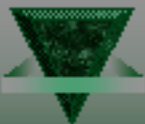


Beef Contracting:
Why Are We Moving That Way, and
How Far Will We Go
Vern Pierce, Ph.D.



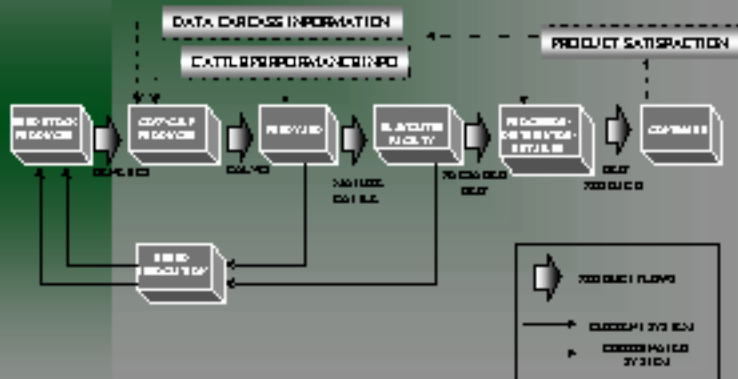
Perfect Competition?


Many Participants

Perfect and Equal Knowledge

Activities of one can't affect
market price

Product and Information Flows in a Commodity Beef System






What **SPECIFICALLY** do you repeat
in your production program if the
market price you receive this year
exceeds your total cost of production?

Decrease Production?

Increase Production?

Reduce Labor costs?

Improve Efficiency?



What **SPECIFICALLY** do you repeat in your production program if the market price you receive this year is **less than** your total cost of production?

Increase Production?

Decrease Production?

Reduce Labor costs?

Improve Efficiency?



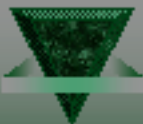
What if the real problem is:

- Quality
- Consistency
- Tenderness
- Carcass Yield

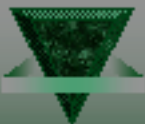


Market “SIGNALS” have several characteristics:

- ▼ Prices based on measurable attributes
- ▼ Prices by attributes equal for all
- ▼ Attributes must be repeatable



The commodity market system does not allow you to get the "SIGNAL" that tells you how to change to get a high price.



Economic Issues

- ▼ Traditional markets underprice superior animals
- ▼ Somebody else may be earning your money
- ▼ You have to be willing to align your production practices with others to maximize efficiency and consistency.



Economic Issues

- ▼ You have the chance of getting the superior price on qualifying animals
- ▼ Of course, you will also get a lower price on inferior animals
- ▼ The system is changing. How big of a leap will you need to make?

Fed Cattle Sample (average):

Prime	0	YG1	25	
High Choice	10	YG2	35	
Low Choice	35	YG3	20	
Select	40	YG4	20	Yield: 65 %
Standard	15	YG5	0	Hot Weight: 780

Quality Grade	Yield Grade				
	1	2	3	4	6
Prime	\$ 114.24	\$ 112.24	\$ 110.24	\$ 96.24	\$ 91.24
High Choice	\$ 110.24	\$ 108.24	\$ 106.24	\$ 92.24	\$ 87.24
Low Choice	\$ 106.24	\$ 104.24	\$ 102.24	\$ 88.24	\$ 83.24
Select	\$ 97.74	\$ 95.74	\$ 93.74	\$ 79.74	\$ 74.74
Standard	\$ 77.74	\$ 75.74	\$ 73.74	\$ 59.74	\$ 54.74

Carcass Price: \$ 94.56

Live Price: \$ 61.48 \$ 737.61

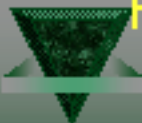
Fed Cattle Sample (average):

Prime	0	YG1	55	
High Choice	10	YG2	45	
Low Choice	35	YG3	0	
Select	40	YG4	0	Yield: 65 %
Standard	15	YG5	0	Hot Weight: 780

Quality Grade	Yield Grade				
	1	2	3	4	6
Prime	\$ 114.24	\$ 112.24	\$ 110.24	\$ 96.24	\$ 91.24
High Choice	\$ 110.24	\$ 108.24	\$ 106.24	\$ 92.24	\$ 87.24
Low Choice	\$ 106.24	\$ 104.24	\$ 102.24	\$ 88.24	\$ 83.24
Select	\$ 97.74	\$ 95.74	\$ 93.74	\$ 79.74	\$ 74.74
Standard	\$ 77.74	\$ 75.74	\$ 73.74	\$ 59.74	\$ 54.74

Carcass Price: \$ 98.77

Live Price: \$ 64.20 \$ 770.37 + 32.76 4.5%



Fed Cattle Sample (average):

Prime	10	YG1	55	
High Choice	25	YG2	45	
Low Choice	60	YG3	0	
Select	5	YG4	0	Yield: 65 %
Standard	0	YG5	0	Hot Weight: 780

Quality Grade	Yield Grade				
	1	2	3	4	6
Prime	\$ 114.24	\$ 112.24	\$ 110.24	\$ 95.24	\$ 91.24
High Choice	\$ 110.24	\$ 108.24	\$ 106.24	\$ 92.24	\$ 87.24
Low Choice	\$ 108.24	\$ 105.24	\$ 104.24	\$ 90.24	\$ 85.24
Select	\$ 97.74	\$ 95.74	\$ 93.74	\$ 79.74	\$ 74.74
Standard	\$ 77.74	\$ 75.74	\$ 73.74	\$ 59.74	\$ 54.74

Carcass Price: \$ 107.92

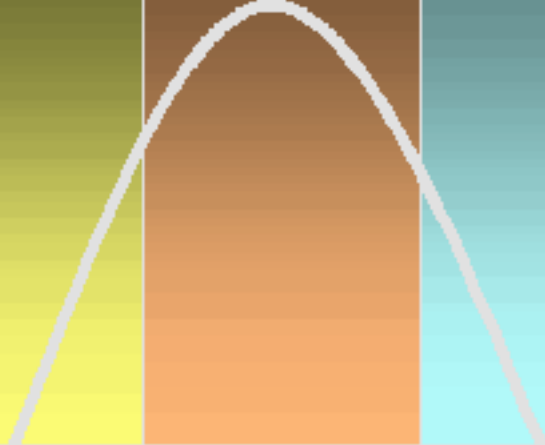
Live Price: \$ 70.15 \$ 841.74 + 104.13 14.2%

Prime

Choice

Select

Standard

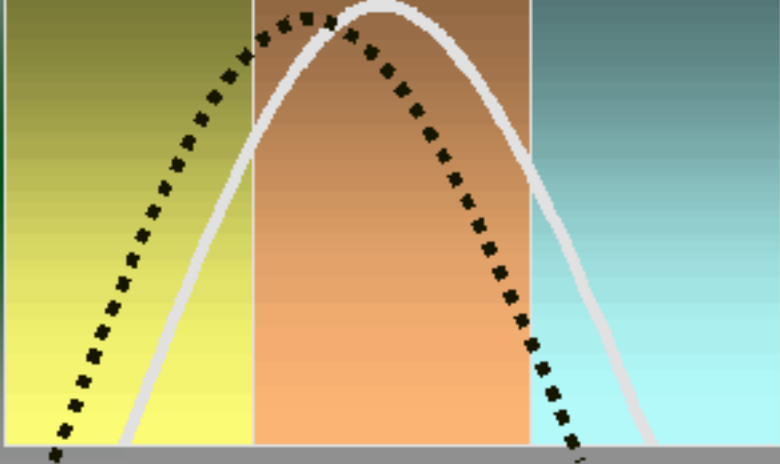


Prime

Choice

Select

Standard





What is the difference?

▼ **Price**

▼ **Cost**

▼ **Value**



Vertical Marketing Agreements





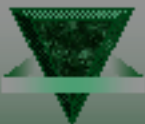
Types of VMA's

- ▼ Retained ownership
 - Partial
 - Total
- ▼ Closed cooperative
- ▼ Product marketing pools



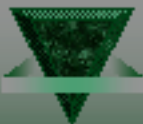
Types of VMA's

- ▼ Resource purchasing pools
- ▼ Input sharing
- ▼ Production specialization



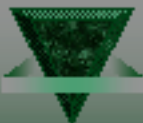
Types of VMA's

- ▼ Total retained ownership
 - The owner may extend the full value of the risk and return period
- ▼ Additional feed costs monthly
- ▼ Longer wait for returns
- ▼ Potential cash flow problem



Types of VMA's

- ▼ Partial retained ownership
 - The owner may extend a part of the risk and return period as a percentage
- ▼ Same issues as partial ownership with less opportunity and less risk
- ▼ Good way to start to learn the issues



Types of VMA's

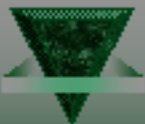
▼ Closed cooperative

- Producers buys a share of the delivery rights to a processing facility
- Full ownership and risk
- Profits of processing are returned to share holders
- Objective is to improve farm profit of members



Types of VMA's

- ▼ Closed cooperative (cont.)
 - Producer has right and obligation to deliver
 - May serve as investment if successful
 - Total loss of stock value if failure



Types of VMA's

▼ Product marketing pools

- Producers form an alliance to take advantage of larger groups and volume marketing
- Pricing premiums from purchaser
- May need to align production practices and genetics
- Lower transportation costs



Types of VMA's

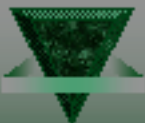
- ▼ Resource purchasing pools
 - Lower transportation costs
 - Volume discounts
 - Increase availability of by-product feeds to your operation
 - Issues with working with neighbors
 - May want a formal agreement
 - Where to locate storage facilities



Types of VMA's

▼ Input sharing

- Purchasing equipment that has low annual use by each that can be shared by agreement
- Issues of timing when each owner needs equipment
- Written agreement is a good idea
- Repair and maintenance issues




Types of VMA's

▼ Production specialization

- Formal agreement between cow/calf and background or feeder to supply animals needed with appropriate husbandry and genetics
- Increases overall end value of the animals
- Allocating added revenues needs formal agreement
- Issue when someone goes outside the circle


The Opportunities and Risks of Being in a Retained Ownership Program



Integration vs. Coordination


▼ Removing a price signal through ownership of successive stages of production

▼ By passing open price discovery or price signals through “Agreements”




Issues with Retaining Ownership of calves

- ▼ Traditional markets underprice superior animals
- ▼ Somebody else may be earning your money
- ▼ You have to be willing to align your production practices with others to maximize efficiency and consistency.



Issues with Retaining Ownership of calves

- ▼ You have the chance of getting the superior price on qualifying animals
- ▼ Of course, you will also get a lower price on inferior animals
- ▼ Keep records on which cattle did well
- ▼ Which factors of the production system helped that performance



Issues with Retaining Ownership of calves

- ▼ Establish your target net return and determine what sale price is necessary to cover total costs to justify taking on the additional risk
- ▼ Consider at least three levels of possible outcome (pessimistic, likely, and optimistic prices)



Break-even Prices of Producing a Feeder Calf at Selected Costs of Gain

Cost of Gain per Owt. (1)	Weight Gain In owt. (2)	Total Cost of Gain (3)	Calf Cost (4)	Break-Even Price (Col 3 + 4)/850 pounds
\$ 25	3.5	\$ 87.50	\$ 425	\$ 60.29
\$ 30	3.5	\$ 105.00	\$ 425	\$ 62.35
\$ 35	3.5	\$ 122.50	\$ 425	\$ 64.41
\$ 40	3.5	\$ 140.00	\$ 425	\$ 66.47
\$ 45	3.5	\$ 157.50	\$ 425	\$ 68.53
\$ 50	3.5	\$ 175.00	\$ 425	\$ 70.59



Estimated Net Income from Retained Ownership at Various Costs of Gain

Cost of Gain per Dwt. (1)	Break-Even Price (2)	Estimated March Selling Price (3)	Net Income per Dwt (4)	Net Income per head
\$ 25	\$ 60.29	\$ 67.92	\$ 7.63	\$ 64.86
\$ 30	\$ 62.35	\$ 67.92	\$ 5.57	\$ 47.35
\$ 35	\$ 64.41	\$ 67.92	\$ 3.51	\$ 29.84
\$ 40	\$ 66.47	\$ 67.92	\$ 1.45	\$ 12.33
\$ 45	\$ 68.53	\$ 67.92	\$ -0.61	\$ -5.19
\$ 50	\$ 70.59	\$ 67.92	\$ -2.67	\$ -22.70

Shorter Flatter Cattle Cycles ?

