Minimum Price Contracts

Highlights:

- Lock in Basis price to eliminate all downside Basis price risk.
- No fee to lock in futures price
- Futures can be set at a later date if expected to improve
- Can take advantage of local supply and demand

How it works

Minimum price contracts are used to set a floor on grain and still participate in markets should they run higher. This is a 2-part strategy and can be done on new crop or old crop bushels. On **old crop** a producer would sell their grain and use an option to keep the upside open. The option premium would be subtracted from the cash price, effectively setting the floor level. The producer would then need to decide when to offset the option to receive any value if markets run higher. The producer would be paid for the sale of grain the day of the contract. The option would be paid out whenever they choose to offset.

On **new crop** a producer would enter a fixed price contract and buy an option against that contract. It works very similar to old crop where the option premium would be subtracted from the cash price of the contract setting the floor level. When the producer is ready to offset the option any value would be added to the cash price of the contract. The producer would be paid at delivery.

When to use

Producer will primarily use this contract if they want to stop storage and get cash while still participating in market. Producers must be ok with the minimum price they will receive in case the market moves to the downside. This could also be used on new crop when prices are above profitable levels. Producers could lock in current levels to protect downside but use option to capture any upside.

Primary Risks

Production Risk- This will be a risk in every contract. Use multi-year average yields to help determine the appropriate amount to forward sell per commodity.

Premium Risk- The biggest downside to this contract is having to subtract the premium from the cash price. If market moves to the downside and producer is forced to take minimum price he would have missed out on the option premium paid. However, this is the price paid to stay in the market.

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