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ADDING VALUE TO OUR PRODUCT: A COW/CALF, FEEDLOT AND MEAT INDUSTRY PERSPECTIVE

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Introduction

Marketing of fed cattle has changed drastically over the last 20+ years. In 1996, an estimated 8.1% of cattle were sold through a grid-based marketing system (Schroeder et al., 2002). By 2001, this number had increased to 43.5%, and in 2018 over 70% of cattle were marketed using a grid, formula or forward contract (Schroeder et al., 2002; USDA, 2018). Changes in marketing methods means that producers' economic returns are more impacted by the quality of their cattle than in the past, increasing the importance of understanding the changing marketplace and changing consumer demands. However, the US beef industry is comprised of a variety of cattle producers that represent different segments of the industry, with very few producers maintaining ownership from birth to harvest.

Each segment of the industry has its own unique saleable product: Seedstock producer – bulls or replacement heifers; Cow-calf producer – weaned calves or yearlings; Feedlot operator – fed cattle; Processing facility – commodity or branded beef products. Nevertheless, it is critical that producers in every segment of the industry realize that the ultimate end product of their efforts is beef, in the form of steaks, roasts and hamburgers that are consumed every day by our customer. If quality and value are not delivered consistently to our customer, all segments of the industry will suffer. Further, the average consumer will not understand these various segments that combine to form the beef industry; they will simply view anyone in the industry as a source of information. Therefore, the more informed all beef producers are about the end product they are producing, the more each of us can help consumers make informed decisions about beef.

The aim of this panel discussion is to learn from successful representatives from the cow/calf, feedlot and meat industry about the practices and approaches they have used to add value to beef.

Meat Industry Perspective – Paul Dykstra

One of the fundamental concepts behind "value-added feeder cattle" is that carcass quality and yield differences upon harvest are impactful to the price of fed steers and heifers. It's well known that most ranchers don't attain the true carcass value of their calf crop given that relatively few retain ownership through the feedlot sector or market their cattle directly to a packer. Even so, carcass value is passed back through the chain of custody from packers to cow/calf producers through known and perceived carcass value differentials for feeder cattle and fed cattle.

The end product side of the beef trade clearly differentiates value for beef cuts through a pricing system, primarily based on marbling differences as measured by USDA graders at the packing plant. The commonly recognized quality grades of Prime, Choice, Select and Standard (often termed "no roll") set the foundation for whole carcass and subprimal beef cut pricing. Branded beef programs such as the *Certified Angus Beef*® brand (CAB®), and others, incorporate marbling degree along with other carcass specifications to further merchandise beef with attributes. From packer to the consumer, beef is priced according to the known palatability and consumer satisfaction expectations based on quality grade and often by brand name.

USDA weekly carcass cutout values for the past 5 years show the Prime premium above Choice as $24.76/cwt. while the Select discount below Choice has been $9.92/cwt. Urner Barry data for the same period lists the CAB carcass cutout at $10.28/cwt. above Choice. These annual price spread averages have remained robust even as volume of Prime, Choice and CAB carcasses (i.e. tonnage) have increased in recent years. The Prime grade has increased from just 2.6% to 7.9% of the fed cattle harvest since 2006. Similarly, the Choice grade in that 12-year period increased from 51.6% to 71.4% of fed cattle carcasses in 2018. Even with this historic improvement in marbling achievement, the Choice/Select spread reached $27/cwt. in October of this year as Choice beef supplies slipped slightly lower than a year ago due to poorer quality grades for the period.

Feedyards and retained owners participate in the carcass value market through grid sales and similar marketing arrangements, such as formulas and contracts, which often include carcass premium and discount structures. These marketing formats accounted for 73% of fed cattle marketing in 2018. This suggests carcass value is very important to a significant number of feedyards today.

Carcass yield is another important factor when merchandising fed cattle, especially on a carcass merit basis. Cattle achieving dressing percentages greater than the industry average 63% have an advantage with a larger proportion of saleable carcass weight as compared to live weight. Furthermore, USDA yield grades 1 through 5 (either assigned by USDA graders or estimated through camera technology) contribute to grid payment structures. In the past 5 years the weighted average grid values for yield grade have averaged the following: YG1 +$5.51/cwt., YG2 +$2.84/cwt., YG3 PAR, YG4 (-$9.51/cwt.), YG5 (-$14.58/cwt.). While red meat yield is economically relevant in the packing sector, modern subprimal cut specifications of 1/4 inch and 1/8 inch external fat trim remove most variation before end users receive the product.

Mathematically, a combination of superior quality and yield return the highest premiums while avoiding discounts. Yet achieving superiority across both categories simultaneously is difficult to achieve. Cattle with genetics and management focused to produce exceptional marbling do not tend to achieve especially high percentages of yield grade 1 and 2 carcasses. The opposite statement also tends to be true, while some producers have proven a reasonable balance of the two is attainable. Ranchers must first prioritize genetic traits to fit their production environment. Once that direction is set, the opportunity to merchandise feeder cattle or fed cattle with "value-added" carcass traits is a pursuit with no downside risk. The aforementioned premium and discount structures should stand as a guide toward success.

Feedlot Perspective – Gary Darnall

The goal of a custom feedyard is to add value to the cattle that a customer has placed in our care to maximize profits (or minimize loss if there is any). We want our customers to be happy they fed cattle with us because we helped them get the most out of them, at the least cost. We feed, take care of, and market customer cattle as if they were our own.

To do this we provide customers the information they need to be, and feel well informed and up to date with their cattle and performance. In order for producers who have not retained ownership in the past to get to that level of comfort, there are a number of questions they typically ask to gain confidence and understand the process. These are questions we would encourage any prospective customers to consider along with our responses:

1. What do you think about these markets? Can I make any money retaining ownership?
   To this we will explain that there are 2 opportunities to market calves (for example), going to feeder or 750 – 800# and selling or all the way to finish or fat. To estimate this we will run a breakeven projection using current value of cattle, the estimated costs to feed to either feeder or fat, the board market pricing based on the projected out date, the estimated medicine or processing costs, interest, and death loss. The Rancher can take this breakeven projection to their lender to talk about retained ownership. We will ask questions about the goals of the customer to look at their situation, weights of calves, when they will be arriving at feedlot, the current vaccination program, and what are the expectations of the customer.

2. How much will it cost me to feed these cattle?
   We have the current/estimated feed and yardage costs and usually give the customer a cost/lb./gain and/or translate that to a cost/head/day.

3. How do you charge?
   The feedyard business is very competitive but in the final analysis there is close cost/head/day. Some yards markup their feed costs and have a small yardage fee, others market their feed at cost and just charge a yardage fee/head/day. You should ask how a specific yard charges to take care of your cattle. The most important thing is the cost/pound of gain based on how well they convert feed into pounds. Feed is primarily based on the corn price. There are questions this year as to the quantity of corn available for feeding with the flooding and other disaster concerns. It appears as if the cost of feed will be about $.10 above last year's cost/lb. of gain for feed and yardage. Last year it was about $.73 to $.75/lb. of gain. This year looks like it may be $.83 to $.85 for the same lb. of gain.

4. Do you finance cattle and/or the feed?

Some yards will finance cattle, you will need to ask and at what rate. Some will finance the feed and some will partner with the current owner in a percentage of ownership to buy in and feed out the cattle depending on what the owner is looking for. It's aldso important to compare interest rates with your bank.

5. Where do you market the cattle in your feedyard?

   We can sell feeder cattle private treaty, video, or through a sale barn direct from feedlot. We sell fat cattle to the 4 major packer buyers who get cattle from this area. Cargill, JBS, Tyson and National Beef. We can sell cattle retained at any time they are in the feedyard based on the customer wants or needs. We can forward contract cattle, place them on a grid or market live. We look at the best grid options or forward contracts for the cattle at the time. There may be more than one marketing date on a group based on the spread of age/ wt. upon arrival at the feedyard.

6. How do you bill?

   We send out a feed bill once a month and it gives a snapshot of how the cattle are eating, their costs for the month, their estimated weight based on what they are eating and how the computer thinks that will convert, any medicine and processing costs and these costs are divided out by lot.

7. How many head do I have to put in or what is your pen size?

   We have pens that will hold from 40 head up to 240 head in a pen. We recommended groups of 40 head for going out on a fat load. But if these numbers aren't feasible we have our own cattle that we can put with at the time of market for truck load purposes.

8. How do you take care of the health on the cattle?

   For us it is like us owning the cattle. We have pen riders who go through each pen at least once every day and look for and treat any sick animals. If an animal dies, there is a postmortem conducted and a necropsy report is given to the owner to be informed of what that loss is from. If for some reason we don't know the cause, photos will be taken and possibly samples and our consulting veterinarian gets involved to solve the issue. If there is a health event in a particular group of cattle, our consulting veterinarian will work closely with the producer and producer's veterinarian to identify and deal with it.

9. Can I get data back on how the cattle performed after they leave the feedlot?

   We always give a closeout on the cattle for their performance in the feedyard. How they gained per day, morbidity/mortality, profit/loss, conversion and so on. We also can get the carcass data back on the cattle whether sold live or in the meat. We get group data at no cost, which shows yield and grade. We can also request individual data, which adds around a $6/head additional cost.

10. Do you do Risk Management?

    We stay abreast of the markets and will give our opinion to our customers of what we think. But we will not make recommendations or hedge cattle for customers.

In summary the customer has to have confidence in us a feeders and that starts with a lot of communication up front and throughout the feeding process. A good health program, pen conditions, feeding cattle at same time each day, and keeping an eye on the market all contribute to a successful experience for producers looking to add value to their cattle through retained ownership. We can't change the markets, but we can add value effectively and efficiently.

Cow/Calf Producer Perspective – Britton Blair

One of the primary goals of Blair Brothers Angus has been to develop commercial bulls that produce offspring with exceptional feedlot and carcass performance. We began to retain ownership of the bottom end of the bull calves and preg-checked open heifers. This has developed into a customer buy-back program where we aim to purchase calves out of our bulls to feed and market on high quality grids.

There is strong data that supports high profitability in retaining ownership of your calves, and early in our endeavor it was hard to understand why more people didn't feed their calves to slaughter. Listening to conversations and asking questions at brandings, receiving calves, or any general gathering of ranchers allowed me to gain perspective on this topic and make few key observations.

1. There are a lot of people that when it comes down to it simply don't like the risk of retaining ownership. They don't know anything about it, don't know who to talk to about it, and don't know any feedyards to work with. It is hard to get started on a project like this. The industry beyond selling a weaned calf is a relatively unknown world to a lot of ranchers…just like ranching might be unknown to a lot of feedyards.
2. A lot of people are also not in a financial position or perceive that they aren't in a financial position to do it. Further, a lot of bankers can be hesitant to support retained ownership of calves.
3. It isn't necessarily wrong to sell your calves right off the cow in our part of the country. We have one of the highest feeder markets and many times you can probably make just as much selling them at weaning or after backgrounding compared to hanging onto them for another 210 days.
4. There is a number of producers that might have tried to retain their calves once or twice and it just didn't work out or it wasn't worth the risk they had to take.

I think a lot of these unknowns are easily overcome. The cattle business is a very easy business to build relationships. Feedlot managers are generally very personable people and I think you could call up about any of them and they would talk to you and help you through it. If they don't take the time to help you, call another one. There is someone you can make a connection with and start the business rolling. Knowing who to call I think is as simple as to starting to ask around. Seedstock suppliers, nutritionists, mineral salesman, order buyers, and other allied industry people you are doing business with, are all great examples of people that could point you in the right direction.

The financial position is also easier to overcome than most people think. Many feedyards will finance cattle, feed, and the risk protection, or parts of those. You can even find yards will keep $200-300 per head when you send your cattle, then send you back the balance on the value of the cattle. This helps your cash flow, as you will get a check when you first ship the cattle and then will get a check (hopefully) when the cattle are sold as fats.

I have come to the conclusion that retaining ownership is almost a moving target and the decision to do it should not be the same every year. I also think the decision can be made rather simply by calculating a simple breakeven, and by having a basic knowledge of the general direction of the cattle market. By running a simple breakeven and using local market prices, you can see if putting the cattle on feed are close to a breakeven, have some profit potential, or if they are losing $50-$100+/head. If your breakeven indicates there is potential to breakeven at commodity prices and the cattle market is trending toward a low or even in a general uptrend it could make sense to try retaining ownership. If you run a breakeven and they are $50-$100+ losers and the market doesn't really seem to be going anywhere, you might as well sell them and let someone else take the risk. This is obviously not something that you can do the morning of sale day but should be considered as you go into late summer and early fall. This is the time to start getting an idea of what calves are really worth.

The last 5 years have given us some great examples of when it works to retain and went it's better to sell at weaning. In 2014 when calves were worth an all-time high, it was definitely not the year to be trying to retain ownership. If you are making record profits maybe it isn't worth taking the risk. Furthermore, 2016 would have been a good year to retain ownership, though you maybe didn't know it at the time. Calves were worth about $700 and everyone was in a bad mood. It seemed like calves were very cheap, and there was not a lot of hope. If calves are worth less than your operating costs, retained ownership is a good tool to use to capture every single bit of value you can from your cattle, and to also buy yourself some time for the market to go up.

The last 2 years have also set up good examples. Last fall (2018) the market was pretty good. People didn't think it was, but it was. The breakevens I ran were showing those calves losing $100-$150 and put your fat cattle breakeven price around $128…I didn't think we could get there. In my mind, if I was trying to decide whether to keep or sell my calves, I would be selling them. Other people could obviously pay more than what I thought they were worth so you might as well let them have them. However, this year seems to almost be a perfect opportunity to try retained ownership or at least backgrounding. The market is down, people are in a bad mood, the farmer feeders have been fighting mud since last November, and a lot of them really don't even want to put cattle in their yards. You can buy calves that come pretty darn close to a breakeven right now, so you have some potential to maybe lock in some profit. There also seems to be some upward potential to this cattle market and by retaining ownership you could maybe take advantage of in the coming months.

Once you have retained ownership it becomes easier to make the decision. If you learn you have average feedlot performance and average carcass merit you have a base line to go off of and something to build from and can compare prices to calves regionally. When you start to raise the kind of cattle that will return high grid premiums and will outperform most of the other cattle in the feedlot, you will realize that no one on the open commodity market will pay you enough for the kind of cattle you are raising.

References

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