

MIN-MAX

Lowering the cost of Minimum Pricing With the Min-Max Addendum

If you want to guarantee a minimum price and preserve the opportunity to gain from potential market increases, the Min-Max Addendum may provide a lower cost alternative to other marketing tools.

What is a Min-Max Addendum?

Under this cash grain contract, you agree to deliver a specific quantity and quality of a commodity for either nearby or future delivery at a guaranteed minimum price and up to an agreed maximum price. You select the minimum and maximum futures strike prices and a premium is deducted from the contract price. This addendum allows you to re-price the guaranteed minimum price at any time prior to the pricing deadline and benefit from the current value of the Min-Max.

What are the advantages of the Min-Max Addendum?

- This addendum provides a price floor.
- You are capable of participating in price rallies, up to a certain level.
- You can write the addendum for any quantity over 1000 bushels.
- You can convert a variety of other South West Ag Partners contracts to Min-Max addendum.
- Payment of the minimum contract price is made at the time of delivery, even if delivery occurs prior to the re-pricing date.
- Since the pricing of this addendum is based on the value of exchange-traded options, price discovery is easy.

What are the disadvantages of the Min-Max Addendum?

- You may re-price the addendum only once.
- Prices may not improve, or they may not improve until after the addendum-pricing deadline.
- The price also may rise, and then fall before you re-price the addendum, wasting the premium.
- During volatile markets, the premiums with this addendum may be high.
- The price may rise further after the re-pricing date, or it may rise above the maximum price, in both cases leaving you unable to benefit from the additional price increase.
- You may not capture any improvement in basis levels.
- There is a maximum limit to the price increase.
- Although you may re-price the addendum once at any time prior to the pricing deadline, a penny-for-penny price increase is only realized on the pricing deadline.

When is it used?

You generally use the Min-Max Addendum when you want to protect what you believe is a favorable cash price while still having an opportunity to benefit from what you believe to be limited futures price increases. By agreeing to a maximum price level, the premium for this contract is typically lower than traditional minimum price contracts. You also may, after a thorough analysis of basis, carry, and interest, use this contract as a substitute for storage.

How does it work?

On April 1, your local South West Ag Partners elevator posts a cash bid of \$3.50 per bushel for harvest-delivered corn, 70-cent basis over the Chicago December futures. You like that price and don't want to pass it up, but you also believe hot and dry weather could prompt a small market rally. You consider a Minimum Price Contract but conclude that the premium cost is too high. Instead, you elect to enter a Min-Max contract with a minimum futures strike price of \$2.80 and a maximum of \$3.30 December giving you a 50 U.S. cent potential gain. Your pricing deadline is November 19, the same expiration date as the exchange traded option. The premium of 8 cents per bushel plus a service fee is charged in return for this protection.

How are the prices determined?

Premium Calculation

In this example, you choose minimum and maximum strike prices of \$2.80 and \$3.30 December.

Value of the \$2.80 Dec strike on April 1	18 cents U.S.
Less Value of the \$3.30 Dec strike on April 1	<u>10 cents U.S.</u>
	8 cents U.S. Premium
	(cost for potential 50 U.S. cent gain)

Min-Max Price Calculation

Contract Price	\$3.50
Less Premium	\$0.12 (.08 U.S. x current exchange rate 1.47 = .12 cost in Canadian currency)
Less Service Fee	<u>-\$0.05</u>
Minimum Price	\$3.33
Plus Spread	<u>*\$0.72</u> (difference between \$3.30 and \$2.80 strikes = .50 U.S. See example \$4.05 below)

* (the price spread will be converted to Canadian Currency on the day of the re-pricing or expiry. In this example .50 x current currency rate 1.45 = .72)

You may re-price the contract once at any time before November 19th - your pricing deadline.

Below are 3 examples of possible scenarios that could result from re-pricing your contract on Nov 19:

Dec Futures level	\$2.30	\$3.00	\$3.50
Minimum Price	\$3.35	\$3.35	\$3.35
+Value of \$2.80 strike	\$0.00	\$0.30	\$1.01
-Value of \$3.30 strike	\$0.00	\$0.00	-\$0.29
Final Strike	\$3.35	\$3.65	\$4.07

All premium values are converted from U.S. currency to Canadian to give the final price in Canadian Currency. The above example is in Canadian currency.

If you choose to re-price your contract before the November pricing deadline, the value of the Min-Max premium on the re-pricing date is added to your minimum price. The value of your min-max premium is calculated the same as the Premium Calculation above. Note that if you choose to re-price the contract before the pricing deadline, it is possible that you would not have gained penny-for penny on the futures level increase.