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VERTICAL COMMUNICATION – THE ALIGNING OF BEEF INDUSTRY SEGMENTS

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INTRODUCTION

Cow-calf producers can count on erratic weather, day-to-day market swings and continuing changes in everything else that affects them. In the last five or six years especially, structural and technological changes in the industry occurred so rapidly as to seem more threatening than those more familiar variables of weather and markets. But there is a silver lining to this storm of change: you can ride it out and come out on top if you understand it and take action.

Consolidation in the feedlot, retail, food service and packing segments has caused many cow-calf and stocker operations to ask that basic question - where do I fit? What opportunities do these branded or integrated beef systems offer me? Will my cattle bring premiums, or be discounted?

BRANDED AND INTEGRATED BEEF SYSTEMS

The company that led the way in branding premium beef products is the oldest and world's largest branded beef marketer – Certified Angus Beef LLC (CAB). Formed in 1978 and based on eight scientific criteria, this program grew to sales of 80 million pounds representing 390,000 cattle by 1990. After sustaining near 20% annual growth through the 1990s, today CAB licensees sell more than half a billion pounds of product representing 2 million cattle per year. By licensing more than 4,000 restaurants, 4,000 retailers, and selling into more than 50 international markets, the CAB brand currently accounts for over 75 percent of branded beef sales from USDA certified programs.

The Strategic Alliances Demonstration Project of the Beef Industry Council in the mid-'90s led the industry to adopt a model of cooperation from cow-calf through packing segments for the mutual benefit of all. That led directly to "integrated beef programs" and the creation of new marketing opportunities for cow-calf producers.

The movement led to changes within the CAB Program as well. Until then, the Program had grown by identifying eligible carcasses at the packing level and tracking CAB product through the marketing channels into retail, foodservice and international destinations. But with most of the packing segment licensed, the Program expanded by licensing the

feedlot segment. This important change created a totally demand-driven integrated system, and new opportunities for cow-calf and feedlot operators.

Because of 18 years in building a demand base, that pull-through effect led to distinct CAB premiums for fed cattle by 1996. They grew steadily over the next five years, to the point where premiums now appear in virtually every grid offered by packing companies. These range from as small as $2/cwt. of carcass to premiums that occasionally reach $7-8/cwt. level. On average today, producers can count on CAB premiums of $3-5/cwt. That adds up to $26 million dollars of grid premiums being paid by packers in 2000 for CAB-eligible fed cattle. In turn, this has resulted in Angus/Angus cross calves bringing a $12-$15/head premium when sold at weaning in auctions or direct sales.

The licensing of CAB feedlots offered another unique opportunity for cattlemen beyond additional price discovery. It opened a gateway for cow-calf producers to get feedlot and carcass data on their calves. This service is provided by cooperating licensed feedlots for a cost as low as $0.50 per head for group data or $2 per head for individual data. That's one of the most inexpensive means of getting this type of information today.

CAPTURE GREATER VALUE IN YOUR CALVES

1. Produce G^2 Calves

Clearly the most profitable cattle to produce in the industry today are "G^2" cattle – those that have the ability to grow and grade. These calves have the upper hand at weaning and will build their value advantage as they leave your ranch.

The importance of growth cannot be minimized. Ten to 15 years ago, feedlot average daily gains of 2.5 to 2.7 pounds were very common. Today, gains of 3 to 3.4 pounds per day are common. Tomorrow, calves gaining over 4 pounds per day and converting under 6 pounds of feed per pound of gain will be the norm. Cattle with growth potential have considerably greater value than those without.

We recently analyzed data on over 12,000 head of Angus-type cattle at one of our licensed feedlots in Kansas. The average daily gain of these calves was 3.55, but the top 25 percent gained over 4.1 pounds per day. At today's calf prices those calves with growth potential to gain half a pound/day over the average are worth an extra $50 per head, while those a half-pound per day below average are worth $50 less. That's a $100 swing – where do your calves fit? Somebody may already know.

The second "G" in the economic equation is the ability to grade. Over half of the fed cattle in the United States grade only Standard or Select, while the demand at foodservice, retail and international levels points to a need for at least 70 percent Choice grade cattle. Today the most profitable cattle for all beef segments from packer to end-user are clearly the higher quality kind. The market is beginning to communicate that all the way back to the

ranch. The following illustration from our 12,000-head study shows how a 600-pound calf should be priced based on potential premium—or discount—potential for quality grade.

CALVES THAT GRADE ARE WORTH MORE MONEY
Value as 600 lb. feeder, assuming $0.90/cwt. average price

Final Grade	$/cwt.	$/head
Prime	1.05	630
CAB	.99	594
Low Choice	.94	564
Select	.86	516
Standard	.70	420

If calves are priced based on quality grade value in the market place, Prime calves are worth $114 more per head as 600 lb. feeders then Select grading calves. Those that qualify for CAB certification are worth $78 more. As a cattle producer you can't ignore the value of quality.

Is quality grade over rated? NOT AT ALL. If anything, the industry faces greater risk by not elevating concern for this key component of consumer demand. The number one reason people eat beef is flavor and the major contributor to flavor is marbling. Nebraska research this year pointed out that consumers will pay more for marbling, even when tenderness is held constant. Colorado State University research has shown that less than 2% of consumers considered Prime grade beef unacceptable and only 4-5% ranked CAB product unacceptable. But that figure soared to 25% for Select grading cattle.

2. Use Genetic Information to Add Value to Your Calves

The current EPD (expected progeny difference) genetic information is powerful and can really add value. The way to add growth and grade to your calves is by focusing on these highly heritable traits. Recent Iowa State University research shows that the reason 92.3% of the Angus/Angus type cattle don't qualify for CAB certification is lack of marbling. By using Angus bulls with marbling EPDs above +.2 the CAB acceptance rates jumps to over 33%.

3. Create Uniformity

In that recent analysis of data on 12,000 calves, we saw individual animal variation, both in feedlot performance and subsequent weights on the rail. These were in predominately Angus calves and considerably more uniform then is present in most feedlot pens. Yet the magnitude of the variability was staggering:

- Average weight of new placements varied by 324 lb. from heaviest to lightest calf
- The average spread in ADG during the feeding period was 2.8 lb./day

- The average spread in carcass weight was 285 lb.
- A typical pen showed a range in carcass value of $366.28

4. Focusing on the Consumer

It is extremely difficult for any industry to succeed if its component producers do not consider the customer as primary target. Through decades of declining demand, the commodity beef industry learned that lesson and began to adjust. In the past two years demand for beef has improved, reversing the trend that had far-reaching and potentially very damaging effects for beef producers.

Why did that change in demand occur? There are numerous reasons that we could point to. Part of it was producers receiving better signals in the premiums and discounts of value-based marketing. Not to be overlooked are the improvements made in producing high quality "heat and serve" products. And certainly not be overlooked is the impact of premium branded beef products and the efforts by many cattlemen to produce a higher quality product. Unfortunately, the average beef produced today is still extremely variable in both flavor and tenderness, which makes branding "commodity" beef a risky move at best.

SUMMARY

In spite of the fact that tremendous changes are occurring in the structural dynamics of the beef industry, Certified Angus Beef LLC is confidant about the future, and specifically the contributions that our program will continue to make in improving the profitability potential of this industry.