

Pork producers out of time

- The "14 days of spring" related to the H1N1 flu situation undermined the market outlook for the entire year.
- Pork producers are facing what would be a second-straight year of losses this year and a likely third year next year.
- Losses are taking many producers to their "breaking point."

By ROD SMITH

The "14 days of spring" from April 24 to May 8 -- when news surrounding the A/H1N1 influenza pounded the hog and pork markets -- has undermined the market outlook for the next 18 months and will cause significant losses for pork producers this year and next year and significant producer rationalization that will create a new, substantially more consolidated industry, according to Feedstuffs sources.

Already, 20,000 sows are in bankruptcy proceedings, and thousands more will be in liquidation come fall, sources said. "I sense that a large group of producers are near the end of their ropes," said Daniel Bluntzer at Frontier Risk Management in Robstown, Texas.

Certainly, the economic collapse and its effects on consumer demand for pork must also be factored in, but the economy is stabilizing and should start to recover later this year or soon into 2010, sources said. Certainly, corn and soybean meal prices remain strong but won't come near the record-high, runaway levels of last year.

It's the H1N1 influenza outbreak that has done the damage, sources said.

Lost rally

The influenza -- a novel version of flu virus -- broke out over the April 24 weekend in Mexico and spread to parts of the U.S. and was widely reported as "swine flu" due to its genetic make-up, although it also contains avian and human components.

By the following Monday morning, the flu was associated with being around hogs and consuming pork, retailers were holding off on pork purchases to watch consumer reaction and more than 20 countries -- including China and Russia, two of the major importers of U.S. pork -- banned pork from the affected U.S. states. (Mexico stopped buying U.S. pork because pork demand simply collapsed in Mexico.)

The association was wrong, and authorities said the flu should be called H1N1, but many broadcasters and reporters either did not change their references or used terms such as "H1N1, formerly swine flu."

Markets tanked. Producers suffered \$100 million in lower hog prices over those 14 days, and, based on the futures markets, will take another \$300 million in lower prices in the May-August period this summer, according to calculations given this column last week.

What's worse is that the situation came just as markets were beginning a seasonal spring rally in which analysts expected pork producers, after losing money for 18 months and experiencing their second-greatest loss ever in 2008, would get high-enough prices to finally break even and even return to some profitability.

Markets seemed to settle down earlier this month as the number and rate of flu outbreaks slowed and as the pork sector seemed to be succeeding in getting out the message that hogs and pork are safe. Prices strengthened but then collapsed again. "We were 10 days into a 45-day rally, but now we're stuck," Bluntzer said.

"The time is past for our rally," added Erica Rosa at the Livestock Marketing Information Center in Denver, Colo.

Glenn Grimes, an agricultural economist at the University of Missouri in Columbia, said the effect of the first seven days of the 14 days is shown in his demand model.

He noted that January-March demand for hogs was down 2.3% and for pork was up 3.3% from January-March 2008, while January-April demand for hogs was down 3.1% and for pork was up 1.3%. Demand for hogs and pork soured considerably in just one month, he said. "The effect of the flu was quite dramatic ... (and) it is not behind us."

Grimes' observation confirms what many others have seen. Hog production will be down 4.0% this year, and pork production will be down 2.6%, according to the U.S. Department of Agriculture, and in normal times, cuts in production of that depth would be supportive to prices.

The industry is getting its house in order: It's not supply but demand.

Big problems

Accordingly, the industry has more housework to do, especially in reducing the size of the breeding herd, sources said.

Grimes called for producers to reduce sow numbers by 5% or more to get production down enough to get hog prices up enough to where prices can cover costs, but, in the same breath, he said there is no way any reduction will exceed 2%.

The industry's structure just prohibits the kind of sow herd reduction needed, he said, as highly leveraged, large complexes need to run at maximum capacity to achieve maximum efficiency, output results and cash flows.

Furthermore, the industry is achieving gains in productivity of 2% or more, which means that any cutbacks in sow herds are not translated into cutbacks in production.

Bluntzer explained it this way: The March breeding herd this year was 3% smaller than the March 2005 breeding herd, while the March-May pig crop estimate he's using will be 1% smaller than the March-May 2005 pig crop. "So, we've been liquidating, and the pig crop is down only 1%," he said. "That's called productivity."

The industry has lots of problems, sources said. Hog numbers are down in line with expectations, but weights are increasing and offsetting some of the benefits of the lower numbers.

Demand apparently is weakening as consumers are buying down the protein chain, which favors pork, but around in protein sectors for cheaper cuts, which hurts sales of the higher-value pork products.

Exports are supported by cheap pork products and the recently weakened U.S. dollar, but China and Russia are closed, and Mexico, the second-largest pork export market after Japan or the third-largest after China-Hong Kong, is just not buying at this time.

Furthermore, Rosa noted that it was at this time last year that China starting buying large quantities of U.S. pork to inventory pork supplies for the Olympics -- buying that won't happen this year. Accordingly, she said while pork exports in the first four months nearly equaled year ago, cumulative exports for the rest of the year may trail year ago.

However, Rosa said "the big story" is the extent to which packers are losing so much money that they don't have cash flows to pay higher prices for hogs. Packers' gross margins went below zero for the week ended May 23 for the first time in the history of the 30-year series that she works with, she reported, attributing this to extremely low prices for pork in the wholesale trade.

Hams and loins are moving through the trade almost 30% under year ago.

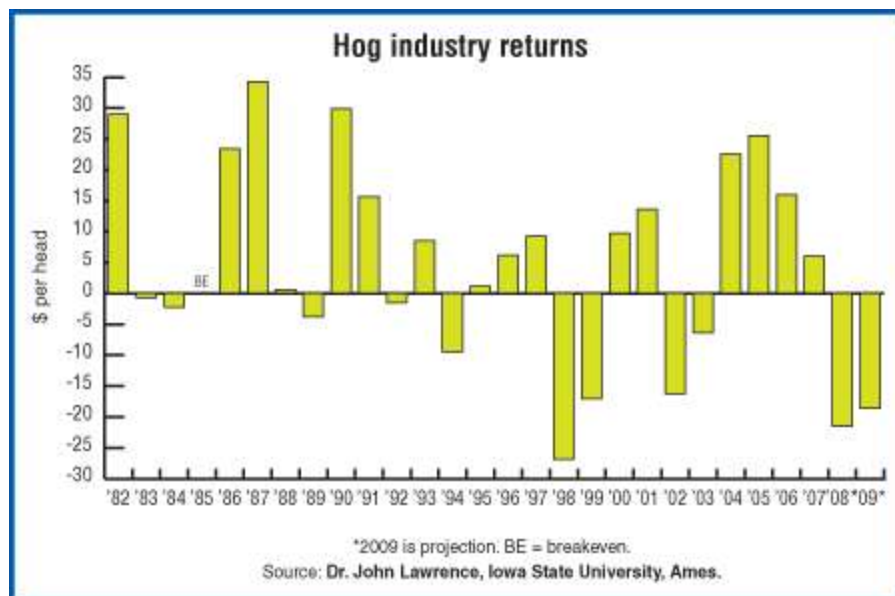
Big losses

This gets into the biggest problem: producer survivability.

Given current prices in the low \$40s/cwt. and breakevens in the low \$50s/cwt., producers are losing \$25 per head, according to agricultural economist Chris Hurt at Purdue University in West Lafayette, Ind.

Moreover, costs will exceed hog prices every month for the rest of this year and well into next year, he said.

Indeed, Dr. John Lawrence, an agricultural economist at Iowa State University in Ames, who maintains a hog production profitability series, projects losses of \$18.60 per head this year after losses of \$23.65 last year (Figure), which means that the second-greatest loss year ever in 2008 will be followed by the third-greatest loss year ever in 2009.



Bluntzer and Grimes agreed with Hurt's scenario, with prices well below breakeven (Table).

Hog market prices (\$/cwt.)				
Quarter	2008*	2009*	2009**	2009***
1st	39.64	43.49	58.11	43.00
2nd	52.51	44-47	63-67	47-50
3rd	57.27	47-51	69-72	51-53
4th	41.90	43-47	63-67	47-50
Year	47.84	45-47	63-66	47-49
*Glenn Grimes, University of Missouri, lean cash hog market prices.				
**Erica Rosa, Livestock Marketing Information Center, lean carcass prices.				
***Rosa estimates punched back to a lean cash hog market.				

Bluntzer explained that hog and pork production is known for the next nine months, based on the March hogs and pigs report, and from there, one can fairly accurately estimate production for the next six months and then, based on the futures, predict costs and prices. He said he has "all but two months in the red next year."

Grimes suggested a loss of \$10 per head next year without the 5% reduction in the sow herd that he proposes.

This points to an industry that will experience heavy losses for three consecutive years -- an outlook that could wipe out a lot of enterprises, analysts said. "The financial stress may be near the breaking point for many producers," Hurt warned.

Rosa said she is more optimistic. First, she said the fundamentals should be in place and should work better than this year as the economy improves to support demand. Costs should be lower, especially as the South American soybean crop comes back, and hog and pork prices should be higher, she said.

Furthermore, bankers do not want producers to fail, she said. Bankers are too heavily invested in pork production, and while "they are not happy (with what's happening), they will work with producers" to get them through, she said.

However, Grimes recalled that many observers said last fall that the outlook for 2009 was one of surviving the year to get to 2010, and now the outlook for 2010 is one of surviving to get to 2011. It may be that too much of the herd is surviving, he said in a repeated call for sow herd reduction.

Bluntzer summed it up this way: The outlook for the hog and pork markets "starts with a prayer."

In the hog markets last week, hogs moved east to west across the Corn Belt at \$54.15-57.79/cwt., lean carcass basis, last Thursday, prices that were down \$1.55 to up 7 cents from the week before and that were down 22.8% from the year before.

Prices were equivalent to a \$40-43 live cash hog market.

Bellies were \$77.29/cwt. last Thursday, down 15.0% from last year; hams were \$40.39, down 41.0%; loins were \$79.80, down 21.6%, and ribs were \$102.74, down 6.8%.

Pork prices remain under constraint as retailers are buying needs only rather than carry inventories in the current economic and still uncertain H1N1 environment and are focused on value cuts, especially dark chicken meat and ground meat, explained Christine McCracken at Cleveland Research Co. in Los Angeles, Cal.

However, she said low pork prices are prompting retailers to set up "unplanned activity" for early this summer.

Elsewhere in the markets last week, the cattle markets were down \$2 to \$84-85/cwt. in the northern Plains last Thursday, 11.1% lower than year ago.

The egg markets advanced another 9 cents and have picked up fully 25 cents in the last two weeks to 96 cents-\$1.00 and 85-93 cents/doz. for large-sized eggs delivered to eastern and midwestern store doors last Thursday. Eggs were 9.3% lower than year ago.