

Satisfying the 21st Century Beef Consumer: A Cattle Feeder's Perspective

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Introduction

Five Rivers is a new name in the beef industry. However, the two firms that merged to form the new company have been feeding cattle for many years. This joint venture between ContiGroup Companies, Inc. and Smithfield Foods operates ten feedyards with a total one-time feeding capacity of 811,000 head. We are the largest cattle feeder in the world, with feedyards located in Colorado, Kansas, Oklahoma, Texas and Idaho. Our yards range in size from 52,000 to 125,000 head of capacity. Production efficiency and economies of scale are clearly an important part of the operation.

We adhere to “commodity” principles as the foundation of our business strategy. Profitably feeding cattle is dependent upon competitive procurement of feeder cattle and corn, excellent operational efficiency, and effective risk management. But those things are just the foundation. The rest of our strategy involves segmenting our cattle inventory and managing cattle to attain grid premiums, and increasingly, premiums associated with branded beef programs. To thrive in the modern-day beef business, we must be both low-cost producers, effective managers of risk...AND good at generating greater top-line revenue through various value-added programs. The beef market is segmenting rapidly at the consumer level, so we must increasingly sort and segment our cattle inventory to fit these programs and reduce variation---all the while maintaining a high level of production efficiency. Being a large operation has some advantages, but it does not guarantee success. We must compete

effectively every day to stay in business and generate acceptable returns for our shareholders.

Through a Cattle Feeder Lens

To satisfy the 21st century beef consumer, we need to address a few major industry problems. We can then look forward and carve out new and better methods for doing business in the future.

Health. The first problem is the health and immunity of cattle entering feedyards. I asked our feedyard managers to identify the biggest challenges they experience with cattle they receive, and health issues topped the list. Despite years of work, there is still much more to do in the area of health. Cattle simply need stronger immunity at the time they leave their farm or ranch origin, and this problem is more about producer education and implementation than it is about technology or know-how. Industry trends toward a greater number of Vac-45 type programs are favorable and have helped put a dent in the problem. However, there are still way too many cattle entering feedyards with naïve immune systems. One of the ways Five Rivers deals with this challenge is by feeding mostly yearling cattle. We certainly feed calves and lighter cattle too, but we emphasize older, heavier cattle because they have greater immunity to disease. We staff only 0.8 people per 1,000 head on feed, so there's little time to deal with problem animals.

The economic impact of sickness and death loss is easy to quantify in the feedyard. And it is sizable as shown in the table below. Keep in mind that these steers are yearling-feds, and

overall they had a death loss of 0.79%, which is considered quite acceptable by industry

standards.

February 2006 Steer Closeout Results

Death Loss Group	Average Death Loss	Profit per head*
0%	0%	\$87.16
0 - 1%	0.43%	\$81.82
1 - 2%	1.39%	\$62.10
2 - 5%	2.46%	\$47.54

*Pre-interest profits on 75,206 total head.

A similar evaluation of calf-fed cattle would be even more dramatic in terms of the range in death loss percentage and profit/loss impact. We also know that morbidity has a big impact on meat quality, so this is not just a production matter. It is a consumer issue too.

Breed Composition. Another problem we face is the fact that huge numbers of cattle are designed wrong genetically. We've all heard the argument that there is more difference within breeds than between breeds. This statement has been used for decades in the name of political correctness---to the detriment of our industry. Breeds are different. They have different strengths and weaknesses, and some bring more desirable traits to the table than others. As cattle feeders, we see this everyday. Unfortunately, my segment of the industry has remained too quiet in speaking up and telling cow-calf producers what we want. Nobody wants to offend anybody else, and the result is that our industry is not as prosperous as it could be.

I am not going to remain quiet. I will tell you exactly what Five Rivers wants from a breed composition standpoint. And the reason we have a preference is because cattle that are well-designed genetically do a good job meeting the needs of the cattle feeder, packer, and consumer. The right breed combination alone does not

guarantee a perfect animal. But it is the right place to start. Furthermore, cow-calf producers understand breeds. So if we identify and communicate the most desired breed combinations to them, they can and will produce more cattle with the right breed mix.

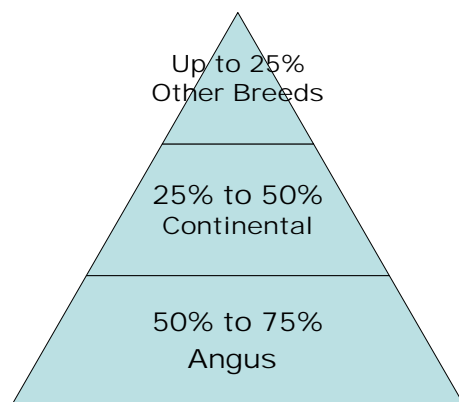
What does Five Rivers want? Our first choice is an Angus x Continental animal that is 50% to 75% Angus and 25% to 50% Continental. This combination makes a right-sized, good-feeding, good-grading, good-yielding animal that covers a lot of important bases. Higher percentage Angus cattle (Black and Red) will grade very well, but are weaker in red meat yield, sometimes producing excess Yield Grade 4s. High-percentage Continental cattle produce high red-meat yields, but they don't grade Choice often enough and often fail to finish before they get too big in the feedyard. A balanced combination of Angus and Continental breeding is tough to beat.

Now let's discuss heat-tolerant genetics. Cattle feeders understand that producers need a cow with some "ear" in Southern States, like Mississippi. This reality is well understood by those of us who feed southern cattle in our Texas and Kansas feedyards. However, to make a desirable southern feeder animal, the heat tolerant genetic component needs to be 25% or less. This enables the southern cow-calf

producer to have up to a 50% ear-influenced cow, as long as the bulls being used are not carrying Bos Indicus genes. I have another rule of thumb about what makes a desirable Southern feeder animal. These cattle need to have twice as much Angus as they have eared-breed influence. Secondly, they need to have an

equal amount of Continental breed influence as they have ear. In other words, a ½ Angus, ¼ Continental, ¼ heat-tolerant breed animal would fit the bill very well, and would still enable the southern producer to keep enough heat-tolerant genetics in his cow herd.

Breed Composition Pyramid: Ideal Feeder Animal



A useful way to package these thoughts is in the form of a pyramid for breed composition. Black and Red Angus fit at the bottom of the pyramid and should be incorporated into the ideal feeder animal at 50% to 75%. Continental breeds merit a 25% to 50% inclusion rate. Any other breed can be incorporated at up to 25%, provided that the bottom two sections of the pyramid are satisfied. Obviously, high-quality genetics from each contributing breed will result in a more desirable final product. So the pyramid addresses breed composition, without replacing the need to make wise genetic selection decisions within each breed being used.

One of the glaring problems we have in our industry is chronically low quality grades in Texas and Kansas packing plants (averaging only 40% to 45%). This is largely a genetic

problem with Southern-origin cattle that simply don't have enough genetic potential to grade Choice. If we breed more cattle according to the Breed Composition Pyramid, much of this problem could be solved. We need to add more Angus to the Southern cattle population. Conversely, in some Northern-origin cattle, Yield Grade 4s have become a problem due to the high-percentage of British breeding. Again, the solution is a more balanced composition of breeds. Cattle with well-designed genetics also fit a variety of branded beef programs, which makes them worth more to everyone in the supply chain.

Progressing in the 21st Century

We've discussed health and genetics which are actually hold-over problems from the past century. Now it's time to peer forward. Let's

look at a few quotes from Five Rivers' feedyard managers:

“Embrace individual animal I.D. and maintain verifiable age and source records on your calf crop.”

“In today’s industry, with source and age verification being on the consumer’s mind, I think this would be one of the easiest and most rewarding steps any cow-calf producer could take.”

“If we in the industry want to give consumers what they are willing to pay for, then cow-calf producers should begin to shift their mental paradigms to the age and source verification process.”

It is trendy to talk about age and source verification, but is there any real opportunity here? Our answer is YES, even if the Japanese do not re-enter our beef market in the near future. Here’s why. Segmentation in the U.S. beef market is creating a host of niche marketing programs, some of which are economically viable for producers to become involved in. The largest niche is natural beef, which by some accounts already exceeds \$1 billion annually. Premiums of \$25 to \$75 per head (depending on specifications) are currently being paid for calves that are verifiably natural. Requirements for verification vary, but you’ll need complete and accurate calving records and a good tagging system to get your calves certified. It takes work and organization, but natural beef is here to stay. We’ll see a lot more natural cattle in the years ahead, because consumer demand for natural beef is growing rapidly. There are other beef market niches that require other types of certification, but the foundation of all these programs is a complete, verifiable set of information on each calf crop.

Another manager quote worth emphasizing it this:

“Cow-calf producers should shift their mindset to more cooperative integration within the overall production chain.”

If we as beef producers are going to satisfy the consuming public, we need to work together and share information. Of course, saying that is nothing new. We have all heard it before. What’s different today is that there are REAL economic opportunities available to cow-calf producers who are willing to develop relationships with producers in other segments of the industry, most notably, with feedyards. Those who work at their genetics, manage their cattle well---and then link up with feedyards who can help them capture value-added premiums---can realistically garner \$50 to \$80 per head over the commodity cattle market. We see it happen all the time. And we believe those value-added dollars will be especially important in the years ahead when calf prices lower cyclically lower. Sustainable premiums are possible today, and will be in the future.

A big part of the benefit of working with people in other segments of the beef industry is the learning that takes place. As beef production becomes more complicated (and it does every year), there is a constant need for every producer to remain on a positive mental growth curve. We in the cattle feeding industry must also remain “life-long learners.” Our world is changing rapidly too. The exciting thing is that much of what we talked about as theory for many years in this industry is actually happening. There are real economic opportunities available to those willing to work at the process and approach their business with an open mind. We have the tools, technology, and marketing system to make it happen.