Details Cloud Signals

by ***Steve Suther,*** *Certified Angus Beef LLC*

Those who read the "USDA Five-Area Weekly Weighted Average Direct Slaughter Cattle — Premiums and Discounts Report" may be surprised to hear of any increase in *Certified Angus Beef®* (CAB®) premiums (see story on page 162). Colorado, Kansas, Nebraska and the regions of Iowa-Minnesota and New Mexico-Oklahoma-Texas comprise the report, which showed the weekly average CAB grid premium rose by only 6¢ from 2010 to 2011 (see Fig. 1, 2).

The CAB premiums are probably understated, admits Live Cattle Mandatory Price Reporting (MPR) Supervisor Brittany Koop, noting "several challenges working with a rigid law and a form that is set in stone."

Some packers say they paid average CAB grid premiums above $5 through 2011, but USDA did not show that kind of CAB premium at the high end for more than a week until late November. There are more than a few reasons for discrepancies between USDA's report and reality.

Under MPR rules, all plants there that harvest at least 125,000 head per year must report on Monday morning the premiums and discounts they expect to pay most often that week.

"Some plants have multiple grids, but they are only required to report the premium they will pay the most frequently," Koop says. "So, no matter the high and low, if they expect $3 to be the CAB premium they will pay most often, that one figure is what they report to us."

In the second week of February, the range of all those best guesses was $2 to $4.50, and $2 has been the lower end of the range for more than a year. Economists often quote the USDA average, which has its own challenges.

"We go with a CAB weighted average by plant capacity, so the company with the most capacity has the most weight for its reported grid price," she explains. Overall harvest volume may not be proportional to CAB volume in those plants, but that is just another variable.

Interpretation and bias are other potential problems, as critics suggest it works to the packers' advantage if the reported premium does not look too high. "I'm sure it does," Koop says. "And that is one of the toughest forms for us to audit, because the rule specifically states it is what they expect to pay. On all of the other forms, it is what they actually pay. If you go in and audit all their grids for a week, you could learn more about it, but that's not going to happen very frequently."

Confidentiality rules add another layer. A "3/70/20 rule" provides that during any 60-day period,

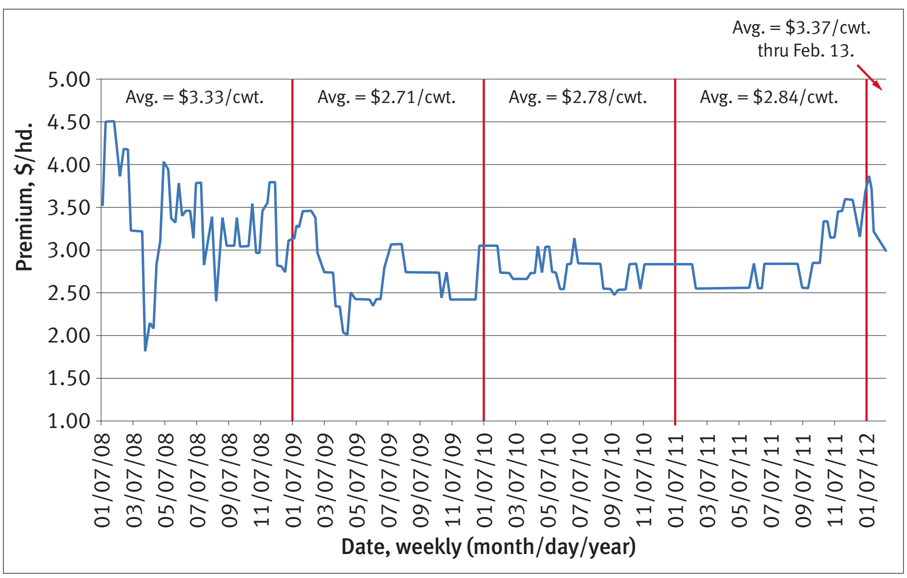
(1) at least three entities have to submit data at least 50% of the time;

(2) no one entity can account for more than 70% of the data for a report; and,

(3) the same firm cannot be the only reporting entity more than 20% of the time.

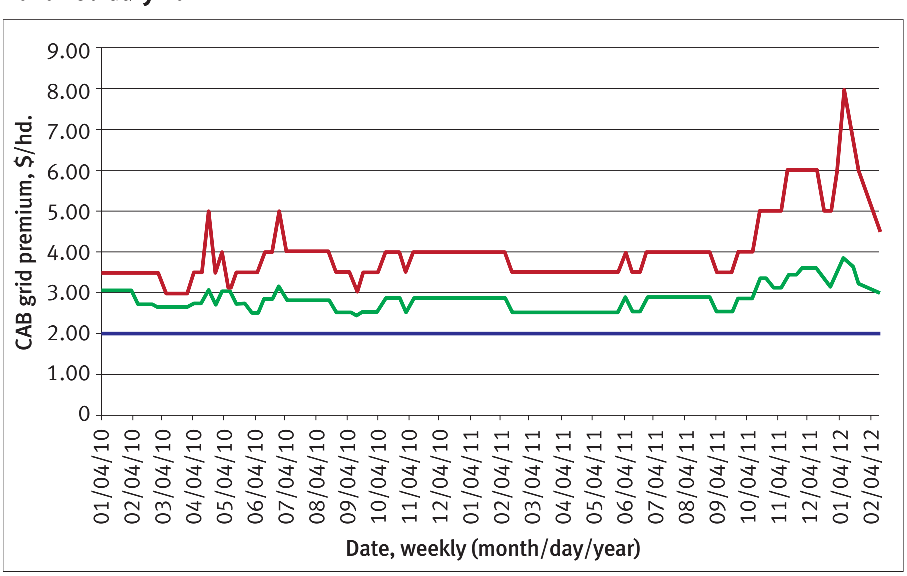
Notwithstanding the potential for that rule to skew reported figures, one of the biggest uncertainty points involves defining a grid. Economists track volumes of negotiated cash cattle sales vs. formula and negotiated grid sales over time (Fig. 3), and the record shows

Fig. 1: Weighted average grid premiums for CAB, weekly, January 2008-February 2012



Source: *USDA.*

Fig. 2: USDA reported CAB high, low and weighted average premiums, weekly 2010-February 2012



Source: *USDA.*

formula and grid pricing has accounted for more and more of the total market since 2003.

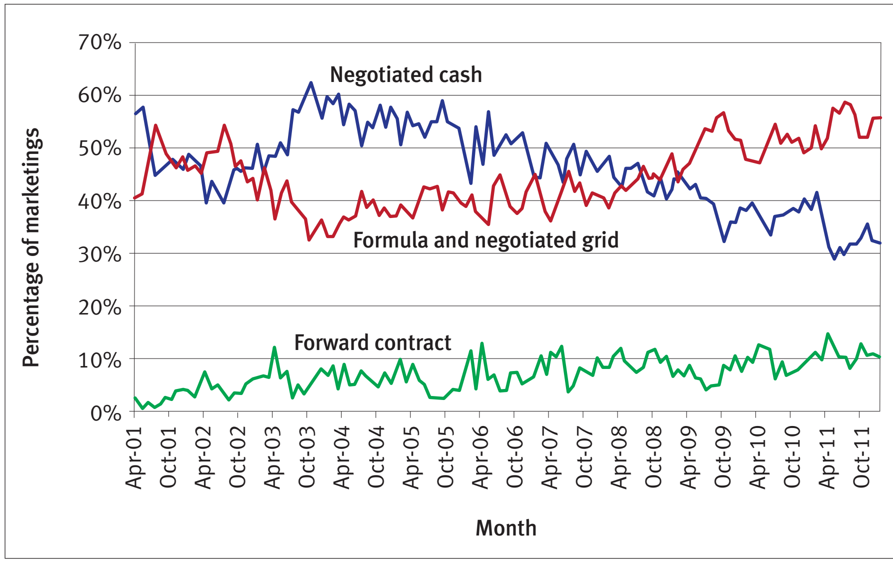
During the past four years, Kansas State University economist Ted Schroeder says formula and grid sales have increased from 11.4 million to 13.5 million head in 2011. Although those are gross numbers that include both dressed and live trade, you might expect the business of reporting grid premiums to become increasingly accurate with growing volume.

However, the MPR law uses a restricted definition. In the second week of February, when the reported range of CAB premiums was published as $2 to $4.50, there were 173,000 formula and grid cattle sold. Significantly fewer than 19,000 head, or less than one-eighth, were sold on a "negotiated grid."

Koop says, "For us, a grid and 'negotiated grid' are the same things. Formulas are based on last week's weighted average cash or some other set price."

Producers may consider it a grid sale if they are happy with last week's price and can add the most value to their cattle using the associated "grid." They may think it is a grid sale if they can lock in an offered price and its associated range of premiums and discounts, but those are not negotiated.

Fig. 3: Monthly fed cattle negotiated, formula and forward contract breakdown, April 2001-January 2012



Source: *USDA-AMS from LMIC.*

"To us, those are formula sales," she says, with no CAB premiums reported. "Definitions and interpretations do go into it."

When MPR began in 2001, what is now the CAB column was an aggregated collection of premiums for "branded" programs, but that was changed to specify only *Certified Angus Beef* premiums.

Schroeder says those have been regularly reported since 2008, and have some value over time if economists keep them in context.