

Market and Industry Trends in the Beef Business

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Introduction

Cattle and beef markets have been volatile in recent years and remain dynamic. The rapid contraction and subsequent expansion of cattle numbers across the United States created an intensely volatile period. The causes of the moves mentioned here are wide ranging. The implications these factors had and have on cattle markets are diverse. Cattle numbers contracted into 2014 and created an incredibly tight market for calves, feeders and fed cattle. Market direction turned sharply higher for most of late 2013 through 2014 and most production margins were extremely positive. During fall of 2014 cattle and beef markets began transition from a contracting market with powerful leverage to an expanding market with less leverage and more fear.

Through 2015 until the present time cattle and beef markets have witnessed massive losses in futures and cash markets and more recently a collapse of feeder and fed cattle basis. Beef packing margins have seemingly remained strong while cow-calf and post-weaning profitability has been challenged to say the least. The loss of packing capacity in some key feeding regions while simultaneously increasing pen capacity and seeing some older feedyards come back online has created a startling loss of leverage between the cattle feeder and the beef packer. There are many fundamental, technical, and outside factors that either have changed or are currently changing within the beef industry. Understanding market setups and cycles is potentially key to knowing how and what decisions to make for our individual operations.

Fundamental Developments

It is no surprise that cow numbers have seen moderate year over year increases since 2014. As a result of this, there are more calves and feeders available and therefore more cattle on feed. As of the March 2019 United States Department of Agriculture (USDA) Cattle on Feed report there is an estimated 11.8 million head of cattle on feed in yards with capacity greater than 1,000 head. This is the largest number of cattle on feed in the United States in ten years and is not significantly smaller than the largest number of cattle on feed in the entire USDA database. On a related note, the increase in available calf and feeder supplies has driven placements into feedyards higher and using these data we can estimate that this number on feed will remain strong. Additionally, breaking down the weights at which these cattle have been placed into feedyards we can estimate the times those cattle will potentially be market ready. The most recent placement data would suggest that May and June 2019 market ready numbers will also be near ten year record levels. Any deviation in marketing's that would disrupt feedyards remaining current could both alter and exacerbate the negative affect of larger summer supplies.

Carcass weights are near normal for this time of year and should bottom in the near term. Considering the winter weather events that have impacted some cattle, weights have remained seasonal. Cheaper feeding cost of gains and milder weather forecasts may cause higher third and fourth quarter weights. As a result of higher supplies, weights, and increased feeding capacity; beef production is topping recent records and is expected to continue to do so. Strong domestic demand, featuring, and export sales have offset many of the possible negative implications associated with increased production. Non-fed and fed harvest is and has been managed well by packing entities in order to effectively handle increased production and manage profitability. Non-fed harvest has challenged the ability to remain current on fed cattle marketing's at times, but still is at or near record levels compared to recent history. Interestingly, feedyard

out weights have steadily increased due to various market factors and allowances for yield grade 4-5 have also increased, further enabling longer days on feed.

Outside Influences

Agriculture markets have long been a haven for investors, producers, and market participants of all types. In the recent era of low interest rates, one could argue that capital has been allocated to various areas in hopes of any return. Ranch and farm ground across the United States as well as feeding capacity and even packing capacity is no exception to the managed money interest in an effort to capture returns or increase exposure to agricultural risk. Money flow in and out of cattle markets through futures trading can, at times, draw the attention of the industry. Late 2014, 2015 and 2016 are good examples of this in the cattle markets. These time frames brought about large changes in both the commercial users and non-commercial traders position.

Late 2014 presented us with a situation where cattle feeders were at very high percent hedged and short levels and non-commercial/managed money traders were very long. In both 2015 and 2016 we witnessed the opposite with managed money traders becoming very short on cattle markets and cattle feeders decreasing their hedged position. Additionally, in many ways the cattle and beef markets are subject to the implications of capital leverage. Indirectly, the leverage associated with trading cattle futures can impact a wide array of industry dynamics and how all the different sectors within the beef industry interact.

Beef Industry Changes

The last five years has brought about some key and interesting changes within the beef industry. In order to tease out what this might mean to any sector of the industry we need to fully understand the evolution of each factor in recent history. Quality grading has moved sharply higher in all cattle feeding areas recently. The increases in percent Choice and higher cattle has brought about much debate and discussion about the causes and implications. The reduction in cow herd numbers and the subsequent herd expansion is suggested to have increased the quality of the cow herd and thus the quality of those offspring. Additionally, the poorer quality genetics are thought to have been culled first even for those operations that may not have expanded at the same rate or at all. Instrument grading has been the topic of much discussion in recent times as a causative factor in the rapidly increasing Choice and higher grading. There have been some changes and developments in plants using instrument grading versus USDA inspectors as well as the instrument grading technology itself.

Marketing methods across the industry continues to transition from less negotiated to more committed or scheduled in nature. Negotiated marketing would be the most well-known and understood method of cash trade. Since the beginnings of large private and corporate model cattle feeding, the percentage of cattle being marketed in an alternative method has steadily increased. The most widely used alternative marketing method would be formula trade with grids and forward contracts being situationally used. Considering the increase in total supplies, the amount of negotiated cash trade has increased, but the alternative methods continue to dominate marketing method of choice for most entities within the beef industry. There are some regional differences in marketing method with the Southern plains having been and remaining much more committed to formula trade. The central feeding areas are similar and have grown more committed in recent years, but remain a solid negotiated trader due to some large custom cattle feeding operations in that area. The northern feeding regions have seen an increase in formula trading, but remain the largest negotiated cash traders in the industry. This is likely due, in part, to the operating model differences and yard sizes in those areas.

Feedyard ownership has seen material changes in the last several years. There has long since been shifts from year to year in the top feedyards, but more material shifts have occurred in feedyard and packing ownership. The most recent key shifts have been packing entities moving out of the feedyard ownership space. Feeding margins are volatile and capital requirements in a rising interest rate environment are extremely high. The corporate packers with feedyard ownership seemed to be interested in liquidating in order to allocate capital in other areas while maintaining cattle supplies through relationships and alignment. Another interesting development in cattle feeding as well as feedyard ownership is entities that formerly did not have cattle production within their operating model, now do. These entities have entered the space and seemingly changed very little of the standard operating procedures as of now. Thinking of how this might impact the industry going forward will be necessary to keep ourselves prepared. How might they operate in periods of weak basis? What changes will be made during sustained poor margin times? How could this affect calf values? What will it look like when publicly traded or managed money entities no longer wish to be in this space?

Conclusion

The cattle and beef markets have been challenging. The markets have been complicated to understand, predict and manage in recent years. The volatility of both physical and futures markets has been staggering and pushed many to believe that the markets are not operating efficiently or transparently. The truth is this has been the case many times over the years and in many agricultural markets. In general, there is no evidence that markets are not operating well and some might make the case the markets are performing very well and possibly as efficiently as they have in recent history. It would seem that making well informed and wise decisions for ourselves and our own operations is key to remaining sustainable.

The fundamental shifts are simply a response to markets signaling expansion through economic incentives. The interesting part about the beef industry is that our generation interval is long. The outside influences in our markets will change over time. Interest rates and money looking for returns will vary the amount of managed money participating in cattle and beef markets. The narrative or lack thereof will also influence non-commercial activity in our markets. As allied industry members, producers, feeders, and packers we need to be aware of several situations including, but not limited to grading percentages, marketing methods, and ownership of key industry entities. Quality grade has rapidly advanced and is beginning to impact how increased Choice and higher grading affect cattle profitability. Marketing methods within the cattle business are trending towards being completely committed and scheduled to accommodate the increasing efficiency of the modern production model. How can we maintain transparency without going backwards? How will marketing methods within the feeding sector might affect calf, feeder or fed cattle sales. Finally, we need to remain cognizant of the shifting nature of the players within the industry and how they may or may not react to different market scenarios.