Contracts Take Center Stage At Pork Expo Educational Seminar

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NORTH CORNWALL (Lebanon Co.) — About 100 hog producers and agri-industry representatives learned Wednesday that it was quite possible, in late 1997, to lock in on $45 per hundredweight prices on some futures contracts for 1998 — the year of the worst hog price recession in U.S. history.

That same year, producers saw prices on hogs plummet into the 'teens.

According to Steve Meyer, director of economics for the National Pork Producers Council (NPPC), the key to survival in the swine business may be to look seriously at futures-based contracts and manage your business accordingly.

Meyer spoke Wednesday morning during the educational session of the 22nd annual Keystone Pork Expo at the Lebanon Valley Expo Center in the fairgrounds.

Meyer provided a lesson in "Marketing 101," pointing out that information on the basics of running a swine operation like a business is available on the NPPC Website at www.nppc.org. The site has a spreadsheet that works on Excel.

Meyer pointed out the importance of timing the decision to sell based on what objective you have. Some research data showed that, historically, it matters little if you select futures contracts, for the most part, at six or 10 months.

Managing, said the NPPC economist, implies decision making. "If you do the same thing all the time, you're not managing," he said.

There are many different ways of managing risks and pricing hogs, whether the producer is looking at cash flow, equity management, or other factors. The key is to find a level that will not put more than 10 percent of the business equity at risk.

A business that works on low equity, high costs of operation, and low prices could be placing the business in peril. Finding ways of cutting input cost, including locking in on low feed prices when available, and examining all the options on futures contracts, could help.

"Know what your costs are and write out an objective for your return on equity," said Meyer. "Get out of the market guessing game and get into something you can control."

"There has been tremendous growth in marketing contracts in the last five to 10 years," said Laura Cheney, assistant professor of agricultural economics at Michigan State University.

In her presentation, "Navigating Hog Marketing Contracts," Cheney noted that in 1997, 57 percent of all hogs were sold under marketing contracts. That number increased to 64 percent last year. Nearly two-thirds of all hogs today are sold under some sort of marketing contract — and the numbers continue to increase.

Producers need to understand the "language" of contracting, said Cheney. There are two different types:

• Marketing contract. This is an agreement with a buyer to sell something in the future. The buyer is the packer, who usually has complete ownership of the animals. This type of contract leaves management decisions to the packer.

• Production contract. This often implies joint ownership, where one firm owns and the other raises the animals. A "producership" agreement is signed.

But keep in mind, Cheney noted, there is no such thing as a "standard" contract. Many variables can be written into them, including short- and long-term agreements that allow producers and packers to "build a relationship."

For the most part, packers and producers who enter the agreements must agree on standards of how the hogs will be raised. Packers are looking for Pork Quality Assurance Level III certification, approved genetics, an environmental assurance program, a quality and specified feeding program, proper facilities, quality hogs, and quality care arrangements.

The contract information is included by Cheney in the book, "Being Competitive & Successful In the Pork Industry," the proceedings from the 2000 Competitive Seminar For Pork Producers, available from the NPPC.

In 1996, a survey was conducted that reviewed what packers enjoyed most about contracts. The packers noted improved plant supply, efficiency, producer relationships, and improved competitive edge as advantages. They noted the downside, too — increased price risk and reduced flexibility.

The survey looked at the producer's side and noted improved prices, market access, and reduced price risk. Disadvantages were potential lower returns and reduced flexibility.

The most common contract was the formula contract, for more than 90 percent of all hogs sold under contract. But in the hog recession, producers were "not getting 40 cents when were in the 'teens," Cheney said. Actually, contract producers fared little better, obtaining perhaps a few cents more per pound.

For those still relying on cash at delivery, those cents can add up.

"Marketing contracts are a risk-management tool," she said. "They are not a solution to imbalances in supply and demand."

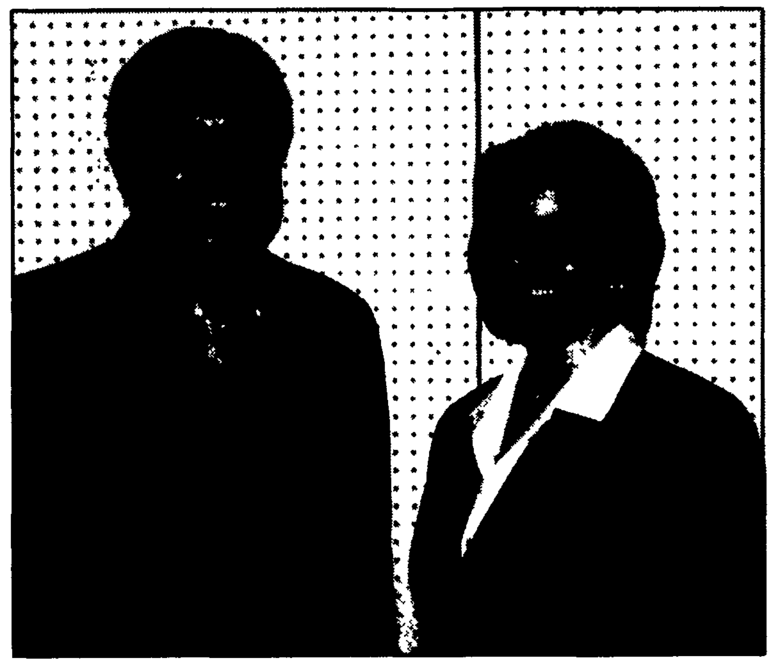
Producers still need to examine their objectives.

"It's a tool, but not the only one," Cheney said. Producers need to examine hedges, cooperative structures, and other methods. Contracting is no substitute for price and financial management.

Cheney herself lives on a five-generation hog farm. The farm itself operates under short-term fixed contracts.

Now may be the best time to look more seriously at contracting. According to Lou Moore, Penn State economist, with luck, producers may reach the break-even point mid-year.

Producers keep on getting bigger. In 1999, the number of hog operations with less than 100 head comprised 53.6 percent of total operations but marketed only 1.5 percent of all hogs. But operators with 5,000 head or more comprised 2 percent of operations, yet their hog inventory was 46.5 percent of all hogs. That number was up from 37 percent from last year.



Evaluating marketing contracts and managing risk were some topics at the Keystone Pork Expo. Speakers included, from left, Steve Meyer, director of economics with the National Pork Producers Council and Laura Cheney, assistant professor of agricultural economics, Michigan State.

In 1978, there were 650,000 hog operations in the country. In 1999, that number had nosedived to less than 100,000 operations.

What would happen if the industry lost all the operations with less than 100 head? "It wouldn't do a thing to hog production," said Moore.

The decline in producers will continue, and "it will be mostly in the smaller operations," said the Penn State economist.

For the first quarter, producers selling on the cash market can look toward about 37 cents a pound. In 2000, in the midst of decreasing hog inventory, which is fairly good news to producers, according to Moore, there will be 20 billion pounds of hogs sold, down four percent in 2000. Hog production actually increased 3 percent in 1999.

Meat from cattle will total about 28.3 billion pounds, down 4 percent in 2000. But in 1999, production was up 2.5 percent.

Moore said he doesn't believe the USDA figures on cattle. He believes cattle production will be down two percent at most this year.

Broiler production continues to expand, projected at 31.9 billion pounds in 2000, up 5 percent. In 1999, production was up 7 percent for broilers.

Total meat production will be 80.9 billion pounds, down one percent in 2000. In 1999, total meat production was actually up 3.6 percent.

Hog prices will be about 37 cents a pound for the first quarter this year, better than a year ago "but nothing to brag about," Moore said. Tough times lag ahead. Total farm income will be 7 percent less than 1999, he said.

Corn prices remain low. Though 1999 wasn't a record corn production year (at 9.54 billion bushels), for four years in a row the U.S. has had good crop years. In 1999, average corn yields were about 130 bushels per acre. Pennsylvania producers grow about 74.2 million bushels, with a 1999 drought year average yield of 72 bushels per acre, yet producers use 170 million bushels of corn every year. They need to go outside the state for the additional 100 million bushels required.

And the U.S. has had three really large soybean crops the past three years. In 1999, 2.67 billion bushels were harvested.

The U.S. continues to spend the least money for their food, about 10.2 percent of income. Russia, on the other hand, spends about 50-75 percent of its income on food. Without their vegetable gardens, Russian people would "starve to death," Moore said.

Though the U.S. economy now has undergone the "largest period of economic growth we've ever had in this country," said Moore, with the lowest unemployment (at 4.1 percent) in 27 years, Russia continues to falter. No more exports are being shipped to Russia because they simply can't afford to pay.

Fuel prices will cause some inflation down the road in the U.S., but consumers, who are simply not putting money in savings, are "not worried about the future," he said.

Moore cautions, however, that an adjustment to the booming stock market will have to be made at some time in the future. Some experts believe the market is overvalued by 50 percent. At the time of the stock market crash in 1929, the market was overvalued by "only" 39 percent.

Most economists believe that the growth will continue through the coming year, at 3.7 percent for the year. All this while Russia and some of the blocks of the former Soviet Union continue to falter.

Ken Kephart, Penn State swine specialist, and moderator of the educational events at the Expo, noted that three economists were included at the session. "I think that's a record," he said.

Odor Control

Robert Mikesell, senior extension associate at Penn State, provided information about a recent odor survey of neighbors near swine operations.

Of the 337 surveyed, 219 people — neighbors of seven farms and some who drove by — responded.

The swine producers were asked not to spread any manure in the six-week period of the survey. The survey was used by

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The York County 4-H team captured third place at the Keystone Pork Bowl Wednesday. From left, Jessica Innerst, Lane Innerst, Coach Melissa Trostle, Hope Long, and Russell Wilson.

Marion Center FFA took second place at the Keystone Pork Bowl. From left, Coach Howard Cattau, Cristen Hetrick, Angela Lloyd, and Lauren Ferringer. Not in photo: team member Nathan Elkin.