

A Closer Look

by Farmers Advanced Risk Management Co

August 2025

Target Price Contracts

Key Points

- Target Price Contracts (TPCs) can make life a little easier for farmers by reducing the need to watch markets closely. Used effectively, they can help get better prices. However, there are pitfalls to avoid, the most obvious is that entering into a TPC limits your market exposure, leading to the potential of missing better pricing opportunities. There are better alternatives.
- TPCs are a great tool for graincos to manage their risk in merchandising grain. They provide graincos a view of the market in terms of where farms are willing to sell and provide a backstop providing both price and supply assurances. In effect, TPCs are very much like call options – without the premium.
- **TPCs have a downside, from the industry's perspective. Increased use of TPCs reduces price transparency, fundamental to a functioning marketplace, and they reduce the need for futures hedges, diminishing liquidity. Both these increase market risk and with that, an increase in cost.**

Background

In recent years, interest in target price contracts has been increasing in Western Canadian grain, oilseed and pulse markets. Although they are a great way to “park” a pricing order at an attractive price so you don’t need to monitor the market, there is a downside too.

They go by different names: Viterra calls theirs a Target Price Agreement (TPA). Cargill’s is called a Grain Pricing Order (GPO). Richardson calls theirs a Market Manager Contract. Paterson Grain has a Target Price Agreement (TPA). And so on. They have different names, but they all do the same thing; to make it easy, we will call them all Target Price Contracts (TPCs).

Company	Contract	Length
Cargill	Grain Pricing Order (GPO)	Set when signed
Viterra	Target Price Agreement (TPA)	Open until cancelled
Pioneer	Market Manager	Set when signed
LDC	Grain Pricing Order (GPO)	Set when signed
Paterson	Target Price Agreement	Set when signed

This article provides a closer look at these contracts, showcasing the pros and cons and different perspectives on their use.

Farmers Advanced Risk Management Company

The Farm's Perspective

There are times when farmers believe that prices could move higher over the next few weeks or months – or maybe they just hope they will – and they want to take advantage of those higher prices. But they're busy and don't always check the markets as closely as perhaps they should. It would be great if they had a way to sell their grain at the price they want – if the market moves there – without having to watch the market like a hawk. The TPC may be just what is needed.

When a TPC with a buyer is entered into, a price is specified – above the buyer's current bid price – at which the farm agrees to sell a specified amount of grain for delivery within a specified delivery window. Some contracts are open ended; they remain open until they get triggered or are cancelled – whichever comes first. With others, a contract termination date is specified, after which, if the target price has not been met, the contract is void – nothing has been sold. Either way, while the contract is open, there is the possibility that the buyer will accept the price, creating a binding contract to deliver at that price, in accordance with all other terms of the contract.

Let's look at an example. Let's say canola prices at local elevators are currently around \$13.50/bu and you want \$14/bu. You enter into a TPC with a grainco with a target price of \$14.00/bu. Over the next few weeks, the market price moves around but the grainco's published price does not reach \$14.00/bu. However, at a point when their price is \$13.80/bu, they need to quickly buy more canola to finish loading a train that is about to be spotted. They look at all their outstanding TPCs with targets near the spot price and decide to accept yours (and others) for immediate delivery. By doing this, they are paying more than their street price bid, but they are avoiding the potential for large penalties from the railroads for late loading or shipping less than a full train.

This example shows just one reason why a company may accept your TPC; there are others. For example, if a grain company is negotiating a large sale, they may want to cover that sale (that is, buy the grain needed for the sale) – or a portion of it – fairly quickly. They may feel that once the market hears about the sale, prices will jump; they may accept all TPCs they have that are close to their current price to minimize the risk of higher prices. Or they may see market factors evolving that they suspect will support prices and they decide to accept TPCs as a quick way to protect themselves from these higher prices.

Perhaps it goes without saying, but if the buyer's current street bid price hits a target, the target is locked in – you now have a sale at that price.

But why that price?

I have often wondered why certain prices are chosen as targets. Is it a price where you are profitable? Is it a price that you think is at the top of the near-term price range?

For the most part, the appeal of TPCs is that it gives an avenue to a better price than today's price. We know that, at times, accepting today's price carries with it the anxiety of potentially watching the price move higher after you have sold. And approaching it differently where you feel as though you have more control – or that you are not just a "price-taker" – is appealing.

One TPC with one company – or one with each company?

For the most part, farms enter into TPCs with one company. But this limits your market exposure.

What happens when buyers are paying your target price but not the company you have the TPC with? It can happen. First, if you're not watching the markets closely, you could very well miss the opportunity to sell at your target. But, assuming you do notice, you have to decide at that time whether you still accept the target or decide you want to wait for higher prices. Now the issue of discipline comes in; many enter into TPCs as a way of staying disciplined and not changing their price ideas when the market gets close.

If you still accept that target price, you can cancel your TPC and sell your grain to another buyer. If you sell your grain to another buyer first, it is possible that by the time you contact the buyer you have the TPC with, they have decided to accept it – then you've sold your grain twice. Best to cancel the TPC first.

Here's where you can negotiate. When you call to cancel the TPC, tell them what you are doing and why. Give them a chance to match the other bid; they may even pay a bit more, just to keep you on their side of the tracks.

What some farms do is enter into multiple contracts – one with each grainco they tend to sell to. But they are hard to manage, and you run the potential of all of your contracts triggering at once.

Alternatives that provide similar results

If farmers are using TPCs to squeeze just a little bit more out of the market, they should also consider other alternatives.

For example, they should check out forward prices. Sometimes the spot price may get close to your target but not close enough to trigger the TPC. At these times, it may make sense to check out the forward (deferred delivery) prices quoted around the same time. For example, let's say you're considering a TPC for canola with a target price of \$14.00/bu when the spot price is \$13.90/bu.

Using average public prices (from www.PDQinfo.ca) for Aug 8th, 2025, we see the average spot (publicly posted) price is about \$13.93/bu, but the forward price for delivery in November is about \$14.03/bu, above your target of \$14.00/bu. Since these PDQ prices are average prices of all elevator bids, a little shopping around and you are likely to find bids that are even better than the PDQ average – and equal to or greater than your initial idea of a target.

Now you have a decision to make. You could enter a TPC with a \$14.00/bu target and hope the spot market rises to \$14.00/bu – or your buyer jumps at your target for some other reason. Or, you could simply sell your canola at \$14.00/bu (or better) with a Deferred Delivery Contract and be done with it.

If you wait to see if the market rallies to trigger your TPC, you are taking the risk that it won't. By locking in with a deferred delivery contract, you will have removed any further price risk while achieving the price you wanted. Either way, you will be waiting to deliver and get paid.

Another alternative is to write call options. When you enter into a TPC with a grain company, you are essentially selling them a call option on your cash grain but without getting a premium (and, the flip side of that is, they are essentially buying a call option without paying a premium). From my perspective,

you could get almost the same coverage as a TPC by writing call options with the added benefit of collecting the premium.

Let's use an example to compare a TPC and a short call position:

- Assume the futures are at 468.60 and the current basis is 30 under; (current market is \$9.95/bu)
- Also assume you want 450.00; at 30 under that means futures at 480.00

TPC	Call option
Set 650 as your target (680-30)	Write (sell) 680 Nov calls and collect 15.50
Expiry: Oct 22	Expiry: Oct 22
Scenario 1: Futures go to 675 but no higher At 30 under, this equals 645.00	
TPC not triggered: no sale	Call not exercised: keep the 15.50/tonne (0.35/bu) premium
In both approaches, there is no sale of the canola. However, with the call option, you have collected \$15.50/tonne by writing the option that was not exercised.	
Scenario 2: Futures go to \$690	
TPC gets triggered: cash canola sold at 650	Call is exercised making you short futures at 680 You buy futures back and sell your canola Futures loss = 10.00 Sale at 690-30 = 660 Plus the premium of 15.50 Net return = 665.50

This shows how TPCs and call options are similar. Key differences are:

- TPCs can be any amount; options are in discreet tonnages (eg: canola options are 20 tonnes)
- TPCs are available on all commodities; options are only available on those crops with futures
- TPCs can be at any price; options are only at set strike prices
- TPCs can be open ended; options have a set expiry date
- TPCs can be cancelled at no cost; options usually have a premium
- TPCs can be triggered due to a strong basis; basis has nothing to do with options

Clearly, there are alternatives to TPCs that can be as effective - if not more. I think the most compelling reason to avoid TPCs is that the focus – the target price – is a flat price only; there is no separation of basis and futures. You might get the flat price you want but it may mean the basis is lousy. You can do much better by separating basis and futures and locking in those prices independently.

The Grain Company's Perspective

Remember the example above where the grain company is negotiating a new sale? It turns out that having TPCs on the books helps out more than you might think.

First, imagine what its like offering say 25,000 tonnes of peas. You have to come up with a price that is competitive, that the buyer will hopefully accept and that will translate into a profit after all costs, including the purchase price. And the purchase price is a big unknown – and can change before you have bought enough to cover the sale. You may have stocks in your elevator(s) that you can sell, but more often than not, you will have to go out and buy more. So the big question is “at what price can I originate enough to satisfy this sale?” “What price do I need to pay to get farms to sell?”

Without TPCs, the grainco trader must rely on his best guess as to the price that will attract the needed grain. Most traders will have a pretty good sense of what that price is, simply by being active in the market, but there is still some risk that they could be wrong. But if the grain company has TPCs, the trader can simply look at the book of TPCs they have and get a much clearer picture of what it will cost to supply a potential sale, with little or no risk.

Think about it; if you have 5,000 tonnes of TPCs at \$8.50/bu, another 10,000 tonnes at \$8.60/bu and another 10,000 tonnes at \$9.00/bu, you know that your replacement cost for 25,000 tonnes is no worse than \$8.74/bu (on average) at the elevator. Assuming you haven't bought these stocks (yet), you can build an offering price based on them; if you get the sale, you can start originating the needed grain by paying slight premiums over your public street bid. Say your street bid is \$8.20/bu; you may first raise it a bit – say to \$8.25/bu or \$8.30/bu – to see what comes in. Not only does this increase the potential of fresh deliveries, it also may become the best bid among the competition. But perhaps best of all, you are buying at prices less than what you used to build your price, so any difference is a plus.

In the event that, as time goes by, you aren't able to buy all that you need, rather than push your public price higher, you may opt to trigger the lower priced TPCs – the 5,000 tonnes at \$8.50/bu. And maybe you tap into the 10,000 tonnes at \$8.60/bu. You will go as high as you need to, to cover the sale. The publicly posted street price may never exceed \$8.30/bu but trade was completed at higher levels.

The TPCs on the books is an effective back-stop, giving the grain company a price ceiling. Think of TPCs as call options for the grain company – options without premiums.

But beyond that, a book of TPCs gives the grain company a view to the market in general. It is safe to say that if they have TPCs hovering around a specific price, other graincos will as well. And, by extension, you could surmise that other farms have similar price ideas. Knowing that there is sizeable selling interest in a particular price range gives the grain company an advantage in how it positions itself in the market. Specifically, when selling overseas, they can be more aggressive sellers based on that price range paid to farms, knowing that, in the event that prices start to rally, there will be stocks available at that price.

Why does a grainco trigger TPCs instead of simply raising its bid price?

Bid prices are market signals – raising the published bid price may send the signal that the market value of the crop has increased. But in reality, it may be that the grain company has only a small and immediate need – and, although they are willing to pay slightly more for it, the general market value has

not changed and they don't want to give the impression that it has. Even so, if they raised their bid price to get a small amount more into the elevator quickly, they would drop their price just as quickly once they buy what they need.

But there's more. Raising your price doesn't automatically mean you will buy more. In fact, a typical reaction by farmers to higher prices is to pull back on additional sales, thinking that there is more upside to come. In this way, raising the general bid price to get a quick injection of new deliveries can be counter productive. Another approach would be to simply get on the phone and call selected farms to offer a premium for immediate delivery (this happens even with TPCs in play.) Nonetheless, TPCs are probably the most effective tool the grain company has to fill these gaps.

Remember, a grain company will have a book of TPCs. Through the TPCs on their books, their view of the market is greatly enhanced. Not only do they have a good idea where their customers will opt to step in and buy, with TPCs they also know what price it will take to buy the same crop.

The Industry's Perspective

There have been times that some farms got \$14.00/bu for their canola on TPCs – but the public bid price never got that high; only those that used TPCs got that price. So more and more, there has been a gentle push into using TPCs – sometimes the only way to get the good prices is through a TPC. The problem is that with increased use of TPCs, we run the risk of eroding some of the fundamentals of the marketplace – and everyone loses.

There's a bigger picture here – beyond the individual farms and grain companies that use TPCs. TPCs have an impact on the industry as a whole, for the most part unnoticed.

Transparency

First, the use of TPCs with target prices at levels different than the public street prices, means grain is being bought at prices that the market in general is not aware. Some may say that this is not important – “what price I pay is nobody's business”. And to a point, they would be right. But price transparency is a fundamental component of a fully functioning marketplace. As more grain is bought through TPCs, the public street bid becomes less indicative of the true market value. What good to the market is a public bid at \$13.00/bu when most of the business is going on at \$14.00/bu? All activities that use those public prices – inventory valuation, credit, crop insurance, market and risk analysis, and all marketing decisions (by farms and even by those companies using TPCs) – become less accurate and less valid with broader use of TPCs.

It also becomes a competitive issue. When a company triggers substantial volumes of TPC's, it may be done in an informational vacuum; other companies don't readily know that grain was being bought at that price and therefore do nothing to compete. Later it may be their turn when no one else knows the price at which they are buying. It is difficult to argue that they are being competitive when their prices being paid are not readily available.

Smaller graincos that perhaps don't offer TPCs rely more heavily on publicly available prices to build their view of the marketplace values. They may make sales at prices on the basis of posted prices,

below where the market truly is, and then struggle to buy where they see the market price is indicated publicly. This increases the risks inherent in the business and with increased risk comes increased costs.

Futures liquidity

As we mentioned earlier, TPCs provide the grain company with an automatic, built-in back stop. They know where they can buy a certain amount of grain they may need which reduces the need for hedging in futures.

In the normal course of business, grain companies will sell large amounts of grain at once. When these sales are made “flat price” (as opposed to selling on a basis only), there is considerable price risk; by making a flat price sale without the stocks to back it up, the grain company is then short – and maybe in a big way. Conventionally when they can, they immediately go to the futures market and buy futures to hedge their price risk exposure. And, of course, when they buy the grain at the elevator, they sell futures. These hedging activities are the basis of futures and provide liquidity in those markets.

However, when a grain company sells grain and covers the sale with TPCs, there is no need for futures at all. Futures are needed when there is a time lag between selling and buying; if there is no time lag – such as when they sell and then buy using TPCs – there is no need to trade futures. True, the TPCs may not be triggered immediately after making the sale, but they reduce the need for futures since they provide a price back-stop, much like a call option. The use of TPCs runs the risk of draining the liquidity out of futures markets.

Futures are among the most effective risk mitigation tools available. If futures liquidity is reduced, risk increases – and that translates to higher costs.

Want to look even closer?

If there's more about Target Price Contracts that you want to explore, don't hesitate to contact me.

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