

The Good, the Bad & the Ugly

Each new year brings with it challenges and opportunities, and 2006 will have its share of both for the U.S. broiler and turkey industries. High energy costs and the threat posed by the possible spread of avian flu are challenges that will be faced by the entire U.S. poultry industry this year. On the positive side, relatively low feed costs will benefit both the broiler and turkey industries in 2006. Wholesale pricing for commodity products for the two industries was dramatically different at the end of 2005. The turkey industry had one of its most profitable years ever in 2005, and for the most part commodity prices ended the year on a high note, but there were some clouds on the horizon. In contrast, broiler breast meat and leg quarter prices dropped precipitously in the last few months of the year, and breast meat prices stood at near historical low levels at year's end.

Crystal ball gazing is never going to be an exact science, but there are analysts who have tracked the broiler and turkey industries for years, and *WATT PoultryUSA* sought their opinions on what might happen to broiler and turkey prices in 2006.



Bill Lapp

Bill Lapp is an analyst and consultant for his firm Advanced Economic Solutions and before this he was an analyst for ConAgra. He commented on what might happen to broiler prices in 2006, saying, "We are in an oversupply situation right now, with production increasing in 2005 by nearly 4 percent. We have had too much breast meat produced for some time now, and it is having an obvious impact on the price. We are at the low point seasonally in terms of demand, so if you were ever going to get to these levels, it would be now. Just because of seasonal trends alone, we should see some improvement in prices as we

go into this summer; how much we can improve on these prices will depend, in part, on whether we can see some moderation in both the number of chickens being slaughtered as well as the weight per bird. We saw an increase of nearly 1.5 percent in the average bird weight last year, and a disproportionate amount of that goes to breast meat."

Lapp believes the broiler industry will respond to the current low commodity meat prices. "I think that there will be some restraint shown by producers.

Not all analysts agree about where industry prices and profits are headed in 2006.

by Terrence O'Keefe

The USDA has forecasted a 2.9 percent increase in broiler production in 2006, and my guess is that when it is all said and done, we will be closer to 2 percent to 2.5 percent,” he said.



Thomas Elam

Dr. Thomas Elam, who does economic analysis and consulting for his firm Strategic Directions, after working for years with Elanco as an

economist and planner, agrees with Lapp that the U.S. broiler industry will need to slow production growth to improve commodity prices. Elam said, “Until broiler integrators take things down to red numbers on the bottom line—to the point that they cut back production—I don’t see them recovering.” Elam has a sobering projection for the U.S. broiler industry; he said, “At least for the next year or two, I think that they will be looking at some breakevens or slender profits at best.”

Lapp noted that factors outside of supply and demand in the USA are affecting broiler prices in this country. “A big part of the change in profitability for the industry has been the decline in leg quarter prices, and this has resulted from a weakening export environment,” he said. Elam and Lapp agreed that fear surrounding avian influenza has had a major negative impact on poultry exports over the last few months.

Exports To Blame

Pablo E. Zuanic, a poultry industry analyst for J.P. Morgan, believes that exports, or lack of them, played a critical role in the fall of commodity broiler meat prices in the USA last fall. “Our theory is that the declining white meat prices have been driven more by the declining dark meat prices,” Zuanic said.

“Some people have talked about over-

supply of meat and oversupply of breasts, but we don’t agree with that. What I am looking at is the decline in the last four months in leg quarters from

around \$0.50 per pound to around \$0.29 per pound and the decline in boneless, skinless breast meat to around \$1.15 per pound. But, when I look at the key metrics—domestic supply, domestic demand and exports—I blame it all on the export markets.”

Over 80 percent of U.S. broiler exports are leg quarters, and if leg quarters are not exported, then they must be used domestically. Zuanic theorizes that this extra dark meat has been forced onto the U.S. market at relatively low prices, and that this results in consumers substituting dark meat purchases for white meat purchases, thus depressing breast meat prices.

Zuanic said that the USDA slaughter numbers until October had production going up about 3 percent to 3.5 percent on average, and that domestic demand was growing around 3 percent and accelerating towards the end of the year. But because high fuel prices squeezed consumers’ pocketbooks, they substituted chicken for more expensive beef. He also pointed to exports that were up around 20 percent through August. So, if exports were up 20 percent through August and domestic demand was up in the 3 percent range, a production increase of 3.5 percent was not a problem for maintaining prices.

U.S. broiler meat exports did decline by 21 percent from 2004 in September and by 9 percent in October. Zuanic said that there was a Katrina effect on exports due to weather-related problems and damage at southeastern U.S. ports. Consumption of poultry products has declined in countries where avian flu



Pablo E. Zuanic

has been found, and these countries have imported less chicken. Zuanic summed up his explanation of what caused the drop in U.S. broiler meat prices, including breast meat prices, when he said, “Based on indicators including hen slaughter and pullet placements, I can make the argument that production is showing signs of deceleration. So, we have a fact, the decline in prices, but I would argue that supply has not been the culprit. If domestic supply was fine and domestic demand was fine before the decline in exports, then the decline in prices was caused by the export markets.”

Three Factors Behind Confidence

Zuanic remains optimistic about industry prospects in 2006. “There was a shock in the export markets from October to December that was the result of three factors,” he said. First, he noted, Western European markets shut down to poultry imports over avian flu fears. This did not affect U.S. producers directly but put more Brazilian production, which would have gone to Europe, on the world market. Zuanic says this effect is “transitory.” Second, after the shock of avian influenza news, consumers do go back to chicken, only gradually, and this has been seen in overseas markets like China. Finally, Zuanic assumes that many importers in China let their inventories drop when avian flu began spreading, and when demand starts to normalize, they will have to rebuild their inventories. “So when I put these three things together, I assume that these have to have an effect on pricing,” Zuanic said.

Because of his export-based theory for the current weak broiler meat prices, Zuanic is optimistic about these prices recovering in 2006. He said, “I think that exports will recover and be back in the range of a 10 percent increase. If exports begin to recover, it will help push leg quarter prices up. If I am right about the

impact that leg quarters have had on the breast prices, this means that breast prices will recover as well. This is based on hypothesis rather than on factual data, but we have had comments from companies like KFC saying they are seeing improving trends in China and Pilgrim's Pride saying that their exports began recovering in the second half of December. Also, the Brazilians are projecting a 15 percent increase in exports in 2006." J.P. Morgan has an investment banking relationship with Pilgrim's Pride Corporation.

Zuanic said that all of this is going to lead to a recovery in leg quarter prices. "I am not saying that we are going back to \$0.50 per pound leg quarters, but maybe we will go back to \$0.35 per pound, which I believe will help breast prices. If I am correct about the increase in hen slaughter and decrease in pullet placements decelerating the increase in supply, then this may also help to support prices," he said.

He explained further his theory of why broiler prices may recover quickly. "The last time that we had prices fall so much was in 2002, and that was event driven because of the closing of the Russian market to U.S. imports, and now we have avian flu. When price changes are cycle related, meaning resulting from overproduction, maybe prices don't recover so fast. But when the price drop is event driven, maybe the price will recover faster once the event is over. If we don't have a pandemic of avian flu, then exports may recover, and thus prices, fairly soon," Zuanic said.

Too Much Turkey In 2006?

After real declines in production volume in 2003 and 2004, the turkey industry increased production by just around 1 percent in 2005. Lapp said, "The year 2005 was one of the best years on record for the turkey industry.

Exports were good for the year, and pork, a competing meat, has shown limited growth. Most importantly, however, turkey production for the last two years has been restrained."

Elam said that most profitability models showed turkey companies making as much as \$0.12 per pound on a ready-to-cook basis in 2005. Unfortunately, the restraint that the turkey industry has shown over the last few years appears to be weakening.

While the USDA is forecasting a 1.1 percent increase in 2006, companies responding to *WATT PoultryUSA's* Top Turkey Company Survey project a 4.7 percent increase in slaughter for 2006. Poult placements were up an average of 3.7 percent in the last three months of 2005 versus the same period in 2004, and they were up 6 percent in December.

Lapp said, "A 4 percent to 5 percent gain in production of any meat in this country is devastating because the market has to work really hard to clear that much meat. So far, the industry has benefited from having no meat in the freezer. One hundred million pounds of meat, which represent about 2 percent of annual production, can be absorbed into the freezer."

Elam also sees cold storage capacity as coming into play. "One bright spot is that the cold storage stocks are way down and that will certainly help early in the year, and maybe all through the year. If dark meat prices start to go down, we will probably see some pretty significant pick-up in exports at the lower prices," he said.

Mexican exports are another plus for turkey prices, according to Elam. He noted that the U.S. turkey industry has done a good job building a market in Mexico for turkey thigh meat and has done well at holding onto this market, even when chicken leg quarters are quite

inexpensive. "In 2005, even at very high dark meat prices, turkey exports did not back off, in fact they actually increased in volume. The export value is at an all time record now," he said.

Not all indicators are positive for continued turkey industry profitability. Lapp said, "There are clear question marks for the turkey industry in 2006. At what level will industry restraint occur, and how responsive will companies be to their profit situations? Will we be able to expand or retain our export markets?"

Elam expressed confidence about the turkey industry's outlook for 2006 based on several factors. First, he questioned whether or not the turkey industry could produce 5 percent more tonnage in 2006, based on constraints like poult availability and housing. But what if turkey production rises by the 4.7 percent projected in the *WATT PoultryUSA* survey, and at the same time there is a little growth in exports, freezer stocks return to normal levels, and there is a little economic growth in the USA? Under this scenario, Elam says the increased production could be absorbed without a disaster.

"Instead of an \$0.85 per pound ready-to-cook price in the fall, you could be looking at a \$0.75 per pound price, which would still be profitable," Elam said. The price he refers to is a blended price based on 60 percent whole birds and 40 percent cut-up product. "We could have a little seasonal rise throughout the year, but not up to the 2005 price levels. So, instead of making \$0.12 per pound, the industry might be making \$0.08 per pound. That's not as profitable as last year, but it's still in the black," he said.



Articles and information in our website archive are protected by copyright by Watt Publishing Co. They may be downloaded for individual use. However, mass reproduction of such articles and information without permission of the publisher is a violation of copyright.