

Dollars & Sense

by Vern Pierce, beef economist, University of Missouri-Columbia



Evaluating risks, rewards of retained ownership

Evaluating the potential for retained ownership must go beyond simply calculating a budget and looking at the services of the backgrounder and feedlot. An important factor in making decisions about management changes is to assess risk.

Prior to committing your cattle, consider your profit

potential and your loss potential. It's good to consider several possible outcomes (pessimistic, likely and optimistic prices). In this column I will develop an example of a retained-ownership situation and go through the issues to consider with risk assessment.

Before looking at risk, however, you must set a budget. First,

consider what the market is offering this fall, then estimate a spring price.

The best estimate for what your price might be in the spring months can be found in the futures market for feeder cattle. Assume it is Sept. 1 and the November feeder-cattle futures price on 700- to 799-pound (lb.) steers is \$77.10/hundredweight (cwt.). But local auctions are selling 400- to 500-lb. calves at \$82-\$85/cwt. Assume that in your region the basis for 400- to 500-lb. calves in November historically has been \$8-\$10/cwt. over the November feeder-cattle futures price.

In this case, the futures market is saying, based on historic price relationships in your area, the local price for 400- to 500-lb. calves should increase to between \$85 and \$87/cwt. as we approach November. This would mean a 500-lb., medium No. 1 feeder calf would be worth about \$425-\$435 in November.

Now assume you have estimated total breakeven costs for raising a 500-lb. steer at \$400 for your operation. You might sell the calves at weaning and net \$25-\$35.

Now, the risky part.

This is the place you need to most individualize your decision. In looking at risk assessment, I have shown a sample budget for backgrounding calves. The example shows the expected net income over variable cost is \$57.06.

Of course, this is an estimate of costs; it would be better to understand the range of returns one might expect. Given the best forecasts for input and output prices, what are the possibilities? Is the \$57.06 gain fairly certain?

What is the chance I will lose money?

The graph illustrates that, for this example and given my market forecasts for prices and seasonality, there is a chance for a loss. In fact, using the the graph I developed by estimating a range of prices, you can see there is nearly a 16% chance that the income will not even cover the variable cost of production.

This is vital information. Can you afford that chance?

The graph also shows nearly a 23% chance of making more than \$100/head above variable cost. This could be used to pay fixed cost and be available for ownership return. An assessment of risk can help you make better choices as you move into the new cattle business.

Remember to include fixed costs in your final analysis, too.

Retained ownership can be a viable marketing alternative for cow-calf producers. The decision requires you to estimate cost of gain and to project market prices. It also requires you to evaluate how the decision influences your total farming operation, your family lifestyle and your relationship with your banker.

Accepting some additional risk should come with the potential for greater profits. If you determine that, in all likelihood, accepting the additional risk can at best bring you a return similar to that which you would have received without the risk, then you will be better off avoiding the risk.

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Table 1: Steer-calf budget, on a per-head basis, wintered for sale to feedlot in spring

1. Gross receipts/head (860 lb. x \$77/cwt.)	\$662.20
2. Purchase cost/head (500 lb. x \$90/cwt.)	\$450.00
Purchased feed	
3. Corn (8.1 lb./day x 180 days = 25.9 bu. x \$2/bu.)	\$51.80
4. Soybean meal (1.25 lb./day x 180 days = 225 lb. x \$145/ton)	\$16.31
5. Salt and additives (0.25 lb. salt/day x 180 days = 45 lb. x \$450/ton)	\$10.13
6. Total feed cost	\$78.24
7. Machinery costs, feed preparation, etc.	\$4.46
8. Production veterinary products (deworm, vaccinations, implants)	\$6.90
9. Disease treatment (treatment rate of 15% x \$20/treatment)	\$3.00
10. Other livestock materials and service (commissions, yardage, hauling)	\$18.04
11. Utilities, insurance, repairs and misc.	\$3.09
12. Operating interest (line 2 + lines 6-11 financed for six months at 10%)	\$28.19
13. Death loss (2% of line 1)	\$13.24
14. Total non-feed variable costs (line 2 + lines 7 through 13)	\$526.91
15. Total variable costs (line 2 + lines 6 through 13)	\$605.14
16. Income over listed variable costs (line 1 - line 14)	\$57.06

Income over listed variable costs does not include a charge for labor or pasture (except for harvested hay). Other cash costs, such as real estate and property taxes, building insurance and repairs, and other overhead expenses, should be estimated for each individual farm situation.

Source: Vern Pierce, beef economist, Commercial Agriculture Program

