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Good News and Bad News

The economic crisis gripping the world financial markets is both good news and bad news for the poultry industry. The bad news is the falling demand for all consumer goods including chicken meat. The good news is that falling demand has seriously eroded the value of grains, and in particular the cost of corn and soybeans. Corn is now just half the price it was just three months ago. When this crisis passes, the lower price of grains should remain while the demand for chicken rebounds. There is light at the end of the tunnel.

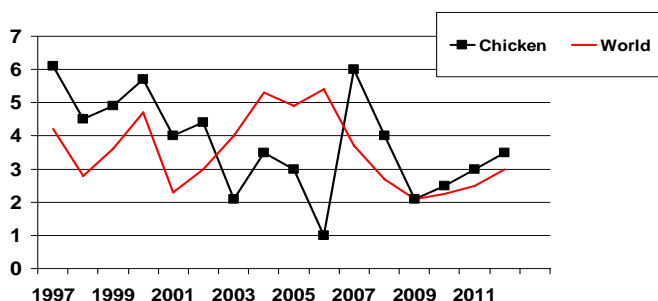
The Bad News

The world consumption of chicken meat is income elastic. That means that when world personal income rises, the consumption of chicken can be expected to increase. The flip side of the coin is that when income falls, chicken consumption is reduced.

Currently the world is experiencing the negative “flip” side of the coin. Income growth is slowing in many areas. Fewer people are able to increase their purchases of chicken meat. Therefore, the worldwide production and consumption of chicken is likely to grow slowly in the next year or so.

As can be seen on the chart, the world economy is currently in a free fall from a growth rate of 5% in 2006 to just 2% (or less) in 2009. It is logical that chicken growth will be falling as well from 6% in 2007 (post bird flu bounce) to 2% in 2009. Both will recover beyond 2009.

World Economic Growth and World Chicken Growth in %



FAO and IMF

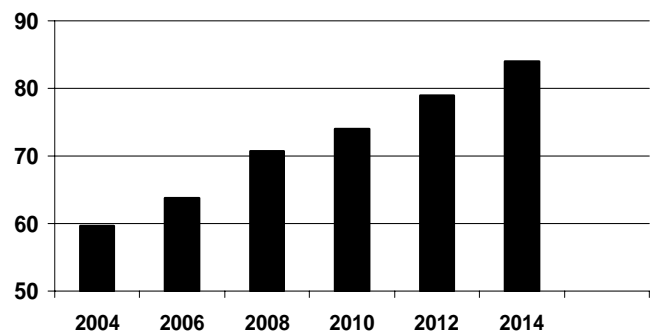
The Economist magazine projects the following increase in global, Brazilian, Chinese and US economic growth. As can be seen in the numbers, even economies like China and Brazil are likely to experience a slowdown in the rate of increase next year and these numbers may well be revised downward.

	Global	Brazil	China	US
2007	3.7%	5.4%	11.4%	2.2%
2008	2.7%	4.6%	9.8%	1.5%
2009	2.1%	3.4%	8.5%	0.5%

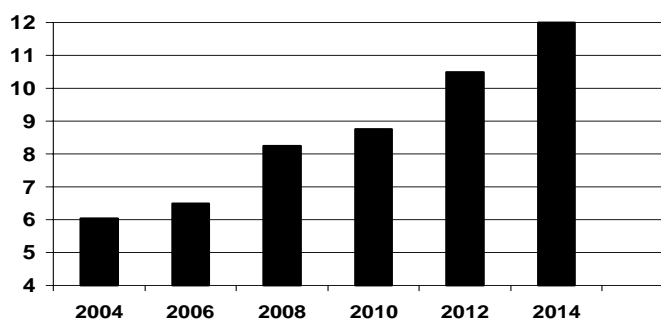
Total World Chicken Production

With slowing world growth, world chicken production can be expected to grow relatively slowly in the next two years before increasing more rapidly from 2010 forward. Similarly, after a 25% increase in just two years, chicken trade growth can be expected to moderate in the next two years before accelerating again from 2010 forward.

**World Chicken Production
Millions of Metric Tons – USDA to 2008**



**World Chicken Trade
In Millions of Metric Tons – USDA to 2008**



The worldwide slowdown in the demand for chicken meat combined with the world credit crisis and high grain prices to produce a chicken crisis. The effects of the crisis can be seen in the stock exchange value of the largest chicken company in the US and the largest chicken company in Brazil. Although each story is different, each company was affected by the world economic downturn and each made an untimely bet.

Pilgrim's Pride, the largest chicken producer in the US made an untimely bet on the price of corn which led to hedging losses. The unfortunate timing of the corn purchase was compounded by the overall weakness in the chicken meat market in the US and the difficulty of raising additional credit in the current market downturn. One year ago the stock traded at \$40 per share. As the industry got caught in the whipsaw of rising grain prices and falling chicken prices, the value of Pilgrim's stock sank throughout the year to reach \$14 at the beginning of September. Then, in a dramatic development, the stock fell to as low as \$2 per share, a loss of 95% in 12 months. The market value of Pilgrim's Pride (price per share times the number of shares) dropped from \$3 billion a year ago to a low of just \$150 million. The company is likely to survive but it has been profoundly shaken by the experience.

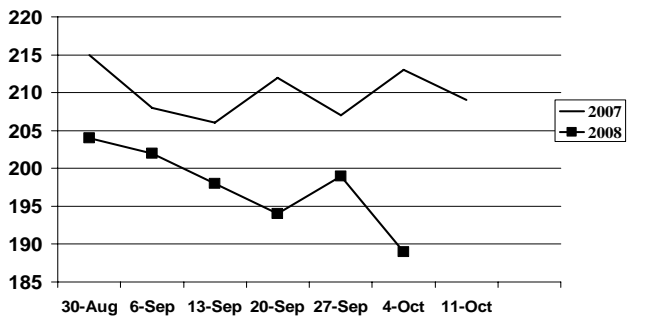
Sadia, the largest chicken company in Brazil has experienced a similar drop in the value of its shares. Sadia made an untimely bet of the value of the US dollar which caused the company to lose hundreds of millions of dollars. The stock which was as high as \$26 per share earlier this year fell to just \$7 per share after the currency debacle. The market value of Sadia has dropped from \$1.8 billion to \$500 million. The falling value of the local currency is a two edged sword. Although Sadia lost money on currency bets, the lower value of the local currency will improve the competitiveness of Brazilian chicken in the international market.

What will happen to the World Chicken Industry?

Although there are pockets of strength in the world chicken market, the overall world situation is weaker than last year because the deepening world economic downturn. As a result, the increase in the world production of chicken meat is likely to slow down over the next year. As demand catches up with supply, most chicken companies in most countries should return to faster growth and better profitability in 2009 or 2010 at the latest.

There is a temporary surplus of meat in many areas, most notably in the US. However, the US industry is now finally reacting to the crisis. The latest numbers for eggs set in the US show that the US industry is getting serious about reducing the production of hatching eggs and therefore the production of chicken meat. As can be seen on the eggs set numbers below, there is a widening divergence between the eggs set in 2007 and 2008. This should lead to significantly lower chicken production starting at the end of the year. If this trend continues, profitability should return to the US industry at the beginning of next year.

Weekly US Eggs Set in Millions



The Good News, Grain Prices

The bad news about the demand for chicken meat is offset somewhat by the good news about corn and soybean prices. The same forces that have destroyed demand for all consumer goods including chicken are destroying demand for grains as well. Grain prices can therefore be expected to be no higher in crop year 2008-2009 than they were in crop year 2007-2008. This is a significant change from the earlier expectation that this crop year would see much higher prices.

The latest results from the USDA show that although the corn harvest is smaller than last year and the ending inventory is relatively small at only 1.1 billion bushels, nevertheless, prices may be no higher than last year thanks to the slowing use of corn for feed and reduced worldwide demand.

Since the corn harvest is still in the early stages, the final harvest is still a unknown at this point. The danger to the upside is that the USDA may be too optimistic about the final harvest numbers.

Corn – USDA – Billions of Bushels

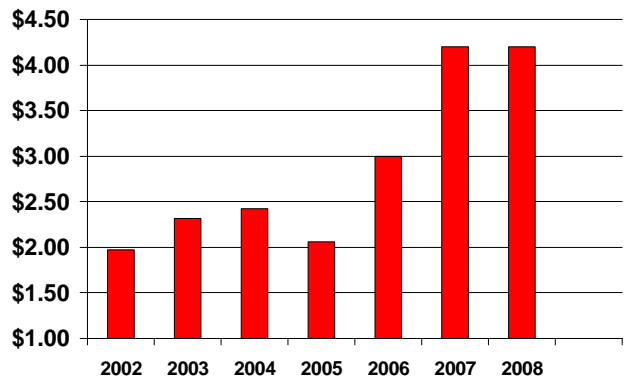
	2005-2006	2006-2007	2007-2008	2008-2009
Harvest	11.1	10.5	13.1	12.2
Ethanol	1.6	2.1	3.0	4.0
Feed	6.1	5.6	6.1	5.4
Total Use	11.2	12.6	12.8	12.7
Ending Inventory	1.9	1.3	1.6	1.1
Price on the Farm	\$ 2.00	\$ 3.04	\$ 4.20	\$4.20 - \$5.60

The USDA farm level price forecast of between \$4.20 and \$5.60 for this crop year is in marked contrast with the current farm level price of just \$3.90. This would seem to suggest that the USDA believes current prices are unusually low on both the farm and in Chicago and that prices will rise significantly during this crop year.

If the USDA is right, that prices are temporarily low, then there is currently an important buying opportunity for chicken companies. Commodities of all kinds were dumped by speculators in the last few months regardless of the underlying fundamentals. The selling may have been over exuberant.

Although the farm price of corn is only \$3.90 at the moment, the farm price of corn can be expected to average at least \$4.20 per bushel this crop year, the same as last year. With the farm price at \$4.20, the price in Chicago can be expected to average close to \$4.50 per bushel. Therefore, the current price of \$4.08 in Chicago for December and \$4.25 for March may be a bargain for this crop year.

Farm Corn Price – \$/Bushel – Crop Years



Similarly with soybeans, the USDA projects the farm price to be somewhere between \$9.60 and \$11.10 per bushel this crop year. However, the cash price at the moment on the farm is just \$9. Therefore, \$9 per bushel must be a bargain. Soybean meal is expected to drop from \$335 per short ton last crop year to \$290 per short ton this crop year.

Farm Soybean Price - \$/Bushel

