

# Forward Contracts and Futures Trading

**Richard Eldershaw**

## **Futures**

The introduction of a Cattle Futures market has presented some opportunities to producers and buyers of cattle to hedge their price risks, and also to use the associated market indicator as a basis for forward contracts. However, the effective use of futures requires at least a basic knowledge of the mechanics.

## **Futures Basics**

- A futures contract is an agreement to buy and sell a specified amount, of a specified commodity at a future specified date. In this case a contract is for 5000 kgs, at a price quoted in dressed weight terms, for settlement on six dates during the year, 15<sup>th</sup> January, March, May, July, September and November.
- "Deliverable" or "cash settled" contracts. These cattle futures contracts are "cash settled". That means, instead of delivering cattle at the price on the contract, a cash adjustment is made, consisting of the difference between the market price on settlement day and the price on the contract.
- The Eastern Young Cattle Indicator (EYCI) is the measure of the physical market. It is reported daily, in dressed weight terms and is calculated using National Livestock Reporting Service (NLRS) data on domestic trade young cattle, from 26 saleyards from Dalby to Warrnambool. Seven days of data is included, so as each sale is reported, the previous week's data from the same centre drops out.
- "Grade Basis". The EYCI is based on young cattle sold through saleyards. Different categories of cattle, eg cows or Japanese feeder steers will

trade at different prices. This difference is called the grade basis. In our experience, 400 kg Angus feeder steers trade at 28-30c liveweight equivalent over the EYCI basis. It is possible for buyers to offer "basis contracts", ie offering to buy, in the future, at the EYCI plus basis, say 30c.

- The market. The Sydney Futures Exchange operates the futures market electronically, and licenses brokers to use it. Bids to buy and offers to sell are posted on screens for the next ten settlement dates, or up to 20 months ahead. If the prices seem attractive, brokers operate on their client's behalf to secure the deal (refer Appendix A).
- Market operators and fees, margin calls. There are many banks and brokers licensed to operate. They all charge different fees, and offer varying levels of service.
- What happens when you do a deal? Brokers hold a deposit from operators, and have access to your designated bank account. As the market moves daily relative to your position, funds are either deposited to or withdrawn from your account. If the market moves badly against you, the broker may require more funds to cover this. This is a **margin call**. On settlement day, the difference between the futures price and the EYCI price is debited and credited to the respective buyers and sellers.

## **Forward Contracts**

- Rangers Valley regularly offers fixed price forward contracts to suppliers. In the last three months we have taken delivery of approximately 2500 contracted steers. All these have been at fixed prices per kg for

delivery in specified months.

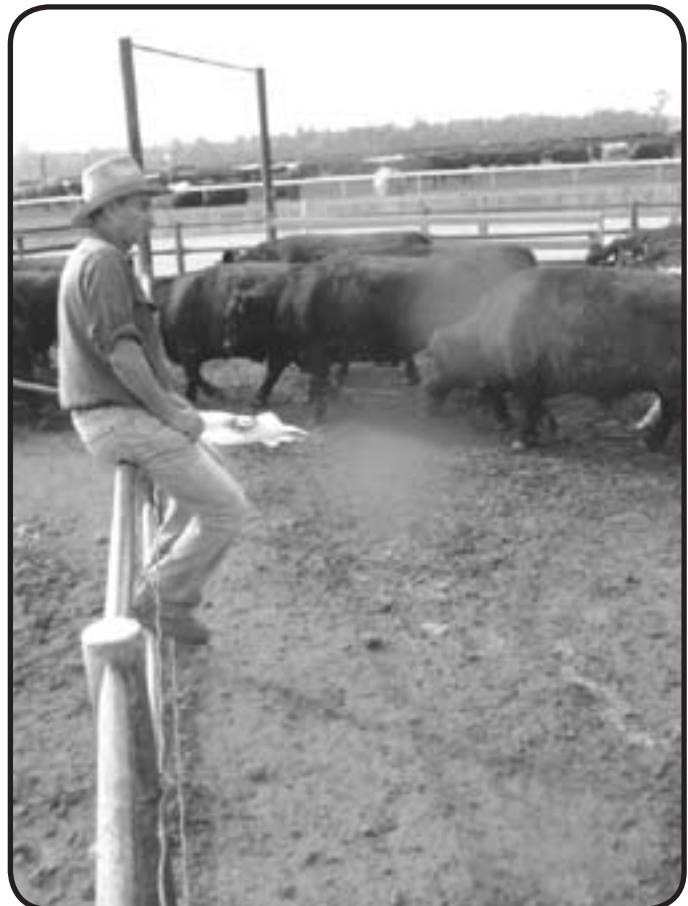
- It is now possible to offer basis contracts, eg EYCI plus 30c. This price will, in effect, be the market price on the day, provided the basis doesn't move too far. Neither of these contracts involves using the futures market.
- Suppliers should realise that forward contracts are a way of locking in a profitable price.
- Producers can turn basis contracts to a fixed price per kilogram to themselves by selling on the futures market, at any time up to delivery (refer Appendix B).
- Rangers Valley usually requires a set number onto feed each month, based on forward predictions of sales approximately one year ahead. If predictions are under or over, the intake is immediately adjusted accordingly.
- Rangers Valley does not increase intake numbers if cattle are lower priced, or reduce intake if cattle are more expensive.
- Steer intake can come from direct purchases, forward contracts, outside agistors or the Rangers Valley farm agistment.
- At certain times agistment cattle will be replaced, meaning Rangers Valley can buy cattle down to 250 kgs when the season allows.
- Rangers Valley prefers buying off farm, not through saleyards and not from Auctions Direct. The use of selling agents is a decision for the vendors, however Rangers Valley acknowledge the role they play.
- Rangers Valley has several commission buying agents.
- Variations in cattle supply leads to shortages and surpluses, so

sometimes Rangers Valley is unable to offer a spot price.

- Usual procedure for supplying cattle;
  - 1. Make contact with Rangers Valley, through agents or direct.
  - 2. Describe cattle, location, weight, condition, number, tail tag and **genetics**.
  - 3. If the cattle are required, and are suitable, Rangers Valley will make an offer, including c/kg, delivery point, weighing point and terms.
  - 4. If this offer is accepted, inspection times are arranged. Inspections must be "in yard".
  - 5. Vendor Declarations confirming sale details are signed (refer Appendix C).
  - 6. Cattle are delivered as arranged.
  - 7. Any "out of specifications" are identified at induction and notified to vendor. This may include steers extremely over or under weight or too old. Steers may be rejected or purchased at a reduced rate.
  - 8. Payment is made electronically within seven days of receiving invoice, Vendor Declaration, weight tickets. Transaction levy is only collected from sales without agent.
  - 9. Feedback is available after slaughter, but **not** sent automatically.
- but animal husbandry is the backgrounders cost.
  - Rangers Valley pays all freight costs.
  - Individual starting weights are established at backgrounders property. Closing weights are established at Feedlot.
  - A good backgrounder;
    1. has good pastures and water
    2. has good facilities
    3. keeps good records
    4. is a capable and observant stockperson
    5. is conveniently located
    6. is a good communicator
    7. can run an average of 500 steers year round

### Backgrounding

- Rangers Valley has arrangements with several producers to background steers. They are located at Jingellic, Holbrook, Forbes, Mandurama and Murrurundi.
- Approximately 25% of Rangers Valley yearly intake is via backgrounding
- Backgrounding is not opportunity agistment. Part of the farms enterprise must be dedicated to backgrounding.
- Backgrounders are paid on a "c/kg gained" basis, ranging from 90c to 115c depending on month of return.
- Rangers Valley owns the cattle, and carries normal losses. Tags are provided,



# Appendix A

## Cattle Futures Price Update

October 21, 2003 12:12 PM

	MONTH	Settle	Last	Change	Bid	Offer	HIGH	LOW	Open Int.
<b>SFE Cattle Futures</b> <b>Contract 5,000 kg</b> <b>Dressed Weight</b> <b>Young Cattle</b>	NOV3	331.00	0.00	0.00	325.00	334.00	0.00	0.00	101
	JAN4	317.00	0.00	0.00	306.00	324.00	0.00	0.00	35
	MAR4	315.00	0.00	0.00	301.00	324.00	0.00	0.00	31
	MAY4	315.00	0.00	0.00	305.00	320.00	0.00	0.00	21
	JUL4	315.00	0.00	0.00	295.00	330.00	0.00	0.00	8
	SEP4	315.00	0.00	0.00	300.00	330.00	0.00	0.00	2
	NOV4	315.00	0.00	0.00	295.00	325.00	0.00	0.00	2
	JAN5	311.00	0.00	0.00	0.00	0.00	0.00	0.00	0
	MAR5	293.50	0.00	0.00	0.00	0.00	0.00	0.00	0
	MAY5	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0

\* Eastern Young Cattle Indicator (EYCI)

Eastern Young Cattle Indicator (EYCI)

	Latest	Change	Date
<b>EYCI</b>	333	-3	<b>October 21, 2003</b>

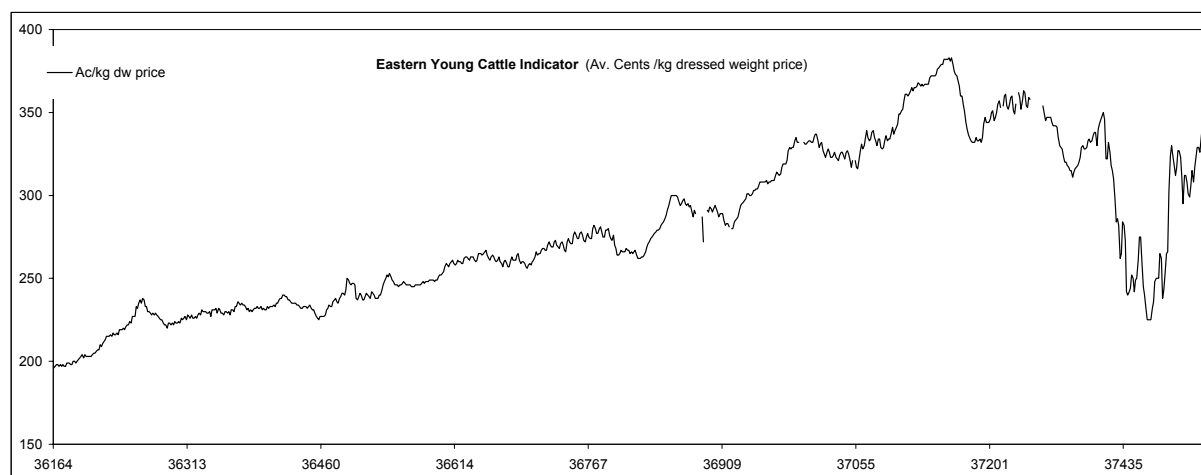
\* Producer By The National Meat and Livestock Reporting Service

Spot Foreign Exchange

Exchange rates	Last (Offer)
<b>AUD/USD</b>	0.6938
<b>AUD/NZD</b>	1.1635
<b>AUD/CAD</b>	0.9178
<b>USD/JPY</b>	109.86
<b>EUR/USD</b>	1.1643

AUD/USD Forwards

<b>1 Month</b>	\$0.6915
<b>2 Month</b>	\$0.6894
<b>3 Month</b>	\$0.6872
<b>6 Month</b>	\$0.6804
<b>9 Month</b>	\$0.6739
<b>1 Year</b>	\$0.6676



**For Indicative Foreign Exchange Option Prices Please Call Toll Free: 1300 300 479**

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**Rabobank**

## Appendix B

Ph: (02) 6734 4977  
Fax: (02) 6734 4985

# RANGERS VALLEY

Rangers Valley Cattle Station Pty Ltd  
A.B.N. 17 001 060 402  
P.O. Box 63  
GLEN INNES NSW 2370

### CATTLE PURCHASE AGREEMENT

Agreement between Rangers Valley Cattle Station P/I ABN 17 001 060 402,  
PO Box 63, Glen Innes, 2370 ("**the Purchaser**") and

.....  
.....

Vendor contact: ..... Ph: ..... Fax .....  
("**the Vendor**"), whereby the Purchaser agrees to purchase and the Vendor agrees to sell cattle ("**the Cattle**")  
under the following terms and conditions.

1. **No of head** .....
2. **Vendor P.I.N. (tail tag no.)** .....
3. **Breed** .....
4. **Origin** .....
5. **Specifications** - The Cattle must comply at delivery with the attached specifications.
6. **Period of Delivery** - mutually convenient date between ...../...../..... and ...../...../.....
7. **Price** .....
8. **Delivery point** .....
9. **Scales** ..... (any weigh fees to be paid by vendor)
10. **Weighing terms** .....
11. **Vendor's agent (if any)** .....  
See further clauses on page 2

#### PURCHASER

Name .....

Signature .....

DATE ...../...../.....

#### VENDOR

Name .....

Signature .....

DATE ...../...../.....

12. **Payment** will be made within twelve (12) days after delivery of the Cattle and receipt by the purchaser of invoice, weight docket, completed National Vendor Declaration and completed Rangers Valley Declaration (in the form attached).
13. **Cancellation** - The Vendor has the right to cancel this agreement by giving written notice to the Purchaser no less than thirty days before the first day of the proposed delivery period, if the property, or properties upon which the said cattle are grazing, is, or are all, declared "Drought Affected" for at least half the period between the date of this contract and the day thirty (30) days before the first day of the proposed delivery period .
14. **Delivery** - When the delivery point is not Rangers Valley, the cattle are to be delivered in such lot sizes as the Purchaser may direct.
15. **Inspection** - The Purchaser or any of its agents may, upon giving reasonable notice to the Vendor, inspect the cattle wherever they may be grazing at any time prior to delivery .Such inspections will not prejudice the Purchasers right to reject any cattle at delivery that do not comply with the attached specifications and the conditions within this agreement.
16. **Liquidated damages** - The Purchaser reserves the right to claim liquidated damages for failure by the Vendor to deliver the cattle as agreed. Such damages shall be payable within twelve (12) days of receipt of written notice from the Purchaser, and shall be calculated as follows; Difference in cents per kilogram liveweight between the contract price and the replacement price of similar cattle, multiplied by 400 kilo grams, multiplied by the number of head not delivered in accordance with the Agreement.
17. **Amendments** - Any amendments, changes or modifications to this agreement shall only be valid if the same are in writing and signed by duly authorised representatives of both parties.
18. **Entire agreement** - This agreement comprises the full and complete agreement between the parties at the time of this agreement, and supersedes and cancels all prior communications, understandings and agreements between them, whether written or oral, express or implied.
19. **Waiver** - Failure or neglect by the Purchaser to enforce any provisions of this agreement does not waiver any of the Purchasers rights under this agreement, or affect the validity of the whole or any part of this agreement.
20. **Authority** - This agreement shall not be binding on the purchaser until it has been signed by the Purchaser's Livestock Manager or Managing Director. No other agent has any authority to enter this agreement on behalf of the Purchaser and the Purchaser accepts no responsibility for the Vendors reliance on any representations by any such agent.
21. **Disputes** - If disputes arising from this agreement are unable to be resolved by discussion between the parties, the matter will be referred to a mutually acceptable mediator within fourteen (14) days of such discussions.

**PURCHASER**

Name .....

Signature .....

DATE ...../...../.....

**VENDOR**

Name .....

Signature .....

DATE ...../...../.....





**RANGERS VALLEY FEEDER STEER INTAKE SPECIFICATIONS**

**FEEDLOT CATTLE**

WEIGHT: 380 - 450 kgs individual empty liveweight.  
 DENTITION: 0 - 2 permanent incisor teeth (15 - 22 months)  
 All steers below 400kgs to have no permanent teeth

**BACKGROUNDING CATTLE**

WEIGHT: 250 - 350 kgs individual empty liveweight.  
 DENTITION: 0 permanent incisor teeth (9 - 16 months).  
 N.B. Steers must have been weaned at least 2 weeks.

**BREEDS:** Angus (Black only), Angus x Shorthorn  
 Murray Grey, M/G x Shorthorn  
No Bos Indicus, Dairy, or European content

**MUSCLE SCORE**

B and C

**FAT SCORE**

1, 2 and 3

**FRAME SCORE**

4 to 6

**GENERAL:**

All cattle must be;

- polled,
- free from secondary sexual characteristics,
- of quiet temperament,
- from herds and properties not on AQIS Targeted Testing Lists and free from any chemical residue restrictions,
- of sufficient frame size and maturity pattern to reach 750 kg mature weight and 300 days grain feeding,
- accompanied by a completed National Vendor Declaration and Rangers Valley Vendor Declaration,
- HGP free,
- in good health, free of vaccination abscesses,
- free of any injury and structural faults, such as;

**FEET:**

Deformed claws  
 Twisted claws  
 Scissor claws  
 Long toes  
 Founder, footrot  
 or abscess.

**LEGS:**

Sickle hock  
 Post legged  
 Cow hocked  
 Weak pasterns  
 Injuries, deformities

**SHOULDERS/HIPS:**

Restricted mobility  
 Hyper-extended hips  
 Narrow shoulders/hips

**HEAD:**

Visible scurs, blindness, cancer eyes, active pink eye, two cloudy blue eyes, poppy or damaged eyes, under or over shot jaws, abscess jaws.