

RETAINED OWNERSHIP STRATEGIES



For CATTLE

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Market Integration

Market integration, or retained ownership, involves carrying over a production activity into the next phase of preparation for the marketplace, and there are certain advantages associated with this production and marketing strategy. Retained ownership through the stocker/feeder and finishing phase eliminates some trading points, which can lower procurement, transportation and selling costs. Cattle or calves may still be moved, but without the stress of being cycled through a variety of market channels. Such cattle can be shipped directly to the place where they will be grazed, backgrounded or finished in a feedyard.

Retained ownership also allows producers to spread risk from one production activity to another and from one period of time to another. Cattle producers should seriously investigate the possibilities of retained ownership and then select the alternative that most closely meets their profit objectives. History reveals that between birth and harvest, someone will often

profit from cattle before they reach harvest weight. One of the objectives of retained ownership is to take advantage of this tendency.

During certain periods and conditions, retaining ownership can be, and has been, more profitable than selling calves at weaning. Ranchers must carefully evaluate each decision period, because by retaining ownership they are assuming more production and marketing risks. If the producer misjudges future market conditions, or if the cattle are not properly contracted, retaining ownership can cause an accumulation of losses rather than profits.

There are other important conditions to consider when deciding whether to retain ownership. First, retaining ownership will increase management and decision-making requirements. More capital will be required for the additional production expenses. The cattle producer's cash flow will change because retained ownership delays income and adds production costs.





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Producer Size

Many cattle producers do not have enough calves of similar kind at one time to use the retained ownership strategy. Usually 100 head are required for a pen at most commercial feedyards. But this should not deter you from using this strategy when trying to make a profit. Producers can form marketing associations, cooperatives or partnerships to put together the necessary cattle. In some cases, it may be feasible to sort and commingle calves or feeder cattle into lots large enough to achieve this minimum size, thus making retained ownership a feasible alternative.

The First Decision Point

The most important piece of information for making marketing decisions comes from you, the producer. It's important to know your individual production costs for each stage of production. Sometimes cattle producers pass up profit opportunities because they do not know their own production costs and, as a result, are unable to project profitability accurately in the next production phase. For example, if at weaning time a cow-calf producer determines

that a profit is not available on the cash market, nor has it been locked in by contracting calf sales, the logical strategy is to maximize returns from that point on. Although the initial production phase, in this case the cow-calf stage, may not be profitable, it's possible the cattle enterprise's total profitability may be improved by retaining ownership into the next production phase. But to accurately assess profitability, you need to be able to project costs for the next production phase.

Buy-Sell Price Relationships

One reason some cattle producers have not used retained ownership strategies more often is to avoid the adverse buy-sell price situations associated with buying lighter calves and selling heavier cattle. Generally, as cattle gain more weight their price per pounds drops, or as a term commonly used in the industry implies, the price "rolls back." This means that producers will generally sell heavier weight feeder cattle at a price per hundredweight that is lower than the price per hundredweight they are accustomed to receiving for lighter weight calves.

Cost Considerations

Even with price roll-backs, retained ownership programs can be profitable. An important consideration in determining whether or not to retain ownership of a group of cattle is the relationship between calf prices and cost of gain. Knowing this enables you to determine the required price relationship between the beginning and end of the production period. For example, if expected costs of gain exceed weaned calf prices, the sale price at the end of the production period will need to be above the weaned calf price at the program's outset. If costs of gain are less than weaned calf prices, some roll-back in prices of feeder cattle can be endured without suffering a loss.

Table 1 illustrates the effects of cost of gain and total pounds of gain on cattle break-even prices. The table

assumes you are grazing or backgrounding a 500-pound stocker calf with a value at the program's outset of \$105 per hundredweight. Costs of gain are given in units of \$5 per hundredweight, beginning at \$35 and increasing to \$55. If, for example, the stocker gained 200 pounds during this period at a cost of \$40 per hundredweight, the break-even price at the program's end would be \$87.65 per hundredweight, including interest charges on the calf and other feeding costs. As one would expect, the price per hundredweight required to break even is below the calf's per hundredweight price at the program's outset because of the lower cost of gain. Also note that as the total pounds of gain during the feeding program increase, you can tolerate a larger price roll-back.

Table 1. Break-even prices for a 500-pound calf grazed to different endpoint weights at various costs of gain.¹

Pounds gained	COSTS OF GAIN \$/CWT.				
	\$35	\$40	\$45	\$50	\$55
	Break-even prices \$/cwt.				
100	94.66	95.50	96.35	97.19	98.04
150	90.10	91.28	92.45	93.62	94.79
200	86.20	87.65	89.10	90.55	92.00
250	82.82	84.51	86.20	87.89	89.58
300	79.87	81.77	83.67	85.57	87.47

¹ 500-pound calf at \$105 per cwt.; costs of gain include all production, management, marketing, finance and transportation costs.

Table 2 provides break-even prices for 750-pound feeders entering a feedlot at a price of \$95 per hundredweight. Once again, costs of gain and total weight gain are allowed to vary. Finishing a 750-pound animal to 1,250

pounds at \$75 direct cost of gain would require a \$86.10 break-even price with interest. Interest is charged on the full cost of the feeder and all other costs, adjusted for the time the cattle are on feed.

Table 2. Break-even prices for a 750-pound feeder fed to different endpoint weights at different costs.¹

Pounds gained	COSTS OF GAIN \$/CWT.				
	\$70	\$75	\$80	\$85	\$90
	Break-even prices \$/cwt.				
400	85.21	86.98	88.74	90.50	92.27
450	84.62	86.52	88.42	90.32	92.23
500	84.07	86.10	88.13	90.16	92.19
550	83.57	85.72	87.86	90.01	92.15
600	83.11	85.36	87.61	89.87	92.12

¹ 750-pound calf at \$95 per cwt.; costs of gain include all production, management, marketing, finance and transportation costs.



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Information Sources

It is essential that cattlemen have good information on current conditions and trends in the livestock, grain and meat sectors as they become involved with retained ownership strategies. They must also be current on consumer eating trends, as well as the general conditions of the U.S. and world economies.

Trends in domestic cattle numbers and prices should be considered before deciding whether or not to retain ownership. Cattlemen should be aware of the size of the U.S. cow herd and the calf crop and also have some knowledge of the current cattle cycle. Perhaps the most important piece of market information to consider is whether cattle prices are expected to rise or fall, as a function of the cattle cycle. Generally, retained ownership strategies will work best when cattle prices are expected to rise cyclically over the course of the feeding period, although retained ownership can still be profitable even without a significant rise in price level.

It may appear to be a difficult task to access such information, but it is not. Much of the information is available at little or no cost through the U.S. Department of Agriculture, the Extension Service or cattlemen's associations. The next step is to determine what factors are having the most impact on the current market and to watch those trends carefully.

One of the simplest ways to monitor market conditions is to subscribe to weekly or monthly newsletters with analyses of current trends and factors that affect the markets. Such newsletters are available through Extension Services or various commercial consulting firms. These resources may help you fine-tune your market awareness and decision-making skills. Examples of these newsletters are *Texas Livestock Roundup* (<http://livestock-marketing.tamu.edu>) from the Texas Agricultural Extension Service and the *CattleFax Update* from CattleFax (<http://www.cattlefax.com/>).

Financial Considerations

Retained ownership increases capital requirements and delays income. This must be considered, and some adjustment to cash flow expectations must be made if retained ownership is going to be successful. You may need to prepare a balance sheet, projected income statement, cash flow, and a marketing plan before the lender will provide the additional capital required for increased production costs and a delayed income. Some lenders may require a portion of the cattle be hedged before lending additional capital.

Geographic Considerations

If you want to retain ownership through the finishing phase, where to place your cattle is an important decision. The three-state area of Texas, Oklahoma and New Mexico offers several advantages including a good year-round climate, proximity to major packers and experienced feedyard operators.

The climate throughout most of the three-state area is characterized by mild winters, low humidity and little precipitation (about 20 inches or less per year) — all of which are beneficial to the growth and overall health of cattle.

All of the major packing companies are active buyers of the cattle that are fed to finish in the region. The concentration of packing plants in and around the three-state area bolsters cattle feeders' bottom line by reducing transportation costs.

And, as you might expect from an area that produces 30% of the nation's fed cattle supply, the cattle feeding belt that stretches across Texas, Oklahoma and New Mexico is rich with expertise. The owners, managers and employees of the feedyards in the region have devoted years — and in many cases decades — to the fed cattle business. They have the necessary know-how to make your investment in cattle feeding a rewarding one.



Feeding Arrangements

In today's cattle industry, leased grazing and custom feeding are options available to most cattlemen. In both options there are various arrangements for assessing charges. The two most common methods are a fixed charge based on cost of gain and the sale of feed and services. These two approaches differ primarily in the way risk is shared between the feeder and cattle owner. Under a fixed cost of gain arrangement, the cattle owner shares in the risks of death loss and assumes all the risks of falling cattle prices and rising grain costs, whereas the custom grazer or feeder shares in the death risks and assumes all the risks of poor cattle performance, bad weather, sickness, rising feed costs, weight shrink and management. If the feeder simply sells feed and services to the cattle owner, virtually all of the risks are shifted away from the feeder to the cattle owner. Very few commercial cattle feeders will feed cattle for a fixed cost of gain, but it is not uncommon for custom graziers or custom backgrounders to offer a fixed cost of gain program. The relative merits of the two approaches to custom feeding depend on the individual situation, but be aware of the big difference in the risk profile under the two approaches.

Today's commercial feedyards offer a variety of services and information to assist cattle owners. Most feedyards offer risk management assistance to customers or have a

direct link to a commercial brokerage specialist. Most commercial feedyards are willing to partner with cattlemen on ownership to help distribute risk as well as provide financing for cattle and/or feed. Virtually all feedyards have consulting veterinarians and nutritionists to assist with animal health and ration balancing. Feedyard managers can also assist customers in evaluating marketing alternatives that are designed to allow cattle owners to offset risk and capture the full value of their cattle.

Tax Advantages

Retained ownership also offers cattle producers some flexibility in managing their annual income tax liabilities. By retaining ownership, a producer may transfer taxable income from one year to the next. This may be especially useful in years when sales have been high. It is possible that some sales can be carried over to the next year at reduced risk by using futures or options contracts. It is important to discuss these options with your financial advisor.

If cattle are being fed in one year and sold in the next, prepayment of feed and production expenses, not to exceed 50% of the total, may be charged against income received during the year the cattle were placed on feed. This allows cattlemen some flexibility in planning their taxable income and tax liabilities from one year to the next. 