The creation of a futures contract for distillers dried grain offers a new risk management tool that livestock feeders and ethanol producers should evaluate for future use, a University of Nebraska-Lincoln Extension livestock marketing specialist says.

The contracts announced in February by CME Group will provide the opportunity for both ethanol and livestock feeding industries to hedge against adverse price moves in distillers grains markets, Darrell Mark said.

“The creation of the futures contract is exciting for the industry,” Mark said. “Now, both ethanol producers and livestock feeders can more effectively hedge their gross profit margins.”

Not only can livestock feeders and other buyers protect against future price increases in distillers grains by using such a futures contract, but feeders also can complete a spread or “crush” hedge to protect their feeding margins, Mark said.

For example, now a cattle feeder can lock in fed cattle sales price, feeder cattle input costs, corn prices and distillers grain prices through simultaneously trading these respective futures contracts.

Similarly, the ethanol industry can lock in distillers grain prices by taking short positions in the distillers dried grains futures contract, he said. However, it also could be used to protect profit margins or the spread between ethanol fuel prices and distillers grains as revenue sources and corn and natural gas prices as major inputs.

Distillers dried grains, or DDG, are a co-product of dry-mill corn ethanol production that is used for animal feed. Nebraska is the second largest ethanol producing state in the nation as well as the second largest cattle feeding state.

Mark’s research shows that more than 90 percent of the cattle on feed in Nebraska are fed some type of ethanol co-product feed.

As a result, Mark said Nebraska already offers one of the largest and most liquid cash markets for ethanol co-product feeds. This has grown over the years partly because of the emphasis that UNL has placed on research exploring ways to most efficiently and economically feed distillers grains to cattle.

That research has discovered that cattle perform better when fed the distillers grains compared to conventional corn-only diets, Mark said. UNL animal scientists also have found that rations containing wet distillers grains are even more beneficial for cattle performance than dry distillers grain rations.

“We actually feed a number of wet and dry ethanol co product feeds in Nebraska,” Mark said. “While this new DDG futures contract may offer an effective risk management tool for buying and selling these products, it’s important to remember that the new futures contract has dry distillers grains plus solubles as the deliverable product, not wet distillers grains or gluten feed.”

Knowing how to appropriately hedge related co-product feeds into the DDG futures contract will be critical for Nebraska cattle feeders and ethanol plants who use it for hedging purposes, Mark said.

“Wet and dry distillers grain prices do trade up and down together, but not strictly on a one-to-one relationship at all times,” he said. “So, it is possible to be over- or under-hedged if these relationships are not accounted for.”

Mark likens such a cross-hedge as being similar to hedging grain sorghum in the corn futures market or previous use of the corn or soybean meal futures contract to hedge various ethanol co-product feeds.

“When the futures contract begins trading on April 26, we’ll begin defining what these cross-hedge relationships are and what the basis risk is,” Mark said.

While more research will be needed to most effectively use the DDG futures contract, this is a positive development for cattle feeders and ethanol plants, he said, noting that some ethanol plants and cattle feeders in Nebraska have had difficulty managing price risk associated with corn and feed co-products in recent years.

The potential participants in the futures contracts are expected to be ethanol producers, feed merchandisers, feed mills, marketers and livestock operations. They will allow these market participants to lock in a price for DDG up to 12 months in advance, thus hedging their price risk.

For more information on the relationship between the prices of corn and various co-products, go to Mark’s Web site , then select the extension tab and go to ethanol co-products.