

Testimony
on behalf of the

National Cattlemen's Beef Association

with regard to

The Impact of Higher Feed Costs on the Cattle Industry

submitted to the

United States House of Representatives - Committee on Agriculture
Subcommittee on Livestock, Dairy, and Poultry

The Honorable Leonard Boswell, Chairman

submitted by

Mr. Ernie Morales

Member

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Washington, DC

Mr. Chairman, members of the Committee, my name is Ernie Morales, and I am a rancher and cattle feeder from Devine, Texas. I appreciate the opportunity to be here today to talk about high feed prices and the impact we are feeling in the cattle business. As an independent cattleman, I have first-hand experience in what these prices are doing to my bottom line.

Our industry is currently facing multiple feed pressures. Due to widespread drought, last year's wildfires, and the recent severe winter weather, we have seen our hay and forage supplies dwindle. The U.S. Department of Agriculture reported that U.S. hay stocks had dropped to an 18-year low of 96.4 million tons as of December 1, 2006. We have experienced dry conditions for several years now, so this year's conditions caused an even further depletion of tight forage stocks. From emergency grazing of CRP acres to hay hotlines, our industry has been working hard to try to find enough supply to meet the demand. We have been forced to utilize lesser quality forage as a result. Although devastating, these winter conditions will hopefully help ease the drought and allow us to replenish our hay supplies. Regardless, we will continue to see high hay demands and prices as drought persists in other areas of the country and we see some hay acres converted to corn.

As with most of my counterparts who feed cattle, corn is our primary feed stock accounting for about 85 of every 100 pounds of cattle feed. We'll feed about two billion bushels of corn to cattle this year out of the nearly six billion bushels fed to livestock. The livestock industry remains the largest consumer of corn by utilizing almost 58 percent of the total corn used over the past decade.

From a cattle feeder's perspective, every \$1 per bushel increase in the price of corn means we must pay approximately \$22 per hundredweight less for a 550-pound calf just to have a chance to make the same income. For the cow-calf producer, that's roughly a \$121 per head reduction in price. So in reality, cattle feeders absorb a portion of higher corn prices in the form of increased operating costs and cow/calf producers absorb a portion in the form of reduced prices for their calves.

From January 1st to February 16th of this year, the average Omaha cash corn price was \$3.68. The average price from that same time period last year was only \$1.91. That is over a 92 percent increase in just one year. The most pronounced effect of this increase was seen last fall when the price for 600 pound feeder steers between September and the end of 2006 fell 20 percent from \$122/cwt to \$102/cwt.

This increase in corn prices has moved our cost of gain from an average of \$0.55 per pound in 2006 to \$0.75 per pound in 2007. Analysts at Cattle-Fax predict that this number may even move into the low \$0.80's as corn demand increases. With increased inputs and decreased prices for cattle, every rancher and cattle feeder in the country is seeing a hit to their bottom lines.

This is not a cost that neither the producer, nor I as a feeder, can pass along to consumers because consumer demand for our beef is fairly inelastic. Although we have built

demand and maintained that through increased retail beef prices over the past several years, there is only so much that a consumer is willing to pay before they begin to choose other protein options. This means that in the short run, the majority of these higher feed costs are borne by cattle feeders and cow/calf producers. Retailers and packers won't pay any more for fed cattle.

As we are all aware, the primary driver of these corn prices is ethanol. As of February 25th, the Renewable Fuels Association's website puts current U.S. ethanol production at 5.6 billion gallons with another 6.2 billion gallons currently under construction. There are currently 114 biorefineries in production, with another 78 under construction, which when fully operational, will need roughly 4.25 billion bushels of corn.

In time, we believe U.S. corn producers can and will meet this rapidly expanding additional demand for corn. However, until the appropriate acreage and yield adjustments can be made during this transition, USDA's current projection of a 50 percent year-to-year increase in ethanol-based corn demand from 2.15 to 3.2 billion bushels will be felt squarely in the wallets of every feeder and cow-calf producer in this country.

So how is the cattle industry supposed to respond? One way is to look at alternative feed sources. Ethanol production results in distillers grains as a co-product. Distillers grains are used as wet (35 percent dry matter), modified wet (50 percent), or dried (90 percent). Each bushel of corn used for ethanol production returns about 18 pounds of dried distiller grains. These co-products can be used in our feed rations, and of all the livestock species, cattle are the ones that can best utilize these co-products.

On average, about 30 percent of a cattle ration can be switched to these ethanol co-products when a feedlot can obtain them, and some feedlots are trying as much as 40 percent. However, at these levels, there is concern about cattle performance, mostly in regards to the higher sulphur content of distillers grains, which tends to suppress appetites and tie up micronutrients that are essential to cattle health. With increased input costs and the inherent risk of cattle feeding, the last thing we want to see is cattle not eating and not putting on weight.

We are also concerned about the variability of the co-products from ethanol production. It has proven difficult to get a consistent product which, in turn, makes it hard to formulate a balanced ration. Nearly every truck load of distillers presents something different for our nutritionist to deal with.

We're also keeping a close eye on any impact that distillers grains might have on the quality of our end product. The beef industry has worked hard for many years to build beef demand. This demand, however, is based on the quality of our product, and any changes to that quality could jeopardize a consumer's willingness to purchase our beef.

Another critical component of our costs is transportation. Basis levels for corn have skyrocketed to historic levels in recent months in Texas and other parts of the country,

and there are very limited risk management tools out there to mitigate these costs. Previously, I mentioned that we're in the midst of a historic transition in the U.S. cattle feeding business. If my operation is to be successful during these historic structural changes to this industry, I believe the key will be our ability to rapidly expand and maintain a viable transportation system. During NCBA's annual convention five weeks ago in Nashville, the grain consulting firm ProExporter indicated that in less than 10 years, this historic transition to biofuels will require a 68 percent increase in rail/ton/miles for bulk agricultural commodities. This is a shocking projection that may very well dictate the success or failure of our business in the coming years.

I should also point out that while wet distillers grains actually makes a better cattle feed than dried distillers grain, a feedlot must be within about 150 miles of the production source in order to manage or handle a wet co-product. Wet distillers are extremely hard to mechanically handle and it is also susceptible to spoilage. Dried distillers grains, or DDGs, are better to handle, but it is still hard to mechanically convey since it just doesn't flow through hoppers and equipment like corn.

At about 90 percent of the value of corn, the use of wet or dry distiller's grains will help mitigate costs, but corn must still make up the majority of the feed ration. The price of distillers grains will also be something to watch. Despite the hype, supplies of ethanol co-products remain tight as most ethanol plants have used 6-12 month forward contracts to lock-in co-product prices. We're hearing that it may be late 2007 before co-product supplies begin to reach a point of being readily available in a spot market.

In the meantime, we fully expect to see an extremely volatile corn market in 2007. As corn becomes more tied to ethanol and energy, we can expect it to become more and more influenced by the same factors that influence energy prices. Increased volatility puts further pressure on the users of corn. This increased volatility will also bring in yet even more speculative interest in agricultural futures markets such as hedge funds.

NCBA supports our nation's commitment to reduce dependence on foreign energy by developing forms of renewable energy such as ethanol. We recognize that federal support of the ethanol industry has been necessary to encourage development of basic production technology, however, we as cattlemen believe in a market-based economy and there is concern amongst our industry about the influence of renewable energy policy on the price of feedstuffs such as corn. This is why we support a transition to a market-based approach for the production and usage of ethanol produced from corn. NCBA calls for allowing the existing blenders tax credit and the ethanol import tariff to sunset as scheduled in 2010 and 2009 respectively. The Center for Agriculture and Rural Development at Iowa State University produced a comparison of corn prices with and without the blenders credit. At a price of \$50 for a barrel of oil, the price of corn with the credit was \$2.67 a bushel. Without the credit, the price fell to \$1.83 per bushel.

NCBA members believe that these credits have served a valuable purpose, but at a projected annual production level of somewhere between 12 and 15 billion gallons, it is clear that this is no longer a fledgling industry. As such, when these incentives expire,

this industry must be subjected to equivalent market forces as the U.S. beef industry. Said another way, we believe the U.S. beef industry can and will remain competitive as long as we have the ability to compete on a level playing field with the ethanol industry for that bushel of corn.

The cattle industry has always depended on the markets to drive our business, and we are firm believers in free enterprise fostering innovation. That is why we believe that other renewable fuel sources, such as cellulosic feedstocks for ethanol, hold great promise. It, and other more efficient means of producing biofuels, could also potentially help to utilize manure and ease the environmental concerns our industry faces. For example, we continue to support the use of animal fats and oils in the production of biodiesel as we also see this as a way to decrease our energy dependence by utilizing what has traditionally been a waste product.

Mr. Chairman, thank you for the opportunity to testify here today. Our industry looks forward to working with you and the Committee in finding ways to develop renewable fuels that will not put an undue burden on any sector of agriculture.

Committee on Agriculture
U.S. House of Representatives
Information Required From Non-governmental Witnesses

House rules require non-governmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. Name: Ernie Morales

2. Business Address: P.O. Box 487
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3. Business Phone Number: 830-663-4441

4. Organization you represent: NCBA

5. Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee:

Commercial Feedlot Owner
Rancher
Stocker Operator

6. Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:

B.S. in Animal Science, Texas A+M

7. If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold:

Board of Directors NCBA

PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF TESTIMONY.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

Name: Ernesto Antonio Morales
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Organization you represent (if any): NCBA

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: None Amount:
Source: Amount:

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2004, as well as the source and the amount of each grant or contract:

Source: None Amount:
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Please check here if this form is NOT applicable to you:

Signature: *[Handwritten Signature]*

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.

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