

# McCracken County Beef Economic and Policy Update

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## Stocker and Backgrounding Outlook for 2012

Feeder cattle prices have surged upward over the last year and are showing little sign of coming back down. The CME© January 2012 contract was around \$127 per cwt one year ago and has risen to \$152 as of mid January. This is an increase of \$25 per cwt, or about \$200 per head on an 800 lb steer. For the most part, this increase has also been seen in Kentucky markets.

There are several reasons for the recent strength in feeder cattle markets. First, cattle inventory remains incredibly low and supplies of feeder cattle are simply tight. Cattle numbers were already down as we moved into the spring of 2011 and massive drought in Texas and the southern Great Plains forced many ranchers to move calves early. This same drought was also partially behind a large increase in cow slaughter during 2011, which has resulted in a further decrease in cattle inventory since summer and will keep supplies tight in 2012. Overall price levels have also been supported by a strong export market and the recent decrease in corn prices.

Given the high feeder cattle market (750-850 lb steers), prices for recently weaned calves in Kentucky, even though high, were be-

low levels many people expected this past fall and early winter. This is largely due to high corn and other feedstock prices needed to get these calves through the winter either at a feedlot in the Great Plains or with a backgrounder here in Kentucky. However, this will very likely change when pastures green up this spring and calves can be grown utilizing relatively inexpensive grass. Producers should expect large price increases for 400-600 lb calves by April unless the CME feeder cattle contracts lose considerable ground.

These high prices will almost surely cause sticker shock at sale barns this spring, which is understandable. We are likely to see calf prices at levels never seen before. Remember, however, that margins need to be evaluated, not the absolute price levels. This involves estimating the value of the calf in the future, rather than where the market is now. In order to evaluate the potential for summer backgrounding, a careful budget analysis should be conducted. The futures prices (adjusted for basis) is an excellent way to estimate the likely value of feeder cattle this fall. Then, grazing costs including pasture costs, veterinary and health expenses, hauling, commission, etc. can be estimated and subtracted from the expected value of the fall feeder cattle. Once this has been done, producers can make a better assessment of what can be paid for stocker cattle this spring as they build in an acceptable return for their management and risk. In all likelihood, some may decide that they can actually give more for calves than they first expected.

Given the recent run-up in calf prices, it is probably worth taking a closer look at summer grazing costs. Assumptions for the stocker analysis are as follows: 1) Graze steers April 1 to October 1 (183 days), 1.5 lb/day gain, 2% death loss, and 4% interest on calf. Given these assumptions, sale weights would be 775 lbs and 875 lbs for 500 lb and 600 lb purchased calves respectively. Using a \$157 CME futures contract for October 2012 to estimate sale price, we estimate a 775 steer worth \$149 and an 875 steer worth \$145 at sale time. This amounts to roughly a \$4 per cwt price slide for heavyweight steers.

Estimated costs for carrying the 500 and 600 lb steers are shown in Table 1. Most of these are self-explanatory except the pasture charge. We assumed 1.0 acre per 500 lb steer and 1.2 acres per 600 lb steer. The pasture charge accounts for variable costs such as bush-hogging, fertilizer, and re-seeding. The last of these pasture costs are on a pro-rated basis and are considered a bare-bones scenario. These costs will be much higher in some

situations and producers are encouraged to work through similar estimates for their operations.

	<b>500 lb Steer</b>	<b>600 lb Steer</b>
Pasture Charge	\$30	\$36
Vet	\$20	\$20
Interest	\$19	\$21
Death Loss	\$19	\$21
Sale	\$15	\$15
Haul	\$13	\$15
Mineral	\$10	\$12
Other (water, etc)	\$10	\$12
<b>Total Variable Costs</b>	<b>\$135</b>	<b>\$151</b>
<i>Note: Interest varies slightly by purchase price.</i>		

Breakeven purchase prices were also estimated for both sizes of steers and adjusted so that gross returns over variable costs ranged from \$50-150 per head. This gives a reasonable range of possible purchase prices for each sized animal this spring. Results are shown in Table 2 on the following page. For 500 lb steers, purchase prices ranged from \$1.74 to \$1.93 per lb. For 600 lb steers, purchase prices ranged from \$1.62 to \$1.77 per lb. When targeting a \$100 per head gross profit, breakeven purchase prices were \$1.84/lb for 500 lb steers and \$1.70/lb for 600 lb steers.

Gross Profit per head	500 lb Steer	600 lb Steer
\$50	\$1.93	\$1.77
\$75	\$1.89	\$1.74
\$100	\$1.84	\$1.70
\$125	\$1.79	\$1.66
\$150	\$1.74	\$1.62
<i>Note: Per 100 wt prices based on variable costs in Table 1. Does not include fixed costs such as depreciation, overhead, and labor.</i>		

Should these price levels materialize, calf prices would be much higher than anything we have ever seen. We believe it is important to be prepared for this sticker shock so that you can make rational decisions when the time comes, considering expected margins rather than absolute prices. It is also worth noting that these projected April prices are also much higher than what we are currently seeing in the market (mid to late January). While there is a great deal of variation in calf prices right now, the market for weaned calves in late January in Kentucky appears to be in the mid-\$160's for 5wt steers and in the mid \$150's for 6wt steers.

Since cost analysis suggests that these calves may get considerably higher between now and spring, something else that may warrant consideration for summer backgrounders would involve placing calves this winter ahead of forage growth. This strategy would allow producers with available feed resources a chance to

determine how hard to push calves this winter, especially if the intent is to move them to pasture once it becomes available. When considering the potential savings from early placement, remember that each \$.10 reduction in price on a 500 lb steer results in a \$50 per head savings. Thus a \$.20 lower price would result in a \$100 per head savings. If prices rally by that much between now and spring, a lot of medium-quality hay could be purchased for the difference.

While the price of stocker cattle this spring is not known with any certainty at this point, it is a safe bet that they will be very high. Summer grazers will likely have more money at stake than ever before. Given the unprecedented market and potential for volatility, price risk management will be critical this spring. If backgrounders can lock in a comfortable sale price, they will be more confident in bidding on calves in the spring.

Further, the price that can be paid for stocker calves will be greatly affected by the expected prices of feeder cattle in the future. For example, if deferred feeder cattle futures increases by \$1 per cwt, the breakeven purchase price of calves actually increases by about \$1.50 per cwt as sale weight is likely to exceed purchase weight by a factor of 1.5 or more. In other words, if fall feeder cattle futures increase by \$5 per cwt during the week and weaned calves increase by the same \$5 per cwt, the calves are actually a better buy than they were the previous week.

As for the expected sale price, backgrounders have many tools available to them as they look to manage that price risk. Hedging, through the sale of futures contracts, provides solid downside risk protection, but will subject the backgrounder to margin calls if cattle prices increase. Entering a cash forward contract with a feedlot or order buyer, or offering cattle through internet sales with delayed delivery, will reduce or eliminate price uncertainty, but will also limit marketing flexibility should weather conditions necessitate sale at a different time. Finally, put options and Livestock Risk Protection (LRP) Insurance offer a less aggressive strategy that provides some downside price protection, but more ability to capitalize on rising prices. Regardless of what makes the most sense for the individual producer, time spent considering price risk management is likely time well spent in these volatile markets.

Successful backgrounders have many traits, but one of those traits tends to be careful planning. This planning usually involves budget / breakeven analysis, consideration of multiple approaches, and deliberate risk management. Given current prices, coupled with the current supply situation, there is room for great optimism in the cattle business. However, risks are certainly there and have the potential to greatly affect the profitability outlook. The best way to ensure profitability is to budget carefully and look to manage the downside. (Greg Halich and Kenny Burdine)

### **Beekeeping and the Business of Farming: Tax Issues Discussion**

The Internal Revenue Service has different definitions for the words farming, farmer, and farm. It is possible, when applying the IRS definitions, to be engaged in farming activities without being a farmer. On the other hand, your activities may define you as a farmer from a social understanding of farming but not be considered as such by the IRS. While there are common themes through each definition; beekeeping or being an apiarist is not always specifically listed in these definitions.

When looking at the IRS definition of farming, it seems reasonable to assume that beekeeping would fit where it specifically addresses “the raising of agricultural or horticultural commodities.” Further, the IRS definition of a farm would allow for apiaries to be considered where the definition specifically addresses “the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.”

When evaluating farm business activities, the processing of a specific commodity is also limited to its first-use stage. For example, harvesting honey and processing it to be sold containerized would be considered a farm business activity. Fermenting honey and processing it into mead would not constitute a farm business activity. The same would apply for beeswax. Processing beeswax for sale as just beeswax would be considered a farming activity. Further processing of beeswax into candles would be considered a non-farm business activity. In cases where both the initial processed products and value-added products are being offered, a distinction needs to be made in the record keeping and tax reporting to separate the farm business activities from the non-farm business activities.

As was mentioned above, just having beehives and producing honey does not automatically qualify you as a farmer in the eyes of the IRS. There are nine areas of consideration that the IRS addresses when determining whether someone qualifies as a farmer or their activities qualify as hobby farming. These include, but are not limited to, the presence of a genuine profit motive, the expertise of the individual or his/her advisors, time and effort dedicated to the activity, whether profits have been realized in the past, and the concept of personal recreation. It is of paramount importance the individuals and their tax professionals are aware of these areas of considerations.

Depreciation is another tax topic that is not as clearly defined for an apiarist as it may be for other farming operations. In fact, there are no beekeeping specifics for depreciation. In general, depreciation applies to the purchasing of, or making, improvements to your farm property such as machinery, equipment, livestock, or a structure, with a useful life of more than one year. In general, the cost of these items cannot be deducted in one year but must be spread over a number of years. Since there are no beekeeping specific depreciation rules, the default is a 7-year class life which covers all items that do not have a specific class life. Therefore, the purchase of hive structures (or the materials to build them) and beekeeping equipment should be depreciated with a 7-year life.

If you are interested in more information concerning the handling of farm income and expenses as a beekeeper, it can be found in the Farmer’s Tax Guide (IRS pub 225) and the IRS Farmer ATG (Audit Techniques Guide). (Jonathan D. Shepherd)

### Regional Farm Market Sampling Study Results

A very large study of over 3,400 farm market patrons from eight states, including Kentucky, is being completed. The project is part of an effort funded by a USDA Federal-State Market Improvement grant looking at the economic impacts of product sampling. A full and detailed report is expected to be released within the next few months, but preliminary findings are quite interesting and may be helpful for market

vendors planning for this upcoming market season.

Market visitors were asked to evaluate their likelihood to sample various kinds of products at the market on a scale of 1 (not at all likely to sample) to 7 (very likely to sample). There are differences by type of market patron, but in general, the results can be summarized by the kinds of products patrons would most likely want to sample. As expected, patrons tend to shy away from the unusual and unique. Another important result, however, is that 55% of the patrons that sampled some product bought it that day, when they had not planned to purchase before sampling the product. Another 33% either already planned to purchase or were now committed to purchase the product in the future. Sampling seems to show strong dividends. Earlier studies of Kentucky patrons specifically showed that more sampling was the number one thing they wanted to see more of in their farm markets.

Look for additional results and a full report on this study on the Food Systems Innovation Center site and the KY Food Consumer Survey: [www.uky.edu/fsic](http://www.uky.edu/fsic). (Tim Woods)

Product	“very likely to sample” (pct)
Favorite fresh fruit	61%
Favorite fresh vegetable	52%
Cheese	48%
Baked product	42%
Fresh fruit I have never tried	40%
Fresh vegetable I have never tried	35%
Grassfed beef in a recipe prepared at the market	31%
Free range chicken in a recipe prepared at the market	31%
Unusual jam or jelly product	30%
Unusual baked good	28%
Unusual cheese	28%
Any recipe demonstrated at the market	26%
Unique ethnic food recipe demonstrated at the market	24%
Sorghum product	17%
Pawpaw product	15%

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**Remember Safety First.  
 Be Alert and Aware!**

