MONTHLY MARKET PROFILE: MAY, 2009

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Last month's Monthly Market Profile focused on the issue of spring highs and included the following excerpt:

> The bigger question now becomes about further upside potential and possible assertion of further gains: is there some gas left in the tank for spring highs over the course of the next four to six weeks?

That question stemmed from the market's six-week achievement of working back to $85 at the end of March following mid-February's sub-$80 low. Upside potential indeed!

Nearly as soon as the MMP was released boxed beef began a new upward march – to the tune of about $18/cwt in the following three weeks. Not surprisingly, the fed market tagged along: cash sales jumped to $86 and then traded mostly $88 for the following couple of weeks. That surge was short-lived, though, as the market quickly ran out of gas. April's ending sales were largely $2-3 lower with fed trade finishing the month at $85-6 and giving back almost all of the gain of the previous few weeks.

It goes without saying, the cattle feeder never complains about higher prices. In fact, by some estimates, a proportion of closeouts have actually been in the black in recent weeks: calf-feds priced against last fall's low point in the feeder cattle market. However, the big winner in recent weeks has been the processor – they've captured an overwhelming proportion of the run-up in wholesale prices. Subsequently, as last month's MMP was coming to press, the packer was on the cusp of ending its losing streak due to improved demand, bigger throughputs and better margins and managed to reverse direction from the following March-issue excerpt:

> Momentum has seemingly turned in favor of the cattle feeder. Per that premise packers are getting squeezed. Beef processors have worked hard to maintain margins in recent months against the backdrop of sliding wholesale values – but even steady live prices in that environment prove detrimental to margins. The fed market's jump to $85 confounds that reality even further. The illustration below reflects estimated gross profit trends; as always, the actual estimates don't matter – what does matter is the trend. Note the 2009 month-over-month differences: the line is in the wrong direction (contra-seasonal). March's values put the processor about $50/head behind breakeven. As such, the packer, too, will be looking ahead to spring – grilling season typically means better beef demand: opportunity for increased throughput, larger supply and ultimately improving operating margins.

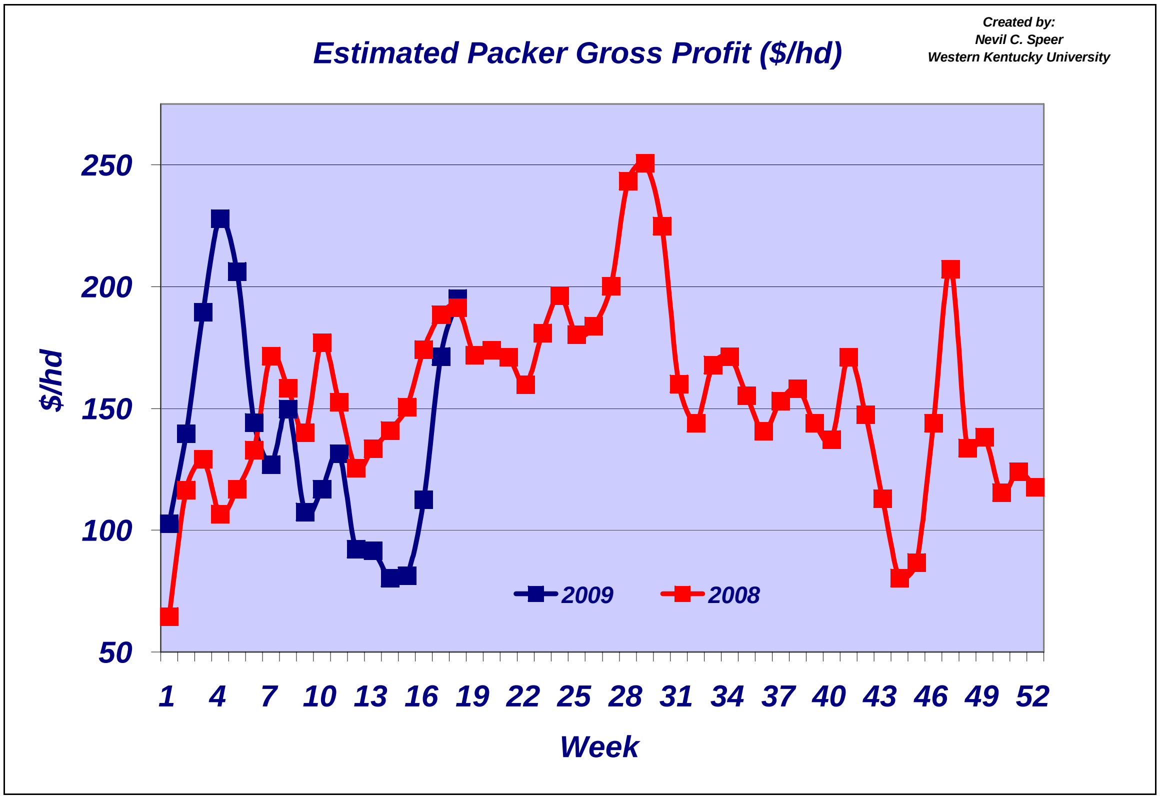
The first graph below illustrates the reversal in recent weeks. Gross profit during the second-half of April jumped above $150/head and provides at least a short window of reprieve in terms of operational profitability. And it's no accident that the average weekly harvest surpassed 650,000 head during the previous two weeks – the first such run time since late-September and well ahead of the non-holiday weekly average of 614,000 during 2009. And cattle feeders have been largely willing to surrender that bounty to processors given the break back to $82 for both the June and August contracts at the CME.

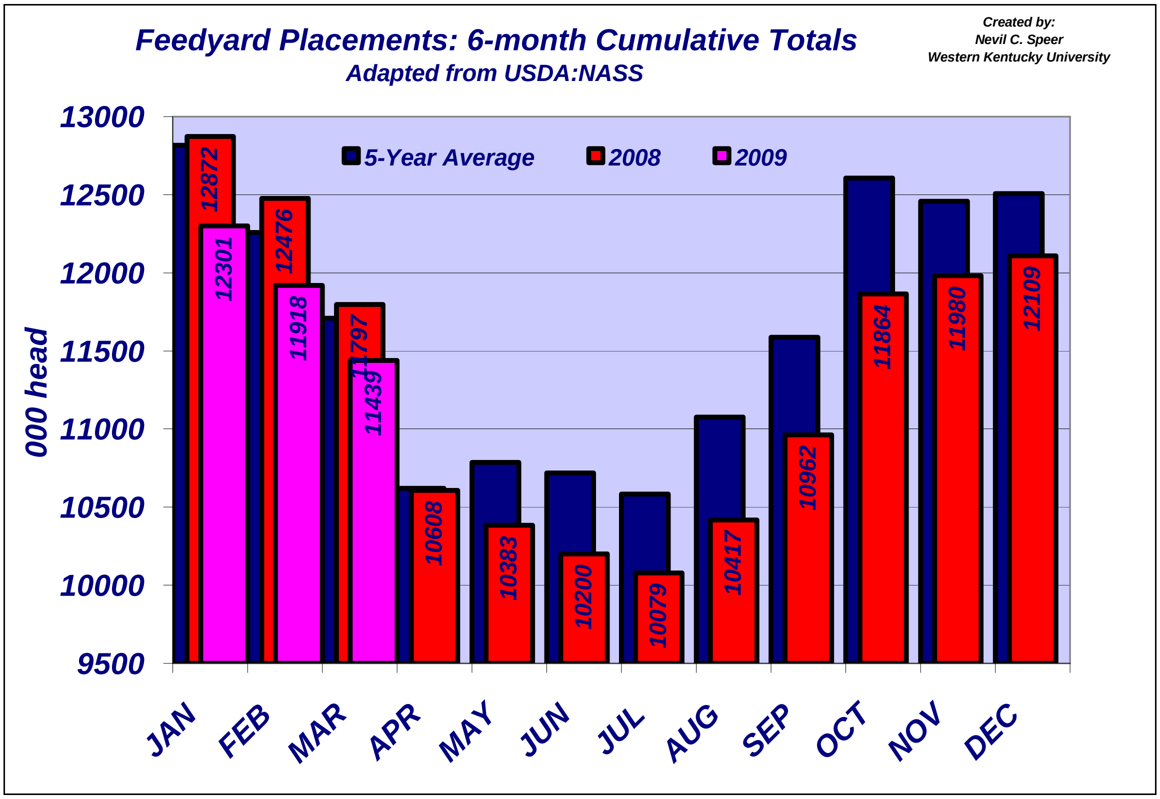
The next few weeks will be very critical and likely prove contentious amidst weekly negotiations. On one hand, feedyards will attempt to cash in to the fullest extent possible per current positive basis (a window which is quickly waning per last week's spot market decline); managers want to sell as many as cattle as soon as possible. And sizeable weekly harvest will remain possible as long as the packer remains in the black. On the other hand, cutout values have come under pressure in recent days; $150+ seems an important resistance level and may not be sustainable much longer once the scrambling to meet Memorial Day needs is over. Further declines will mean shrinking potential for margin; the answer will either be lower margins or lower bids. Meanwhile, there's indirect fallout from H1N1 influenza: closed export markets means additional pork that ultimately will land within the domestic market; Memorial Day is traditionally beef-focused but pork may favorably compete as consumers look for value in a struggling economy.

Lastly, USDA's April cattle-on-feed report revealed larger March placements versus 2008. But turn-level placements remain behind both the year-ago and the five-year average pace (second illustration below). However, in my estimation there's one hugely important item that's seemingly been overlooked in recent weeks: USDA's quarterly estimate of the steer vs. heifer mix within the nation's feedyards. This one was especially important as it represents culmination of calf-fed placements from the spring, 2008 calf crop; that is, it's indicative of calves having been placed on feed through fall '08 and spring '09 – the remainder of the calf crop will likely arrive later in the year following summer grass programs. Nonetheless, it's the mix that's important.

The third illustration below provides some reference from which to work: it outlines the U.S. beef cow inventory during the past several decades. Note that beef cow inventory has declined a whopping 3.6 million cows since the recent peak in 1996. Even more dramatic, though, was the loss of 700,000 cows last year alone. The final illustration highlights the quarterly steer/heifer mix during the past ten years. One would surmise that last year's sharp cow sell-off might induce increased interest in heifer retention – that'd subsequently be reflected in this spring's steer/heifer feedyard mix and partially explain lower placement activity. But that's not been the case and heifers continue to comprise approximately 37% of the total feedyard population – consistent with previous years.

There are likely a number of varied reasons for that occurrence; many readers undoubtedly can provide a number of logical explanations. Ultimately, though, it depicts a relative bearish outlook with respect to profitability – a decision making process that is especially important and revealing amidst the current financial crisis. Increased production costs coupled with household financial pressures are influencing the cow/calf sector: the outcome clearly is not in favor of running more cows. But most important are the ramifications on an industry-wide basis. Most notably, further declines in beef cow numbers will eventually impact the industry's infrastructure in an unfavorable manner. Clearly, that's not a feel-good message. But it's also reality and should neither be avoided nor placated if the beef complex is to remain competitive. Stay posted.


Estimated Packer Gross Profit ($/hd)
Created by:
Nevil C. Speer
Western Kentucky University
$/hd
250
200
150
100
50
2009
2008
1 4 7 10 13 16 19 22 25 28 31 34 37 40 43 46 49 52
Week


Feedyard Placements: 6-month Cumulative Totals
Adapted from USDA:NASS
Created by:
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5-Year Average
2008
2009
000 head
13000
12500
12000
11500
11000
10500
10000
9500
12872
12301
12476
11918
11797
11439
10608
10383
10200
10079
10417
10962
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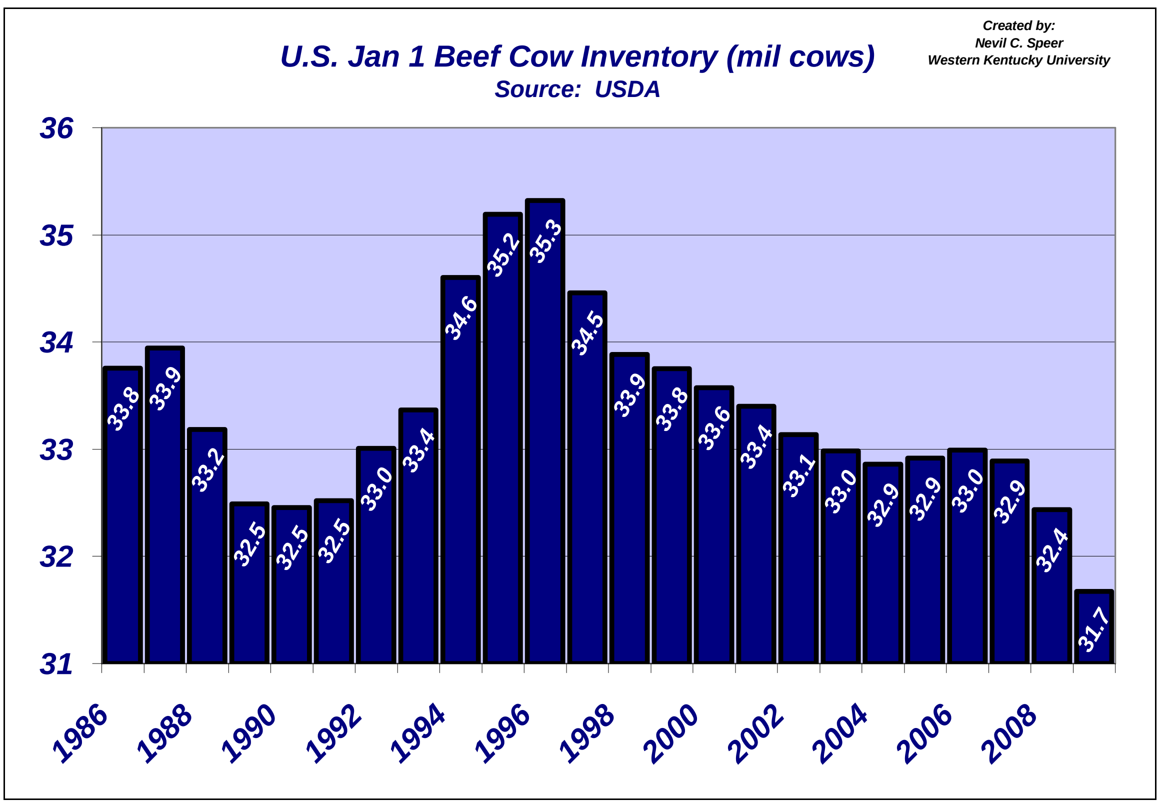
SEP
OCT
NOV
DEC


U.S. Jan 1 Beef Cow Inventory (mil cows)
Source: USDA
Created by:
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Western Kentucky University
36
35
34
33
32
31
33.8
33.9
33.2
32.5
32.5
32.5
33.0
33.4
34.6
35.2
35.3
34.5
33.9
33.8
33.6
33.4
33.1
33.0
32.9
32.9
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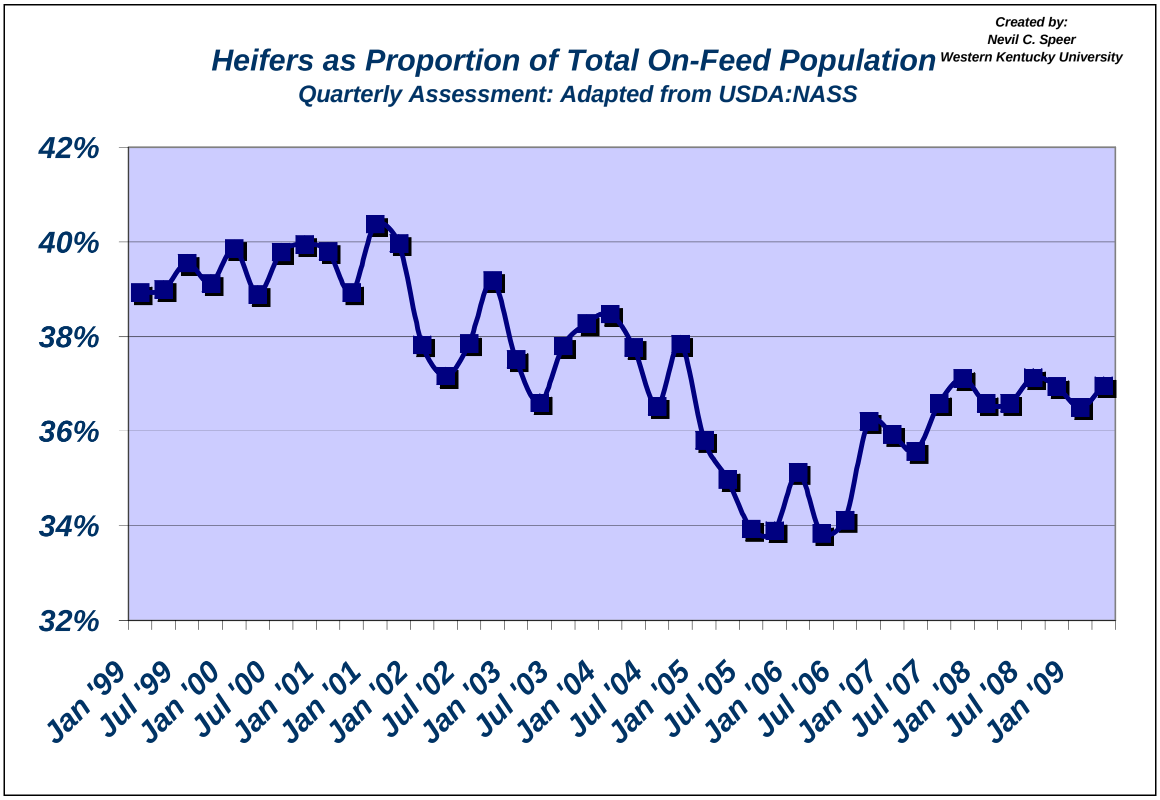
1998
2000
2002
2004
2006
2008



PRICE SUMMARY

	1-May	24-Apr	17-Apr	10-Apr	3-Apr
Slaughter Steers ($/cwt)	84.50	88.00	88.93	85.97	84.69
Choice Cutout ($/cwt)	151.00	152.83	145.37	137.71	135.20
Select Cutout ($/cwt)	148.05	150.65	144.17	136.99	135.33
Hide and Offall ($/cwt)	5.85	5.95	5.95	5.93	5.85
USDA Slaughter Weights (lb)	1287	1296	1303	1307	1311
USDA Steer Carcass Weights (lb)	828	835	839	846	848
CME Feeder Cattle Index ($/cwt)	99.52	100.30	99.55	97.06	94.99
Cow Cutout ($/cwt)	115.35	114.20	112.93	111.37	112.34
Corn (basis Omaha: $/BU)	4.02	3.70	3.67	3.79	3.93
Cattle Harvest (000 head)	665	644	606	600	606
Beef Production (million lb)	516.7	503.6	476.6	473.1	478.6