Grid Marketing:

Establishing the Target Through Quality Grade

Commentary by ***Paul Dykstra***

If you produce high-quality Angus cattle, grid marketing is probably the best way to capture full value.

Right. You've heard that before, and it sounds good, but vague.

Although the concept is clear, the devil is in the details. Since most of us don't sell finished cattle every week, the knowledge gap makes sense. Exasperated critics say there are 100 or more grids out there, and it's just too confusing to sort through them all.

Let's not throw in the towel based on that exaggeration. Most cattle marketed on a carcass-merit basis are sold on just a handful of grids. Each packer offers one or two that make the most sense for the kind of product mix they're trying to procure and sell.

From the start, the biggest driver in beef price discovery has been quality grade (QG), and it hasn't changed. The 2005 National Beef Quality Audit (NBQA) reports marbling as the No. 1 deficiency, as identified by retailers and restaurateurs, in our beef product.

Following that logic and the money, most grid premiums encourage USDA low-Choice or higher beef. Their premiums and discounts favor lean, muscular carcasses with yield grades (YG) lower than 4 that fall within an acceptable hot carcass weight range, such as 550 pounds (lb.) to 999 lb. More discounts discourage production of dark cutters, Standard and ungraded (or no-roll) carcasses. Qualifying for branded programs typically adds to the premium side.

Grid defined

Before we get too deep in those devilish details, let's revisit and visualize the term "grid." It comes from the intersecting lines and boxes describing the grading factors that create or detract from carcass value. It kind of looks like a grid.

To insert some numbers, let's start with the average values from the U.S. Department of Agriculture's (USDA's) weekly reporting of carcass premiums and discounts for 2006 (see Table 1). The combination of quality grade and yield grade, as determined for each carcass by USDA graders, forms the basis for grid marketing. As we move from left to right and from top to bottom on the grid matrix, we move away from premiums and toward discounts.

These per-hundredweight (cwt.) dollar amounts are added to or subtracted from the "par price" for each carcass. The goal is to pile as many animals and as much weight as possible toward the upper-left corner of the grid matrix.

Choice, YG 3 is usually par on a grid, with no price adjustment up or down. USDA reported a few pennies' discount for YG 3 last year, but we'll leave it at zero to simplify.

We'll also insert a value of $4.50 above Choice for the *Certified Angus Beef* ® (CAB®) brand premium, since USDA doesn't report specific brands. The CAB premium can vary from less than $3 per cwt. to more than $7 per cwt., depending on the market and the plant. Most packers offer an additional branded product line, often with its own premium.

Most grids are set up to assign more than one discount to a carcass, but only the larger discount is typically imposed.

Base and par price

Any grid must set a base price and then calculate the par price for a Choice, YG 3

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Fig. 1: Calculating par

Use plant average Choice % to calculate 'par' price for Choice, YG3

If plant average percent Choice = 60%
Then 100% – 60% = 40%
And if Choice/Select price spread = $10 per cwt.
Then 40% x $10 = $4 per cwt. (Choice, YG 3 adjustment)

Apply Choice premium to weekly market to figure 'par'

If weekly weighted average carcass price = $135
Then $135 + $4 = $139 ("par" price for a Choice, YG 3 carcass)

Table 1: USDA-reported carcass premiums and discounts, average of weekly reports for 2006

	Yield Grade				
Quality Grade	**1**	**2**	**3**	**4**	**5**
Prime	$19.32	$17.04	$14.91	-$0.49	-$7.37
CAB®	$8.78	$6.50	$4.50	—	—
Choice	$4.28	$2.00	-$0.00	-$15.53	-$22.41
Select	-$10.13	-$12.41	-$14.54	-$29.94	-$36.82
Standard	-$19.28	-$19.28	-$19.28	-$29.94	-$36.82

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carcass above that base. Some popular grids use as a base the week's USDA weighted regional average price for carcasses. The region refers to location of the plant where the cattle are to be harvested. Variations for base setting include linking to the weekly market top within a region or current boxed-beef values, or other negotiations between buyer and seller.

The base is all about average value — primarily the average percentage of Choice or higher-grading cattle. The purpose of a grid, however, is to pay more for groups of cattle that hang higher-quality carcasses and discount those that are below average.

That's where the "par price" comes in. Packer grids only pay quality grade premiums for cattle that reach a higher percent Choice than the plant's weekly average (better than par). To calculate par, the plant average percent Choice is subtracted from 100%, then multiplied by the Choice-to-Select price spread and added to the base (see Fig. 1, page 177).

The spread

In Fig. 1, each Choice, YG 3 carcass is worth $4 per cwt. above the base price, or market average, for the week. Subsequently, the full Choice/Select spread ($10 per cwt.) will be applied to each Select carcass as a discount, moving the value of those carcasses below the regional weighted average by a margin of $6 per cwt.

Reviewing the grid matrix and the par formula, you can see potential pitfalls in marketing cattle with unknown marbling potential. Previous years' carcass data or selling an initial sort from the pen to test grid value may be the best guideposts. In many recent months, the Choice/Select spread has been much wider than our example, often more than $20 per cwt. This provides a great opportunity for producers with exceptional marbling in their cattle, but adds risk for cattle that can't hit the target.

As a rule, packing plants in the North and East (Nebraska, Iowa and Illinois, for example) expect to harvest a higher percentage of Choice-grading cattle than those in the South. Fig. 2 shows the three-year trend in the three major packing states for which USDA reports grading trends.

Remember that weekly plant average for percent Choice is a key for marketing on the grid. Cattle that grade in the range of 60% Choice in Nebraska or other northern states will not be rewarded much, while the same cattle harvested in the South would stand to gain a higher premium due to the lower expected percent Choice there.

There are exceptions, of course. At least one plant in Kansas creates a buffer zone between 40% and 50% Choice, so cattle that fall within that range are neither discounted nor rewarded. Furthermore, some grids don't change their weekly Choice percentage target. Producers using those grids don't worry about hitting a "moving target" as the quality grade mix within a plant changes seasonally. Obviously, you and your cattle feeder need to outline the details of each packer's grid before entering a marketing agreement.

AJ

Editor's Note: *Dykstra will continue this series in future issues with a focus on yield grade and dressing percent.*

Fig. 2: Three-year trend in the three major packing states