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Editor's Corner

As we move forward through the summer, there's plenty of time to consider markets, outlook and pricing expectations for this year's calf crop. Although operating plans are set in terms of breeding intentions, grazing rotations, and so on, there is still much that is left to mother nature and the markets to deliver. Time invested in formulating marketing strategies for this fall, and working longer term outlook into the next few year's business plans, is always well spent.

In this issue, Diane McCann-Hiltz provides a run-down on cattle market fundamentals and outlook looking into the short and intermediate term. She addresses both the current policy/trade scenario and the basics of supply and demand, translated to the Alberta market place.

In the **"So What …?"** column, I've posed the question, "What do next generation's beef producers look like?" This column sheds light on one way we're preparing the next generation of producers to "follow in our foot steps".

Dale A. Kaliel, Editor

Cattle Market Fundamentals and Outlook

Diane McCann-Hiltz

The cattle and beef market over the past three years has been riddled with a number of policy changes, trade disruptions and beef demand dynamics that have made watching and analyzing the markets an interesting task. These changes and disruptions have made predicting cattle prices more challenging than pre-BSE. Consequently, this article will include a discussion about market fundamentals and some price expectations but the focus will be on key market factors that could impact the North American cattle and beef markets over the summer.

Key Policy Changes

Export market access has for the past while been driven by verifiable age of animals. In late 2004 the Canadian Cattle Identification Agency (CCIA) initiated the development of an age verification component in their animal identification database and in May 2005, Alberta Agriculture, Food and Rural Development mandated that all animals be age verified prior to slaughter effective April 1, 2007. These changes were expected to provide more certainty in export market access.

The *Livestock Identification and Commerce Act*, Bill 38, was introduced in the Legislative Assembly of Alberta on April 25, 2006 and received Royal Assent on May 24, 2006. Through this Act, Alberta has taken steps toward a more effective and efficient livestock industry. The Act consolidates and revises three existing Acts: the *Brand Act*, the *Livestock Identification and Brand Inspection Act* and the *Livestock and Livestock Products Act*. The *Livestock Identification and Commerce Act* facilitates fair commerce, increases the protection available for livestock buyers and promotes the integrity of marketing practices within the livestock industry.

Canada and the U.S. are in the process of finalizing Specified Risk Material feed regulations that will strengthen existing animal feed control. The changes to the regulation could impact the cost of animal feed and feed replacement.

The Canadian Food Inspection Agency (CFIA) is currently conducting a review of import conditions for bluetongue and anaplasmosis for cattle and other ruminants from the U.S.. CFIA is proposing further changes to its import policy and is seeking comments. The consultation paper, *Reviewing the Canadian Food Inpsection Agency's import policy for bluetongue (and anaplasmosis) for ruminant animals imported from the United States* is available on the CFIA web site[1].

It is unlikely that the USDA will publish the rule this year that will provide for importation of cattle over thirty months of age from Canada.

[1] www.inspection.gc.ca/english/anima/heasan/disemala/blufie/blufie-consul-1e.shtml

Trade Disruptions

For the Canadian and U.S. markets to normalize, the U.S. needs an export outlet for their beef. Unfortunately, a definite time line has not been announced for resuming U.S. beef shipments to Japan. However, some analysts are suggesting late June or early July.

The U.S. and South Korea are in the process of finalizing an agreement allowing resumption of U.S. exports of boneless beef from cattle less than 30 months of age. Typically, "bone-in" short ribs make up most of South Korea's beef imports.

There will be a battle for market share in the Asian markets especially once Japan announces when it will begin importing U.S. beef. In 2005, Australia supplied 86% of Japan's and 71% of South Korea's imports. Australia has been the major beneficiary of the Asian bans on U.S. beef, and will now be preparing for major competition in these markets for the first time in over two years.

Demand Dynamics

In the U.S., there is no shortage of meat. The oversupply of meat and the subsequent dip in meat prices is a result of good profits in 2004 and 2005 which tempted farmers and agribusiness to raise production faster than the growth in consumption. Total meat production is up by 4 percent over 2005's year-to-date cumulative total while domestic demand is soft.

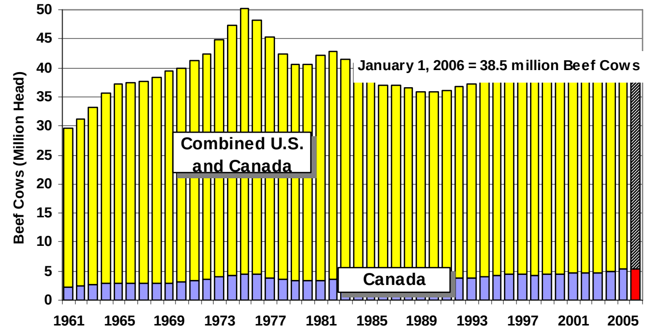
Some analysts are suggesting demand is being negatively impacted by shrinking disposable incomes due to rising interests rates and rising fuel costs, the waning popularity of the high protein diets and perhaps consumers are being negatively impacted by BSE and Avian Influenza. Low prices for competing proteins (pork and poultry) have also put a strain in beef demand.

Cattle Supply

Overall the North American herd is increasing. Statistics Canada's latest Cattle Statistics report indicates Canadian cattle producers are in the process of reducing herd size. Beef cows and replacement heifers on Canadian farms (at January 1, 2006) are down by about half a percent from year-ago levels. The decline is even more apparent in Alberta with beef cows down about 2% and replacement heifers down about 4%.

Generally, prices for feeder cattle have improved

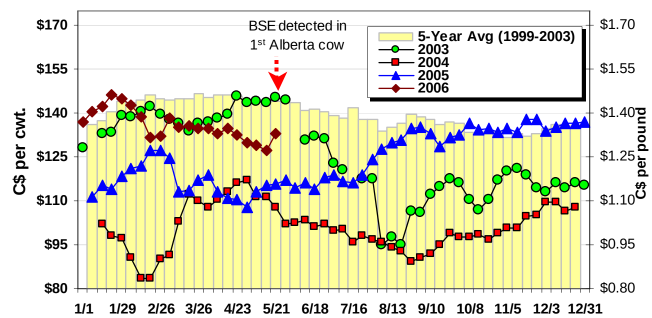
Figure 1. Beef Cows in Canada and the U.S.



Source: USDA; Statistics Canada

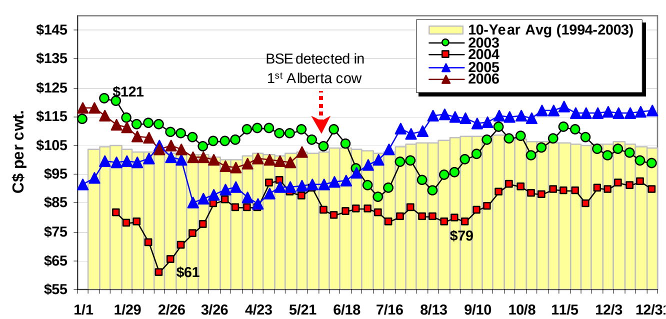
since the border opened in July 2005 to exports of under thirty month cattle from Canada to the U.S.. After a period of profitability in 2005, fed cattle margins eroded. Prices for feeder cattle this fall are likely to be less than optimal. Prices for light weight feeder cattle (5-600 lbs) have been below the 10 yr average since February while heavier feeders (8-900 lbs) have been hovering around the 10 yr average since then (Figures 2 and 3).

Figure 2. Northern Alberta 5-600 lb. Feeder Weekly Feeder Prices



Source: Canfax (ave. of midpoint of the range); Economics & Competitiveness Division, AAFRD

Figure 3. Central Alberta 8-900 lb. Feeder Weekly Feeder Price



Source: Canfax (ave. of midpoint of the range); Economics & Competitiveness Division, AAFRD

Looking out to late summer and fall, prices for heavier feeders could be between $1.10/lb to

$1.20/lb in August and to $1.05/lb to $1.10/lb in October and around $1.00 in November.

Obviously, the big question is where will calf prices be this fall? This will depend on a number of factors including market access to the U.S., exchange rate, and recovery of the fed cattle market.

Market Factors to Watch

Drought conditions in the U.S. have led to poor pasture conditions in the key cattle states of Texas and Oklahoma, which has contributed to the increase in cow slaughter. U.S. cow slaughter has increased by 3% (Jan – Apr) from year-ago levels.

However, it is premature to conclude that the rise in cow slaughter marks the end of herd expansion. Decreases in heifer slaughter indicate modest expansion is still likely underway.

Canadian fed cattle slaughter is down compared to year-ago levels. Steer and heifer slaughter as of May 26, 2006 was at 76% and 81% of year-ago levels. The decline in fed cattle slaughter has been partially offset by live trade to the U.S.. While fed cattle slaughter is down, cow slaughter is up 49% compared to year-ago levels. Industry needs to be commended for moving cows through the system and for using cow beef to meet domestic commercial beef demand. Using domestic cow beef has displaced much of the commercial beef that historically would have been imported from non-NAFTA countries.

Another couple of factors worth mentioning are the exchange rate and feed costs. The Canadian dollar has been gaining steadily against the U.S. dollar for the past month. If this trend continues it could have an impact on beef and cattle trade with the U.S. and cattle prices in Canada. The rise in the Canadian dollar negatively impacts feeder cattle prices and producers will need to adjust their costs accordingly.

Feed grain prices remain at relatively low levels. However, corn consumption is increasing at a fairly rapid rate due mainly to increased ethanol production. A fairly good-sized U.S. corn crop is needed this year to meet these consumption needs. This will exasperate any supply shocks, which will result in more price volatility. Cattle producers are advised to use a hedging program this year to capture the low feed grain costs.

Home Stretch

Many things may change during the summer that could positively impact feeder prices. The value of the Canadian dollar might start to fall or the Japanese may start importing U.S. beef allowing Canada to export more beef to the U.S.. Regardless of whether factors change or the situation remains status quo, you need to know your cost of production and do your homework on feeder markets before the fall to get the best possible price and make the best of a what could be a less than optimal situation.

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So What … Do Next Generation's Beef Producers Look Like?

Each fall, a few Alberta Agriculture staff assist Dr. Erasmus Okine with the Animal Science 474 Applied Beef Production course at the University of Alberta. I deliver a segment on economics, finance, business strategies and business management. A few of us guide the students through their class projects, which involves preparation of a business analysis of a "real" cow/calf operation … and many of them choose to assess their own family's farm.

After a few years in University most of the student's are well versed in the fundamentals of nutrition, reproduction and production management. By the end of this course, many have gained a "comfort zone" in translating production basics into managing for sustainable profit. And … in each class, a few really "figure it out". After finishing University, they enter the real world with their eyes wide open, understanding the tight connection between production and economics. They realize that in the future, success in running a beef operation will rely more-and-more on their abilities to apply economics and business management skills.

By way of example, this past winter I received an e-mail from Melissa Reinhardt, a former student from south central Alberta. She was seeking information, references and direction in preparing for an AIA speaking competition. Her topic was "farm management information and skills today's farmers should possess".

Well, we didn't manage to get together. Melissa forged ahead, developing her presentation from course materials and what she could glean from ***AgriProfit$*** material posted on Ropin' the Web. Later, she sent me her speech and what caught my attention was how she had captured the essence of the keys to success in managing a beef business.

Melissa began with a quote from Dr. Michael Boehlje from Purdue University, "family farmers of the future will be defined by their management of labour, production and marketing opportunities and less by their own labour and land holdings." What she read into this was "success on today's farms means farmers must have proficient skills in making knowledgeable management decisions." It's not what you have … it's how you use it.

Melissa proceeded to compare two hypothetical farms that, although having basically the same in resources, experienced drastically different financial performance. Her evaluation … the Jones' showed consistent profitability and low unit costs per lb. of calf produced. The Smiths' experienced constant financial stress and were high cost producers.

Melissa went forward from here, offering suggestions as to why the Smiths would continue to operate in this fashion and then what they could do about it. The Smiths managed their business on the basis of cash … they didn't recognize that:

- their time deserved a return,
- depreciation, a non-cash cost, had to be retired,
- in the long run, their cow herd had to cover the value, not just the costs of producing feeds.

By taking a "cash-only" view, the Smiths' worked themselves into long term economic and financial problems. The Jones', on the other hand, took steps to ensure that each of their profit centers pulled its weight in the long term, covering all cash and non-cash production costs. This guided their choices of what to produce, and how to produce … based on sound economics.

Melissa's suggestions for the Smiths'? Start out with a business analysis of important profit centers so that their own productivity and economics are known. Benchmark their performance over time, both in their business and compared to peers. Follow this up with an analysis of their business strengths and weaknesses … and let this guide their planning for the future. Finally, move to manage, constantly, by unit cost of production.

Melissa ended with a quote from Harlan Hughes, "… for the industry to survive, cow/calf producers must be driven by unit production costs, have information driven management systems, involve a high degree of management intensity, and be information based." If Melissa is an indication of the next generation of beef producers, the future of this industry is indeed bright!

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