



Managing Feed Costs in Beef Production

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Producers are aware that the cost of production for corn and other feed grains have increased along with the demand for corn as we accelerate the need for feedstock to produce biofuels. The implications for beef producers, both cow/calf operations and feedlots can be immense. We have seen some of the largest swings in price for grains and oilseeds ever in the last year and a half and producers who made higher cost input purchases and/or relatively low price commodity sales may have adversely impacted their operation financially.

As we move ahead, it is important to understand what can be done to manage input price risk. At this point we will not spend anytime on pricing feeder cattle or finished cattle using futures, options, or Livestock Risk Protection insurance, rather we will explore ways that feed price risk can be offset or at least kept under control. Some producers with enough scale, access to capital, and an understanding of futures and options markets (along with the ability to sleep at night when huge margin calls are arriving regularly) can use futures to fix the price of grains and some proteins needed in their operation. I have not met very many producers that have the comfort level along with the previously mentioned requirements to effectively hedge inputs or outputs on their own. If you fall into the "I would rather not use futures" category then you need to explore other options, including options on futures contracts to manage input price risk.

Corn and other feed grains are an important part of the

majority of livestock operations, and as we know we have seen a shift, not only in the relative cost of corn, but in the volatility in the both the futures price and basis for corn over the past year or more. Historically, if you track the nearby corn price on the Chicago Board of Trade you will find that we normally have a trading range of around a dollar a bushel from the calendar year high to the calendar year low. You will see in the table that we can have price swings that are quite a lot larger than the average. In 1996 we experienced a trading range in nearby corn futures of \$2.97 per bushel. We also saw all time corn contract highs set at that time with futures peaking out in the late spring and early summer and prices returning to more normal levels at harvest or late in the year.

Corn Year	Calendar High	Calendar Low	Cal. Year Range
1990	\$ 3.02	\$ 2.16	\$ 0.86
1991	\$ 2.66	\$ 2.33	\$ 0.33
1992	\$ 2.74	\$ 2.05	\$ 0.69
1993	\$ 3.07	\$ 2.10	\$ 0.97
1994	\$ 3.12	\$ 2.10	\$ 1.02
1995	\$ 3.71	\$ 2.30	\$ 1.41
1996	\$ 5.55	\$ 2.58	\$ 2.97
1997	\$ 3.20	\$ 2.40	\$ 0.80
1998	\$ 2.84	\$ 1.85	\$ 0.99
1999	\$ 2.34	\$ 1.77	\$ 0.57
2000	\$ 2.50	\$ 1.74	\$ 0.76
2001	\$ 2.31	\$ 1.84	\$ 0.47
2002	\$ 2.86	\$ 1.92	\$ 0.94
2003	\$ 2.62	\$ 2.05	\$ 0.57
2004	\$ 3.35	\$ 1.91	\$ 1.44
2005	\$ 2.63	\$ 1.86	\$ 0.77
2006	\$ 3.78	\$ 2.04	\$ 1.74
2007	\$ 4.37	\$ 3.10	\$ 1.27
Average	\$ 3.15	\$ 2.12	\$ 1.03

If we take the time to study the price history a number of things jump out at us. While we had the largest price move in 1996, we returned to more normal prices in a short period of time. The second largest trading range occurred last year in 2006 and we are experiencing one of the larger trading ranges so far in 2007. Another and perhaps more concerning number is the calendar year low of \$3.10 that has occurred so far in 2007. You can see that the average futures price low since 1990 has been \$2.12 per bushel with the highest low price being \$2.58 again back in 1996 with the exception of this year. Due to that increased demand for corn acres driven by historically high prices we have seen input inflation for corn production that has impacted all of the crops that we grow in the region including forages for winter feed.

So let's review what producers can do to manage some of this input price risk. We will focus on purchased feeds as cost of production for homegrown feed and forage will be a topic for another time. One of the safest ways to achieve price risk management is to attempt to buy feed at the average price for the year. This can be accomplished by making smaller multiple purchases of feedstuffs

throughout the year. Producers should work with their local elevator or feed supplier to develop plan that allows this to take place. The risk with this strategy is if we see another large increase in corn price as we have since the fall of 2006, then feeding margins can be threatened if beef prices don't respond and increase along with the corn price change. This is especially a problem if farmers and ranchers hedge with futures or contract cattle at a fixed price without trying to limit the impact of potentially increasing feed prices. Call options on corn and soybean meal futures contracts can be used to create a maximum price contract on feedstuffs. This can be accomplished by purchasing call options on futures contracts that would allow a producer to offset any potential price increase by having the right to buy a futures contract at the strike price of the options contract. This type of strategy would require a producer to set up a brokerage account and have access to enough capital to purchase options, potentially increasing the cost of production on feeder or fed cattle.

If you would like to learn more about managing price risk or marketing contact the author at oelke002@umn.edu.