U.S. Premium Beef, A Beef Marketing Strategy for the Next Millenium

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I appreciate the opportunity to come before you and discuss solutions to the challenges that are facing the beef industry today. As a fourth generation cattle producer and the CEO of U. S. Premium Beef, the first large scale beef marketing cooperative in the United States, I am proud of the history of independence and perseverance that is a stalwart of the beef industry. Historically, it has been these traits that have enabled us to survive and prosper. Today and in the future it will be our cooperative efforts through strategically aligning ourselves between our many segments that will ensure survival. And, when referencing segments, I am referring to all participants up and down the food chain from the ranch to the consumer.

We will look back on this time as a watershed moment for both cattle producers and other segments of the Beef Industry. The issues and factors effecting our industry are complex. You have heard much testimony concerning issues of cattle and beef marketing. I am not here to defend the packers or producers that have entered into controversial marketing agreements. Frankly, I don’t have the facts to make those judgements. However, it is my intent today to come before you in an uncommon role. As both a producer and a packer, U. S. Premium Beef is in a unique position to cut through the rhetoric and mis-information that is gripping our industry today, and make informed observations and introduce logical solutions to the challenges we are facing.

Who is making the money?

In our capitalistic society, competition can create the aura of winners and losers. "Who go out traded?" is a common question in the cattle trade The facts I am about to share were arrived at as a result of a combination of the due diligence process during the formation of USPB and knowledge we have gained as an owner of a beef processing company.

As we look at the historical movement in live cattle prices, wholesale cutout prices and retail prices, as referenced on exhibit A, we will observe the cyclical nature of the beef industry. Especially noteworthy is the parallel nature of live price to cutout.

There has been much discussion within the industry over the past six months concerning the profit margins within the meatpacking sector. The fact is that when this issue began re-surfacing in August of 1998, the previous 12 months represented the worst packer margin index in five years as referenced on exhibit B and C. In contrast, the earnings reported beginning in August represented the seasonably higher earnings that normally occur during the summer months. While the months of August and September of 1998 represent above the five-year average earnings level, as is apparent in exhibit D, the balance of the year reveals below normal earnings. Quite simply, because beef packing margins are so highly seasonable, you can not look at one point in time and draw conclusions without looking at the year as a whole.

Since 1994, however, we have seen a more stable retail price as compared to live and cutout thus causing high farm to retail beef price spreads. This would lead some to believe that the retailer is gaining an unfair advantage. To direct energies toward reducing beef prices therefore reducing retailer margins would be a mistake. It is in best interest of our entire industry that we maintain as high of level of value in our products. The key is that as producers, we must move up the value-added food chain and reap these rewards. This, as I will discuss, can only be achieved through more coordinated efforts.

As our industry continues to evolve, advancements in technology, genetic improvements and sophisticated marketing practices provide for increased opportunities. The ability of small independent producers to compete with large conglomerates is difficult. However, much of our ability to succeed will not be tied to size alone. A producer's ability to adapt to change and the utilization of the latest technologies and other management tools, including creative marketing strategies, are just as critical.

Much has been said regarding the consolidation of the meat packing industry. However, consolidation within our industry is not limited to meatpacking. As referenced in exhibit E, since 1974 we have approximately 25% fewer beef farms, 50% fewer feedlots and 65% fewer beef processing plants. All sectors of the industry including producers and packers are dealing with the challenges of changing competitive factors implicit in beef's declining market share. For our industry to reverse the trends of fewer players and reduced market share, we must work toward coordinated efforts between sectors verses building greater barriers and increased regulation.

Why are prices Low?

Once again, producers find themselves asking, Why are prices so low? Is it because the packer has gained leverage over the producer? According to USDA numbers, over the last five years the gross packer margin (the value of beef cutouts vs. live cattle price) has dropped over $20 per head. If through forward pricing of cattle or so called captive supply arrangements, it was the intention of the packer to create wider margins, then they failed miserably. 1998 will be known for a year of beef processing business closures. The sixth largest beef processor, BeefAmerica closed in the fall and in March, IBP's Luverne, MN beef slaughter plant was closed permanently as well as Hermando Boneless Beef Co. and there are more.

The cause of lower cattle prices is simple. Production of meat proteins has reached record levels. Beef production alone in 1998 reached record levels of nearly 26 billion pounds (see Exhibit F). This is an increase of over 3 billion pounds annually or 13% in five years. During the same time period, however, beef continues to lose market share to both pork and poultry. In the last 20 years, per capita consumption of beef has dropped over 30% (see Exhibit G).

As revealed in exhibit H, a stark inverse relationship between supply of beef and average fed steer price has existed for years. This chart provides the clearest evidence of the fundamental reasons behind low cattle prices. How can anyone viewing this chart not come to the logical conclusion that our price is driven substantially by economic factors.

As one reviews the facts, there certainly exist today efforts by both producers and packers to enter marketing arrangements that take cattle off of the weekly spot market. Some estimates are that at times this could be as much as 50% of the cattle on a weekly basis. Structural change within our industry will continue and accelerate as producer's decline in number and grow in size. Does this provide for an unfair advantage to the participants and remove the competitive forces of the live cattle market? Week to week certainly it is reasonable to assume that there could be a negative impact on price. However, looking at a year as a whole or even historically, there is little evidence that so called captive supplies have played a role in depressed live cattle prices.

As we look at the shear economic factors, as producers, the thought of limiting production to raise price is not one easily embraced. The key to producers of any size to remaining competitive is to respond to consumer's quality needs, increasing productivity, and lowering costs. Market development is key for the cattle and beef industry as we as we look toward reversing the trend of eroding market share to competing proteins. Reliance on antiquated marketing practices that inhibit value based marketing; stifle communication and breed mistrust between sectors will only lead to further loss of market share. It was and is our conclusion that these disturbing trends can only be reversed through creative marketing systems that provide:

1. True Value based carcass merit pricing (price based on meat quality)
2. Transfer of carcass data back to producer (earned through shared risk)
3. Ownership in value-added processing through vertical integration

Background of U. S. Premium Beef, Ltd.

As early as the fall of 1995, Midwestern producers from all segments of the cattle industry, seed-stock, cow/calf, farmer feeder and feedlots, began meeting to discuss solutions to the problems plaguing the current cattle marketing system; These include:

1.A system that promotes mediocrity by the gathering of cattle in large numbers, primarily entire feedlot showlists, and establishing one average price without regard for quality or value differences.

2.A system that has provided incentives only for production efficiencies (i.e.: faster weight gain and lower feed costs) and little or no regard for carcass or meat quality thus lowering the overall quality of beef and consumer demand.

3.A system that provides large producers the advantages of the efficiencies of economies of scale and the leverage to negotiate private marketing agreements with little opportunity for the independent family rancher or feeder to enter agreements that reward for producing a more valuable animal.

After much research by a group of cattlemen, frustrated with the rhetoric of problems and finger pointing, and committed to taking control of their own destiny, U.S. Premium Beef, Ltd. was formed. Founded on July 1, 1996, U.S. Premium Beef was structured as new generation marketing cooperative, the first and only in the United States. Shortly thereafter a business plan was established and a mission statement was adopted. This mission reads:

> "To increase the quality of beef and the long-term profitability of cattle producers by creating a fully integrated producer-owned beef processing system that is a global supplier of high quality value-added beef products responsive to consumer desires."

From there, more than 675 producers from 24 states committed both cattle production and capital to seek out the most economically feasible inroad into further processing and value added products. After extensive research into the different alternatives of acquisition, building or joint venture, it became evident that the only viable avenue for producers to enter further processing was through joint venture.

As producers, what we bring to the table is the ability, through known genetics and cattle management, to design supply cattle tailored to consumer demands and delivered in a systematic way that will provide a year around supply of cattle to plants. As producers, we provide little expertise in processing and marketing and are ill equipped to compete in a mature beef packing industry that is highly competitive.

In July of 1997, we announced that U. S. Premium Beef had signed an agreement to enter a partnership with Farmland Industries, the nations largest farmer owned cooperative, to purchase up to 50% of Farmland National Beef Packing Company. Farmland National Beef is the fourth largest beef processing company and an international leader in value-added branded products.

During the fall of 1997, USPB mounted a stock offering drive throughout the United States. By December 1, 1997 our efforts were successful. We had commitments for close to 700,000 cattle annually and over $72 million of capital raised. The following week, USPB began operations, buying more than 10,000 member cattle on an individual animal basis over a progressive carcass value based grid.

Current USPB Operations

To date, USPB and its members have marketed over 500,000 cattle through its plants and beef company. Membership totals over 675 producers from all segments in 24 states. While still in its infancy, USPB has paid out over $4.8 million dollars in premiums over the cash live cattle market. This represents an average of over $9 per head premium. The top 25% of performers earned an average of $29 per head. In addition, our stockholder/members will realize earnings of over $10 per head through the profits of the Beef Company they own. This represents an average return on investment of over 34% on the initial $55 investment. For those producers in the upper 25%, the return on investment is over 70%.

Additionally ever producer member is insured a competitive carcass merit grid pricing, carcass data on individual animals, transportation credit up to 110 miles and livestock and meat consulting, all at no charge.

The results of our first year of operations are very encouraging. As is apparent in exhibit I, the level of premiums has steadily increased over the past year. This has occurred in great part due to the utilization of carcass data and the financial incentives in place through grid pricing. Any producer armed with the correct tools can achieve these results.

Conclusion

For years the cattle industry has talked about problems. For years we have witnessed devastating erosion of market share and loss of independent cattlemen and women. U. S. Premium Beef is a solution, created as an effort to respond in a proactive way to challenges of our industry. U. S. Premium Beef. Strategies that will add value for producers while improving our product and winning back consumers to beef.

Thank you for this opportunity to present today. I will be happy to respond to questions.