BASIS CONTRACT

Basis is defined as the cash price minus the futures price.

Example:

<table>
<thead>
<tr>
<th>Cash price</th>
<th>$5.12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Futures price</td>
<td>$5.77</td>
</tr>
<tr>
<td>Basis</td>
<td>$0.65</td>
</tr>
</tbody>
</table>

In this case the basis is said to be 65 under the futures.

In a basis contract you establish a price on the spread between the cash and the futures market. A basis contract is done when the spread is normal or narrower than normal, or when one thinks the basis will widen into the time frame one wishes to sell.

Normal basis on soybeans at 54 car rail markets in Eastern South Dakota is 50-55 under the futures.

If an elevator quoted you a basis of 50 under or less it should be a signal to set the basis for the time period you wished to sell in. By establishing a basis contract you have in no way set the price. If prices move higher you will receive more, if prices move lower you will receive less.

Basis contracts carry the same delivery obligations as cash contracts.

Basis contracts in most situations cost nothing to establish.

If basis is narrower than normal you are in essence being offered a premium for your product so lock that premium in. Then watch the market to fix the futures price when it is acceptable. The combination of the two contracts will set a cash price.

In August of 1998 basis for harvest delivery soybeans was: -60

During harvest of 1998 basis for soybeans was: -80

If you would have established a basis contract in August for harvest delivery you would have received 20 cents more for soybeans you delivered at harvest than if you would have just taken the price the day you delivered the soybeans. Example:
It is August 15th and the November soybean futures are: $5.30
That day you establish a basis contract for 60 under the
November futures: $-0.60

On October 15th you inform the elevator you wish to
establish a cash price on your 60 under basis contract.
November futures are: $5.60
You would have received $5.00
Others who had not set the basis and sold the same day
at 80 under basis would have received: $4.80

By fixing the basis you were able to acquire any gains in the market but you didn’t have
to worry about the basis widening. When it did it cost many producers 20 cents per
bushel. If you knew you were going to sell at harvest, it was prudent to set the basis
when it was near normal. Because with the anticipated large crop it was evident
elevators would be over flowing and thus taking protection or widening the basis to make
up for any losses incurred by piling soybeans on the ground.

Pros and Cons of Basis Contracts:

• You can control part of your price risk coming into harvest and avoid dumping
  charges if the elevator is piling on the ground.

• You are not limiting upside price movement. But neither are you limiting downside
  price risk.

• You establish a delivery obligation.

• If for some reason you can’t deliver the grain your risk is much less than in a cash or
  HTA contract.