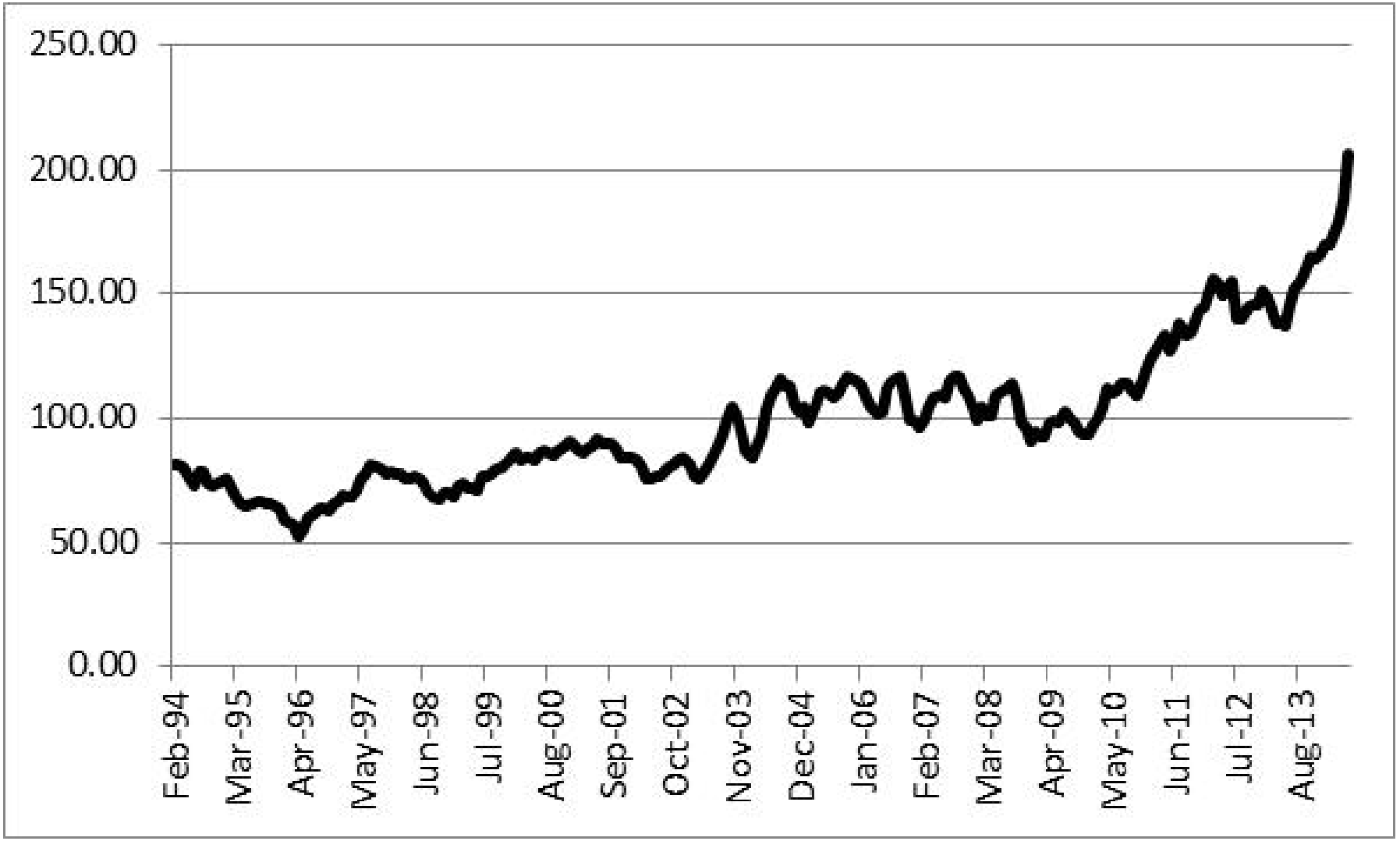
Cattle Market Update: August 2014

Kenny Burdine
UK Agricultural Economics

Market Fundamentals

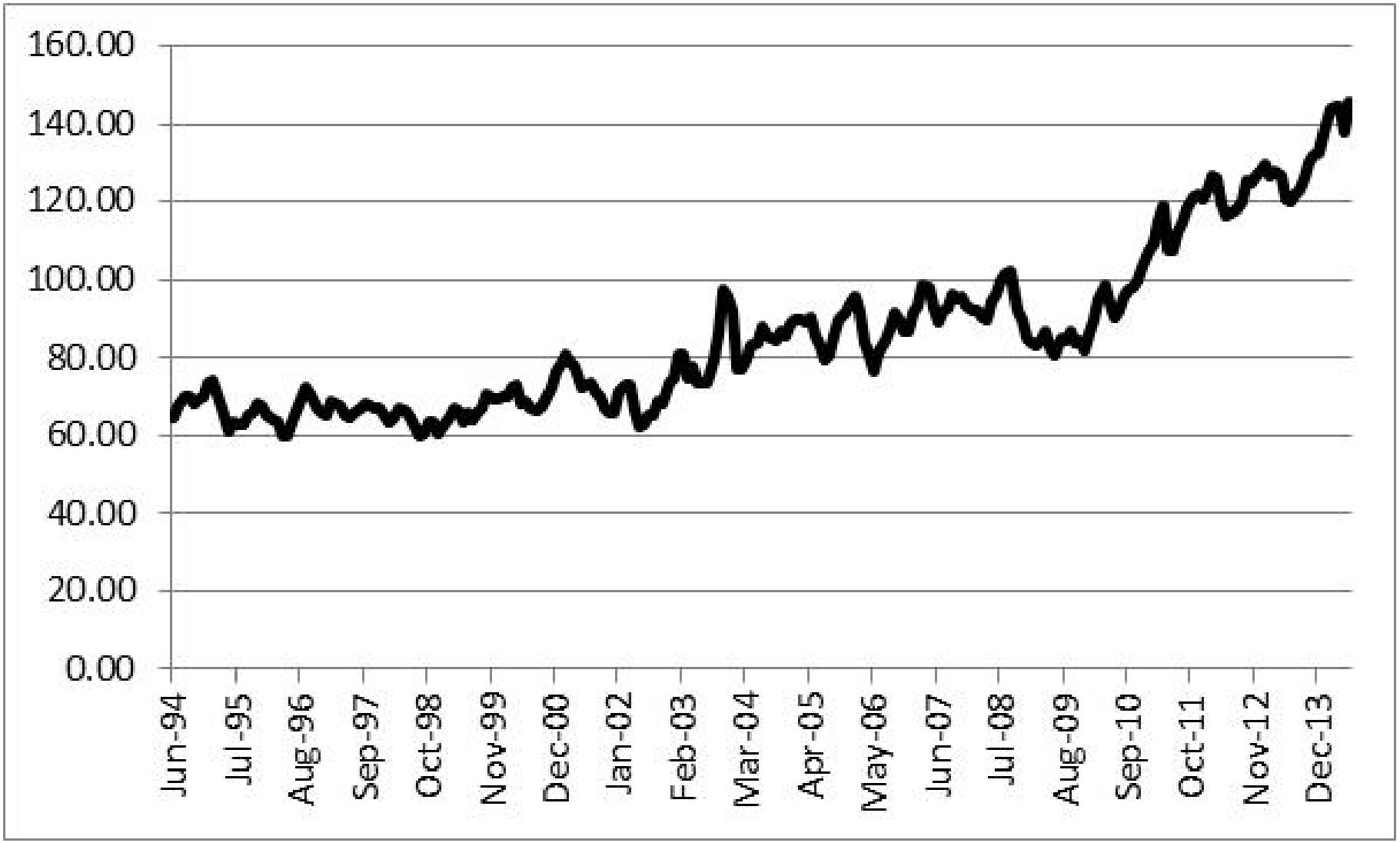
- Small cow-herd
  - Profit can’t make it rain, competition for ground
  - Has expansion begun?
- Domestic demand has improved
  - Exports still very strong
- Calf / feeder markets still adjusting to feed prices - $2.50, $3.50, $7.50, $5.00, $3.50
- A lot of uncertainty / volatility

Nearby CME Feeder Cattle Futures
(June 1994 - June 2014)



Source: CME© and LMIC

Nearby CME Live Cattle Futures
(June 1994 - June 2014)



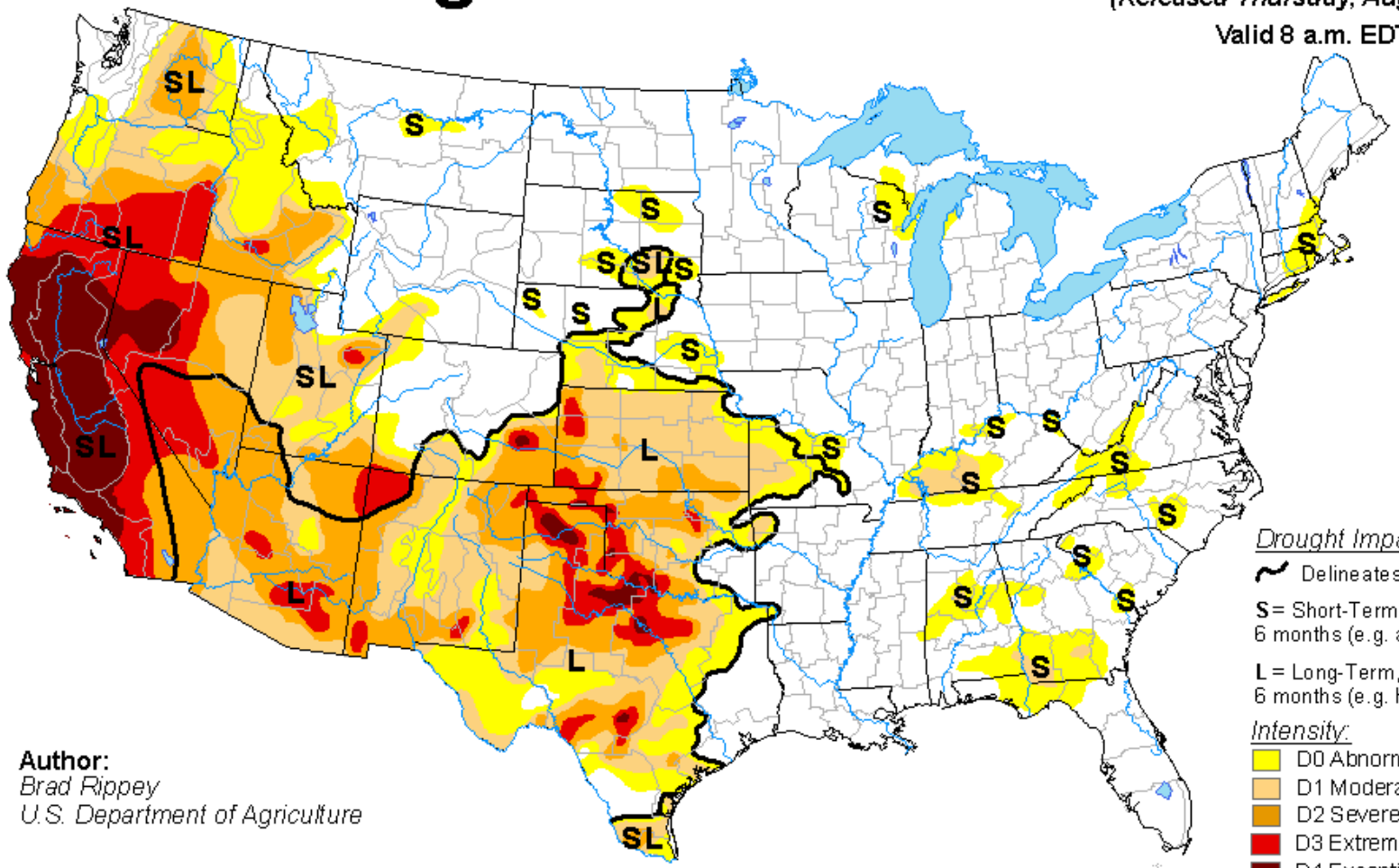
Source: CME© and LMIC

U.S. Drought Monitor

August 5, 2014

(Released Thursday, Aug. 7, 2014)

Valid 8 a.m. EDT



Author:
Brad Rippey
U.S. Department of Agriculture

Drought Impact Types:

Delineates dominant impacts

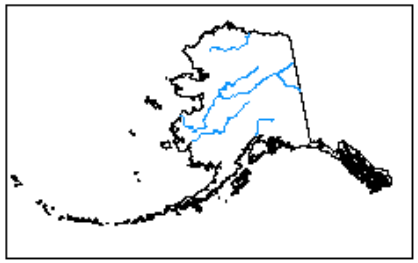
S = Short-Term, typically less than 6 months (e.g. agriculture, grasslands)

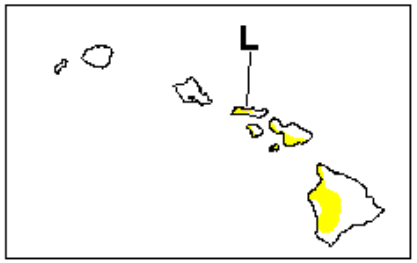
L = Long-Term, typically greater than 6 months (e.g. hydrology, ecology)

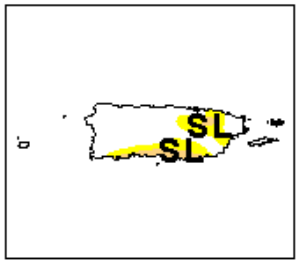
Intensity:

- D0 Abnormally Dry
- D1 Moderate Drought
- D2 Severe Drought
- D3 Extreme Drought
- D4 Exceptional Drought

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.







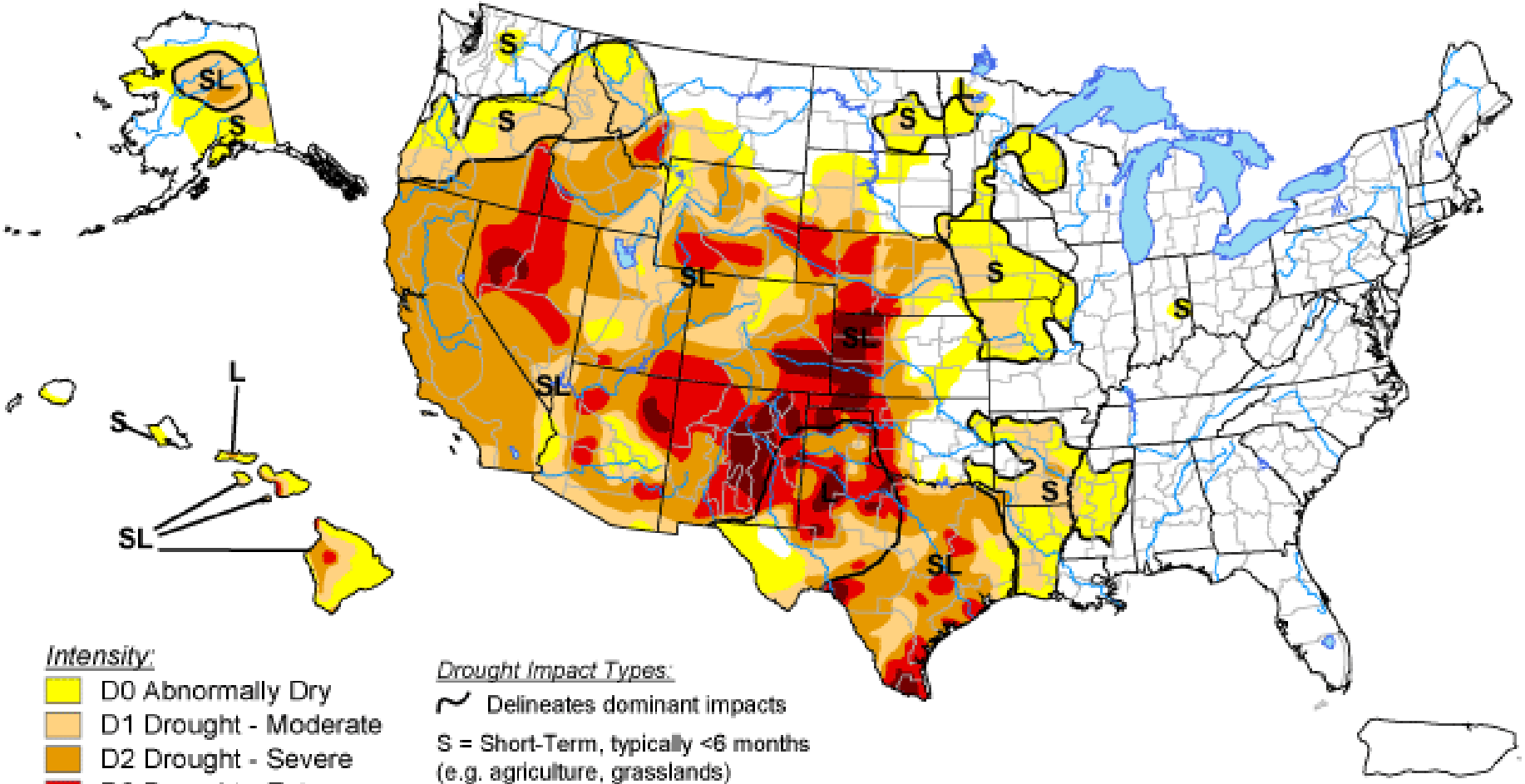
USDA

National Drought Mitigation Center

http://droughtmonitor.unl.edu/

U.S. Drought Monitor

August 6, 2013
Valid 7 a.m. EDT



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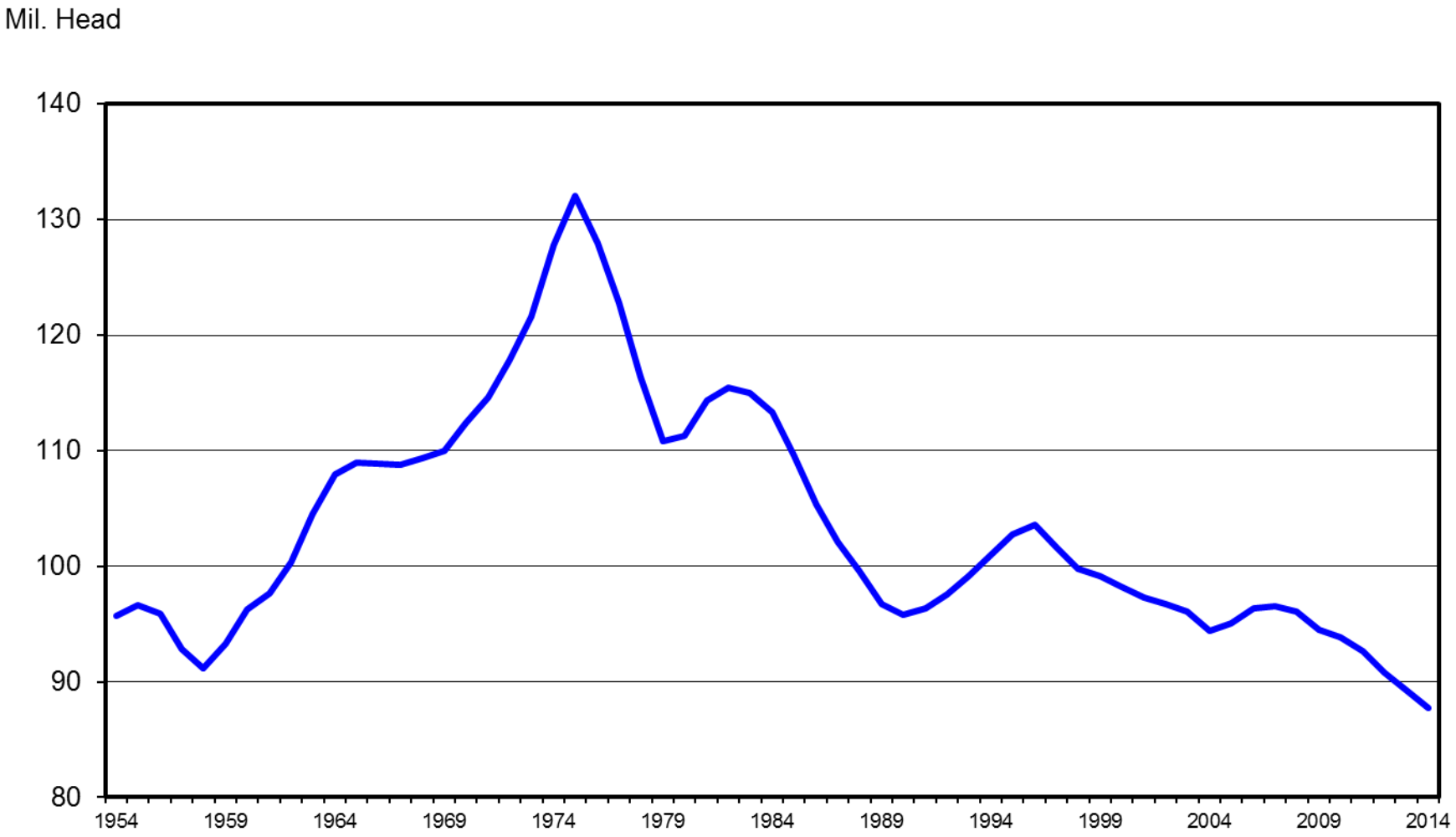
http://droughtmonitor.unl.edu/

Released Thursday, August 8, 2013

Author: Brian Fuchs, National Drought Mitigation Center

JANUARY 1 TOTAL CATTLE INVENTORY

U.S., Annual

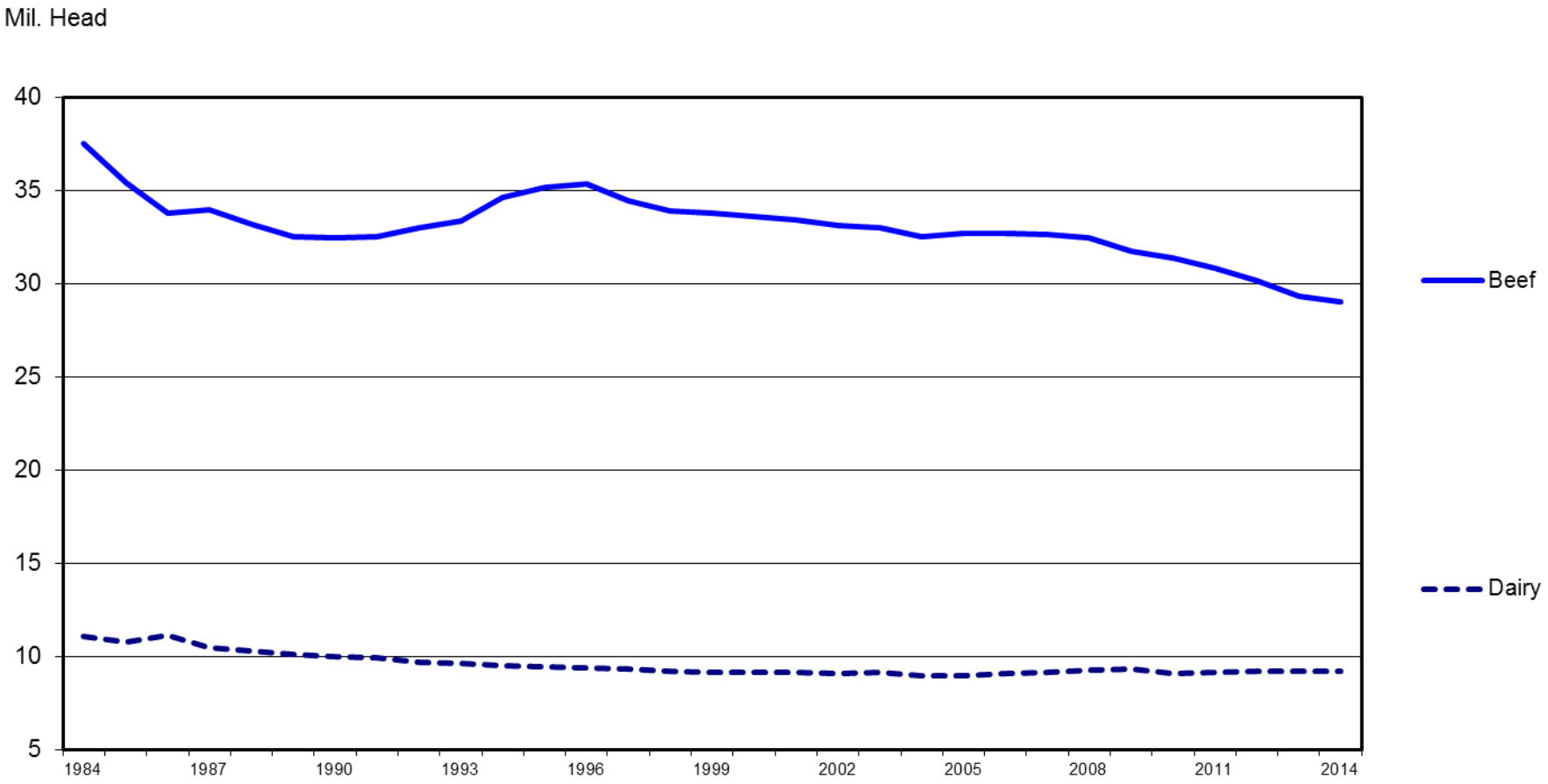


Livestock Marketing Information Center

Data Source: USDA/NASS

JANUARY 1 COW INVENTORY

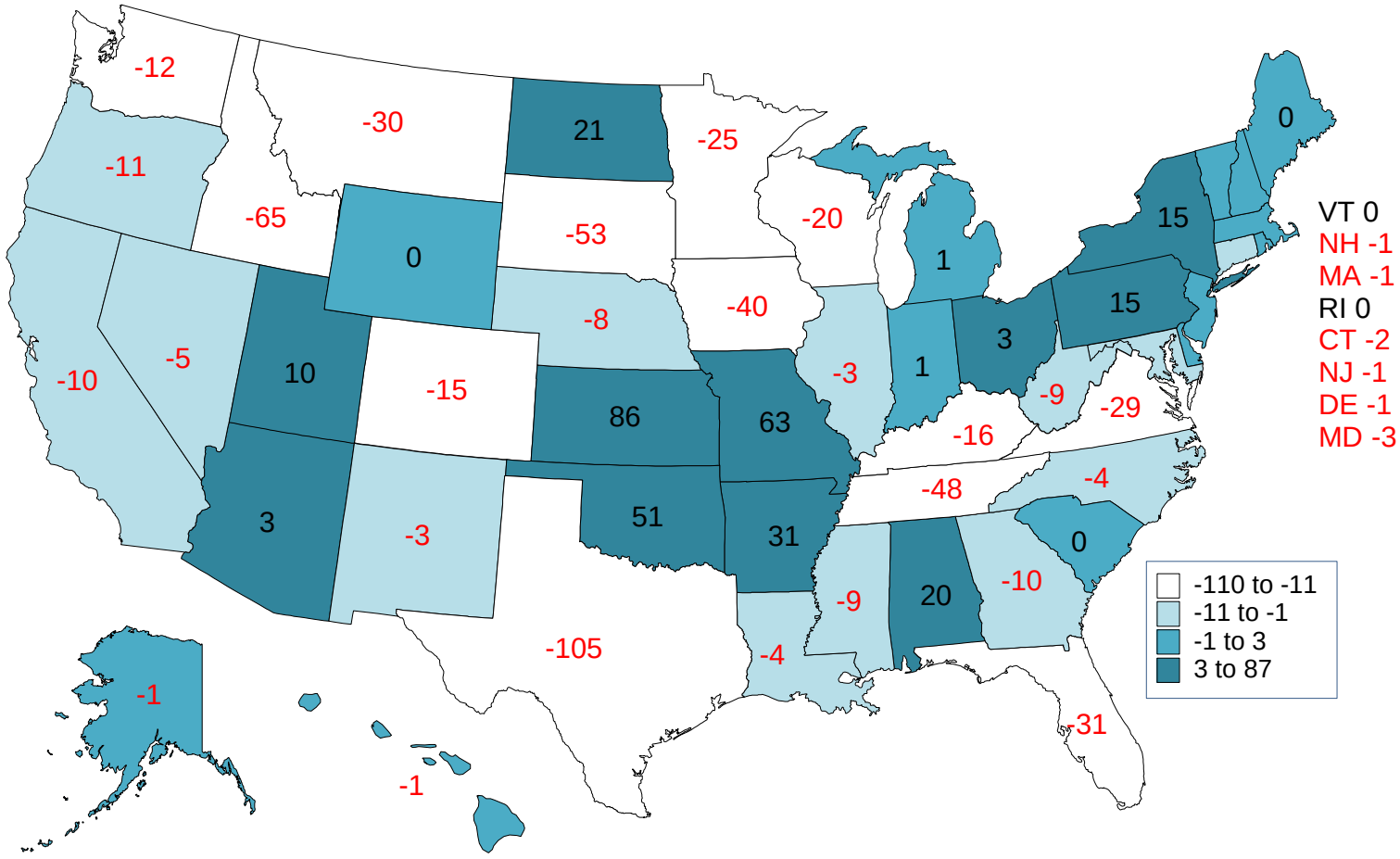
U.S., Annual



Livestock Marketing Information Center

Data Source: USDA/NASS

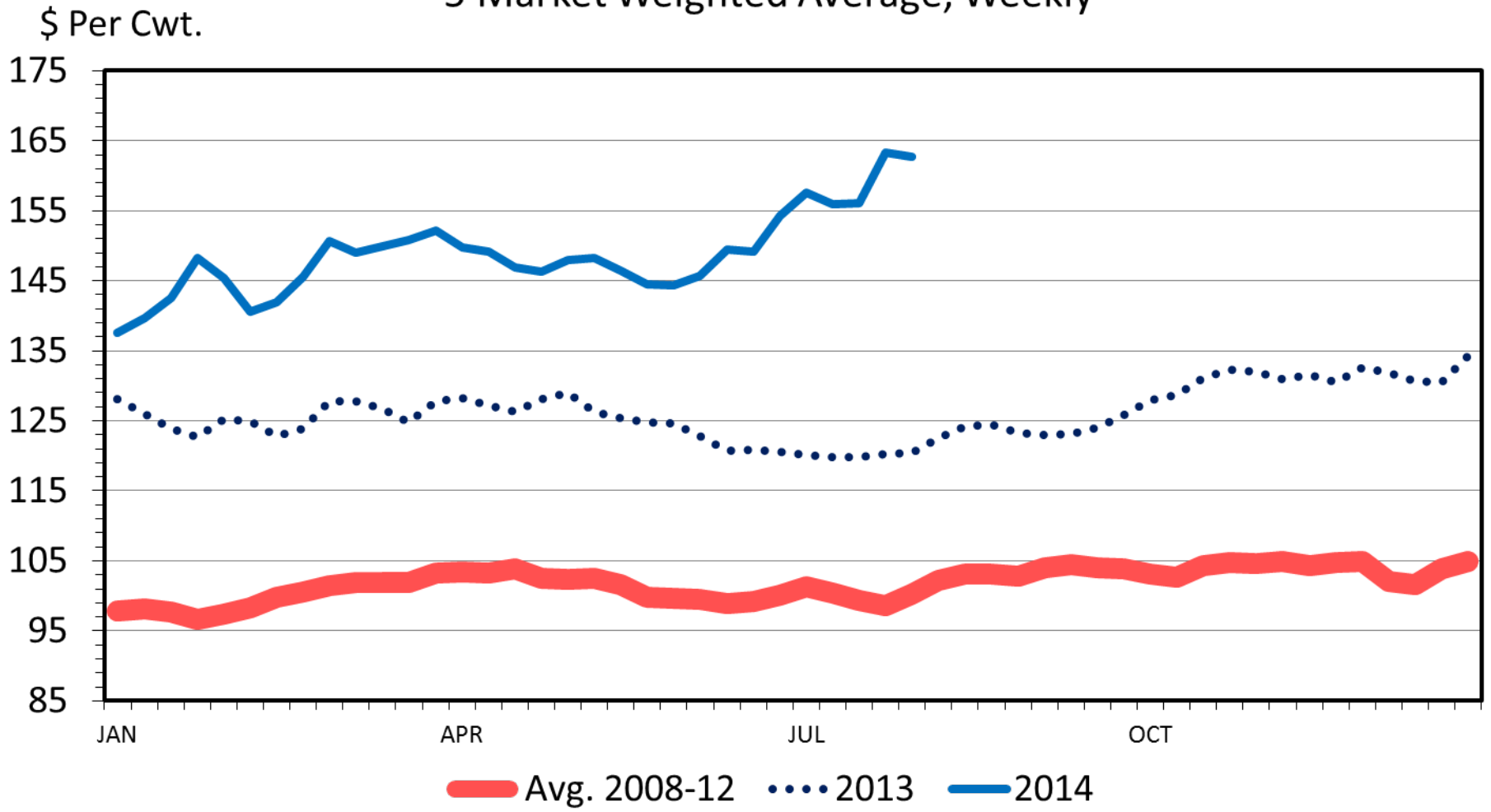
CHANGE IN BEEF COWS NUMBERS
JANUARY 1, 2013 TO JANUARY 2014
(1000 Head)



Livestock Marketing Information Center
Data Source: USDA-NASS

SLAUGHTER STEER PRICES

5 Market Weighted Average, Weekly

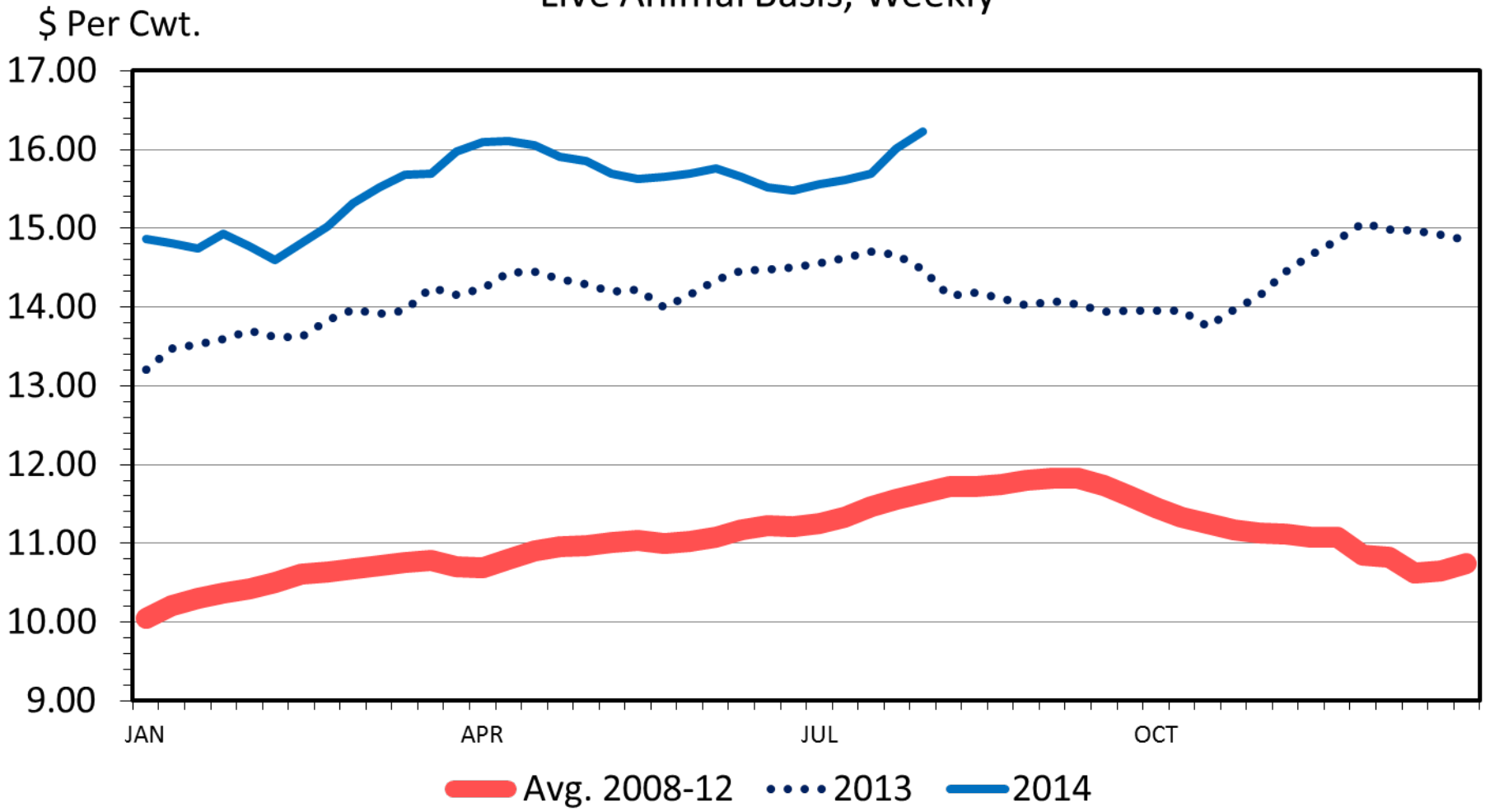


Data Source: USDA-AMS

Livestock Marketing Information Center

STEER HIDE AND OFFAL VALUE

Live Animal Basis, Weekly

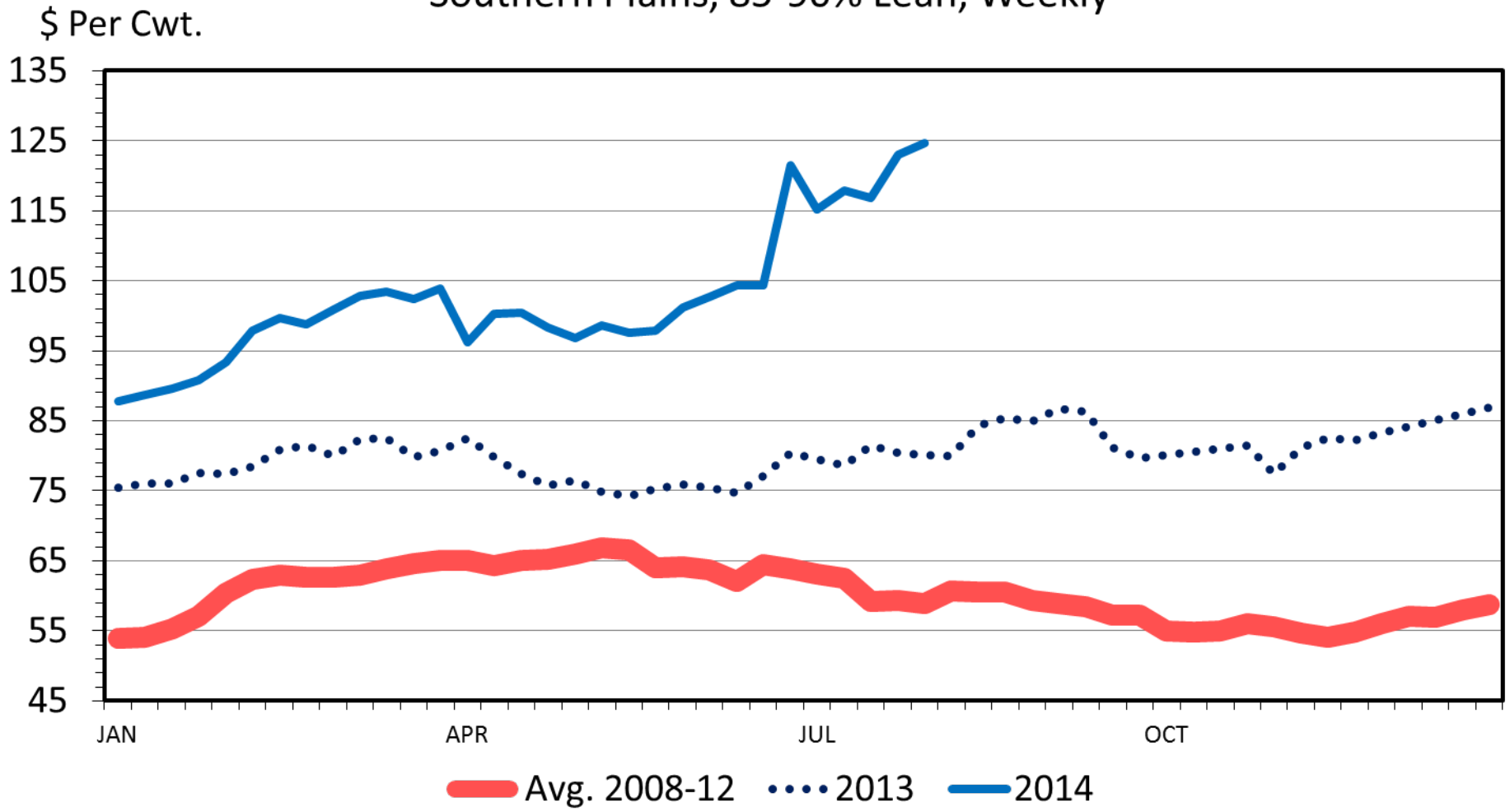


Livestock Marketing Information Center

Data Source: USDA/NASS

SLAUGHTER COW PRICES

Southern Plains, 85-90% Lean, Weekly

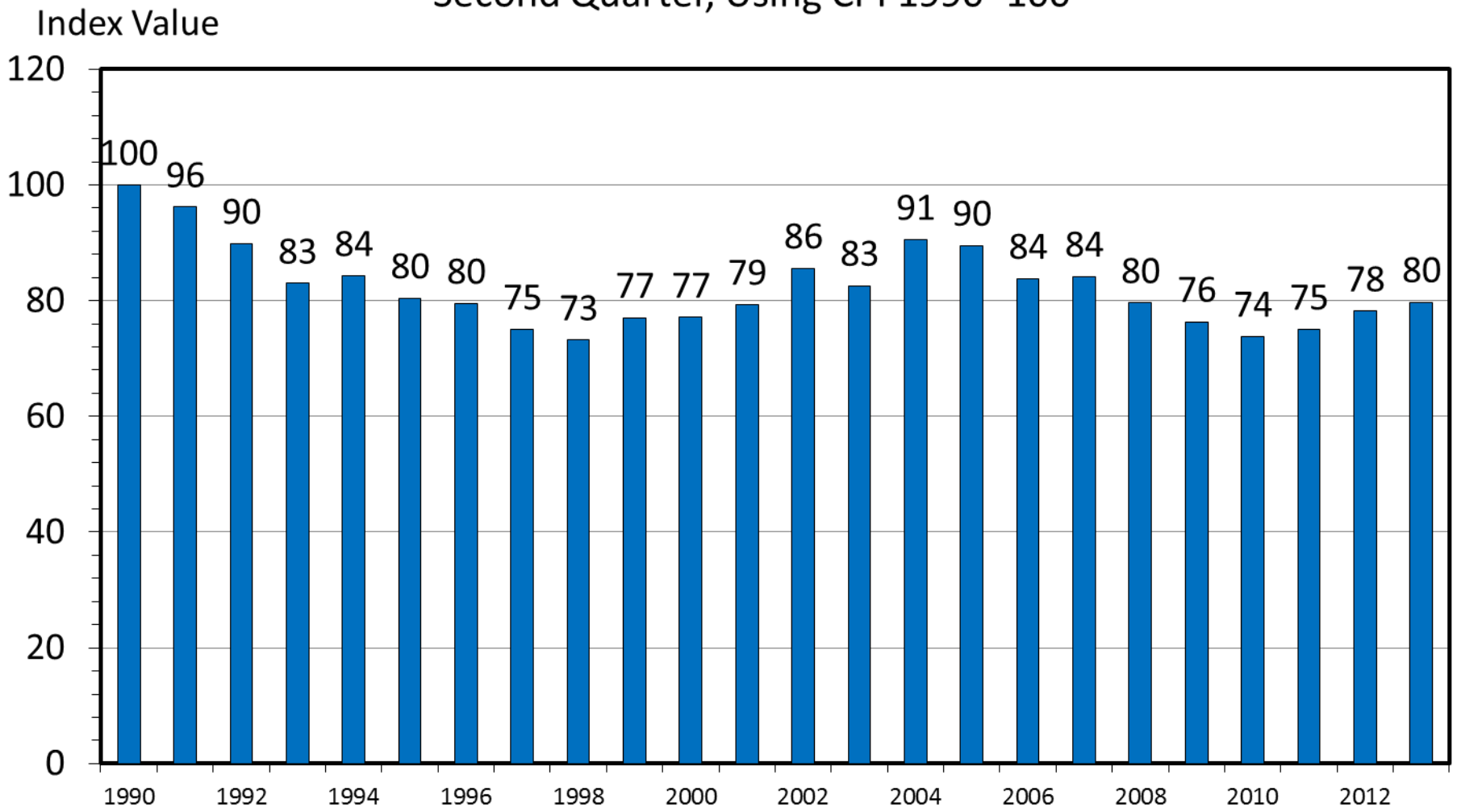


Livestock Marketing Information Center

Data Source: USDA/NASS

RETAIL ALL FRESH BEEF DEMAND INDEX

Second Quarter, Using CPI 1990=100



Data Source: USDA-NASS

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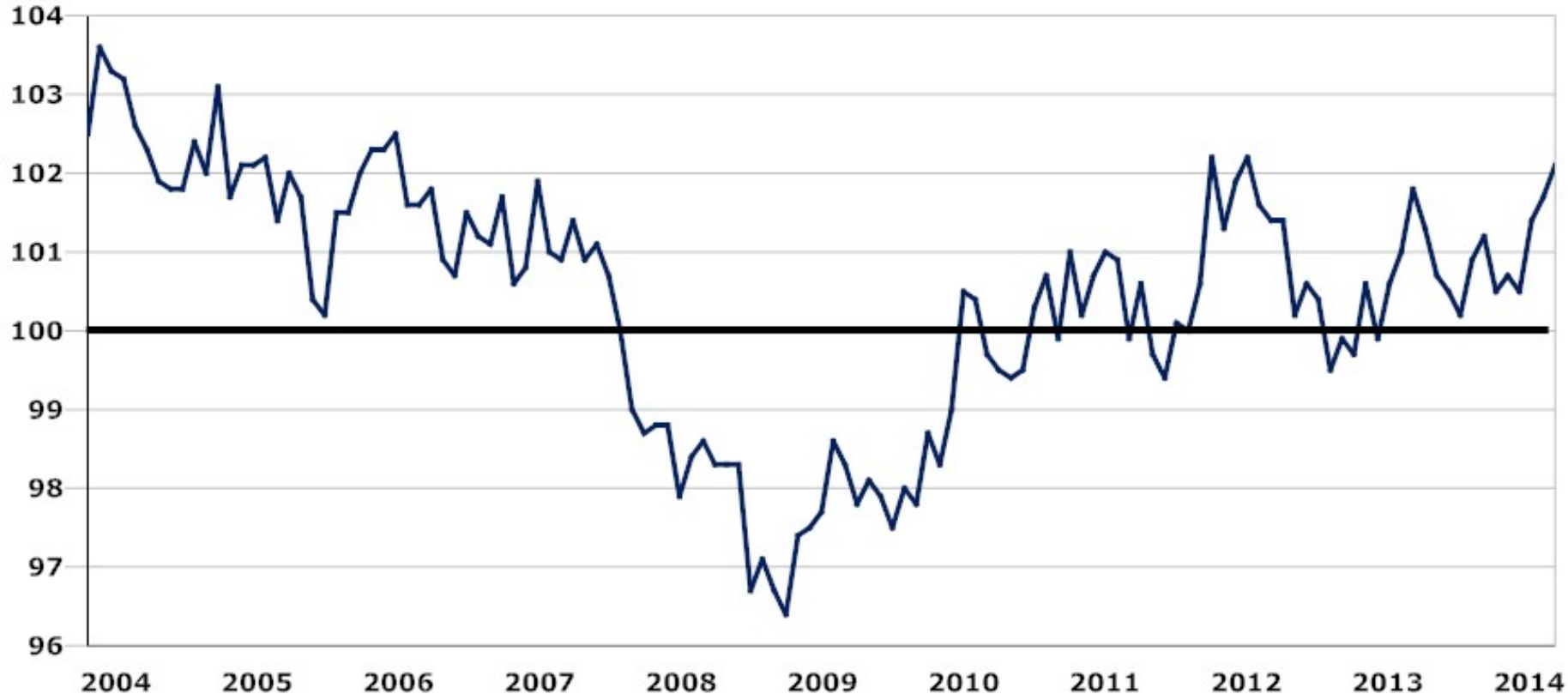
Restaurant Performance Index

Values Greater than 100 = Expansion; Values Less than 100 = Contraction

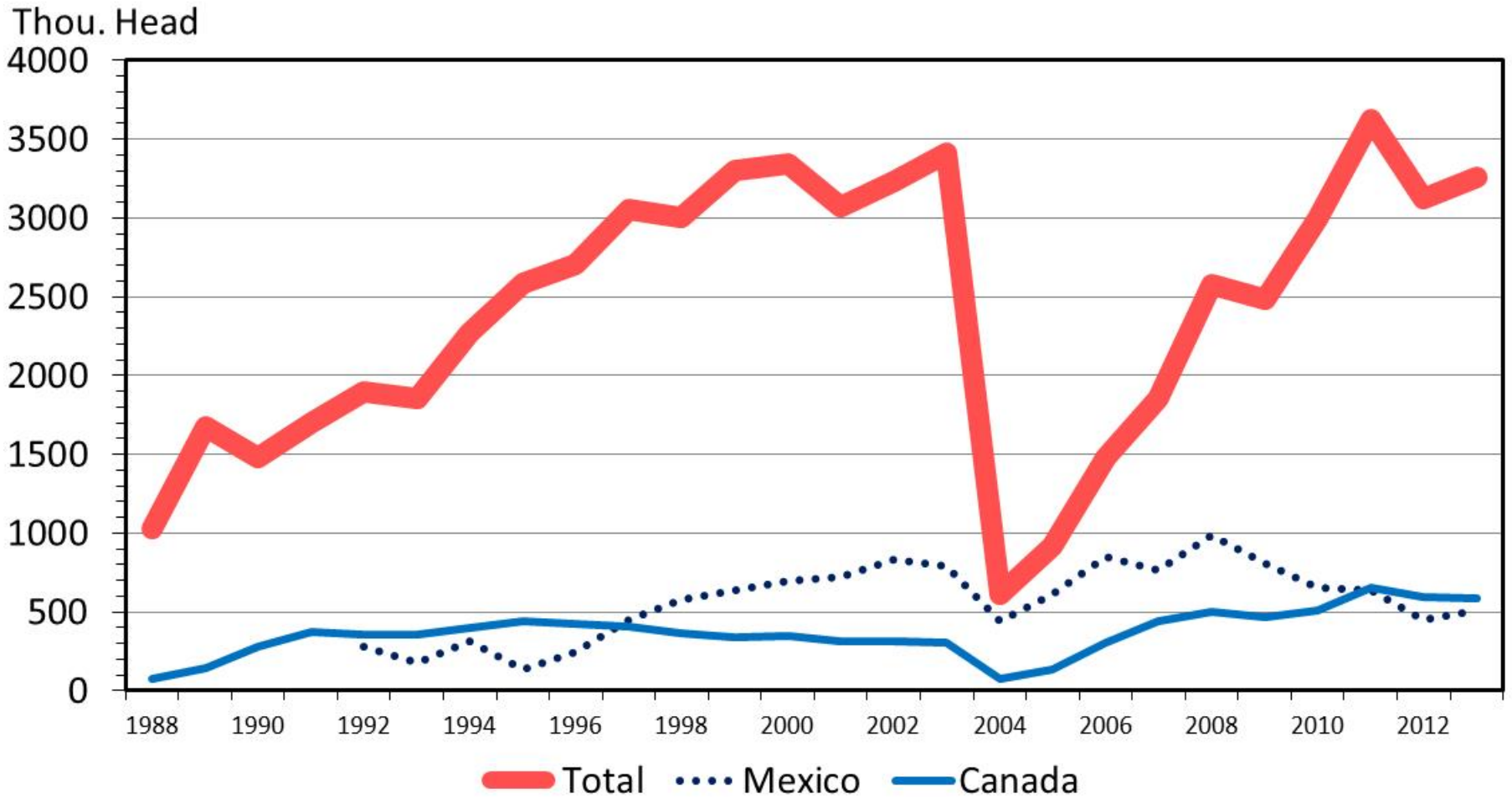


Source: National Restaurant Association

NATIONAL RESTAURANT ASSOCIATION

US BEEF AND VEAL EXPORTS

Animal Equivalents, Annual



Livestock Marketing Information Center

Data Source: USDA/NASS

The Last Three Corn Crops

- 2012 – Corn crop that kept getting smaller
  - 13 B bushels becomes 10.8 B bushels
  - Corn price jumps nearly $3 during season
- 2013 – Corn crop that kept getting bigger
  - Very inverted corn market
  - Old crop vs. new crop
- 2014 – following a large crop with another large crop – first estimate noon today
  - Market has taken nearly $1.50 off expected harvest time price

Corn Impacts on Feeder Cattle Markets

- Corn price inversely related to price slides
  - Value of pounds added
- Corn price effect smaller at high corn prices
  - Substitution affect
- Greater price impact on calves in fall
  - More corn needed to finish
- Less impact on calves in spring
  - Who is bidding on calves when?

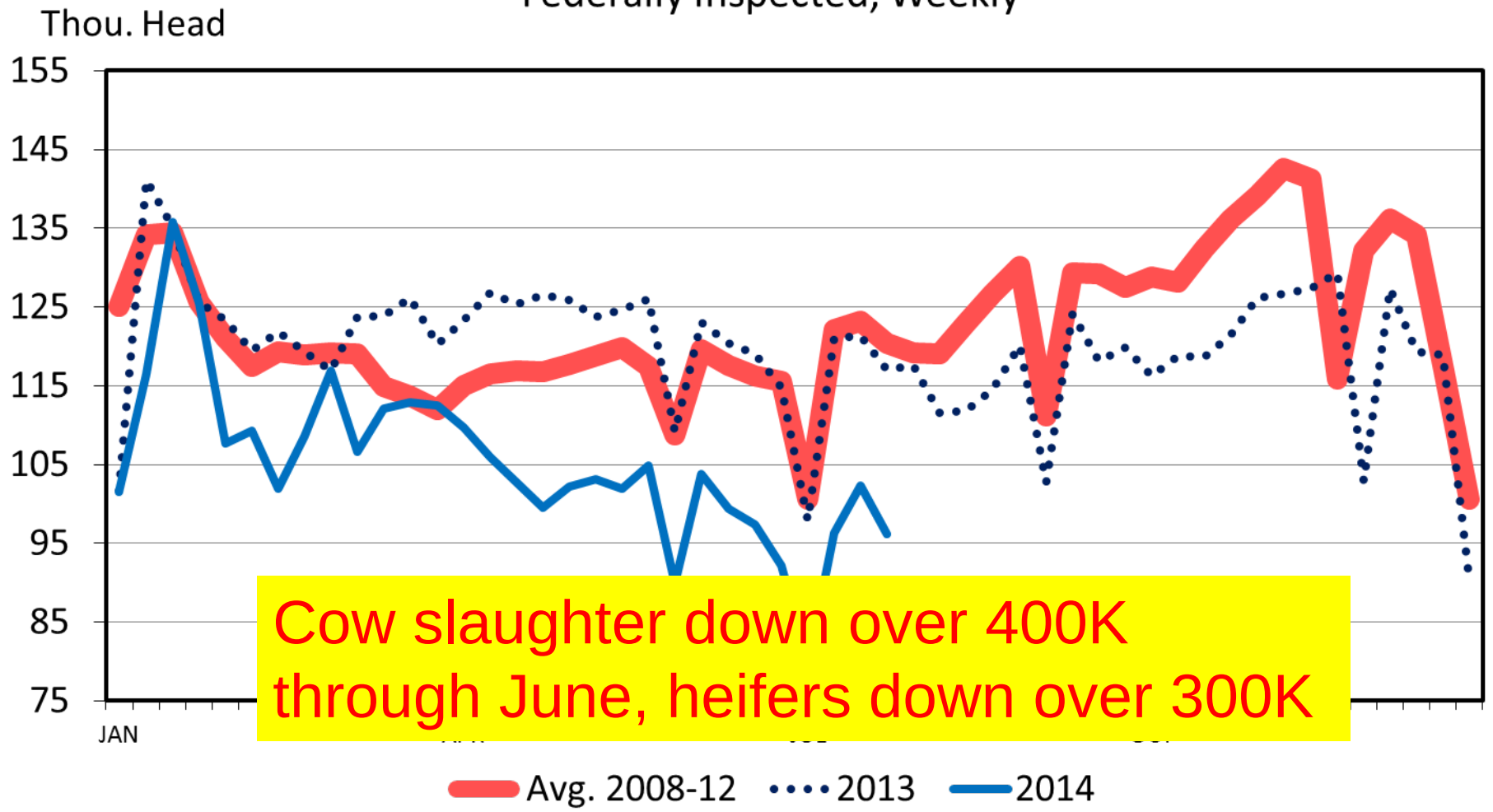
Crop Information Timeline

Some Thoughts on Expansion

- Profit can’t make it rain
  - Consider 2004-2006
  - Is there pent up expansion desire?
- Competition from other land uses
  - Reverse conversion?
  - Do we have the farmer / land base to do it?
- It’s more than heifer retention
  - Culling patterns
  - Impact on speed of expansion

TOTAL COW SLAUGHTER

Federally Inspected, Weekly



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Data Source: USDA/NASS

Some Thoughts on Expansion

- Breeding stock is a long-term Capital Investment
  - Likely 8-12 years
- Current only matters so much
  - Danger with single annual budget approach
  - Expectations get bid into female values
  - **Risk impacts desired returns**
- Volatility equals risk

Hypothetical Cash Flow per

Now	Year 1	Year 2	Year 3	Year 4	Year 5
($2,200)	$300	$275	$220	$200	$175
	Year 6	**Year 7**	**Year 8**	**Year 9**	**Year 10**
	$150	$125	$100	$75	$900

- Now: Purchase or development costs
- Yrs. 1-9: calf sales – expenses
- Yr 10: (Calf sales – expenses) + cull value

Assumptions of the Analysis

- Total fixed and variable costs
  - $550, $650, $750, $850, $950
- Bred heifer expected to have 10 productive years
  - 85% weaning rate
- Bred heifer costs
  - $1,750, $2,000, $2,250, $2,500, $2,750
- Calf prices start roughly at today's levels
  - (1) flat prices, (2) 20% steady decrease, and (3) 40% steady decrease over the next 10 years

Return for Bred Heifers Steady Price Scenario

	Total Costs per Cow				
Bred Heifer Cost	$550	$650	$750	$850	$950
$1,750	25%	19%	12%	6%	-
$2,000	21%	15%	10%	3%	-
$2,250	18%	13%	7%	2%	-
$2,500	15%	11%	6%	-	-
$2,750	13%	9%	4%	-	-

Assumptions: 10 year useful life; 85% combined calving/weaning rate; 550 lb steer/heifer and $2.15/lb combined price, $1000 cull value.

Return for Bred Heifers Moderate Price Drop Scenario

	Total Costs per Cow				
Bred Heifer Cost	$550	$650	$750	$850	$950
$1,750	19%	12%	4%	-	-
$2,000	15%	9%	2%	-	-
$2,250	13%	7%	-	-	-
$2,500	10%	5%	-	-	-
$2,750	8%	3%	-	-	-

Assumptions: 10 year useful life; 85% combined calving/weaning rate; 550 lb steer/heifer, start at $2.15/lb combined price and decline to $1.72 by year 10. $800 cull value.

Return for Bred Heifers Large Price Drop Scenario

	Total Costs per Cow				
Bred Heifer Cost	$550	$650	$750	$850	$950
$1,750	12%	2%	-	-	-
$2,000	8%	-	-	-	-
$2,250	5%	-	-	-	-
$2,500	3%	-	-	-	-
$2,750	1%	-	-	-	-

Assumptions: 10 year useful life; 85% combined calving/weaning rate; 550 lb steer/heifer, start at $2.15/lb combined price and decline to $1.29 by year 10, $600 cull value.

Breeding Stock Investment

- Bred heifer prices much like land values
  - assume continued current profit levels
- What are producer expectations for price over next several years?
- For upper end of bred heifer price range…
  - Both continued high price levels and very low costs structure need
- How have the last few years impacted required returns?
- Keeping mature cows vs. purchasing heifers

Thoughts for Summer Backgrounders

- Market has forgiven many mistakes this year
- Price early – I would stay the course
- Unpriced – protect what you have made thus far
- Don’t get greedy
  - Years like this often followed by severe underpricing

Thoughts on Winter Backgrounding

- Board was on a roll through Wednesday, calf basis super strong
- Feeder futures now inverted, expect calf basis to weaken
- Spring 2015 futures suggesting 8wts in mid-$190's, 7wts upper $160's – low $170's
  - March / April board around $205
- We usually take gross margins $350-450
  - Put 5wt steers in $215 - $235 range
- Re-evaluate at weaning / placement

Sensitivity of Gross Margin
(Revenue minus calf expense)

550# calf price	850# feeder price $185	$195	$205
$215	$390	$475	$560
$225	$335	$420	$505
$235	$280	$365	$450

What do I expect for winter margins?

Winter Backgrounding Budget est.

Sales	# units	unit	price / unit	total
Feeder	851.5	lbs	$1.95	$1,660.43
Expenses				
Stocker Calf	550	lbs	$2.25	$1,237.50
Hay	1407	lbs	$0.04	$56.28
Hulls / Gluten	1,407	lbs	$0.10	$140.70
Feed 2	0	lbs	$0.04	$0.00
Mineral	0.25	lbs / day	$0.40	$13.40
Vet / Med	1	head	$25.00	$25.00
Commision	1	head	$15.00	$15.00
Hauling	1	head	$12.00	$12.00
Other	1	head	$5.00	$5.00
Interest	6%	rate		$32.44
Death loss	2%			$25.26
Total Expenses				$1,562.58
Return to Land, Capital and Management				$98

A few things to remember…

- A $1 movement in futures is worth about $1.50 on calves
- Think through cost differences – owned calves vs. purchased
- Sometimes you make your money on the buy…
  - Budgets based on 550# @ $2.25
  - Each nickel is worth $27.50
- Manage downside sale price risk
  - 10% increase in feed costs – ($20) WINTER
  - 10% decrease in sale price – (**$166.00)**

My Predictions

- I expect cow numbers to grow slightly during 2014
  - Delay is less relevant this time - culling
  - Likely expand quicker in early stages
  - Slower growth after cow-herd stabalizes
- Prices more sensitive with tight supplies
  - Fed cattle prices peak in 2015
  - Prices decrease fall-over-fall in 2015 for calves and feeders

Contact Information

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