

**In a year full of surprises, one that has gotten a bit lost is the lack of growth in the U.S. chicken business.** Most analysts went into 2014 expecting U.S. chicken companies to quickly ramp up production to take advantage of lower grain costs and their price advantage in the marketplace. Chicken having a price advantage is nothing new but the situation this year set up perfectly for higher output and lower but still profitable prices which would provide an even larger-than-normal advantage against high-priced beef and well-priced pork. Beef and pork have more than held up their end of that deal but chicken output growth has been a non-starter. But even those tighter-than-expected supplies — and thus availability/consumption — have not been able to light a fire under retail chicken prices. What gives?

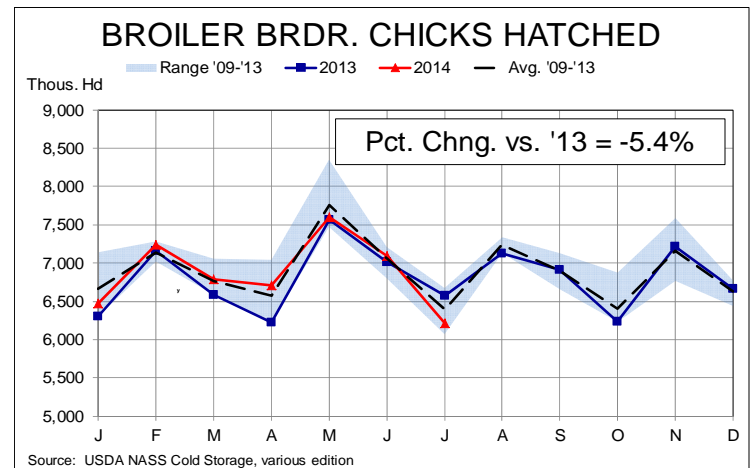
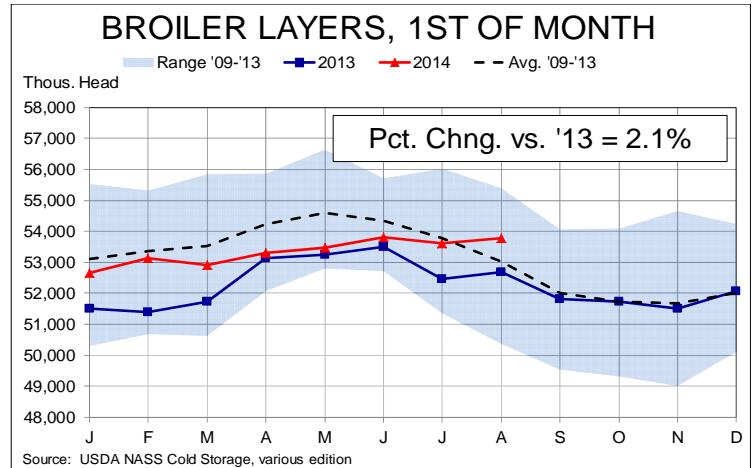
Let's go all the way back to 2011 and 2012 when livestock and poultry companies were paying through the nose for feed ingredients. Any thoughts of growth were canned as were, we understand, a large number of orders for breeder birds at the three major broiler genetics companies, Cobb-Ventress (owned by Tyson), Hubbard and Aviagen. Those companies quite understandably reduced production capacity.

Fast forward to the winter of 2012-2013 when U.S. companies were still paying huge prices for feed ingredients and Mexican broiler farms broke with avian influenza. Depopulation of Mexican breeder flocks created an opportunity for U.S. breeders to sell genetics — primarily in the form of fertilized eggs, we understand — south of the border. The reduction of breeder egg supplies continued well into 2013 even as the 2013 crop developed well, causing some optimism that exorbitant feed costs were behind us. The combination of cutbacks in the breeder flock and selling eggs to Mexico resulted in an aged flock as cost conditions changed.

We expected U.S. chicken companies to begin ramping up their breeding flocks in mid-2013 just in case crops turned out large and costs fell. They were slow to do so but did increase flocks by over 4%, year-on-year every month from August through November last year.

Then the wheels came off. U.S. breeder flock growth slowed to about 3% in December through February and then slowed even further this year as breeding companies ran into a number of production difficulties associated with that aging flock. The result was significantly lower numbers of chicks placed versus eggs set. Beginning-of-month broiler breeding flock inventories have begun to grow again, exceeding year-ago levels by 2.2 and 2.1% in July and August. But those growth rates may be short-lived as the number of broiler breeder chicks hatched fell to just 6.212 million in July, over 300,000 and 5.4% fewer than one year ago. Lower numbers of breeder chicks will make it more difficult to support the renewed growth of the breeder flock which, in turn, will limit egg sets and placements of the actual broiler chicks that are grown for slaughter.

USDA's August World Agricultural Supply and Demand Estimates has 2014 U.S. broiler production growing by 1.5%. Poultry production through August 16 is virtually unchanged from last year. With two-thirds



of the year in the books at zero growth, September-December production would have to grow by 4.5% to get the annual number to 1.5%. We think that is VERY doubtful even though there are signs of improvement on the productivity front. After spending virtually all year within 1% of year-ago levels, egg sets have grown by 2.1%, on average, over the past four weeks. Chick placements, which had been down fractionally versus last year for most of this year, have grown by 1.8% and 1.2%, year-on-year the weeks of August 9 and 16. Those figures will not get the industry to +4.5% but they represent improvement. USDA's forecast for 2015 broiler output is 38.894 billion pounds, read-to-cook weight, an increase of 2.4% from 2014.

**BOTTOM LINE:** U.S. broiler companies have been profitable but have had their expansion efforts scuttled by production challenges. They are solving those problems and will move back to growth this fall and into 2015 but that growth will likely be slow by historical standards.

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