Sell Cash Bushels and Buy Call Option

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Call Option

• A call option is the right, but not the obligation to buy a futures contract. The buyer of the option pays a premium for “price insurance” to the upside.

• Market Lower: Call premium is the only cost

• Market Higher: Call option gains value.
Sell cash bushels and buy call option strategy

• This is a re-ownership strategy.

• This is price risk management since the cash bushels are sold and the limited risk is the call option premium.

• Call option “replaces” cash ownership

  Strategy is not considered hedging by IRS.

• The call option tends to gain value as the market moves higher.

• Strategy is reasonable if conditions are right (avoid storage costs, good basis at harvest, lack of carrying charge).

• A “minimum price contract” includes the same mechanics as this strategy.
Estimated Floor Price Calculation

Cash Sale Price $8.30

less Premium Paid - 31¢ premium
(to buy March $9.20 call)

= Est. Floor Price* = $7.99

*Option examples do not include commissions and interest

Sell Cash & Buy Call Option

<table>
<thead>
<tr>
<th>Futures Market Outcome</th>
<th>Cash Sale Price</th>
<th>$9.20 Call Option Worth</th>
<th>less Premium</th>
<th>equals Cash Estimate</th>
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Upside potential AND floor price
Comparing Marketing Alternatives

Crop Marketing Matrix

1. Store & wait
2. Delayed price contract
3. Minimum price contract (open basis)

1. Basis contract
2. Sell Cash Bushels and Buy Futures or Call Option
3. Minimum price contract (fixed basis)

1. Hedge
2. Non-roll hedge to arrive
3. Buy put option

1. Cash sale now
2. Forward Contract

- - - Market + + +
Key points:
Sell cash bushels & buy call option strategy
  • Re-ownership strategy: price risk transferred from cash market to call option.
  • Minimum price: cash price is set and the call option has the limited risk of the premium.
  • Cash Sale Price – Premium = Floor Price
  • Consider when: want to avoid storage costs, basis is good, lack of carrying charge.