AgriProfit$

Newsletter for Alberta Cattlemen

Editor's Corner

As we're moving into the "fall run" of calves, it's timely to shift our focus to marketing and market outlook.

In our feature article, Darren Chase gives a run-down on cattle market fundamentals, outlook and key items to keep in mind when setting up your marketing plan and replacement intentions.

Responding to the questions I've fielded on "what's a profit center?", in the *"So What ...?"* column, I've put together a short definition and explanation of how profit centers fit in with measuring performance and business planning.

In upcoming issues we'll go into the "low-cost vs. high cost" debate and what this means as you consider the pro's and con's of rebuilding your herd.

Dale A. Kaliel,
Editor

Economics Unit

Cattle Market Fundamentals and Outlook

Darren Chase
Livestock Market Analyst

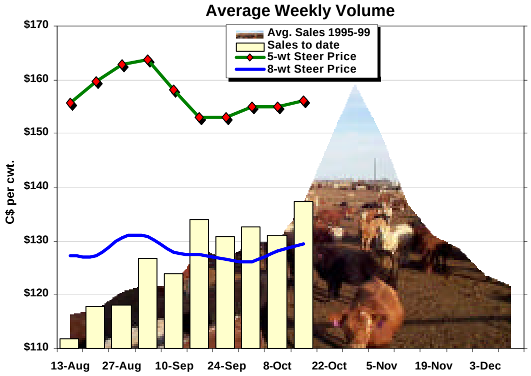
Three terms you'll hear a lot these days in beef cattle markets are ***seasonal patterns, trends and cycles***. In this article, I'll introduce these three time dimensions, review the current market situation, provide short term outlook and put marketing into context with the overall business of managing your cow/calf profit center.

Seasonal patterns are short term regularly occurring annual events. The large marketing volume of calves after weaning is a good example (Figure 1). These events are often expressed as highs and lows. Comparing the large volumes of calf sales to fall run prices helps build an understanding of market fundamentals.

The ***trend*** component involves the longer run direction of the industry. An example is the change in beef production over the past decade.

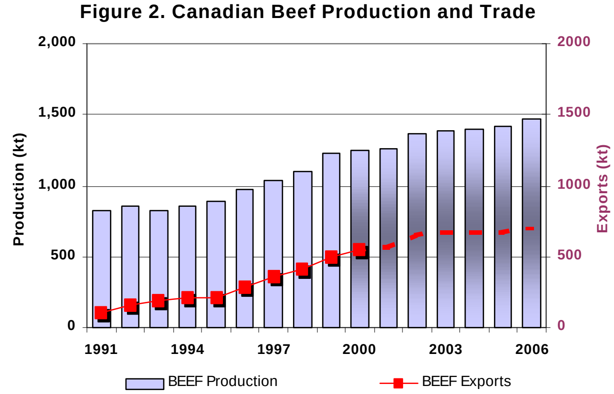
The trend of increased beef production (Figure 2) is paralleled by a trend of beef export growth. Export markets have absorbed an increasing share of our beef production, and lent support to local calf prices in the process.

Figure 1. Alberta Feeder Cattle Marketings



Source: Canfax; Economics & Competitiveness Division, AAFRD

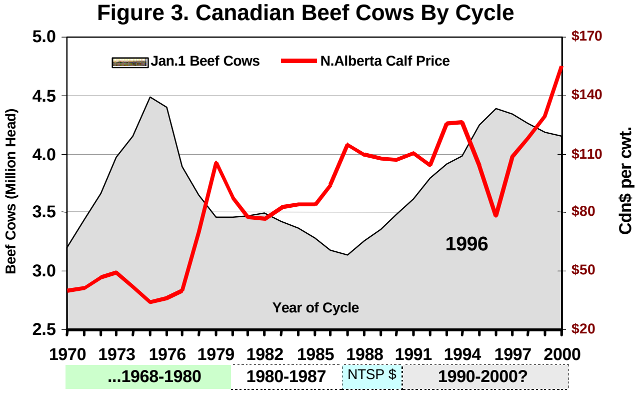
Figure 2. Canadian Beef Production and Trade



Source: Statistics Canada, Livestock Market Review ; Ag.Canada (projections to 2006)

Finally, ***cycles*** refer to events that tend to repeat over a period of years. The cattle cycle is a prime example of this concept. Cattle cycles are in large part a response to the biological nature of beef production. The length of time it takes producers to respond to price signals (to get a heifer calf to produce her first calf) creates a lag between price highs (lows) and subsequent inventory highs (lows).

Figure 3. Canadian Beef Cows By Cycle



Source: Statistics Canada, Economics & Competitiveness Div., AAFRD

In general cattle inventories peak about once every 10 to 12 years. Keeping an eye on the cycle helps us understand where prices are headed. I'll go into cycles, and the other time aspects, in future issues.

A working knowledge of these time concepts builds an understanding of market fundamentals and becomes a valuable addition to your "manager's tool box".

Economic Signals

With this in mind, what do the market fundamentals look like today? Record high price levels, resurgent beef demand, and relatively low feed costs have contributed to a renewed profitability in the cow-calf sector. The resulting strength of cash flow positions influence producers' decision making processes – either:

< it takes fewer calves to net out the same sales revenues (opening the possibility to keep a few heifers back), or

< the good prices today build desire to increase the cow-herd base for even larger profits.

Cattle Supply Forecast

Statistics Canada's latest *Livestock Estimates* report indicates Canadian cattle producers have continued the inventory liquidation trend that began four years ago. The number of beef cows and heifers that calved on Canadian farms (at July 1st , 2000) is down 2% from year-ago levels. However, Alberta and Saskatchewan producers have indicated a desire to expand, with heifer retention up 3%, and 7% respectively, echoing trends of lower heifer slaughter thus far in 2000.

By comparison the United States appears headed for another year of consolidation. Drought conditions extending from Texas to the Canadian border are effectively pushing back any expansion plans into 2002 or until pasture situations improve.

For Alberta cattle feeders, the first significant gains in calf crops (feeder cattle supply) from herd expansions are still a year or two away. Until then calf supplies will remain tight.

Beef Demand

By most accounts, the price improvement for 2000 has been demand-driven. The first half of 2000 witnessed a continued resurgence of beef demand (up 2.3 % in Canada last year). While movement has slowed in recent months, export markets have helped pick up the slack. As well the recent outbreak of foot-and-mouth disease in Argentina has slowed the South American "beef train" for the moment, setting back most of the region's aggressive export plans.

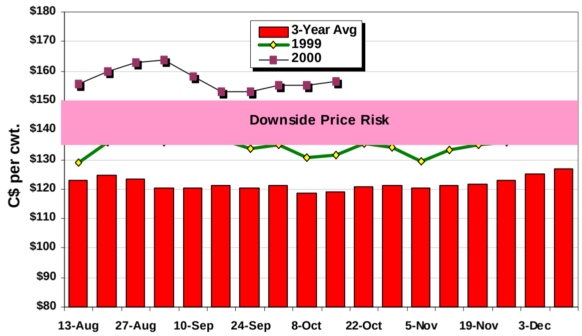
Price Forecast

With the fall run upon us – lots of calves coupled with relatively tight feeding margins – prices will be under pressure in the weeks ahead unless feedlots are intent on running at full capacity or are able to extract more dollars from the processing end.

Figure 4 relates that for the near term, the downside looks to be about 15-20% off the August peaks, somewhere in the $1.40 to $1.50 per pound range. With the Canadian beef herd looking by all accounts to be heading into an expansionary phase, tight calf supplies should mean steady prices for a couple more years.

Figure 4. Northern Alberta 5-600 lb. Feeders

Weekly Average Fall-Run Steer Price



Source: Canfax; Economics & Competitiveness Division, AAFRD

Risk Management

Managing your risk in this time of transition is critical. Creating flexibility in your operation, in:

< resource use,
< risk management strategies,
< asset ownership, and
< equity and cash flow management

will allow you to take advantage of opportunities this next cattle cycle presents, or at least help avoid the pitfalls.

With prices at record levels and ample profits, the best choice may be to sell all your calves and stock up the cash reserves. If you are intent on building up your herd at least make a mental note of:

… *What is it costing you to keep each heifer, in terms of foregone sales revenue this fall?*

… *How many dollars can you expect to make over her productive life?*

Harlan Hughes notes that the 2000 bred heifer may well prove to be the most expensive cow in your herd during this turnaround phase of the beef cycle.

Undoubtedly cost control has been a big focus over the past few years. Now is the time to make all that hard work pay off. A little marketing this fall can go a long way. With this in mind remember you don't have to move your calves now to get them sold! You have forward selling options allowing you to price your calves relative to today's price levels for delivery in the future.

Key Market Factors

Profitability conditions in the cow-calf sector will continue to build momentum for another round of growth – the key is how aggressively the industry proceeds with heifer retention and how long before US expansion begins. Here are some questions for you to ponder in the coming months:

< *Feedlot Margins*: Will the hefty losses over the last few months and high breakevens ahead pressure operating margins enough to spill over to the calf market?

< *U.S. Beef Herd*: With the drought ravaged regions of the southern Plains continuing to market cattle (especially heifers), the US cattle cycle will likely fall one year behind our trend.

< *Beef Demand*: Is this renewed strength in beef demand for real? Will rising energy prices stimulate inflationary pressures – on interest rates and exchange rates – and impact consumer spending, domestically and abroad?

What effect will these issues have on your farm's bottom line?

Darren Chase

Livestock Market Analyst
Phone: (780) 422-4056 Fax: (780) 427-5220
darren.chase@gov.ab.ca

We'd like your comments and questions about the articles featured in this newsletter. Suggestions for future issues are also welcome. Please contact me at:

E-Mail: dale.kaliel@gov.ab.ca Phone: (780) 427-5390
or, by mail, to: 302, 7000-113 Street, Edmonton, Alberta T6H 5T6

AgriProfit$ If you'd like to learn more about and/or participate in our research program, please contact me, as well, at the above.

If you're interested in the CowProfit$ software, training or seminars, contact:
Ted Darling at (403) 948-8524 (ted.darling@gov.ab.ca), or Jeff Millang at (403) 556-4220 (jeff.millang@gov.ab.ca)

So What … Is A Profit Center?

In many senses, a farm is like a tractor. If all of the components are tuned and in good working order, you get good (fuel) efficiency, power when you need it, and long lasting performance.

Although you judge the tractor on its overall ability to do the jobs you have at hand, you still monitor and fine tune each of the components to ensure they're operating up to acceptable standards, contributing to overall performance.

***So what** does this have to do with "profit centers"?*

Like the tractor, you have expectations of your farm's performance. These are judged on:
< ability to generate sufficient cash flow to meet your living needs,
< a longer term expectation of asset growth and return on assets comparable with non-farm investment options, and
< some degree of "certainty" in both of the above, ie. although there will be lean years, you try to have these balanced off, in the long haul, by good years.
Your judgement happens at the farm level, considering all of the commodities you produce. However, to meet your expectations, the "fine tuning" you do on your farm is on each of your component enterprises, or profit centers.

Simply defined, a ***profit center*** is a production activity focused on creating:
C a commodity for final sale, or
C a product for use in one of your other farm profit centers.
For example, as a cow/calf operator, you likely have in addition to your cow herd (selling weaned calves), a forage enterprise (raising feed for your herd and to sell) and a pasture profit center (raising grazing "dry matter" to support your herd).

***So what** do these profit centers have to do with managing your cow herd and your farm?*

Many producers consider these three enterprises as one business. By taking the profit center approach, you can focus on ensuring each is performing at an "economic optimum" and making a positive contribution to your farm's bottom line.

By managing each enterprise as a business within your farm, your analysis, planning and decision making is more focused. You'll make better production and management decisions about <u>each of your profit centers</u>, and improve your farm's ability to meet the three basic expectations noted earlier.

Grouping all of your activities together allows a poor economic performer to hide behind good performance elsewhere. Peter can rob Paul. By taking the profit center approach, you:
< get clarity of management information,
< can readily identify operational strengths and weaknesses,
< can plan and implement direct action to improve productivity and efficiency,
< can identify and cull "dead weight", inefficient activities that consistently draw on the farm's bottom line, and
< can value activities that may only break even over time but reduce risk in input supply at an acceptable price or cost (eg. feed).
Every product you raise has a market value. If you use it in one of your other enterprises, cost it in at this value. When you build your farm income statement at the end of the day, all of these non-cash transfers are washed out but you're left with the message as to how each of your profit centers has contributed to your overall profit.

Going back to our example, I'll pose a couple of pointed questions:
< if you can't make money raising and selling hay, should you ask your cows to essentially pay more than market value for feeds?
< if you can raise hay in a profitable manner, but your cows are "hay-burners", should you be "giving" the hay to the cows at cost and making them look better than they really are?
These questions may be simplistic but they do highlight the importance of assessing each of the building blocks on your farm.

Dale A. Kaliel
Sr. Economist: Production Economics
Edmonton, AB
dale.kaliel@gov.ab.ca   (780) 427-5390