



Every car needs wheels



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Suppose you walked to your car one morning and discovered it only had three wheels. Not a great way to start the day, is it? It's even worse when you're in a race and you don't have all the parts.

A car is analogous to the Daily Position Report (DPR) you use to track your company's risk positions and logistics. Both help

you get where you're going, hopefully efficiently and easily. Whether your DPR is prepared manually or by computer, make sure your DPR format has four wheels so merchandising will be easier.

What could be missing?

A complete position report (PR) shows the company's exposure to both price risk and basis risk. An ideal PR should summarize cash contracts by delivery period and show the total of unpriced basis contracts. When

Figure 1: Calculating Basis Risk

		Example (bu.)
+	Net long or short price risk	4,200 (short)
-	Net futures position	250,000 (short)
+	All unpriced basis purchases	40,000
-	All unpriced basis sales	200,000
=	Net basis risk	+85,800

Simple basis risk formula.

all cash contracts and hedges are correctly shown by time slots, the PR will also reveal additional features — spread risk and some logistics factors.

Merchandising profits for hedgers come from capturing favorable basis moves. You profit when you make the best possible basis decisions taking into account factors such as your cost of carry, local basis, futures spreads, logistics and alternate uses of warehouse space. To merchandise effectively, you need a full breakdown of all basis risk positions so you can look for appropriate opportunities. Detailed information can keep you from selling to the wrong market or for the wrong time slot, for example. A DPR format that doesn't calculate basis risk is a DPR with a wheel missing. A DPR that doesn't show more time slots than just "old crop" and "new crop" also has a wheel missing.

What components have basis risk?

- 1) Company-owned grain, priced
- 2) Company-owned grain, basis fixed but unpriced by the farmer
- 3) All open purchases,

- priced or unpriced, excluding Hedge to Arrive (HTA) contracts
- 4) All open sales, priced or unpriced

What doesn't have basis risk?

- 1) Delayed Price (DP) inventory, even though it's company-owned

2) DP obligations from direct-ship grain (e.g., grain taken direct from a farm to a terminal for your account and sold to you by the farmer on DP)

3) HTA contracts

4) Grain with storage obligations against it. (Note: Writing or canceling collateral warehouse-receipts does not change either your basis or price risk position.)

(Note: DP inventory and HTA contracts will have the basis set at some point. Some merchants might include those in basis risk. That's a philosophical debate. Most merchandisers want their basis risk position to only show quantities on which the basis is already set.)

Figure 1 shows a quick and easy method of calculating basis risk. This formula is simple, but it's often difficult to apply to computerized DPRs. Some don't show total basis purchases or total

Figure 2: Position Summary

	June 1	July	August	Oct/Nov	Total
	Nearby				
Inventory	650,800				650,800
- Storage obligations	220,000				220,000
= Company-owned	430,800				430,800
- DP inventory	75,000				75,000
= Net Basis inventory	355,800				355,800
Open contracts basis fixed (priced or unpriced)					
Purchases excl HTAs	50,000	40,000		15,000	105,000
Sales	30,000	170,000	175,000	0	375,000
1) Basis position	375,800	(130,000)	(175,000)	+ 15,000	+85,800
2) Price risk (carry line 1) basis position forward					
Hedges Long			175,000 Sept	0	175,000
Short		405,000 Jly	0	20,000 Dec	425,000
Hedge to arrive purchases		0	0	0	0
HTA sales		0	0	0	0
Unpriced contracts:					
- purchases ("gives")	0	40,000	0	0	40,000
+ sales ("takes")	30,000	170,000	0	0	200,000
Price risk:	+405,800	(405,000)	0	(5,000)	(4,200)

Detailed DPR with time slot breakouts.

unpriced basis sales as shown in the example. In real DPRs, unpriced contracts are often scattered across "open" contracts, off-premise, in-transit, or other categories. Not all software companies use the same formatting, and report formats can vary even within a software system.

Some merchandisers assume they can tell their basis position

simply by looking at their net futures position — long 100,000 bushels of cash vs. short 100,000 bushels of futures, for example. But that fails to address unpriced contracts, and certainly doesn't tell sufficient detail about time and logistics.

Another problem area is HTAs. Many DPRs include HTA purchases in with all other "priced" pur-

chases, even though basis isn't set on them yet. In that case, you need to monitor the HTA total and adjust for it.

Software variations such as these make it difficult to even manually calculate basis risk from many computerized DPR formats.

Figure 2 shows a more detailed position report form. This format is still incomplete, but does provide a good summary of both price and

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basis risk — by time slots. As a result, you can now see spread risk and some logistics information.

A useful DPR won't necessarily be short and simple, but it will tell you what you need in order to expedite managing merchandising and logistics risks. In today's environment, having a DPR that shows too little is as ineffective as trying to drive in that car with no wheels. If your software was designed internally and doesn't show the detail you need, visit with management or your computer staff and let them know what is missing. If your software is from an outside firm, talk to your software company and learn about all available report formats. Insist your reports provide a basis risk summary.

The grain industry continues to consolidate and larger firms produce highly sophisticated reports that may give them a trading advantage. Don't get left behind on Lap 1. **EG**

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