

## The Canola Basis Contract

The basis is the difference between the futures price and the cash price. It fluctuates from day to day or week to week, and differs by buyer and delivery point.

**Example:** If the futures are trading at \$400 per tonne and a local elevator is bidding \$360, their basis is \$40 under. If the neighboring crush plant were bidding \$365 per tonne against the same futures contract month, their basis would be \$35 under.

Under a Basis Contract, a grower fixes the basis portion of the canola price and leaves the futures open until a later date. If the futures price rises, the value of the canola goes up but if the futures fall, it drops. In general it is up to the grower to decide when the futures portion of the contract is priced, but some restrictions may apply.

### What Makes Up the Basis?

In using the basis to your advantage, it helps to understand where it comes from.

First a buyer decides where the canola they buy will be merchandised into. Then, they calculate their local basis by backing off from the next-use market price the cost to move it there. Grain companies don't buy grain at a price any higher than they can sell it for.

Because most of Canada's canola is exported off the west coast, the port of Vancouver is where most interior points back their basis off of. Thunder Bay, Canadian crushers and locations in the U.S. and Mexico are also important canola pricing points.

In Manitoba, crushers and certain line companies sometimes bid a basis that is narrower than the west coast equivalent. Crush plants use the value of canola and meal to calculate their bids for canola; also Manitoba tends to be the most cost-effective source of canola being exported to Mexico by rail. These factors keep the Manitoba basis from moving exactly in line with basis levels on the west coast.

### Basis Strategies

Farmers should be able to recognize an attractive basis when they see one and act on it accordingly. Checking the basis regularly with a variety of buyers will help make you more familiar with the market, so that when a 'premium' basis comes along it's an easy decision to act on it.

When an attractive basis is available, farmers should take advantage of it and make some sales. But if the futures are forecast to fall, even if the basis looks good the Basis Contract isn't the best option. Here are some guidelines, assuming a negative basis (the cash price is less than the futures):

- When the basis is **wide** and the futures are expected to **rise**: don't sell anything.

- When the basis is **narrow** and the futures are expected to **rise**: take out a Basis Contract and price the futures later.
- When the basis is **wide** and the futures are expected to **drop**: hedge the futures portion of the price (see ‘Hedging Canola Using Futures and Options’).
- When the basis is **narrow** and the futures are expected **drop**: sell canola into the spot/cash market, fixing both the basis and the futures portion of the price at the same time.

### **Where Does the Basis Come From?**

At any given point in time, different buyers show different basis levels. This has a lot to do with a particular company’s willingness and ability to (a) find the highest-price next-use market; (b) keep their costs down and (c) pass along that value to the farmer.

A crusher producing oil and meal can often pay farmers a more attractive basis because in buying direct, they bypass the country handling and elevation stage in the supply chain. In delivering directly to a local crush plant, a producer is taking out the elevator as a middleman.

At other times a grain company may find itself with a big export sale on the books for a certain shipping date, and not enough canola to fill the boats on time. In this case, they need to make the price attractive enough to farmers to pull more stocks into their elevators, quickly. The only way they can do this is to narrow the country basis.

Because of these differences, the basis can vary widely from one buyer to the next, even within a very short distance. Farmers find bids in their area different by as much as \$15-\$30 per tonne on the same day. This underscores the importance of shopping the basis around to a couple of different elevators, and any crushers located nearby, on the day a sale will be made.

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