Herd Expansion Means Tighter

by
LYNDEE STABEL,
Certified Angus Beef LLC

In a roomful of cattle feeders, an Oklahoma State University (OSU) livestock marketing specialist had everyone's full attention as he said there is no way around it: In the next two to three years, the already short supply of feeder cattle will only get tighter.

OSU Breedlove Professor Derrell Peel described the current feeder-cattle situation and the circumstances leading to it at the eighth annual Feeding Quality Forum in Omaha, Neb., and Garden City, Kan., in August.

With a U.S. cattle inventory at levels not seen since 1952, "We're much smaller than we ever intended to be," Peel said. Drought and other circumstances led producers to liquidate their cow herds 15 out of the last 17 years, despite recent market signals to expand.

Peel expects that to change.

Throughout much of the United States, drought conditions have improved, opening the door to herd rebuilding. Instead of looking for the likeliest animals to cull, many producers will begin looking for the best heifers to keep.

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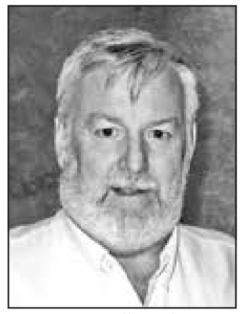
Growth potential

"For the next several years I would expect the [heifer replacement] percentage to be above average," Peel said, "and that has implications to what happens to feeder supplies in the short run."

Growing the cattle population is the ultimate solution to the limited feeder supply, but it is not an instant fix. Until a heifer starts calving, each replacement kept is one less animal available for feeding. Cattle feeders already competing for a piece of that small supply know and don't relish the fact, but "it will get worse before it gets better."

Even so, Peel is optimistic about the growth rate of the national herd. Many producers were forced to cull heavily during the drought, but they did not do it at the expense of their herds' quality. Many heifers were kept and older cows were sold.

"We've probably got this herd as young and productive as maybe it has ever been," Peel said. "When we do start to expand, we have the capability for a year or two to expand faster than what we could have probably seen otherwise."


Derrell Peel

Growth will still take time. Peel expects it to be 2017 before herd numbers can recover to 2011 pre-drought levels. Strong markets for feeders will continue to pull in a share of animals and moderate herd growth.

Cattle imported from Canada and Mexico make up only a small portion of the feeder-cattle market, but Peel said the industry cannot expect extra animals from these sources to help supplement its own limited supply.

Mexico contended with its own extreme drought and liquidated much of its herd, many of those animals entering the United States.

"Last year we got just short of 1.5 million head of cattle from Mexico," Peel said. "That is not a sustainable number. Those exports were at the expense of their ability to produce in the future."

Already the results are evident, with 450,000 fewer head imported from Mexico from August, compared to last year.

With Canada rebuilding its own national herd, those imports will remain relatively low.

All these factors lead Peel to believe the coming years will see the number of feeder cattle fall even further than the 3.5% decline projected by the end of 2013.

Even though overall herd numbers have been declining since the 1970s, the number of cattle on feed has not followed the same pattern. The industry has been able to keep those numbers up by feeding cattle more intensively and at a younger age so cattle move more slowly through the feeding process. For every calf on feed during the early 1970s and 1980s, there were three more available to replace it. By last year, less than two calves were available for every one calf on feed.

Years of cheap corn prices made it profitable to buy smaller calves to feed over a longer period of time.

"The question is, what has to go on to go forward, because over the last few years, that hasn't been true," Peel said. He projected price relationships between cattle weights and cost of gain, given a range of corn prices that should trend lower.

All these circumstances may lead to

Grain markets sink as cattle rise

Corn prices were on a rocket with ethanol boosters for several years, but that's in the past now, said Dan Basse, AgResource Co., in remarks to cattle feeders in Omaha and in Garden City, Kan.

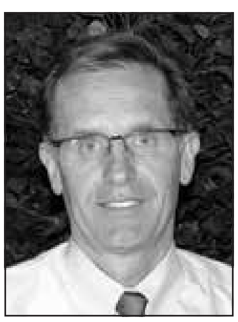
"Last year I said you just have to try and hold on for another year while grain farmers maximize revenue," the Chicago-based market analyst said at the eighth annual Feeding Quality Forum. "Now the picture is reversed. We're just trying to keep corn farmers in business as livestock producers have their turn."

Big changes are rocking the agricultural markets. Why?

"You have been fighting ethanol for corn these past six or seven years, but the biofuel rush is over, and the aftereffects have reshaped the market," Basse said.

With no plants under construction, ethanol demand will be "flat-lining" into 2022. An ethanol boom that started a decade ago needed 5 to 9 million more acres for corn each year and drove world prices higher, but it kept more and more U.S. corn home while competitors led by Brazil reacted to fill those international orders.

Industrial demand is stable at 4.6-5 million bushels (bu.) of corn each year in the United States, but production has adjusted now. Normal weather will only build ending stocks since Brazil, Argentina, the Ukraine and the rest of the world have stepped up to supply global needs, Basse said.


Dan Basse

The U.S. share of world corn trade has fallen to a record low 28% compared to 65% in 1979. Last year, for the first time, U.S. soybean exports exceeded corn. Even that stands to fade this year with record increases in South American soybean yields, he said, noting U.S. prices could be less than $10 per bu. early next year, and down from there as more South American acres switch away from corn.

"Investor money has been leaving the grain market and going into stocks on Wall Street," Basse added. "There's no export story in grains; there's no biofuels story; there's no consumption story."

Showing a corn price chart dating to 1866, he predicted the fall from last year's peak could reach $4 per bu. in fall 2013 and should range from $3.25 to $6 for the next 10 years.

"I can't really tell you how important that is for you in the feeding business, to have ending stocks of corn built up," the economist said. "The new stocks/use ratio means a short crop in the future won't bring worries about $8 corn. That tremendously reduces your risk."

One cure for falling prices is to take land out of production, but without political intervention, U.S. farmers react to lower prices by planting more as long as they can, Basse noted.

China won't buy much of the cheaper corn because it must keep its own 570 million farmers on course to produce, and they will ramp up to export more.

Basse said he didn't expect passage of a Farm Bill in 2013. Even without such structure, he said, "We may see 3 to 5 million acres go back into pasture in this country" as farmland prices undergo a 5%-35% downward price correction.

"When it costs $5 to grow corn and the market is offering you $4, that brings up a new kind of farm crisis, like back in the mid-1980s," he said. "This won't be about interest rates, but rather the cost of operation vs. price."

The livestock producer's advantage — a pretty robust cattle outlook — will come with greater volatility starting in fall 2013, Basse said.

Feeding cattle should be profitable in 2014, "but it's not as good as it should be, because feeder-cattle prices are likely to be at record highs in the initial part of an expansionary phase," Basse said.

Still, the outlook is solid enough that "feedlots are an investment option again," he said, citing one more reason for optimism.

During the next five or six years, the United States will make dramatic strides in oil and gas production, along with Canada, both exporting crude oil to Mexican refineries. "We will move from the largest net importer of energy to the world's leading exporter by 2018 to

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other unusual premiums. "I think there is a good chance that when we get really low with herd expansion, we will see much less discount on heifers relative to steers," Peel speculated. "You may even see heifers bring premiums this year because the breeding female demand on top of the tremendous demand for the feeder animal will be there."

Next generation

Such strong market signals for more feeder cattle would typically send producers into high gear to expand their herds and calf crops, but for many American cattlemen today the situation is not that simple. Most producers are more than 62 years old, and at this point in life they are not looking to increase their workload.

When you show a lot of older producers the potential that is out there from the cow-calf standpoint, they say, " 'Yeah, I see all of that, but it ain't going to be me. It's going to be someone else,' " Peel said, but who will that "someone else" be? Getting into the cattle business is not an easy task.

The next generation of cattlemen cannot borrow enough money to get started, so Peel said it is up to the older ranchers to help get them into the business. He suggested looking at different financial arrangements such as long-term contracts or lease arrangements to transfer equity to the next wave of producers.

No matter who takes on the challenge, the fact remains that the market needs more feeder cattle than are available today. "Now the question is how far do we need to grow, and how fast can we do it," Peel said.

The Feeding Quality Forums were sponsored by Certified Angus Beef LLC (CAB), *Feedlot* magazine, Purina Animal Nutrition, Roto-Mix and Zoetis.

Editor's Note: *Lyndee Stabel is a freelance writer for Certified Angus Beef LLC.*

2020, and oil prices will fall to $65 or $70 per barrel," Basse said. "That will put more discretionary income in consumer pockets, and they will buy more beef."

How fast will bankers open their doors for cattle expansion?

Interest rates are starting to rise, but Basse does not see interest or inflation making much of a move in the near term because too much money is just sitting in banks for lack of confidence in the economy and the government.

"This is a very, very important tipping point for U.S. livestock," he said. "I imagine bankers will be on your side in the next year or two, but it takes a few years for everybody to get on board."

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— Steve Suther,
Certified Angus Beef LLC