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MARKETS

Bowles gives 'crash course' on risk management

"Ag producers last year were blamed for high prices and inflation... but our economy's position was really the perfect storm, and it was (high-priced) energy that pulled the trigger," said Jonah Bowles, ag risk management coordinator for the Virginia Farm Bureau. He spoke about risk management options during Cattle Feeders Day at the Lancaster Farm and Home Center in February.

With a degree in economics and 25 years of experience as a former stock and commodities broker, Bowles, today, serves as an educator and conducts risk management workshops. He also teaches classes periodically at Virginia Tech and publishes a weekly "Commodity Comments" newsletter.

This information more than fills a full semester university course, said Bowles: "If you don't get this today, don't feel bad."

He reviewed the path of the futures markets on corn and cattle through 2008, noting that even though contract prices rocketed up, by the time the contracts closed, they were really not any higher than the previous year. The trick, he said, is to realize a profitable position when it presents itself.

"Since the beginning of futures markets in the 1860's, there has never been a year that profitable prices have not been offered—at some point—by a contract on the Chicago exchanges," said Bowles.

The problem last year, he said, was the fact that as prices went up, so did the costs of production. "When those prices turned and came down sharply, the cost of production did not, and it has not yet come down to the same extent as the price," he explained.

Bowles emphasized that, "2009 will be a very different year for marketing. Demand has been damaged, some of it irreparably."

Bowles does not expect to see the level of speculation we saw in 2008 because "the regulatory agencies won't tolerate it, nor will the shareholders."

As for the futures markets, he said, "You can go crazy trying to make rhyme or reason of it. The market does not have to make sense. It is not rational, but it is still the market—the determining factor with impact on

Jonah Bowles at Cattle Feeders Day

your costs for feed, energy and other inputs as well as the price for your cattle."

Know your cost of production

Before a beef producer can use the risk management tools that are available, Bowles stressed that, "You first have to know your cost of production."

Evaluate your risk

He also urged producers to evaluate their risk. "Risk has three elements: The probability of risk, the magnitude of that risk, and the duration of the risk," he said. "It all comes down to the perception of risk and the farm's individual tolerance for that risk."

For example, the probability of risk could be near 100%, said Bowles, but the magnitude of the risk may be low at about $1/cwt. On the other hand, he explained, the probability of risk could be 50/50 that the producer could lose $30/cwt., which is a relatively low probability but a very high magnitude of risk.

"If the risk is small, then maybe I don't have to do anything to manage it," he said. "But if the risk is large, then the next step is to know: What is my tolerance for that risk? Maybe I can sit through it and not be pressed to do anything. But if my tolerance for the risk is not very high, then I'm going to have to manage that risk."

Know your options for managing risk

Hedging on the futures market is not for the faint-of-heart. "Before doing any hedging, realize there will be margin calls, and you have got to have a banker who understands this and is in it with you," said Bowles.

Options trading is also available for slaughter cattle and feeder cattle. Options are traded differently than hedging. There are no margin calls, but you have to have 50,000 pounds of live cattle for the trade. Options consist of 'puts' and 'calls.' A 'call' is the right to buy a commodity at a given price. A 'put' is the right to sell at a given price.

"A 'put' makes money when the market goes down," said Bowles. "A 'call' makes money when the market goes up. It is like an insurance policy with a 'premium,' but no margin calls."

Downside protection / Upside potential

Bowles used August feeder cattle as an example. "If I buy a 'put' at a cost of $5/cwt ($2500) and the 'put' creates my minimum price at $94 (less the local basis), then if the market goes to zero, I still get paid $94/cwt, but I pay my $5/cwt for the 'put,' so I actually receive $89/cwt.," he explained. "If, on the other hand, the market goes to $113, I still get the $113, and it still cost me $5/cwt. So I lost the $5. In this way, I have protected the down side, but I have also left the upside potential wide open. But this coverage has a cost. It's like car insurance. You buy it, but you don't really want it to pay off."

He also noted that producers need to be aware of their "basis" which is the local price difference (mainly transportation equivalent) between Chicago and, say, Lancaster.

Bowles also talked about Livestock Risk Protection (also known as Livestock Gross Margin or LGM Insurance). "This is a crop insurance product that uses the 'put' option on the Chicago Mercantile Exchange," he explained. "It's that same instrument that was $5/cwt., except you can get it from a crop insurance agent and the insurance premium is subsidized by the government."

Bowles noted that this insurance policy is available in Virginia and other states, but not in Pennsylvania. "But it could be available here," he said. "In Virginia and West Virginia, we got it by asking our legislators."

Industry lukewarm to 'COOL'

During Cattle Feeders Day in February, Penn State University meat scientist Chris Raines and Cargill cattle procurement manager Drew Wilkins provided information on mandatory Country of Origin Labeling (COOL), which went into effect March 16.

As beef producers quickly learned, COOL may be 'not so hot.' In fact, it is downright confusing, and the economic impact—industry wide—has been estimated at $212 million in the first 10 years, in addition to the $2.6 billion in first-year incremental costs to execute COOL requirements.

According to Raines, consumers have shown they prefer U.S. food products and will pay more for them, so there is value in this for farmers and ranchers. "That's the big impetus for COOL... to provide consumers with this information," he said.

But he also explained that after nearly seven years and more than 100,000 comments during rulemaking, there are many loopholes and inconsistencies, making it hard to tell what informative value COOL will actually have in guiding consumer choices.

COOL heats up ID debate. The trace-back abilities that are involved in implementing COOL have stimulated debate over whether COOL is becoming a potential "back-door" for ushering in a mandatory National Animal ID System (NAIS). Meanwhile, some of the most vocal pro-COOL factions are also some of the most vocal anti-NAIS.

Meat products from animals that were born in Canada or Mexico, but raised and/or harvested in the U.S. can be labeled "product of Canada, Mexico and the United States," but the listing can appear in no particular order (U.S. Ag Secretary Tom Vilsack recently suggested voluntary measures for packers and retailers to detail the label with born in country X, raised in country Y and slaughtered in country Y or Z).

But the actual COOL rule allows, in effect, "Meat that is processed from a Canadian-born or Mexican-born animal that was raised in the U.S., can carry a blanket 'Product of Canada, Mexico and the United States' label," said Raines. The question is: Will businesses use a blanket label as a simplified way to cover everything from North America and reduce segregation and documentation costs? And if so, will consumers all of a sudden think: "Hey, have we been eating Mexican beef all these years?" That would be a counter-productive result, to say the least.

Does it 'look' un-American? According to Raines, there is yet another loophole for cattle only. Apparently wording in this rule suggests that as long as the cattle 'look' like they are from the U.S... they can be deemed of U.S. origin. Further inspection of the COOL rule reveals that NAIS 840 tags are considered a way to easily identify U.S. origin cattle. On the other hand, cattle can also be visually inspected for identifying brands or marks that would suggest they are from Canada or Mexico. The absence of such foreign marks is reportedly good enough evidence for signing a COOL affidavit that the cattle are of U.S. origin.

Chicken is COOL, but Turkey is un-COOL. Mandatory COOL covers a long, and what Raines called "strange," list of perishable food products. For example, chicken was added to the mandatory COOL list, but turkey is absent. As for the "strange list of perishables. We wonder why some things are on this list and others are not," said Raines. For example: some nuts are on the list, along with beef, pork, lamb, goat, chicken, vegetables and fruits, and ginseng; however, eggs, dairy products, and turkey are not.

Plain steaks are COOL, but marinated steaks are un-COOL. Furthermore, not all beef, pork, and chicken are required to be COOL. Retail items with any "change in character" are exempt. Processed or smoked meats are exempt. If one step of consumer preparation is removed, no label is required. For example, a flat iron steak must be labeled, but a marinated flat iron steak, not. "Dump a little zesty sauce in the package with the beef, and now you don't have to label it," said Raines.

Retail ground beef is COOL, but McDonalds hamburgers are un-COOL. Foodservice items are also exempt from mandatory COOL. This means the single largest beef market in the U.S.—McDonalds, Burger King, etc.—do not have to pony up where the beef came from. Also, meats that are sold by non-retailers (those with invoice costs from fruit and vegetable sales less than $230,000), are not required to be COOL.

Producer affidavits are necessary. Loopholes and inconsistencies aside, cattle feeders need to be aware of their responsibilities in filing affidavits with beef packers and in keeping a 'paper trail' for their cattle.

Wilkins said government audits will be conducted at the retail level. When meat is found carrying a COOL label stating 'Product of the U.S.,' then the auditor ask the retailer where he bought the beef.

"Then the auditor would come to Cargill (as the processor of the beef, for example), and we are required to show where that beef came from," said Wilkins. "The packer is on the hook for this. That's why we have to have the ability to trace-back, so we can show the beef came from cattle supplied by John Doe in Lancaster County, and that John Doe has an affidavit in our files showing the cattle were born and raised in the U.S."

Chris Raines talks about Country-of-Origin Labeling (COOL) during Cattle Feeders Day

Wilkins noted that as of early February, they had sent out 3200 affidavits for the beef they are in possession of. "COOL means more tracing and more tracking and more separation costs for inventory," he said.

Local program requirements. Local labels, like PA Proud Choice Angus Beef and PA Preferred already require their beef to be processed in Pennsylvania from cattle raised at least their last 100 days in Pennsylvania. These labels, alone, will serve to meet the COOL requirements as long as the cattle were also born in the U.S.

Cattle in U.S. feedlots as of mid-July 2008, no matter where they came from, are grandfathered in as U.S. origin. After that, paperwork is required to show country-of-origin.

NEWS from the Center for Beef Excellence

Willard Lemaster recently updated cattle feeders on Pennsylvania's Center for Beef Excellence. He was appointed as the CBE's first full-time director in December. Lemaster earned his B.S. in Animal and Veterinary Sciences from West Virginia University and a Masters in Animal Sciences, with specialization in beef cattle reproductive physiology, from the University of Tennessee. He is currently conducting doctoral research in food science and technology with a specialization in animal sciences at the University of Maryland, Eastern Shore.

Lemaster began his career as owner and farm manager of a cow/calf, farrow-to-finish and crop operation at Railroad Farm in Martinsburg, West Virginia in 1987. He has held research and instruction positions at a number of universities and has experience as a private consultant, working with beef industry clients on quality and profits. Most recently, Lemaster served as a risk management specialist with Pennsylvania's Center for Dairy Excellence.

From Brazil to our backyard...
Getting to know the new owners at Souderton

At Cattle Feeders Day in Lancaster, PA, Chandler Keys—head of government affairs and industry relations for JBS USA, LLC—talked about the company that now owns the former Smithfield and previously Mopac plant in Souderton, PA. JBS was founded in Brazil by the Batista family and is today the world's largest beef packer.

At the Feed and Grain Summit in Harrisburg, PA, Al Perez (center)—vice president of cattle production for JBS Packerland—talks with Willard Lemaster (left), executive director of Pennsylvania's Center for Beef Excellence and David McElhaney, western PA Shorthorn breeder and member of the PA Beef Task Force.

Even though the Souderton, PA beef plant—owned previously by Smithfield and before that Moyer—is now owned by the largest beef processing and exporting company in the world, the story behind the plant's new owners is anything but typical.

JBS SA (South America) is the family-owned parent company. Three brothers from Brazil run the business, along with more than a half-dozen other family members holding executive positions. Their father, Joe Sobrinho Batista, began over 50 years ago as a small butcher killing three cattle a day. He started out as a cattle producer, and today, he runs one of the largest cow/calf operations in Brazil and is one of that country's largest cattle feeders.

The company's U.S. holdings operate as JBS USA LLC, with middle son Wesley Batista as its CEO.

"This family knows the beef business. They love this business. They grew up in it and are committed to it," said Chandler Keys during Cattle Feeders Day in February. Keys hails from a Virginia cow/calf operation and worked 20 years for the National Cattlemen's Beef Association before his current position as head of industry relations for JBS USA.

Keys told how, from modest beginnings, JBS grew to be South America's largest beef processor. Two years ago they became the largest in Australia and the world through their acquisition of Swift/ConAgra. Last year they acquired Smithfield Beef Group, adding its U.S. capacity to their former Swift holdings—to run neck-and-neck with Tyson and Cargill.

The Smithfield deal gave JBS more geographic reach and added 7,600 head/day capacity to their 20,500 head/day kill in the U.S. Along with the four Smithfield beef plants, JBS also received from Smithfield the "Five Rivers" feedyards in four states with one-time capacity of 820,000 head.

Globally, JBS harvests 65,200 head/day with 22 plants in Brazil, 6 in Argentina, 16 in the United States, 10 in Australia and 10 in Italy.

According to Keys, concentration in the beef business is unavoidable. "This is a highly regulated, low-margin industry, which yields concentration," he said.

Keys explained JBS is committed to improving plant efficiencies, including Souderton, to increase their ability to compete for cattle.

As a major beef exporter, Keys said that JBS wants to work with U.S. cattle producers to open doors to new markets, increase sales

(continued on page 4)

Ken Hackman joins Agri-Basics team

EPHRATA, Pa.—Agri-Basics, Inc. welcomes Ken Hackman to our team of independent beef nutrition consultants. Hackman joined the AB team January 1, 2009.

"This is a great opportunity for me to work with Curt Umble and maintain my contacts in the industry, now working in the consulting side of cattle feeding," says Hackman, who grew up on a dairy farm and then purchased his own Ephrata area farm where he fed cattle for many years. As a former cattle feeder, Hackman says he benefited from the expertise of AB nutritionist Curt Umble and always appreciated the "partnership" AB consultants have with their customers.

"I like the independence of the Agri-Basics team because it enables each nutritionist to work with each of their customer's individual situations to achieve the best results for them," Hackman observes.

"We are delighted to have Ken on-board," notes Umble. "Ken's farming and cattle feeding experience, and his business knowledge, make him a valuable asset to the AB team and our growing group of customers."

Ken lives with his wife Cindy in Ephrata, Pa. He can be contacted at 717.738.3422, or by email at: kandchackman@dejazzd.com.

Weis PA PROUD Beef sales 'clicking along'

Nearly one year after its April 18, 2008 launch, the Weis Markets Pennsylvania Proud Choice Angus Beef program passed the 2,000-head mark in the number of Pennsylvania cattle harvested, processed and sold through just 32 of the supermarket chain's total 154 stores. Plans are underway to expand the PA Proud beef to 100 of its stores this spring and summer.

Pennsylvania Beef Council Executive Director Paul Slayton gave a product update at Cattle Feeders Day in February. He said that despite the current economy, the PA Proud Beef program is "clicking along."

"There is a significant amount of meat needed to keep this program chugging along," said Slayton. To-date, 16 Pennsylvania beef producers have sent cattle to the program, and they have collectively received more than $100,000 in premiums alone.

Cattle are purchased on a grid developed and managed by Wolfes Neck Natural Beef, a division of New England-based Pineland Farms. The Choice premium is 4.8 cents/lb dressed weight above the USDA five-state Midwest/High Plains average, and producers benefit from an attractive freight allowance and no discounts for Yield Grade 4 or 5.

The cattle are slaughtered and processed by the Cargill plant in Wyalusing, Pa. The beef is then shipped to the Weis Markets' meat distribution center in Sunbury, where it is packaged, labeled and shipped to the stores. The beef is dry-aged 17 to 21 days.

"So far, the cattle that have gone through this program have graded 85% Choice," said Slayton. To meet the quality requirements of the PA Proud program, the beef must be Choice or better and from cattle less than 30 months of age. Any steers grading Select are purchased by Cargill at the plant's carcass price.

The cattle must have at least 51% black hide color and be finished a minimum of 100 days within the state of Pennsylvania. The cattle must also come from BQA-certified farms.

The next level in merchandising this 'home-grown' beef product to consumers is to connect farm faces with the product at the point of sale by using photos of the cattle feeders who produce the cattle for the PA Proud label.

Slayton also reports that 16 beef producers and students have already participated in media training to prepare for in-store demos.

For more information, contact the PA Beef Council at 1-888-4BEEFPA (423-3372).

JBS Packerland *from page 3*

in the premium beef market, and stabilize the declining U.S. beef cow herd.

Keys also confirmed the Batista family views its position in the U.S. as “a beacon. The higher value beef market is here. It is 43% of the company’s revenue,” he said, adding that with the genetic differences in Brazilian cattle, there is “no way they will compete with U.S. producers in the fresh beef market here.”

“They did not just plop down their own money and move their families up here to come and ruin our industry,” he stressed. “They are hands-on people. These guys really like running beef plants, and they work hard to run them efficiently.” One of the brothers ran his first plant at the age of 18.

“The Batista family are country people. They have a lot in common with producers here. They know about working hard, putting in 12 to 14 hour days, six days a week,” said Keys. “They are very producer-oriented.”

Keys also noted that the former Smithfield-Packerland team is still in place, and is now known as JBS-Packerland.

“We need producers to keep producing cattle here to keep these plants running,” said Keys about the Souderton, Pennsylvania and Green Bay, Wisconsin facilities. “These guys are looking to partner with producers. This is a 1% margin industry—in a good year—so there is very little room for error. This business is about disassembling and adding value to your cattle. For the people we have still in the beef business, we need to find ways to keep them in the business. Without your product, we can’t do anything.”

At the March Feed & Grain Summit in Harrisburg, Al Perez, vice president of cattle production for JBS-Packerland, echoed the company’s goal to “keep cattle feeders viable across this region.”

While JBS owns a 9500-head feedyard in Ohio, Perez explained that only about 10% of the cattle fed there are native breeds, most are Holsteins. A whole year of cattle production there represents only 24 days kill at Souderton.

All JBS plants harvest Holsteins. “They are a very big part of our mix,” he said.

“With the population centers adjacent to this region and our customers accustomed to fresh meat supplies, this area is very important to us,” said Perez about the Souderton plant.

He stressed that JBS is “here to help. We actively worked with producers in South America, and we want to do the same here. We are reconfiguring all of our operations to offer vast and far wider services. If we can’t keep the cattle supply in business here, it will be very difficult to maintain a plant in all the locations we are in. We are dependent on the cattle feeders here to stay in business.”

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