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Rethink, Renew and Reshape

Building back from drought offers individuals and the industry a unique opportunity.

by ***Wes Ishmael***

Sooner than later, hopefully, cow-calf producers will have enough moisture in the ground and enough feed on the horizon to begin rebuilding herds stripped to the core by the current long-term drought. If they do, how producers go about it will drive how high prices go and for how long. It could also change the complexion of individual herds and the industry.

Some lessons from the past apply, as do some cautions.

Perhaps, the primary caution is as obvious as it will be tempting: high prices.

"Grass turns green, streams run, ponds fill, and we lose our minds," says Rick Machen, the Paul C. Genho Endowed Chair in Ranch Management at the King Ranch Institute for Ranch Management (KRIRM), Kingsville, Texas.

He remembers the last historic price surge in 2014-15, which was also the result of a cow herd depleted by widespread, long-term drought. Five-weight calves bringing well beyond $200 per hundredweight (cwt.) was a common sight. For a brief period, they brought $300 cwt. and a little more.

"People were paying more for commercial females than they could ever hope to pencil out. Prices returned to normal more quickly than many anticipated," Machen says.

Economic pain associated with purchase decisions lingered longer.

"Those high-priced heifers are going to be on your depreciation schedule for five years. That's a real cost they burden you with," Machen says.

Stan Bevers, Vernon, Texas, a ranch consultant and Professor and Extension Economist Emeritus with Texas A&M University remembers those same pricey heifers.

"Half of them were gone from the herd in the first three years, and depreciation went through the roof. Everyone and their dog started selling bred heifers, and the quality declined. It would have

continued on page 16...

... Rethink, Renew and Reshape continued from the cover

been cheaper for some to keep paying their employees to run fence and keep trespassers out rather than to restock," Bevers says.

That's not the same thing as ignoring the opportunity to cover costs.

"Every ranch has a set of fixed costs to run the operation," Bevers says. "For example, say you've got $100,000 in fixed costs and that's low. Fixed costs include depreciation, property taxes and repairs to fixed assets. The financial incentive is to restock and overcome those."

Then there are the variable costs.

"Economics say to produce as long as you can cover variable costs, which means adding cows back, but over time, if you're not also covering fixed costs, you produce until you run out of equity," Bevers explains.

So, the incentive comes with a caveat.

"The financial incentive is still to restock in order to help overcome fixed costs; that's not new. The new stuff is that we took such a beating from the start of the bottom in 2010 and 2011 to the high prices in 2014 and 2015 that some producers left the business," Bevers explains. "If we survived that period, we're probably coming into this current situation with some scars that I hope we learned from."

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In this case, aside from over-paying to restock, a different class of livestock could make the most economic sense, at least for a time.

Rethinking value relative to the cycle

Todd Thrift, Extension beef cattle specialist and associate professor at the University of Florida Institute of Food and Agricultural Sciences, says rethinking what it means to restock could pay dividends.

"Everything with four legs and four teats pointing down will be kept as a cow," Thrift says. "I think the heifer market will be strong for the next three or four years. You shouldn't be keeping any heifers the next three or four years because of what they're likely to be worth. Short term, through the high of the cycle, I might be better off to stocker cattle rather than restock cows."

Or do some of both.

"Reevaluate why you're in business," Bevers recommends. "You've already destocked. You don't have to restock. The simplest axiom out there is to buy low and sell high. Rather than restock, what if you took the bottom half of the herd you have left, which is presumably the most productive, and sold half of those in the high part of the market? Then, run the remaining cows and stocker cattle until cow prices are lower again."

Likewise, Thrift notes restocking could be aimed toward building replacements for the up-trending market. He uses the example of someone with Brangus cows who buys more of the same but starts using a Hereford bull on them.

"You have a desirable product to sell when the market says they likely have the most cyclical value," Thrift says. "Or you can retain them. If you do a good job with Hereford bull selection, you should be able to keep 90% of the heifers and either sell them or retain them."

Especially for larger operations, if it's a good year for rain, Thrift says another option is to overbuy heifers, develop 200, cherry pick 100 of those to retain and sell the rest.

Of course, others are likely to have the same notion.

"It's an economic survival question, rather than one of rebuilding the cow herd," Thrift says.

Even if stocker cattle or heifer development are not options, Machen says, "We often overlook the opportunity to buy cows. Heifers typically sell at a premium to cows." Yet, the lag time between buying heifers and punching a pay stub with their first calves is 18-24 months.

Plus, Thrift points to the challenges often associated with heifers.

"Suppose you culled hard and kept the middle cut — 4- to 6-year-olds from the heart of the herd," Thrift says. "If I buy heifers, that changes the herd dynamics to a much younger herd, which has advantages. But heifers tend to produce calves with the lightest weaning weights and typically have the most trouble rebreeding. If you're going to give up pounds and reproduction, maybe you're better off re-stocking with cows."

Economic success favors those who make such decisions with a firm understanding of costs.

"Many producers and operations of all sizes don't know their unit cost of production," Machen says. "It baffles me that as an industry we don't do a good job of accounting and knowing our unit cost of production." (See Targeting Critical Performance, Page 54).

Buying considerations

When bringing in breeding stock Thrift emphasizes maintaining focus on herd health and matching the environment the females originated from to the one where they will be producing. Doing otherwise could represent a financially successful decision in the short run, but he doesn't believe it's an effective long-term strategy for rebuilding.

"The further away from the house they come from, the less positive results I see," Thrift says. "If you're in the lower third of the U.S. get them from there. It's the same if you're in the middle third or upper third of the country. The closer you stay to home, the better they will thrive."

Even within a region, Machen points out freight costs are much higher today than they were during the last runup in cattle prices.

Thrift also advises keeping in mind that purchased bred heifers may be less tightly bred than advertised.

"Get heifers bred to calve 30-60 days in front of your calving season so they will fit into what you're doing," Thrift suggests.

Lock in some costs

Producers establish future input and output prices on a routine basis through a variety of mechanisms from futures prices to forward contracts. But few attempt to do the same with their genetics.

Especially at this stage of the cattle cycle, Bevers says, "How can I lock up some heifer prices now for the next two to three years without taking possession of them?"

One example would be contracting with someone to buy a certain percentage of their heifer crop — a cut — with an established base price, then price additions and deductions based on such things as weaning performance relative to the entire crop, whether they were born in the first 30 days of the calving season and so on.

Likewise, Bevers says, the same opportunity could exist for locking in bull prices for all or a part of estimated needs.

"I would be thinking about ways to contract breeding stock for the next three years," Bever says.

Rebuilding the cow herd offers individuals and the collective industry the opportunity to shift direction. "Let's sustain quality grade and the consumer eating experience, but how can we improve reproduction efficiency and the production efficiency of the calves?" says Rick Machen, the Paul C. Genho Endowed Chair in Ranch Management at the King Ranch Institute for Ranch Management.

Given the likely surge in prices, Stan Bevers suggests it could pay buyers to figure out how to lock in heifer prices for for the next few years, with delivery in the future. Bevers is a ranch consultant and Professor and Extension Economist Emeritus with Texas A&M university.

Whether contracted or not, Bevers says, "Find the highest quality genetics you can for the cheapest price. If bred heifers are selling for an average of $3,000, you can't tell me there isn't genetic variation. How do I train myself to go into a pool of prospects and find the ones that will bring a $3,500 value at some point?"

For that matter, Bevers sees value in commercial producers visiting more intently with seedstock providers to help them more fully understand the resources and goals of your operation and identify genetics that will be most useful to you. Some already do that routinely.

Speaking of which, Bevers notes, how producers market their cattle should have some bearing on genetic selection. He explains there is a big difference in incentives between a producer who plans to retain ownership through the feedlot and one whose marketing plan is to sell calves at weaning with as many program designations as possible.

Bevers suggests thinking in terms of profit rather than production.

"Because production is status-quo (see Rethink Cow-calf Profitability, Page 28), how do I get more revenue for my product? The goal is the highest profitability, and profitability maximizes prior to maximum productivity. I can give up some productivity and have higher profitability. Production plateaus; it doesn't just go up, up, up. Prices fluctuate up and down, so focus on increasing revenue from the production you have."

Industry opportunity

Rebuilding the cow herd offers both individuals and the collective industry the opportunity to shift direction.

Nationally, for instance, Machen explains, "Our focus in the beef industry, since the first National Beef Quality Audit in 1991 has been increasing carcass quality and the consumer's eating experience. When more than 85% of the fed cattle are grading Choice and higher, as they are now, I'm not sure how much more improvement needs to be made. Let's sustain quality grade and the consumer eating experience, but how can we improve reproduction efficiency and the production efficiency of the calves?"

Regionally, Thrift says, "Over the last 20 years, we've bred the ear out of cows along the Gulf Coast and guys struggle to keep it. Now might be the time to reintroduce ear into the many three-quarter-blood and seven-eighths Angus cows we have in the southeastern states."

More specifically, Thrift and Machen believe this is an opportunity for producers to reassess mature cow size and the added cost and reduced reproductivity associated with too much size and too little heterosis.

Both emphasize adding heterosis back into the national herd is a positive opportunity if it comes in the form of strategic, disciplined, complementary crossbreeding. That, as opposed to the willy-nilly flavor of the day approach from yesteryear that some would say mongrelized the herd.

"This is a unique opportunity to make a change in the direction of your cow herd, if you've already been thinking about it and can make the move quickly," Thrift says.

"It gives producers an opportunity to change genetics if change is warranted," Machen believes.

The industry from here

Aside from when adequate moisture arrives to enable herd rebuilding, there are plenty of other questions to consider.

For one, Bevers says to keep in mind national cow numbers will likely continue to trend lower over time as they have done ever since the mid-1970s (see Simmer, Page 44).

"Beef production bottomed in 2015 at 23.8 billion pounds. It's projected to be 26.3 billion pounds in 2023. Unless drought persists, I don't see us going back to 23.8 billion pounds. We'd be buying bred heifers at $4,200-$4,300," Bevers says.

In the meantime, input costs continue to climb.

"We focus on the incentive of rising prices, but production costs also continue to rise," Machen says. "The other thing we have to keep an eye on is the cost of beef in the meat case, relative to pork and poultry. It's amazing how resilient beef customers have been."

Never mind the enigma of potential future governmental regulations nor the myriad reasons folks own cattle.

"We often forget that unlike the pork and poultry industries, there are a significant number of cattle producers who are not profit driven," Machen says.

That's not to say some folks ignore cash flow; rather, there are economic motives besides profit, per se. It could be pure want-to, the tax break that comes with agricultural production on a piece of ground or parking large sums in land as a hedge against inflation. Decisions and planning horizons differ for each one.

One other industry change, on the drawing book at least, is new and expanded beef packing capacity. Machen is cautiously optimistic this could bring more opportunity to producers.

"I think there will be new opportunities regionally to partner with feedyards that are developing relationships with new packers," Machen says. Retained ownership is a possibility, but he also sees opportunity to provide supply through more vertical cooperation.

At the same time, Machen notes, "Packers learned a lot in 2014-2015, as well, and demonstrated a willingness to reduce shackle space in order to maintain margins."

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Time is of essence

In the meantime, the historic opportunity facing individual producers and the collective industry comes with a timeline. Those mentioned here and others believe the window of opportunity is roughly from 2023 through 2025, assuming recent widespread moisture continues and drought abates.

"The slippery slope of ranch economics is going to get more slippery," Bevers says. For anyone who has considered exiting the business in recent years, he says the next three years should offer a sterling opportunity.

For those who plan to reload, Thrift explains, "Price discrimination will be narrower through this phase of the cycle. The quicker you can rebuild, the better off you'll be."

"Market timing will be huge," Machen believes. "Higher prices won't stay forever. The quicker you can get in, the better off you'll be."

Machen and KRIRM students recently conducted an analysis for one cow-calf client. In every scenario tracking net present value over the next 10 years, the quicker females went into production, the more the profit potential.

"But you can't go until your country is ready. Oftentimes, we're tempted to restock before the grass has fully recovered," Machen says. He adds that's understandable, given the fact that fixed costs typically represent about two-thirds of total costs for most cow-calf operations.

For him, reloading comes down to the art and balance of management — being financially positioned, knowing when the country has recovered and is ready, and finding the right kind and class of animal. HW