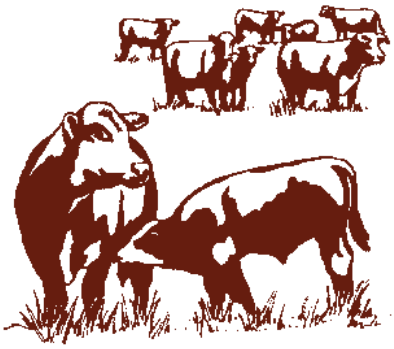
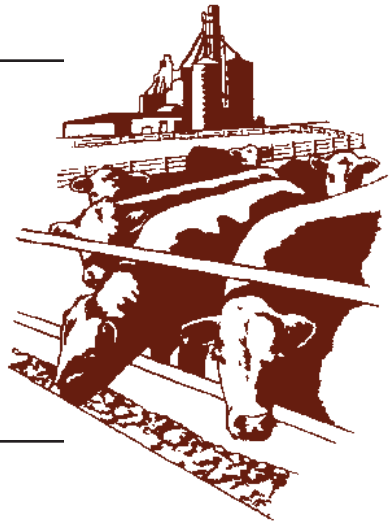


Beef Cattle Handbook



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Price Slides for Feeder Cattle

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Most cash-forward contracts—including regular cash-forward contracts, basis contracts, minimum-price contracts, and contracts for cattle sold through video auctions—require the seller to estimate average-delivered weight before delivery takes place. Since sellers can never be certain what the actual weight of their cattle will be at delivery, a mechanism called a price slide allows for an adjustment in price if the seller's estimate is wrong.

Generally, lighter cattle sell for higher prices per pound than similar, heavier cattle, since feeding efficiency decreases as weight increases. Buyers procuring cattle with cash-forward contracts are at risk that cattle will be delivered at heavier average weights than expected, while sellers using these types of contracts risk delivering cattle that are lighter than expected. For example, a seller would not want to establish a price for his/her cattle and expect them to weigh 550 lbs. when their actual delivered weight was only 500 lbs. Obviously, the accuracy of the seller's estimate is crucial to negotiations between the two parties, and using a price slide has become the principal method for dealing with the risk associated with delivery weights.

Calculating Price Slides

A price slide, or adjustment to price, specified by the seller is initiated if the average per head delivered weight exceeds a limit specified in the contract. For example, a seller might sell calves with an estimated average weight of 550 lbs. with a price slide of $0.10/cwt. for each pound that actual average weight exceeds 570 lbs. If the actual average weight of the calves at delivery were 565 lbs., no adjustment to the original contract price would be made. If the calves averaged 580 lbs., $1/cwt. (10 lbs. x $0.10) would be deducted from the original price. For instance, if the original contract price were $85/cwt. and the calves were delivered averaging 580 lbs., then the price would be adjusted down to $84/cwt.

Price Slides as a Merchandising Strategy

Developing the proper price slide can be an important seller merchandising strategy since it communicates to the buyer the confidence the seller has in his/her weight estimate. A small price slide, coupled with a large allowable weight variance, communicates to the buyer that the seller has serious doubts about the average weight the cattle will be at delivery. On the other hand, a relatively large price slide and small allowable weight variance communicates to the buyer that the seller is quite certain what the average weights will be. For example, assume two similar lots of cattle are estimated by two sellers to have an average delivered weight of 510 lbs., per head. One seller assigns his/her lot a $0.10/cwt. price slide if the average weight is more than 520 lbs., while the other seller's lot is assigned a price slide of $0.08/cwt. if the cattle have an average weight of more than 525 lbs. Buyers will recognize immediately that the seller of the first lot has more confidence in his/her estimate of average delivered weight than the seller of the second lot. Research at Utah State University has shown that buyers tend to discount cattle purchased at video auctions that have relatively small price slides and large allowable weight variances.

Ideally, price slides should not offer a net benefit to

either the buyer or the seller, since they are a tool to adjust prices for incorrect approximations of delivered weight. However, in practice, price slides are usually offered only on weights above the estimated delivered weight. That is, price slides usually adjust prices down but rarely up. Sellers can require a price slide increase if their cattle have an average delivered weight that is less than anticipated. However, this adds a source of risk to the buyer, and may cause buyers to pay a lower price than if the price slide affects only cattle with average weights heavier than expected.

Table 1 presents the average slide and allowable weight variances for cattle sold at one video auction during 1987-92, inclusive.

Table 1. Average Price Slides and Allowable Weight Variances for Steers and Heifers at a Major Video Auction Company During 1987-92

Weight Category (lbs.)	Slide 1987-89[a] ($/cwt.)	Slide 1990-92 ($/cwt.)	Allowable Weight Variance 1987-89 (lbs.)[b]	Allowable Weight Variance 1990-92 (lbs.)[c]
300-400	$0.089	$0.102	10.54	10.0
400-500	$0.087	$0.099	10.69	10.0
500-600	$0.081	$0.094	11.61	10.0
600-700	$0.040	$0.051	17.76	10.0
700-800	$0.036	$0.041	17.93	10.0
Over 800	$0.022	$0.040	15.58	10.0

[a] *Includes only price slides down for average delivered weights heavier than anticipated. This number is multiplied by the number of pounds that delivered weight exceeded estimated weight to determine the slide in $/cwt.*

[b] *The average number of pounds that average estimated delivered weight could exceed actual delivered weight before the slide became operational.*

[c] *After 1989, the auction company did not allow weight variances to exceed 10 lbs. above the estimated weight.*

Examining Table 1, it can be clearly seen that over time producers have reduced the weight variance while increasing the price slide they have offered. This suggests that higher prices are received when sellers reduce buyers' risk by offering smaller weight variances and larger price slides.

Choosing the "Correct" Price Slide

Some contracts may have standard price slides. For example, a contract may have a set $0.10/cwt. price slide with a 10 lb. allowable weight variance. Video auction representatives may also suggest different price slides based on their own judgement of the weight risk associated with a given lot of cattle. The most critical element of the process is estimating the average per head delivered weight of the cattle. Past records and experience may be the best method for estimating average delivered weight. However, the seller must also account for current conditions, such as drought stress, when estimating weight. Ideally, the cattle should be weighed and then an estimate made based on projected weight gains per day until delivery. Unfortunately, this is not always feasible, since it may not be possible to gather the cattle for weighing at a low cost.

Prices offered by buyers tend to increase with the precision of the estimated average delivered weight, and the price slide and allowable weight variance communicate this precision. Current prices for cattle of different weights can be used to determine the proper price slide. For example, assume a seller's steer calves are estimated to weigh about 525 lbs. at delivery, 500-lb. steer calves have been selling for $85/cwt., and 550-lb. steers have been selling for $82/cwt. This suggests that the market discount for calves weighing above 500 lbs. is currently averaging $0.06/cwt. (($85-$82)/50) for each pound steer calves weigh above 500 lbs. This figure ($0.06/cwt.) could possibly be used as the seller's price slide.

The price slide will vary with the weight of the cattle since the price slide for heavier cattle is generally less than for lighter cattle. For example, a study completed at Kansas State University with data gathered at the Dodge City Auction between 1987 and 1991 found that the average discount in $/cwt. as weight increased was from $0.07/cwt. to $0.10/cwt. for steers weighing less than 600 lbs. and from $0.03/cwt. to $0.05/cwt. for steers weighing between 550 lbs. and 850 lbs.

When deciding which level of price slide to use, be sure to examine current prices and price discounts as the weight of cattle increases. Good records and experience, along with an examination of current market conditions, will aid the seller and buyer in choosing the correct price slide.

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