

DEPARTMENT OF AGRICULTURAL ECONOMICS

Retained Ownership Strategies for Cattlemen

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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 market place. 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 regular market channels. Such cattle can be shipped directly to where they will be grazed, backgrounded or finished in a feedlot.

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 elect the alternative that most closely meets their profit objective. History reveals that between birth and slaughter someone will often profit from cattle before they reach slaughter 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 situation will change because retained ownership delays income and adds production costs.

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 accurately project profitability 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.

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

Pounds Gained	Costs of gain \$/cwt.				
	35	40	45	50	55
	Break-even prices \$/cwt.				
100	73.45	74.29	75.13	75.97	76.81
150	70.96	72.13	73.29	74.46	75.63
200	68.85	70.29	71.74	73.19	74.64
250	67.03	68.72	70.42	72.11	73.81
300	65.45	67.36	69.28	71.19	73.10

¹500-pound calf at \$80.00 per cwt.: costs of gain include all production, management, marketing, finance and transportation costs.

Buy-Sell Price Relationships

One reason some cattle producers have not utilized 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 cwt. that is lower than the price per cwt. they are accustomed to receiving for lighter weight calves.

Cost Considerations

Even with price rollbacks, 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 rollback 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 \$80 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 cwt., the break-even price at the program’s end would be \$70.29 per cwt., including interest charges on the calf and other feeding costs. As one would expect, the price per cwt. required to break-even is below the calves’ per cwt. price at the program’s outset because of the lower cost of gain. Additionally, note that as the total pounds of gain during the feeding program increase, you can tolerate a larger price rollback.

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

Pounds Gained	Cost of gain, \$/cwt.				
	50	55	60	65	70
	Break-even prices, \$/cwt.				
300	64.38	65.83	67.28	68.73	70.18
350	64.01	65.63	67.24	68.86	70.47
400	63.68	65.45	67.22	68.99	70.76
450	63.38	65.3	67.21	69.12	71.04
500	63.12	65.17	67.21	69.26	71.3

¹ 750-pound calf at \$68.00 per cwt.; costs of gain include all production, management, marketing, finance and transportation costs. Average daily gain of 3 pounds per day assumed.

Table 2 provides break-even prices for 750- pound feeders entering a feedlot at a price of \$68 per cwt. Once again, costs of gain and total weight gain are allowed to vary. Finishing a 750 pound animal to 1150 pounds at \$55 direct cost of gain would require a \$65.45 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.

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 at first 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 most prominently affecting the markets. Newsletters that do this are available through the Extension Service or various commercial consulting firms. These resources may help you fine-tune your market awareness and decision-making skills. Examples of these newsletters are the K-State Ag Update newsletter available from Kansas State University via subscription or free on the Internet (<http://www.agecon.ksu.edu/livestock>) and the Texas Livestock Roundup from Texas A&M University located at <http://livestock-marketing.tamu.edu>. Go to the website and click on *Texas Livestock Roundup*.

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 delayed income. Some lenders may require that a portion of the cattle be hedged before lending additional capital.

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 how 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 whereas the custom grazer or feeder shares in the death risks and assumes all the risks of poor cattle performance, bad weather, poor facilities, sickness, rising feed costs, weight shrink and management. If cattle are fed where 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.

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 utilizing 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 percent 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.

Decision Aids

The Texas Agricultural Extension Service has computer software that helps prepare financial statements and retained ownership budgeting and summarize closeouts. This software can be obtained from area or state Extension livestock marketing and management Economist or at the following web site: <http://agecoext.tamu.edu/irm-spa/irm-spa.htm>.

Also, for estimating returns in a cattle feeding program, you may obtain a copy of the Extension bulletin *Seasonality in Steer Feeding Profitability, Prices and Performance* (publication C-734, Revised June, 1997) from Kansas State University. It is available at county extension offices in Kansas or on the Internet at <http://www.agecon.ksu.edu/livestock>.

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