Managing Risks Associated With Feeder Cattle Terms of Trade

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2010 Eastern Livestock Co. Situation:

- Owes $133M to 743 producers in 33 states (that’s an average of about $175,000 per producer)
- Insufficient funds, Check Kiting, Fraud, etc.
- Bank alleges $2.5B in fictitious cattle sales

http://www.easternlivestockbkinfo.com/ [website of Jim Knauer, Trustee]
What has been the impact of Eastern Livestock Co. going bankrupt?

It has adversely impacted:

- Banks
- Cattle farmers (cow-calf & stocker)
- Trucking agents
- Agribusinesses (feed, vet/med, etc.)
- Feedlots
- Auction barns
- Other order buyers
What is the annual impact of non-payment on “one load” of feeder cattle?

Assumptions:
50,000 lbs per truckload
$110 per cwt. market price
$55,000 per truckload
5% interest rate
15 years financed

→ Annual Payment of $5,299 per year for 15 years
Table 1. Estimated annual payments to cover a feeder cattle sale default of $55,000 (1 load) based on various interest rates and length of loan.

<table>
<thead>
<tr>
<th>Years</th>
<th>Loan Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.0%</td>
</tr>
<tr>
<td>10</td>
<td>($6,448)</td>
</tr>
<tr>
<td>15</td>
<td>($4,607)</td>
</tr>
<tr>
<td>20</td>
<td>($3,697)</td>
</tr>
</tbody>
</table>
Estimated Total of Payments to Finance A Feeder Cattle Sale Default of $55,000

Table 2. Estimated total dollar payment to cover a feeder cattle sale default of $55,000 (1 load) based on various interest rates and length of loan.

<table>
<thead>
<tr>
<th>Loan Years</th>
<th>3.0%</th>
<th>4.0%</th>
<th>5.0%</th>
<th>6.0%</th>
<th>7.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>($64,478)</td>
<td>($67,811)</td>
<td>($71,228)</td>
<td>($74,728)</td>
<td>($78,308)</td>
</tr>
<tr>
<td>15</td>
<td>($69,108)</td>
<td>($74,202)</td>
<td>($79,483)</td>
<td>($84,945)</td>
<td>($90,581)</td>
</tr>
<tr>
<td>20</td>
<td>($73,938)</td>
<td>($80,941)</td>
<td>($88,267)</td>
<td>($95,904)</td>
<td>($103,833)</td>
</tr>
</tbody>
</table>
Managing Risks Associated With Feeder Cattle Terms of Trade

Selling Feeder Cattle:

- Market Procedure
- Contract Contents
- Contract Adjustments
- Performance Guarantee
Factors To Help Manage The Risks Associated With Feeder Cattle Terms of Trade

- Sort feeders for uniformity (sex, weight, quality, breed, color, etc.)
- Specify feeder description (head, sex, weight, quality, breed, color, etc.)
- Be within 30 lbs on your estimated weight
- Specify price slide
- Specify delivery dates
- Specify a given cut number
- Specify no adjustments to shrink
- …… continued
Factors To Help Manage The Risks Associated With Feeder Cattle Terms of Trade

…continued

- Specify no adjustments to shrink
- Specify no adjustments to price
- Specify no adjustments to price slide
- Specify adjustments to delivery date
- Specify adjustments due to truck arrival
- Animal identification (branding, EID)
- Specify amount of binder money
- Specify type of payment (wire transfer of funds, etc.)
- …….. others
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Selling Feeder Cattle:

1) With a Marketing Agent
2) Without a Marketing Agent
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Selling Feeder Cattle With a Marketing Agent (MA)

- MA must be bonded and licensed
- MA must have the proper bond
- MA must follow the procedures and regulations under GIPSA
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Selling Feeder Cattle With a Marketing Agent (MA)

- Added cost may involve a flat fee per head

- Added cost may involve a commission based on market value and insurance (i.e. 1.5% commission of market value plus insurance at $0.25/$100 of market value).

- On an $800 animal @ say 1.5% commission and insurance ($0.25/100 lbs.) that amounts to $14 per head ($12 comm. + $2 ins.)
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Selling Feeder Cattle With a Marketing Agent (MA)

- Can MA improve the economic package you are selling to justify a higher sell price?
- Can MA increase the number of buyers/bidders to increase the market price you receive?
- Can MA reduce/eliminate buyer default?
- Can MA help merchandise animals in less than economic units?
- ........ ?
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Selling Feeder Cattle w/o a Marketing Agent

- Seller/Assoc. collects information about the market
- Seller/Assoc. collects buyer info and makes contacts
- Seller/Assoc. organizes and conducts sale
- Seller arranges delivery w/ buyer
- Seller accepts the risk of buyer default
- Seller is responsible for any contract adjustments
- Seller is responsible for ensuring the buyer performs per contract specifications
Advantages and Disadvantages of Using A Marketing Agent To The Seller

**Advantages**
- MA maintains current information that helps merchandise cattle in economic units
- MA maintains information on reputable buyer contacts
- MA can sometimes increase the number of buyers/bidders
- MA organizes and conducts the sale and pickup
- MA provides prompt payment w/in 24 hours (reduces sales default risk)
- MA serves as an arbitrator

**Disadvantages**
- Involves more communication
- Increased cost to market cattle
- ......
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Summary

Question/Answer
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Summary

What do we do now?

It depends on your risk capacity!
What is your risk capacity?
What is your risk capacity?

Can you afford to lose $50,000+ per truckload if the buyer defaults?
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Thank You!

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