

Canadian Pork Market Review

Market Analysis for the Hog and Pork Industry

February 11, 2011

THE MARKETS AT A GLANCE			
	Last Yr	February 4	February 11*
CME Constructed**	66.79	80.79	84.14
Nearby Hog Futures	68.15	84.50	86.40
2nd Deferred Hog Futures	77.85	98.35	92.37
USDA Pork Cutout	68.47	88.95	88.80
Canadian Pork Cutout***	148	173	174
Manitoba (Man Agric)	127.88	145	151
Quebec	131.58	146.88	151.77
US Slaughter	2,152,000	2,051,000	2,156,000
Cdn Slaughter	437,000	428,000	N/A
*Estimated. **LM_HG201. ***Primal values/ ckg at standard industry yields. (US slaughter is FI; Cdn is FI and PI)			
<i>Note: Due to the wide variety of price reporting and collection methods, it is misleading to compare prices between regions.</i>			

Canadian Market Developments

Fearman Moves Forward

Fearman Pork will soon be announcing Pat Sugrue as the new CEO of the Burlington-based operation. Fearman's owner, Sun Capital has not made the announcement officially yet but plenty of industry participants in Ontario already know that he is from Atlanta and has a packaged goods background. Some say he used to work at Coca Cola, but then people think everyone from Atlanta worked at Coke. One can only assume that the news on Sugrue must have found its way to Wikileaks.

In addition, **Fearman is getting their pork sales team in place with the hiring of 2-3 new traders.** Maple Leaf was doing all of the sales for the plant but that ends at the end of February. A transitioning process has been going on with Fearman staff gradually taking more responsibility. I expect that sales agreements between Fearman and Maple Leaf for processing products will stay in place.

Sun Capital bought the plant in early November for approximately \$20 million. Prior to the purchase, Maple Leaf had been slaughtering an average of about 25-27,000 head each week in the 43,000 head capacity plant. **Hogs were hard to come by and the company was not defending the plant's market share in Ontario.** Over the course of December and January, I estimate that Fearman has been slaughtering an average of over 35,000 each week, not counting the Christmas and New Year's weeks. Slaughter may have pushed the 40,000 mark during January as packer margins have been very good and hog numbers have been decent. Kills may have dipped to 32,000 the first week of February.

Additions and changes to the pork sales team is of interest, because it shows the gradual process that is underway to become an independent competitive presence in the market. **Retail buyers will welcome**

that presence as a countervailing weight to Maple Leaf and Olymel. What producers are most interested in, however, is Fearman's strategies and pricing on the procurement side of the business. In that regard during the three months that Sun Capital has owned the plant, **producers were hoping for more of a competitive pull from Burlington.** That is especially the case given the supply related changes in the hog market. **The market has changed dramatically in a short time.**

At the same time, however, it has been too early to see what kind of presence Fearman was going to exert in the live market. In other words, it was likely too early to see if Fearman was going to be a 20,000 head plant or a 40,000 head plant. With the arrival of the new boss, that question should become clearer. **If it is going to be competitive, it is going to need to improve the Maple Leaf formulas and get more creative in terms of premiums and weights.**

While producers in Ontario had been less than enthused about Fearman through January, as of this week, it **appears that Fearman might be prepared to be a more aggressive buyer.** New contracts and pricing from the company are reportedly much more to the producer's liking. The message producers are hearing now is **"we want your pigs and we are willing to pay to get them."** In addition, the company is offering better terms for 2-3 year contracts. While that is not surprising, it again sends a positive message. Some are getting impatient with the fact that the company does not yet have forward booking capacity, but that takes time.

Ontario Supply Situation

Fearman, and all packers in Ontario have their work cut out for them on the procurement side. First of all, **Sun Capital purchased the plant at a time of the highest margins that I have tracked since 2002.** Maple Leaf probably told them that those margins are not typical. In addition hopefully the company was informed that there are serious hog supply challenges coming.

Year over year sow numbers were down in Ontario in the third quarter by 5%, market hogs were down by 6%. During 2010, sow numbers were down by 23% from the peak year of 2004. Market hogs were down over the same period by 27%. Furthermore, material numbers of larger scale producers who have survived are more and more focused on weaners to the US. They are going to need more incentive to keep the hogs in Ontario. This January, Ontario shipped 7% more weaners and feeders south than last January. The 17,000 head each week that went south in January can make a huge difference in the supply situation in Ontario. In addition, there were another 5-6,000 market hogs that went south in January. That was a huge jump over January 2010. **The US market continues to offer profitable opportunities, especially on the weaners, but also increasingly on market hogs.**

Another factor in the Ontario market is that, the Quebec-based firm, Sunnico, continues to make plans to kill hogs in Les Cedres, about 20-30 kilometers from the Ontario border. I have been claiming this was going to happen sooner, but the hope is to have financing in place to be killing up to 6,000 per week shortly after the start-up at the end of summer. The plan is to eventually kill *4,000 per day* over the next five years. Given that Quebec's marketing plan locks hogs to existing packers, **Sunnico's hogs are going to have to come from Ontario.**

In 2007 marketings in Ontario averaged 105,000 head. Last year with 19% fewer sows than in 2007, Ontario marketed an average of 87,000 hogs a week, a decrease of 17%. Marketings in the first weeks of 2011 are down by about 6% compared to early 2010 with sows down year over year by about 5%. The message of course is that unless there are big changes in weaner and feeder shipments, summer marketings could be down in the 80,000 range. Existing plants in the province including the provincially inspected plants are typically slaughtering about 55-58,000, with Quality taking at least 35,000 of those. If marketings do go to 80,000 head, that is only going to leave about 25,000 head for Fearman.

Canadian Pork Products

The following is based on information provided by Ronald A. Chisholm, Toronto.

Overall the market could be called up slightly due to moderate demand and light offers. Hams were up at least 10 cents a kilo over the last two weeks. Russian approval of more plants in Canada helped to reduce product availability on the domestic market. Canadian hams were relatively stronger than US hams. Bellies were steady at exceptionally high levels. Pricing is very high at retail which may be starting to hurt demand, but the big driver is foodservice. Every QSR chain seems to be pushing bacon. Loins were flat the last couple of weeks and are one of the few primals that is not soaring compared to previous years. As with the Bellies, the Ribs were steady over the last two weeks at very, very high levels. The Rib continues to travel trade at levels that the industry is not familiar. With that noted, processors are starting to back away which may be forcing some product into freezers for speculation. Butts jumped another ten cents due to Korean demand. Product is not available as suppliers continue to work to make Collars for Korean buyers. Korean buyers still seem to be in panic mode, paying more than they need to pay, relative to other buyers. Other big buyers are not participating in the rush. The situation is the same with Picnics. The situation in Korea remains still very unsettled. Any lean trimmings that are on sale are going to Korea.

Market Drivers and Outlook

- Lean hog futures technical signals are extraordinary. The only possible negative that bears can point to are that they may be “overbought,” which can be a signal of being topsey, or not. DTN said on Thursday that follow-through buying and ideas that runaway feed costs would work to significantly cut meat production later this year. (dtn.com, February 10)
- Corn futures soared to \$7 for the first time in 31 months Wednesday after the government cut projected supplies to what analysts said was precarious levels. The USDA's monthly supply and demand report, which projected corn supplies at the end of the marketing year would dip well below analyst estimates. If realized, that dip would put supplies as a percentage of total usage at 5%, matching a low set in 1996. Analysts said anything below that would potentially cause disruptions in the supply pipeline. That ratio has not dipped below 5% since 1937, according to the USDA. The report also reaffirmed that prices must climb yet higher in order to discourage demand and stave off a supply crisis, analysts said. The main cause for the supply cut was continued growth in ethanol demand. The USDA increased its projection both for ethanol...(meatfyi.com, Feb 9)
- *The following is a direct excerpt from CIBC World Markets, Monthly FX Outlook, January 31.* January saw the loonie swim above parity for most of the month, and domestic economic data helped boost the loonie, with accelerating employment gains and stronger-than-expected GDP and retail sales supporting C\$ sentiment, despite weaker housing reports. Given the higher starting point for resource markets, we slightly strengthened our target range for the C\$ earlier this month, but still expect to see softness in the loonie in the months ahead. The Bank is forecasting the exchange rate to soften to about 0.94 during the second quarter before firming to near par again by the end of the year.
- *The following is a direct excerpt from Commodity Nuggets, Cleveland Research Company, Feb 8.* According to industry analysts, South Korea may take up to 2 years to recover from its recent outbreak of foot-and-mouth disease (FMD). The disease as led to the recent culling of 30% of the country's hog herd and 5% of its cattle and poultry numbers. Lower sow and cattle numbers are expected to slow the recovery in pork and beef production and are likely to result in higher demand for meat imported from the US. Reports suggest that it is unlikely that SK's hog population will begin to grow until sometime in 2012. In addition, SK announced that it will drop its 25% tariff on pork imports of up to 60KT (to be imported through June) in a move to ease tightening supplies and rising prices that have resulted from the FMD outbreak. We expect easing of the tariff to spark some demand for imports from US pork producers, although the allotment is expected to be split between exporters.

- Separately, according to Cleveland Research, US hog packers are enjoying their strongest January-early February margins in the last five years. For their part, US hog producers look to have moved into the black in recent weeks. In Canada, the most efficient producers may be pushing close to breakeven.
- The director of risk management with h@ms Marketing Services is encouraging hog producers to forward price a large portion of their production and to secure feed supplies to manage the volatility in both hog and grain markets. Tyler Fulton, the director of risk management with h@ms Marketing Services says the futures prices have consistently suggested we could expect a better than average rally over the first quarter of 2011 and the cash market has met and even surpassed those expectations but, he concedes, because of rising feed costs profitability hasn't changed. "Quite simply we've needed the gains in the cash market and for that matter in hog prices to simply maintain profitability at what I would say is generally pretty good given the volatility that we've got," says Fulton. He recommends pricing a large percentage of production at current prices and securing feed supplies because feed is where the major risk to profitability is going to come from. (farmscape.ca, February 11)

The Next Two Weeks

- Good margins for US packers should keep them strongly in the hunt at least at current price levels.

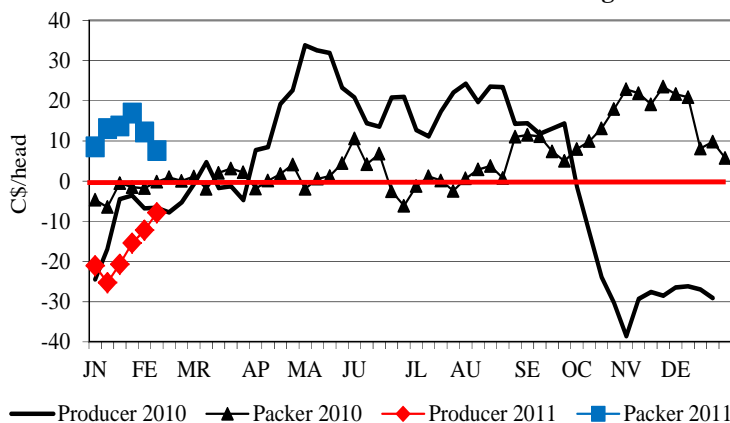
George Morris Centre Hog Price Forecasts*				
Period	US Lean Carcass	Lean Hog Futures	Ontario C\$/ckg	Alberta C\$/ckg
Next Two Weeks	85	86.40	155-160	
March	86	--	155-160	
April	90	92.37	165-170	
May	94	100.57	170-175	
Third Quarter '11	94	100	170-175	
Fourth Quarter '11	82	88	150-155	

Using a par exchange rate

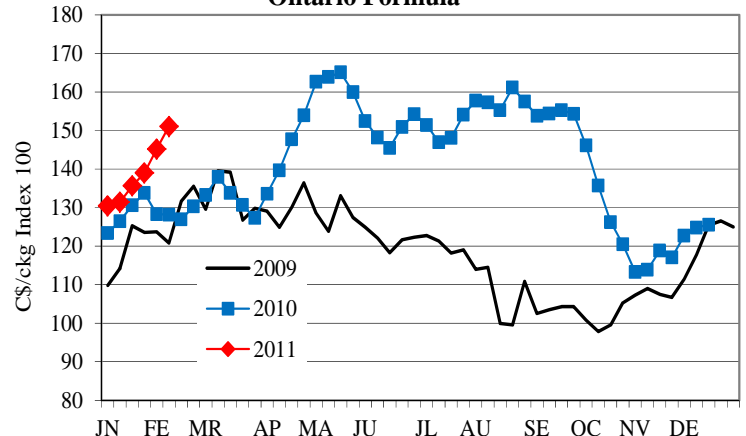
IMPLICATIONS/ACTIONS

Tyler Fulton is recommending hedging based on what the futures market is offering. Closely related to those thoughts is the fact that there is not a market analyst that can actually generate a forecast as high as the futures are offering, even before the Korean FMD became such a huge issue. In addition, in Ontario, producers are clearly in the driver's seat in terms of opportunities, finally.

Ontario Producer and Packer Net Margins



Ontario Formula



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