Negotiating a Grazing or Feeding Contract

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The theme of the afternoon program refers to retained ownership of calves and/or yearlings through a grazing and/or feeding program. Those of you that sat in on the January Cattle-Fax meeting in Nashville, heard Randy Blach's closing remark: "Those producers who do not retain ownership beyond the weaning of the calf crop are leaving money on the table most years."

Those producers that retained ownership of last years calf crop are currently enjoying well above-average gains on wheat pasture and those who have been, or are currently, selling fat cattle at these levels are enjoying substantial profits.

To make best use of the time allocated and to best address the subject matter that was assigned, we will look at your concerns as a producer when you elect to retain ownership through a grazing or feeding program.

Working with producers for several years, our management service has identified those concerns to include: comfort with the decision to retain ownership, frequent and reliable communication, development of credible performance projections, meaningful progress reports, the availability of financing so as to offset some of the interruption of cash flow, implementing a risk management program that has some flexibility, developing a marketing program that is tailored to the quality, kind, weight and time of year, and a comparison of performance of your cattle with others of like quality in a similar program.

Grazing programs are divided into winter and summer although they will sometimes overlap. For instance, Florida calves make best use of a winter grazing program on wheat or rye grass, but because they are weaned 60 or 75 days before the winter grass is ready, we have a need to find summer grass or a preconditioning yard to care for the calves in the interim. The strength of the grass and/or the energy level of the ration in the preconditioning yard need to match the flesh condition of the calves.

A satisfactory grazing program begins with the selection of the pasture operator. The pasture operator must own or have leased the acreage we intend to graze, live on or near the pasture being used, be actively engaged in operating their personal grazing program, and be financially able to perform contractual obligations.

If we are not familiar with the pasture that is offered (have not grazed it before) we will make a visual inspection to determine: (1) if the pasture has had sufficient moisture to produce early growth; (2) if there is sufficient turf (in the case of grass pasture) or sufficient stand (in the case of wheat pasture) for the intended carrying capacity; and (3) if pasture in this geographic area historically produces in excess of 200 pounds of gain for the season. If the above criteria cannot be met, we need to look elsewhere.

The grazing agreement spells out the responsibility of both parties. The length of agreement is determined and on/off dates are established. The weight, sex, and quality of the cattle to be furnished by the owner, the weighing conditions to generate the weight going on pasture, and the weighing conditions to determine the weight off pasture are provided for in the agreement.

The pasture rate (cost/pound of gain, cost/hundredweight/month, or cost/head/ month) is agreed upon. The amount of front money or partial pay is established. The pasture operator may ask for these funds to be in his hands before the cattle arrive at the pasture.

The pasture operator is to stand all death loss over 2%, but give him the option to reject any animal that appears to be sick on arrival. The animal is marked and the responsibility for the death of that animal is with the owner for the first 30 days. The owner will be notified immediately of any death loss. Such death loss will be verified by a hide brand or photo of the dead animal that clearly shows ownership. If the death loss exceeds 2%, the original value of the additional death loss is to be deducted from the final payment to the pasture operator.

The head count is guaranteed. The market value of any cattle short, or unaccounted for at the time of delivery back to the owner, will be deducted from the final payment to the operator. Any front-money or partial payments made during the pasturing period will be deducted from the final payment. The pasture operator has the right to request a wire transfer of funds before the cattle leave his pasture.

It is necessary that the pasture agreement be signed by both parties before the cattle are shipped to the operators pasture.

Once value of the calf crop, based on the weight leaving Florida, has been decided and including all costs of production, freight to the pasture and/or growyard, pasture, feed, care, medicine, death loss, and interest; we can develop a reliable performance projection as to the marketing date, weight, and breakeven selling price as the calves come off pasture. Any changes in the inputs affecting the performance should be communicated immediately. If the calves have gained well and the feeder market is unusually strong, the producer may elect to sell the calves as they come off pasture. One of the reasons for us to favor pasturing wheat in Oklahoma is the strength of the feeder market in this state which is supported both by order buyers for feedlots in Kansas, Nebraska, and the Oklahoma City auction market.

Summer grazing in Kansas, Oklahoma, Texas, and New Mexico offers unique opportunities depending on the availability of stocker calves as to their weight and preconditioning. Both the Kansas Bluestem country and the Oklahoma Osage will provide exceptional gains for a 90- to 120-day period beginning in mid April for those stockers that have been thoroughly preconditioned and are ready to go. These cattle will come off pasture in July and August and market as November/December fats. The New Mexico grass is usually available by early May and the season runs into October. These cattle will market in February and March. Historically, the fat cattle market is at its highest levels during these months.

While most producers favor placing cattle on a cost of gain/pound basis, we sometimes see good opportunities to place cattle by the hundredweight/month or by the head/month.

The selection of a feedlot, whether for placing cattle as they are shipped from Florida or as they come off a grazing program, deserves careful consideration. During the past two years, as we worked our way thru some burdensome numbers, the feedlots ability to get the cattle sold to the best advantage was our paramount concern. The ability of the feedlot to care for and manage the health of the cattle is of equal importance, particularly if the cattle have not been thoroughly preconditioned.

The cost of not preconditioning in the terms of greater death loss, increased cost of medicine, increased cost of gain, and higher percentages of chronics is well documented by the data collected over the past several years by the Texas A&M Ranch to Rail program. Producers who have gone to the expense to thoroughly precondition their calves before offering them for sale have been, at times, disappointed by the buyers reluctance to pay a premium for this service. Some of this reluctance is based on the fact that occasionally calves have been misrepresented as to the thoroughness of the preconditioning program.

We work with producers who: (1) send us calves that are loaded on trucks as they are stripped from the cows with no exposure to creep feeding and without a vaccination program while on the cow that was specific for the respiratory disease complex; (2) send us calves as they are stripped from the cows, but have had access to feed (they do know how to eat feed) and have been vaccinated against the respiratory diseases while still on the cow by the use of a killed product; (3) send us calves that have been vaccinated with a killed product while on the cow, boosted with a modified live product the day that they are weaned and then held on a ranch pasture for a few days until they get past the walking and bawling stage and have had some exposure to dry feed; and (4) some producers, mostly those who have experienced the costs of a semi-preconditioning effort, will go the extra mile and implement both vaccination programs, teach the calves to eat and hold them for 30-45 days before shipping. We work with some producers who cannot or do not want to do the preconditioning themselves, but will send the calves to a stocker operator here in Florida and have it done for them. A word of caution is needed concerning the use of highly medicated feed in the preconditioning program. It is probably good practice for a few days after weaning, but the usage needs to be tapered off and scaled down to zero before the cattle are shipped.

Once we have selected a feedlot for its ability to care for the cattle we need to look at how that feedlot goes about marketing the cattle. If we are working with a feedlot that is involved with an alliance, such as Ranchers Renaissance, the marketing will be decided jointly by the packer and the feedlot that is involved. For the most part, we favor using those feedlots that make best use of the grids offered by several packers. Not all feedlot managers have the ability to select that grid that will net the most return for a particular pen of cattle. We work with those managers who have the ability to estimate the hot yield (dressing percent), quality grade, and yield grade of the cattle, and if needed due to the difference in the genetic make up of the cattle in the pen, sort the cattle and offer the sorted cattle to that grid that will provide the most return. The higher grading cattle, that usually finish first and at lighter weights, will be offered to that grid with the greatest premiums for quality grade. The balance of the pen, normally those with more Brahman or Continental influence, will be offered to that grid with the greatest premiums for yield grade and the least discount for the quality grades. This grid is offered by the nation’s largest packer to generate a supply of carcasses that are used to produce a pre-packaged product for the nation’s largest retailer of beef and that product comes from select grade carcasses. Cattle that produce carcasses with a high percentage of yield grade 1s and 2s and do not grade a high percentage of choice, are well marketed using this grid.

The schedule of premiums and discounts of most grids favor the packer. It is the responsibility of the manager (either feedlot or hired) to see to it that we have as few as possible of those carcasses that carry the greatest discount, namely discounts for over and under weight carcasses and for yield grade 4s. The discount for dark cutters is equally severe and while we cannot control it as easily as the others, most feedlot managers work closely with the packer to coordinate the shipping so that the cattle leave the home pen at the feedlot and walk on the kill floor with the least amount of waiting time.

Once we have eliminated the problem cattle before shipping, marketing the cattle using the grid that fits the cattle, will usually show a substantial premium to the cash market. This winter and spring, when the choice to select spread has been in the $5.50 area, the premiums for yield grade 1s and 2s, as well as those paid for prime and Certified Angus Beef carcasses, have more than offset the discounts of the choice to select spread. There is a time of the year however, when the spread between choice and select grades widens to a point where marketing using the grids needs a closer look. If the cattle are projected to market during this time of the year, are estimated to have a less-than-average quality grade, and not be able to offset this discount with premiums for yield grade, the producer and the manager need to look at forward contracting the cattle for future delivery.

Again we need to look for that feedlot that has a good track record for their ability to get the contract made with the best possible basis and to flat price the cattle at the most opportune time. These contracts are best negotiated early in the feeding program. As the cattle near finishing, the manager needs to work closely with the packer/buyer to select that week during the contract month to ship the cattle. Shipping too early will result in a lower yield and lower percentage of choice and prime; shipping too late can result in an increase in the cost of gain, over weight carcasses and yield grade 4 problems.

If the feedlot we have selected has the ability to satisfy all of the above concerns, we need to look at the cost of ration and the grain position. Normally there is not a great deal of difference in the dry matter cost of the ration and the difference is usually associated with the energy level of the ration. The rapid and unexpected run up in grain prices last fall, particularly the future contracts, resulted in some of the feedlots pricing grain a good deal higher than others. This caused us to limit the placing of cattle with those feedlots until their cost of the ration came back in line. For those producers that have a concern about the price of the ration throughout the feeding period, we can forward contract the grain with the feedlot or a local grain supplier, or take a position for that period with a futures contract with the Board of Trade.

If a producer has historically sold the calf crop at weaning, retained ownership may cause some problems as to the interruption of cash flow. To offset this problem, most of the feedlots we work with have “in-house” financing available on a pen by pen basis that is easily accessed and does not require a great deal of information as to current financial statements and past years tax returns. If we can arrive at an agreed on market value for the cattle, most feedlots are willing to partner with the producer. They will pay him for half of the cattle as they arrive at the feedlot, pay their share of the feedlot charges as they occur, work with the producer to develop the most favorable marketing plan, and share in the profit or loss at the end of the feeding program. We have been able to go the extra mile for some producers by selling a one-half interest in the cattle to the feedlot and gaining financing by the feedlot for the one-half interest retained by the producer.

Once all of the input values have been determined, we can develop a performance projection that, when including all feedlot charges, estimated death loss, and interest charges, indicates the date of marketing and the break even selling price. Based on this projected selling price, we can work to develop a risk management program using the futures contracts offered by the Chicago Mercantile Exchange. During the past 24 months, outside factors have had more effect on the price of fed cattle than the simple supply-demand relationship and those cattle that were protected by a futures position during this time period were somewhat insulated from the change in the market.

Some producers will be satisfied to buy an out of money put that will protect the equity dollars. Others will want to buy a more expensive put that is close to the projected breakeven selling price and offset some of the cost of this put by selling a call. If the futures contract for the projected marketing month is trading at a level that will provide for a satisfactory feeding profit, we may elect to trade that position to cover all or part of the risk. We need to be reminded that a change in the projected breakeven selling price due to increased feeding costs or an unfavorable basis at the time that the cattle are sold will detract from the value of the position. If you do not have an established account with a commodities broker we suggest that you do so. There is no cost to establish the account. You may never use it, but if the need arises, you need to be able to act quickly.

As the cattle progress thru the pasturing or feeding program the producer needs to maintain close communication with whoever is managing or looking after your interests. We find that some prefer a simple phone call updating the progress of the cattle, others who may be pressured with other business interests, would rather have a written update faxed or emailed to them that they can review at a more opportune time. If a change occurs that needs attention it is important that you know about it as soon as possible.

We give close attention to and provide the most frequent communication for the first 30 or 45 days the cattle are on feed or on pasture and again for the 2 or 3 weeks prior to the shipping or marketing of the cattle. Inspections as to the progress of the cattle are made on regular basis and the findings are communicated immediately.

As soon as the cattle are sold any existing futures position needs to be lifted. When the cattle have been shipped and all of the feedlot charges have been determined, a detailed close-out is produced that relates to both the physical performance of the cattle (average daily gain and dry matter feed conversion) as well as to the financial performance of the feeding or pasture program.

If the cattle have been marketed with an alliance or have been sold using one of the packer grids, all of the meaningful data including hot yield, premiums paid for quality and yield grading, and discounts for “outs or non-conforming” carcasses needs to be a part of the close out data.

All physical performance data from the cattle during the feeding program as well as collected carcass data, by the use of a spread sheet, can compare the performance and carcass data with other cattle of similar weight when going on feed. The confidentiality of producers furnishing the data used is closely protected.

The value of this information, when making management decisions concerning the genetic makeup of the cattle and when making changes in production practices, runs a close second to the profitability of the feeding program itself. Retained ownership is well justified if your cattle posses superior genetics and produce above-average performance both in feeding and carcass value. If not, the information should be used as the basis for making needed changes.

For those of you who normally retain ownership through a grazing and/or a feeding program, all of the above is quite elementary. Our discussion, however, is targeted to those producers who have not retained ownership or have done so on a limited basis, and/or who may have had an unpleasant experience when retaining ownership the first time. We believe that by making full use of all of the tools available and by close supervision as the cattle progress thru the program, a reasonable amount of success can be obtained the majority of the time.

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