CME Group

Daily Livestock Report

Vol. 9, No. 165, August 30, 2011

Please see page 3 for an announcement from CME about additional listings of Live Cattle and Lean Hogs Options.

In the past, record-high livestock prices such as we have seen this year usually meant that packers lost money by the boatload — but not so in 2011. Packer margins in both the beef and pork sectors have been exceptionally good for much of the year and have, on occasion, neared all-time record levels.

The top chart at right shows our estimates of gross pork packer margins for this year, last year and the average for 2005-2009. These are not NET PROFITS since packers must still pay utilities, transportation costs, labor, plant costs, etc. from these gross margins. It is clear that 2010 and 2011 have been very good years, though, as gross margins neared the all-time highs set in 1999 (which were realized when hogs were less than $20/cwt. live weight!) last fall. Further, gross margins have stayed well above the 5-year average every week since late 2009! And, after dipping this summer when hog supplies got relatively tight and performance was hampered by very high temperatures, they have recorvered to over $30 per head since early July.

Why the strength? In the long-run, middleman margins are driven primarily by costs. There is no doubt that packers' costs have increased since 2007 as energy prices have grown. Prices of everything from diesel fuel to plastic film have risen. While we don't have a detailed model of packers costs, we are pretty confident that these costs have not risen by nearly as much as have margins. Recent quarterly reports from Tyson, Smithfield, Seaboard and others bear this out pretty clearly.

We think that the biggest reasons for strong packer margins are strong domestic and international demand and a packing sector that is very close to the perfect size for current hog supplies. Demand provides pricing "space" for higher-valued products. A correctly sized sector means packers seldom have to chase pigs to keep lines running at speeds that keep unit cots near their optimum.

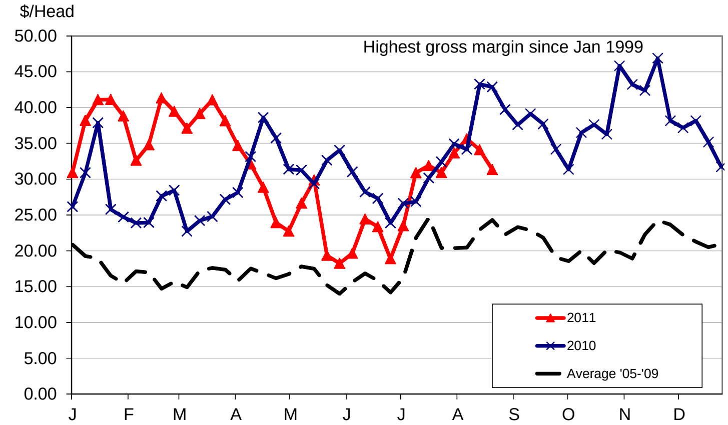
And then there is the roll of by-products (see the top graph on page 2). These items have collectively fetched over $23/head in recent weeks and, unlike the China-driven spike in 2008, these levels appear to have some staying power — at least as long as the U.S. dollar stays relatively low.

Beef packer margins have been generally good in 2011 as well but, as can be seen in the bottom chart at right, they have been wildly volatile. Twice this year, beef packer gross margins have increased by $115/head in two weeks or less and then dropped by nearly that much in the same time period. Margins in May were near record high but those of mid-March and the week of August 14 (the last week for which complete data are available) were among the lowest since late 2007.

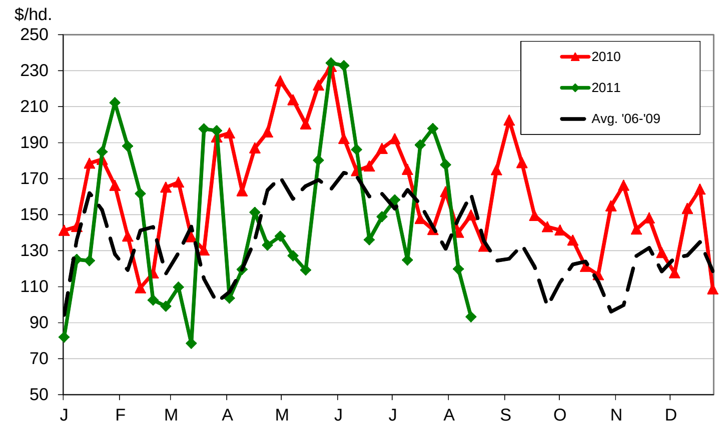
Beef packers, like pork packers, have benefited from relatively strong domestic demand and exceptional exports. Those factors have kept cutout values near record-high virtually all year. And by-product values (see the bottom chart on page 2) have been even friendlier to total beef packer revenues than they have to revenues of pork packers. Drop values have been over $160/head all year, driven by a cheap U.S. dollar and recovery in the auto business which drives leather and hide values.

But there is one major difference between the beef and pork packing sectors: The beef packing business is still too large relative to fed cattle supplies — and that problem will get worse before it gets better. This excess capacity is very likely a major reason for margin volatility — which will likely continue as well.

PORK PACKERS' EST'D GROSS MARGIN



BEEF PACKERS' EST'D GROSS MARGIN



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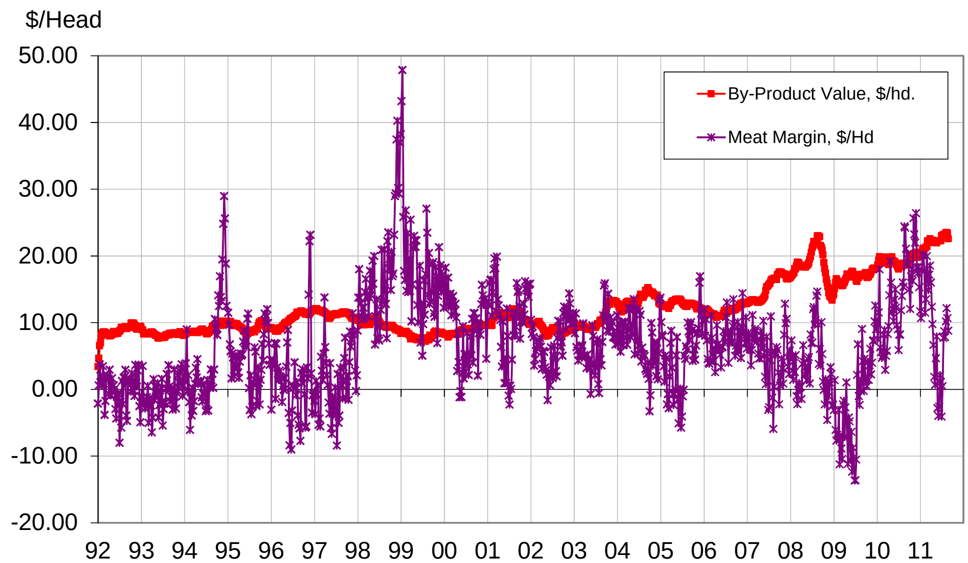
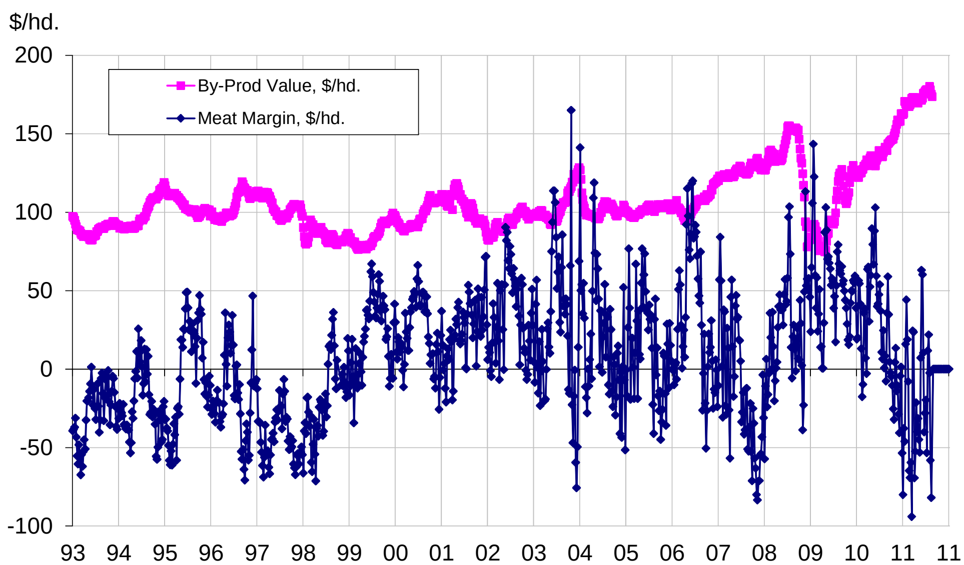
PORK PACKER MARGIN COMPONENTS



BEEF PACKER MARGIN COMPONENTS



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Special Executive Report

S-5896 August 18, 2011

Extended Listings for Live Cattle Options and Lean Hog Options

Effective on Monday, September 12, 2011 the listing cycles for options on live cattle futures and options on lean hog futures will be extended so that every listed futures contract has a corresponding listed option. Currently, the Exchange lists fewer options months than futures months for both live cattle and lean hogs. With this change, the same number of futures months and options months will be listed. As a result, the following additional options contract months will be added:

Options on live cattle futures-October 2012, December 2012, February 2013
Options on lean hog futures-December 2012, February 2013

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