

CAB CONNECTION

A stormy ride brings beef demand drivers into focus

by Paul Dykstra, Certified Angus Beef LLC



Stepping into another year and another decade provides opportunity to analyze both short-

and long-term effects on the beef business. It's often the short term that shapes our attitudes on the market, but the trends across a decade or more give shape to where the beef industry is actually headed.

Fed-cattle supplies crept slightly higher again in 2019, a culmination of the larger U.S. cow herd still bulging on better weather and feed supplies, but lacking the bullish market signals that triggered prior years' expansion. Weekly average USDA steer and heifer harvests were perhaps 1.4% larger than in 2018, at just above 500,000 head.

Breaking it down by season tells the year's story more aptly, led by first- and second-quarter increases of 1.2% and 1.6% in harvested steers and heifers, respectively. That was spurred by the packer profitability so prevalent since late 2015 that it allowed the bids to fuel burgeoning cattle supplies.

In keeping with the theme of growth during the first half of 2019, carcass quality grades kept to the higher road through mid-May, with the Choice grade scoring another all-time high at 72.17% of all USDA-graded fed cattle for the period. The coveted Prime grade rose to new heights even more impressively during that time, with 9.17% of the

graded carcasses reaching Prime vs. 7.8% the year before. To add context, that means Prime carcasses were 19% more numerous through May 2019 than in 2018.

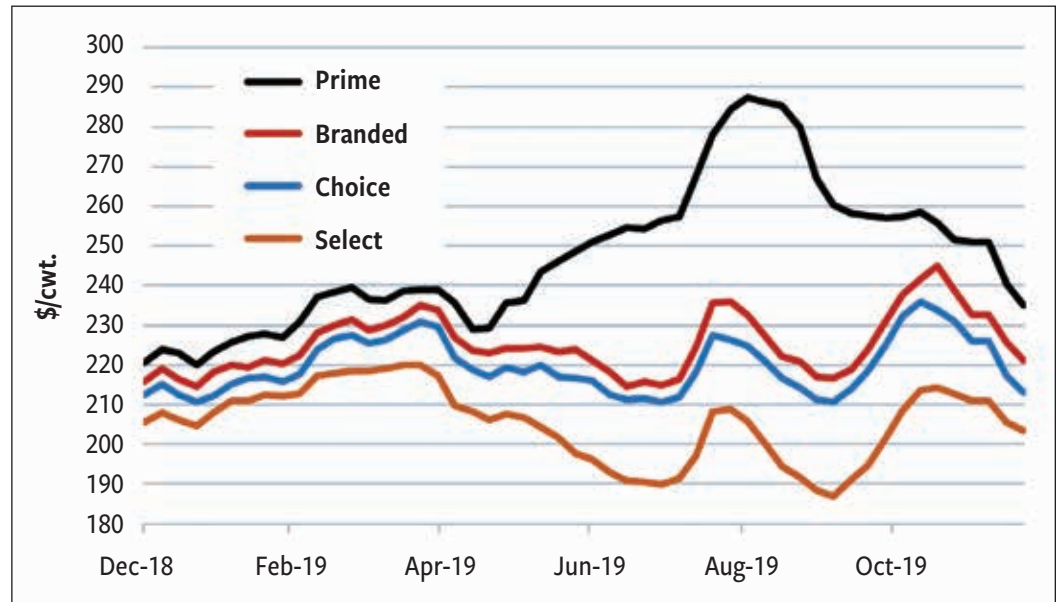
May in the beef business means grilling season, so retailers start their buying run for marbling-rich middle meats well ahead, in March and April. Choice, Prime and Certified Angus Beef® (CAB®) brand carcasses were plentiful last spring, keeping the marbling-driven price spreads from Prime down through Select narrower than the year before.

Spreads

Feedyards focused on carcass values. Therefore the foundational Choice-Select spread was moderately disappointing, with the season's high of \$12 per hundredweight (cwt.) in April and May. Rather than rally in June, more air was let out of that balloon.

This early-2019 trend for more cattle and higher-quality carcasses came and went with average fed-cattle prices just \$1.79 per cwt. higher year on year. Cattle numbers

Fig. 1: Fed-cattle carcass cutout values, 2019



SOURCE: Certified Angus Beef LLC

left the potential market-high bells unring even as tumultuous winter and spring weather marred much of the central United States. Carcass weights, however, trended lower than the prior year into late April as poor feedyard conditions pulled at cattle performance while a positive basis into June encouraged feeders to market cattle early.

The quality beef market saw a turning point in July as seasonal pricing patterns previously ingrained in our market knowledge bank were broken. The "dog days" of summer are normally marked by weaker beef demand, especially for the marbling-laden middle meats that inspire quality carcass premiums from April to June. Dog days mean hot weather in much of the country as families

opt for lighter fare and vacations.

However, July 2019 saw price spreads begin to widen in atypical fashion. While Choice and CAB ribeyes were pricing 70¢ higher than the 2018 week, Select ribs were 80¢ lower. Demand for Select ribeyes essentially fell off a cliff, while Choice and higher middles gained steam. The total carcass Prime cutout value began what would become an epic run, generating a monumental premium into the fall.

The fire

Early in that epic came the event that would underpin the rest of the 2019 beef story: An Aug. 9 fire at Tyson's Finney County, Kan., plant, set the industry momentarily on its ear. Everybody questioned the packing sector's ability to keep pace in the absence of a 6,000-head-per-day processor. Losing 5% of the industry's harvest capacity hit many Tyson employees at its core, while the news sent fed-cattle prices into a tailspin. To say the least, the ensuing weeks were tough on the

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cattle business. Feedyards mitigated losses while accepting lower and lower bids into early September, finally reaching the bottom just below \$100 per cwt.

Shock was equally prevalent on the end-user side as wholesalers, retailers and restaurateurs saw product shortages looming. The scenario put packers in a position of ultimate profitability as their sales teams fielded frenzied calls from buyers looking to secure boxed beef at prices inevitably escalating, particularly on the higher-end products such as Prime and CAB.

The packing segment went to work to partially fill the capacity void through expanded Saturday production shifts. Aggressive harvest schedules in November were productive enough to surpass the 2018 head counts for those weeks, dispelling preconceptions of at least a short-term production ceiling on packers during the ultra-profitable scenario.

Supply restrictions generated

enough angst without further complications, but those were in the works. A lower year-on-year Choice grading trend had begun to enter the storyline in July when the Choice share fell eight-tenths of a percentage point (ppt.) below 2018 to average 71%. The trend only worsened as weeks ticked by, with the September Choice deficit closer to 2 ppt. below September 2018.

Market sensitivity to smaller Choice, CAB and Prime beef supplies proved quite high because retailers had slowly adapted to a 12-year industry migration toward greater availability of the premium beef offerings. The short-term grade setback on fewer

total head processed generated third- and fourth-quarter quality spreads much wider than seasonal expectations. The Prime cutout premium over Choice for September soared to \$65 per cwt. before quickly settling down and then drifting toward \$20 per cwt. by late November.

CAB brand fiscal year growth, at 3.1%, came largely in retail with that division up 8.8%, which further emphasizes the phenomenon of premium beef's penetration there. That's been especially true in regions where Select and low-Choice beef had been mainstays. Furthermore, CAB brand Prime continued to lend a heavy effect in 2019 with 36% sales growth by volume, accounting for 25% of the brand's total growth for the year.

The CAB brand carcass cutout premium over Choice, normally in the \$9-per-cwt. range during late summer and fall, shot to \$15 per cwt. in August, but found a tight range around a \$13-per-cwt. average from late August through year's end, still \$5 per cwt. higher than that period in 2018.

Perspective

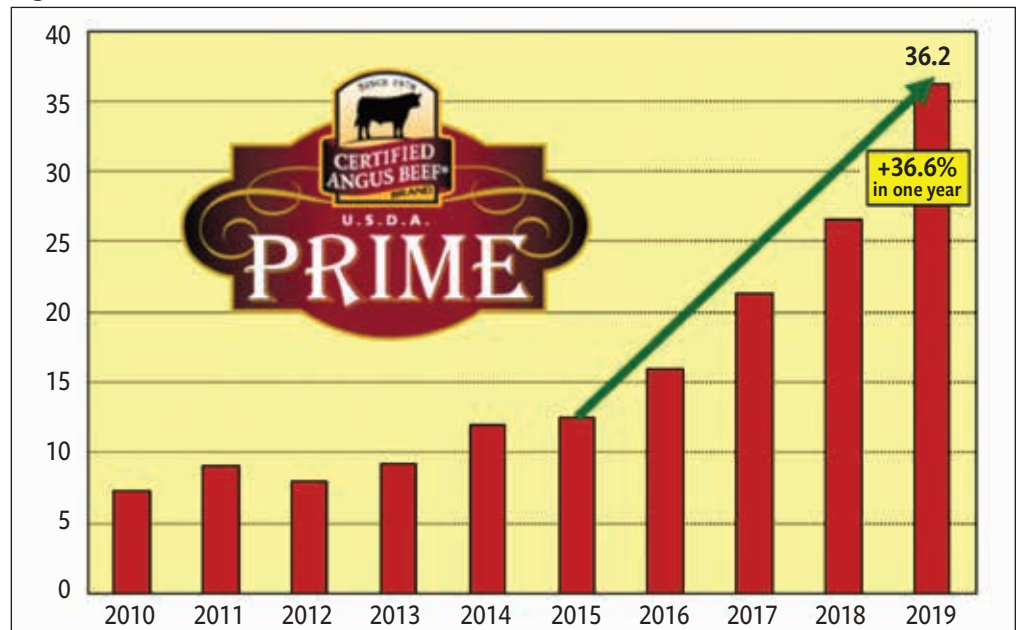
Those are the supply and price highlights, but let's keep some perspective in mind. The 2019 count of Prime-graded carcasses was an

estimated 90% larger than just five years earlier, based on USDA data. Additionally, CAB brand carcasses were 60% more numerous in the same five-year comparison and 2019 tallied the company's largest fiscal year sales volume yet at 2.25 billion pounds (lb.). USDA Choice carcasses were 0.8% more numerous in a year-on-year trend, at 71% of the total mix, but those have increased by 19% in five years.

Finally — and it can't be emphasized enough — the 2019 Select carcass count was down 4.6% since 2015; while the Select cutout discount on the year was \$15.37 per cwt. below Choice, vs. \$7.57 per cwt. five years ago.

While cattlemen have hoped for better weather and markets this year, we can't predict either with enough clarity to matter. Exactly which day the high-marbling fed cattle will bring the most premiums on the rail is equally uncertain. Yet some trends are firmly established: The beef market is increasingly driven by taste and the consumer's overall pleasurable eating experience, regardless of alarming headlines that cast doubt on the future of beef demand. Market signals don't come from those headlines. |

Fig. 2: CAB Prime annual sales, million lb.



SOURCE: Certified Angus Beef LLC

Editor's note: Paul Dykstra is a beef cattle specialist for Certified Angus Beef LLC.