the futures and market trends to lock in a favorable futures price.
4. Full payment is not made until the futures price is locked in.

MINIMUM PRICE CONTRACT
(Option Contract)

- Minimum price contracts are commonly used among producers as they are very simple to execute and have the least risk involved. The seller locks in his cash price, buys a call option to replace the amount of the sale, and delivers his grain. This strategy can be executed through your elevator or through a broker. The seller establishes the minimum price by subtracting the cost of the option from the cash sale price. He can choose to sell his option at any time before expiration, as long as it has value. Any premium that he collects from his option is then added to the original minimum price to arrive at the final selling price.
- Although a minimum price contract does not improve the final cash price in every case (option may expire worthless), the strategy reduces risk by eliminating the downside exposure. The advantage to a minimum price contract is that once the seller locks in his cash price, he is no longer exposed to adverse market movement. If the futures market moves higher after the cash sale, he can still participate in that move through the call option. The increase in the value of the call will be added to his net selling price once he sells the call.
- The disadvantage of a minimum price contract is that the seller can no longer take advantage of an increase in the basis since he has locked in the cash price, and the call only reacts to futures price movements. Also, time decay will erode the call's value as it approaches its expiration date, which will partially offset increases in value due to rallies in the futures.

FEES: $.02 per bushel plus cost of option

ADVANTAGES
1. No downside price risk.
2. If futures rally, you receive increase in option value.
3. Full payment (at established minimum price) is received when grain is delivered.

DISADVANTAGES
1. Can't take advantage of basis appreciation.
2. Cost of option can be expensive depending on length of expiration date and strike price used.
3. The value of an option does not move 1 for 1 with the futures market.
4. If futures fail to strengthen, contract will expire and the minimum price will be the final price.
5. This contract can only be executed during trading hours (from 8:30 am to 1: 15 pm CST).