Assessment of the Livestock and Poultry Industries
Fiscal Year 2007 Report

United States Department of Agriculture
Grain Inspection, Packers and Stockyards Administration

May 2008

TABLE OF CONTENTS

TABLE OF FIGURES

Executive Summary

This report is prepared in accordance with the Grain Standards and Warehouse Improvement Act of 2000 (PL 106-472, Nov. 2000). The Act requires that by March 1st of each year, the Secretary of Agriculture shall submit to Congress a report that: 1) assesses the general economic state of the cattle and hog industries; 2) describes the changing business practices in those industries; and 3) identifies market operations or activities in those industries that appear to raise concerns under the Packers and Stockyards Act. Additionally, this report includes sections on the sheep-lamb and poultry industries.

This is the seventh annual report made by the USDA Grain Inspection, Packers and Stockyards Administration (GIPSA) to Congress. The report focuses on data GIPSA collects under its regulatory authority for the livestock and meat market channels in the cattle-beef and hog-pork industries. By focusing on the marketing segment (livestock dealers, market agencies, and packers) that GIPSA regulates, the report highlights information unavailable from other sources. The report covers events and data available as of September 30, 2007, which is the close of the Government's 2007 fiscal year. Projected annual outcomes are, however, on a calendar-year basis.

Data from annual reports filed by regulated firms provide a snapshot of the industry each year. Time trends reveal key industry characteristics and can be used to form expectations for 2007. The data show that the four largest firms' share of the total value of livestock purchases, i.e., aggregate industry concentration, has trended upward over the past 10 years. Patterns of concentration in purchase of different types of livestock, however, have exhibited different trends. Four-firm concentration by volume of slaughter in steer and heifer slaughter and boxed beef production have been relatively stable in recent years. Concentration in poultry slaughter was fairly constant from 2003 through 2005, but increased in 2006. Cow and bull slaughter increased in concentration through the 1997-2007 period. Hog slaughter increased sharply in 2003, but was stable since then until declining in 2006. Concentration in sheep slaughter declined from 1998 through 2004, increased sharply in 2005, then declined in 2006.

Trends in marketing practices of packers vary by species. For example, carcass-basis purchases of cattle exhibited a strong upward trend from 1998 through 2002, remained about the same in 2003 before falling in 2004, and have been relatively stable since. By comparison, carcass-basis purchases of hogs increased steadily from 1996 through 1999, fell slightly in 2000, and have increased at a relatively slow rate since 2000.

The four largest beef packers' use of committed procurement methods increased in 2006, but packer feeding and use of marketing agreements continue to be below levels of the beginning of this decade. Forward contracts and packer feeding each continue to represent relatively small portions of total cattle procurement.

Another source of information on marketing arrangements is the Swine Contract Library (SCL) maintained in accordance with the Livestock Mandatory Reporting Act of 1999. Reports to the SCL of estimated future deliveries under contracts provided a useful indication of expected future trends in deliveries prior to the expiration of the Act in September 2005. The Act was renewed in 2006, but until new regulations are issued, reporting is voluntary.

As carcass-based procurement has historically increased in volume, packers have increased the development and testing of carcass evaluation devices in the beef industry. Changes to carcass merit programs for hogs were not significant in 2006, perhaps reflecting the fact that trends in carcass-basis purchases of hogs have stabilized at high levels in recent years.

I. General Economic State of the Industries

The Packers and Stockyards Program (P&SP) of the Grain Inspection, Packers and Stockyards Administration (GIPSA) administers and enforces the Packers and Stockyards Act (P&S Act). Enforcement involves monitoring financial and business practices in the livestock, meatpacking, and poultry industries. As part of this monitoring, every packer, live poultry dealer, stockyard owner, market agency, and dealer must file a report annually with GIPSA. Since reporting year 1977, packers that operate in interstate commerce and purchase $500,000 or more of livestock on an annual basis are required to file an annual report with GIPSA. The reports filed by these packers contain data on the quantity and costs of the firms' purchases of livestock for slaughter, the firms' business practices, and financial aspects of the slaughter firms' operations. Data available from these reports provide a snapshot of the industry each year. Data from reports for reporting years through 2006 are used below to describe recent trends in key characteristics.[1] The data were also used, along with more recent information from other sources on current industry conditions, to develop estimates of those characteristics for 2007. All analysis is based on data and information available to GIPSA at the end of fiscal year 2007. Because most of the data series are on a calendar-year basis, the anticipated outcomes that are described refer to calendar year 2007.

A. Aggregate Livestock Industry

Data on the total value of all livestock purchased for slaughter reveal that the four largest slaughter firms' share of total industry expenditures on livestock for slaughter increased from 1997 to 2003 but with downturns in some years, and has declined the past 3 years (Figure 1). The largest four firms' share for 2007 will likely have shown a slight increase based on mergers that occurred during the year (see later sections).

[1] Unless otherwise indicated, P&SP data represented in the graphs and discussed in this report are as reported in various issues of the annual Packers and Stockyards statistical report (see http://www.gipsa.usda.gov/GIPSA/webapp?area=newsroom&subject=landing&topic=pub-stat), supplemented with other data from reports filed with Packers and Stockyards Program by business entities subject to the Packers and Stockyards Act. The majority of firms file reports on a calendar-year basis, and the reports for 2007 are not due until April 15, 2008. GIPSA provides a 90-day extension when requested, and performs a data verification process after receiving the reports. Thus 2007 data will be published in early 2009 in the GIPSA publication *Packers and Stockyards Statistical Report, 2007 Reporting Year*.

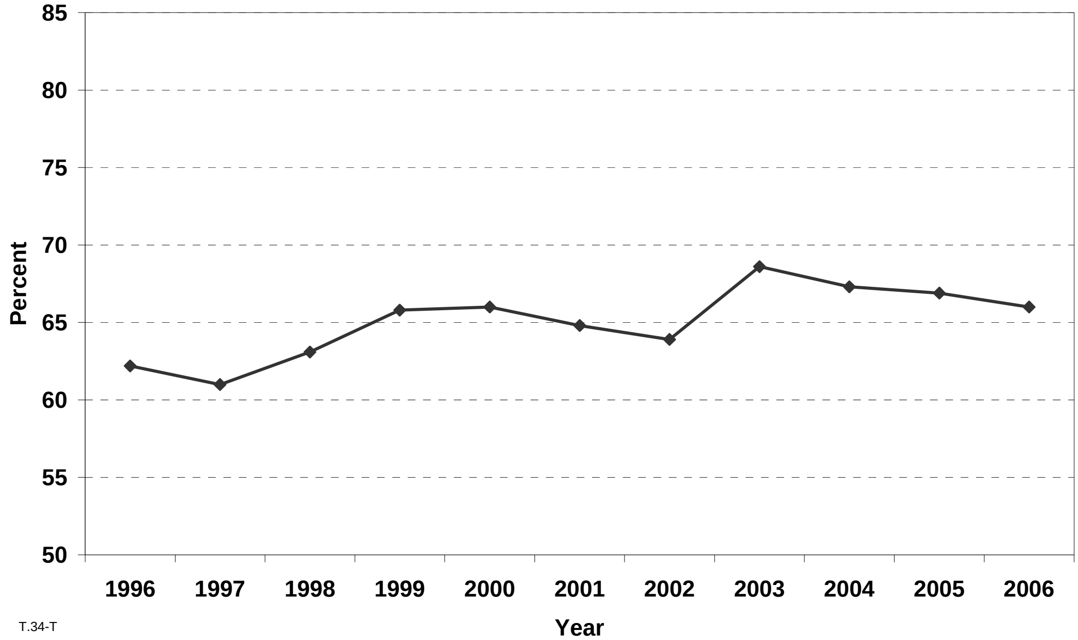

Figure 1. Share of Total Industry Livestock Procurement Expenditures for the Four Largest Slaughter Firms, Ranked by Total Livestock Procurement Expenditure

Several financial ratios can be used to provide a summary of financial conditions in the meat-packing industry. Two examples, one for expenses and one for income, are used below. First, trends in operating expenses as a percentage of revenue from sales illustrate the combined effects of changes in input costs, excluding livestock procurement costs, and in firms' production practices on the costs of doing business over time. Second, trends in operating income as a percentage of revenue from sales over time provide a measure of profitability.

Operating expenses expressed as a percentage of sales of large meat-packing firms have trended upward since 1996, whereas operating expenses as a percentage of sales for smaller firms have trended downward since 2000 except for a sharp increase in 2002. Manufacturing costs, i.e., the costs of actual slaughter and processing operations including labor, make up the greatest component of operating expenses. Operating expenses include manufacturing, advertising and selling, administrative, depreciation and amortization, interest, and other day-to-day expenses of running the business. This ratio for large firms has tended to be lower than is the case for smaller firms. For example, in only 2 years from 1996-2003 were operating expense as a percentage of sales higher for the four largest firms than for firms ranked 21st through 40th. The ratios were similar for both size groups in 2003 through 2005, and in 2006, the ratio of total operating expenses to total sales for the group of smaller firms declined while the ratio increased for the largest four firms

(Figure 2). While these differences may suggest that larger firms historically have tended to operate larger, lower cost plants than the smaller firms, these financial data are highly aggregated across a variety of types of firms. Note that size rankings are based on total livestock procurement expenditures. There are differences both across and within size groups in combinations of species slaughtered (beef, pork, sheep, poultry) by the included firms.

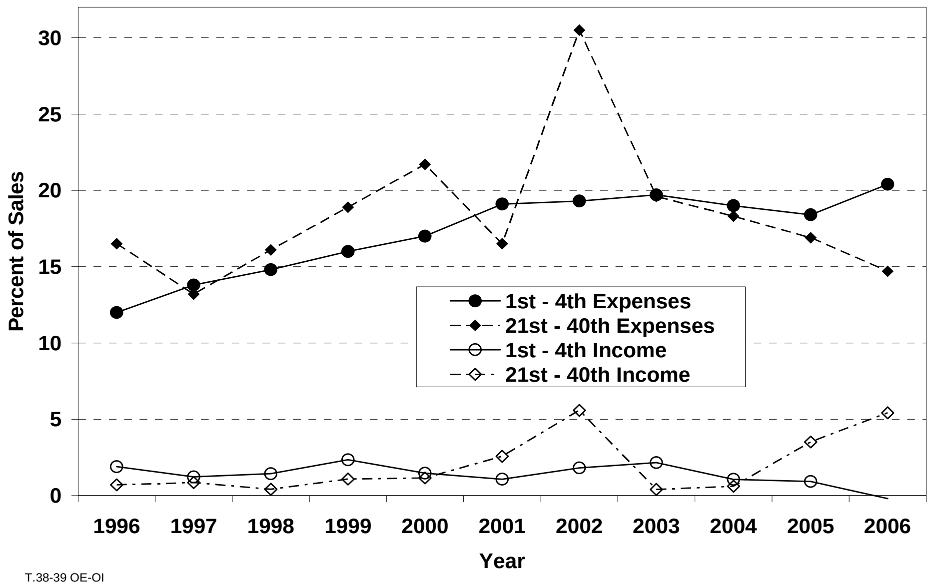

Figure 2. Total Operating Expenses and Total Operating Income as a Percentage of Sales for the Top 4 and the 21st-40th Firms, Ranked by Total Livestock Procurement Expenditure

Note also that financial data reported to GIPSA by some firms may include information on operations other than meat packing and processing. Variation in other types of non-meat activities included in the data from some firms occasionally leads to large swings in some of the ratios, especially for the group of smaller firms as exhibited in the graph in Figure 2.

Operating income as a percentage of sales of meat-packing firms had been relatively constant in recent years until 2006 (Figure 2). Operating income as summarized here is sales minus cost of sales (primarily cost of livestock) and operating expenses, and is essentially a measure of profit before taxes. Since 2000, the four largest firms have generally had lower operating income as a percentage of sales than the firms ranked 21st through 40th, a reversal of the relationship that existed prior to 2000. The lower ratio of operating income to sales of the larger packers, despite having a lower operating expenses ratio, is due to the larger packers paying a higher average cost for livestock (see Table 35, 2006 P&SP Statistical Report). The larger packers all slaughter a large proportion of steers and heifers in their total slaughter mix, whereas about half of the group of smaller packers specialize in cow and bull slaughter and almost no steers and heifers. Given the increase in expense ratio for the larger firms and the decline for the smaller firms as described above, the difference between the income ratios for the two size groups widened in 2006, with the operating income ratio for the four largest firms falling below zero.

B. Cattle Industry

The volume of cattle slaughtered by firms reporting to GIPSA (firms with livestock purchases equal or exceeding $500,000 per year) fluctuates with the cattle cycle, with changes in total U.S. commercial slaughter trending downward over the past 10 years (Figure 3). Total cattle includes steers and heifers (often collectively called “fed cattle”), cows, and bulls. In most but not all cases, individual plants operated by firms that report to GIPSA tend to slaughter either fed cattle or cows and bulls.

Data from the USDA National Agricultural Statistics Service indicate that total commercial cattle slaughter through the first 8 months of 2007 was slightly higher than for the equivalent period in 2006.[2] Assuming this pattern holds throughout the year, this suggests that total cattle purchases for 2007 for firms reporting to GIPSA will likewise have increased slightly over 2006 levels.

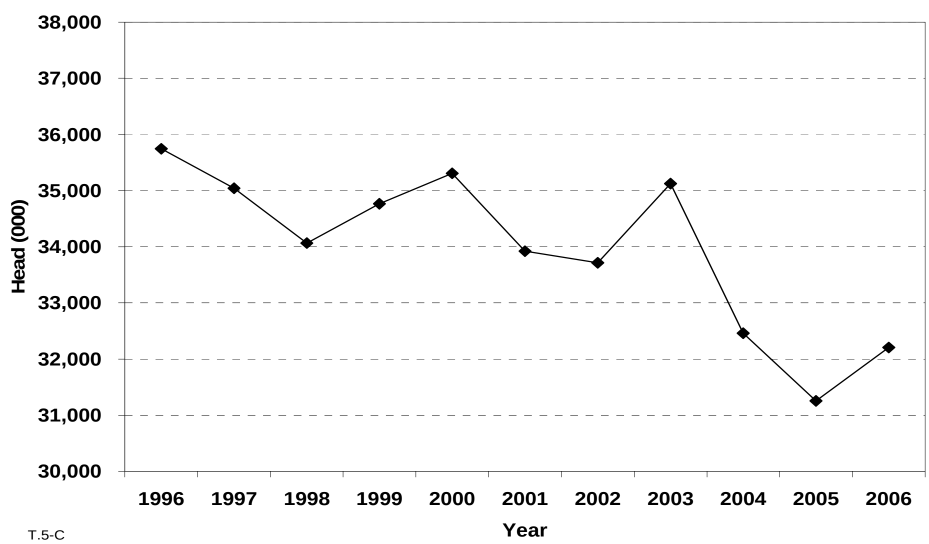

Figure 3. Total Slaughter Cattle Purchases for Firms Reporting to GIPSA

The number of plants reporting to GIPSA declined by approximately 115, or 42 percent, from 1996 through 2003, as plant size increased and smaller plants closed. The number has shown some signs of stabilizing since 2004. Based on preliminary information,

[2] National Agricultural Statistics Service, *Livestock Slaughter*, MtAn 1-2, September 21, 2007.

GIPSA expects there will have been little change in the number of cattle slaughter plants reporting in 2007.

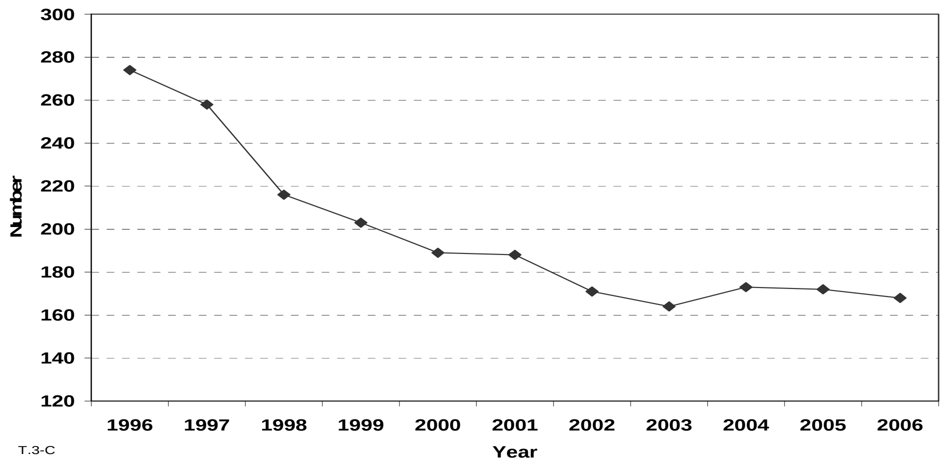

Figure 4. Number of Cattle Slaughter Plants for Firms Reporting to GIPSA

The percentage of the total volume of steer and heifer purchases accounted for by the four largest firms that slaughter steers and heifers has remained between 78 and 82 percent since 1996. The share of boxed beef production has moved with slaughter concentration, although slightly higher (Figure 5). In 2006, acquisitions by larger firms were largely offset by plant closings among those firms, but several smaller packers also ceased operating, resulting in a slight increase in the combined market share of the four largest firms. GIPSA does not believe that firm reorganizations in 2007 will have resulted in any significant increase in steer and heifer slaughter concentration or in boxed beef production.

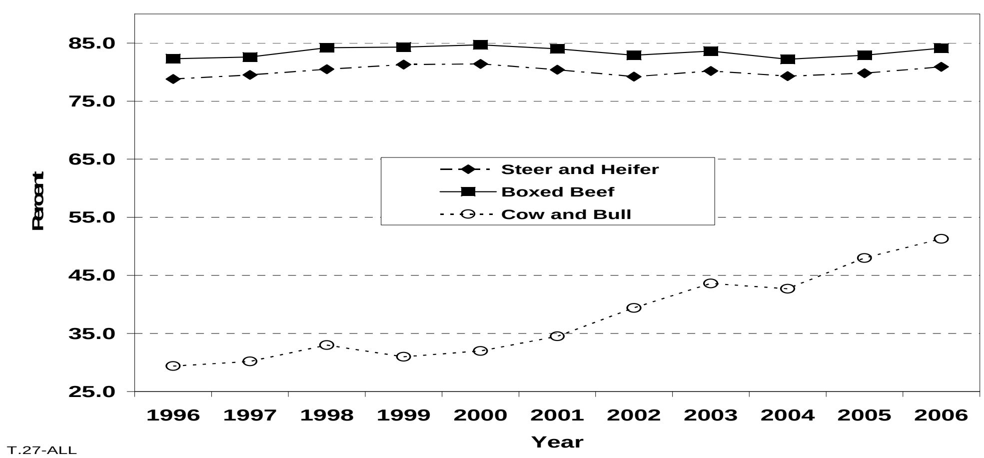

Figure 5. Combined Market Share (by Volume) for the Four Largest Steer and Heifer Slaughter Firms, Four Largest Cow and Bull Slaughter Firms, and Four Largest Boxed Beef Producers.

Concentration in cow and bull slaughter has trended upward since 1999. In 2006, several smaller packers ceased operating, with some smaller plants being acquired by larger firms. These factors resulted in an increase in the combined market share of the four largest firms slaughtering cows and bulls. Based on events through September 2007, GIPSA expects the market share of the four largest firms slaughtering cows and bulls will have remained stable in 2007.

C. Hog Industry

Hog slaughter has trended upward in the last 10 years, with slaughter plants reporting purchasing about 105 million hogs for slaughter in 2006 (Figure 6). The volume of slaughter by plants reporting to GIPSA tends to track total commercial slaughter. Data from the USDA National Agricultural Statistics Service indicate that total commercial hog slaughter through the first 8 months of 2007 was about 3 percent higher than for the equivalent period in 2006.[3] Assuming continuation of this level throughout 2007, slaughter by plants reporting to GIPSA is expected to have increased by about 3 percent in 2007. The number of hog slaughter plants exhibited a downward trend in all but 2 years since 1996 (Figure 7). Based on firm restructuring through September 2007, GIPSA believes it is likely that the number of plants will have declined slightly in 2007.

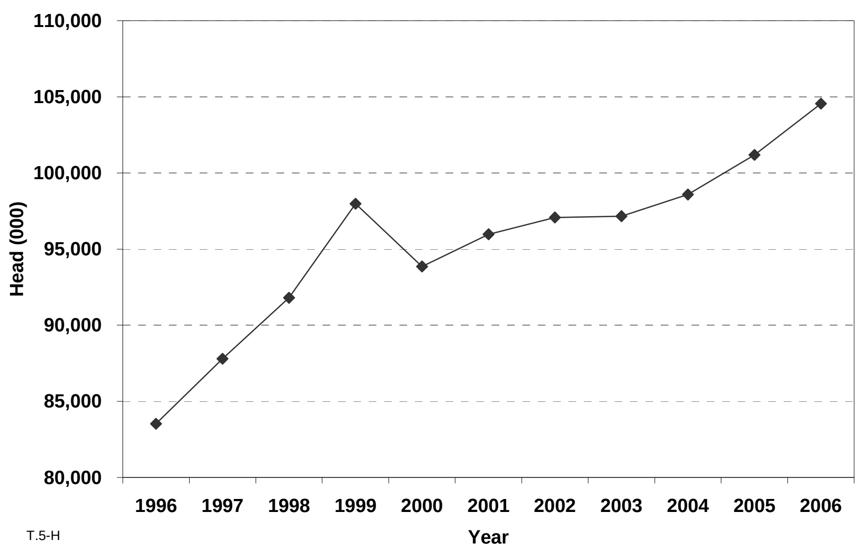

Figure 6. Total Hog Purchases for Slaughter for Firms Reporting to GIPSA

[3] National Agricultural Statistics Service, *Livestock Slaughter*, MtAn 1-2, September 21, 2007.

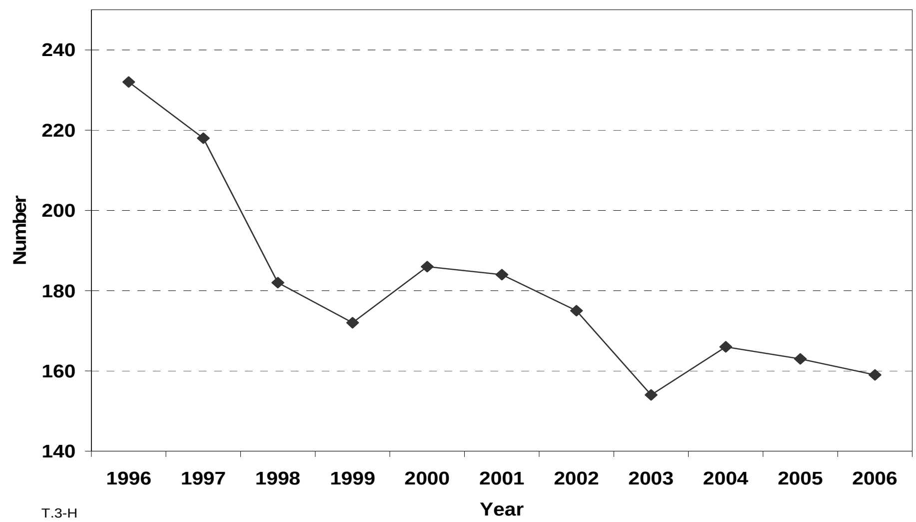

Figure 7. Number of Hog Slaughter Plants for Firms Reporting to GIPSA

After remaining stable in the latter half of the 1990s, hog slaughter concentration increased from 55 percent in 2002 to about 64 percent in 2003, but declined to about 61 percent in 2006 (Figure 8). The share of slaughter by the top four firms may have increased slightly from that level in 2007, based on firm acquisitions in 2007.

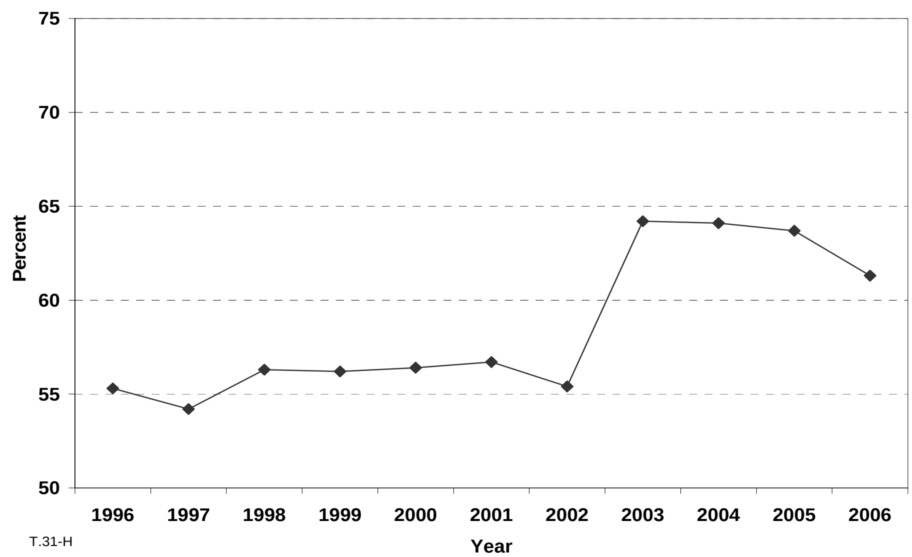

Figure 8. Combined Market Share (by Volume) for the Four Largest Hog Slaughter Firms

In FY 2004, GIPSA implemented a Web-based Swine Contract Library (SCL) in accordance with the requirements of the Livestock Mandatory Reporting Act of 1999

(LMRA). After the LMRA expired in September 2005, approximately half the previously responding plants continued reporting to GIPSA on a voluntary basis.[4] The SCL reports swine contract information from swine (hog) packing plants with a slaughter capacity of 100,000 or more swine per year. The SCL reports information from the submitted contracts by region, including price, premiums, discounts, grids, formulas, and other important contract terms that GIPSA extracts from offered and available contracts that packing firms use to purchase hogs. Each month the SCL also reports estimates of total future deliveries of hogs under contract for the following 6-month and 12-month periods. The SCL data are known in advance of Agricultural Marketing Service (AMS) data on actual deliveries and thus provide a forecast estimate (Figure 9).

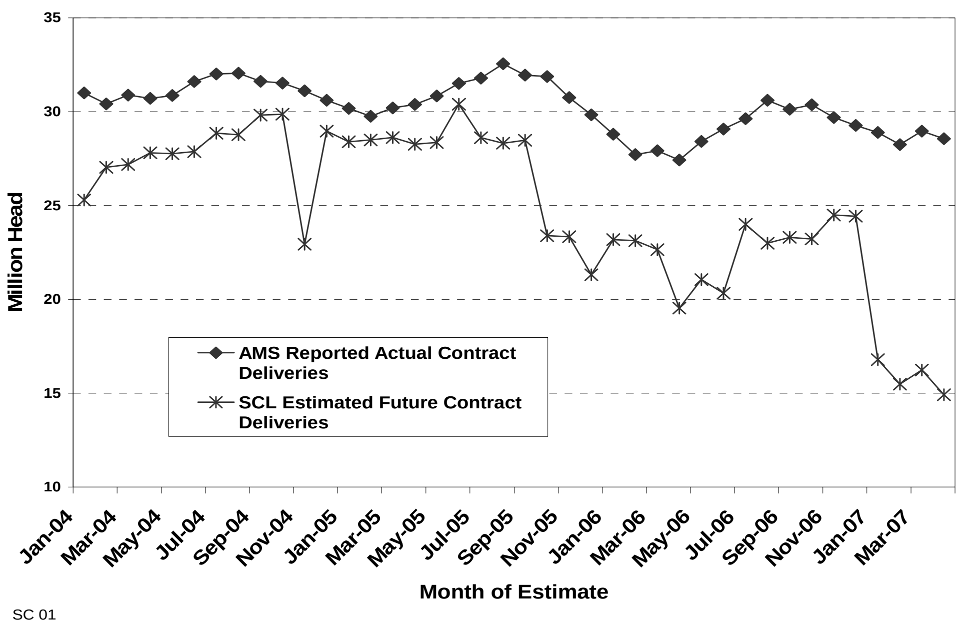

Figure 9. Estimated Future Contract Hog Deliveries Compared to Actual Contract Deliveries During the Same Period, National Totals, All Contract Types

Prior to the expiration of the LMRA, GIPSA found that packers' reports to the SCL of estimated future deliveries under contract tended to under-estimate actual deliveries subsequently reported by AMS but still provided a useful indication of the trend in deliveries. When reporting to the SCL and to AMS became voluntary in September 2005, fewer plants provided data to the SCL about estimated future deliveries under contract than those that voluntarily provided data to AMS about actual deliveries. As a result, SCL estimates became a less accurate predictor of the trend than they had been previously. In October 2006, President Bush signed legislation renewing the Livestock Mandatory Reporting Act, including the SCL provision. Submission of contract information continues

[4] The Act actually expired briefly in the fall of 2004 but was extended for 1 year. During the 2004 period when the Act had expired, about half of the plants reported to GIPSA on a voluntary basis, thus the large decline in late 2004 shown in the graph in Figure 9. Normal reporting then resumed during the 1-year extension.

to be voluntary until GIPSA regulations are issued. GIPSA expects that the relationship between estimated and actual deliveries should approach a more consistent pattern once all packers resume filing reports to the SCL as required.

D. Sheep and Lamb Industry

The volume of sheep and lambs slaughtered by packers reporting to GIPSA declined in every year but 2 from 1996 through 2005, but remained relatively constant in 2006 (Figure 10). Data from the USDA National Agricultural Statistics Service indicate that total commercial sheep and lamb slaughter through the first 8 months of 2007 was slightly less than in the equivalent period in 2006.[5] Assuming this pattern held throughout 2007, this suggests that total sheep and lamb purchases by firms reporting to GIPSA will have declined slightly in 2007.

The number of plants slaughtering sheep and lambs declined in 2006 after increasing somewhat in 2004 and 2005 (Figure 11). Given the apparent adjustments in slaughter capacity as evidenced by the decline in number of plants in 2006, GIPSA does not expect much further change in number of plants to have taken place in 2007.

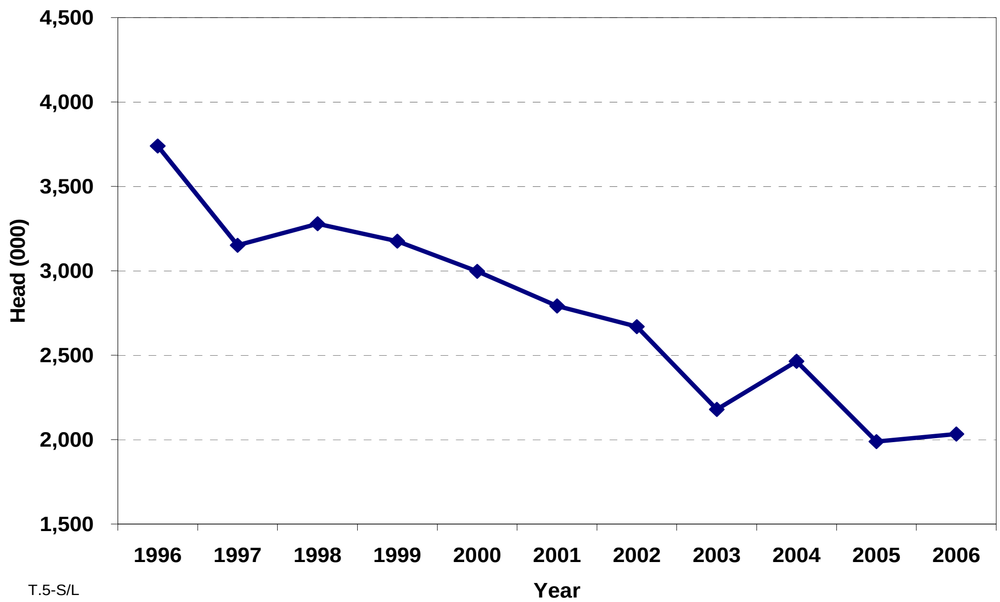

Figure 10. Total Slaughter Sheep and Lamb Purchases for Firms Reporting to GIPSA

[5] National Agricultural Statistics Service, *Livestock Slaughter*, MtAn 1-2, September 21, 2007.

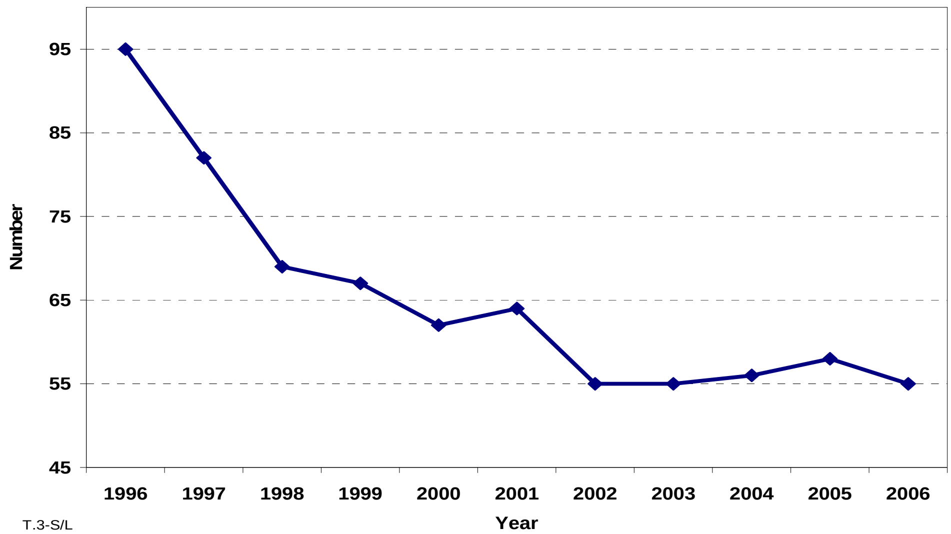

Figure 11. Number of Sheep and Lamb Slaughter Plants for Firms Reporting to GIPSA

The combined market share of the four largest sheep and lamb slaughter firms trended steadily downward from 1998 through 2004 as the largest plants in the industry decreased slaughter at a greater rate than total industry slaughter declined (Figure 12). Due to the small total slaughter of the industry, large volume adjustments among the largest four firms can result in exceptions to the steady downward trend, resulting instead in relatively large changes in the percent of slaughter by those firms. For example, in 1997 total slaughter of the four largest firms as a group declined at a greater rate than total industry slaughter. The next year, a large new plant entered the industry as a new member of the group of four largest, and increased the share of the top four. The long-run decline in share then resumed until 2005. In that year, one of the four largest firms exited but the remaining three large firms increased their combined volume by an amount equal to the output of the exiting firm. Since an additional firm then entered the group of four largest, there was a net increase total slaughter of the four largest firms and in their share of total industry slaughter. The share of the four largest then declined in 2006, and is expected to have remained near the 2006 level in 2007.

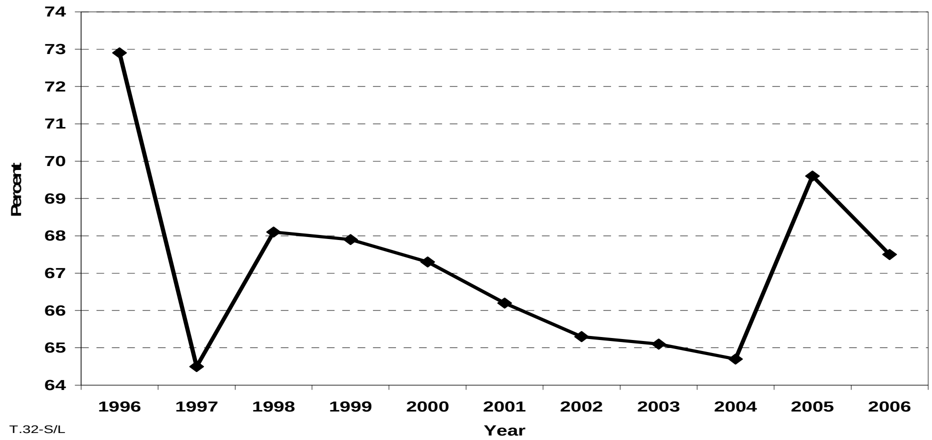

Figure 12. Combined Market Share (by Volume) for the Four Largest Sheep and Lamb Slaughter Firms

E. Poultry Industry

Federally inspected broiler slaughter (measured in pounds of ready-to-cook broilers) has trended upward since 1996, while turkey slaughter has increased only slightly throughout the past 10 years (Figure 13). Current information suggests that slaughter of both types of poultry may have increased in 2007, as through August 2007 total broiler slaughter equaled 99 percent of the volume for the same period in 2006, while total turkey slaughter increased during the first 8 months of the year and totaled 104 percent of the volume for the equivalent period in 2006.[6]

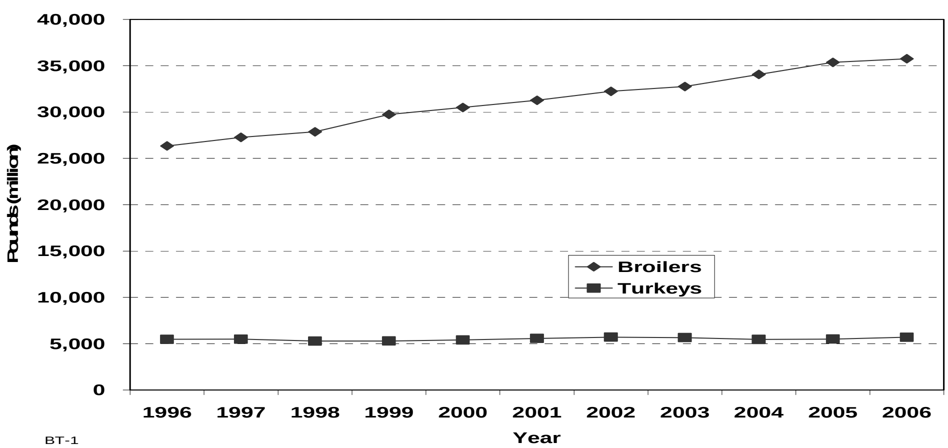

Figure 13. Total Federally Inspected Broiler and Turkey Slaughter (Pounds Ready-to-Cook)[7]

---

[6] National Agricultural Statistics Service, *Poultry Slaughter*, Pou 2-1, September 28, 2007.
[7] National Agricultural Statistics Service, *Poultry Slaughter*, *Annual Summary*, various issues.

Concentration in broiler and in turkey slaughter remained fairly constant from 2003 through 2005, but increased as a result of firm acquisitions in 2006 (Figure 14).[8] Any additional growth among the top 4 firms in 2007 likely will have been offset by restructuring and acquisitions among smaller firms (see section below).

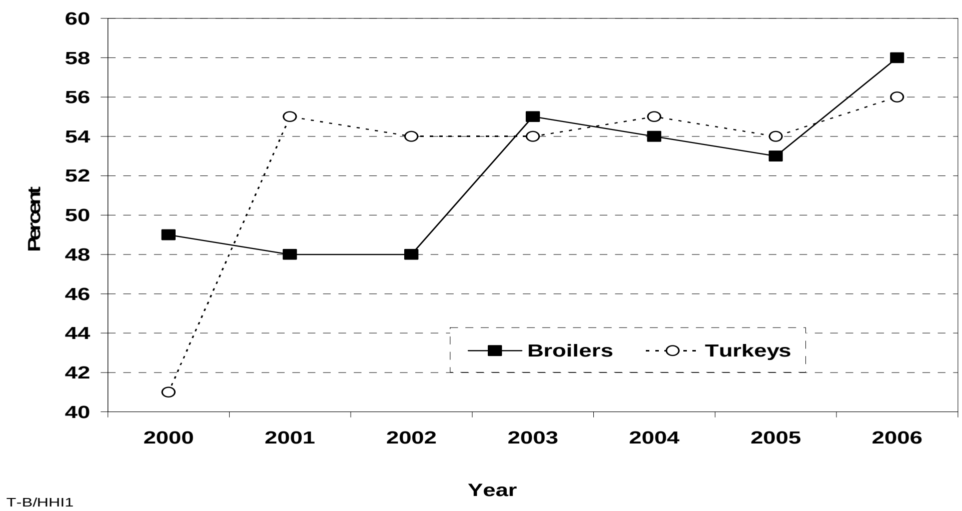

Figure 14. Combined Market Share for the Four Largest Broiler and Four Largest Turkey Slaughter Firms

F. Livestock and Poultry Production

GIPSA does not have jurisdiction over livestock producers and poultry growers and does not obtain data from those operations. The Economic Research Service (ERS) and World Agricultural Outlook Board (WAOB) within USDA devote considerable resources to the tracking and analysis of economic conditions in livestock and poultry production. According to projections by the ERS, the value of livestock production in 2007 is forecast at $140.2 billion, exceeding $100 billion for the fifth consecutive year and $15 billion more than the previous record high in 2005.[9]

---

[8] Concentration or 4-firm market shares reported here for broilers and turkey refers to share of total industry output, rather than share of total industry input as in other sections of this report for livestock slaughter firms.
[9] Economic Research Service, Farm Income and Costs Briefing Room, "2007 Net Farm Income Is Forecast To Be $87.1 Billion**,"** http://www.ers.usda.gov/Briefing/FarmIncome/nationalestimates.htm**.**

II: Changing Business Practices of the Livestock and Poultry Industries

A. Aggregate Livestock Industry

A long-term decline in the number of livestock slaughter firms reporting to GIPSA has been accompanied by a trend toward increased specialization in slaughter. This is illustrated by a greater decline since 1996 in the number of firms slaughtering two or more classes of livestock than in the number of firms slaughtering a single class (Figure 15).[10] The decline in number of firms, however, has followed similar patterns for both types for the last few years, and GIPSA expects small additional declines in both classes to have occurred in 2007.

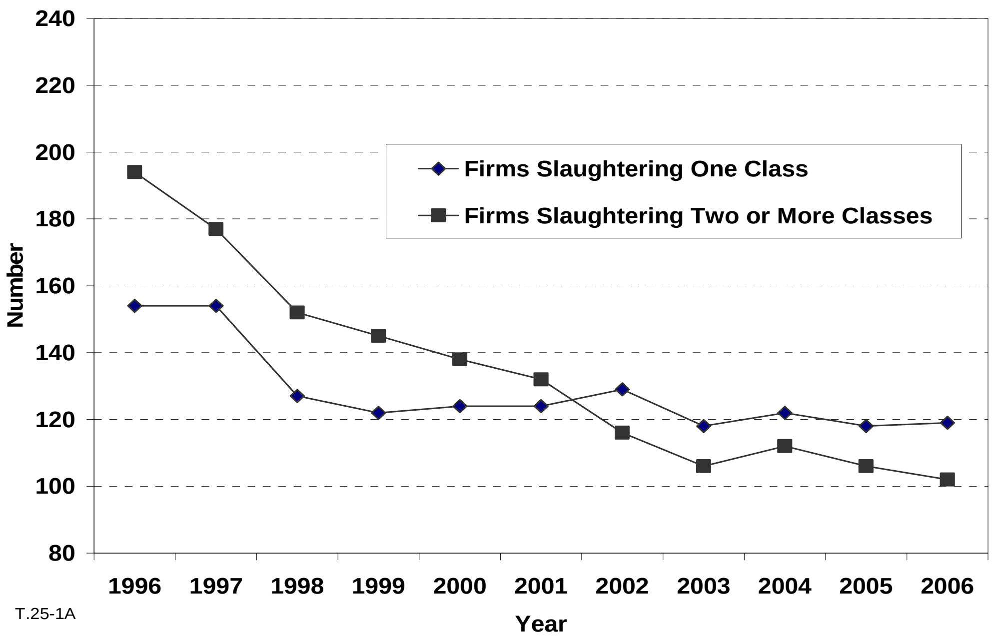

Figure 15. Number of Firms Slaughtering One Class and Number of Firms Slaughtering Two or More Classes of Livestock

B. Cattle Industry

Major Acquisitions, Divestitures, and Plant Closures in the Cattle Industry

There were some major changes in ownership and operations among the largest U.S. beef processing firms. J&F Participações S.A. of Sao Paulo, Brazil, parent company of Brazil's JBS S.A., completed its acquisition of Swift & Co. in July 2007. The new company, JBS

[10] For purposes of this comparison, the separate classes of livestock are steers and heifers; cows and bulls; calves; sheep and lambs; and hogs.

Swift & Co., initiated a second shift at its Greeley, Colorado, beef processing plant in September 2007. It planned for the new shift to have reached its full capacity by January 2008.

Tyson Foods closed its Boise, Idaho, fed cattle slaughter plant in October 2006. In February 2007, XL Four Star Beef reopened the Nampa, Idaho, cow and bull slaughter plant it acquired from Swift & Co. North Star Beef, formerly Minnesota Beef Industries, Buffalo Lake, Minnesota, reopened a plant in September 2007 that had closed in February 2006.

Carcass-Basis Purchases

Purchases of cattle on a carcass basis, as opposed to on a live-weight basis, trended upward from 1998 through 2002 (Figure 16). Since a sharp decline in 2004, the volume stabilized in 2005 and 2006. GIPSA expects the volume purchased on a carcass basis to have increased slightly in 2007.

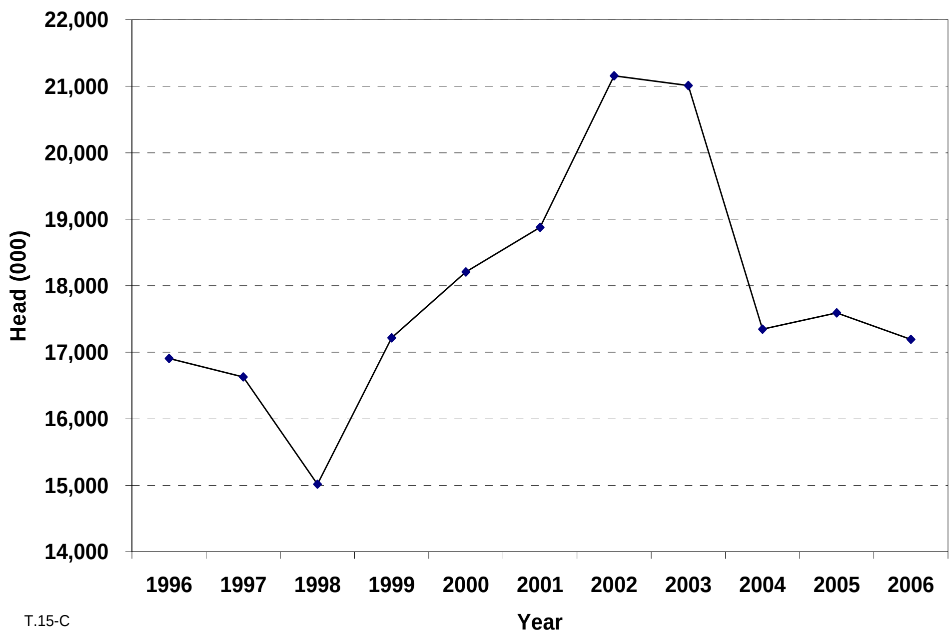

Figure 16. Cattle Purchases on a Carcass Basis

Packers have increased the development and testing of carcass evaluation devices in the beef industry. GIPSA has attended carcass tests conducted jointly by AMS and device manufacturers to evaluate device performance under real-time conditions in packing plants. While these devices are not yet being used as a basis for payment to producers, the industry is poised to augment traditional USDA AMS meat grading services with complex images that provide a "score" of carcasses for both yield grade and marbling.

Procurement Methods

Packers use multiple procurement methods to obtain live cattle for slaughter. The methods commonly fall into two categories: (1) cash sales for immediate delivery or sometimes on a delayed delivery, normally within a 2-week period, and (2) "committed procurement" arrangements that create an assured exchange and commit the cattle to a particular packer in excess of 14 days prior to delivery. Since 1999, GIPSA has collected and audited data on the three major committed procurement methods used by the four largest firms that slaughter fed cattle and, beginning in 2006, it collected the data from the five largest fed cattle slaughter firms. These methods include packer feeding, forward contracts, and marketing agreements.

GIPSA defines "packer fed" livestock as all livestock obtained for slaughter that a packer, a subsidiary of the packer, the packer's parent firm, or a subsidiary of the packer's parent firm owns, in whole or part, for more than 14 days before the packer slaughters the livestock. The percentage of total purchases of fed cattle that are obtained through packer feeding arrangements by the largest steer and heifer slaughter firms declined in 2004 and 2005 but increased slightly in 2006 (Figure 17). GIPSA expects that the percentage of total procurement obtained from packer feeding by these firms will have remained in the 7-8 percent range in 2007.

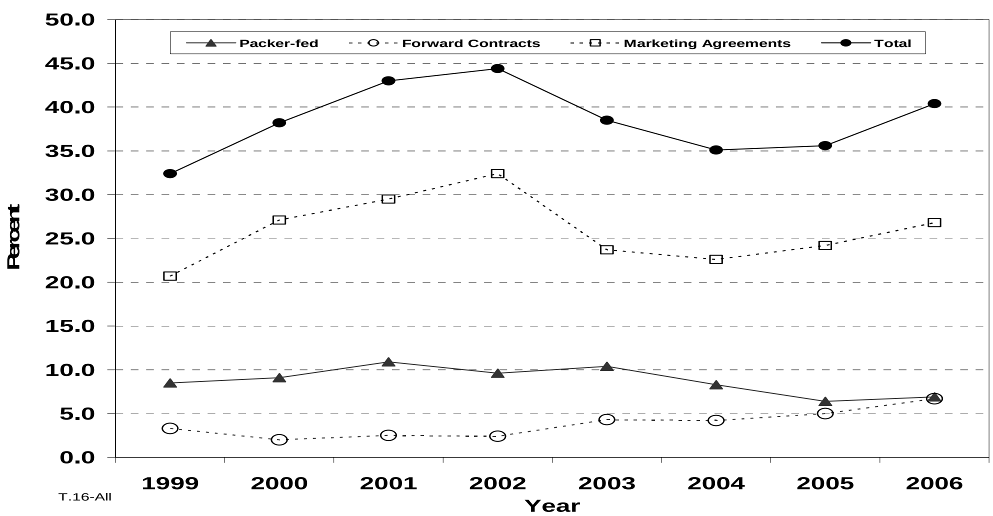

Figure 17. Percentage of Steers and Heifers Procured Through Alternative Types of Committed Procurement Arrangements by the Four (Five) Largest Steer and Heifer Slaughter Firms[11]

[11] Prior to 2006, data refer to the four largest firms. In 2006, data include the five largest firms.

Marketing arrangements termed “forward contracts” are agreements between packers and sellers for future delivery of a specific lot or quantity of livestock. The price of the cattle in a forward contract can be set at the time of the contract or determined upon delivery based upon an agreed pricing arrangement, e.g., using prices from the Chicago Mercantile Exchange futures market for live cattle with an adjustment for the basis at the time of delivery.

The four largest firms’ use of forward contracts has been trending upward in recent years and continued with the addition of the fifth largest firm (Figure 17). The percentage of fed cattle procured through the use of forward contracts by the group of largest steer and heifer slaughter firms may have increased slightly in 2007.

The term “marketing agreements” includes a variety of agreements that establish an ongoing relationship for trading multiple lots of cattle rather than negotiating single lots of cattle. In these arrangements, the seller agrees to deliver cattle to the packer at a future date, with the price generally being determined by some type of formula pricing mechanism. The price is often based on the current cash market at the time of delivery with premiums or discounts determined by evaluation of carcass characteristics. Many of these arrangements commit livestock through an alliance or cooperative of some type.

Of the three categories of committed procurement, marketing agreements account for the largest proportion of total committed procurement. The percentage of fed cattle procured through the use of marketing agreements by the four largest steer and heifer slaughter firms fell in 2003 and 2004, then increased in 2005, and continued to grow in 2006 with the addition of a fifth firm to the group (Figure 17). GIPSA expects that use of marketing agreements will continue to increase and will likely account for between 27 and 29 percent of total procurement in 2007 by the five largest steer and heifer slaughter firms.

Since marketing agreements account for a large portion of total committed procurement, the trend in the percentage of fed cattle procured through the use of all methods of committed procurement closely resembles that for marketing agreements (Figure 17). Total committed procurement (packer feeding, forward contracts, and marketing agreements) by the five largest steer and heifer slaughter firms in 2007 is expected to lie between 42 and 45 percent of those four firms’ total procurement for slaughter.

Importance of Commission Firms

Although the volume of cattle handled by commission firms has trended downward over the last 10 years, these firms continue to play an important role in the cattle industry, particularly for cull cows (Figure 18). While data are not available for 2007, GIPSA expects that the downward trend may moderate somewhat.

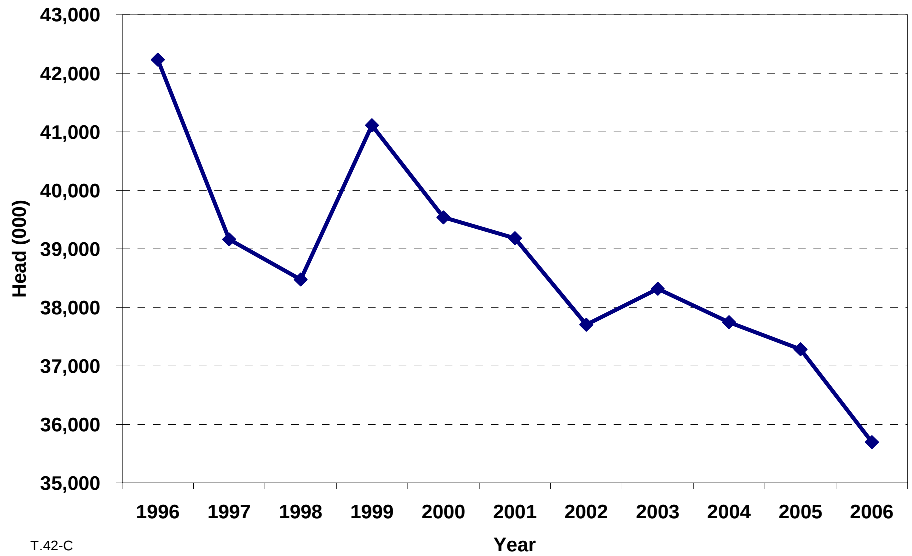

Figure 18. Volume of Cattle (Slaughter and non-slaughter) Marketed Through Firms Selling on Commission

C. Hog Industry

Major Acquisitions, Divestitures, and Plant Closures in the Hog Industry

On October 6, 2006, Smithfield Foods announced completion of its acquisition of ConAgra Foods Refrigerated Meats Business. The products have been renamed under the Armour Eckrich brand, a unit under Smithfield's John Morrell subsidiary. Armour Eckrich also announced the closing of two processing plants this year—in Kansas City, Missouri, and Lufkin, Texas.

On May 7, 2007, Smithfield's acquisition of Premium Standard Farms was finalized. Premium Standard's Milan, Missouri, plant will be operated by Smithfield's Farmland Foods subsidiary, and the Clinton, North Carolina, plant will be operated by Smithfield Packing Company. Both plants are slaughtering and processing facilities.

In February 2007, Smithfield ceased operating the second shift at its John Morrell slaughter and processing plant in Sioux City, Iowa. The shift was restored in September 2007 to supply the Chinese market, which was significantly affected by the outbreak of blue ear disease in China. An additional 3,200 hogs per day, or half a regular production shift, were being slaughtered and processed as of September 2007.

JBS S.A. of Brazil completed its purchase of Swift & Company on July 12, 2007. On March 26, 2007, Sara Lee Corporation ceased operations at its Bryan Foods hog slaughtering and processing plant in West Point, Mississippi. The plant had capacity to process around 6,200 head daily.

Carcass-Basis Purchases

Carcass-basis purchases of hogs have stabilized at high levels in recent years, gradually increasing from 70,000 head in 2000 to 80,000 head in 2005, after increasing more rapidly from 1996 through 1999 (Figure 19). With continuation of long-term trends, carcass-basis hog purchases for 2007 would range between 76.3 million head and 93.4 million head. However, given the trend since 1999, GIPSA expects that the number will have been near the bottom end of the range.

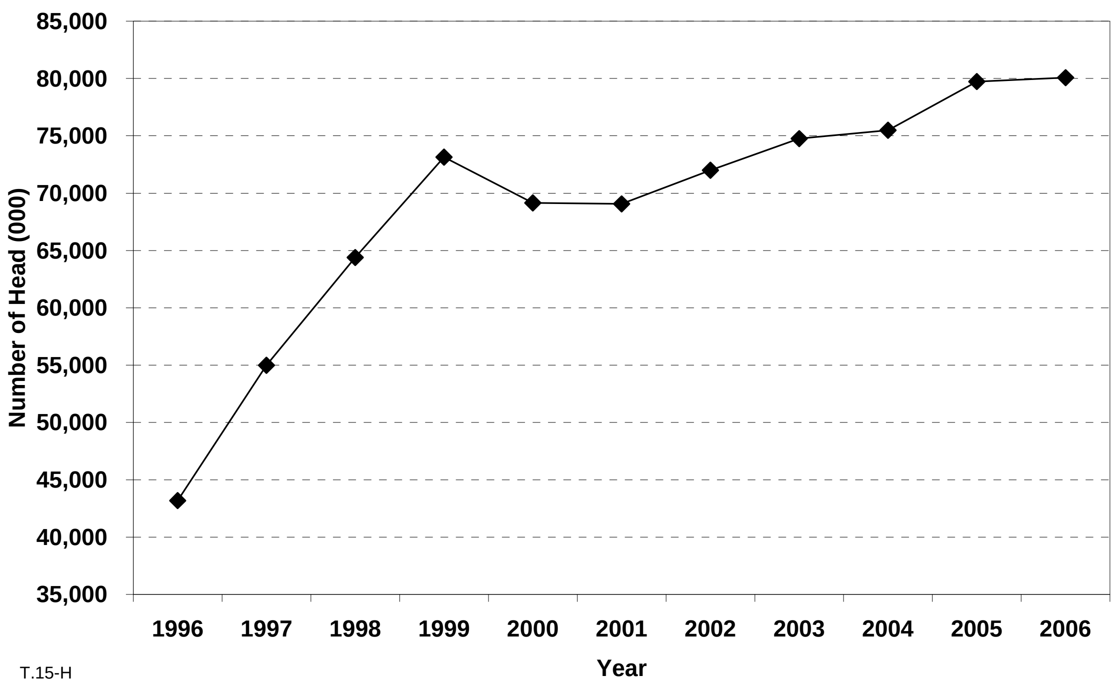

Figure 19. Hog Purchases on a Carcass Basis

Procurement Methods

Production contracts and marketing contracts continue to be the most common methods that packers use to procure hogs. In production contracts, contractors provide hogs, retain ownership, and contract with growers to care for and raise hogs according to contract standards. In marketing contracts, producers who own the hogs contract with a packer to sell them under agreed-upon terms. Although these methods continue to evolve, GIPSA did not observe major changes in the use of production and marketing contracts during 2007.

Importance of Commission Firms

The volume of hogs marketed through firms selling on commission declined from 1998 through 2002 (Figure 20). The volume of hogs marketed through commission firms has trended upward since 2003, and likely will be shown to have continued to increase in 2007.

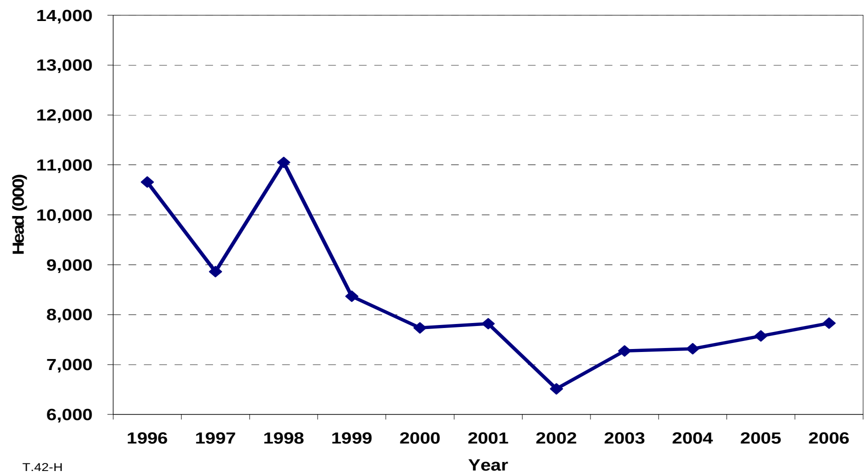

Figure 20. Volume of Hogs Marketed Through Firms Selling on Commission

D. Sheep and Lamb Industry

Major Acquisitions, Divestitures, and Plant Closures in the Sheep and Lamb Industry

Producers Lamb & Goat, L.P., which had started business as a new firm in 2005 by reopening a closed plant previously operated by Rancher's Lamb in San Angelo, TX, ceased operations in the spring of 2006. The closed plant's capacity had been among the largest in the industry.

Carcass-Basis Purchases

The volume of sheep and lambs purchased on a carcass basis has fallen by half since 1996 and continued declining the past 2 years after exhibiting some stability in 2003 and 2004 (Figure 21). The decline in carcass purchases has corresponded to the decline in total slaughter over time, so GIPSA expects that purchases of sheep and lambs on a carcass basis will have declined slightly in 2007 given the expected small decline in total volume of sheep and lamb slaughter noted above.

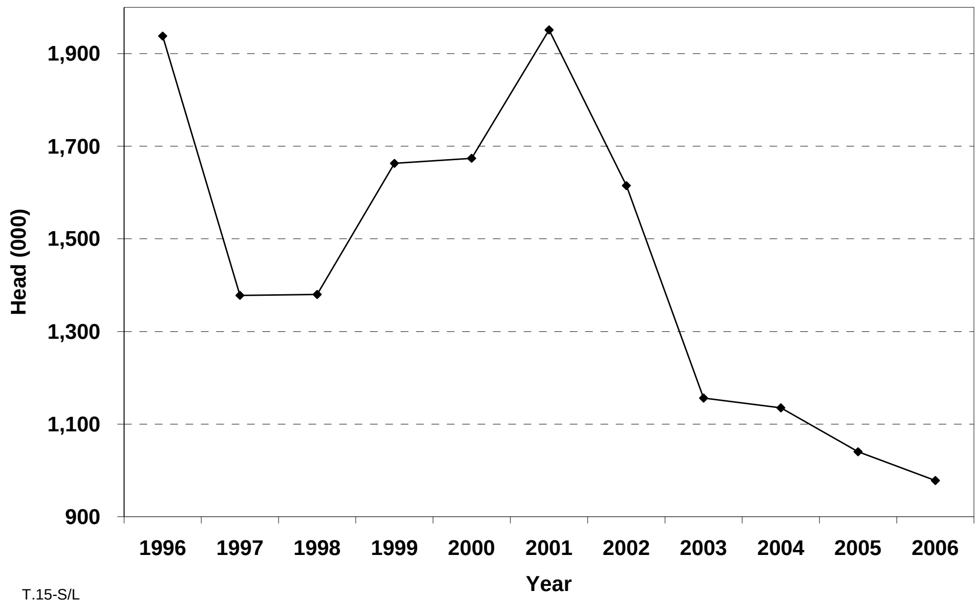

Figure 21. Sheep and Lambs Purchased on a Carcass Basis

Procurement Methods

Procurement methods used in the purchase of sheep and lambs for slaughter are similar to those used for other species and include purchase in spot markets, use of marketing agreements, use of various other forms of advance sales contracts, and packer feeding. Some lamb producers who feed their own lambs market their lambs through a lamb feeding operation or feedlot that has a supply contract agreement with a packer. There are also business arrangements where individuals who have a financial interest in large lamb packing companies also have lamb feeding operations and supply lambs to the packing company. Some producers participate in cooperatives, associations, or pools of lamb producers to collectively market their lambs and lamb products. As with other species, the various procurement methods used for lambs continue to evolve but GIPSA did not observe major changes in the methods during 2007.[12]

Use of Commission Firms

Use of commission firms for the sale of sheep and lambs has followed a downward trend similar to the trends for cattle, but has been constant the past 2 years (Figure 22). GIPSA expects the recent stability to have continued in 2007.

[12] For additional information, see *GIPSA Livestock and Meat Marketing Study, Volume 5: Lamb and Lamb Meat Industries*, Final Report, RTI International, January 2007, http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_5.pdf

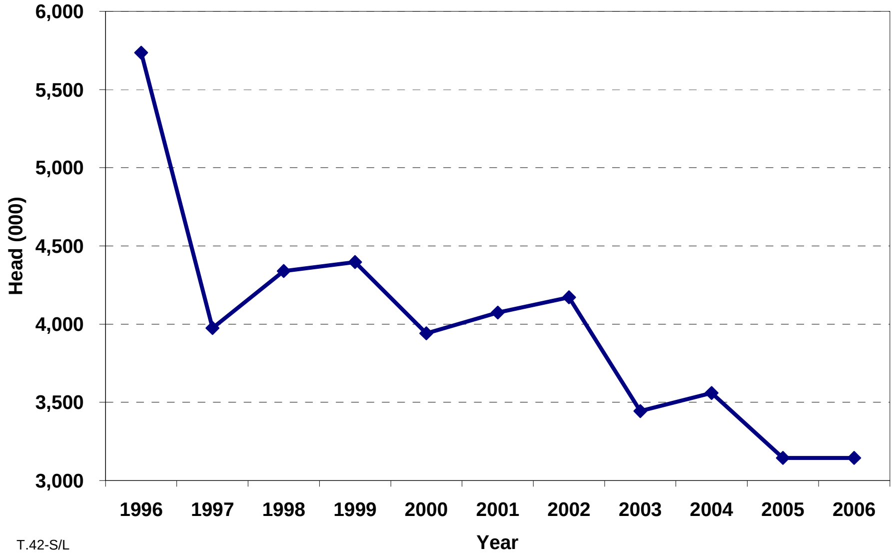

Figure 22. Volume of Sheep Marketed Through Firms Selling on Commission

E. Poultry Industry

Major Acquisitions, Divestitures, and Plant Closures in the Poultry Industry

In 2007 Koch Foods, Inc. purchased two Tyson Foods, Inc., Alabama-based complexes in Gadsden and Ashland. Pilgrim's Pride Corporation, Pittsburg, Texas, completed its takeover of Gold Kist, Inc., making Pilgrim's Pride Corporation the largest broiler processor in the United States.[13]

Procurement Methods

The poultry industry has been almost completely vertically integrated for several decades, and the use of spot markets for poultry is virtually nonexistent. Live poultry production is coordinated through production (grow-out) contracts, company-owned farms, and marketing agreements. In production contracts, the integrator (poultry slaughter and processing firm) owns the birds and the feed and provides them to the contract grower. The grower's compensation is based on the services the grower provides, including labor, housing, water, and in some cases other purchased inputs. In marketing agreements, growers retain ownership of both the birds and the feed, and growers' compensation is determined by the difference between the stipulated price of the finished product and the cost of producing it. There are no marketing agreements in broiler production, but they are used in turkey production. GIPSA did not observe any major changes in the basic industry structure and procurement methods used in the poultry industry in 2007.

---

[13] *Watt Poultry, USA, February 2007,* http://www.wattpoultryusa-digital.com/wattpoultryusa/200702/?pg=14&search=rankings&per_page=5&results_page=1&doc_id=-1

Changing Production Technology

Genetic and nutritional improvements in broiler production have increased the efficiency of broiler meat production, but reaching the full genetic and growth potential of broilers requires a controlled environment in the broiler house. Housing construction, equipment, and operating methods affect the efficiency of broiler houses. Contract growers continue to face rapidly rising energy costs. Some older houses that are currently structurally capable of growing birds are rapidly becoming “energy obsolete” because of high operating costs. Although modernization of broiler houses may benefit some growers by improving their productivity, the modernization cost of upgrading broiler houses will most likely fall directly on the growers with a possible net negative effect on the cash flow of some broiler operations.

III: OPERATIONS OR ACTIVITIES IN THE LIVESTOCK AND POULTRY INDUSTRIES THAT RAISE CONCERNS UNDER THE PACKERS AND STOCKYARDS ACT

Industry Annual Reports

Regulations issued under the authority of the P&S Act require that every packer, live poultry dealer, stockyard owner, market agency, and livestock dealer, unless exempt, file a report annually with GIPSA.[14] Completeness and timeliness of these annual filings are a concern to GIPSA. Firms operating on a fiscal-year basis must file their report not later than 90 days after the close of their fiscal year. Firms operating on a calendar-year basis must file their report not later than April 15, which is the latest a report can be received without being late in a given filing year. GIPSA grants extensions of up to 90 days to firms that report difficulty in completing reports by the firm's established due date. Not counting extensions, for the 2006 reporting year GIPSA received 46 percent of its reports late (or the forms were so incomplete as to require re-filing). Receiving a large percentage of late or incomplete annual reports affects other GIPSA operations adversely, including timely determination of bond requirements; custodial account and firm solvency validations; accurate determination of active businesses; and public reporting requirements GIPSA itself must meet. Statistical analysis shows a high positive correlation between late reports and other violations of the Packers and Stockyards Act that do directly affect sellers.[15]

GIPSA Actions

GIPSA had historically relied heavily on voluntary compliance, including granting extensions and working with respondents to correct and complete reports. Starting in 2006, GIPSA began identifying firms with a history of repeated late filings, or incomplete filings, and developed cases to be referred to the Office of the General Counsel (OGC) for processing in conjunction with the Department of Justice (DOJ). Because the filing of a late report is a violation of Section 6 of the Federal Trade Commission Act, these cases are prosecuted by Assistant U.S. Attorneys within the Department of Justice. Fines can be substantial (in the $10,000 range) based on a $110 per day assessment for each day the report is late. In fiscal year 2006, 4 files were referred to OGC for review and transmittal to DOJ, and in fiscal year 2007, 35 files were forwarded to OGC. In addition to seeking stronger enforcement action, GIPSA is examining its annual report forms and has contacted industry associations to schedule meetings within industry to determine if there are options available that would facilitate timely reporting including formats for electronic submission of data and less detailed forms. GIPSA will also consider regulations in 2008 that would establish a 5-year registration limit to aid in tracking active businesses.

[14] As noted in Section I of this report, since 1977 packers that purchase less than $500,000 of livestock on an annual basis have been exempt from filing an annual report with GIPSA.
[15] The 2007 composite compliance rate was 73 percent for regulated industry behavior that directly affects sellers.

Structural Change and Increased Coordination in Meat Packing

Concerns about increases in concentration and related changes in industry structure, and the perception that these changes are inherently anticompetitive continue to be expressed as criticisms of economic efficiency within the livestock and meat industry. Although concentration has stabilized somewhat in recent years in some segments of the livestock and meat industry, continued mergers and acquisitions, plant closings, and plans of leading firms to build new plants all suggest concentration and structural change will continue to be a source of concern. With increasing concentration (share of total market or production at a given stage), there has also been an increase in consolidation of control by individual firms. Consolidation refers to changes that often reduce the number of firms but also increase individual firms' coordination and control of activities across stages of the production and marketing system. Increased cross-stage coordination and control are often associated with use of production contracts, marketing contracts and ownership of production operations at another stage in the production and marketing system.

GIPSA Actions

GIPSA has administrative authority in the livestock sector under the P&S Act and acts to enforce the Act and enhance competitive markets. GIPSA does not have authority to review or to prevent mergers and acquisitions, but often cooperates with and lends its industry expertise to DOJ in its review of mergers in the livestock, meatpacking, and poultry industries.

Changes in industry structure, such as concentration levels and vertical integration, tend to alter the focus GIPSA has on particular firms and behavior. These industry-wide changes reflect the dynamics of competition, and hence are not prohibited by the P&S Act. It is important to note that many of the changes in coordination associated with industry consolidation may also provide for improved economic performance of the industry, that is, lower processing costs and consumer prices. Also, structural change can lead to downstream market alliances to facilitate penetration of retail markets with branded products to increase consumer choices. Merger and acquisition activity in recent years has increased the market shares of firms with management expertise in supply channel management across channels, including value-added processing and branded product retailing. The capability to increase branded retail products depends on high levels of input supply management to achieve uniform and high levels of packing plant utilization, and production of carcasses that can be processed into uniform retail products.

In fiscal year 2003, GIPSA received $4.5 million in appropriations for a broad study of marketing practices in the entire livestock and red meat industries from farmers to retailers, food service firms, and exporters. The study addressed many questions and concerns that have been raised about changes in the structure and business practices in the livestock and meat industries. RTI, International Inc. delivered a final report in the late fall of 2006, and GIPSA publicly released the report in February 2007 after briefing Congress on the results of the study.[16] The study provided a quantitative analysis of prices and of costs-benefits of alternative marketing arrangements, and it assessed the implications of potential future changes in the use of various types of marketing arrangements, including packer feeding.

The study found that alternative marketing arrangements provide net benefits to producers, packers, and consumers, and that net economic losses would result from restrictions on the use of such arrangements.

In particular, the study found that packers and consumers receive better quality and more consistent product as a result of alternative arrangements, and producers receive value for better quality livestock. All parties are better able to set delivery/sale dates. The arrangements help to stabilize the flow of supply, and provide cost savings in sellers and buyers interactions to arrive at a market price (i.e., the price discovery process). In general, the use of alternative marketing arrangements provides livestock buyers and sellers with improved risk management options that lower costs or allow for the creation and capture of greater value.

Currently, GIPSA inspects the procurement records of the five largest fed cattle packers to verify firm reporting accuracy for cattle procured under alternative marketing agreements, including cattle procured through packer ownership, forward contracts, market agreements, and the spot market. In 2008, GIPSA will expand its inspection of procurement practices to include the five largest hog packers. GIPSA's review assists in correctly categorizing the cattle procured under contract into one of the committed procurement methods, or alternatively into a non-committed method. The review also contributes to available information on the trends and methods by which the packers procure cattle.

Adequacy of Bonds for Regulated Entities

The P&S Act provides that the Secretary may require packers, market agencies, and livestock dealers to have reasonable bonds (7 USC§204). The regulations issued under the P&S Act prescribe bond requirements and bonding formulas for market agencies either buying or selling on commission or acting as clearing agencies; for livestock dealers; and for packers purchasing over $500,000 of livestock annually. These entities must maintain a bond or bond equivalent to protect unpaid livestock sellers. The bonding formulas, last modified in 1983, rarely provide full coverage to livestock sellers when a bonded entity experiences financial difficulty. Between fiscal years 2002 and 2007, sellers who were not paid as a result of financial failures by market agencies selling on commission recovered between 35 and 78 percent of their total claim amounts each year. During the same period, the recovery rate ranged between 5 and 21 percent for livestock sellers owed by dealers that failed financially. Members of the livestock industry and Congress have expressed

[16] Copies of the report can be obtained at:
http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=lmp&topic=ir-mms.

concerns about the adequacy of bonds and GIPSA is concerned about the low recovery rates and the effect on orderly marketing of livestock.

GIPSA Actions

GIPSA has analyzed options to improve the recovery rate of payment owed to livestock sellers. GIPSA is preparing to publish an Advance Notice of Public Rulemaking in the *Federal Register* in fiscal year 2008. The notice will seek public comment on an industry-wide bond increase and on an additional increase for regulated entities identified as a high risk.

Transparency of Market and Dealer Information

Livestock sellers have indicated to GIPSA that they have difficulty obtaining information about the tariff schedules of markets and bond protection levels carried by livestock dealers, markets, and packers. This is nonproprietary information that should be readily available to sellers.

GIPSA Actions

To facilitate improved access to public information of businesses regulated under the P&S Act, GIPSA will initiate Web postings in 2008 of the bond levels carried by regulated entities and their tariff schedules if applicable.

Live Poultry Dealer (Poultry Processor-Integrator) Requirements To Upgrade Broiler Housing Types

A range of poultry housing technologies is currently in use in the broiler industry. Older conventional houses are generally equipped with fans for circulating air and curtains on the house for ventilation. Conventional houses continue to be replaced with broiler houses utilizing tunnel ventilation and cool cells enhancing the ability to control the birds' environment. This added control allows growers to produce birds more efficiently using less feed, with lower mortality rates and a reduction in the age of the broiler to reach target weights. These efficiencies in turn reduce the live poultry dealer's costs of growing broilers. These new houses may also benefit growers by allowing live poultry dealers, i.e., integrators, to place more birds per square foot in houses in the summer, increasing output per square foot of house and thus payments to growers.

Adoption of the new technologies requires the grower to make substantial investments in new housing or improvements to existing broiler houses. In order to encourage growers to adopt these technologies, integrators often offer a higher base pay, base pay adjustments, or bonuses on top of normal pay to growers producing in houses using the improved technologies. These practices may result in different growers receiving different compensation per pound for producing the same size broiler. Moreover, the growers using improved housing technologies have an advantage when competing with growers using older technologies under the relative performance payment systems used in many broiler contracts. Under relative performance payment systems, a group of growers receives birds for feeding simultaneously. Payment to an individual grower is in part determined by the cost per pound to the integrator for birds grown by that grower relative to the cost per pound for birds grown by other growers in the group. In addition, more favorable contract terms, such as longer contract length, may be offered to growers using the improved housing technologies.

GIPSA Actions:

Differences in contracts or payments are not prohibited by the P&S Act unless they constitute engaging in or using an unfair or unjustly discriminatory or deceptive practice or device in commerce, or unless they constitute making or giving, in commerce, an undue or unreasonable preference or advantage, or result in undue or unreasonable prejudice or disadvantage as between persons or localities. Live poultry dealers may have valid business reasons for requiring upgrades to broiler houses, and growers may benefit from increased productivity and reduced growing costs. Many courts have found that to constitute a violation of the P&S Act, such practices must be shown to result in an adverse impact on competition or that they are likely to produce an adverse competitive impact. Examples of practices that potentially could be deemed unfair include:

- Live Poultry Dealers may offer contracts to some of their poultry growers with less advantageous contract terms than those offered to other poultry growers without a justifiable and reasonable business reason.

- Live Poultry Dealers may abuse their power by requiring poultry growers already under contract to make significant capital improvements in their operations as a condition for continued placement of chicks, or other benefits, with no guarantee that the growers will continue to be offered contracts or placements of chicks for a period long enough to recover their investment.

GIPSA continues to actively monitor developments in this and other areas of concern to determine whether action is warranted, and, if so, the nature of the action.

U.S. DEPARTMENT OF AGRICULTURE GRAIN INSPECTION, PACKERS AND STOCKYARDS ADMINISTRATION PACKERS AND STOCKYARDS PROGRAM	**ANNUAL ASSESSMENT REPORT COMMENT FORM**

Thank you for your interest in GIPSA's Report, *Assessment of the Livestock and Poultry Industries*. As a means of both improving the publication and gaining insight on the issues arising in the cattle, hog, poultry, and sheep industries we invite your comments and ideas for future publications.

1. Please indicate which area of the report you found to be the most useful (please check one box):

❑ General Economic State ❑ Changing Business Practices ❑ Operations or Activities that Raise Concerns

2. Please indicate which area of the report you found to be the least useful (please check one box):

❑ General Economic State ❑ Changing Business Practices ❑ Operations or Activities that Raise Concerns

3. Please rate your overall satisfaction with the report (please check one box):

❑ Excellent ❑ Good ❑ Average ❑ Poor ❑ Very Poor

4. Please identify each industry you are involved with (please check all that apply):

❑ Cattle ❑ Hog ❑ Poultry ❑ Sheep ❑ Other: ____________

5. Please identify your primary role(s) in the industry:

❑ Producer ❑ Processor ❑ Packer ❑ Stockyard ❑ Feedlot ❑ Other: ____________

6. **What changing business practices have you witnessed in the livestock, poultry, or meat industry?**

____

____

7. **What concerns in your industry would you like us to address in future publications?**

____

____

8. Additional comments or suggestions:

____

____

9. If you would like to provide your contact information, please do so below.

Name: ____
Last Name First Name

Business Name (if applicable): ____

Mailing Address:____
Street

____
City/Town State Zip Code

E-mail Address: ____

Telephone Number: (including area code) ___________________________________

Thank you for your response to this questionnaire.

Please submit the completed questionnaire using one of the following methods:

1) Mail the document to the following address:
   Grain Inspection, Packers and Stockyards Administration
   Packers and Stockyards Program, Assessment Report
   1400 Independence Ave. SW, Stop 3647
   Washington, DC 20250-3647
2) E-mail the form to: pspiad.gipsa@usda.gov with the subject line as "Assessment Report," or
3) Fax the form to: (202) 690-1266, ATTN: Assessment Report Coordinator.

Instructions for Completing
The Annual Assessment Report Comment Form P&SP-6020

You may use any of the following methods to submit the form:

1) Mail the document to the following address:
   USDA Grain Inspection, Packers and Stockyards Administration
   Packers and Stockyards Program, Assessment Report
   1400 Independence Ave. SW, Stop 3647
   Washington, DC 20250-3647
2) E-mail the form to: pspiad@usda.gov, with the subject line as "Assessment Report," or
3) Fax the form to: (202) 690-1266, ATTN: Assessment Report Coordinator.

Line No.	Subject	Instruction
1.	Most Useful Part of the Report	Check the appropriate box to indicate which part of the report you found most useful.
2.	Least Useful Part of the Report	Check the appropriate box to indicate which part of the report you found least useful.
3.	Overall Satisfaction	Check the appropriate box to indicate your overall opinion of the report.
4.	Industry Segment	Check the appropriate box(es) to indicate each livestock category you work with.
5.	Industry Roles	Check the appropriate box(es) to indicate your primary roles in the livestock, poultry, or meat industries.
6.	Changing Business Practices	Enter a description of the changing business practices that you noticed during the past year.
7.	Industry Concerns	Enter a description of the concerns you experienced in the livestock, poultry, or meat industries over the past year that you would like us to address in future publications.
8.	Additional Comments	Enter any additional comments that will help to improve future annual assessment reports.
9.	Contact Information	Enter your name, business name, mailing address, e-mail address, and telephone number.