

THE BEEF OUTLOOK

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DISEASE DOMINATES

- ❑ **BSE:** Has disrupted the global meat trade since the UK crisis began in the mid-1980s. Has cost the U.S. and Canada \$14 billion so far despite only five home-grown cases. Still shut out of Japan, Korea
- ❑ **FMD:** Afflicted the UK, Taiwan and South America in recent years. Brazil has several new cases that will severely impact its beef exports for some time. Brazilian and Argentine fresh beef remains cut out of North America and parts of Asia
- ❑ **AI:** Avian influenza decimates poultry flocks in parts of Asia, moves into Europe
- ❑ **RESULT:** Market instability in the three major meats

Key Market Factors In 2006

- ❑ Beef demand was down 3% in the first three quarters of 2005 compared to 2004. Will likely stay weaker than year ago into 2006. Pork demand still solid but depends on strong exports
- ❑ Key factor is gas/winter heating costs and their impact on consumers' disposable income. Hurts beef most
- ❑ Meat and poultry supplies will be larger: Beef up 2-4% to 25.1 to 25.9 billion lbs, pork up 1-2% to 20.9 to 21.1 billion lbs, broilers up 2.4-3% to 36.3 to 36.5 billion lbs, turkeys up 1.3% to 5.5 billion lbs
- ❑ Beef exports to Japan and South Korea should resume but will be small. Will only reach 15-20% of 2003 shipments by year end
- ❑ Cattle and hog slaughter will be slightly larger
- ❑ Beef processing margins will remain under pressure. May result in more plant closures and consolidation

Supply Factors-Beef

Domestic numbers

- ❑ 2005 production: 24.6 billion lbs, almost flat with this year, say private analysts. USDA has output up 1.1% at 24.8 billion lbs
- ❑ 2006 production: 25.1 billion lbs, up 2%. USDA forecasts 25.98 billion lbs, up 4.6%. That's way too high, say analysts
- ❑ Cattle on feed numbers Oct 1 – 100% of last year
- ❑ Front end supply is smaller than earlier forecast and will increase less than normal to February 1
- ❑ Carcass weights are heavier than last year but close to peak
- ❑ U.S. herd is growing after nine years of liquidation. USDA's midyear report confirmed modest increase in cattle numbers
- ❑ All Cattle and calves = 104.5M, 100.9% of 2004, the first increase since 1995. Beef cow replacements = 5.0M, up 4.2%. 2005 calf crop = 37.8M, up 0.5%, also the first increase since 1995.
- ❑ All Cattle total Jan 1, 2006 might be 2% higher than in 2005

Supply Factors-Beef

- **Scarcity of domestic lean**

- ❑ U.S. lean or manufacturing beef supplies have been tight for two years and will remain tight into 2007
- ❑ U.S. F.I. cow slaughter 1996 = 7.30 million head
- ❑ 2005 = 4.90 million head (est.)
- ❑ 2006 = 4.97-5.15 million head (forecast)
- ❑ Historically low cow supplies force several plant closures
- ❑ Beef costs rise for QSR chains and other users. More chains use BPI's lean boneless beef and imported beef. Wendy's uses imported beef for first time, with up to 30 loads per week from Australia. Its beef costs in its third quarter rise 18%. McDonald's third quarter U.S. costs rise 10%, will rise 8% for year. Its European beef costs rise 17%, will rise 14% for year
- ❑ Will be modest expansion of domestic lean beef supplies in 2006, mostly BPI product as fed cattle slaughter will increase slightly

Supply Factors-Beef

- **Import uncertainties**

- ❑ One uncertainty was removed July 14 when a federal appeals court set aside an injunction that had postponed the border's reopening to Canadian cattle
- ❑ That allowed cattle under 30 months of age (fed cattle direct to slaughter and younger cattle only to designated feedlots) to enter the U.S. for the first time since May 20, 2003
- ❑ The first cattle crossed the border July 18. Most unlikely that any further legal events will close the border again
- ❑ BUT 30 and over cattle and beef are still banned. USDA is working on a rule. But it may not appear until early 2006
- ❑ Will USDA allow Brazil to start exporting fresh beef to the U.S. in 2006? Or will latest FMD cases delay this until 2007 or later?

Supply Factors-Beef

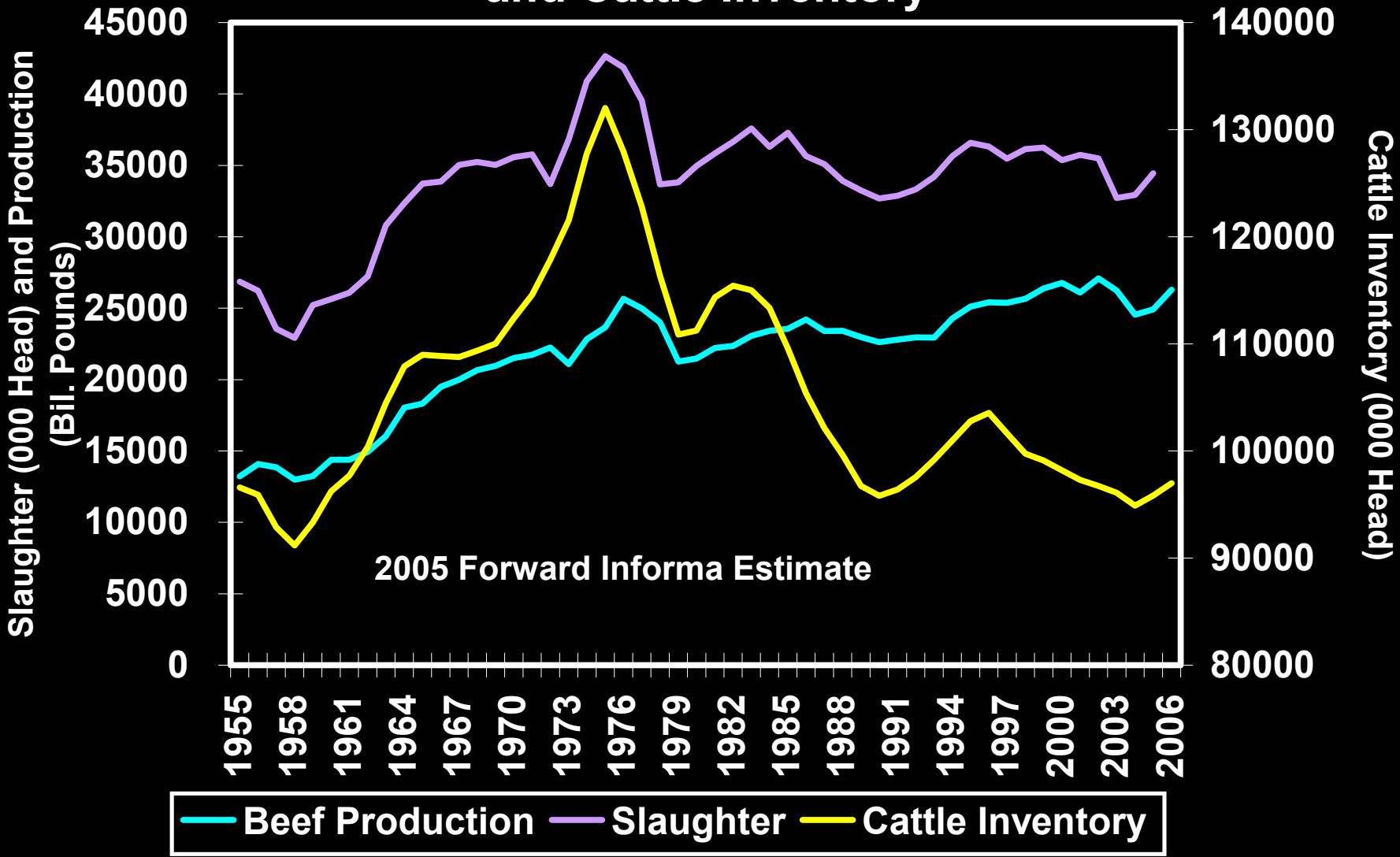
- **FMD Hurts Brazil**
 - ❑ Brazil became the world's largest beef exporter in 2004. Exported 2.2M MT to 150-plus countries. This gave it 24% of global exports, with Australia 20%, Argentina 10%. U.S. had 3%
 - ❑ Brazil expected its exports to increase 20% in 2005. But FMD cases in early October have dealt a big blow to this
 - ❑ Brazil spent \$2.3 billion in past decade to eradicate FMD. But something broke down in Mato Grosso do Sul. 50% of Brazil's beef exports come from that state. Brazil now faces the loss of \$1 billion in exports unless countries accept Brazil's argument that it has completely contained the disease
 - ❑ Uruguay: Exported record 360,000 MT in 2004, with 129,000 MT out of quota to U.S. Passed that total this year by Sept 15

Supply Factors-Beef

- **Canadian supply**

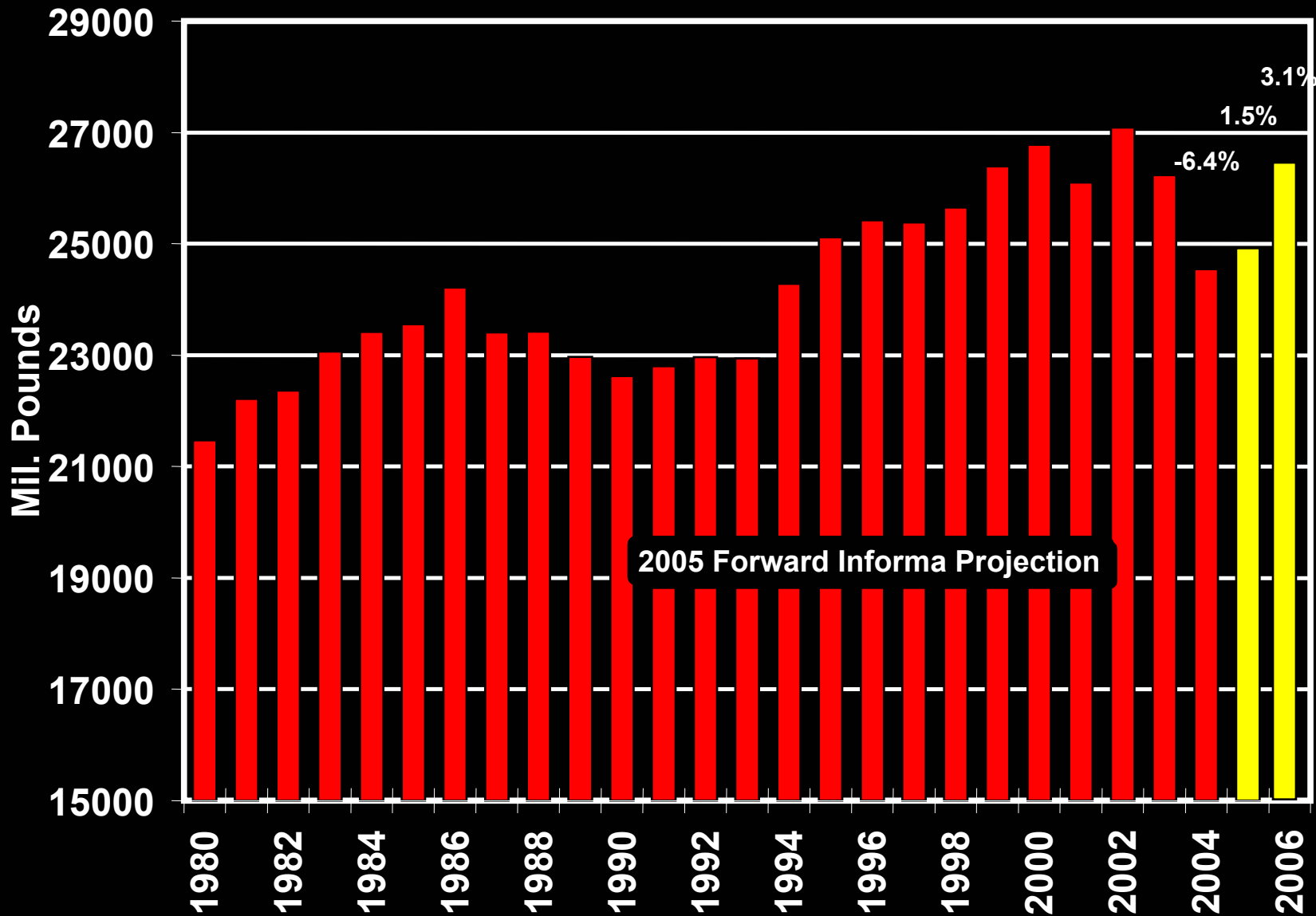
- ❑ Canada shipped 1.1 billion pounds of boneless beef from under-30 cattle in 2004 to the U.S. Can now ship carcass beef and other under-30 beef items.
- ❑ But Canada can't send any cow beef to the U.S. Yet it has a huge backlog of cull cows – 915,000 head on July 1
- ❑ Canada's fed and feeder cattle exports to the U.S. so far run below the 1998-2002 average. Has been no market impact on U.S. cattle prices, despite what R-CALF warned of
- ❑ Shipments are unlikely to exceed these levels. Canada has increased its processing capacity; its fed cattle prices are much closer to U.S. prices; there is no surplus of Canadian fed cattle; Alberta is most economical place to feed cattle in North America
- ❑ Overall supply from Canada will increase only slightly

Commercial Cattle Slaughter, Beef Production, and Cattle Inventory

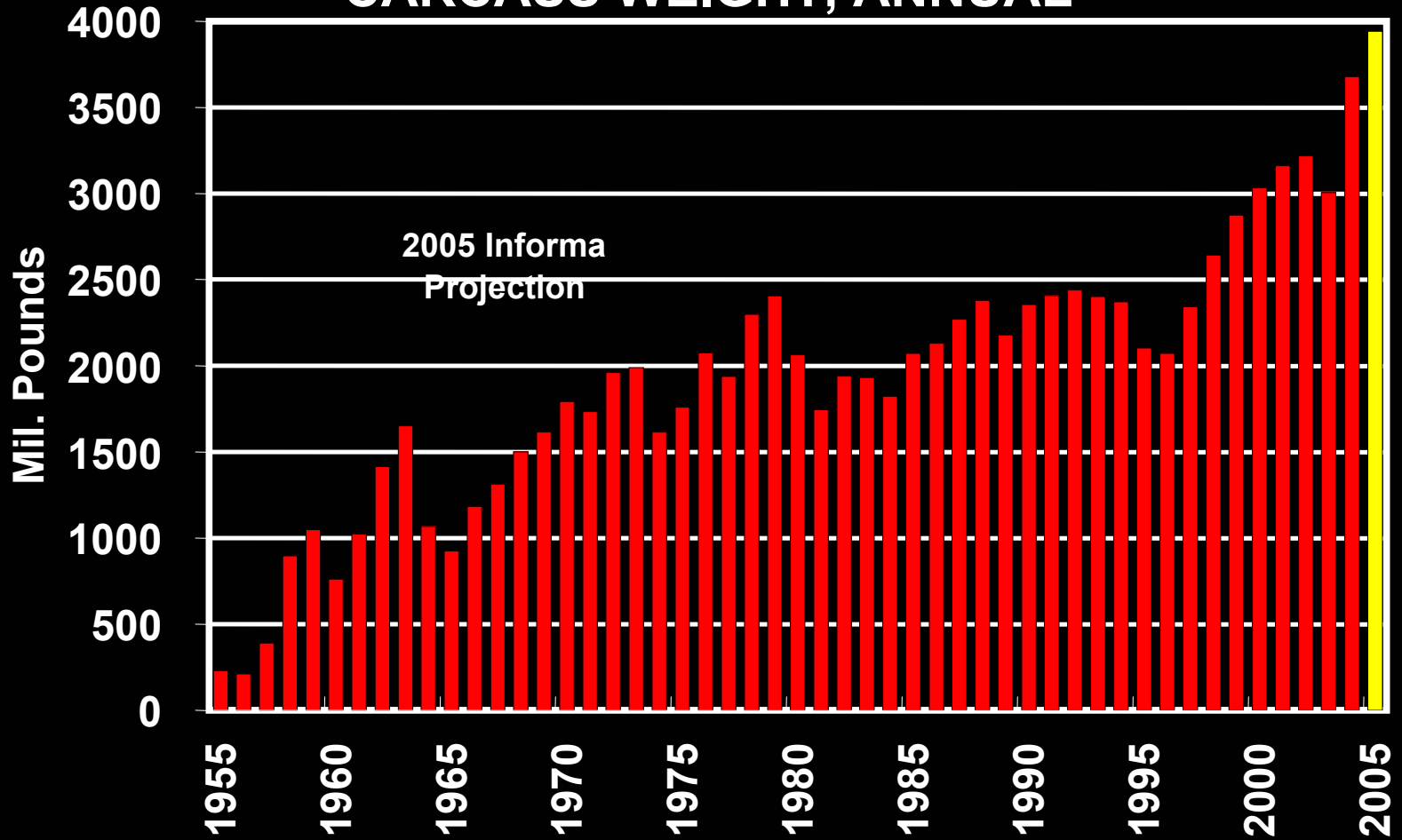


COMMERCIAL BEEF PRODUCTION

Annual



BEEF & VEAL IMPORTS CARCASS WEIGHT, ANNUAL



Supply Factors-Beef

- **Plant closures**
 - ❑ Border was closed to all Canadian cattle for 26 months. Still closed to cattle 30 months of age and older (OTM). They may not cross for another year. Packers understandably want border reopened to OTM cattle and beef at the same time
 - ❑ Packing industry has lost 7800 jobs since May 2003
 - ❑ Packers suffered losses from July 2004 to mid-April, the longest period of red ink in history. Margins improved this spring but slumped in July. Packers lost money in 12 of the last 14 weeks, with losses averaging \$14 per head
 - ❑ Losses and closed border forced the closure of five U.S. processing plants. More are at risk, especially cow processors

Canada The Competitor

- **Self-sufficiency**

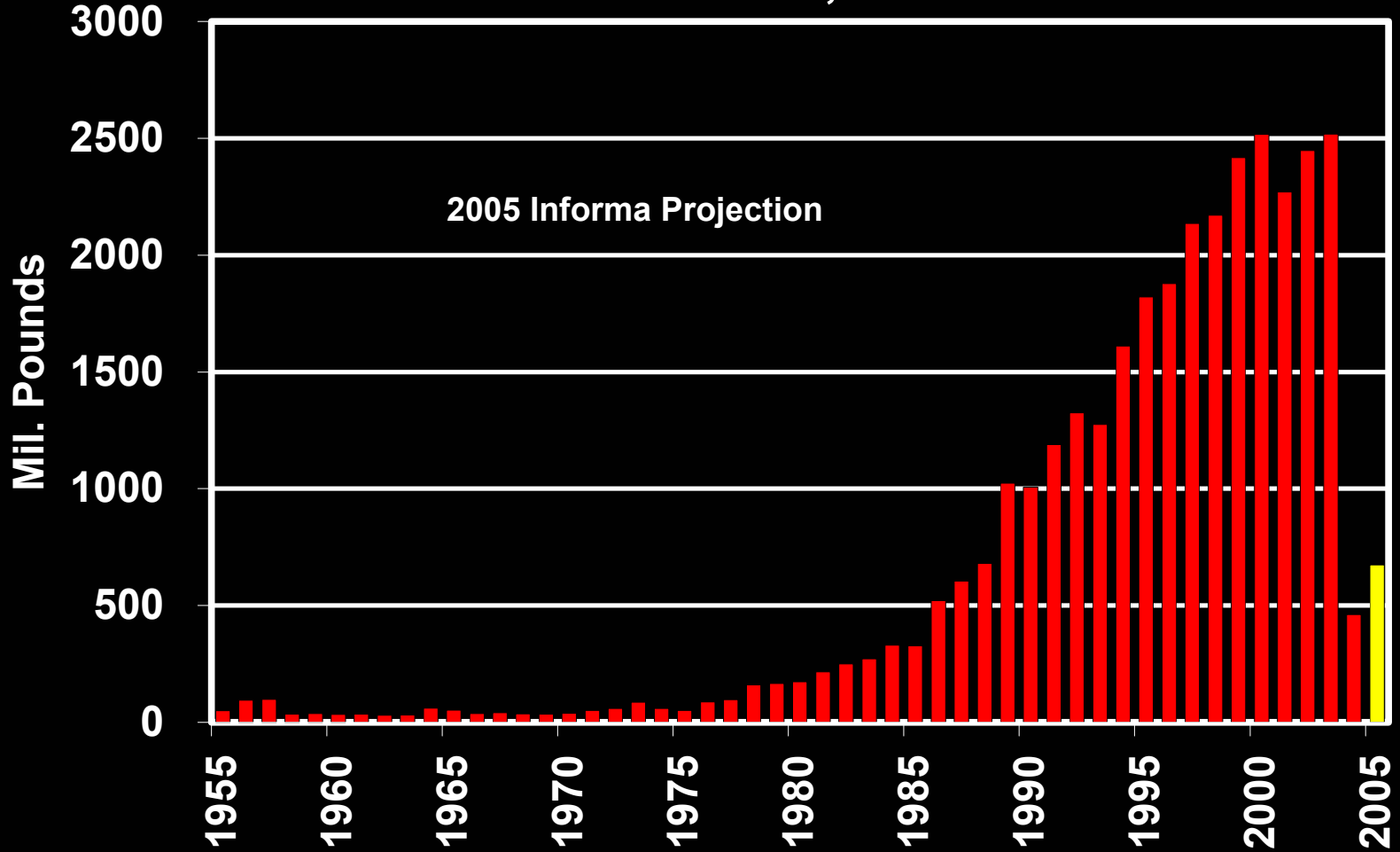
- ❑ Canada has goal of self-sufficiency in cattle slaughter/beef processing. It added 1 million head of capacity 2002-2004. It continues to add capacity in 2005, from 85,000 to 95,000 per week
- ❑ This puts at risk some of the 30-plus U.S. plants that previously processed Canadian cattle
- ❑ Border might remain closed until mid to late 2006 for older cattle, and therefore to Canadian manufacturing beef
- ❑ Canada might start exporting to Japan before the U.S. because of its superior age verification system
- ❑ Events of the past two years have turned Canada into a competitor rather than a complementary part of the U.S. beef industry

Demand Factors-Beef

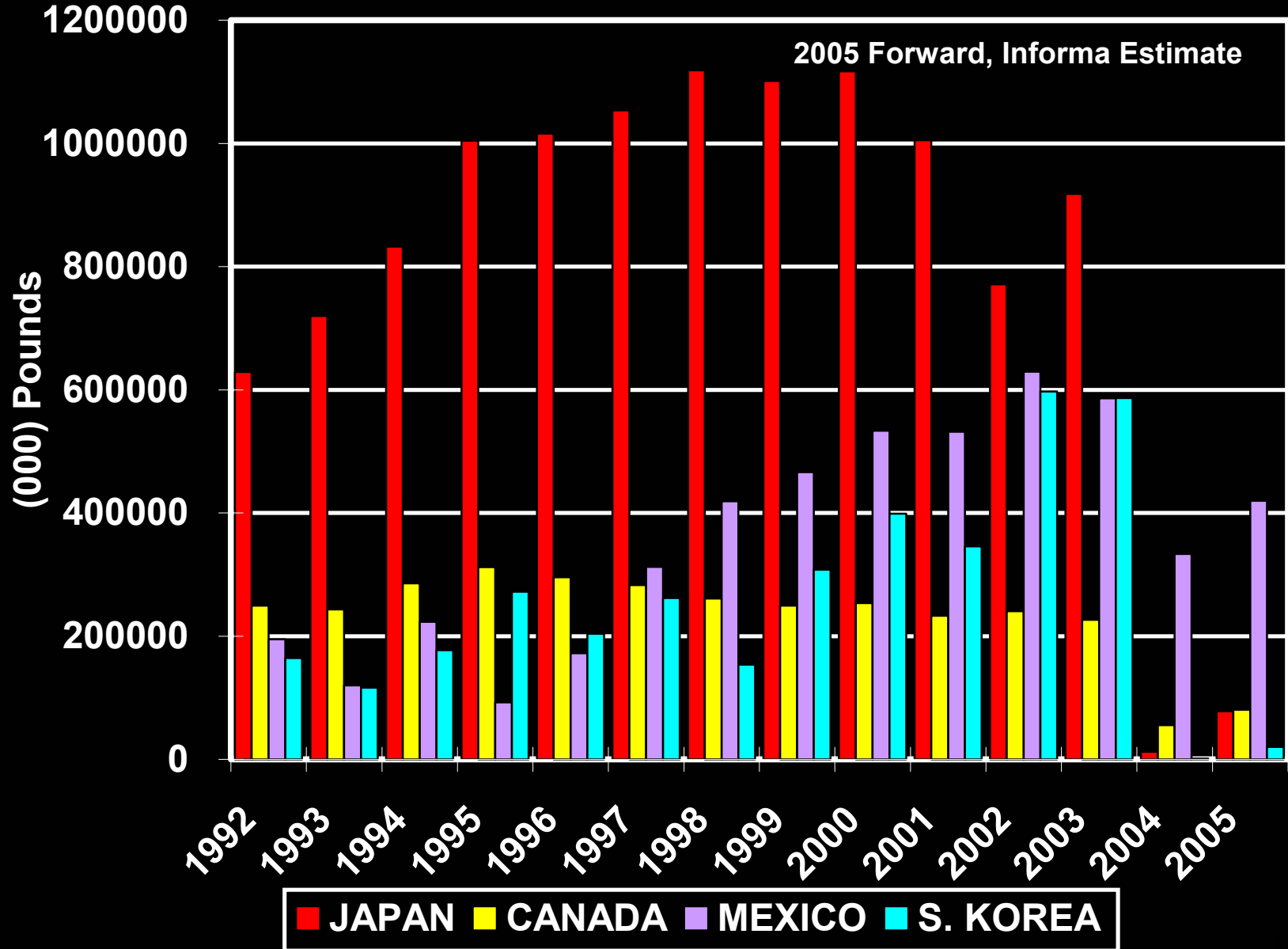
- **Energy costs**

- ❑ Supply will determine the price trend, demand the price level
- ❑ Gas (autos) and home heating costs will be critical factor. Heating costs will rise 30-50% this winter, says Energy Dept
- ❑ Since mid-July, the 43% increase in crude oil prices has taken \$100 billion out of consumers' discretionary income (analyst Andrew Gottschalk). In same period, natural gas costs increased 83%. Impact has yet to be fully seen
- ❑ Americans' love affair with low-carb diets has waned. Peaked in Feb 2004 with 9% of American on such diets. Now under 5%, according to latest data from NPD Group
- ❑ Real impact is beef's high price relative to other proteins. So retailers aren't featuring beef as aggressively as in previous years, also because of market volatility and supply uncertainties

BEEF & VEAL EXPORTS CARCASS WEIGHT, ANNUAL



BEEF EXPORTS TO MAJOR DESTINATIONS



Demand Factors-Beef

- **Asia's go-slow**

- ❑ U.S. beef has been shut out of Japan and South Korea since Dec 2003. They accounted for 60% of all U.S. exports, \$43M per week
- ❑ October 23, 2004: U.S. and Japan announce “framework agreement”. The term means different things to each side
- ❑ Aug 1, 2005: Japan no longer requires 100% domestic BSE testing. But it has yet to issue a rule for imports. Final approval must come from Japan’s Food Safety Commission.
- ❑ Oct 24, 2005: FSC’s prions expert committee meets. But it delays its final report. Congress and industry get even madder but threats of a trade sanctions won’t hasten process
- ❑ Prion panel may meet in next 10 days. If it recommends U.S. beef is safe, Ag and Health Depts. have to agree to final FSC report. A 30-day comment period will follow. Then an amended import rule must be published. It will be well into 2006 before trade resumes

Demand Factors-Beef

- **Japan will be tough re-entry**
- ❑ Only 15-20% of U.S. fed cattle will initially qualify. Smaller firms that have supply agreements and/or source-verified programs will benefit most
- ❑ U.S. beef is “tainted” in eyes of Japanese consumers. Japan’s 45 prefectures continue blanket BSE testing as consumers want it. So there will be a double standard at retail for domestic and U.S. beef when the latter re-enters Japan
- ❑ Australian beef has deepest ever market penetration. It exported 393,500 MT in 2004. It forecasts 430,000 MT in 2005
- ❑ Exported 172,00 MT of grain-fed beef in 2004, up 55%. Its COF numbers June 30 were record large and up 24% from year earlier
- ❑ U.S. will have to buy its way back into Japan
- ❑ U.S. faces similar challenges in South Korea when that market reopens

To Summarize

- **Another volatile year ahead**
 - ❑ Demand will be key market factor in 2006
 - ❑ Slightly larger overall beef supplies but manufacturing beef supplies will remain tight
 - ❑ Asian exports may start in first quarter 2006 but will be a trickle the first few months. Will still be less than 20% by the end of the first year of trade
 - ❑ Packer margins will remain tight. Expect to see more plant closures and/or consolidation
 - ❑ USDA tests more than 500,000 cattle for BSE. Now testing 20,000 apparently healthy older cattle. Possibility of a third BSE case still exists. Will impact only if found in a healthy animal