Your Link to CERTIFIED ANGUS BEEF® BRAND

by **MARK MCCULLY,** *Certified Angus Beef LLC*

What's up with beef?

The price of beef is up, but not just because there are fewer cattle and less beef. Consumers are paying a higher price only to the extent they find today's beef is worth the money.

During the last several years, packers and cattle feeders have had some great years — and some not so great. Cow-calf producers have had few reasons to frown, unless dealing with uncooperative weather or insufficient pastureland.

Certainly, every link in the beef chain has seen much higher risk per head and per pound. Angus producers are in a strong position because of cattle functionality, genetic prediction tools and the ability to produce beef worth the premium price.

Margins increasing

CattleFax says the value of an average 550 pound (lb.) steer has increased by 125% in the 14 years since 2000 to reach nearly $1,250. The cost to keep a cow has risen by 65% in that timeframe, which tells us cow-calf profit margins are increasing (see Fig. 1). In fact, only one year (2009) in that span shows a loss for that sector, according to Sterling Marketing Inc. They also show the cost of a finished steer increased from $900 to more than $1,800 since 2000.

Next year is projected to bring still higher profits for cow-calf producers, and lower-priced corn points toward another year of favorable closeouts in feeding.

An economist once observed that the best cure for high prices is high prices. That speaks to the cyclical nature of commodity markets, with producer capacity to generate more than the market can absorb. At the low end of quality, the beef market fits the model. USDA Select beef prices have moved sharply higher as supplies fell faster than the supply of premium beef.

Quality holds value

When just about any calf sells for $1,250, you could divert a feedlot pen of unknown-quality heifers and breed them to an accidental bull to create more calves that might sell for that amount. That's being done now. Eventually, it will lower the price of common calves and beef.

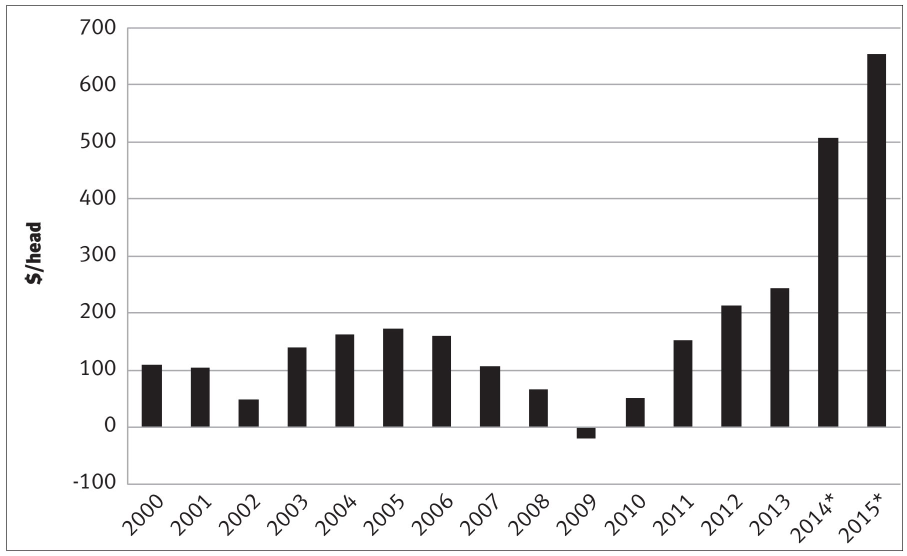
Premium calves and premium beef may follow a similar path, but recent history suggests they have more potential to satisfy profit and palate needs than the broad commodity classes. They're called premium because they hold more value.

Very few in the cattle and beef supply chain get to work on a cost-plus basis. Ranchers are feeling great about the price of calves now, but those whose job it is to process and add value to the already-expensive beef are mostly worried. How long will their customers keep paying the increasing prices?

"This stuff better be good," they keep saying.

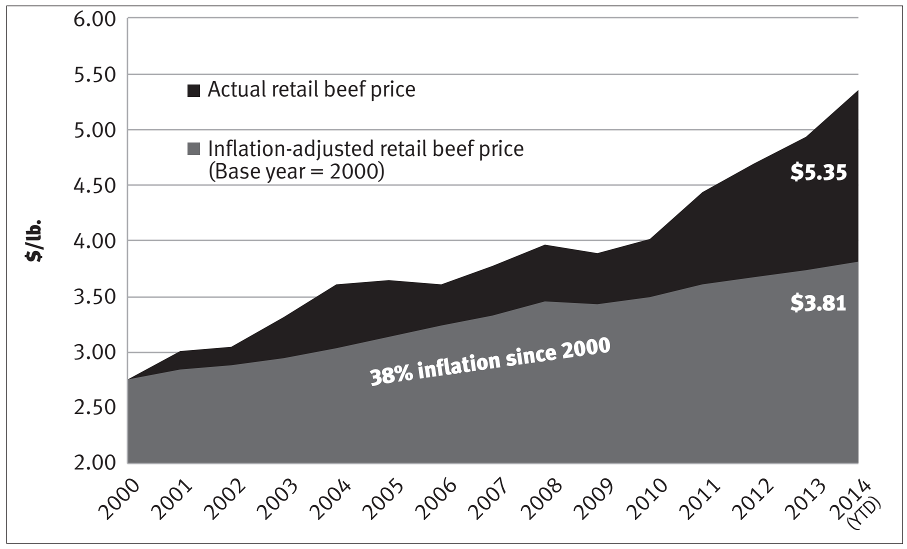
Beef has to be good enough to maintain sales when it seems to go up

Fig. 1: Cow-calf margins are increasing



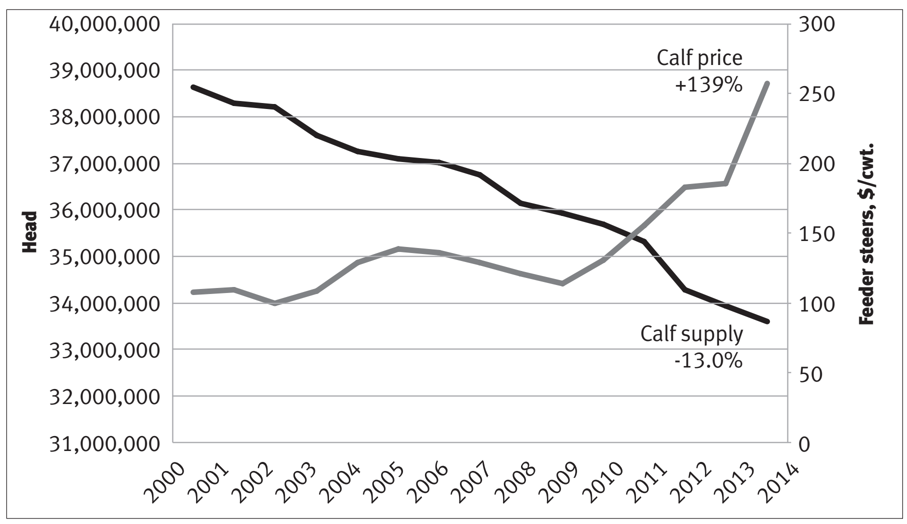
Source: Sterling Marketing Inc. *Estimated.

Fig. 2: Beef prices are outpacing inflation



Source: USDA ERS

Fig. 3: U.S. beef calf supply and feeder-steer price



Source: USDA.

every time the consumer checks the price.

To some extent, retail prices have always been based on the question, "How much can we sell this perishable product for?" Whatever the traffic will bear creates the market-clearing price.

Retailers and restaurateurs use a micro version of cost-plus pricing: They aim for a certain gross margin over beef cost for the quarter or year. When they aim too high for the product quality and demand, the meat does not sell and business suffers.

This has always been true, but the 20th century had little of the market drama we have today. Through the 1980s we sold beef in the mid-$2-per-lb. range for years on end. Prices adjusted upward in the 1990s, and we sat just under $3

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per lb. for another 10 years. For about 20 years, the consumer only saw one shift in the price they paid for beef at retail.

Then the 21st century came around, and we have been on a pretty consistent march upward in price ever since. From 2000 to 2014, so far, average USDA Choice beef retail price has gone up 87%. Whether buying or selling it, you have to ask, how did we get here?

Inflation added 38% during those years, but inflation alone would only carry retail beef to $3.81 per lb., and yet it averages $5.35 today (see Fig. 2). There's something else going on.

Retail margins under pressure

Cattlemen might look at prices in the grocery store and assume all grocery store owners are making huge profits. The price per pound in the "finished good" is far greater than the price received on "finished cattle." While packers and retailers merchandise every pound of the carcass, when lower-value bone and fat yields are considered, the price discrepancies start to make sense.

Moreover, we should compare that 87% increase in retail Choice beef price to Choice boxed-beef cutout, which moved up by 96%. Because the retailer's beef cost has increased at a faster pace than selling price, retail margin on a percentage basis has actually come under pressure. Like every other business, the retailer has seen dramatic increases in labor, energy and overhead.

What about packer margins? Sterling Marketing calculates those and reports the past two years have been unprofitable for packers simply because the price they've had to pay for cattle has been out of line with what they have been able to get for boxed beef. This year, however, even with record-high fed-cattle prices, Sterling estimates packer margins are positive.

Feeding cattle has been historically profitable in 2014. With high prices for finished cattle and declining feed costs, this sector is making up for two years of equity-draining losses. They know profits come and go, but an increasing number of feedlots are turning toward higher-quality cattle to get the most out of each head fed, considering both feeder calves and feed costs are 139% higher than they were in 2000, though feed prices have eased this year.

A huge "X factor" in the market for years has been overcapacity in both the feeding and packing sectors. These infrastructures were built for a much larger cow herd than we have today. The need to buy animals in short supply to fill pens or hooks has produced a demand that is likely short-term. Some of this competition has been to grow market share despite being unprofitable. That is not a sustainable long-term situation, and eventually infrastructure must adjust. That's happening now.

The signal to expand the U.S. beef cow herd has been sent for a few years, but Mother Nature has not cooperated. Margins today are at historic high levels, and farmers and ranchers will rebuild in response to this opportunity. Beef marketers and consumers must realize that once grass and feed become available, expansion will take several years to produce significantly more beef.

In the past few years as the overall supply of beef declined, the higher-quality portion grew as a percentage of the whole, and in the case of the *Certified Angus Beef*® (CAB®) brand, supplies grew in terms of tonnage sold. That's a response to demand that could reshape the industry as it enters the overdue expansion phase.

Editor's Note: *Mark McCully is vice president of production for Certified Angus Beef LLC (CAB).*