

# CattleFax

# INSIGHT

THE  
DECIDING  
FACTOR



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## Cattle Inventories Smaller Yet Again

The total U.S. cattle inventory decreased 1.9 million head in 2011 and totaled 90.8 million head on January 1, 2012. This marks the fifth consecutive year for a decline in the total cattle inventory and puts the 2012 total at the smallest level since 1952. Over the past five years the total cattle inventory has declined by 5.8 million head.

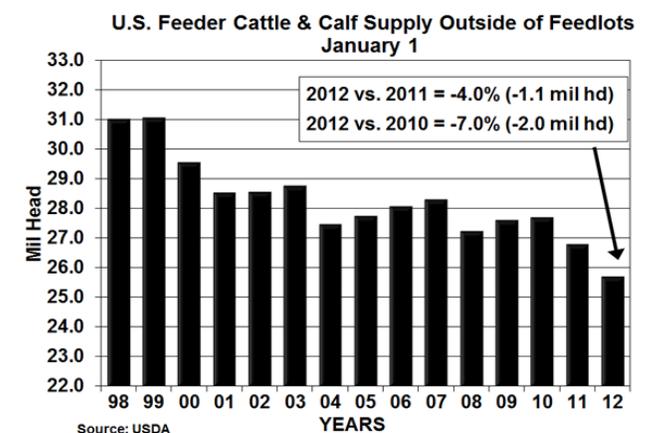
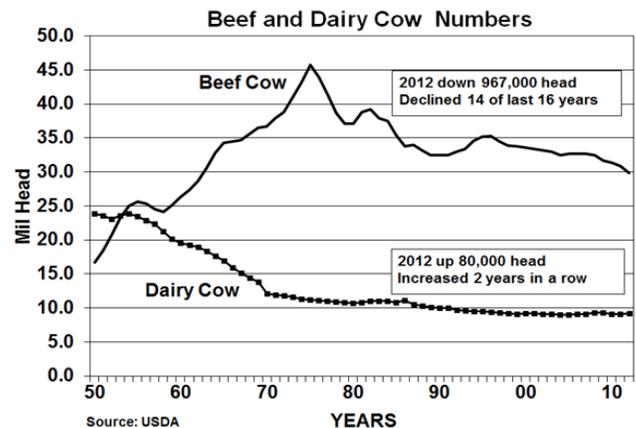
The beef cow herd was down 967,000 head (-3%) on January 1 and totaled 29.9 million head. Beef cow slaughter was up 122,000 head in 2011 versus 2010 and was the largest since 1996. This marks the sixth year in a row for a decline in the beef cow herd and the 14th out of the last 16 years in which the beef cow herd has declined. This is the longest consecutive decline in beef cow numbers in history. The decline in the beef cow herd in 2011 was most significantly impacted by the drought. And even though calf prices were record high in 2011, increasing gross revenues for producers, costs also continued to escalate as they have for the past several years. At the same time, the cost of capital/credit to operate, pressure from alternative land uses and uncertainty of what the future holds also contributed to the decline in the beef cow herd.

The dairy cow herd increased 80,000 head in 2011 and totaled 9.23 million on January 1. Although feed costs remain a wildcard in the dairy business, milk futures increased more than any other commodity on a percentage basis in 2011. Strong demand and growing exports should encourage producers to maintain their herd size with slow growth expected to continue during 2012.

Beef replacement heifers were up 73,000 head totaling 5.2 million head and dairy replacement heifers were down 41,000 head totaling 4.53 million head. Based on CattleFax data collected from its members, the percent of heifers placed into feedlots was down only slightly in 2011. This is an early indication that producers are beginning to hold back more heifers, but this percentage will have to decline more significantly during 2012 before we can say more definitively that expansion is underway.

The 2011 calf crop was down 382,000 head and totaled 35.3 million head. This is the 16th year in a row in which the calf crop has declined. With the smaller beef cow herd, the 2012 calf crop is also projected to be lower by an estimated 500,000 head.

The smaller 2011 calf crop and increased number of cattle placed on feed in 2011 has resulted in a significantly smaller feeder and calf supply outside of feedlots. On January 1, 2012 the feeder and calf supply outside of feedlots was down 1.1 million head (-4%) and totaled 25.7 million head. This is the largest one year drop since 2004. The utilization rate, or cattle on feed as a percentage of the total available feeder and calf supply, was at 35.4 percent on January 1 which is the highest utilization rate in history. In other words this confirms what most thought, that cattle feeders were very aggressive in placing cattle into their feedyards from the available supply, which has been supportive to the higher feeder and calf market. Cattle prices are forecast to average significantly higher again in 2012, but beef demand and cattle feeding margins will largely determine how much higher.



Source USDA	2010	2011	2012	% YA
Total cattle	93.9	92.7	90.8	97.9%
All cows	40.5	40.0	39.1	97.8%
Beef cows	31.4	30.8	29.9	96.9%
Dairy cows	9.1	9.1	9.2	100.9%
Heifers >500lbs	19.7	19.6	19.4	99.0%
Beef rep. heifers	5.5	5.1	5.2	101.4%
Dairy rep heifers	4.5	4.6	4.5	99.1%
Other heifers	9.8	9.9	9.6	97.8%
Steers >500lbs	16.5	16.4	16.1	98.0%
Bulls >500lbs	2.2	2.2	2.1	95.2%
Calves <500lbs	15.0	14.6	14.1	97.2%
Calf crop	35.7	35.7	35.3	98.9%
Feeder/calf supply	27.6	26.8	25.7	96.0%
U.S. Cattle on feed All sizes	13.6	14.0	14.1	100.8%

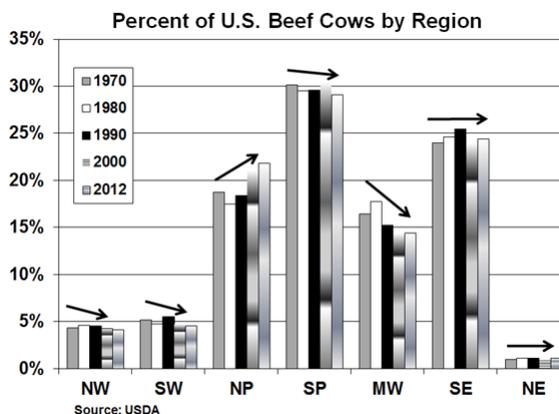
## Herd Expansion Has a lot of Work to Do

The USDA Cattle Inventory Report revealed very few surprises as the trend of declining cattle supplies continues. That said, the report showed a wide variation in changes between the different regions of the U.S., which is a reflection of the severity of the drought in the South. The report also indicated producers are beginning to hold back more heifers as the beef replacement number was up 73,000 head and totaled 5.2 million head. However, it is important to note that this is still the second smallest beef replacement heifer number in the past 25 years. Only last year's number was smaller. In addition, looking at beef replacements as a percentage of the total beef cow herd was 17.4 percent, which is still well below past periods when the beef cow herd was expanding. For example, during the early 90s, the last time the beef cow herd saw major expansion, this percentage averaged on top of 18 percent. More heifers will need to be held back and fewer cows slaughtered in 2012 before significant expansion is likely to occur.

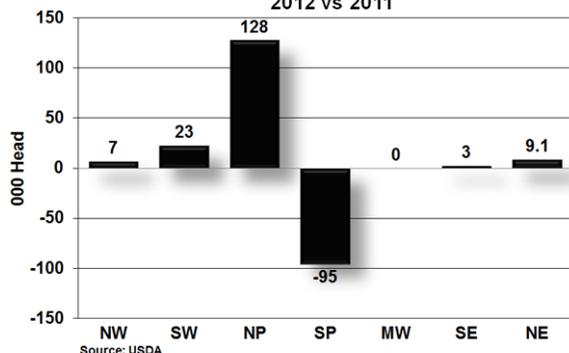
Regionally, the inventory report indicated some significant differences between the regions in terms of current herd expansion. There are two regions of the country that are at completely opposite ends of the spectrum when it comes to replacement heifer retention. The South Plains (TX, OK, NM, KS, CO) region beef replacement heifers were down about 100,000 head. Looking at replacement heifers as a percentage of the beef cow herd in the South Plains was at 15 percent, which was the lowest percentage since 2004. At the

other end of the spectrum there is the North Plains region (NE, SD, ND, MT, WY), which saw an increase in beef replacement heifers of 128,000 head. As a percentage of the total beef cow herd, Northern Plains beef replacements were at 22 percent, which is the highest since at least 1980.

The top seven beef cow states (TX, OK, KS, MT, NE, SD, MO) declined by 217,000 beef cows compared to last year. At the same time beef replacement heifers in the top seven states declined by 35,000 head. In spite of the expansion optimism across much of



Change in Beef Replacement Heifers  
2012 vs 2011



the United States these numbers still indicate the U.S. beef cow herd is likely to be smaller yet again on January 1, 2013, unless beef cow slaughter drops sharply soon. It will take a drop in beef cow slaughter by at least 1.2 million head, or 24,000 head per week, in order for much expansion to occur by next year. Through January total cow slaughter has averaged about 4,000 more head per week than a year ago.

**Bottom Line:** In spite of record high prices and plenty of expansion optimism, the drought is still restricting overall U.S. expansion. As a result beef production is still likely to decline for two more years before finally seeing an increase in 2014 at the earliest, assuming the drought subsides this year and allows for more significant expansion.

## Hide and Offal Values

In years past there has been a strong correlation of hide and offal (drop credit) values to global car sales. The reasoning is all cars use fuel (oil), which correlates to tallow (fat). Moreover, many cars use leather (e.g. hides) - leather and tallow make up the majority of hide and offal values.

As you examine the chart you will see the correlation is very strong. What the chart does not show is virtually all the growth in recent years has come from Asia - specifically China. It has taken much analysis to figure the index correctly, but the data clearly shows that the global economy is very relevant to drop credit.

The drop credit has rallied over 70 cents since the beginning of December. This chart shows why the drop credit has had its recent rally - car sales picked up in the fourth quarter of 2011. That being said, going forward, one must consider recent sales in China, Europe and Japan. Those regions have slowed as of late and suggest that the rally may be limited in months to come. Other regions such as Russia, Brazil, and India have had recent improvements; yet, the total index

remains flat to lower. This simply suggests that hide and offal should rally for the next couple of months (which is seasonal), but then stay flat to lower, and likely below \$14/cwt after the April time frame.



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