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Caution follows reprieve for Morrell

BYLINE: By, Anna Bahney

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Like many longtime residents of Sioux Falls, Craig Gronewald doesn't have to look far for a connection to its 100-year-old John Morrell plant.

He hauled meat out of there for more than a decade as a truck driver, he said looking across a snowy expanse toward the plant from the nearby Silver Moon tavern.

This week's announcement that Morrell's plant in Sioux City, Iowa, would close April 20 left him and others in Sioux Falls sad for the workers there but relieved it wasn't the Sioux Falls plant.

"There's other packing plants in Sioux City that can take up some of the slack," said Gronewald, who now works for a construction company. "Here, this is all we have. We dodged the bullet this time, I guess."

That sentiment is shared by many in Sioux Falls.

Just as the announcement that Sioux City's plant will not have one single effect on the region, it was not caused by one single factor. It was a confluence of elements, including a tightening hog supply, the financial situation of Smithfield Foods and the changing consumer marketplace for pork.

Further fluctuation in any of these factors - or those that affect them, such as the price of corn or the reopening of pork exports to China - could result in another shift within the pork packing and processing industry.

In a sector as volatile as this, the Sioux Falls plant is not, and probably never will be, entirely in the clear.

For Sioux City, the immediate hardship of the plant closing will create ripples of economic effect well into the future - and not only negative ones. The plant has a payroll of \$35 million and an annual economic jolt of \$450 million, according to Sioux City officials. It employs 1,450 workers.

For employees at the Sioux Falls plant 80 miles to the north, the closure of the Sioux City plant creates job preservation, said Randall Stuefen, professor emeritus of economics at the University of South Dakota and head of Stuefen Research in Vermillion.

"By better using the capacity they have in Sioux Falls, they will have more work for people," he said.

Dwindling hog supply - or numbers deception?

To hear Smithfield tell it, a tightening in the hog market precipitated the closing of this plant.

"In the Midwest, we have begun to have trouble getting enough hogs to run these plants," Smithfield CEO Larry Pope said in the company's most recent quarterly earnings conference call with investors in December.

"For the first time, we are really having days when we are having trouble filling the kills out. I think you probably will see a plant or two ... I think you will see a plant go down. If not one, maybe two."

Indeed, one has.

"Smithfield found themselves with the least-efficient plant," said Steve Meyer, livestock and meat marketing economist and president of Paragon Economics, which consults with the Pork Board.

He said that depending on the price of corn, further actions, including another plant closing, might be required.

"As tight as we are with corn for ethanol, there is still some risk with having some financial problems down the road," said Meyer, whose biggest fear is the return of \$6 a bushel corn.

U.S. inventory of hogs and pigs was 65.8 million head Dec. 1, down 2 percent from the year before, according to the hogs and pigs report from the U.S. Department of Agriculture. In the four-state area around Sioux Falls, including South Dakota, Minnesota, Iowa and Nebraska, there were 900,000 fewer hogs in December than a year before.

Still, historically, that's a lot of pigs.

From 2000 to 2006, the number of hogs and pigs ran from 58 million to 62 million. In 2007, the number jumped to 68 million. It has come down since.

"That drop is only relative to the last few years where we've had these unusually high number of pigs," said Matt Diersen, agricultural economist at South Dakota State University.

"I don't know where Smithfield would be coming up with the shortage in their numbers," he said. "It is just not obvious."

Put simply, Diersen said, "There are too many pigs,"

He said that the U.S. has experienced incredible increases in productivity and expansion.

"On some level, regardless of feed cost, it is hard to ignore the increase in supply."

Of course, he said, he's not privy to the same numbers Smithfield has.

It could be that the winnowing of Smithfield's own herd - 13 percent in the past year and a half and an anticipated 3 percent to 5 percent this year - could be the equivalent of the capacity at Sioux City.

It could be that Morrell wasn't getting the contracts in that area. It could be that the company could have seen that it was down almost 1 million head in this area for the year and the number available for slaughter is down by a number similar to Sioux City's capacity.

Some hog supply has been cut off by the recent mandatory labeling requirements, in which each pork product must be identified by its country of origin. The transport of Canadian hogs into this region has fallen off.

Or, he said it could be the company figures the farrowing numbers could continue to decline for a longer period of time.

"But that's a lot of 'ifs,'" Diersen said. "And if that's the case, why didn't they do this before?"

Perhaps because it wasn't just the hog supply that caused the plant to close.

Smithfield tries to trim fat, reinforce financial health

Smithfield Foods, despite being a company with \$12 billion in sales, the leading processor and marketer of fresh pork and packaged meats in the U.S. and the country's largest producer of hogs, is not in prime financial shape.

But it is trying.

A year ago, Smithfield announced it was embarking on a corporate restructuring of its pork business by closing six factories and cutting 1,800 jobs.

The plan, now completed and not inclusive of the Sioux City plant closing, was designed to regain \$55 million in fiscal 2010 and \$125 million the following year. None of that has yet been realized.

The company, which also is a producer of hogs, suffered mightily from the high costs of hog production - including \$6 a bushel corn it had to chew through - in the past two years. That has caused it to lose about \$20 a hog. This, among other complications in 2008 and 2009 such as high energy costs and tight credit markets, resulted in a \$190 million loss for the company in the fiscal year that ended last May 2009 vs. an income of \$128.9 million the year before.

It marked the first loss the company had experienced in three decades. Losses continued into the next quarter, when it was down \$107.7 million.

By September, the company had reduced its herd size by 13 percent and embarked on a \$300 million stock offering. In December, the company assured investors it planned to be profitable by the second half of fiscal 2010.

The stock, which closed at \$16.13 on Friday, has a 52-week low of \$5.55 and 52-week high of \$17.62.

According to industry analysts, the closure of the Sioux City plant was a demonstration of discipline within the industry and will have a positive effect on other pork packers - perhaps even greater benefits than for Smithfield itself.

Shift from pork production to packaged meats

The closure of the Sioux City plant is in line with the company's strategy to get out of the pork production business - where profits are lower than historical averages - and into the packaged meats business, according to Kenneth Zaslowsky of BMO Capital Markets.

"While Smithfield Foods' actions are moderately positive to the company's performance over the long-term, it may limit hog production margins," he said, adding it also reduces Smithfield Foods' overall pork packing capacity.

Zaslow said that while the positive effects for Smithfield are "somewhat questionable," it is definitely good for other pure pork packers such as Tyson, "given that it improves the balance between hog supply and demand and indicates ongoing discipline within the pork packer industry."

A huge part of the equation for American pork producers such as Smithfield are exports, and they are down for Smithfield and the entire industry.

The volume leader in American pork exports is Mexico, and the company said it hopes to see those exports continue to grow.

But exports took a big hit this year as China and Russia imposed bans on imported pork in the wake of the H1N1 virus, while trying to rebuild domestic industry. Last year, those countries were responsible for 80 percent of the drop-off in the value of U.S. pork exports and 116 percent of the volume decline, according to the U.S. Meat Export Federation.

It is expected that the borders will reopen for American pork, but that hasn't happened yet.

In its announcement of the Sioux City closing, Smithfield said the plant was one of its oldest, most outdated and least efficient.

The 1959 plant, with few modern improvements, limited the company's "ability to produce value-added packaged meats products."

Consumer demand turns to processed pork

Demand for pork, especially the easy-to-prepare variety, is growing. Through restructuring, Smithfield has made packaged meats such as hams, bacon and sausage - the company's core emphasis.

Sioux City slaughtered hogs and fabricated fresh meat, unlike Sioux Falls, which can process a full variety of packaged meat.

Pork consumption went up for both fresh and processed pork from 2006 to 2009, with annual consumption of fresh pork increasing by 1.2 percent and annual consumption of processed pork increasing by 2.2 percent. But the number of times people eat each type a year still is vastly different.

Americans consume fresh pork 20.9 times a year and processed meat 77.6 times a year.

"Further processed and easily prepared meats are in higher demand," said Cindy Cunningham of the Pork Board.

"Folks don't have time to cook like they used to, and they want a product that makes them feel like they've had a full home-cooked meal, and these are products that allow them to do that when they get home from work and have kids running around in less time."

According to the Pork Board, of the pork consumed in American homes in the two years leading up to August 2009, 79 percent was processed pork such as ham, bacon and sausage. Only 21 percent was fresh pork such as chops, ribs or roasts.

Ham was the most consumed type of pork, either as an entree or lunchmeat making up 31.4 percent of the pork consumption during that time, according to the same study done by NPD's National Eating Trend. Bacon and sausage were almost even in consumption at 19.8 percent and 18.2 percent.

In short, people are buying processed pork products, and Smithfield wants to be in the game.

If there is any shining spot for the company, it is its profits from packaged meat. Smithfield's profits from packaged meats were \$131.1 million last quarter, up from \$40.4 million in the same quarter the year before.

"I couldn't be more pleased and more optimistic about what I think the packaged meats business is going to do for this company," Pope said in last month's earnings call.

He said changes made by the company to focus on packaged meats are vital to its future.

"This is propelling this company's profitability," Pope said, "and were it not for the changes we've made in that, the company's financial situation would have been worsened significantly over this last year."

Reach reporter Anna Bahney at 331-2326.

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