Your Link to Certified Angus Beef

by **PAUL DYKSTRA,** *Certified Angus Beef LLC*

The cycle turns

The beef business is never short on drama, but the 2015 markets were as tumultuous as any we've seen. Stakeholders knew how the smallest cow herd since 1960 could build up cash, but the shock of how quickly those record prices could unwind was a devastating blow to many.

Federally inspected fed-cattle harvest was down by 4.6% in 2015, and cow harvest was down 4.3%. Those were just the latest in consecutive annual reductions since 2010 and 2011, respectively, while 2016 is expected to begin gradual increases with cow herd expansion under way.

That was evident from the meager 32.5% heifer share of the fed-cattle harvest, compared to 36% and higher during years of cow herd contraction. The number of heifers harvested in 2015 was 12% lower than 2014, while steers were down just 0.3%.

Carcass weights played "the heavy" in the cast of characters that brought cattle prices down. They diverted from a multi-year upward trend line in July 2014 by breaking to the topside as reduced fed-cattle numbers met runaway record cattle prices. That year's fourth quarter brought on a 23-pound (lb.) average jump in steer and heifer carcass weights, indicating the trend would continue as the spread between cost of gain and fed-cattle price remained wide. Although 2015's first quarter saw a narrower, 15-lb. year-on-year increase, a wider divergence returned and built up to a seasonal fall peak when the steer-carcass average reached 930 lb. mid-October (1,525-lb. live weight before shrink).

Under pressure

Reduced harvest counts throughout 2015 were not simply the result of fewer available cattle. Wholesale cutout values could not hold above the $250-per-hundredweight (cwt.) mark called for by the fact of $160-per-cwt. fed cattle, which put packer profits under water on a cash-to-cash basis. That curbed any desire packers might have had to bid enough to match prior-year head counts.

Meanwhile, the recent record calf prices were softening, but still far above breakeven level for cattle feeders. Their obvious course was simply adding 15 or 30 days on feed to their existing inventory, given their cost-of-gain advantage.

Detailing the price break since August would be academic, but it's understood that leverage shifted in the packers' favor with the burdensome level of heavyweight cattle on feed in late 2015.

Further price-limiting pressure came from competing proteins. Recovery from porcine epidemic diarrhea virus (PEDv) woes led to pork production 6.8% above 2014, depressing prices by 25% on the year, the lowest since 2009.

Competition from chicken was keen, as well, with broiler supplies up almost 5% in 2015. Broiler weights reached a record 6.2 lb., combining to push production tonnage up 4.6%. Avian flu-induced trade barriers forced a 12.4% decline in exports to net an 8.5% increase on the domestic market. Consequently, the second half of 2015 had whole-bird values pressured below any of the previous three years.

Getting back to beef trends, the positive side came in the form of carcass quality grades. 2015 was the ninth straight year that the industry pushed marbling levels and carcass quality grades higher. We immediately look to carcass weights and those extra days on feed as a clear driving force.

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However, that would not have worked without enabling genetics from U.S. seedstock producers, who have continued to place pressure on carcass traits, specifically marbling, to the benefit of the consumer.

A year ago, we noted the impact of Holstein steers, known for their marbling advantage, rising from a more common 15% to as much as 20% of the fed-cattle mix. This factor remained in 2015, though we believe it was relatively less impactful than giving improved native genetics more time on feed.

Regional improvements

On a regional basis, we saw more quality-grade improvement in Kansas packing plants than in Nebraska when analyzing the "big three" packing states that include Texas, as well. Shawn Walter of Professional Cattle Consultants pointed out early in the year that both Kansas and Texas cattle feeders had begun to extend their feeding periods to match those of Nebraska and the north, where days on feed were traditionally up to two weeks longer than in southern feedyards.

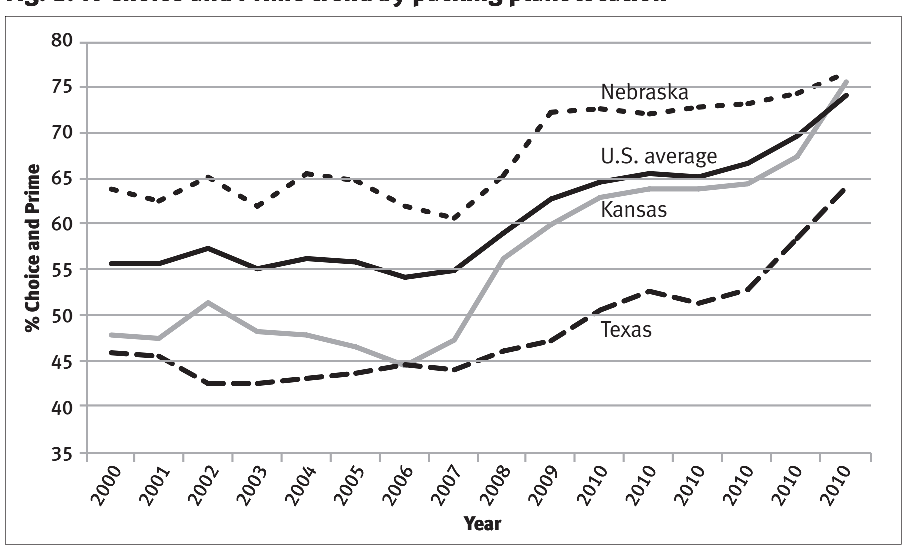
Table 1: 2015 U.S. beef production changes

Total F.I. harvest	-4.75%
Fed-cattle harvest	-4.58%
Fed-cattle carcass lb.	-2.10%
Steer harvest	-0.29%
Heifer harvest	-12.43%
Carcass weight avg.	+21 lb.
Dairy cow harvest	3.77%
Beef cow harvest	-13.20%
Total cow harvest	-4.33%
Prime, lb.	20.39%
Choice, lb.	3.45%
Select, lb.	-20.20%

Just 10 years ago, Kansas packers were producing 44% Choice and 1.6% Prime carcasses with a steady history of figures in those ranges since 2000. Annual incremental improvement began industrywide in 2007, but as of 2013, Kansas was still 9 percentage points behind Nebraska's 68.5% Choice grade and managed only half as many Prime carcasses.

In 2014, the gap narrowed a bit as Kansas moved higher by 3 points and Nebraska by just 1 point. It's hard to believe, but in 75 days from mid-March to June 1, 2015, Kansas packers surpassed Nebraska in the quality of their carcass output, averaging 75.7% Choice and Prime to Nebraska's 73.9%. Nebraska regained the lead for the rest of the year, posting an annual weekly

Fig. 1: % Choice and Prime trend by packing plant location



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average of 72% Choice and 5.8% Prime, with Kansas a close second at 72% Choice and 4% Prime.

While the tremendous improvement in Kansas gets the spotlight, it's also notable that Texas packers have followed a similar, if not as aggressive, pattern in improved quality grades. Since 2007, Texas processors have seen their Choice percentage grow 16 points, from 44% to 62% in 2015, along with 2% Prime for the year. Moreover, while USDA details only those three states individually, we know packers in other northern states such as Washington, Iowa, Illinois and Pennsylvania often surpass Nebraska's figures when it comes to percent Choice, Prime and premium Choice branded products, albeit on a smaller scale due to much smaller head counts.

Heavy discounts

The downside of record-breaking carcass weights in the past year has been the increased incidence of yield grade (YG) 4 and 5 carcasses. Genetic trends in beef breeds for improved yearling growth have allowed today's fed cattle to grow to heavier final weights while remaining relatively lean in terms of external fat cover. Even so, in 2015 we saw multiple pens of steers finished significantly heavier than 1,600 lb. on average. These cattle were too fat in nearly every case, with extreme YG 4 and 5 percentages, often more than 50% YG 4.

USDA data shows an October YG 4 percentage of just 14% and 3% YG 5s, neither of which appears problematic — nor do they align with the examples above. However, the USDA data is far from comprehensive because only about 26% of fed steer and heifer carcasses are assigned a yield grade by USDA since packers have largely moved away from utilizing the USDA grading service for yield grade.

Instead, many firms are assigning their own yield grades through use of camera imaging systems and employing that data to determine appropriate premiums and discounts. Nonetheless, high incidence of YG 4 and 5 carcasses became a problem weighing on the fed-cattle market and red-meat yield in packing plants in late 2015.

The dramatic eight-year increase in marbling levels and recent cattle-feeding trends leave us with questions as to consumer demand. Will the marketplace continue to set premiums at each interval for low-Choice, premium-Choice and Prime? That's hard to discern given the wide swings in total cutout value since the start of 2014.

The Choice-Select spread for 2015 — at $7.53 per cwt. — averaged roughly $1 per cwt. (12%) lower than the year prior in the face of 3.5% more Choice tonnage. Meanwhile a 20% reduction in Select supplies netted managed to generate only a 64¢ price increase. The seasonal patterns for widening and narrowing of the Choice-Select spread remained intact however, with lower peaks and a markedly lackluster performance in October and November.

Certified Angus Beef® (CAB®) brand premiums above the low-Choice cutout were more resilient, posting an $8.61-per-cwt. premium in 2015, only a penny decline from 2014. That's alongside a 1% increase in sales volume for the brand's fiscal year, totaling 896 million lb. We calculate production of Prime-grade beef at a 20% increase for 2015, with a collateral $8.90 per cwt. (25%) premium decline for the Prime cutout above low-Choice last year, still netting an 11% premium over Choice.

Although annual comprehensive cutout averages for the past two years are virtually identical, the 30% differential in prices throughout that period make it challenging to create smooth demand indicators. Even so, with such a quality-rich product mix in the marketplace, indications are good that consumers will continue to pay a premium for quality.

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