

# Financial Risks, Concerns & Opportunities for Pork Producers

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## ■ Introduction

Let me start off by reminding you of who Farm Credit Canada (FCC) is. FCC is a federal crown corporation, with our roots dating back over 45 years. Back then, we were strictly a mortgage lender, offering one type of loan. Today, we offer 24 types of loans – 18 of them being customized products to meet the various needs of the agriculture industry and the sectors within it. In addition to financing, through our expanded mission, we provide a variety of other business solutions to farm families and ag-business.

The last time I had the privilege of addressing delegates at this event was in 2004, when growth in the industry was the order of the day. Much of this was a result of continued confidence that supply contracts would level out the cycles typical of the industry. Hog operations were getting bigger and bigger, and as a provider of term financing, I can tell you that lending followed suit – both in terms of numbers of loans and loan sizes.

One of the advantages of being a company with a National presence is our ability to tap into what our customers are thinking in all parts of the country. Back in 2004, “How do I fund the growth?” was on the minds of producers.

Today’s discussions have taken on a different focus. There are still producers out there who are interested in accessing financing. However, there is broader set of needs that producers are telling us about.

## ■ A Cross-Country Tour – What’s on the Minds of Canadian Producers

FCC operates out of 100 offices across the country – so we are represented in every hog-producing region in Canada. And, we hold a fairly large loan portfolio in the sector. In 2004, our hog portfolio was sitting at \$886M and, leading up to that year had enjoyed year over year growth rates as high as 21%. Now, three years later, our hog portfolio has crossed the \$1 billion mark, with lending in this sector remaining a key part of FCC’s portfolio at just under 10% of the total.

I want to discuss what our Account Managers are hearing in their travels, you can be assured that it is fairly representative of the issues facing the industry in each region.

Let’s go East first...

### *In Quebec...*

- Animal health is top of mind; the focus is on disease control and stabilization of the herd.
- Environmental issues & public opinion along with regulatory barriers have taken expansion plans off the table
- The strength of the Canadian dollar does not appear to be as big a concern as these other issues
- With pork production largely being under contract...and, the increased incidence of contracts not being honored, opportunities exist for producers who can renovate/re-tool existing operations in order to finish their own hogs. Opportunity also exists for farrow-wean operators who can buy existing finishing barns. Similar opportunities exist for contract growers.

### *Moving to Ontario...*

- Again...disease control is an issue.
- The cost of feed and the desire to lock in soy and corn prices is also being discussed.
- There is concern over the erosion of working capital because of rising costs (feed & energy), coupled with expectations of lower pork prices.
- Things are quiet on the barn expansion front due to market uncertainty and general herd health concerns, although this may change with an increase in pork prices

- What we have seen is a continued interest in bio-digesters as a means of offsetting high energy costs, in addition to the favorable environmental impact.

### *Over to the West...*

- The ability to weather lower prices until the upswing starts again is top of mind in Manitoba – particularly in areas where hog numbers are higher and density (combined with a difficult permit process) prohibits further growth.
- Expansion is also hampered by difficulties finding adequate acres to spread manure.
- The expansion opportunity will be in the form of operations buying existing barns; – the intent being to close their own production loops and reduce reliance on the U.S. market for weaners.
- There has also been some talk of bio-digesters; although this is still quite preliminary.
- And...producers are paying much closer attention to their working capital position.

### *In Saskatchewan & Alberta...*

- Finding qualified staff is a huge concern. ...and keeping them.
- The need to supply the packers who wish to operate at their most efficient capacity may present some opportunity for new finishing barns in Saskatchewan;
- In Alberta, the booming economy and the increase in population has created a barrier to expansion in pork production. Competing with the oil & gas sector for workers is a big part of this.
- There is also a concern over increasing feed costs. More producers worry about contracting for adequate quantities of wheat and barley than worry about hedging the dollar.
- Producers recruiting foreign workers have had positive experiences in terms of the skill and qualifications of the people they are getting, however the process is slow.
- In Alberta, the very slow and difficult development permit process has also prevented expansion in production. There has been no meaningful growth in Alberta production for 10 years; whereas Saskatchewan and Manitoba have increased production very significantly during this period.

To summarize, these are the common themes:

Although the reasons may be varied, expansion in the form of increasing the scale of operations is not in the forefront of producers' minds. Rather, producers are placing more emphasis on how they can "hold their own" at least through 2006/07.

The general consensus is that this core business goal will be achieved if they can:

- Withstand tightening margins; in particular maintain their working capital position;
- Re-tool or enhance existing operations in order to find finishing space – either under the umbrella of their own operation, or through contract barns;
- Stabilize the herd from a health perspective;
- Find and keep good employees.

## ■ What Can You Expect From FCC?

As stated in the introduction, FCC had broadened its focus from strictly being a provider of term credit to the agriculture industry.

Our term credit offerings have been enhanced in ways that will allow producers to meet their goals. But, in addition to that, we now offer other business solutions that enhance our customers ability to manage their operations through good times and challenging times.

## Lending Products

Although we have a suite of business solutions, lending remains our core business, so I would be remiss in leaving out reference to some of our loan products.

### *Flexi-Loan*

The concept behind our **Flexi-Loan** came to us from some of our hog clients and is tailored specifically to assist in preserving working capital at those points in the cycle when margins are particularly tight. This loan allows the producer the flexibility to put principal payments on pause for up to one year, for as many as five times through the life of the loan. Because of this feature, this product is also ideally suited for those needing to address herd health situations. And, it also works well if a temporary slow down in production occurs due to a project such as a barn renovation.

## ***Construction Loan***

Renovation projects as well new construction (including bio-digesters) can be financed using our **Construction Loan** product. Disbursements are staged and, depending on what best suits cash flow, interest on the advances can be paid as the project progresses, in one lump sum at the end or capitalized into the loan.

## ***Advancer Loans and Cash Flow Optimizers***

**Advancer Loans** and **Cash Flow Optimizers** are FCC's two interest-only products. Capital purchases that will enhance the operation over the long term can still be made at times when cash flow is tight through use of the Cash Flow Optimizer. Advancer loans give the producer a pre-approved line of credit that can be re-advanced at any time, allowing the producer to take advantage of opportunities when they arise – without having to fully utilize their operating loan, or without needing to access costly supplier credit.

## **AgriSuccess**

Continuing to enhance management skills is an essential key to success. I'm sure you agree, or you wouldn't be attending seminars like this one. Through our AgriSuccess business line, FCC offers an e-based newsletter as well as a bi-monthly publication that provides leading edge management information. We also offer a series of eight management workshops covering a variety of subjects – many of them specific to the issues currently top of mind to hog producers. These workshops are delivered by professionals, recognized as experts in their fields.

Producers have told us that recruiting and keeping qualified staff is a key concern. Our two-part workshop, "**Hiring Employees**" and "**Keeping Employees**" are designed to address these concerns.

When producers tell us that managing price risk, locking in feed costs and making decisions about hedging are important to them, our **Commodity Marketing Management** workshop immediately comes to mind.

As you might expect, we also offer **Farm Financial Management** workshops that assist producers in making optimal use of their financial records to monitor cash flow, to develop their overall risk management plan and to measure progress against that plan.

## **AgExpert**

As a tie-in to the financial workshops, FCC also has available the only brand of accounting software that is specifically designed for agriculture – AgExpert

Analyst. Through its GST and inventory tracking, it provides a quick, cost effective way of completing CAIS reporting. When working capital is a concern, a program that can speed up the conversion of a CAIS receivable to cash can pay for itself. Analyst also has an optional automated payroll module to automatically calculate all Revenue Canada source deductions, allowing the producer to more effectively manage human resources.

### **Feed & Feeder Hog Financing**

Through third-party alliances, FCC has also begun a foray into the current liability portion of the hog producers' balance sheet. Although we've been in the feeder cattle and farm input financing business for a number of years, the adaptation of the concept to the hog sector is a new approach for us. It is designed to provide producers with an alternate source of financing, apart from conventional operating credit and/or higher priced supplier credit.

### **■ Conclusion**

At Farm Credit Canada, "Agriculture is all we do." So says our slogan. In French-speaking parts of the country, the literal translation is closer to "Agriculture...our reason for being". Recently, a friend of mine (who, incidentally, is not involved in agriculture) remarked about the sense of passion evident in the slogan. Passion for the industry has made it easy for FCC to be there during the peaks and the troughs. Cycles in the industry result in continuous change in the needs of producers. And, with that change, FCC continues to broaden its focus and to add value in a variety of ways.