Full Steam Ahead

By Kindra Gordon

Record cattle prices, solid beef demand, and continued cowherd expansion expected for 2015, but we all know the good times never last forever - so what should your management strategy be?

If you had to use one word to describe current conditions in today's cattle industry, that word would likely be – unprecedented. Indeed, cattle prices have reached peaks never seen before.

Cattle producers thought the 2013 average price received for a 550-pound steer was quite good at $168/cwt. Then 2014 came, and tight supplies drove prices even higher. The CattleFax average estimated price for 550-pound steers for 2014 is $240/cwt and the 2015 estimate is $255/cwt. Unprecedented.

What's even more astonishing is that this price phenomenon may stay in place through 2015 and even into 2016.

Kansas State livestock economist Glynn Tonsor credits much of this to the fact that the beef industry is facing tight supplies coupled with continued strong beef demand. He says this is a scenario that is likely here to stay for at least another year – depending on herd expansion. Tonsor projects prices for 500-600-pound calves in 2015 could be as high as $270/cwt, and in 2016 they could be $280/cwt.

As a result, average cow-calf returns are over $500. Tonsor says, "In the past a $150 return was considered great, we saw that in 2004 and 2005 and got close in 2013. Now, producers are seeing over $500 and that is expected to hold for 2015. This sets the stage for a lot of excitement for expansion."

Expansion Underway- In addition to dollars, several other factors are helping encourage expansion – including cheaper feedstuffs and improved drought conditions allowing for available range, pasture and hay.

Tonsor says heifer placements on feed and cull cow rates have slowed over the past year – indicating herd expansion is occurring. However, he says since July 2014 there have been some mixed signals in the marketplace, indicating expansion slowed a little.

In spite of that, long-term forecasts suggest between now and 2023 the national cowherd inventory could grow from 4 to 16%. That would move the U.S. from a current 29 million cows to upwards of 33.7 million head, which Tonsor says is about equivalent to what the cowherd was in the year 2000.

The U.S. cattle cycle has not seen a significant expansion phase since the 1991 to 1996 expansion, increasing by 1.7 million cows. Moderate efforts for expansion from 2004 to 2006 expansion were cut short by drought in the Southern Plains.

Tonsor says indicators to watch with regard to expansion are the percentages of cull cows and heifer placements. When the cull cow rate is below 10%, that's an indicator that expansion is happening. In 2015, the rate is projected to be below 9%t. Another indicator that expansion is on the horizon can be seen in the years when heifer slaughter percentage of total fed slaughter is around 35% or lower.

The bottomline, says Tonsor, is that the beef industry has "lots of positive things going on." Now, if expansion occurs, consumer demand will need to be maintained or increased as well.

Surprisingly, to date in spite of increased retail beef prices, consumer demand in the U.S. has remained resilient. But the question analysts are monitoring will be how will beef demand hold up going into 2015 with expected larger pork and poultry production? That's a question that remains to be answered.

Going forward, a report authored by ag economist Jessica Sampson and James Robb with the Livestock Marking Information Center suggests that two major uncertainties need to be monitored: crop production and the macroeconomic environment as it relates to domestic and international beef buyers. If those factors remain favorable, LMIC projects average cattle prices could peak in 2016 or 2017.

However, if unfavorable weather impacts U.S. crop production, that could in turn impact cattle feeders and calf prices. Additionally, if significant economic slowdowns – a recession – come into play, beef prices and consumer purchasing could be adversely affected.

But for now, it continues to be an unprecedented ride.

Management Matters- But the risk during the "good times" is to forget to carefully manage business expenses and planning, say many management experts. Business chores often get pushed to the back-burner, because prices are good and cash flow is positive.

Purdue Distinguished Ag Economics Professor Michael Boehlje advises for ag producers to strive to be a low-cost producer – no matter what the market conditions. He says, "When you wake up each day, tell yourself, 'My job today is to lower my costs.'

With continued volatility in market prices for cattle and crops, Boehlje says, “I’m worried about profitability, especially in 2016.”

He advises that producers should continually strive to “think like a CEO” and to focus on strategy – including production, management and adding innovation. He also notes that sometimes using a consultant to offer new perspective and ideas can be a good investment.

Boehlje has compiled a checklist for ag producers to consider as they look ahead for their business:

1. Manage operating risk

- Keep cash costs and land rents in line with revenues.
- Recognize continued leaner profit margins and margin risk.
- Take advantage of forward pricing and crop insurance to manage risk.

2. Manage money and capital

- Protect your working capital. Extend your terms for items purchased on 10- and 20-year terms. “Now is the time to refinance that land on a 20-year mortgage,” Boehlje says.
- Lock in today’s relatively low interest rates on capital expenses.
- Deleverage.

3. Emphasize execution

- Do fewer things better. Identify areas that lose money.
- Use standard operating procedures (SOPs).
- Optimize data management.
- Simplify operations and automate where possible.
- Pay attention to details.

4. Increase asset utilization (asset turnover)

- Lease rather than buy. Short-term operating leases increase asset turnover.
- Use joint venture and shared machinery to intensify production.
- Think in terms of “earns and turns,” the key financial metrics known by every machinery dealer and hardware store owner. Stated differently, they are operating profit margins on sales and asset turnover.
- Outsource or custom farm. “You already outsource your taxes and legal work,” Boehlje says. “Recognize where you capture value by hiring things done.”

5. Increase margins

- Control costs. You have to measure before you can manage.
- Buy right.
- Use best management practices and technology.
- Market rather than price.

6. Use time efficiently

- Focus on management.
- Hire skilled employees.
- Use scheduling and workflow planners.
- Develop standard operating procedures.

7. Grow volume and sales

- Increase productivity.
- Generate more volume with less investment.
- Joint venture for size and volume to gain market access.

As a final point, retirement planning shouldn’t be overlooked. Most retirement specialists advise contributing manageable amounts at regularly scheduled times throughout the year, so that your retirement fund stays secure and begins to build.

Should you expand your herd?- With regard to expansion, K-State’s Glynn Tonsor says that is an individual question that each producer should ask themselves, and he notes that it may not be the right option for some cattle operations.

Tonsor says other important questions to ask yourself with regard to expansion are: What can I afford to pay for a replacement female? Should I buy cows instead of heifers? Should I buy or raise my own replacement heifers?

Tonsor says two web spreadsheet resources can help answer those questions. They include:

- http://www.agmanager.info/Tools/default.asp#LIVESTOCK (scroll to KSU Beef Replacements and download)
- http://www.extension.iastate.edu/agdm/livestock/html/b1-73.html