Daily Livestock Report

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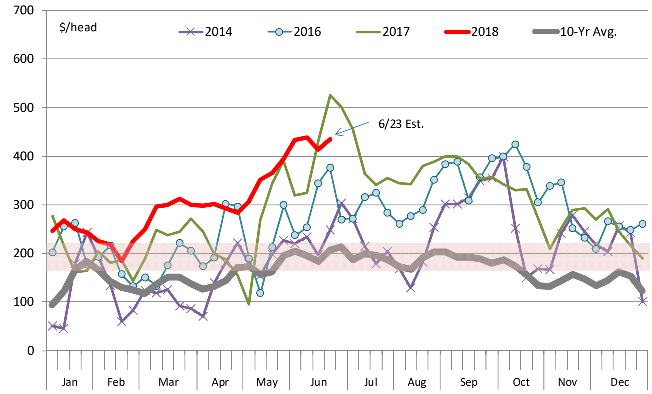
Beef and pork packing margins are going in opposite directions. This is not that unusual for this time of year. Generally beef packing margins improve in the spring and early summer as fed cattle supplies increase and grilling demand and higher foodservice traffic bolsters the value of the cutout. Fed cattle inventories have rebounded sharply in the last three years, with the beef cow herd at the start of this year some 2.6 million head larger than five years ago. More beef cows means more calves born each year. The calf crop in 2017 was 2.3 million head larger than it was in 2014 and we expect the 2018 crop to be almost 3 million head larger than it was in 2014. The reason we reference 2014 is because fed cattle processing capacity steadily declined in the first part of this decade and likely hit its lowest point in that year. We think the supply of cattle has increased at a faster pace than processing capacity. Margin performance tends to improve as capacity slack declines, and vice versa. We make no pretense to know actual packer margins are at this time. Much depends on the time of year, how much they are getting for the cattle they source, the quality of those cattle, how much they make on their export sales, including sales of by-products, what their labor contracts say, etc etc. Rather we calculate a broad gross margin. The idea is to offer a rough indication of gross margins over time. Last week we calculate the gross packer margin at around $414/head. Again, this is a gross margin. We think a packer needs to get a little over $200/head to cover processing costs and overhead but that can be debated (see shaded area in the chart). This is lower than the peak we observed last year but margins so far this year still are ahead of where they were a year ago. It is always critical when you see these calculations to understand the assumptions behind them. Devil likes to hide in the details. For the week ending June 16 we used a $9.47/cwt live by-product value, an average dressed carcass price of $181.69 (from comprehensive cattle report) and a cutout value of $216.51 (from comprehensive cutout report). The cattle price is down 12% from last year, the cutout is down 9% and the by-product value is down 19%.

Pork packer margins are now in negative territory. As with cattle, we run a gross margin, which last week we think was around $24/head. We think packers need to clear between $25 and $30/head to cover other costs. For this week we think the gross margin could be under $20/head, a decidedly negative number. How do we calculate the gross margin?. Consider the estimates for this week. We think the pork cutout for the week will be around $85/cwt, give or take a little. The one day cash index was last quoted at $86 and we think the net average price for the week could also be around $85, maybe even a bit higher. So the meat margin is basically zero. But packers make money on the by-products they sell and it's always a bit of a guessing game as to what number to use there. USDA calculates a drop credit for hogs, last reported at $3.90/cwt live. On a 285 pound hog this means about $11/head. LMIC has a bit of a different methodology, and they come up with around $19/head. Different from cattle, there is significantly more packing capacity now than three or four years ago and so more competition. Packer margins should improve into the fall but the main risk hovering this market is the outlook for trade and where to sell all the pork now in the pipeline.

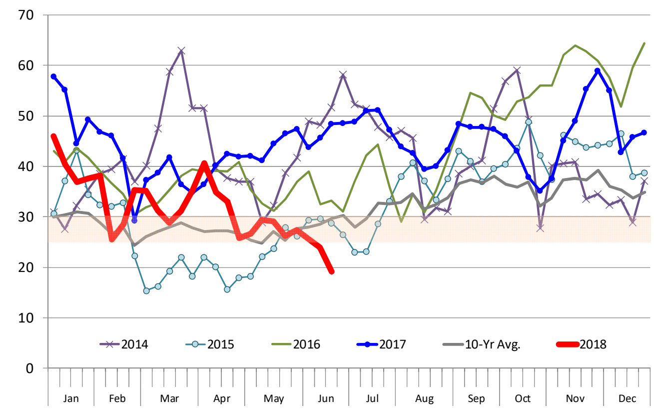
BEEF PACKER CALCULATED GROSS MARGIN. $/head

Calculated using the Comprehensive Cutout, Drop Credit and Negotiated Fed Cattle Prices



PORK PACKER CALCULATED GROSS MARGIN. $/HEAD

Calculated Using the Weekly Pork Cutout Value, Number of Head Processed, and Drop Credit Value. Data Source: USDA, Steiner & LMIC Drop Credit



PORK PACKER MARGIN COMPONENTS. $ PER HEAD.

Calculated Using USDA Price Data for Cutout & Hogs. LMIC Data Used for By-Product Value