Conditions Ripe for Retained Ownership

Analyze signals in the decision-making process.

by ***Barb Baylor Anderson***

If you generally look for calf buyers in the fall, you may want to rethink your strategy this year. Market analysts say retained ownership may be a profitable option.

"Cow-calf producers should consider retained ownership, unless they are in an area where pasture is a concern," says Roger Norem, analyst with AgriVisor Inc., Bloomington, Ill. "The opportunities will be better this fall than they have been in the last few years."

Better because the industry remains in a liquidation phase. Persistent drought in several areas of the country has crimped forage supplies and forced cow-calf producers to continue to sell cows rather than to retain heifers.

"The present high cow slaughter and continued drought in many areas will almost certainly extend even the beginning stages of expansion beyond 2003," stated the U.S. Department of Agriculture (USDA) *Livestock Outlook* this spring, noting that 2002 marked the seventh year of herd liquidation in the current cycle.

Traditionally, the up cycle provides cow-calf producers with greater profits from retained ownership than do other phases of the cattle price cycle. Once a downward trend begins, which is generally marked by a decline in cow slaughter, an increasing number of cows and greater heifer retention, profitability starts to decline.

"The January inventory report indicated that producers were holding some heifers, but significant beef cow slaughter has offset that," Norem says. "We are another year away from expansion, depending on the weather. There won't be any buildup in fed-cattle supplies for two or three years, and that will help support calf prices."

In fact, the USDA expects cattle inventories to continue to decline in 2003. If forage conditions improve this summer, inventories may begin to stabilize in 2004. But the USDA says inventories are not likely to begin to rise before 2005, with production beginning to rise in 2006.

Review potential impacts

With that in mind, analysts recommend that producers thinking about retaining ownership may want to consider their options and review such factors as cost, including labor and land, and potential tax implications. Advisors agree that every operation is different, so each scenario will be unique.

Producers may wish to begin by contacting Extension specialists who can shed light on determining breakeven costs, which will need to include such items as weaned calf prices, weaning weight, feed costs, other inputs and more. Producers must also evaluate how retained ownership will affect cash flow, the need for and ability to pay off loans, and changing the timing of grain and calf sales.

"You have to consider first-year cash flow and income tax implications," stresses John Lawrence, Extension economist, Iowa State University (ISU). Beyond that, Lawrence adds, "retained ownership can help cow-calf producers more fully capture investment in genetics, increase diversification and improve marketing flexibility. One of the greatest and commonly overlooked opportunities is the direct feedback to the genetic decision maker to improve the animal and product quickly. Cow owners can discuss performance with the feeder and adjust breeding programs."

Lawrence says that decision-making signals become clearer when there is a direct economic link between cost of production, price received and the person in charge of the genetics. He expects producers to become even more proficient with the growing use of grid marketing.

Timing is important

For this fall, Norem encourages cow-calf producers who choose retained ownership to watch the market for chances to lay off price risk vs. marketing calves to feeders.

"Timing on the feeder market is important. This fall we will see good demand for feeder cattle and a good price run in mid- to late fall," he says. "I do not expect much of a winter setback, and if feeder prices strengthen again into spring, I would use that opportunity to sell."

Norem says fed-cattle prices could slip to the low $70s late this summer. "But, there will be hedging opportunities down the road with relatively little risk," he forecasts. "Seasonal weakness during the summer will likely lead to a rally in the August-September time frame. There will be a better hedging opportunity then. Producers will have to watch pasture and weather conditions and their implication for feed prices, because those may affect the strategies for the best price protection this fall."

Cattle cycle vs. beef supplies

While cow-calf producers traditionally view the cattle production cycle for clues about price direction, Mike Zuzolo, Risk Management Commodities Inc., Lafayette, Ind., says that's all changed since the mid-1990s.

"It used to be that the cattle cycle and cattle numbers in the U.S. were the major supply force for determining the quantity supplied. Now, however, due to increased efficiency and beef and live-cattle imports from both Canada and Mexico, we are working from the framework that the cattle cycle means very little compared to beef production, when looking at supplies," he explains. "Price trends have not correlated with the cattle cycle trends since the cattle cycle supply peaked in 1996."

As such, Zuzolo says the price outlook for the remainder of 2003 depends on beef production over the third and fourth quarters. He notes that the U.S. Department of Agriculture (USDA) predicts third-quarter beef production of 6.78 billion pounds (lb.) with an average fed-cattle price of $72-$78. Fourth-quarter beef production could total 6.18 billion lb., representing a fourth-quarter average price in the $74-$80 range.

"Our bias for the third quarter is that feeder-cattle futures will make a significant cycle high by August, consequently dragging live-cattle futures up with it," he says. "Our bias for feed-grain prices is friendly, and we believe dressed weights will continue to fall toward their five-year average, tightening up actual production. Lead month live-cattle futures can reach $79-$80 by August."

For the fourth quarter, Zuzolo says current weaknesses in the domestic and world economies will negatively affect red meat consumption, unless retail beef prices steadily fall. He also expects weaker exports during the fourth quarter, given prospects for softening Asian economies and continued stress on travel, tourism and restaurant trade.

"There is also a chance that USDA is underestimating fourth-quarter beef production, as 6.18 billion pounds would be 9% less than the fourth quarter of 2002. That seems like a big reduction," he says. "Fourth-quarter prices more realistically may fall between $72-$74."