

Total Marketing Performance of the CWB



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Table of Contents

Basis	1
Flat Price and Futures.....	2
Cost Reduction.....	4
Conclusions	5
References	6

Total Marketing Performance of the CWB

The CWB often refers to the total revenue of the CWB as an indication of marketing performance. For example, in the Annual Report for 2007-08, the CWB reported:

Western Canadian farmers received \$7.2 billion through the CWB in 2007-08, compared to \$4.6 billion in 2006-07 and well over double what they received in 2005-06. That in itself is exceptional. So also is the fact that a considerable portion of these returns resulted from the CWB's system of marketing. In an exceptionally volatile market, our disciplined approach allowed us to price throughout the year and capture a portion of market highs; as a result, western Canadian farmers' pool returns were enhanced.

In 2007-08, market prices more than doubled and yet the CWB's total revenue did not follow. And whereas the CWB saw a significant increase in revenue from the previous year, there is no evidence to support the CWB's assertion that "a considerable portion of these returns resulted from the CWB's system of marketing."

Total revenue is a function of many things outside of the CWB's control. In fact, most of factors that influence total revenue are beyond the CWB's control. Total revenue is a function of total crop size and quality, both functions of weather and agronomics. It is also a function of the general market condition over the crop year. The CWB has no control over these factors.

The CWB does have an impact on the quantity sold. It also has limited impact on basis; more impact on flat price (pricing pace), and limited impact on costs. It is these areas that the CWB should be held accountable in terms of marketing performance. Total annual revenue is not a meaningful measure of marketing performance and should be avoided.

Basis

If the CWB gets premiums on sales, it should be considered to be a better basis than what a multiple-seller market would get. In other words, where there is a relevant futures market, the cash sale price can be determined to be a combination of futures and basis (even if futures were not used in the execution of the sale). For example, if the CWB sold wheat at a price of \$250/tonne and futures were the equivalent of \$200/tonne, then it can be said that the CWB sold a basis of \$50 over futures, and priced the sale with futures at \$200.

The CWB can't get a better futures price than the "market". Therefore, any premium it gets is not in the futures component of the price; it must, therefore be expressed in the basis.

As a marketer, the CWB can try to maximize its basis sales through timing (when the basis is most attractive) and through gaining some price advantage (premium). It can be argued that the CWB does not have the luxury to sell only when the basis is attractive since it needs to be selling throughout the crop year. However, it can be equally argued that the CWB can use its market power to hold back sales when the basis is weak and to get aggressive when the basis is firm. Unfortunately, there is no way to measure this with the information publicly available from the CWB and the CWB does not appear to measure its sales performance in this way.

Unfortunately, there is no way to extract the basis component of CWB sales for analysis; neither is it apparent that the CWB uses this approach to measuring its marketing performance. However, the CWB does report premiums over its competitors' prices that it has determined that it achieves when marketing. Because the

CWB indicates these “price spreads” are over competitors’ prices offered at the same time, it can be assumed that these are achieved in the “basis”. Recent reported premiums are found in the table below.

Year	2006-07	2007-08	2008-09	2009-10
Wheat	\$6.00	\$13.81	\$6.65	\$4.90
Durum	\$7.77	\$48.84	\$15.37	\$11.16
Malt Barley	\$13.45	\$29.47	\$14.65	\$13.71

Unfortunately, there is no way to assess or analyze these statements. Intuitively, we know that grain buyer will pay for premiums for quality (which the CWB has no control over) and service, upon which the CWB must compete with other sellers who are equally anxious to do business and which are very good at providing service as well.

Moreover, the CWB operates at a cost which should be assessed alongside any premiums achieved. Once taken into consideration together, the level of “premiums net of costs” is much less. Moreover, once included in the flat price analysis below, these premiums are noted to be quite small.

Flat Price and Futures

Flat price is another term for the major component of price – it relates to the net cash price of a transaction or market price. It also refers to futures, in that when a basis contract is priced, it is often referred to as being “flatted”. Once a basis contract is flatted, it becomes a flat price contract.

When a basis contract is “priced”, a futures price is attached to the contract; it can be either a price at which the buyer and seller exchange futures, where a pricing order is placed by the buyer with the seller and the seller puts the order into the futures market, or by simply “spotting the board” (picking the futures price at the time and both agreeing to that price for the contract.

The CWB cannot get a better futures price than the market value. In the process of pricing a contract, the CWB (as seller) could attempt to use a futures price above the current market, but the buyer would have no incentive to accept it. Also, if futures were being exchanged, the CWB could ask to exchange at a price above the market. This too would be counterproductive, since, although the cash sale price would be higher, through the exchange of futures, the CWB would be a buyer of futures at the higher price specified. Whereas the CWB would show a higher cash sale price, it would show an equal loss in the futures market.

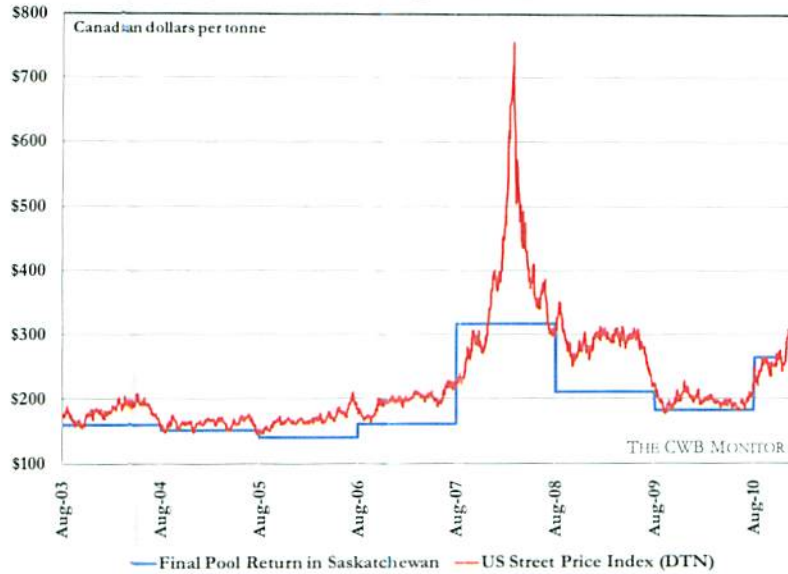
The only way that the CWB can add value in flat price is to price sales at above average prices over the crop year. However, the CWB has indicated that (on spring wheat) it uses a pricing pace over the crop year. This means that the CWB has a prescribed timing for pricing sales. If the priced cash sales are lagging behind the pace, the CWB sells futures to keep with the pricing pace; if the cash sales are ahead of pace, the CWB buys futures to reduce the total priced and to keep within the pace requirements.

In markets where there is no related or relevant futures market, such as durum and malt barley, the CWB’s performance can be assessed just on a flat price basis. It should be noted though that the CWB performance is being assessed in relation to the whole crop year and not just on individual sales.

To assess the flat price performance of the CWB, a relevant test is a price comparison to the US markets. The US markets are relevant because the CWB competes within the US markets and competes with the US on offshore sales as well. If the CWB suggests it gets a premium over its competitors, US prices are relevant because it is a major competitor of the CWB’s.

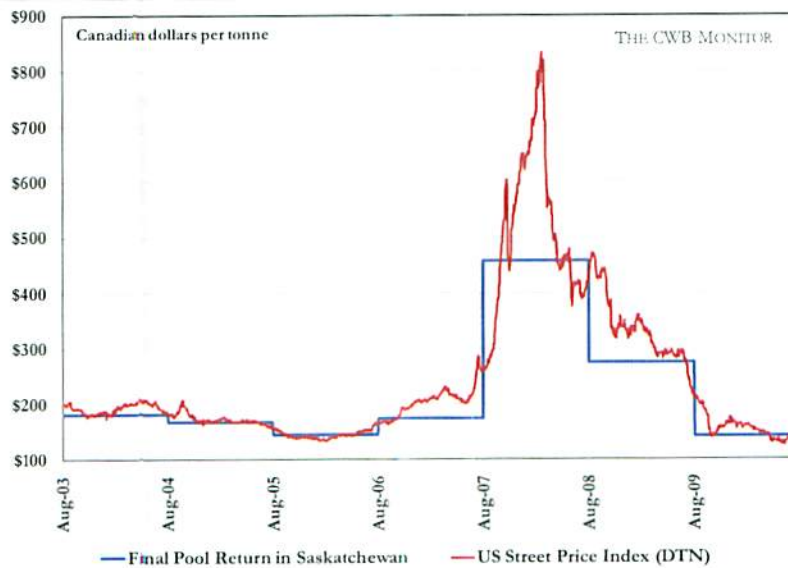
The chart below depicts the daily average street price in the US Northern Plains for spring wheat (in red) as published by DTN, over the period since August 1, 2003. It also shows (in blue) the final pool return for similar Canadian wheat in Saskatchewan. It is clear from the picture that the returns to Canadian farmers are consistently lower than the US market prices.

Spring Wheat Price Comparison: Canada vs US



The next chart is the same analysis, but for durum. It shows a similar pattern with Canadian durum showing no signs of premiums. In fact, although not as relatively low as the spring wheat prices, CWB durum returns are consistently lower than US prices.

Durum Price Comparison: Canada vs US



The final chart below shows the price comparison for 2-row malt barley. Here, since DTN does not report malt barley prices, cash prices from the Montana Wheat and Barley Committee are used. Again, the CWB returns lag seriously behind the US prices. It should be further noted that the majority of malt barley in the US is contracted and the contract price data is not readily available. Contacts within the malt business in the US advise that these contract prices tend to be higher than the street price data being used here.

2 Row Malt Barley Price Comparison: Canada vs US



Another way to measure the CWB's marketing performance using the US data in the charts above is to calculate the spread between the CWB's final pool return and the average US price for each crop year. Then, to give an idea of the magnitude of the issue, multiply the spread by the size of the pool in each year. The results are summarized in the table below.

Total Pool Price Comparisons (\$ millions)

	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10
spring wheat	-\$354	-\$389	-\$436	-\$536	-\$662	-\$845	-\$592	-\$785
durum	-\$277	-\$185	-\$198	-\$179	-\$127	-\$152	-\$87	-\$46
2-Row malt barley	-\$34	-\$69	-\$36	-\$35	-\$89	-\$156	-\$78	\$1
TOTAL	-\$665	-\$642	-\$671	-\$750	-\$878	-\$1,153	-\$757	-\$829

This shows that, when applied to the whole pool, the shortfalls seen in Canada relative to US prices, the total dollar amounts are substantial, exceeding \$1 billion in 07-08 and coming close that number a few other times.

Cost Reduction

Since the CWB employs the assets of grain companies, railways and vessel operators, and is a large client of all, it is in a good position to negotiate best rates and terms on behalf of farmers. Evidence indicates that the CWB is exercising this market power only in a limited manner. Where it does have the opportunity, it is

expected that the CWB will operate in such a fashion as to foster and encourage competition and will get the best possible deals for farmers.

Using the Federal Grain Monitor's net-back figures from the last few years we can see potential trends in costs. In the period from 99-00 to 08-09, the CWB costs to handle and move wheat and durum – including costs charged by grain companies to handle these CWB grains – have gone up 22.2% and 29.5% for spring wheat and durum respectively. However, the cost to move and handle canola has gone down 7.4% in the same period. In addition, canola costs are about half of CWB costs.

Conclusions

In the realm of grain marketing, the greatest potential for high performance by the CWB is in flat price, particularly when there is volatility as we have seen lately. Other areas of potential benefit, albeit smaller in magnitude, is in basis levels and cost controls. When applied to the whole pool size, the Western Canadian farmer is getting in the hundreds of millions less than the average US market price. This is a serious competitive disadvantage.

References

Federal Grain Monitor Data

http://quorumcorp.net/current_report.html

CWB Pool Return Outlooks

<http://www.cwb.ca/public/en/farmers/outlooks/what/>

Minneapolis Grain Exchange Cash Data (DTN)

http://www.mgex.com/history/historical_new.cfm

Montana Wheat and Barley Committee

<http://wbc.agr.mt.gov/>