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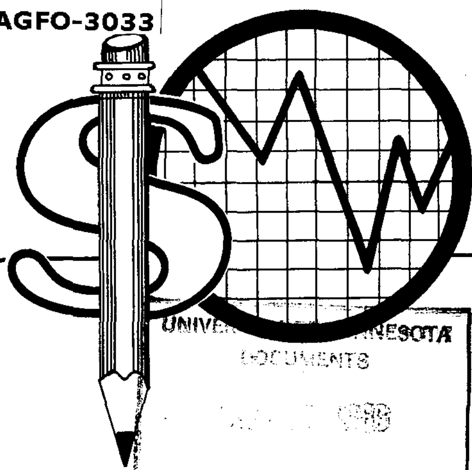

Delivering on a Live Cattle Futures Contract

Producer Marketing Management—Fact Sheet #6

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

A producer holding more than one contract can use delivery of some contracts to narrow the basis (the price difference between the futures contract price and the cash price) and make it possible to lift the other contracts by repurchasing them and selling the steers on the cash market.

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, the theory does not always hold true.

Basis is determined by subtracting the current cash price from the appropriate futures contract 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. ($67 − $65 = $2). In this case, if delivery costs were less than $2 per cwt., delivery would be the best alternative for lifting the hedge. If delivery costs were greater than the $2 per cwt. basis, delivery should not take place.

Before making delivery, a hedger should carefully calculate all the delivery costs and, if possible, contact a livestock commission firm or a market representative at the delivery point to obtain assistance in selecting the steers to be included in the delivery unit. The brokerage or firm representative also can give 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. 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 Chicago Mercantile Exchange must weigh 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 must weigh 20,000 pounds (about 18 steers). Again, the number of steers to be delivered depends on their market weight. The delivery unit cannot exceed pounds specified by more than 5 percent.

Delivery Period

Cattle can be delivered from the first of the contract month to the last business day of the month. Deliveries are not allowed on Fridays, holidays, or days preceding a holiday. Deliveries are optional for the short hedger from the first of

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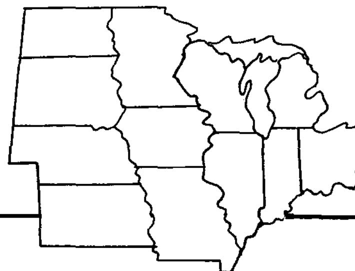

the contract month until the close of trading of the contract, normally the 20th of the contract month. Delivery after the 20th is mandatory for all contracts that have not been offset.

Delivery Costs

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

Marketing Fee

Cattle delivered on a futures contract normally are assigned to a livestock commission firm. It is this firm's responsibility to weigh, 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.

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

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

These three factors make up the marketing fee and should total approximately 50 cents per cwt. for delivering a live cattle contract.

Transportation Costs

A producer estimating transportation costs for delivery should estimate only the added transportation cost to the delivery point. To do this, the producer should subtract the cost of hauling to the local market from the cost of hauling to the delivery point.

If, for example, it costs the producer 35 cents per cwt. to transport cattle to the local market and 50 cents per cwt. to transport to the delivery point, only the 15 cents per cwt. additional cost (50 cents − 35 cents = 15 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. Subtract the local shrink loss from the delivery shrink loss to obtain the added shrink loss—in this case 1 percent (4 percent − 3 percent = 1 percent).

The 1 percent shrink loss is multiplied by the price level 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 × .01 = 65 cents).

Quality Grade Discounts

The futures contract calls for delivery of USDA Choice or better steers. USDA Good steers in the delivery unit are discounted and only a limited number of Good 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. A limited number of USDA Yield Grade 4 steers are allowed, but excess USDA Yield Grade 4 steers are discounted at 15 percent of the contract price.

Dressing Percent Discounts

Steers in the delivery unit must meet minimum hot dressing percent standards. Any delivery not meeting the minimum standards will be discounted 50 cents per cwt. for each ½ percent below the minimum.

An Example Delivery Cost Worksheet

Futures price (appropriate contract)		$67.00 per cwt.
Delivery costs		
Marketing fee	$ .50 per cwt.	
Transportation (added)	.25 per cwt.	
Shrink (added)	.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	$1.73 per cwt.	− 1.73 per cwt.
Net futures price (futures price minus total delivery costs)		$65.27 per cwt.

Rules to Remember

Rule 1. If the 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 net futures price is higher than the current cash price for Choice steers, the hedger should either deliver on the futures or delay lifting the hedge.

A delivery unit that has a dressing percent of less than 60 percent will not be accepted. The minimum dressing percent for 1,050- to 1,125.5-pound steers is 62 percent. For 1,125.6- to 1,200-pound steers, the minimum is 63 percent.

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.

Peoria, Illinois
Joliet, Illinois
Omaha, Nebraska
Sioux City, Iowa
Greeley, Colorado
Dodge City, Kansas
Amarillo, Texas

Since the designated delivery points may change, a producer considering delivery should obtain the current delivery points from a broker.

Delivery Procedure

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 delivery will be made.

Certificate of Delivery Procedure

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

If the oldest long retenders, a long desiring 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 can issue a reclaim notice. Under the reclaim notice, the deliverer will not have to deliver the cattle and will receive the $600 paid by the retenderer. A reclaim notice may 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 receive the cattle plus collect 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 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 traders who received the cattle.

Grading, Weight, and Yield 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, but weights of individual steers are estimated by the grader. If the grader estimates 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. The penalty is assessed on the basis of the grader's estimation of the weight of individual steers. In no case are the actual weights of individual steers obtained.

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.

A deliverer dissatisfied with the grade, weight, or dressing percent estimations can call for a re-grade. In the case of a regrade, a market news reporter from a different market is called in to grade the cattle. If the new grader verifies the original grade, the deliverer must pay the cost of the re-grade including transportation cost and the time of the grader. If the new grader disagrees with the original grader, no additional grading fee is charged against the deliverer.

Live Beef Delivery Worksheet

Use this to calculate your delivery costs.

Futures price (current price, appropriate contract)		______ per cwt.
Delivery Costs		
Marketing fee	______ per cwt.	
Transportation (added)	______ per cwt.	
Shrink (added)	______ per cwt.	
Quality discount	______ per cwt.	
Yield Grade discount	______ per cwt.	
Dressing percent discount	______ per cwt.	
Weight discount	______ per cwt.	
Total delivery costs	______ per cwt. –	______ per cwt.
Net futures price (futures price minus total delivery costs)		______ per cwt.

Rules to Remember

Rule 1. If the 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 net futures price is higher than the current cash price for Choice steers, the hedger should either deliver on the futures or delay lifting the hedge.

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), Gerald Campbell (Wisconsin), Ken Egertson (Minnesota), John Ferris (Michigan), Darrel Good (Illinois), Glenn Grimes (Missouri), Hugh McDonald (North Dakota), Gene Murra (South Dakota), Mike Sands (Kansas), Marvin Skadberg (Iowa), Bill Uhrig (Indiana), Al Wellman (Nebraska), and Ken Bolen (Nebraska), Administrative Liaison. Partial funding support provided by the Farm Foundation.

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