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J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY

SEPTEMBER 2019

RED MEAT OUTLOOK: CATTLE & BEEF

A major event occurred in the cattle and beef complex shortly after we published the RMO last month (August). The Tyson slaughter facility located in Finney County, KS suffered a fire in the boxing area of the plant on August 9th (See Special Report: Tyson Fire). The damage appears to be contained to that one area of the plant, but Tyson officials have recently indicated that the plant might not be fully functional again until January. The Finney County plant was one of the largest cattle slaughter plants in the country, with an estimated daily capacity of approximately 6500 head (representing ~6% of industry capacity). This was an extremely unfortunate event for cattle producers since packing plant utilization was already high before the fire and the loss of that plant called into question the industry's ability to kill all of the cattle that will become market ready in the next few months. Live cattle futures reacted swiftly to the news of the fire, dropping about $7 over two days. At the same time, boxed beef prices rallied sharply as buyers scrambled to replace product that could no longer be sourced from the Finney County plant. From an economic perspective, the loss of that plant caused all of the other plants to become more valuable and the owners of those plants were rewarded with huge margins as cattle prices tanked and beef prices soared. In the week following the fire, we estimate that packer margins were over $400/head and the largest on record going back to 1990. This truly is a black swan event and it has caused beef prices to become disconnected from the cattle market – something that will cause a lot of financial pain for long hedgers in live cattle futures. Cash cattle last week averaged around $102. Before the fire, cash cattle prices were running $113-114.

> **Markets thrown** into **disarray**
> by Tyson beef plant closure after major fire

SUPPLY PICTURE

Prior to the fire, steer and heifer slaughter had been averaging about 522,000 head per week and in the weeks immediately following the fire, fed kills were still at the same level. This was encouraging and showed that by moving cattle around and adding shifts at some plants, packers were indeed able to kill at pre-fire levels. However, labor constraints and aging plants will make it difficult for the industry to maintain this slaughter pace for the remainder of the year. Our analysis indicates that fed slaughter will need to average 530,000 head per week during September and October in order to keep feedyards current. That is a tall task with a major plant down and so it's likely that the cattle feeding industry will become a little less current with each passing week. The good news is that when the fire occurred, the industry was already at a high level of currentness and so it may take weeks or months of lighter-than-needed kills before a backlog of cattle builds up.

Figure 1 provides a year-over-year look at blended steer and heifer carcass weights. Currently, the blended weight is running about 5 pounds below last year, but the forecast has that narrowing over the next few weeks and it's likely that carcass weights will move over last year sometime around mid-October and then track modestly above last year for the remainder of 2019. This is simply a consequence of the industry not having enough slack capacity to keep kills consistent with available supplies. Thus, animals will end up staying on feed longer than they would have if all of the beef plants were operating. Normally carcass weights top out in mid-to-late October, but this year that top might not happen until mid-November or later due to a slower-than-required slaughter pace.

Since early August when the fire occurred, beef production has been at or slightly below last year's level. But as carcass weights march higher in the next few weeks, we could see beef production running 2-3% over last year in September and by October that could expand to a 4-5% YOY increase. Packers have plenty of incentive to kill as many cattle as they can because packing margins are very large (last week they were around $390/hd). It is a good bet that packer margins will stay very wide as long as the Finney County plant is offline. We look for packer margins to slowly trend lower from here, but they probably won't fall below $200/hd until sometime in November.

The most recent *Cattle on Feed* report showed feedyard placements in July were down a little over 2% and it's likely that the sharp

J.S. FERRARO & COMPANY | RETAIL READY Foods Inc.

THE MONTHLY SEPTEMBER 2019
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decline in cattle futures after the fire limited August placements as well. The current forecast has August placements down 8.6% and there is risk that they could be down 10% or more. If that comes to pass, it will be the fourth month in a row to post a YOY placement decline (**Figure 2**). That has the potential to cause some significant tightness in the beef supply during Q1 when those cattle start coming to market. The futures market is not currently reflecting that risk and so buyers might want to consider long hedges in the February or April contracts as a means of managing their Q1 beef price risk.

Packer margins exceed $400/head in recent weeks

DEMAND SITUATION

The beef side of the market is just beginning to settle back down after being thrown into chaos due to the plant fire. A lot of beef buyers were caught short bought, since they were anticipating beef prices to trend lower in August and early September. As buyers scrambled to cover their needs, prices for all beef items shot higher. Now, a month post-fire, those needs have been mostly covered and the market is beginning to return to a more normal state. Cutout values are still more than $10 over where they were when the fire occurred but should continue to work lower in the next few weeks. Buyers seem to recognize that beef is going to be more expensive this fall than they originally anticipated. So, there could very well be some shifting of retail ads away from beef and towards more attractively priced pork and chicken. That would temper beef demand in October and beyond. However, consumers have shown an increasing preference for beef over other proteins and so retailers could opt to keep beef in the ads and just raise the retail price in an effort to offset higher procurement costs. That would be a good test of retail beef demand. If consumers don't balk at the higher pricing then retailers will likely keep the price increases in place for the remainder of 2019 or until the wholesale market retreats closer to last year's level.

The export market for beef is only so-so at the moment. USDA released its official export numbers for July last week and they showed a 2% YOY decline in movement. That, in and of itself, is not all that bad, but the price spike in August and continued high prices here in September probably slowed export sales considerably. We think that when the August export figures are released, beef exports could be down 10% or more YOY and will likely stay below last year for the rest of 2019. Currently, we are forecasting 2019 beef exports to be down 5% from last year.

SUMMARY

The cattle and beef markets were thrown into disarray by the closure of Tyson's Finney County plant due to fire in early August. The net result of losing that slaughter capacity is that beef prices have been much higher than expected and cattle prices have been much lower than expected. Packer margins have swelled to record levels. Beef prices are on their way back down and still have further downside risk in the next few weeks, but are unlikely to get as low this fall as they would have if there had not been a plant closure. Carcass weights are trending higher seasonally and will continue to add to beef production until possibly mid-November. Domestic beef buyers may substitute other proteins for beef in the weeks ahead, which would cause beef demand to ease and provide some price relief. For now, however, it looks like buyers need to get used to the idea that pricing will be higher than expected for the remainder of Q3 and most of Q4. Buyers also need to be cautious of pricing in Q1 because cattle feeders have dramatically slowed placements in the wake of the plant fire and that could result in a tightening of beef production after the first of the year. Our price forecasts for the upcoming period are in **Table 1**.

Choice cutout spiked nearly **$25** following Tyson fire

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THE MONTHLY SEPTEMBER 2019

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Figure 1: Blended Steer & Heifer Carcass Weights

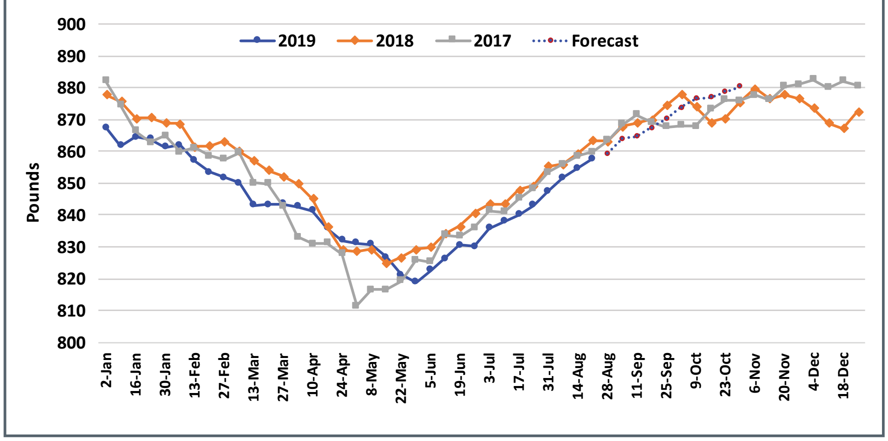

Figure 2: Year-over-Year Change in Feedlot Placements

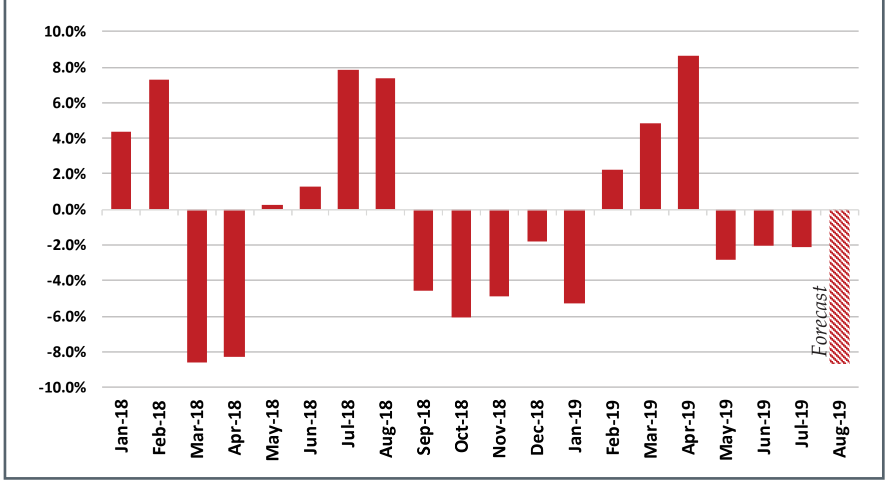

Table 1: JSF Cattle and Beef Price Forecasts

	18-Sep	25-Sep	2-Oct	9-Oct	16-Oct	23-Oct
Choice Cutout	220.4	217.1	213.9	210.6	211.5	211.8
Select Cutout	204.0	202.5	200.9	196.5	196.0	194.9
Choice Rib Primal	354.4	360.0	367.7	371.0	378.0	381.0
Choice Chuck Primal	177.8	175.6	173.8	171.6	173.3	175.0
Choice Round Primal	185.0	181.1	175.7	172.2	174.1	175.0
Choice Loin Primal	294.7	286.6	279.0	271.2	268.2	265.4
Choice Brisket Primal	204.3	200.1	195.4	189.7	185.4	188.2
Cash Cattle	104.7	106.0	106.7	105.5	105.8	107.3

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