Testimony of

Dillon Feuz

May 7, 2008

The potential market impacts of the proposed merger of JBS Swift and Company with National Beef Packing Company, Smithfield Food's beef operations and Five Rivers Ranch Cattle Feeding

May 7, 2008

Dillon M. Feuz Professor Livestock Marketing Specialist Utah State University

Overview

Issues of concentration, market power, and vertical coordination are not new issues for the beef industry. They have been a part of the industry for well over 100 years. Congressional involvement in the beef industry also has a long history. The Sherman Act of 1890, the Packer and Stockyards Act of 1921, and "The Consent Degree" of 1922 were all in response to concerns over mergers between packers, stockyards, and the railroads.
The dominant beef packing firms of the early 1900's all essentially disappeared by the end of the century. However, they were replaced with new dominant firms that brought new innovation to the beef industry and that followed the cattle out of the eastern corn belt to the western corn belt and the high plains.

A brief look at the major packers of the last 30 years shows a continued process of mergers, acquisitions, buy outs and sell offs. For example, the nations current largest beef packer, Tyson acquired IBP, the then largest beef packer in 2001. IBP had grown from one original plant in Denison, Iowa in 1960 through a process of acquisitions and new plant construction. The current number two largest beef packer, Cargil, who owns Excel beef first acquired MBPXL, formerly Missouri Beef, in 1979. They then acquired Spencer Beef in 1986. The present third largest packer, JBS Swift, acquired Swift and Co. in 2007. Swift and Co was formed in 2002 when ConAgra Beef was sold to a group of investors in Texas and Colorado. ConAgra Beef was formed after acquiring Monfort of Colorado and Swift in 1987. The present day number five beef packer, Smithfield Beef, was formed when Smithfield purchased Moyer Packing and Packerland, two separate companies, in 2001.

There has also been a changing history of cattle feeding within these companies. Tyson/IBP has never for the most part owned cattle feeding facilities. However, they do have a grain only company, acquired Caprock cattle feeding in 1974 prior to owning any packing plants. Cargil continues to own and feed cattle. Monfort was originally a cattle feeder who then constructed a beef packing plant to kill their own cattle. When ConAgra purchased Monfort they also purchased the feedlots. However, when ConAgra sold off its beef operations to Swift, the feedlots were not part of that deal. ConAgra continued to operate the feedlots until 2004 when they were sold to Smithfield Beef, the same company above who acquired Moyer Packing and Packerland in 2001. Continental Grain got into the cattle feeding business in 1975 with the purchase of its first major feedlot. Continental Grain expanded its feeding capacity over the next 25 years with acquisitions of a number of large feedlots. In 2000, Continental Grain formed ContiBeef, LLC out of its feedlots. In 2005, ContiBeef and Smithfield Beef merged their feeding operations into one company, Five Rivers. The proposed merger of JBS Swift, with National Beef, Smithfield Beef and Five Rivers cattle feeding will reunite the original Monfort feedlots with the original Monfort packing plant in Greeley, Colorado.

I provide this brief overview and history for a few reasons. First, to call attention to the fact that there has been and continues to be a changing ownership structure to the beef packing and feeding sectors. I suspect that with each of these prior mergers, buy outs, sell offs, and acquisitions there were industry groups that supported them and industry groups that were opposed to them. Those opposed probably claimed that many of them would be the end of the beef industry. In fact, the beef industry continues to move forward and market efficiency and economic returns continue to reshape the industry and the dominant firms. Secondly, I think it is noteworthy that major agribusiness firms have entered and have exited the cattle feeding and beef packing industry. One would not expect a major agribusiness firm to get out of an industry if these type of mergers.

Rather, I would think these continued ownership changes are a result of firms trying to stay competitive in an increasingly competitive global market place. I am certain that there would have been few beef industry experts in 2000 that would have predicted that IBP, the dominant beef packing firm for the previous 20 years, would have been purchased by the dominant chicken firm, Tyson, in 2001. I would be equally positive that those who saw ConAgra enter the cattle feeding and beef packing business in 1987 would have predicted that in less than 20 years they would be completely out of both of those sectors. These are examples of just how competitive this industry is and how at times the returns are not great enough for those in the industry to continue or to stave off a takeover bid from another competitor. Lastly, I would point out that owning both major cattle feeding enterprises and beef packing companies has not led to that firm being the dominant force in the market place.

With that background and short history lesson provided, I will now set forth what I view as the potential benefits and the potential setbacks to the current proposed merger of JBS Swift with National Beef, Smithfield Beef and Five Rivers feeding. I do so with the caveat that in ten to 20 years someone may ask who is JBS Swift and why were we concerned about them in 2008. Potential Benefits
Certainly a potential benefit to the beef industry is the infusion of new capital and new ideas into the industry. The last couple of years have been very difficult economic years for the cattle feeding and beef packing sectors. I won't elaborate on all the reasons for these difficult economic times, but our own past trade bans on Canadian cattle do to concern over BSE and continued trade sanctions on some of our exports due to concerns over BSE has cost the packers on both the cattle supply side and on the beef demand side of the market. Equity has been drained that at least one of the packing plants within the proposed merger of plants would be shut down or perhaps even more challenging to the industry would be if one of these companies shut down.

The infusion of new ideas may even prove more beneficial than the infusion of new capital. JBS Swift is a dominant firm in world beef trade. They have been trading with countries in the past that have not been major US markets. Perhaps their credibility in these markets could lead to increase US beef exports and therefore improved beef and cattle prices. The upstart, Iowa Beef Packers, took the packing industry by surprise in the 1970's with the introduction of boxed beef, rather than hanging carcasses. Perhaps, JBS Swift will revolutionize the way American beef packers do business in the international market place.

The producer owned cooperative, U.S. Premium Beef (USPB) has a majority ownership in National Beef. That cooperative provides its members some very attractive pricing grids on which to sell fed cattle. Presently, all those cattle must be harvested at one of the three National Beef plants. With this proposed purchase, it is my understanding that USPB will acquire shares in the new JBS Swift company and that members of USPB would then be able to ship cattle to any of the JBS Swift/National/Smithfield packing plants that harvest steers and heifers. This could greatly expand the desirability of owning or leasing USPB shares and selling fed cattle through this cooperative. Cattle producers in the more isolated feeding areas of the West and the North East would then have potential access to this marketing cooperative.

As one considers the market power dynamics of the new beef packing industry if this merger were approved, it might well be that there is actually increased competition. Considering the present five biggest firms, it might be argued that there have been two dominant firms the last few years, one weaker large firm and two medium sized firms, one of which may itself be in very aggressively for a limited supply of fed cattle. Given that the present beef packing industry has excess capacity relative to the size of the fed cattle population, these three large firms may compete very aggressively for fed cattle and the resulting price paid for fed cattle may be very close to a perfectly competitive market price.

I visited with an independent feedlot operator in one of the market areas where there is really only one packer. He was basically supportive of this merger. His thoughts were it would be better to have one strong packer that he could sell to then it would be to have one weak packer or no packer to purchase his cattle. This argument goes both to the argument of an infusion of capital into the industry and the argument that a large packer will not necessarily exercise more market power than a smaller, weaker packer. I will again restate, margins are very competitive in the beef packing and cattle feeding sectors. Packers recognize that to remain competitive they need an adequate supply of cattle. It is therefore, not in their long term interest to consistently buy fed cattle below the competitive market price, if in doing so they put their cattle suppliers out of business. It may in fact be the case that a weaker packer, struggling to compete with the larger, perhaps more efficient packer, would be more inclined to try and buy cattle cheaper for short term gains. Potential Setbacks I see two potential setbacks to the cattle industry if JBS Swift is given the approval to acquire National Beef, Smithfield Beef and Five Rivers cattle feeding. The first is a loss in the number of competitive bids in a market area and the second is the increase in captive supply, or at least the increase in packer ownership of cattle.

acquired cattle on a regular basis from cattle feeders in Colorado, Kansas, Nebraska, Oklahoma and Texas. JBS Swift has packing plants in Colorado, Nebraska and Texas that also obtain cattle from feeders in Colorado, Kansas, Nebraska, Oklahoma and Texas. Rather than being two separate head buyers for these plants, there would only be one head buyer for JBS Swift. Feedlots in these areas may have had four bids on a regular basis from Excel, National, JBS Swift and Tyson. They will now only have 3 independent bids. So long as excess capacity remains in the industry, this may not be any problem as was previously noted. Even plants within the same company do compete on the margin to obtain enough cattle to operate their plant efficiently. However, if cattle supply more closely matched packing capacity, then economic theory would suggest that a loss of an independent buyer in the market place would likely result in a lower market price for fed cattle.

National Beef presently has a plant in southern California and Smithfield Beef has a plant in Arizona. Each of these plants presently offer independent bids to cattle producers in those market areas. With the proposed purchase of National Beef and Smithfield Beef, those two plants would be under one ownership. Going from two independent buyers to one buyer in a market place certainly as the potential to lower the price paid for cattle.

In all other market areas, I do not see that the proposed purchase will alter the number of independent buyers. It is merely a change of name of who those buyers are and not a change in the number of independent buyers.

Perhaps the largest potential setback to the cattle industry from this proposed agreement is the increase in the packer ownership of cattle. With the purchase of Five Rivers feedlots, JBS-Swift would have a one time feedlot capacity of 813,000 head and total annual cattle fed would
head, that does not seem like it would have much of a market impact. It is less than 5% of the expected annual slaughter. However, in looking at the location of the feedlots and the packing plants, it is likely that about 40% of the plant capacity in Greeley, Colorado could be supplied from Five Rivers and that over 25% of the plant capacity in Liberal, Kansas and Cactus, Texas could be supplied by Five River feedlots. This level of packer ownership of cattle could take those plants off the effective market for fed cattle in some weeks. However, those cattle are also taken off the market and not available to other plants within JBS Swift nor are they available to other packers.

There has been considerable debate about the impact of captive supplies of cattle by packers, of which ownership is one form, on the market price for cattle in the cash market. In general, past studies have found small negative impacts on fed cattle prices from increased captive supplies. There has been legislation debated by this Senate to ban beef packers from owning or controlling cattle for more than 14 days prior to slaughter. I am on record as opposing that legislation. See the following paper for a detailed analysis:

Feuz, D., G. Grimes, M.L. Hayenga, S.R. Koontz,J.D. Lawrence, W.D. Purcell, T.C. Schroeder, C.E. Ward. 2002 "Comments on Economic Impacts of Proposed Legislation to Prohibit Beef and Pork Packer Ownership, Feeding, or Control of Livestock" White Paper. Authors Listed Alphabetically.
http://www.aaec.vt.edu/rilp/publications.html January 14, 2002

Concluding Remarks

As I have previously stated, the cattle feeding and beef packing sectors are very competitive in that they operate on very narrow profit margins. The competition is global and across protein species. To limit the ability of packers and feeders to enter into relationships that they believe will make them more efficient and more competitive in the global market place, I believe is counter productive to the long term survival of the US beef industry.