Cattle Markets Up, Time To Talk About Backgrounding

LEXINGTON, KY.

Cattle markets have been steadily trending upward since the first of the year. "We are approaching our seasonal price peak for calves, which usually occurs in April or May," said Kenneth Burdine, livestock marketing specialist for the University of Kentucky College of Agriculture. "For 7 and 8wts (cattle weighing in the 700 and 800-pound range), the market typically peaks near the end of the summer. It's an appropriate time to discuss backgrounding, since spring is quickly approaching and many backgrounders are already looking to place calves."

Since the first of the year, prices for stocker cattle have increased, almost on a weekly basis. Summer feeder cattle futures have been increasing as well. For backgrounders, it is this potential buy-sell margin that should drive decisions, Burdine said.

"Even with prices changing recently, gross margin for adding 300 pounds has been hovering around $250 per head," he said.

Gross margin is the difference between the expected value of a feeder when sold in the future and the current value of a stocker or light feeder now. From this gross margin, cattle producers must cover feed, medical expenses, minerals, labor, interest, death loss and any other expenses they incurred during backgrounding.

"For example, recently 5wt feeder steers averaged about $1.11 per pound on a state average basis. That would put placement value around $610 for a 550-pound feeder steer. At the same time, the August feeder cattle futures contract was trading around $109 per cwt," he said. "While many factors can affect this, I would expect August basis to be around $8 or $9 less for groups of 8wt feeder steers. Using this as a price expectation, we would expect to sell 850-pound feeders in August for about $100 per cwt. We estimate our gross margin by subtracting the cost of the stocker ($610), from the expected value of the 8wt this summer ($850). This would put our expected gross margin around $240 for cattle placed now to be sold in August."

Burdine took it one step further to discuss the target cost of the gain.

"If we expect gross margin to be $240, and we are adding 300 pounds during 5 months, we know our total cost of gain must be $0.80 per pound to break even," he explained. "Similarly, if we can put those 300 pounds on for $0.70 per pound, we can clear $30 per head. And if we can put those pounds on for $0.60 per pound, we can clear $60 per head, and so on."

Burdine emphasized that backgrounders should constantly look for opportunities in the market to place calves on an expected gross margin that will lead to profits, given feed prices and expected cattle performance.

"The quick scenario I just worked through was realistic and very timely, at least as of the first 10 days or so of March. However, we clearly run the risk of placing those calves and seeing the market move against us, reducing our gross margin," he warned. "This is precisely what happens when cattle prices decline after placing calves. Similarly, feed prices could rise, which would increase our expected cost of gain. These are common risks backgrounders must manage year in and year out."

Just as producers look for opportunities to place calves at attractive times, they should also look for opportunities to manage risk. If feed prices appear favorable, they should consider booking at least a portion of their feed needs. Burdine said producers can manage price risk on feeders by using forward contracts, commodity futures and options or through relatively new Livestock Risk Protection Insurance. Backgrounding is a margin business, and it's important to constantly manage those margins to ensure profits. Δ