SURVIVAL

In the last month, hog prices have risen from incredibly miserable to just plain miserable.

In the 20 years that I've been involved in the hog industry, prices have never been so low that producers couldn't at least cover feed costs.

But it happened this fall. For a time, producers who had good production and typical facility costs were losing $25 per hog or more. Now, with prices in the range of $35/cwt., the red ink has been reduced to $10 or less per hog.

When will this turn around completely, and how much of a rebound can we expect?

For sure, the next four months look better than the last four. But taken together, those eight months will have most producers asking the question, "How am I going to survive this?"

To that question, I have no answers, only opinions. But to me, it comes down to three factors — productivity, risk protection, and an understanding banker.

Productivity

Besides price, production-related items which have the greatest influence on profit typically include feed costs, sow productivity, and maintaining facilities at capacity.

Feed costs. The price of feed is difficult to control. But since total feed costs reflect both feed price and feed conversion, do what you can to maintain satisfactory feed conversion.

Most producers are aware of the dozens of management practices that impact feed conversion. The critical items on that list include environment, feed wastage, and health. Pay close attention to those areas. Is now the time to eliminate growth promotants or vaccines? Hopefully, those tools should be paying their way already, or you shouldn't be using them under any market conditions.

Some producers have considered decreasing the amount of soybean meal in the diet. That will help if the protein is already too high. But if the protein level is close to the requirement, any reductions in soybean meal will almost certainly impair growth rate and feed conversion, and the backfat on the hogs may also creep up. And since soybean meal is fairly cheap right now, decreasing soybean meal by a hefty 50-70 pounds per ton would save a meager $5/ton at most — savings could be quickly gobbled up.

Maintain sow productivity. Most sows will wean at least eight pigs/litter with a minimum of effort from you. Getting that average up to 8.5 or 9 takes more of your time — making sure things go well at farrowing, checking sow comfort and temperatures, and watching pigs throughout lactation and transferring as needed.

But of all the things that you do, it's farrowing management that pays major dividends. The extra pigs that you're able to raise basically go to market for the cost of feed, since the overhead costs are covered by the other pigs in the barn. So the profit on these extra pigs, even with today's depressed market, is at least $25 per head.

Maintain facilities at capacity. Under normal conditions, there is no excuse for operating at less than 100 percent capacity. That's because the same overhead expenses will be spread over fewer pigs. Decreasing capacity by 10 percent will generally reduce profit by $1 to $2 per pig.

The exception to this, of course, is when prices are so low that variable costs (feed, for example) aren't even met. Under those conditions, decreasing inventory would reduce losses in the short term. But those conditions, if history is any indicator, are rare and brief. Further, at some point, inventories will have to be brought back to capacity, which will negatively impact cash flow (especially if replacement gilts are purchased) until the 100 percent level is reached.

Risk Protection

A number of alternatives are available to producers.

Production contract. The classical contract involves a feed company covering the costs of breeding stock, feed, and some utilities, with the producer providing buildings and labor. This establishes and stabilizes a positive cash flow as long as production doesn't crash.

Production contracts at present seem to be available only to large operations. Chances of getting a production contract are slim if the operation has only a few hundred sows or finishing hogs.

Hedging. Using the futures market can help lock in a price. If the price is above break-even, you also lock in a profit. With a true hedge, you make money either on your hogs, or on the futures contract, but not both.

About 130 hogs are needed to match the weight in a futures contract (30,000 pounds). And most importantly, you'll need to know your break-even costs.

Forward contracts. PACMA (Pennsylvania Agricultural Commodities Marketing Association) has, since 1986, offered forward contracts for hogs. The program is based on the futures market but is less complicated than a hedge. You simply call PACMA, get a price for a certain month, and then deliver your hogs when that month arrives. No margin calls, and no need to watch the market to wonder if you should liquidate the contract.

Do many producers use the program? As Mike Orndorff at PACMA would tell you, it goes in spurts. Late last winter, when PACMA was offering a weighted average of $48 for 1994, not one producer signed up. Now that we've been through the October/November/December price war, lots of producers have locked in forward prices. Unfortunately, many of these prices will be significantly lower than can currently can be offered for the same periods.

A related program that gives producers a way out if prices start to climb is a minimum price contract. In this case, you establish a minimum price with the contract. If prices go up, you can lock in a higher price at any time, or you can wait and simply take the price offered when the hogs are sold. A heftier premium is needed for this program, but it might be a good idea if prices are expected to climb.

Minimum/maximum price agreements. Some packers offer these programs as a means for reducing or eliminating losses during times of depressed markets. Details differ with each packer, but for example, a packer may pay a minimum of $42/cwt. and a maximum of $54/cwt.

Marketing agreements. At least one feed company has offered a hog price in the high $40s over a five-year period in exchange for a five-year agreement to buy their feed. Roughly speaking, if the average price over the five-year period exceeds the price set in the contract, you get the proceeds.

For many producers, this program has merit. Yes, you're committed to purchasing a particular feed, and in the long you may be better off completely independent. But that's dependent upon your ability to survive the short run.

Know Your Banker

I recently spoke with representatives of four lenders that do a fair amount of lending in the swine industry: Farmers Home Administration, Keystone Farm Credit, Meridian Bank, and Lebanon Valley National Bank.

I posed the same questions to each of these individuals, focusing around survival through times of negative cash flow. And their answers were surprisingly similar.

First, when you find yourself in a financial bind, and need additional operating capital, have your act together before you show up at the bank. Know what your break-even cost is. Have a plan for repaying the operating loan. And be prepared to repay the loan fairly quickly — a year or two at most.

Second, producers that have a good production history will have the best success at getting the loan. Even those that have had production difficulties can get additional capital if the problems were beyond the producer's control.

If the debt load is approaching the total amount of equity on the operation, that can be a problem. These situations are approached case by case. Foreclosure is one option, but so is a loan guarantee from Farmer's Home.

And as producers already realize, bankers love risk protection. Production contracts are the most popular form of risk protection, but any loan will be easier to obtain if the risk to the lender is somehow reduced.

Summary

1. In these periods of miserable prices, don't lose sight of the major factors that impact profit. The items over which you have some control include sow productivity, feed conversion, and herd health.

2. Risk protection is not new. After the last few months, most producers could probably stand some risk protection. For many in this state, forward contracts, packer agreements, and marketing agreements with feed companies may offer the best alternatives.

3. Get the most from your lender. Do that by doing your homework. Have cash flows, price projections, and break-even prices prepared before you ask the banker for anything. And remember that bankers like the items in #1 and #2 — good productivity and risk protection.

Pork Producers Seek Representative

FLEETWOOD (Berks Co.) — The Pennsylvania Pork Producers Council is seeking candidates for pork industry representative.

Applicants, male or female, should be between the ages of 18-23 yrs.

Participants should have a strong background and sincere interest in the future of the pork industry.

The selection process will be completed at the Keystone Pork Exposition on Feb. 15. The selection process will include a personal application and interview.

The pork representative must be able to attend the Pork Leadership Institute on July 13-18. While attending the institute, the attendee will expand his or her communications and human relations skills. While a representative, responsibilities include attending state activities such as conferences, media interviews, service on state committees and boards, and county programs. Speaking engagements may include local pork producers, consumers, FFA, 4-H and other industry-related organizations.

For more information, call Floyd Huber, youth committee chairman, (610) 944-6687.