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By Whitney McFerron, Tony C. Dreibus and Elizabeth Campbell

Aug. 23 (Bloomberg) -- The worst U.S. drought in a half century and record feed prices are spurring farmers to shrink cattle herds to the smallest in two generations, driving beef prices higher.

Beef output will slump to a nine-year low in 2013 after drought damaged pastures from Missouri to Montana, the U.S. Department of Agriculture estimates. The domestic herd is now the smallest since at least 1973, and retail prices reached a record last month, USDA data show. Cattle futures may rise 8.6 percent to an all-time high of \$1.35 a pound in Chicago in the next 12 months, said Rich Nelson, the chief strategist at Allendale Inc. who has tracked the market for 15 years.

Feedlots are losing \$300 a head this month fattening cattle for slaughter, after corn surged 65 percent since June 15, University of Missouri data show. JBS SA, the largest beef

producer, fast-food chain Wendy's Co. and Red Robin Gourmet Burgers Inc. are among those planning price increases. The USDA expects food inflation of as much as 4 percent in 2013, compared with an average of 3 percent since 2004. A United Nations gauge of global food costs jumped 6.2 percent in July.

"We've had a huge liquidation off of pastures," said Walt Hackney, 74, who buys and sells 250,000 cattle a year in Omaha, Nebraska, and has worked in the livestock business for about a half century. "It's all due to the drought. There's no grass for them to graze on."

Eight Commodities

After rising 11 percent since late April, cattle are now 2.4 percent higher for the year at \$1.243. The Standard & Poor's GSCI Agriculture Index of eight commodities advanced 20 percent since the start of January, and the MSCI All-Country World Index of equities added 9 percent. Treasuries returned 1.8 percent, a Bank of America Corp. Index shows.

Beef output in the U.S., the world's largest producer, will drop 3.9 percent to 24.575 billion pounds (11.147 million metric tons) next year, the lowest since 2004, the USDA estimates. The domestic herd across ranches, feedlots and dairies dropped to 97.8 million head on July 1, the smallest for the date in at least 39 years, the latest data show.

The domestic price of beef will rise as much as 5 percent next year, more than any other food group including fruits,

cereals and dairy products, the USDA estimated on July 25. Pork may increase by 3.5 percent and poultry 4 percent, the agency said. Retail ground-beef averaged \$3.085 a pound in July, the highest since at least 1984, and whole chickens were \$1.454 a pound last month, the highest in at least 32 years, according to the Bureau of Labor Statistics.

Eating Corn

Cattle spend 12 to 18 months eating grass before they are sent to feedlots, where they consume mostly corn for five months until they are fat enough for slaughter. The drought has left pastures in the worst condition since at least 1995, with 59 percent rated poor or very poor on Aug. 19, the government estimates. The corn harvest will drop 13 percent this year to 10.779 billion bushels, the USDA said Aug. 10. The grain reached a record \$8.49 a bushel in Chicago that day.

Prices for hay, the third-biggest domestic crop by value, have also surged. This year's alfalfa harvest will probably be the smallest since 1953, and the price of meal made from the crop was \$334 a ton yesterday in Kansas City, Missouri, up from as low as \$239 a year earlier, the USDA estimates.

Slaughter Increases

A faster slaughter may initially drive prices lower. Almost 3.09 million cows were culled in the first half of the year,

compared with a 10-year average of 2.8 million, USDA data show.

The figures have “increased dramatically” since early June because of the drought, the department said in an Aug. 16 report.

Demand for exports may slow as a strengthening dollar makes shipments from Australia and Brazil more attractive, David Nelson, an analyst at Rabobank International in Chicago, said in an Aug. 13 report. U.S. exports in the first half were 11 percent smaller than a year earlier, government data show.

U.S. consumption of red meat and poultry will fall below 200 pounds per person next year for the first time since 1990, the USDA predicts. Retail beef reached an all-time high of \$4.715 a pound in July, according to the USDA’s composite price, which includes choice beef, other beef and hamburger values. The Iowa Corn Growers Association estimates one bushel of the grain converts to 5.6 pounds of retail beef.

Fewer Calves

The expansion in supply probably won’t last long because it will “curtail the already limited availability of calves this fall,” Goldman Sachs Group Inc. analysts said in a report last month. The bank anticipates a futures price of \$1.15 in three months and \$1.30 in 12 months. Prices next year may exceed the Feb. 22 record of \$1.315, Rabobank estimates.

“Our U.S. cow-herd population is low, and there’s not going to be much adding to the herd with the drought going on,”

said Henry Beel, 40, who co-owns a 1,200-head cattle business with his brothers near Johnstown, Nebraska. Beel Brothers LLC has reduced its breeding herd by selling heifers to feedlots, which means “there’s going to be a smaller amount of cattle available to the packing plants” next year, he said.

The slide in output may not stop until 2016 or 2017, Rachel J. Johnson, a USDA livestock economist, wrote in an Aug. 16 report. Once the herd starts to expand, it takes more than two years to boost supplies, according to Ron Plain, a livestock economist at the University of Missouri. Calves have a nine-month gestation period and take about 20 months to reach slaughter weight, he said.

Raising Prices

“We expect higher beef cost will be the largest driver” of commodity spending at Dublin, Ohio-based Wendy’s, Stephen E. Hare, the chief financial officer, told analysts in an Aug. 9 earnings conference call. The company, which operates more than 6,500 fast-food restaurants, will “implement selective price increases” and cut other expenditures, Hare said.

Wesley Batista, the chief executive officer of Sao Paulo-based JBS, said on a conference call Aug. 15 that the company will raise beef prices because of the grain rally, without saying by how much.

Red Robin, the Greenwood Village, Colorado-based restaurant operator, said on an earnings conference call on Aug. 9 that the

chain will be making “modest” price increases partly because of the outlook for rising commodities and the impact of the drought.

Steakhouses

Arne Haak, chief financial officer of Ruth’s Hospitality Group Inc., the owner of upscale steakhouses, said on an earnings conference call on July 27 that higher beef costs are hurting the Heathrow, Florida-based company’s bottom line. The company is evaluating “additional menu engineering and pricing opportunities,” he said.

Federal Reserve policy makers “acknowledged that the drought would likely result in a temporary run-up in consumer food prices later this year,” according to minutes of the Federal Open Market Committee’s July 31-Aug. 1 gathering released yesterday.

Expensive grain also is hurting livestock producers from Asia to Europe. The Korea Feed Association, South Korea’s biggest grain importer, urged the U.S. in July to consider cutting the use of corn and soybeans in biofuel production. The Asian country gets about 80 percent of its feed corn from American growers.

In Germany, Europe’s biggest pig producer, farmers lost about 30 euro-cents (38 cents) on every kilogram (2.2 pounds) of pork sold in the first half, said Matthias Quaing, a consultant at farm group Interessengemeinschaft der Schweinehalter

Deutschlands. The U.K.'s National Pork Association estimates farmers accounting for 10 percent of the country's output may leave the business by late December.

'Losing Money'

"We're losing money on every pig we sell," said James Hart, a second-generation producer in Cirencester, England, who will sell the last of his pigs in November. "The problem in the Midwest states and the critical drought is driving our corn prices and our wheat prices around the world to levels we've never seen before."

In the U.S., hog farmers may lose \$25 a pig in the fourth quarter, said Scott Brown, an agricultural economist at the University of Missouri in Columbia. Higher feed costs are detrimental to the credit ratings of producers including Tyson Foods Inc., Pilgrim's Pride Corp. and Smithfield Foods Inc., Moody's Investors Service said in a report Aug. 16.

Dan Harris, the owner of the Holton Livestock Exchange in Holton, Kansas, said he is selling twice as many cattle as usual for this time of year. Less than half the normal amount of rain fell in parts of the state during the past 30 days, according to the National Weather Service. Without more moisture, producers will keep shrinking herds, Harris said by phone Aug. 15.

"People are selling their calves 60 to 90 days early to preserve their cow herds," he said. "Conditions will not improve until we get some rain."

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