Alternative Retained Ownership Strategies for Cow Herds

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Retaining ownership of calves beyond weaning is a value-added process that provides cow owners opportunities for additional profit. It turns lower value calves and feedstuffs into higher value animals. The accelerating trend toward value-based marketing also provides an opportunity for cow owners to more fully capture their investment in health, nutrition, and genetics. It increases the size of the operation while adding diversification and improves marketing flexibility. Producers considering retained ownership must consider first year cash flow and income tax implications for their operation. Producers must also decide whether to feed their calves at home or in a commercial feedyard.

Obviously, prices for feeder cattle, fed cattle, and feedstuffs impact profit potential in beef production. While feed supplies and prices are impacted annually by weather, cattle supplies and prices tend to follow a cyclical pattern. Recognizing this pattern and what stage of it the industry is in can help fine tune the retained ownership decision. This paper examines factors to consider in the retained ownership decision and evaluates the returns and risks for selected strategies over the 1983 - 2004 calf crops.

Opportunities From Retained Ownership

Retained ownership provides opportunities to cow owners that selling the calves in the fall does not. One of the greatest, and commonly overlooked, opportunities is the direct information feedback to the genetic decision maker to improve the animal and product quickly. Cow owners may discuss the performance of their cattle with the cattle feeder and be able to adjust the breeding program. However, the signals are clearer if there is a direct economic link between cost of production, the price received at slaughter, and the person controlling the genetic make up of the cattle. These signals are becoming clearer with increasing use of grid marketing. Thus, in any retained ownership program information is essential.

Retained ownership provides cow owners the opportunity to capture the benefit of their superior genetics, nutritional practices, health program, and overall management system. It is also an opportunity for adding value to or marketing other resources such as labor, facilities, feedstuffs, management skills, capital, and others. While it provides the opportunity, it is up to the individual to be sure the full potential is realized. The points below are important to consider when evaluating retained ownership in an operation.

Increased marketing flexibility

Retained ownership increases marketing flexibility as to when, what, and where the cattle are sold. Calves can be sold as feeder cattle of different weights up to approximately 900 pounds or sold as fed cattle. While it is difficult to attract a packer buyer to the farm for a small pen of cattle, the producer can increase market access and competitive bids by feeding the cattle in a commercial feedyard that is visited by several buyers.

Selling some at weaning, some as feeders, and some as fed cattle spreads marketing and price risks over time. It is also easier to manage risk for fed cattle than feeder cattle. Packers offer cash forward contracts on fed cattle, but they are less common on feeder cattle. While feeder cattle futures and options and

Livestock Revenue Protection does exist, the live cattle futures and option market is typically easier to use because it has higher liquidity and orders are filled quickly.

Feeding at home or in a commercial feedyard

Regardless of whether the calves are fed at home or in a commercial feed yard, retained ownership adds an enterprise to the farm or ranch increasing gross revenue and making it more diversified. The cow owner must decide whether to feed the calves at home or in a feedyard. When examining this question the producer must first determine what resources (skills, labor, facilities, feedstuffs) he or she has and how they can best be utilized.

Feeding the calves at home adds value to farm resources such as the calf and excess feedstuffs. It is also a way to sell resources that may otherwise be difficult to market, i.e., labor, forages, facilities, and equipment. While feeding the cattle at home may not produce as efficient gains as those of a commercial feedyard, net farm income may increase by marketing available resources through a retained ownership program.

Feeding cattle in a commercial feedyard allows the cow owner to hire specialists and state-of the- art facilities and equipment. Many feedyards have consulting nutritionists, marketing and risk management specialists, and other professionals whose sole objective is profitable cattle feeding. For cow owners using information to improve their herd, some feedyards have scales under their working chute and can record individual weights when the cattle are worked and can work with the packer and data collection services to gather individual carcass information. Feeding cattle in a feedyard may provide greater access to lower feed costs such as alternative feedstuffs or simply a wider corn basis.

Pooling calves from multiple farms, efficient sized pens of steers and heifers allows them to be fed in a cost effective manner. Most Midwest cow herds are small and find it difficult to have a uniform pen of heifers and a pen of steers. It is also difficult for smaller feeders to justify the type of equipment and facilities needed to efficiently feed cattle and to develop the expertise that a professional has when dealing with a limited number of cattle. Extension in most states offer a steer feedout program that helps producers experiment with retained ownership. These programs combine cattle from several farms into a uniform group, but individual gain, carcass data, in some cases a calculated feed efficiency and of course net returns are provided. Commercial feedyards can also combine cattle from different owners in the same pen and can equability divide the feed bill according to the animal's size and average daily gain using the net energy system.

Some custom feedlots offer shared risk programs for the cow owner. Variations include (1) sharing ownership of the calf and the feeding cost, (2) the feedlot provides the feed and yardage and the cow owner supplies the calf and the revenues are split according to the percentage of inputs provided. Many lots now offer financing for feed and may finance a percentage of the value of the calves to the owner at placement to ease cash flow problems.

Cash flow and tax implications

Cash flow requirements may be complicated for the first year that a producer retains ownership. In addition to not having the income from selling calves in the fall, the producer must buy feed increasing the cash outflow. If the producer typically sold calves and sold corn that he is now feeding, the cash flow can be a particular problem. Because the cattle are not sold and feed may be purchased, debts may remain unpaid for a few additional months. While the cattle are collateral for the loan, the producer's financial risk may increase. Lenders must be aware of the producer's plans and see the benefit of the retained ownership strategy. Financing packages offered by lenders or feedyards that free up part of the value of the calf and finance the feed can greatly ease cash flow binds.

Feeding calves one year and not the next will complicate income tax management. This is only a problem for a cow owner on cash accounting that switches from a retained ownership program to selling both calves and fed cattle in the same tax year. In a diversified farming operation in which cattle sales are only a part of total income, selling two calf crops in one year may not cause a problem because sale of grain may be shifted. However, if cattle sales are a major part of total revenue, tax considerations are significant. Pre- or post-paid feed bills may provide some relief for an uneven income stream.

Additional advantages to retained ownership

In addition to the market access, resources utilization, and specialization advantages discussed above, retained ownership can capture additional efficiencies if properly planned. Because the cattle are under single ownership over their lifetime, management practices that favored either the buyer or seller but not both can be utilized. For example, creep feeding is known to reduce stress at weaning and help get calves started on feed sooner, but sellers are typically discounted for having fleshy calves that were not rewarded by the buyer. A cow owner can creep feed and reap the benefit of giving a quicker start to healthier calves in the feedlot. There is less stress on the calf because it is moved directly from the farm to the feedlot and bypasses additional handling. The calf has less stress and shrinks less that has to be made up in the feedlot. The cow owner can also benefit from a sound health program including early nutrition without the costly duplication of vaccination if he communicates with the feedyard on processing protocol.

Alternative retained ownership strategies

Alternative retained ownership strategies were compared for 22 calf crops, 1983 - 2004, that would be sold as fed cattle in 1984 - 2005 and the results are shown in the table. Iowa State University Extension Beef Cow Business Records for each year were used as estimates of the cost of producing a weaned calf and as the estimated weaning weight assuming a November 1 weaning date. The ISU Extension Feedlot Enterprise Records and the Feedlot Monitory Program Summary for each year were used as estimates of variation in feedlot feed efficiency and average daily gain. The enterprise records serve as a proxy for the weather related risk that affects feedlot performance and more accurately captures the production risk a producer would have faced during the time period. Selling prices for calves and fed cattle were the weekly average price reported in the USDA Livestock Meat and Wool. It assumed that two-thirds of the calves fed are steers and one-third is heifers. The remaining heifers are kept for breeding animals. A $4.00/cwt price slide is assumed for cattle weighing other than the midpoint of the quoted price range. Other input prices (corn, hay, supplement, and interest) were monthly average prices reported for the placement month (ISU Estimated Livestock Returns). Yardage and health cost were adjusted over the 22 years to reflect inflation. The cattle were assumed to be trucked 100 miles in and out and the cost per mile per cwt was held constant over the period.

Selling at weaning: Selling calves at weaning serves as the bench mark strategy. Calves are weaned and sold on November 1. This strategy produced a lower average return than did the feedlot strategies.

Background for 60 days: The calves were weaned November 1 and backgrounded for approximately 60 days. Average daily gain was targeted at 1.75 pounds but was adjusted each year to reflect the performance conditions experienced in feedlots. This strategy had on average return similar to selling at weaning.

Retain backgrounded cattle to slaughter: The backgrounded calves in the earlier strategy were put in the feedlot January 1 and fed until August 20. The cattle were assumed to grade 75 percent Choice, 25 percent Select, and were priced accordingly. Average returns were higher than the previous two strategies, less than another feeding strategy, and had significant downside risk.

Early wean calves into feedlot: Calves are weaned September 1, placed directly into the feedlot, and sold April 15 grading 60 percent Choice. This strategy was the most profitable one evaluated due to the improved feedlot performance and because the cattle were sold before seasonal price declines.

Place directly in feedlot at weaning: Calves were weaned November 1, placed directly in the feedlot, and were sold grading 70 percent Choice July 1. Returns averaged better than the backgrounding strategies or sell at weaning and had comparable risk to the combination strategy above.

Profit share arrangements: The three feedlot strategies outlined above were used to illustrate a profit sharing agreement between the cow owner and the feedyard. In this example the cow owner and the feedyard divide the revenue from selling the finished animal based on the percent of inputs provided by each party valued at placement time. These examples assume that the cow owner provides the calf, interest, trucking to the lot, and half of the vet bill. The feedyard provides the feed, interest, yardage, trucking to the packer, and half of the vet bill. For example, if the feedyard's share is 45 percent of the cost to finish the calf it will receive 45 percent of gross revenue at market time.

The most profitable strategy was retain backgrounded cattle to slaughter, produced a considerably lower return to the profit share agreement under the cow owner. In this strategy the cow owner adds more value to the calf than does the feedyard. The feedyard and cow owner returns were relatively stable and, with the exception of the early wean strategy, the feedyard return were less than the cow owner return.

Summary

Cow herds selling at weaning earned positive returns on their 2000, 2001, 2003, and 2004 calf crops, but lost money on the six calf crops 1995-1999 and 2002. The 1995 calf crop losses were the largest in the series. Cowherds that retained ownership into the feedlot suffered losses in only two years in the last 10. The early wean strategy, in average, was most profitable among the strategies examined. In some years, 1983-85 and 1995-97, cow herds lost money under all strategies. Unprofitable years trigger a liquidation of the breeding herd to reduce beef supplies. They are also inevitable and should be planned for.

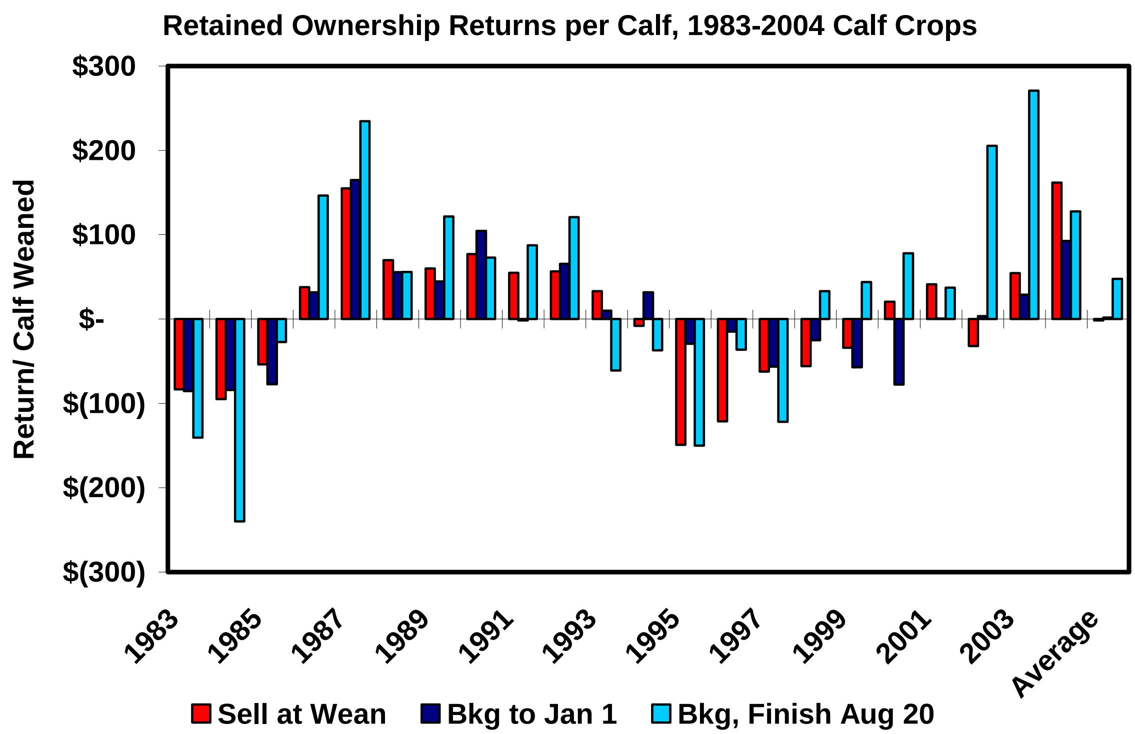
Retained ownership alternatives examined added value to the cow owner's resources in most years. It paid market rates for the calf, feed, capital, labor, and facilities and produced a profit. Compared to selling at weaning, retaining ownership until slaughter increased average profits. In individual years the return was over three times higher. However, retained ownership was more profitable in the other years. These results suggest that no one strategy is most profitable every year. Successful cow owners will be those who can adjust their program to changes in market conditions to achieve the greatest returns to their resources.

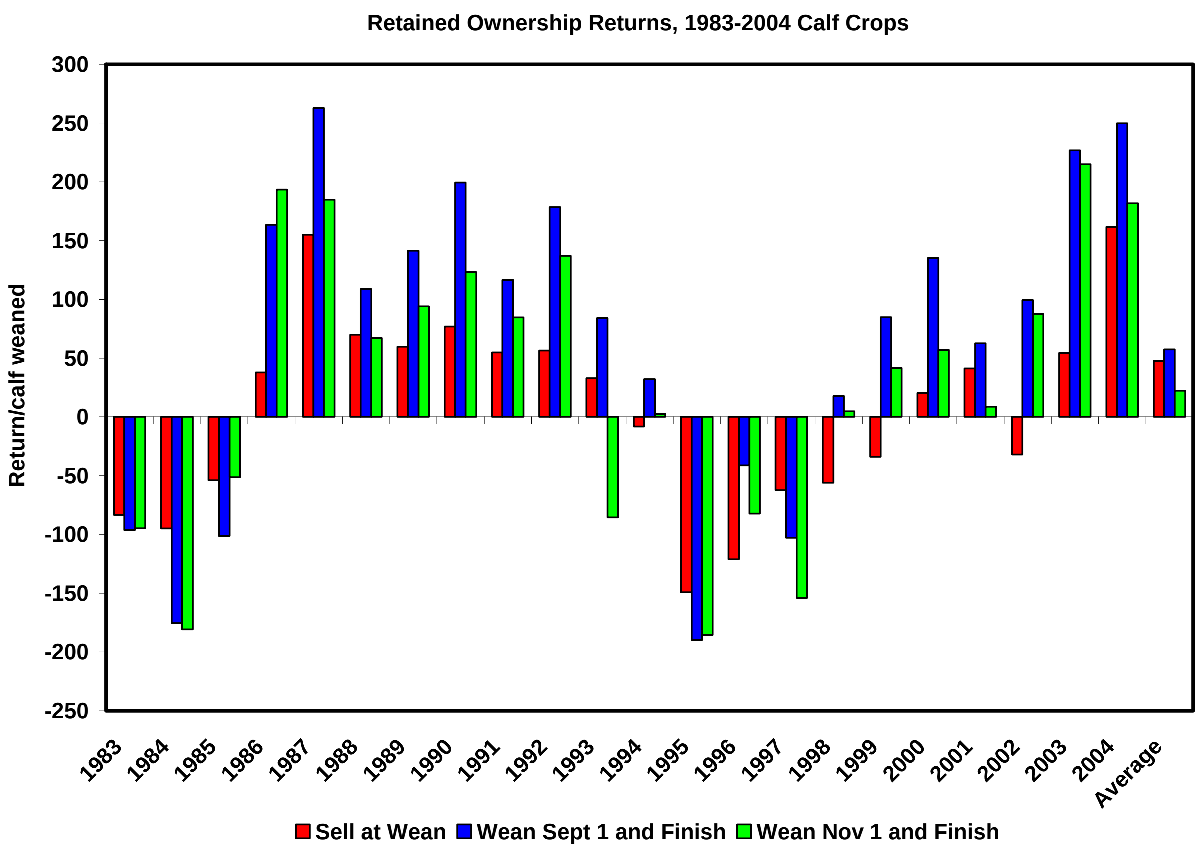
Cow Owner Retains Ownership of the Calf

											10 Yr Summary			22 Yr Summary		
Calf crop year	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**Avg**	**Min**	**Max**	**Avg**	**Min**	**Max**
Wean & sell Nov 1	-149	-121	-62	-56	-34	21	41	-32	54	162	-18	-149	162	-2	-149	155
Background & sell Jan. 1	-29	-15	-57	-25	-57	-78	1	4	29	93	-14	-78	93	2	-82	163
Backgrd & finish Aug 20	-133	-36	-122	33	44	78	37	205	271	128	51	-133	271	48	-209	271
Wean Sep 1, finish Apr 15	-190	-41	-103	18	85	135	62	99	227	250	54	-190	250	57	-190	263
Wean Nov 1, finish July 1	-185	-82	-154	5	42	57	9	88	215	182	17	-185	215	22	-185	215

Cow Owner and Feedyard Share Inputs and Returns

											10 Yr Summary			22 Yr Summary		
Calf crop year	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**Avg**	**Min**	**Max**	**Avg**	**Min**	**Max**
Background and finish Aug 20																
Cow owner	-51	7	-73	45	46	60	64	194	247	176	71	-73	247	59	-162	256
Feedyard	-49	-11	-20	15	25	46	2	43	57	-12	10	-49	57	21	-49	66
Wean Sep 1, finish April 15																
Cow owner	-170	-101	-103	-31	23	72	54	54	168	232	20	-170	232	16	-184	226
Feedyard	-19	60	0	49	62	63	8	45	59	18	35	-19	63	41	-19	70
Wean Nov 1, finish July 1																
Cow owner	-137	-75	-88	7	48	81	58	88	208	230	42	-137	230	38	-145	208
Feedyard	-28	13	-42	19	18	5	-23	25	37	-12	1	-42	37	12	-42	71


Retained Ownership Returns per Calf, 1983-2004 Calf Crops
$300
$200
$100
$-
$(100)
$(200)
$(300)
Return/ Calf Weaned
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
Average
Sell at Wean
Bkg to Jan 1
Bkg, Finish Aug 20


Retained Ownership Returns, 1983-2004 Calf Crops
300
250
200
150
100
50
0
-50
-100
-150
-200
-250
Return/calf weaned
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
Average
Sell at Wean
Wean Sept 1 and Finish
Wean Nov 1 and Finish