

**MONTHLY MARKET PROFILE: JANUARY, 2012**  
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The primary focus within December's Monthly Market Profile was on the past two years and the ensuing implications for the market. Looking out to 2012 and beyond, those implications are potentially very influential from a business perspective. As such, it's important to assess the current environment as the new year opens for business.

Unquestionably, the primary dilemma for the beef complex in the foreseeable future surrounds available supply of cattle. That's particularly true when considering the sizable drought-induced / market-incentivized liquidation that occurred during 2011. Is the current inventory sufficient for beef's supply chain? That question makes 2012's January cattle inventory especially important. It'll serve as a significant benchmark for the industry's production capabilities going forward.

Regardless of the report's official inventory, supply is becoming increasingly tight. And that exacerbates the issue of excess capacity - especially at the feeding and packing level. The imbalance will likely prompt further shifting of business priorities and strategies throughout the value system. Under-used infrastructure simply can't be maintained indefinitely (at least not without sacrificing profitability given the nature of the business and within the current operating capital environment).

With that background, annual beef cow inventory (first graph below) starts us off. The U.S. cowherd has experienced significant downsizing over the past fifteen years. Perhaps more significant, the graph represents our need to reassess long-standing, traditional assumptions regarding cattle prices and inventory cycles.

Fewer cows means declining feeder cattle supply. And excess bunk space chasing dwindling numbers of calves results in what I refer to as the "feed truck premium." Normally that would induce producers to create more calves. But that no longer holds true - producers aren't entering expansion mode simply because prices are working higher. Decision-making at the farm/ranch has become increasingly complex and multi-faceted - revenue is NOT the only determinant (or at least, within the current framework, prices haven't gotten high enough yet - more later). Some discussion of the potentially more important factors follows.

First, the matter of diversification: operations that run cows (especially the larger ones) are opting to allocate physical and financial resources to other enterprises, e.g. farming and/or recreation. There's significant acreage competition out there. For example, one doesn't have to travel very far to come across corn fields that used to be pasture. Second, producers are getting older and simply not interested in committing time and/or energy into growing their respective herds. Third, as mentioned previously, drought has taken its toll - the current situation being especially detrimental in the heart of cow country. The ramifications will be long-lasting. And lastly, markets work! Cull cow prices have induced producers to load the gooseneck and make a trip to the sale barn.

Last, and most important though, are the financial issues - and they converge with all of the considerations above. There's been a steady escalation of production costs and ensuing risk associated with rebuilding or expanding of the cowherd. Additionally, the recession holds a huge influence over the beef complex in an indirect way. Households that run cows find themselves in a similar position to most Americans; they're being pressured by unemployment and/or the mandate to shore up their personal balance sheets. For part-time operators, employment uncertainty sheds a different light on maintaining the cowherd and subsequent risk tolerance. In many instances, cows represent a financial drain and thus are being liquidated as the financial pinch hits home.

The key word in all of this discussion, though, is *uncertainty*. Irrespective of an operation's size, uncertainty represents the ultimate concern when it comes to expansion. After

all, keeping back open cows or saving replacement heifers represents an intention to invest in the future. The time horizon is relatively extended – a lot could go wrong over the duration of a cow's useful life. As such, producers are increasingly careful in the risk / reward evaluation.

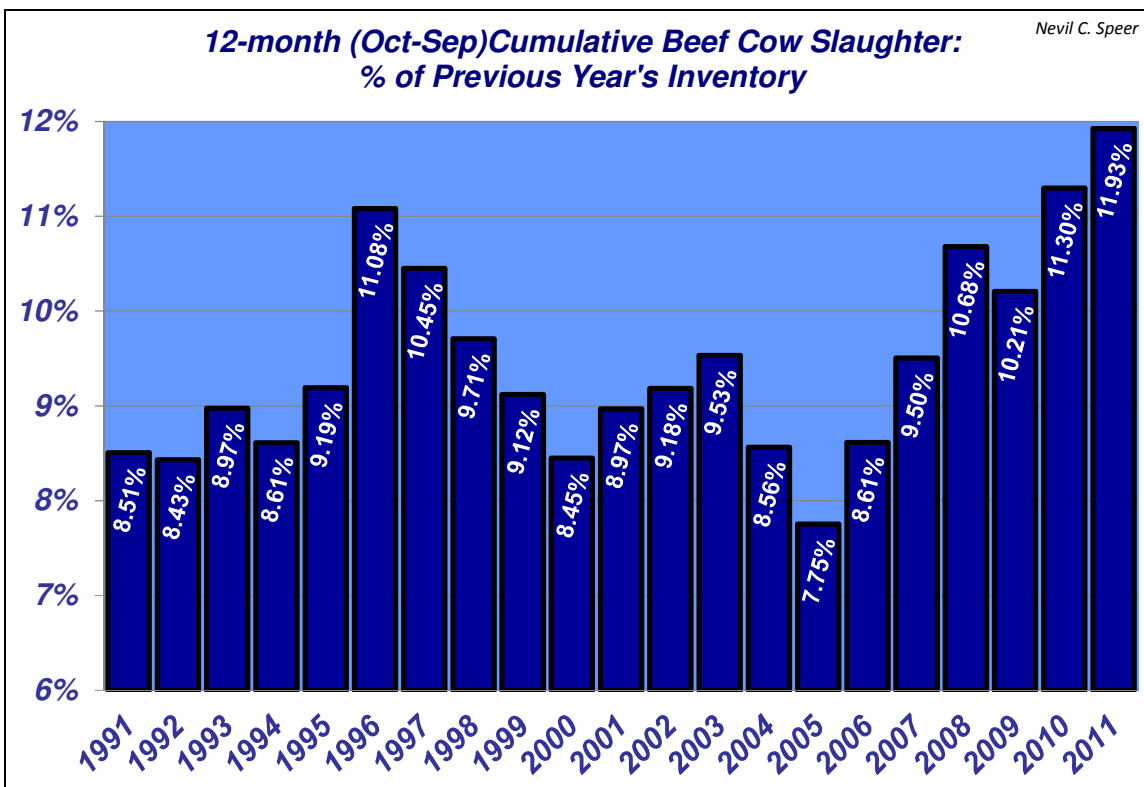
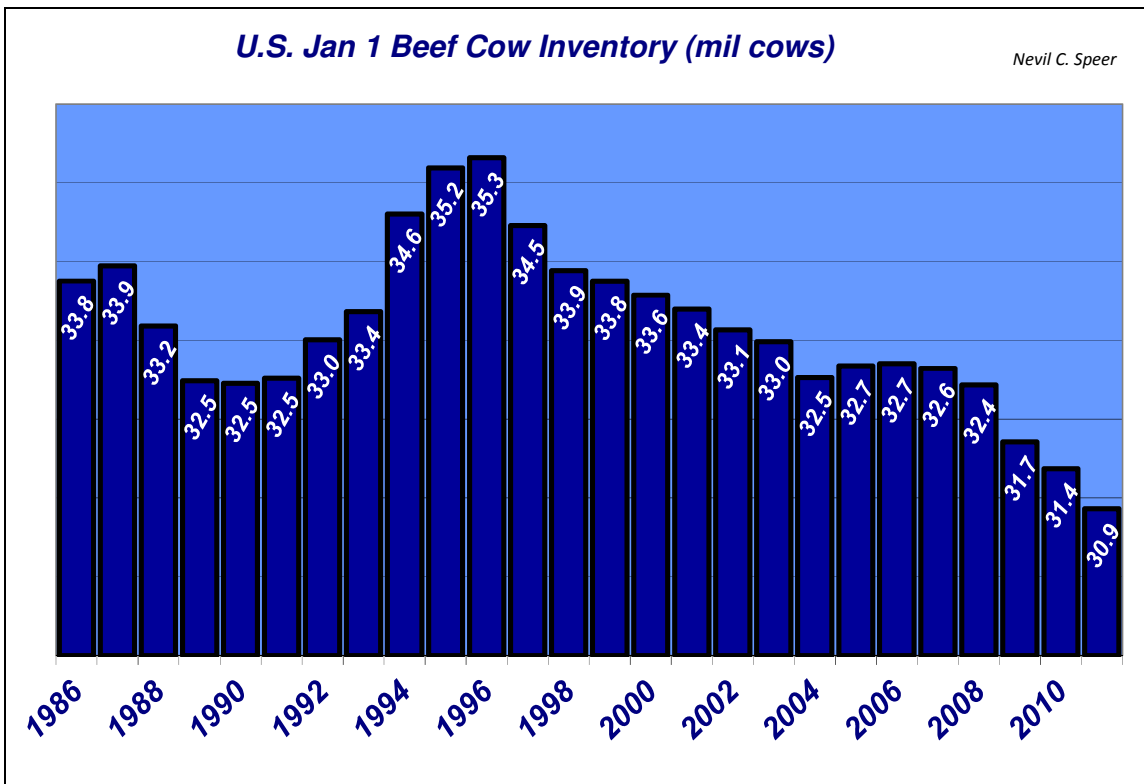
Michael Porter (*Competitive Strategy*) summarizes the dilemma well that many beef producers face (like other businesses in other industries): “Businesses in maturity [e.g. cow/calf operations] can be cash traps, particularly when a firm is not in a strong market position [especially true in commodity businesses where producers are often market takers] but is attempting to build a large market share in a maturing market.” In other words, given the potential turbulence and instability looking ahead, many producers are likely viewing expansion investment as a “cash trap.” The cash trap perspective has been further reinforced by tighter lending restrictions and more careful management of working capital since the financial crisis. The outcome being risk off – expansion is not a favorable option.

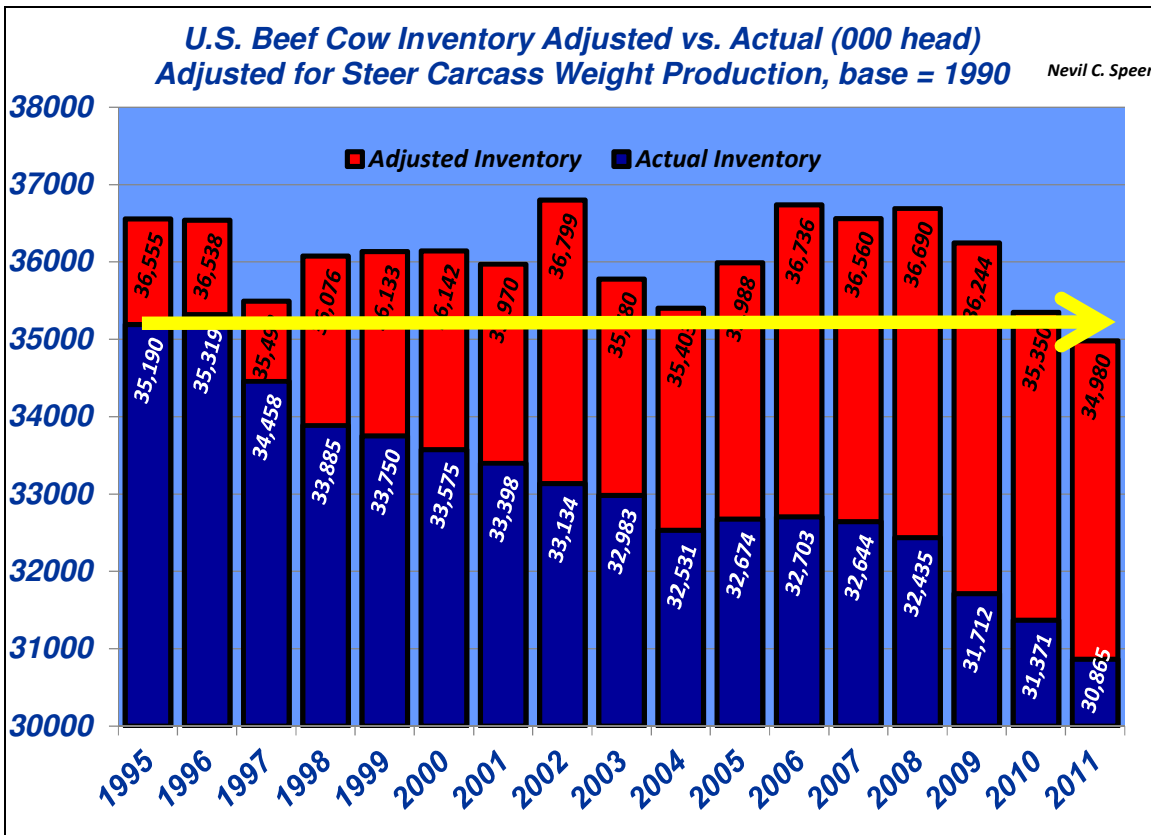
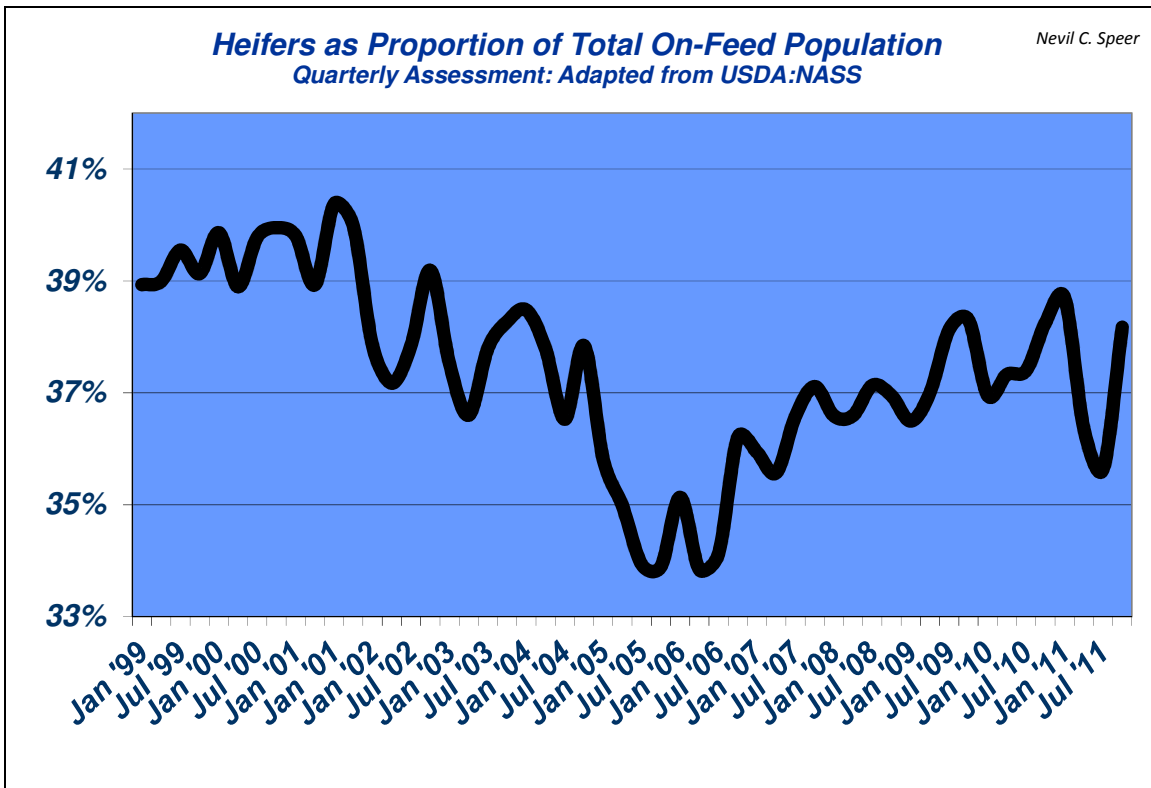
However, it's also important to note that head count isn't the only measure of the industry's production capabilities. The end-product is beef – not cattle. What really matters is throughput of pounds. And therein enters consideration of the incredible advancements the beef industry has made during the past twenty years. Heavier carcasses (advancing roughly 100 lb. since 1990) have effectively made the cowherd larger. Stated another way, increased productivity has buffered the decline in cow numbers. (And it should be noted here that we've also managed to improve beef quality and consistency!!! For more on that discussion see last month's MMP.)

The final graph below reveals that cow inventory - adjusted to a 1990 steer carcass weight basis - is effectively identical to 1995 (the most recent cow inventory peak). It speaks to the enormous power of technology and free enterprise – in combination they've partially resolved the supply issue along the way. That perspective mutes some of the supply concerns.

However, the supply issue remains tenuous. Continued liquidation and/or slowing of production efficiency will further compound the concerns. Those are important considerations about longer-term sustainability for the beef complex. Bottom-line, though, given the cash-trap potential and other intangibles surrounding expansion prospects, price signals will likely need to get even bigger yet before the production sector ramps back up to deliver more calves.

In the meantime, there'll likely be lots of scrambling up and down the supply chain to capture what supply is available. That means more changes ahead in 2012! Stay tuned.





**PRICE SUMMARY****WEEK ENDING:**

	6-Jan	30-Dec	23-Dec	16-Dec	9-Dec
Slaughter Steers (\$/cwt)	120.97	121.70	125.38	118.51	122.28
Choice Cutout (\$/cwt)	192.34	193.79	191.37	189.14	188.57
Select Cutout (\$/cwt)	179.82	178.97	174.64	171.49	172.18
Hide and Offal (\$/cwt)	12.32	12.35	12.30	12.31	12.38
USDA Slaughter Weights (lb)	1,297	1,299	1,302	1,300	1,295
USDA Steer Carcass Weights (lb)	849	846	853	855	856
CME Feeder Cattle Index (\$/cwt)	147.65	145.98	143.83	143.34	145.31
Cow Cutout (\$/cwt)	157.79	156.58	153.22	152.55	150.27
Corn (basis Omaha: \$/BU)	6.34	6.38	6.16	5.83	5.98
Cattle Harvest (000 head)	560	539	598	642	650
Beef Production (million lb)	433.2	417.6	465.3	498.4	502.4