

### High Cattle Prices and Good Forage Availability Are Attracting Interest in Cattle Retained Ownership Enterprises Current High Calf Values and Market Risk Will Require Enterprises to Be Carefully Planned and Monitored

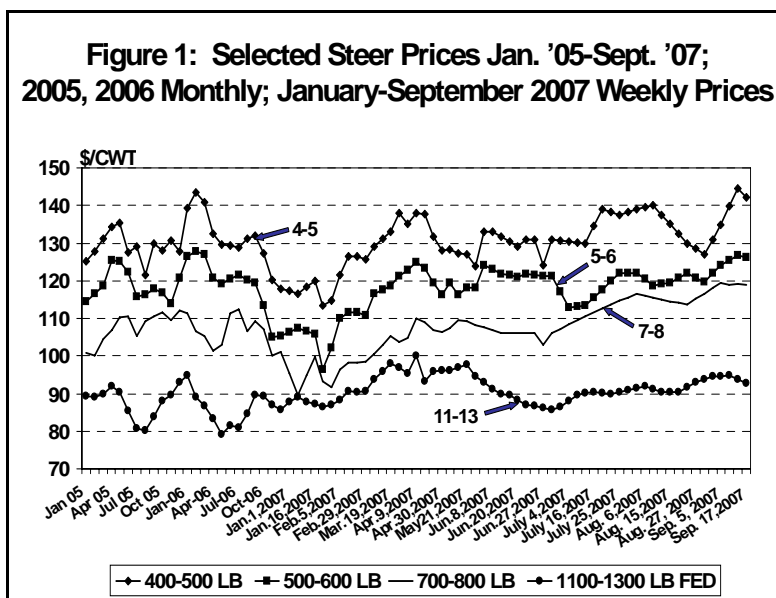
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High prices for calves and feeders (see figure 1) and relatively good forage availability is causing interest in retained ownership enterprises this fall/winter/spring season, but high costs of corn are increasing market vulnerability.

While current market prices appear to indicate that retained ownership enterprises may be profitable, price roll-backs of 10-15 cents per pound between current calf prices and next spring's price forecast for feeder cattle and the risk that prices may weaken, indicate that retained ownership enterprises carry high risk and will require careful planning and monitoring.

#### Forage Availability

Forage availability remains above average as a result of excellent year-to-date rainfall across the state, but most of September has been very dry. Weather forecasts predict a dry fall/winter as a result of weather shift to La Niña (cold ocean temperatures in the eastern equatorial Pacific, often causing drier than normal conditions in the Southwest in late summer through the subsequent winter). While forage availability remains above average for this time of the year, lower than average rainfall in September and forecasts of potential below average rainfall this coming fall/winter season appears to indicate that forage availability may decrease during the next 5-6 months. Forage production from small grains and ryegrass may be very limited unless pastures are irrigated. As a result, it appears that in addition to price roll-back and market risk, retained ownership enterprises this year will also carry higher than average production risk and will require careful planning, monitoring and a review of alternatives. Alternatives include comparing the value of calves now versus the potential additional profits from retaining owned calves and/or buying calves to carry through the stocker/feeder phase on native, small grain or ryegrass pastures and/or a feedlot.



### **Lower Cattle Inventory**

One of the factors that is keeping calf and feeder prices high is the low number of cattle available. U.S. cattle numbers are just slightly above the low point of this cattle cycle. Scarce supplies of calves will keep upward pressure on prices, especially for feeder cattle ready to enter feedlots as feedlots empty out this fall. The January 1, 2007 and the mid-year cattle inventory report indicated a relatively flat herd size. All cattle and calves in the United States, as of July 1, 2007, totaled 104.8 million head, down slightly from the 105.2 million head herd on July 1, 2006, but up about 600,000 head from an inventory of 104.2 million two years ago. The total cattle inventory is just 1.4 million head larger than the current cycle's low of 103.4 million head in 2004. Calf prices remain at near record highs and may encourage selling rather than herd re-building.

### **Placements Down**

Cattle placements are down as feedlots empty out this fall. USDA-NASS Cattle On Feed report, released on September 21, 2007, indicated that cattle on feed on September 1, 2007, in feedlots with capacity of 1,000 or more head totaled 10.3 million, down six percent from September 1, 2006, but up three percent from September 1, 2005. Total placements during August '07 at 2.12 million head was down seven percent from August '06 but 6.0 percent above August '05. Fed cattle marketings during August '07 at 2.07 million head was virtually unchanged from 2006 but two percent above 2005. The net effect was relatively empty feedlots. It appears that feeder prices may remain strong as supplies are down and feedlots bargain for limited cattle supplies.

### **Ample Supplies of Competitive Meats**

While the cattle inventory and feedlot placements are down significantly, adequate supplies of red meat may keep a lid on potential further improvement in fed cattle prices. The September '07 estimate of beef production for 2007 at 26.109 billion pounds is down just slightly from 26.258 billion produced last year. According to USDA-NASS September 1, 2007 Livestock Slaughter report, the average live weight of the 3.13 million head of cattle slaughtered during August '07 at 1,279 pounds was up three pounds from the previous year.

While the beef production forecast is down slightly, the market situation for slaughter cattle may be vulnerable as a result of abundant supplies of competitive meats. USDA's total red meat and poultry (Beef, Pork, Poultry) production forecast for 2007 at 89.629 billion pounds is up 465 million pounds from 89.164 billion pounds produced last year, providing consumers a vast opportunity for substitution with cheaper alternatives to beef.

### **Feedgrain Prices**

Price bids for corn have almost doubled from spring '06 as a result of increased demand for ethanol production. Even with USDA's September '07 corn production forecast at a record 13.3 billion bushels, up 26 percent from 10.54 billion bushels produced last year, the estimate of usage, also at a record 12.8 billion bushels, will keep ending stocks at 1.7 billion bushels, up just slightly from beginning stocks of 1.5 billion bushels. While futures price bids on the Chicago Board of Trade

(CBOT) ended off slightly on Monday (9.24.07), after last week's 21 cent/bu rally, most '08 and '09 contracts closed at \$3.90-\$4.25/bu. USDA's September '07 projected average price range for corn remained unchanged at \$2.80 to \$3.40 per bushel supported by record wheat prices and strong soybean prices. It may require one-to-two million additional acres in addition to the 14.6 million additional acres planted to corn this year and good weather to cause the corn market to weaken to more manageable levels for the livestock industry. Where are these acres coming from? As a result, it appears that feed prices will remain relatively expensive in terms of the cost of gain.

The price of cost of gain contracts on winter forages varies widely depending on the quality of the forage. Near record high feedgrain prices are influencing price bids for forage. Prices vary from a low of about \$0.40/lb of gain to as high as over \$0.50/lb, depending on the forage quality and the services provided.

### **Stockers Retained Ownership Profit Margin**

A retained ownership enterprise and/or buying stockers this fall will provide an opportunity to add value to the calves through additional gain from relatively inexpensive forage and/or cost of gain through a feedlot (in relation to market prices). Keep in mind that strong current demand and cattle shortages are keeping cattle prices up, especially for calves. So, the enterprise would require a relatively high initial investment in terms of the current value of calves.

With four to five weight #1 and #2 grade calves trading in the \$1.30-1.40/lb range compared to cattle-feeder futures contracts for January '08 through August '08 delivery trading in the \$1.13/lb (August '08) to \$1.15/lb (January '08) range at the Chicago Mercantile Exchange, price roll-backs may erode profits. If good quality forage is available at affordable prices, stocker retained ownership enterprises this winter could be profitable if properly planned, managed and monitored. The feedlot option, while probably less risky from a production viewpoint, may carry higher financial risk.

The accumulated cost of the calves, their current market value and the owner's financial situation should serve as the benchmark to evaluate the profit potential and risk associated with a retained ownership enterprise this coming winter. Keep in mind that retaining ownership will increase management and decision-making requirements. More capital will be required for the additional production expenses and annual cash flows will change because retaining ownership will delay income and add production costs.

Table 1 provides an estimate of potential profits for a 450 pound steer with a current value of \$1.30/lb, by varying the cost of gain and the sale price next spring (150 days on small grain pasture).

If, for example, the total cost of gain averages \$0.42/lb, at 1.7 lb average daily gain (adg) for 150 days, and the steers are sold at the current futures price quote for April '08 delivery (\$1.13/lb), a rancher could average \$73/head in profits.

Similar profit opportunities may not work in native pasture since the rate of gain and the days left before a killing frost may be limited.

**TABLE 1: RETAINED OWNERSHIP PROFIT MARGIN PER STOCKER ON SMALL GRAIN PASTURE**

<b>ASSUMPTIONS:</b>											
450 Initial Steer Weight, Lbs											
\$1.30 Current Steer Value, Per Lb											
7.5% Annual Percentage Rate (APR)											
1.7 Average Daily Gain, Lbs											
150 Days on Pasture											
1.5% Death Loss											
<b>Cost of Gain</b>	<b>Sale Price</b>										
	\$1.08	\$1.09	\$1.10	\$1.11	\$1.12	\$1.13	\$1.14	\$1.15	\$1.16	\$1.17	\$1.18
\$0.35	\$56	\$63	\$70	\$77	\$84	\$91	\$98	\$105	\$112	\$119	\$125
\$0.36	\$53	\$60	\$67	\$74	\$81	\$88	\$95	\$102	\$109	\$116	\$123
\$0.37	\$51	\$58	\$65	\$72	\$79	\$86	\$93	\$99	\$106	\$113	\$120
\$0.38	\$48	\$55	\$62	\$69	\$76	\$83	\$90	\$97	\$104	\$111	\$118
\$0.39	\$46	\$53	\$60	\$67	\$73	\$80	\$87	\$94	\$101	\$108	\$115
\$0.40	\$43	\$50	\$57	\$64	\$71	\$78	\$85	\$92	\$99	\$106	\$113
\$0.41	\$41	\$47	\$54	\$61	\$68	\$75	\$82	\$89	\$96	\$103	\$110
\$0.42	\$38	\$45	\$52	\$59	\$66	\$73	\$80	\$87	\$93	\$100	\$107
\$0.43	\$35	\$42	\$49	\$56	\$63	\$70	\$77	\$84	\$91	\$98	\$105
\$0.44	\$33	\$40	\$47	\$54	\$61	\$67	\$74	\$81	\$88	\$95	\$102
\$0.45	\$30	\$37	\$44	\$51	\$58	\$65	\$72	\$79	\$86	\$93	\$100
\$0.46	\$28	\$35	\$41	\$48	\$55	\$62	\$69	\$76	\$83	\$90	\$97
\$0.47	\$25	\$32	\$39	\$46	\$53	\$60	\$67	\$74	\$81	\$87	\$94
\$0.48	\$22	\$29	\$36	\$43	\$50	\$57	\$64	\$71	\$78	\$85	\$92
\$0.49	\$20	\$27	\$34	\$41	\$48	\$55	\$61	\$68	\$75	\$82	\$89
\$0.50	\$17	\$24	\$31	\$38	\$45	\$52	\$59	\$66	\$73	\$80	\$87

**Price risk management**

Price risk management would be an essential part of a five month retained ownership commitment on small grains. A price base for the steers next spring could be established by selling a feeder cattle-futures contract or buying a put option (option to sell a futures contract) contract. A put option contract with a strike price at \$1.12/lb (Monday, September 24, 2007) with a May '07 delivery date would cost about 3.8 cents a pound.

This means that after option costs and commissions are deducted, a price base of about \$1.08/lb could be established with a May '08 put options contract. Using the same basic assumptions as above, this alternative would erode profits to about \$38.00/head.

**NOTE:** In terms of capital costs and managing risks, this example would require a total investment of \$692/steer (450 lb x \$1.30 plus 255 lbs gained x \$0.42) compared to an average investment of about \$585/steer. In other words, the investor is placing about \$107 of addition capital, given the higher calve prices, at risk through this venture.

As a result, while near record cattle prices are causing increased interest in cattle retained ownership enterprises, high price roll-backs between current calf and feeder cattle prices next spring indicates that enterprises will require very careful planning and monitoring. Any pricing alternatives that are utilized should provide a floor price yet keep any price improvement open. These alternatives include buying a put option and/or using a minimum price contract.