$1 Million per Week

Grid premiums for CAB set new record in 2015, reaching cumulative $550 million.

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

Rewards for hitting the *Certified Angus Beef*® (CAB®) brand target have never been greater, even after 11 consecutive years of growing supply.

A recent biennial survey of CAB-licensed packers showed they paid producers a record $51.8 million in grid premiums in 2015, or about $1 million per week. Those packing companies include Cargill, JBS-USA, National and Tyson. The consistent yearly average for CAB grid premiums they have paid is near $50 million, and those accumulated over two decades exceed $550 million (see Figs. 1 and 2).

That does not count the smaller amount paid for the cattle having graded USDA Choice, or the Prime premiums paid for the hundreds of thousands of cattle that supply the increasing demand for CAB Prime.

The annual 3.6 million cattle accepted for the brand now account for 16% of all North American fed beef. Yet USDA's Mandatory Price Reporting (MPR) data logged the highest grid premium any packer ever reported as intended to pay for CAB last November, at $10 per hundredweight (cwt.). USDA's "5-Area Weighted Average" CAB premium that week was $5.51 per cwt. and remains above $5 this year into late February.

Those premiums are clearly driven by product demand, as Fig. 3 on page 176 shows how closely premiums match the CAB advantage over the Choice cutout value.

"For a company with the mission of adding value to Angus cattle through our branded-beef program, it's satisfying to see the market working to reward producers, even as they supply us with more product to keep setting sales records," says CAB President John Stika.

Calculating premiums

Many producers think of the Choice premium as a key reward for raising better cattle, and seeing that quoted at less than $5 per cwt. makes some question their goals.

Paul Dykstra, beef cattle specialist for CAB says high-quality beef remains a logical target for anyone using Angus genetics, but they must realize the market has moved beyond significant rewards for Choice.

"If you ship a load of 100% Choice cattle to a plant with a 70% Choice average, your net grid premium for Choice will be $1.50 per hundredweight, given a $5 spread," Dykstra explains. "If the load made 80% Choice, and the market base is $200 per hundredweight, then you'd get paid on the 10% of cattle that beat plant average, and 10% of the $5 spread is 50¢. Your price, including the Choice premium, would be $200.50 per hundredweight on every carcass."

> **"The Choice-Select spread can move up or down a fair amount without creating much impact to your bottom line. You need to keep aiming for CAB and Prime."**
> ***— Paul Dykstra***

Grid premiums for CAB and Prime apply to each animal that qualifies, on top of any Choice premium, he adds.

"The Choice-Select spread can move up or down a fair amount without creating much impact to your bottom line," Dykstra says. "You need to keep aiming for CAB and Prime."

The boxed-beef cutout in early 2016 had CAB $15-per-cwt. higher than Choice for several weeks, while Choice languished at $5 per cwt. Both the CAB-Choice and the Choice-Select spreads have narrowed since 2012 (Fig. 4 on page 176 shows yearly averages, not recent activity), but the latter rarely exceeds the former.

Accumulated premiums paid for CAB over time were barely measurable for the first 19 years of the brand's presence in the market, though first noted in the 1980s. The second half of what is now a 38-year run shows increasing momentum in rewarding producers.

In fact, more than half of all grid premiums ever received for CAB acceptance have been paid in the last seven years. More than 41% of cumulative CAB premiums have come in the past five years.

Since the first few head in 1978 and 1979,

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Fig. 1: CAB brand premiums paid by year

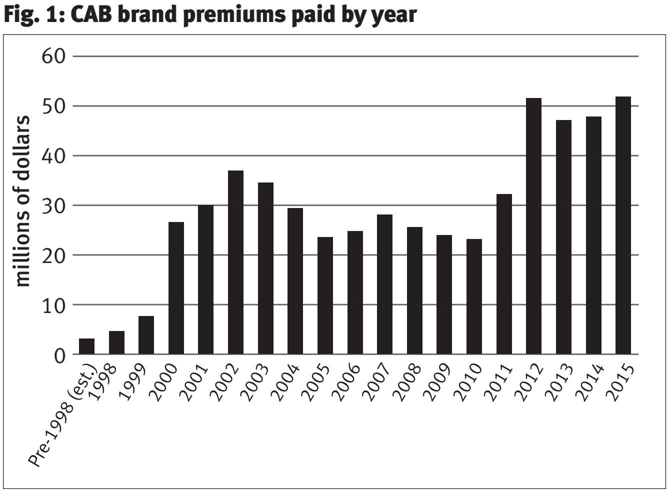
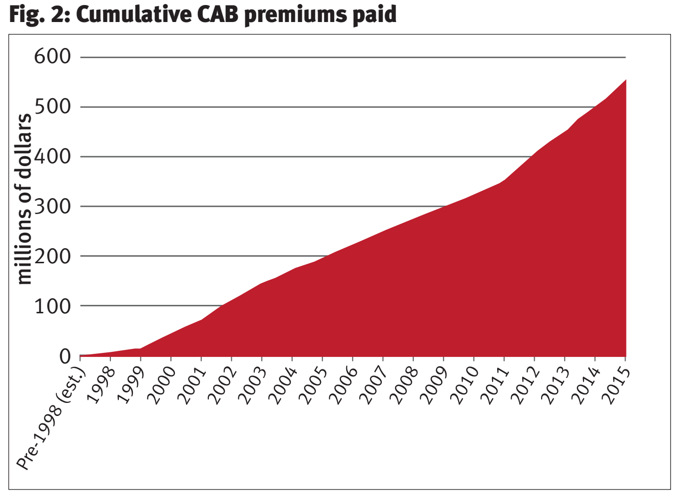


Fig. 2: Cumulative CAB premiums paid



right up through 2015, total dollars paid for the 53 million cattle accepted for the brand amount to $65.5 billion. Not surprisingly, with the recently higher prices, 46.6% of that total has been paid in the past five years.

That's a lot of money, but it still does not account for the growing category of CAB Prime, for which grid marketers could typically find an extra $20 per cwt. last year. The 217,000 Prime cattle that fed into the CAB supply chain in 2015, at the average 868-pound (lb.) carcass weight, add another $37.7 million in related premiums.

Raising standards

North American cattle and beef are clearly getting better, thanks to a combination of value-based marketing opportunities and enabling genetics, observers say.

Improved genetics in a relatively young beef cow herd bode well for the future, says Bruce Cobb, general manager of Consolidated Beef Producers (CBP), Canyon, Texas. Plus, better cattle are easier to market.

"When we do something good, it comes from negotiating the base price for the formulas and grids, and their standing premiums or discounts are on top of that," Cobb says. "That's 99% of the time with the big four packers, and all have CAB components in their grids."

The company markets a million fed cattle per year for feedyard members from Iowa to Texas.

Cobb says Angus genetics have fueled an evolution in beef cattle, especially obvious in Texas, toward "a new commodity norm."

Quality grades move up another step each year, he says.

"More pens here are all black now. We were used to seeing that in Nebraska and then in Kansas, but now even in Texas," Cobb says, thumbing through harvest sheets of cattle grading 90% Choice. "Those are black cattle; those are Angus cattle.

"Years ago we saw a few pens like that, but now those are becoming the norm: high-quality, good-yielding genetics, and Angus are a big part of that," he continues. "We keep progressing toward that new commodity."

With the average CAB acceptance rate at 30% some weeks and the average share of Prime cattle now greater than 5%, consider what some fairly average cattle can do on a grid if they avoid most discounts.

If you have 100 steers that make 90% Choice or better at a plant with 70% Choice, and the Choice-Select spread is $5 per cwt., the math above says the Choice premium is $1 per cwt., or $8.68 per head on last year's average CAB carcass weight, across all cattle. The 30 CAB cattle in that pen earning an average $5 per cwt. contribute ($43.40 × 30) ÷ 100 = $13.02 across all cattle.

The five CAB Primes at the $20 premium kick in ($173.60 × 5) ÷ 100 = $8.68. That adds up to $30.38 before discounts, which are sometimes balanced out by some Yield Grade (YG) 2 premiums. Those are pretty average premiums for good, but not great, cattle.

Here's the math

100% Choice (100% – 70% = 30%): 30% × $5 per cwt. = $1.50 per cwt.

70% CAB: 70% × $5 per cwt. = $3.50 per cwt.

20% Prime: 20% × $20 per cwt. = $4 per cwt.

$1.50 + $3.50 + $4 = $9 per cwt. premium net per head across the pen

$9 per cwt. × 8.68 cwt. = $78.12 premium per head

CAB contributes $30.38 per head, or 38.8%

Live equivalent of total premium is $5.72 per cwt. ($9 × 0.635)

If the above example moves to 100% Choice or better with 70% CAB that includes 20% Prime — which many producers are achieving with today's registered-Angus genetics — then the total premium jumps to more than $78 per head with CAB contributing nearly 39% of that. That's $5.72 per cwt. added to the cash live price equivalent (see "Here's the math" sidebar box).

South Dakota State University market economist Scott Fausti, who has published several papers on value-based marketing, says fear of discounts kept producers from using grid and formula marketing for years. A 2015 paper suggests value-based marketing has caught on, based on wider reports of quality premiums received.

"In these last few years with strong demand for beef, packers were making more

Fig. 3: Relationship between CAB-Choice boxed premium and the CAB grid premium

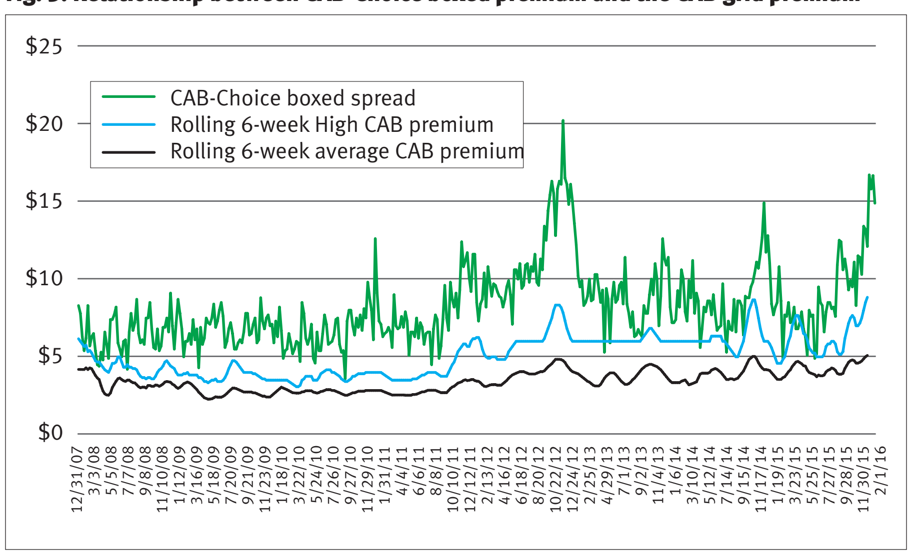
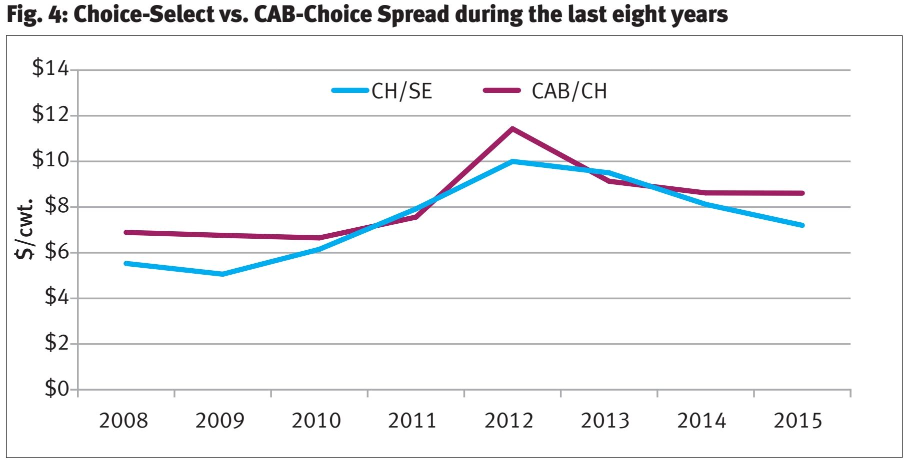


Fig. 4: Choice-Select vs. CAB-Choice Spread during the last eight years



allowances for Yield Grade 4s, and as more producers used grids and formula contracts, they learned to take more precautions to avoid discounts," Fausti says.

►"The premiums all begin with that steak on the plate, and they trickle back through the system all the way to the ranch and to me as a purebred Angus producer," says Nebraska cattleman Jerry Connealy.

Controlling genetics, health, management and market timing, producers have been able to reap more rewards than discounts, he says, while noting shortcomings in the system.

"Value-based marketing should reward your investments in the production system," Fausti says. "If I could change anything, it would be to find ways to move toward more transparency in pricing. Price is the mechanism for telling producers what the market needs, so they can respond. The system could be improved if they could better see where prices come from, how they vary and why. Then they could better react or respond to them."

The economist says commercial cow-calf producers can participate in value-based marketing by documenting their investments in genetics, health and management, and by developing relationships with cattle feeders who will help them gain feeding and carcass data. More positive information in the market will lead to higher bids.

Starting with seedstock

Whitman, Neb., Angus seedstock producer Jerry Connealy helps bull customers work on relationships and gain access to a greater revenue stream.

►"We've just scratched the surface as far as helping them earn premiums," says James Henderson, referring to commercial cattlemen.

"The premiums all begin with that steak on the plate, and they trickle back through the system all the way to the ranch and to me as a purebred Angus producer," he says.

"CAB truly is a pull-through demand entity in the market," Connealy adds. "The commercial guy may not always think about why he's getting $5 or $10 more per hundred for his calves, but that's what is pulling it to him. It's flowing back from the packing plant and feedyard."

Connealy helped link customers with cattle feeders and even had contact with packers looking for premium cattle sources.

"So then you know it's coming full circle," Connealy says. "The demand is there, and we're experiencing it here, or they wouldn't be knocking on our door."

Childress, Texas, Angus seedstock producer James Henderson says the best is yet to come for commercial producers.

"We've just scratched the surface as far as helping them earn premiums," he says. "Angus genetics bring more at every level from weaning on as you walk on through the market, but I think as we add more information with genomics in our database, we can structure programs that bring them more rewards from the market."

His team at Bradley B3R Ranch aims to help customers get feedyard and packing data back and find the specific bidders they need, from order buyers to feedyards and stocker operators.

"That's different for each customer," he notes, and not just because one may wean at 500 lb. and another at 750 lb. "Those are very different sets of calves, but there are different buyers who can pay more because those cattle fit what they're doing."

Some customers who retain ownership are seeing better than 50% CAB acceptance, but Henderson notes recent heavier carcass weights have helped get the most out of quality potential. Still, he says, the Angus breed average of 0.62 marbling expected progeny difference (EPD) in 2015-born calves says both commercial and seedstock breeders are responding to market signals for quality.

Mike Kasten, commercial Angus producer from Millersville, Mo., says there is no reason to let up on that selection pressure when the Angus database contains the tools for covering all reproductive and environmental traits first.

"The average consumer has never had a Prime steak," he says. "They love our product, but they haven't even tried our best. Just think about how we'll drive demand forward as we continue to ratchet quality up."

The 2004 CAB Commitment to Excellence Award winner draws on decades of experience organizing alliances, feeding and selling on grids when he says marbling is one of the best risk-management tools.

"Last year was not a good one for feeding profits, but in pens with average per-head losses of $220 or more, we saw the only profits were from those that gained more than 3.75 pounds a day or graded Prime. If they did both, they made more than $100 profit," Kasten reports.

►Millersville, Mo., cattleman Mike Kasten says there is no reason to let up on selection pressure for marbling when the Angus database contains the tools for covering all reproductive and environmental traits first.

He stresses that point with young producers, who are most aware of scarce resources.

"It's so expensive to get into this business," he said. "But using no additional resources, if you can plan on another $100 or $150 above the market, that gives you a lot of leeway, and it is often pure profit."

CBP's Cobb credits the Angus breed for supplying the genetics to perform at heavier weights. He says that specific need will not fade much, if at all.

"Longer term, there's no reason to think we will see a serious pull-back in carcass weight — we're certainly not going back to 1,225 or 1,250 pounds — simply because genetics have adjusted," Cobb says.

Producers have adjusted and gone through their own version of culling because of the recent drought, he adds. "It caused an early exit for those who were not approaching it as their core business. Those expanding now have the ability to expand their game with better genetics that pay the premium on top of any negotiated base advantages."

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Editor's Note: *Steve Suther is the director of industry information for CAB.*