Inventory Inspires Ingenuity

Declining cattle inventories require new ideas about beef production, affect Angus and CAB demand.

*Story & photos by **Kasey Miller***

This is an exciting time to be in the beef business, but unless risk management and adaptability are your strong suits, you may be sweating just a little. Everyone knows that the national cow herd is at an all-time low since 1952, but what does that actually mean? More importantly, what does it mean for Angus producers and the *Certified Angus Beef*® (CAB®) brand?

Decline in numbers

"The decline in cattle numbers is just the beginning," says Mike Sands, vice president of Informa Economics Inc. He said that there are many challenges for beef producers in the years to come, mentioning feedlots consolidating and shifting north, cattle and beef prices going higher, and tight and unsustainable margins. The earliest turnaround, he predicted, won't be for another two years.

Sands predicted national total cattle inventory numbers will decline into 2013, with about 89.7 million head, a decline of about 1.1 million head from 2012; then growth in 2014, with 90.3 million head, an increase of about 0.56 million; and then up to 91.4 million in 2015, an increase of 1.2 million head.

"Between now and then, numbers will get tight," he says.

Larry Corah, vice president of supply development for Certified Angus Beef LLC (CAB), agreed. "We really won't see true rebuilding effects until 2015. This means that there will be three or four years of lower live numbers and higher prices."

This slow expansion mode is starting to show itself, though, said Gary Fike, CAB beef cattle specialist. "I think the thing that is important to remember is that animals are bigger now; we don't need as many females. This expansion will take place, but on a percentage basis it will be fairly small. We can expect to see a larger harvest occur two to three years down the road, at least from domestic cattle."

Because of the low inventory, cow-calf producers are firmly in the driver's seat. Sands said this year will see historical expansion of cow-calf numbers. The record returns to the cow-calf business this year will be historically good, creating an incentive to expand. Expansion is shown in two places, by cutting cow slaughter and retaining heifers. He predicted that cow slaughter could be cut by about 15% this year, adding that 15% could be conservative. January reports showed that the number of heifers retained was up by 1%. Though with the tight feeder-cattle supply, he said optimal heifer retention is about 5.6-5.8 million head.

"We're going to take the tightest feeder-cattle supply we've got, and subtract out 2, 3, 400 thousand head, divert them from the slaughter channel back into the breeding herd," Sands emphasized. "The supply of feeder cattle, of stocker cattle, is going to get even tighter as we build numbers in the cow-calf business."

The caveat is that weather has to cooperate, especially in the Southern United States, though recent rains in the Southern Great Plains have alleviated many drought conditions.

Increased feed prices

Another challenge is the astronomical jump in corn prices, and corn prices won't go back down in the foreseeable future.

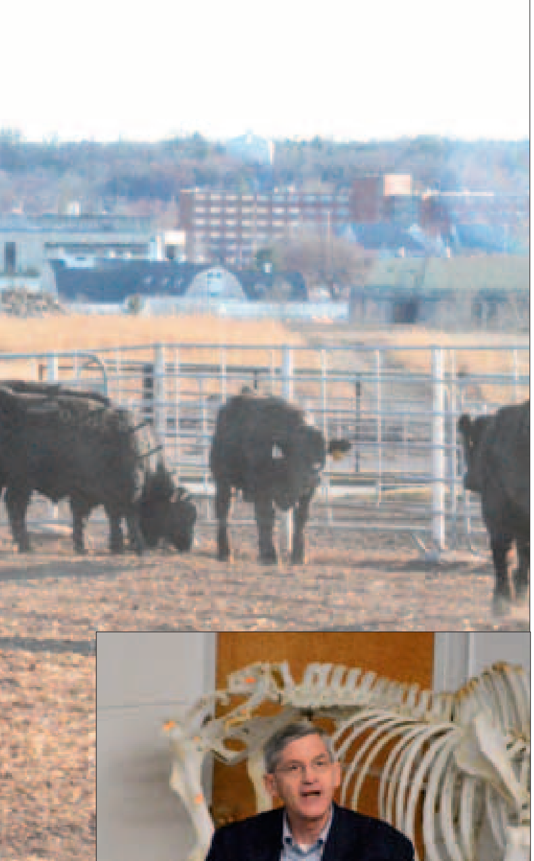
"A change in policy and an explicit decision to allocate more corn to the production of ethanol has made a profound impact on the livestock industry. The cattle industry has not come away unscathed," points out Sands.

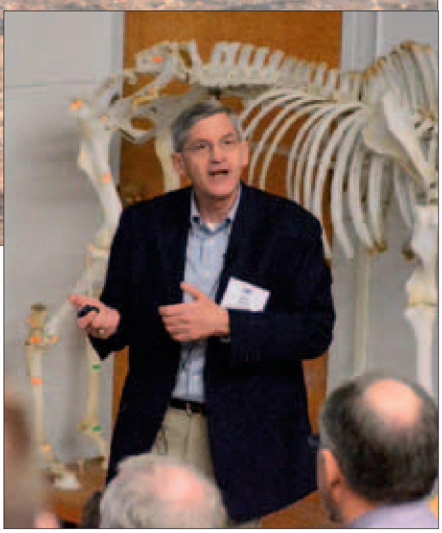
Everyone was primed for the increase in corn acreage, with the potential to plant 95 million acres, and this could have been advantageous to the beef industry. This sharp increase in supply could have driven the price of corn down to $4 per bushel, he said.

However, the deterioration of the South American soybean crop has driven U.S. soybean prices up, and the battle returned between soybean and corn acreage, and with it, the prospect of having $4 corn has all but disappeared.

A few years ago, almost 60% of the annual corn use went to feed for the livestock industry, and somewhere between 5% and 10% went to ethanol, Sands explained. Conversely, in 2011, more than 40% of the annual corn supply went to ethanol production, and less than 40% went to livestock feed.

Because of such high corn prices and short supply, the beef industry has understandably transitioned to using cheaper feedstuffs, Fike said, grazing forages like wheat, rye and triticale or feeding ethanol byproducts. Due to the availability of ethanol byproducts, Sands observed,





►Mike Sands, vice president of Informa Economics Inc., said that cattle inventory numbers won't increase until 2015. Inventory and other challenges require risk management from beef producers.

feedlots are shifting north and consolidating.

Feedlot shift

Due to the smaller inventory of feeder cattle, fewer cattle are entering the feedyards, so feedyards are more competitive for cattle or have had to make adjustments.

The competitive feed advantage is in the Corn Belt, and feedlots have shifted accordingly, in location and size, Sands said. Larger feedyards have grown in size by 3% last year, and so has the percentage of cattle coming out of the larger feedyards. The number of smaller feedyards (fewer than 1,000 head) has declined significantly, and many have switched to crop production. The real question is, will they come back to the beef industry when crop prices go back down, he asked.

"People were looking at the on-feed reports, which we had more cattle on feed, anticipating that we were going to see a larger fed-cattle slaughter. And because of the hole created by the smaller Midwest farmer-feeder, we now see a fairly substantial deviation between what we see in the steer and heifer slaughter and what we see in the fed-cattle market," Sands explained.

This came about the same time when Wal-Mart started carrying Choice and the Choice-Select spread was about $19. "Fed-cattle supplies turned out to be a lot tighter than what people had anticipated," he added.

In terms of CAB supply, Corah mentioned that the transition away from the fewer than 1,000-head feedlots is concerning, because they take to less-aggressive management strategies, which generally yield a higher CAB-acceptance rate.

Fike further explained, "Cattle are entering the feedlot older and bigger, and yearling cattle will tend to be implanted more aggressively, and there will be even more widespread use of beta-agonists, which is negative to quality."

However, Corah mentioned that the northern transition benefits CAB greatly. He said that the northern yards already had about a 30% CAB acceptance rate, and are now getting 35%-40% acceptance, already boosted by the newly higher numbers in those yards.

Domestic and international markets

Price levels are trending higher, and as volatility increases, so does the credit requirement, equity, risk management and need for a good relationship with your banker, Sands recommended. He mentioned the $25 range in feeder cattle prices, and that large of a range means that risk management is even more important.

"I think in many respects, the futures market and option are going to be a lot more important in managing risk as numbers tighten and price variability increases, along with some of that financial risk," Sands says.

Because of these higher input costs, the costs must get passed on to consumers for producers to stay in business. The question is, though, how much more are consumers willing to pay, especially when beef is already the higher priced of the meat proteins?

A way to offset this is in international markets. International markets can be a challenge, but can also be a large opportunity.

The challenge is that with the current low dollar value and difference in currency strengths, Sands explained international consumers have essentially been paying the same price level as they were in 2003. This is why exports have boomed recently — last year was a record year. He anticipates less growth in the coming years as the dollar gets stronger.

Another challenge is with U.S. supply down and empty feedlots, more heifers may be brought in from Canada and Mexico, Fike cautioned. For CAB, those imported heifers will lower the overall percentage of black-hided females.

However, domestic consumers have been paying more for quality on the home front, and with more international markets opening to the United States, opportunity is there for international consumers to also pay for quality.

Fike added that Canada and Mexico are CAB's largest customers, and not just for beef. "Hide and offal values are still supporting beef cattle prices to the tune of about $12 to $13 per hundredweight on a live basis."

Corah asserted that opportunity in international markets is absolutely huge. As international economies improve, beef prices can be higher. Many international consumers eat smaller amounts of beef, but the opportunity for market growth is there. International growth is imperative to maintaining beef prices here.

CAB strategy

Despite these many challenges, all is not lost. The beef industry is full of ingenious and resilient people, and because of this, new strategies are being developed. Despite the lower number of cattle, beef production has gone up. This means that new cuts have been discovered and new ways have been developed to use more beef products.

Corah said that CAB licensees have been creative in finding ways to handle higher prices, especially in retail and foodservice. Foodservice licensees have kept prices down by managing portion size. Restaurants always serve more than recommended servings, and switching from a 12-oz. steak to a 10-oz. steak has been an effective tool.

Restaurants have also been using many alternative cuts, he added. They have been looking at other cuts that still provide a good eating experience and are easier on consumers' wallets. For example, new cuts from the clod and chuck, like the flat iron, allow for more creativity from chefs. Another popular alternative is using premium grinds. These blends alter the flavor profile by using round, sirloin, chuck or other cuts.

For the retail side of things, Corah explained that many stores are pricing by the serving instead of by the pound. Consumers see the price per eating or grilling experience.

Challenges bring new opportunities. "I do feel that with our (CAB) brand presence and position within the industry and consumer acceptance of our product, despite a few short-term supply issues, overall we will remain stable to a very slight uptick in supplies of product, and demand will remain strong," Fike asserted. AJ