Make Informed Decisions
KevinGrier
Market Analysis and Consulting Inc.
79 Pheasant Run Drive
Guelph, Ontario
N1C 1E4
T 519 823 9868
C 519 240 8779
E Kevin@KevinGrier.com
KevinGrier.com

The Strategic Factors for Beef Plants in 2015

Kevin Grier
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In a recent edition of Canadian Cattle Buyer I noted the importance of the Pacific Northwest cattle and beef industry to the industry in southern Alberta. The prospects and status of the plants and feedlots in that region are important for the viability of cattle feeders and ranchers in Alberta. The oft-cited "U.S. Floor" maybe severely damaged due to COOL, but that market remains an important component of the competitive mix in Alberta.

I noted in the last edition that the bottom line for Alberta cattle feeders is that there are not statistical factors that point to concerns regarding the future of the two plants in Washington State (Tyson Pasco and Agri Beef (Toppenish). That is, cattle availability is not out of line with history and relative to other regions. This does not mean that there are not corporate strategic considerations or other factors such as efficiency and depreciation that might outweigh the raw statistics. Nevertheless, from a statistical supply and demand perspective, the two plants in Washington do not appear to be outliers and by some measures, they appear in good shape.

This of course does not mean there are not supply challenges there, as there are in other regions. Pasco for example is pulling cattle in material numbers from locations much further afield than normal. That overall tight supply situation is the main reason why there was so much interest or even surprise in the announcement of the Caviness Beef joint venture with J.R. Simplot Company. The two plan to build a $100-million beef packing plant near Kuna, Idaho. The new facility, named CS Beef Packers, will process up to 1,700 head of cattle daily. The 300,000 square foot plant construction would begin in spring 2015 and is expected to open in fall 2016. The primary purpose of the plant is to harvest cull cows and bulls from Northwest dairy farms and cattle ranches throughout the region. There are more than 600,000 beef cows and an estimated 600,000 dairy cows that the plant will serve.

There have been a handful of closed cow plants in the northern tier states in recent years. In fact, the PNW region was net deficit cow slaughter with numbers being shipped far out of the region. Cattle Buyers Weekly, February 2, says there are only three small cow plants in the region since XL closed its plant in Nampa in 2011. Added to that is the fact that when the plant opens, the beef cow herd will be in its third year of expansion. In addition, the dairy cow and dairy heifer replacement numbers for 2015 versus 2014 point to growth in the PNW and decline in California. The region arguably is one of the few in North America that needs capacity, at least with regard to cows.

JBS obviously sees that same picture given its announcement of a $75 million expansion at Hyrum, Utah. Feedstuffs, January 29 stays that the expansion includes a new fabrication building as well as new ground beef facility and a distribution centre. The expansion will allow for an increase in production levels by more than 400 per day and will help to increase efficiencies. It currently processes nearly 500,000 head per year. The press reports indicate that the expansion is to add cows to its current fed cattle-only run.

The bottom line is that with this expenditure and the $30 million JBS spent in 2011, this plant is here to stay.

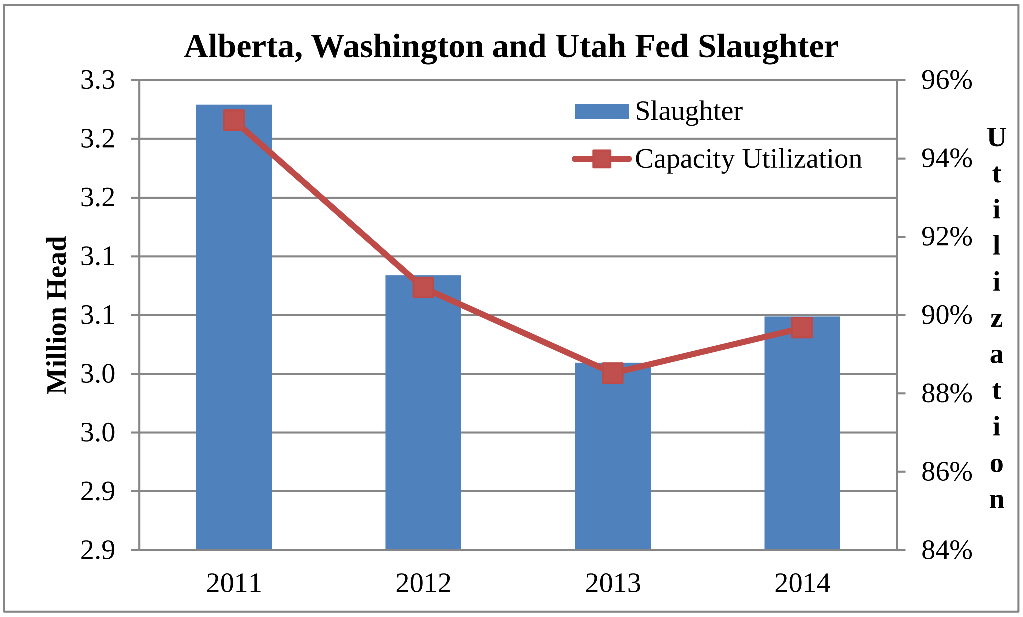
The $75 million is a major JBS expenditure considering the Caviness green-field plant is costing $100 million. The question has to be whether that plant won't be able to do much more than an added 400 cows. In other words, the plant is single shift, and even with the added 400, it would still be killing fewer than 2,500 per day. There may be more potential there rather than just 400.

This again brings up the issue of plant closures in 2015. Cargill and JBS are North American packers, not Canadian or American. The presence of operations, procurement, sales and decision-making in both countries probably makes them look at Alberta as part of the Pacific Northwest (PNW) or northern tier states region. Cattle procurement is done based on Alberta and northern tier allocations and considerations.

If Alberta is part of the PNW, then its slaughter capacity must be included in the PNW equation. The total daily capacity of Hyrum, Pasco and Toppenish amounts to about 6,300 according to Cattle Buyers Weekly tabulations. Using a 252 work day year puts fed cattle capacity at just under 1.6 million per year. In Alberta, the two plants have capacity of well over 4,000 per day each. Given the need or desire to kill cows, it is reasonable to say that the fed cattle slaughter capacity is in the range of over 3,600 per day at each plant. The combined fed cattle capacity of the Hyrum, Pasco, Toppenish, Brooks and High River amounts to about 3.4 million head.

According to USDA regional slaughter data for Region 10 which includes Washington and no other state of any slaughter significance, the annual Washington fed cattle slaughter amounts to about 900-940,000 head per year. As stated by JBS, the slaughter at Hyrum was just under 500,000 head. That means total slaughter in the three plants amounts to about 1.4 million. For its part, I estimate that Alberta's fed slaughter has been 1.6 million the last few years on average. Combined US and Alberta slaughter is about 3.1 million at the most.

The combined slaughter plus capacity puts the utilization rate at about 90% in the PNW US and Alberta combined region. That is about 5% less capacity utilization than in 2011. Furthermore that compares to utilization rates that were more typically in the upper 95% range during the mid-2000s in the whole of the United States. Most of the utilization challenge is in the PNW, not Alberta. Lower utilization means higher costs.



When the total regional cow capacity including Washington and the PNW region is added to the fed capacity, the utilization rate remains in the 90% range. By the fall of 2016 there will be an additional 10,000 per week cow kill added in the region. That is the added kill with JBS and Caveness added to the mix. At that point the total capacity utilization rate in the region dips to just over 80%, based on 2014 kills. The actual rate will be higher as the local NW cows stay in the region, but the point is that the utilization rate will not be as strong as what the industry would strive for in "normal" periods.

The point of course is that the region has capacity issues that are going to get worse in the coming two years.

In terms of candidates for downsizing or shutting, I can't see Cargill closing High River. The company has invested tens of millions in recent years. With the closure of Plainview and a Milwaukee cow plant, they likely believe that they have done their share. Tyson is not likely to close Pasco. Tyson already closed its Boise plant in 2006 and Emporia closed in 2008. They might feel they have already bit the bullet. Furthermore, based on press reports its Denison plant has been an off and on proposition for a few years, but never a mention of Pasco.

In addition with regard to Tyson, the company's first quarter results showed a profit of over $500 million. While beef was in the red, I expect the company is willing to let chicken, pork and prepared food carry the load. The reality is that a closure of one of their beef plants is not likely to change bottom line beef results. So results would not be material but they lose market share with a closure which they would not want.

Furthermore, if Cargill or Tyson close or reduce kills at Pasco or High River, those cattle will not be able to be picked up by another of their own company plants. For example the closure of Cargill Plainview meant that any lost Plainview kills would have been picked up by Cargill Friona and northern Panhandle cattle could have gone to Cargill Dodge, perhaps. High River or

Pasco cattle are simply lost if the plants are not there for the companies. Agri Beef has one plant. I cannot see that they would close that plant.

JBS is another story. They have not closed any beef plants. Hyrum is in the southern Alberta neighborhood and has been slaughtering southern Alberta cattle every week for many years. As argued above, Hyrum is here to stay. Brooks on the other hand is likely higher cost and less profitable than Hyrum. Add in the issues with labor and the Temporary Foreign Worker program and the plant becomes more in focus. In addition, cows have always been the lifesaver for the Brooks plant. With High River processing cows for many years now and with the expansion noted above, that positive cow outlet is being eroded.

The issue for debate is likely whether to close, go to one shift with added costs, or keep it running full and work through the major supply challenges of the next three years.

On the positive side of the debate, the cheaper C$ will make its operating costs look much better in U.S. dollars. Also JBS has put a Batista in Alberta to run the operation and there is seasoned support there as well. I doubt that JBS would take that step if there was not going to be every effort to keep the plant. Furthermore there is construction going on at the plant that will increase its efficiency.

On the negative side of the debate is the prospect for a very narrow basis if the plant continues to run full out. That prospective tighter basis would take out much of the relative cost advantage out of the plant. The prospect of COOL being tossed out in the next year or so also has to factor into the picture. In addition, there is the massive and probable long term flow of feeder cattle off the prairies into the U.S. High Plains. That is going to exacerbate the supply situation for Alberta feeders and packers.

The decision on any plant's future is strategic. The strategy is based on the big picture of competition, market share and the willingness to weather the results for the next few years. With that noted, however, corporate decisions are often reactive, not anticipatory.

Clearly in Alberta it is an industry that is getting smaller, at least in the short term, therefore no possibility can be ruled out. Growing industries allow for mistakes however shrinking industries are unforgiving.

A version of this report first appeared in Canadian Cattle Buyer. For a free trial subscription to Canadian Cattle Buyer send an e-mail to kevin@kevingrier.com