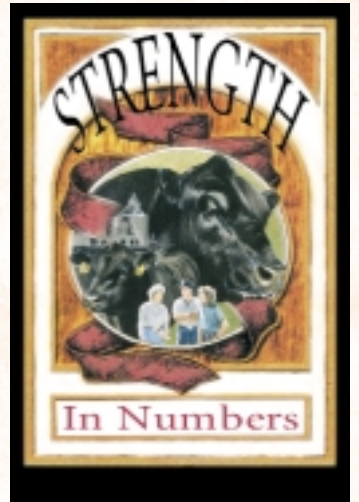


2nd
in a series



PHOTOS COURTESY OF USPB



STEPPING UP TO THE PLATE

*U.S. Premium Beef, a producer-owned beef marketing cooperative,
is responding to consumer desires by supplying high-quality value-added products.*

BY LORI GILMORE

Tired of the timeless battles and limited information shared between sectors. Confused by economic signals, or the lack thereof, sent by a cash pricing system based on averages. Frustrated with the headlines describing declining beef demand due to inconsistency. Concerned beef producers, representing all industry segments, came together to address these issues and to create a unique marketing company called U.S. Premium Beef Ltd. (USPB).

This producer-owned beef business is the first to vertically integrate, on a large scale, every segment from seedstock producer to consumer's table. After more than one year in operation, USPB is proving it can step up

to the plate — the consumer's plate.

"We could see that our industry needed to change in order to survive," says Steve Hunt, one of four Kansas cattlemen who started the USPB movement and the company's chief executive officer. "We had focused so much energy on competing with each other, we had taken our eye off of the ball."

USPB founders believed working together and sharing information in a coordinated system could help them compete against the true opposition, pork and poultry. In late 1995, with a value-based system that offers incentives for producing quality beef, this small, determined group set out to convince fellow industry players to vertically integrate.

Teaming with Hunt, a fourth-generation cattleman from Arkansas City with work experience in commercial banking and finance, were Terry Nelson, a commercial cow-calf producer, backgrounder and cattle feeder from Long Island; Doug Laue, a custom backgrounder and cattle feeder from Council Grove; and Terry Ryan, a commercial cattle feeder from Scott City. Their game plan included removing age-old information barriers and improving coordination throughout every sector.

"We believe producers can improve their quality with the right information and incentives," Hunt says.

The core group first recruited colleagues to serve on a steering committee for the non-breed-specific beef program. At that point Mark Gardiner, an Angus seedstock producer from Ashland, Kan., signed on. Today Gardiner Angus Ranch is a member-

Above: Participants were required to buy a minimum of 100 shares of U.S. Premium Beef at \$55/share. Each share acquired provided a right and obligation to deliver one finished animal per year to Farmland National Beef.

stockholder of USPB, and Mark Gardiner serves as the seedstock representative on the board.

"This is one of the biggest things that has come along in the beef industry," says Gardiner. "We always want to fight and blame everybody else for our problems. USPB is the first thing that I've seen in my lifetime that is about taking control and providing solutions."

■ Taking ownership

An integral part of the USPB plan was member commitment to ownership. The group studied several business structures and finally decided to form a closed, vertically-integrated beef cooperative. Established on July 1, 1996, the producer-owned business based in Kansas City, Mo., is set up much like other agricultural cooperatives, including SunKist Oranges and Blue Diamond Almonds. A seven-member board of directors representing all industry segments was put into place.

The newly formed company next held a stock offering, and producers from 26 states purchased shares. Interested beef producers were required to buy a minimum of 100 shares at \$55 per share. Each share acquired provided a right and obligation to deliver one finished animal per year to Farmland National Beef's processing plants. Players represented a wide geographical area, drawing interest from backgrounders, commercial cow-calf producers, stocker operators, custom cattle feeders, farmer-feeders and purebred producers. This variety assured project organizers they could secure a steady beef supply throughout the year.

On the roster is A.M. Ward, a West Virginia commercial producer with 160 cows bred to proven Angus and Hereford sires. Ward made a substantial financial commitment in buying 120 shares.

"I try to purchase bulls through the West Virginia bull test station," says the owner of A.M. Ward Stock Farm, located near Clarksburg, in the north-central grassland area of the state. "By using performance testing and having a good health program, I felt I was producing a higher-quality product and was receiving the same price as the producer that never tagged a calf, gave a shot or used superior genetics. I was looking for the best price paid for the quality I was producing."

Jack Shelton, a commercial Angus producer from Amarillo, Texas, joined USPB "to take advantage of a better outlet

for our cattle." His family has been managing a cow-calf and stocker operation on the same Texas ranch for the past 75 years. "We thought with the kind of cattle we are raising, we are better off with U.S. Premium Beef as opposed to just selling on a cash market," says Shelton, owner of Bravo Cattle Co.

To complete the vertically integrated chain, USPB needed to become involved in processing. "We knew if we could team up with a company with marketing and processing expertise, we could match our production capabilities and it would be a home run," Hunt says.

The group analyzed a number of options, including building a new facility and custom-slaughtering cattle. In the end they voted to partner with an existing, successful company. After meeting with several interested packers, the USPB board decided to buy a minority interest in Farmland Industries' Farmland National Beef Co. (FNB). That deal, which grants USPB the option to buy up to 50% ownership in FNB, immediately placed the producer-owned company as the fourth-largest processor in the country.

According to Hunt, by partnering with Farmland Industries in the ownership of FNB, USPB producers gained market access to the consumer through Farmland's name

recognition and already successful labels. As a result, highly desirable products could be sold through branded beef labels, including the *Certified Angus Beef*[™] brand, Farmland Black Angus Beef, Farmland Certified Premium Beef and the recently acquired Kansas City Steak Co., a high-quality portion-control business.

■ An industry-leading grid

In order to fulfill USPB's mission of getting more money in the producer's pocket, improving the quality of the product and ultimately selling meals, the company had to set up a value-based pricing system. Today, after several revisions, the USPB grid is leading the industry with incentives for high-quality beef.

While the program is not breed-specific, Hunt admits that premiums are slanted toward quality Angus cattle. "The Angus breed has the genetic predisposition to achieve the type of meat qualities that sell well through our company," he says. Members receive larger premiums for USDA Prime and *Certified Angus Beef* carcasses since the company realizes greater margins through the sale of these products.

"If there weren't branded products, there wouldn't be many premiums," says Kelly Giles, a board member representing the commercial sector. "You have to have



To complete the vertically integrated chain, USPB needed to become involved in processing, says Steve Hunt, CEO. "We knew if we could team up with a company with marketing and processing expertise, we could match our production capabilities and it would be a home run."

LORI GILMORE PHOTO



Information is a key component of USPB. Individual carcass data is provided at no cost to members. Premium data, including individual identification tag transfer, ribeye area external fat measurements and marbling scores, are available free of charge upon request.

branded products before you can pass anything back to the producer.”

Giles, a producer involved in the commercial cow-calf, stocker and feeder sectors, has been heavily involved in USPB since 1996. Today Giles Ranch Co., based in Ashland, Kan., delivers its own commercial Angus steers, buys feeder cattle and leases shares.

“We never truly got the full value out of our cattle until we delivered them in the U.S. Premium Beef system,” Giles says. “USPB has the most financially rewarding grid for high-quality cattle in the industry. If you are selling the high-quality cattle, especially Angus cattle, anywhere else than through U.S. Premium Beef, you are leaving money on the table.”

The USPB system pays a premium of \$9/hundredweight (cwt.) for all USDA Prime carcasses. Every *Certified Angus Beef* carcass is rewarded with a \$4.50/cwt. premium. At the same time, the USPB marketing system discourages outliers through discounts. Carcasses that weigh less than 550 pounds (lb.) or more than 975 lb. are penalized \$15/cwt.

One recent change to the payment plan

increased the discount weight from 950 lb. to 975 lb. At first glance, this decision looks contradictory to other market signals. In making the revision, USPB leaders determined that bringing in a larger supply of quality product would offset the risk of



plant damage caused by extra weight.

“In analyzing the cattle that have topped the 950-pound threshold, we found a significant number of high-grading cattle,” Hunt says. “Those cattle provide high-quality meat products that earn the highest margins for Farmland National Beef.”

■ **Armed with information**

On Dec. 1, 1997, USPB started processing cattle. Its more than 650 members from 26 states delivered approximately 8,100 finished cattle each week through the end of 1998 to packing

plants in Dodge City and Liberal, Kan.

Since information is a key component to the success of this program, individual carcass data is provided at no cost to members. Premium data, including individual identification tag transfer, ribeye area, external fat measurements and marbling scores, are available free of charge upon request.

During the first 13 months of operation, more than 450,000 cattle were marketed through the USPB system. During the same time, the company paid approximately \$4 million in premiums, an average of \$8.88/head over the cash market.

The top 25% of the cattle brought premiums of \$28.71/head during the first 13 months of operation. The top half earned an extra \$21.56, while the top three-quarters of the animals averaged \$16.12 premium to cash.

Hunt says member stockholders received an additional return on investment based on company earnings, capturing nearly \$12/head for every animal delivered.

Even with this documented success, USPB leaders admit change has not come easily or smoothly. Many factors, some

Angus producers take advantage of customer-service opportunity

While all industry sectors are represented in the U.S. Premium Beef (USPB) initiative, seedstock suppliers know building better beef begins at the ranch.

When USPB formed, some Angus seedstock producers joined solely to pass shares to their bull buyers as a customer service. Whether leasing shares or offering delivery rights at no cost, seedstock suppliers are helping their valued commercial customers take the first step in obtaining carcass data on every animal. In some cases they are making it possible for smaller producers to participate in the USPB marketing system.

"Our customers paid for genetics in the past, and now they can start realizing premiums for better cattle through U.S. Premium Beef," says Mike Molitor of Molitor Angus Farm. Based in Zenda, Kan., this seedstock program is working to become a preferred genetic source for high-quality meat.

Molitor's marketing strategy includes the purchase of several hundred USPB shares. He offers several options to commercial customers: leasing shares, finding buyers for high-quality calves or partnering with cow-calf producers through to processing. If customers don't want the added risk of retained ownership, Molitor will arrange for buyers to bid on calves. If the finished cattle later go through the USPB marketing system, he sees that the cow-calf producer receives valuable carcass data.

"The more information that we can get back, the quicker we can make changes, if necessary," he says.

In addition to receiving carcass data, he believes producers will be paid more for source-identified, quality calves. As a result, commercial customers will be more interested in buying better bulls.

"I believe U.S. Premium Beef is going to identify herds that have the genetics to produce a higher-value product, like *Certified Angus Beef*[™] [product]," Molitor says. Molitor Angus Farm will conduct its 20th annual production sale this spring, offering 100 bulls and an equal number of females.

Right now Molitor leases USPB shares. In the future he may only offer delivery rights to Molitor Angus Farm's bull-buying customers.

No doubt, customer profitability is critical to the long-term success of seedstock businesses. For this reason, Gardiner Angus Ranch (GAR), Ashland, Kan., is also making USPB shares available at no cost to their customers. The Gardiners are providing delivery rights, allowing finished cattle to be processed through the USPB system at Farmland National Beef's packing plants. They made a substantial investment, buying approximately 4,000 shares.

"U.S. Premium Beef is quite easily the best system out there for Angus cattle," says Mark Gardiner. "We have a firm belief that if you are using good genetics, most years you are better off retaining ownership."

Currently, USPB pays the most, a \$4.50/hundredweight (cwt.) premium, for carcasses meeting *Certified Angus Beef* specifications. With larger premiums, Gardiner believes the value-based marketing system will pull better beef through to the consumer.

All USPB participants receive individual carcass data. This allows producers to see results firsthand and make genetic improvements based on facts.

The Gardiner family understands the true value of obtaining individual carcass data. As part of their ongoing commitment to evaluate GAR sires, they have gathered data on every steer raised on the Kansas ranch since 1970. Now they want their customers, particularly those with no experience retaining ownership, to get started and to learn.

"The bottom line: U.S. Premium Beef is a system that rewards good genetics," Gardiner says. "And we think USPB will pay our customers more money for using our genetics."

uncontrollable, have made for a bumpy maiden voyage toward value-based marketing. Challenges included the worst price market period in recent history, harsh winter feedlot conditions, an unusually narrow Choice-Select spread last February-June and inexperience marketing on a value-based grid.

Since sending proper economic signals throughout the year is critical, the USPB board recently implemented a change to provide a natural hedge for producers if the Choice-Select spread narrows again. Instead of competing against plant averages before receiving the Choice premium, USPB members now face a 52% Choice threshold year-round before earning the premium.

■ Lessons learned

In addition to sending carcass data to members within a week after slaughter, the company will assist in analyzing results. A

field representative works with members to identify problem areas. In the future, regional meetings will be held and producer-education manuals will be distributed.

"With information on more than 500,000 head of cattle, we now have a database that is second to none," Hunt says. "We are in a position to really help our members find out what is working and what is not."

One early discovery: Pens of cattle that have not suffered from heavy- or lightweight carcasses or from Yield Grade (YG) 4s have consistently received premiums over the cash market.

Armed with carcass data, producers are now looking at immediate improvements through management practices ranging from sorting to days on feed to health programs. Understandably, genetic change will take time.

Ward has been pleased with the premiums he has received, as well as the lessons learned. "The U.S. Premium Beef program has given me a good education," says the commercial cattleman, who had prior experience retaining ownership in Ohio, Illinois and Iowa feedlots. Now, as a USPB member, he is sending his high-quality calves nearly 1,300 miles to a Kansas feedyard.

Prior to receiving carcass data, Ward believed he was raising and feeding out quality cattle. Now he is receiving documentation to prove it. For example, one load of steers that he marketed graded 88% Choice or higher, with 31.5% meeting *Certified Angus Beef* specifications. While the final numbers showed Ward what's working, they also revealed areas that needed improvement.

By looking at the percentage of YG 3s and 4s and heavyweight numbers, Ward



While the program is not breed-specific, premiums are slanted toward quality Angus cattle, says USPB CEO Steve Hunt. "The Angus breed has the genetic predisposition to achieve the type of meat qualities that sell well through our company."

discovered he was keeping his calves too long before shipping them to the feedyard. In the future he'll send calves to the feedlot earlier at more-uniform, lighter weights. Another option is to make genetic changes based on the Angus sires he buys.

Shelton agrees that his participation in the USPB program has been a learning process. "I don't care how long you have been in the business, you are getting an education," he says.

"In our particular situation, we had always sold cattle for a certain cash price, and they would be gone," Shelton says. "With the cattle on the USPB grid, you see precisely how the cattle did. It just opens up a whole new field of information. You learn where you are deficient and what needs improvement. The numbers leap out at you."

In his program Shelton is working to raise more cattle that meet *Certified Angus Beef* specifications. "The premiums have given me an extra incentive," he says. "I have

fed, handled and raised almost all of the popular breeds of cattle. I just think from watching the different breeds that the Angus cattle probably can do a better job today."

■ Value-added markets

A promising growth area with larger returns is the export market. In the last year, FNB opened offices in Tokyo, Japan, and Seoul, Korea, focusing on direct meat sales. Since last summer, sales in Japan have jumped 50%.

"We have had tremendous success in Japan with the U.S. Premium Beef concept," Hunt says. "The Japanese like dealing face-to-face. They like being able to trace back cattle to producers who are accountable for the meat."

In the future USPB and FNB will be designing and creating new beef products. In addition, members will be improving genetics and management practices.

"As producers we do own the processing; we do own the labels," Hunt says. "It's so

exciting to see all of these people in different segments of the industry focused on meat quality. Today we are selling meals."

This rookie beef company has stepped up to the plate, kept an eye on the consumer pitching the ball and has consistently scored with a high-quality product to cross the consumer's plate.

For more information on becoming involved in the U.S. Premium Beef Program, producers can contact Tracy Thomas, USPB Director of Marketing, USPB Headquarters, 10100 N. Executive Hills Blvd., Suite 105, Kansas City, MO 64513; (816) 891-2304; fax: (816) 891-2310. Thomas can tell interested individuals the details on purchasing shares or leasing from other producer members.

