Retained Ownership Strategies for Cattlemen

Curriculum Guide

I. Goals and Objectives

A. Understand the advantages and disadvantages of retained ownership.
B. Learn what information is required and the steps involved in determining (analyzing) if a retained ownership strategy is economically feasible.
C. Understand the difference in risk sharing between leased grazing and custom feeding.

II. Descriptions/Highlights

A. 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 such as lowering procurement (by eliminating some trading points), stress, transportation and selling costs. Retained ownership also allows producers to spread risk from one production activity to another and from one period of time to another. History reveals that between birth and slaughter someone will often profit from cattle before they reach slaughter weight.

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.

B. When considering retaining ownership through a commercial feedlot, you may have to consider forming a marketing association, cooperative or a partnership to put together enough cattle to meet minimum pen size requirements of the feedlot.

C. It's important to know your individual production costs for each stage of production. Although the initial production phase (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.

D. Review Table 1.

E. 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.

F. Review Table 2.

G. 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.

H. 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.

I. 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 grazier 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.

J. 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.

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.

III. Potential Speakers

A. Extension economists

IV. Review Questions

A. What do you need to know to analyze the feasibility of a retained ownership strategy?

Answer: You need to know what your production costs are in each stage of production, the relationship between calf prices and cost of gain, and have a good feel for current and future market conditions, i.e. price, supply and demand factors.

V. For More Details

A to Z Retained Ownership, Inc. - 1997 Year-End Summary, A. E. Extension Series No. 97-6. University of Idaho Cooperative Extension System.

Rodney Jones, James Mintert, Martin L. Albright. Seasonality in Steer Feeding Profitability, Prices, and Performance. Publication C-734. Kansas State University Agricultural Experiment Station and Cooperative Extension Service. June, 1997.

! Retained Ownership

- ☞ Market integration - involves carrying over a production activity into the next phase
- ☞ Eliminates some trading points
- ☞ Can lower procurement, stress, transportation and selling costs
- ☞ Spreads out risk
- ☞ Requires more management & marketing decision making
- ☞ Flexibility in managing income taxes
- ☞ Misjudging market conditions and/or improperly contracting cattle can cause financial loss

! Common Retained Ownership Strategies

- ☞ Owned or leased grazing
- ☞ Backgrounding
- ☞ Feedlot - many producers may have to pool cattle to meet pen size requirements

! Analyzing Retained Ownership Strategy

- ☞ Must know production cost for each production stage
- ☞ Relationship between calf prices and cost of gain
- ☞ Market conditions - supply, demand, price expectations

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

	Costs of gain $/cwt.				
Pounds Gained	35	40	45	50	55
	Breakeven 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	73.1

[1]500-pound calf at $80.00 per cwt.: costs of gain include all production, management, marketing, finance and transportation costs.

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

	Cost of gain, $/cwt				
Pounds Gained	50	55	60	65	70
	Breakeven 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 lbs. per day assumed.

! Capital Requirements

- ☞ More capital required
- ☞ Delays income
- ☞ Must adjust projected cash flow
- ☞ Lender may require more information such as updated financial statements

! Leased Grazing and Custom Feeding

- ☞ How charges are assessed varies
- ☞ Common methods:

  - ✔ Fixed charge based on cost of gain
    1. Cattle owner and custom grazier/feeder share death loss risk
    2. Cattle owner assumes all price risks
    3. Custom grazier/feed assumes all risks of poor cattle performance

  - ✔ Sale of feed and services
    1. Cattle owner bears all risks (death loss and price)