



Managing for Today's Cattle Market and Beyond

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Retained Ownership of Cattle: Factors to Consider

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Introduction

Cattle producers often follow the same marketing and/or pricing pattern year after year. The dynamics of the U.S. cattle industry, however, make it necessary for cattle producers to evaluate relevant marketing alternatives. Even then, changes often are not made unless something "shocking" occurs. That shock can take many forms, not the least of which is lower prices. Then, there is a danger that producer reaction to the shock may result in inappropriate action which results in less profit, not more.

Retained ownership (holding cattle longer than would "normally" be the case) is one action some

producers take in response to low prices at the time they would normally sell their cattle (calves). Retained ownership practices include everything from the use of pastures and crop residues to dry lot feeding and many combinations of those alternatives. Positive returns to retained ownership are possible; so are losses. One needs only a quick look at Table 1 to prove that point.

In deciding whether one should retain ownership of calves, there are some major factors to consider. The focus of this article is on some of those factors. Factors are not necessarily presented in order of importance; what may be important to one producer may not be important to another.

Table 1. Retained Ownership Returns Compared to Selling a 475 lb. Weaned Steer Calf (\$/head) from 1980-1996.

Retained Ownership Program	Average	Highest	Lowest
Dry Lot Winter	-17	60	-106
Dry Lot Winter & Summer Grass	30	151	- 63
Dry Lot Winter, Summer Grass & Feedlot	87	164	- 36
Background	32	101	- 61
Background & Feedlot	43	196	- 79
Direct to Feedlot ^a	93	212	- 26

^a The Direct to Feedlot returns are for a 575 lb steer calf.

Source: Adapted from Cattle-Fax, "Retained Ownership Analysis 6th edition," 1997.

Economics

The extent to which producers maintain flexibility often depends upon personal resource constraints and attitudes toward change. Thus, even though in some years it may be economical to hold calves, some producers may forego the opportunity simply because of personal preferences, tax reasons, or the perceived risks involved. Numerous factors account for making retained ownership decisions.

Producers may hold calves because of unutilized labor and facilities, available feed and pasture, tax purposes, etc. As long as profit incentives are important, probably the most important factor would be comparing estimated extra costs with extra returns (marginal analysis). Other factors constant, producers will market calves under the above alternatives if projected extra returns exceed projected extra costs; i.e., net returns would be expected to increase from some type of yearling/finishing program.

Because of market dynamics, such a decision process should account for risk and uncertainty. Risk occurs because realized values of production and marketing tend to deviate from their average or expected values; variables of concern usually include weight gain, health and death loss, feed costs, cattle prices, and final grade. Consequently, a retained ownership analysis using average (or expected) prices and costs might favor backgrounding calves, but accounting for risk, the optimum decision might be to sell at weaning. Particularly so if the cattle are not hedged.

Budget Analysis

Retained ownership factors such as weaning weights, rates of gain, feed costs, and calf and yearling prices will vary across regions of the U.S. Their variation may be attributed to different cattle breeds and quality, calving seasons, climatic and range conditions, feed sources, and local demand-supply conditions in livestock markets. Thus, retained ownership decisions cannot be a universal recommendation; each region and, for that matter, each ranch setting is unique so as to justify its own recommendations.

Partial budgets have been developed in many areas for specific retained ownership alternatives. Producers should check with Extension personnel in their area for appropriate budgets.

One purpose of these budgets is to calculate breakeven costs for retained ownership alternatives. With breakeven costs, it is useful to subtract them from anticipated revenues so as to calculate net returns for a particular program. Net returns, which can be positive or negative, are often calculated on a dollar per head basis. In general, breakeven cost is:

$$(1) \text{ BE}(\$/\text{cwt}) = [\text{Weaned calf price} \cdot \text{weaning calf weight} + \text{feed cost per head} + \text{nonfeed cost per head}] \div \text{net end weight},$$

where BE (\$/cwt) is breakeven cost in dollars per cwt. Net end weight is merely gross end weight multiplied by a shrink factor (i.e., 0.96 for 4.0 percent shrink). Estimated net returns of retained ownership would be:

$$(2) \text{ NR} (\$ \text{ per head}) = [\text{Sale price} \cdot \text{net end weight}] - [\text{BE}(\$/\text{cwt}) \cdot \text{net end weight}],$$

where NR (\$ per head) is net returns per head above (below) breakeven cost. Often these net returns are referred to as profits, but they are only profits above variable operating costs. Costs associated with fixed factors of production (land, buildings, etc.) and ownership costs are not included. For positive NR, profits would be allocated entirely to ownership risk if calves were custom fed. If cow-calf producers utilize their own facilities for backgrounding and grazing, then net returns would be allocated to ownership risk, management, and other fixed factors.

Impact on Cash Flow

Changing the sale date of any product will affect cash flow. If calves are not sold in November (which might be the case before retained ownership was used) but now are sold in the following year, the ability to repay loans (lenders also have an interest here), the ability to meet production and personal living expenses, and the amount and payment of taxes all can be affected. Each of these areas should be evaluated to determine both short term and long term consequences. For example, moving the sale of calves from the Fall to after January 1 could affect not only income tax and social security taxes for the current year but also for a year or two later.

Price Risk

The longer any product is held, the more price risk there is. That price risk for cattle may be related to changes in demand and supply factors, changes in animal quality (such as more fat), and changes related to weight. Cattle usually gain weight as they mature. Generally, heavier cattle, especially feeder cattle, receive a lower price per hundredweight than do lighter cattle. If that price risk creates an unacceptable burden or if there is a lack of ability or unwillingness to transfer that risk to someone else by using forward prices, then retaining ownership may not be a suitable alternative. Each person's situation is different.

Futures hedging permits management of price risk in retained ownership, although basis variability

changes the success of the hedge. Consider a producer who places weaned steer calves (averaging 575 pounds) directly into a feedlot. Calves are fed for 215 days, with an average daily gain of 3.2 pounds. Table 2 shows the potential net returns (above or below \$67.00/cwt breakeven cost) on a per head basis using a futures (sell) hedge. With a hedge price of \$68.80/cwt (\$71/cwt futures - \$2.00/cwt basis - \$0.20/cwt commission) the producer realizes a hedged net return of \$22/head, with no basis risk. In an unhedged position, if the market falls by \$4.00/cwt, the producer realizes a net return of -\$24.00/head. Of course, if the market price increases with a sell hedge, the producer forfeits the price gain (hence, one reason for using options).

Table 2. Example of Hedged and Unhedged Net Returns (\$/head) of Placing Steer Calves in Feedlot (CME Live Cattle Futures = \$71.00/cwt, basis = -\$2.00/cwt, commission = \$.20/cwt, breakeven cost = \$67.00/cwt, and market price declines \$4.00/cwt).

	Hedged Price (\$68.80/cwt)	Unhedged Price (\$65.00/cwt)
Revenue	\$834.00	\$788.00
Breakeven Cost	\$812.00	\$812.00
Net Returns	\$ 22.00	-\$24.00

Note: Net ending weight of finished steers is 1212 pounds, using 4% shrink.

Cattle Performance

If a producer does not have knowledge of how "his/her calves will perform" as they get older, retained ownership can be a disappointment. All cattle are not created equally. Some gain faster than others. Some are more efficient than others. And, some yield a more desirable end product than others. That means some cattle will be more profitable (or yield greater losses) than others. For example, returns from placing calves directly into a feedlot vary greatly depending upon the performance of the calves. Unless you know the performance of your cattle, retained ownership is risky.

Other Enterprises

Retaining ownership of calves can affect other enterprises. Capital and labor requirements for retained calves may be more than some producers can spare. Added inputs may be required (purchased). Or, the returns to labor may be greater elsewhere. Even a trip South in the middle of Winter may not be possible if you "have to take care of the cattle."

Inputs

In some cases, inputs which cannot be sold (or at least not for very much) can be used in a retained ownership project. They simply are low opportunity cost. However, if some inputs can be sold or if other inputs must be purchased, then those considerations

must be included in the decision-making process. Keeping cattle to use surplus feed and labor could end up being very costly, especially if other inputs are purchased. Cattle should be kept to earn profits, not for other reasons. Or, if they are kept for other reasons, know that those reasons are not always "dollars and cents" in nature (or maybe dollars and sense in nature).

You or Someone Else

In some cases, producers are equipped (financially, knowledge-wise and facilities) to carry out retained ownership programs on their own farm or ranch. If retained ownership is to be "farmed out" to someone else (custom performed), it is absolutely critical that all aspects are covered before activities take place. A written contract covering "all things which could go right or wrong" should be used. Consultation with others who have used retained ownership, both at home and away, might provide some guidelines regarding factors to consider and questions to ask.

Conclusion

As indicated, many factors should be considered before retaining ownership of calves. Each factor should be evaluated by each producer for each situation. Calculation of breakeven costs under different retained ownership alternatives will help the producer estimate profit potential. Forward pricing (contracting or futures) should be considered to manage price risk. What worked last year for last year's cattle on the neighbor's farm or ranch may not work for you this year for this year's cattle on your farm or ranch. And, next year the process must be re-evaluated again.