University of Nebraska - Lincoln
DigitalCommons@University of Nebraska - Lincoln

Historical Materials from University of Nebraska-Lincoln Extension

Extension

1992

RP92-217 No. 6 Delivering on a Live Cattle Futures Contract

Al Wellman
University of Nebraska - Lincoln

Follow this and additional works at: https://digitalcommons.unl.edu/extensionhist

Part of the Agriculture Commons, and the Curriculum and Instruction Commons

Wellman, Al, "RP92-217 No. 6 Delivering on a Live Cattle Futures Contract" (1992). *Historical Materials from University of Nebraska-Lincoln Extension*. 1926.
https://digitalcommons.unl.edu/extensionhist/1926

This Article is brought to you for free and open access by the Extension at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Historical Materials from University of Nebraska-Lincoln Extension by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

Delivering on a Live Cattle Futures Contract

By Al Wellman, Extension Marketing Specialist, University of Nebraska-Lincoln

Reviewer: Gene Murra, Extension Economist, South Dakota State University

A producer who hedges with a live cattle futures contract normally will offset the futures position by buying a futures contract and selling the cattle on the cash market. However, there may be a time when it is advantageous to make delivery of the cattle against the contract. In fact, the potential or alternative for delivery is an important necessary contract feature.

Live cattle futures follow a Certificate of Delivery procedure, the details are covered later in this Fact Sheet. Mid-America Exchange delivery units equal one-half the size and have the same delivery conditions as the Chicago Mercantile Exchange (CME) delivery unit.

When to Deliver

Delivery should be considered only if the basis at the time the contract is to be lifted is greater than delivery costs. According to theory, basis during the delivery period should never be greater than delivery costs. In reality, however, theory does not always hold true.

Basis is determined by subtracting appropriate futures price from the current cash price. If, for example, the local cash price for a group of cattle is $65 per cwt. and the futures contract price is $67 per cwt., the basis is -$2 per cwt. ($65 - $67 = -$2). In this case, if estimated delivery costs are less than $2 per cwt., delivery may be the best alternative for lifting the hedge. If estimated delivery costs are greater than $2 per cwt., delivery should not take place and the original action (sell futures) would be offset by buying back the appropriate futures contract.

Before making delivery, a hedger should carefully calculate all delivery costs and then contact a livestock commission firm or a market representative at the selected delivery point to obtain assistance in selecting the steers to be included in the delivery unit. The broker or firm representative also often can provide information on contract specification changes or any other details about delivery.

An alternative to delivery of the producer's own cattle would be for the producer to buy cattle on the market and make delivery of those cattle. This would eliminate transportation costs. Also, this may be necessary to have cattle which can be delivered at all, or at least not be forced to incur large discounts on cattle not meeting contract specifications. The producer should check with a livestock commission firm or representative at the market before making this transaction.

Size of Delivery Unit

The delivery unit on the CME is 40,000 pounds (approximately 36 steers). The actual number of steers depends on the weight of the steers.

The delivery unit on the Mid-America exchange is 20,000 pounds (about 18 steers). Again, the number of steers to be delivered depends on their market weight. The delivery unit cannot deviate by more than 5 percent (CME 38,000-42,000 lbs., Mid-America 19,000-21,000 lbs.).

Delivery Period

Delivery months for slaughter cattle are February, April, June, August, October, and December. Cattle may be delivered any business day of the contract month, except: (1) Deliveries may not be made on a holiday or the day preceding a holiday; (2) Deliveries may not be made prior to the fourth

NCR Extension Publication 217, #6/ June 1992

business day following the first Friday of the contract months. All contracts not offset by the last trading day for the contract must be delivered. The cattle feeder should consult the CME rules for a detailed description of tender, demand, retender, reclaim and assignment of Certificates of Delivery.

Delivery Costs

Delivery costs for cattle involve seven major factors: marketing fee, transportation (difference), shrink (difference), quality grade discount, yield grade discount, dressing percent discount, and weight discount.

Marketing Fee

Three factors make up the marketing fee and generally should total slightly less than $1.00 per cwt. for delivering a live cattle contract. The three factors are:

(1) Cattle delivered on a futures contract normally are assigned to a livestock commission firm. It is this firm's responsibility to weight, sort, and pen the cattle; notify the grader; and collect the money due on the cattle. The livestock commission firms charge a fee for this service.

(2) The delivery point public market charges a fee for feeding, watering, and weighing, and for use of the pens.

(3) The USDA Market News Service charges a fee for grading the livestock.

Transportation Costs

A producer estimating transportation costs for delivery should estimate only the difference in transportation costs to the delivery point compared to costs to the normally used market. To do this, the producer should compare the cost of hauling to the local market with the cost of hauling to the delivery point. If, for example, it costs the producer 50 cents per cwt. to transport cattle to the local market and 75 cents per cwt. to transport to the delivery point, only the 25 cents per cwt. additional cost (75 cents - 50 cents = 25 cents) should be used for delivery decision purposes.

Shrink Costs

Shrink loss on delivering a contract is estimated in a manner similar to that used to estimate transportation costs. Assume that a producer's shrink to the local market is 3 percent, whereas the shrink loss to the delivery point is 4 percent. Compare the local shrink loss to the delivery shrink loss to obtain the change in shrink loss—in this case 1 percent (4 percent - 3 percent = 1 percent).

The percent shrink loss is multiplied by the price per cwt. to estimate the shrink cost of delivery. If, for example, the price level is $65 per cwt. and it is multiplied by a 1 percent shrink loss, the producer's shrink cost of delivery would be 65 cents per cwt. ($65 x .01 = 65 cents).

An Example Delivery Cost Worksheet

Futures price (appropriate contract)		$67.00 per cwt.
Delivery Costs (Estimated)		
Marketing fee	$.85 per cwt.	
Transportation (difference)	.25 per cwt.	
Shrink (difference)	.65 per cwt.	
Quality discount	.33 per cwt.	
Yield Grade discount	0 per cwt.	
Dressing percent discount	0 per cwt.	
Weight discount	0 per cwt.	
Total Delivery Costs (Estimated)	$2.08 per cwt.	- $2.08 per cwt.
Estimated Net Futures price (futures price minus total delivery costs)		$64.92 per cwt.

Rules to Remember

Rule 1. If the estimated net futures price is the same as or lower than the current cash price for Choice steers, the hedger should buy back futures and sell cattle on the cash market.
Rule 2. If the estimated net futures price is higher than the current cash price for Choice steers, the hedger should consider delivery on the futures contract.

Quality Grade Discounts

The futures contract calls for delivery of USDA Choice or better steers. USDA Select steers in the delivery unit are discounted at $3 per cwt.; up to 8 Select steers are allowed in the delivery unit. No heifers are allowed in the delivery unit.

Yield Grade Discounts

The futures contract requires that only USDA Yield Grade 1, 2 or 3 steers be allowed in the delivery unit. Up to 4 USDA Yield Grade 4 steers are allowed, at par. Delivery units with more than 4 head of estimated Yield Grade 4 Choice steers are **not** deliverable. No steers with estimated Yield Grade of 5 shall be deliverable.

Dressing Percent Discounts

Steers in the delivery unit must meet minimum hot dressing percent standards. The minimum dressing percent for 1,050 lbs to 1,125.5 lbs steers is 62 percent. For 1,125.6 lbs to 1,200 lbs steers, the minimum is 63 percent. Any delivery not meeting the minimum standards will be discounted 50 cents per cwt. for each .50 percent below the minimum. A delivery unit that has a dressing percent of less than 60 percent will not be accepted.

Weight Discounts

Steers weighing from 100 to 200 pounds over or under the average weight of the shipment are discounted $3 per cwt. No steer weighing less than 950 pounds or more than 1,300 pounds will be accepted. The judgment of the grader on individual cattle weights is final.

Delivery Points

The delivery points for the Choice steer futures contracts are at public markets at the cities below. All delivery points for Choice steers are par, that is, no delivery point requires a discount.
Omaha, Nebraska
Sioux City, Iowa
Greeley, Colorado
Dodge City, Kansas
Amarillo, Texas
Since the designated delivery points may change and each delivery point has specific delivery times and conditions, a producer considering delivery should obtain the current delivery information from a broker or market representative.

Delivery Procedures

All Choice steer futures contracts must follow the Certificate of Delivery procedure.
Under the procedure, the producer making delivery must notify the broker, three days before the intended delivery date, of the date and place of delivery.

Certificate of Delivery Procedure

Once a delivery notice has been issued, the "oldest long" (the trader who has been in a long or "bought" position the longest) is assigned the contract. Under the certificate of delivery, the trader (long) who receives the delivery notice may take delivery. Or, the trader may avoid delivery by offsetting (selling short) the futures position (retendering) and paying $600 per contract. The $600 is added to the value of the cattle.

If the oldest long retenders, any other trader who is long the contract under consideration and who desires the cattle may issue a demand notice. The long issuing the demand notice will receive the cattle and the $600 paid by the retenderer. If the oldest long retenders and no demand notice has been issued, the deliverer (producer) can issue a reclaim notice. Under the reclaim notice, the deliverer will not be required to deliver the cattle and will receive the $600 paid by the retenderer. A reclaim notice will not be issued until the deliverer has established a new long position. The new long position must be taken before the contract is tendered or before any demand notices are issued. Therefore, the deliverer must take a new long position before it is known if the reclaim is to be accepted. A demand notice supersedes a reclaim notice.

If the oldest long retenders and no demand notice or reclaim notice is issued, the contract is assigned to the second oldest long.

The second oldest long can follow the same procedures as the first oldest long. Again a demand notice or a reclaim notice can be issued as in the preceding case, but now the contract is worth $1,200 plus the cattle.

If the second oldest long retenders and there is no demand notice or reclaim notice, the contract is assigned to the third oldest long. The third oldest long, when assigned the contract, must accept delivery of the cattle. However, now that person collects the $1,200 per contract penalty paid by the first and second oldest longs when they retendered.

Payment Procedure

A producer making delivery on a futures contract receives payment from the livestock commission firm that handled the delivery, less commission, grading fees and yardage fees. The livestock commission firm collects the money due for the livestock from the exchange clearing corporation. The clearing house collects the money due from the individual or firm who received the cattle.

Grading, Weight, andYield Estimates

The official grader for the futures contract delivered is the USDA Market News Service representative located at the delivery point.

The grading is accomplished by the grader's examination of the live cattle. The grader establishes both the USDA quality and yield grade by visual appraisal.

The weight of the entire delivery unit is obtained by weighing on scales, and individual steers may be weighed by the grader. If the grader determines that an individual steer or steers in the shipment are 100 to 200 pounds over or under the average weight established by the scales, a penalty is attached.

Live Beef Delivery Worksheet

Futures price (Current price, appropriate contract)	_____ per cwt.	
Delivery Costs (Estimated)		
Marketing fee	_____ per cwt.	
Transportation (difference)	_____ per cwt.	
Shrink (difference)	_____ per cwt.	
Quality discount	_____ per cwt.	
Yield Grade discount	_____ per cwt.	
Dressing percent discount	_____ per cwt.	
Weight discount	_____ per cwt.	
Total Delivery Costs (Estimated)	_____ per cwt.	- _____ per cwt.
Estimated Net Futures price (futures price minus total delivery costs)	_____ per cwt.	

The dressing percent of the delivery unit also is established through visual appraisal by the grader. Actual carcass weights are not obtained; only live estimation of the dressing percent (yield) is used to determine the dressing percent penalty. After cattle are surrendered for inspection and grading by USDA Livestock Market News Service personnel, the decisions of the graders are final. Since some of these decisions are arbitrary, they may differ from what the deliverer expected. As a result, delivery costs may be different than first estimated.

Rules to Remember

Rule 1. If the estimated net futures price is the same as or lower than the current cash price for Choice steers, the hedger should buy back futures and sell cattle on the cash market.
Rule 2. If the estimated net futures price is higher than the current cash price for Choice steers, the hedger should consider delivery on the futures contract. Again, the preciseness of the estimates discussed earlier could affect the final decision.

Reproduction and Publication

These fact sheets were intended for a variety of educational programs. Reproduction is permitted, but the authors should be properly cited. We request that Producer Marketing Management, NCR Extension Publication No 217, be identified as the source.

North Central Regional Extension Publications are subject to peer review and prepared as part of the Cooperative Extension activities of the 13 land-grant universities of the 12 North-Central states, in cooperation with the Extension Service, USDA, Washington, D.C. The following states cooperated in making this publication available (with telephone numbers where additional copies may be ordered): Illinois (217-333-2007), Indiana (217-494-6795), Iowa (515-294-5247), Kansas (913-532-5850), Michigan (517-355-0204), Minnesota (612-625-8173), Nebraska, publishing state (402-472-3023), North Dakota (701-237-7881), and South Dakota (605-688-5628).

This fact sheet is a product of the North Central Ad Hoc Producer Marketing Committee including the following members at the time of preparation: Dean Baldwin (Ohio), Edward Jesse (Wisconsin), Stanley Stevens (Minnesota), John Ferris (Michigan), Darrel Good (Illinois), Ron Plain (Missouri), George Flaskerud (North Dakota) Richard Shane (South Dakota), Jim Mintert (Kansas), Robert Wisner (Iowa), William Uhrig (Indiana), Al Wellman (Nebraska) and Tom Yonke (Missouri), Administrative Liaison. Partial funding support provided by the Farm Foundation

Programs and activities of the Cooperative Extension Service are available to all clientele without regard to race, color, national origin, age, sex, religion, or handicap.

In cooperation with the NCR Educational Materials Project. June 1992.

Issued in furtherance of Cooperative Extension work, Acts of Congress of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture and Cooperative Extension Service of Illinois, Iowa, Indiana, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. Kenneth R. Bolen, Director University of Nebraska Cooperative Extension, Lincoln NE 68583.