Manage Risk with Quality

Large-scale cattle feeder says quality = less risk, more rewards.

Story by
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Quality vs. quantity. It's an age-old debate, but cattleman Tom Brink, J&F Oklahoma Holdings Inc., says it doesn't have to be either/or.

And he would know. Brink is the president and COO of the cattle ownership arm of Five Rivers Cattle Feeding. Its 12 feedlots can hold more than 950,000 head, annually marketing up to 2 million finished cattle.

Brink talked about managing and hedging high-quality cattle at the fifth Annual Feeding Quality Forum (FQF) in Grand Island, Neb., and Amarillo, Texas, in November.

"The topic of quality cattle is always relevant, because the commodity business simply doesn't pay that well," he said. "We have worked for a lot of years in this industry to differentiate our product and have the opportunity to capture additional value."

Brink profiled cattle sold from July through October, sorting them by the top 10% premium-earning pens and the other 90%.

There were 40,000 head in that top 10%. That group had an average of 27 pounds (lb.) higher live weight and a 19-lb. hot carcass weight (HCW) advantage. Dressing percentage was 1.2 points better than the rest, too.

"That added weight speaks well for their performance in the feedyard," Brink said.

Where the top value-getting group really racked up the premiums was in the grade, he said. Choice and Prime percentage was 15.1 points higher than the lower-value group, 67.9% vs. 52.8%. The *Certified Angus Beef*® (CAB®) difference was even more dramatic: 17.7% for the top tenth compared to just 8.4% for all others.

"If we were to assume the others sold at the average of the live market, those top 10% brought $48 per head more," he said. "That would mean if we took

Below: "There's no question that today's market is less predictable, it is more volatile, and it's harder to manage than ever before," said Tom Brink, president and COO of the cattle ownership arm of Five Rivers Cattle Feeding.

this same top 40,000 steers and valued them appropriately as a feeder animal, they are worth $6 per hundredweight (cwt.) more than a commodity animal. So there is tremendous value in those cattle."

Brink profiled the heifers and found similar trends.

"It does say you can give up a bit in terms of yield grades because the premiums are so large on these high-grading cattle," he noted. "Around 20% of the money we'll make this year is from the value-added side. That's in a profitable year, so think of how much more value-added premiums matter in a narrow-margin year."

When it comes to risk management, high-quality cattle have an often overlooked advantage.

"They are going to sell at the top of the market or even above the market, and that gives us a better basis to work with," Brink said.

Managing risk

Of course, basis is only one piece of the picture. Brink shared his "Ten Tenets of Risk Management:"

1. Understand your risk tolerance.
2. Decide what the futures market should do for you (hedge risk or become a profit center).
3. Start with a competitive breakeven.
4. Know your position.
5. Analyze financial outcomes over a wide range of potential prices.
6. Establish risk management decision-making structure.
7. Write down a specific plan. Follow the plan. Update it regularly.
8. Project the market's likely range, and shorten and lengthen your position accordingly.
9. Manage your coverage in percentages while evaluating risk vs. reward.
10. No one gets the market right 100% of the time, so work for a good batting average.

"There's no question that today's market is less predictable, it is more volatile, and it's harder to manage than ever before," said Brink, who has worked in risk management for more than 20 years.

Bankers, spouses and employees might all have a say in determining risk tolerance. Once that's decided, it will be easier to establish futures market goals.

"Your actions over time should reflect that, and they should be consistent with your overall strategy," Brink said.

Without a known competitive breakeven, "it's very difficult to make hedging decisions," he said. That's achieved by buying cattle as competitively as possible and managing all other inputs.

He suggests reanalyzing market position at least once a week. That routine allows cattlemen to "spend more time thinking about what they should be doing and not just trying to figure out where they are."

Every business — no matter how small — should designate who makes those decisions and then write them down, Brink said.

Then, in the end, it's important to remember: "You won't always be right with the market."