Monthly Meat Lookout

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Light at the end of the tunnel

Beef packers know only too well that the last two years have been tough. Fed cattle processors may have lost as much as $700 million in 2004 and 2005, according to market consultants HedgersEdge.com. That seems a lot until you consider that largest processor Tyson Foods will lose $128 million in beef in its current quarter. That will mean $205 million in beef operating losses in three quarters. Processors of non-fed cattle have also struggled with losses as cow slaughter numbers dipped in 2005 to their lowest level in 42 years.

There is light at the end of this long, dark tunnel, as the latest cattle supply numbers indicate. But the damage has been done. Such losses have forced packers to initiate paradigm shifts in their priorities. It includes closing plants that might be quite functional and even profitable but are closed to protect much larger assets. Protection of market share has become redundant under the sea of red ink. Managing capacity, i.e., raising utilization rates, and adding value are the new mantras of the industry. In the future, there will be no room for any plant, large or small, that cannot run close to 90% of capacity most of the year.

All this has meant plant closures and consolidation. At least nine beef packing plants have closed since the summer of 2003. Seven killed either all or some cows. Last Friday, National Beef Packing, the fourth largest processor, announced it is buying Brawley Beef, the ninth largest. A brave effort by cattle feeders to establish and run a successful meat operation seemingly became too much of a financial strain on them. And in case you missed it, Smithfield Foods has confirmed plans to build a huge new fed beef plant in Oklahoma. That has produced some interesting responses, to say the least. I'm convinced Smithfield is serious about the plant and plans to expand its beef business in the next several years. In short, the business is in the midst of the biggest structural changes since the mid-1980s.

Timing is everything in the meat business. Several of the nine operations that closed might have survived had the U.S. not lost its export markets and the ability to kill Canadian cows, both events caused by BSE. Smithfield over the years has been exceptionally canny in its timing. Planning a new plant today that will kill 6,000 head per day might look crazy to some. But by 2008, the cattle will be there. Actually, Smithfield already has the cattle it needs under its control. It's the nation's largest cattle feeder by far. It's applying the same principles of integration that it brought to the pork business.

The market fundamentals provide the immediate light at the end of the tunnel, and for some years to come. The U.S. herd on January 1 totaled 97.1 million head, 1.7% higher than a year earlier. Analysts suggest that numbers will build to about 103 million by 2010. Right now, there is a record (for any month) number of cattle on feed, just over 12 million head on March 1 or about 8% more than a year ago. These numbers mean that beef production will increase about 5% this year to 25.95 billion pounds. Record carcass weights are part of this equation. The latest weights, for the week ended February 25, showed overall weights at a record (for this time of year) 782 pounds. That's 23 pounds above last year. Meanwhile, pork production will increase this year about 2.5% and poultry production will be up as well (unless avian influenza hits the U.S. or batters our exports even more). The bottom line for 2006 is record meat and poultry supplies.

The industry will therefore be highly dependent on strong domestic demand and a rapid recovery of key Asian markets, notably South Korea and Japan. Right now, both look shaky. Domestic retail demand improved every year from 1998 to 2004. But it fell 3-4% in 2005, with the biggest fall in the fourth quarter. It has continued to slide in this first quarter. Last week's softer boxed beef prices were a reminder that March is the weakest beef month of the year. The Choice cutout was at $147.75 per cwt. last Friday and is likely to fall to $145 in the next week or so. A key factor is whether the weekly slaughter exceeds 600,000 head or not. It shows how soft demand is if packers "overkill" and have to lower prices. Packers were able to get cattle bought lower last week (Friday's Southern Plains trade was at $86 per cwt., compared to $88 the Friday before). But they'll need to buy cattle even lower or get more for the beef, or both, if they're going to make money in March.

Mexico remains the industry's brightest export market. It took 282,000 metric tons of beef worth $882 million in 2005, 73% of the total value of our exports. Everyone is hoping Japan will agree to take U.S. beef again very soon. But it's going to be at least June or July before that trade resumes. And then the volumes will be small for most of the rest of the year. I'm pinning more on exports resuming in April to South Korea.

The **Monthly Meat Lookout** is provided by Steve Kay, Editor & Publisher of *Cattle Buyers Weekly* (*www.cattlebuyersweekly.com*). *CBW* is a marketing and business newsletter for the North American meat industry. For a free copy of *CBW*, call Steve at (707) 765-1725, fax him at (707) 765-6069 or e-mail him at *info@cattlebuyersweekly.com*.