

**Featured Speaker**

Dr. Bill Hollis

**Host**

Dr. Sarah Probst Miller

**Commentary**

Dr. James F. Lowe



**SARAH:**

Hello, this is Dr. Sarah Probst Miller with Carthage Veterinary Service. I want to welcome you to our fourth edition of P's in a Pod. P's in a Pod covers practical tips on pigs, production, and profitability. P's in a Pod is a monthly podcast brought to you by Fort Dodge Animal Health and Carthage Veterinary Service.

Last month we heard about SIV and the potential for zoonotic transmission and the more likely transmission from humans to pigs. Jim Lowe led the discussion with commentaries from Joe Connor and Bill Hollis. Today we shift gears and welcome Bill Hollis back to talk to us about weaned pig agreements.

Bill, as contracts mature, I have a lot of producers discussing what their next weaned pig contract should look like. Many of them have moved historically from set contracts to contracts with a weight slide. Some have Cost Production contracts. Only a few had a slide in contracts for corn prices. And after last year's record corn prices and low open market weaned pig prices, having weaned pigs locked in the right contract is a hot item for farrow to wean farms, especially in this volatile market. I'm anxious to hear how to help producers get this right.

**BILL:**

Our system in Western Illinois has been assisting producers, developing their wean pig agreements, and managing sow farms since 1996. Over the past 12 years, we have seen dramatic changes in the structure, in the pricing, and even in the specs included in those wean pig agreements. As we look at this topic, I think it is valuable to look back at the past, how it has affected the present, and look forward the future.

As we compare the present day wean pig agreements to those of the last ten years and also try to consider what will come in the next ten years, I believe it is the most simple to look at three major categories with each of those agreements. And those three categories are:

- Price formulation
- Security and contract performance type language
- Specs on pigs, the weight, age, and quality variation in those agreements

**SARAH:**

So Bill, talk to me about the past. Ten years ago, what were we seeing?

**BILL:**

Ten years ago, most of our weaner pig buyers would basically hand a check to the delivery driver the day of delivery and it was a cash business where pigs were delivered and the payment for pigs was

anticipated at delivery. That has changed to the present day deliveries which allow for a seven-day turnaround time prior to placement of that check in the bank. This has evolved because many of the pigs are being delivered to off-site separate locations.

So, security in the past was cash on the barrelhead. The pigs arrive, the buyer and seller evaluate the pigs, and the seller leaves with a check. Any dispute as to quality or payment were settled at delivery (standing there looking at the pigs) and the weaned pig seller was secure driving home with a check. Today our clients selling weaned pigs have more open and unsecured credit arrangements with many of their wean pig buyers.

Security will continue to be a topic as we evaluate contract performance and try to understand how best to partner the wean pig buyer with the sow farm owner. Nonetheless, this has changed dramatically in the last ten years.

**SARAH:**

What was the role of the futures?

**BILL:**

Ten years ago, futures were the forecasting tool for pricing of weans pigs and 50 to even 54 percent was the range. I recall an agreement over ten years ago, that started with 50 percent of the six month futures and then had premiums for various different specs on pigs. That has seen a major change as well. I would say that pigs are either good pigs or bad pigs and there is very minimal variation in-between. Trying to discount and credit for all kinds of different specs or challenges has led to frustration and disagreement among the business partners. And therefore, I would say the majority of specs from the past are not at all present today.

**SARAH:**

What sort of schedule were we setting pigs on?

**BILL:**

One final past item we have moved away from is a 27 week schedule where producers are using nine weeks as a nursery wheel. I believe that genetic performance today and even the heavyweight marketings we are pushing to can be achieved at a 25.5 or 8.5 week nursery term at the maximum and many of our producers are tightening up to even our present day schedule of 24 weeks wean through finish.

**SARAH:**

And what are we currently seeing in these weaned pig relationships?

**BILL:**

Present day contracts that have an unsecured creditor relationship with the buyer need to change. The sow farm owner will have to either be present when the pigs are delivered to the buyer's farm, or the buyer will have to allow a security interest clearly defined to the seller (which is the sow farm owner) until the pigs are paid for. I believe allowing the buyer to take delivery of pigs and wait for payment leads to the buyer having an unnecessary leverage over the sow farm producer. Even though everyone is shaking hands and is expecting that they are moving into this in good faith, once the pigs are delivered, the sow farm has very little recourse but to demand payment or to go back and pick up the pigs. I anticipate that the future agreements will have this spelled out differently where both parties know up

front that the business deal is being done and are responsible for their share of the security on either side. And whether they have the ability to cut the check that day or they are a large business and their accounting system needs five or seven days, we still need to ensure that security language is well spelled out.

**SARAH:**

And what has been the present day impact of corn on these contracts?

**BILL:**

Corn and market variations are built into many of our present day agreements, either by using six month futures with a large premium for weight or by using a corn matrix that allows for an increase in price in the wean pig in the event that corn exceeds a predetermined floor pricing.

The futures market formulations have also been used for programs like an equitable pricing model where we've seen some of our clients balance cost with the wean-to-finish operator. I believe the challenge in using equitable pricing is where you put the cost of production from one wean-to-finish operator who has a cost advantage over another or if a sow farm has higher sow productivity over another. For that reason, we're still seeing most of our clients go to either a flat pricing or a percentage of futures for their base and then adding premiums for weight or premium for corn and weight if that fixed flat floor is predetermined.

**SARAH:**

What about how pigs are graded upon receipt? What are the trends there?

**BILL:**

The trend toward less specifications on the pigs is continuing, whereby the allowance for health challenges if two parties get in the room and agree to a time period and a production schedule laid out by their veterinarians, and if the specs basically allow for euthanasia or removal of the no value pigs from the pricing and allow for full pricing on that average pig that may not be the pick of the litter.

**SARAH:**

And minimum specs? I remember when it was six pounds when our lactation lengths trended a lot shorter in the late 90's and early 2000's.

**BILL:**

The six pound pig is gone, Sarah. What I see more common are minimum specs for minimum weight somewhere in that eight pound range for a 21-day pig system. There are a few with a seven pound if it is an 18-day average lactation system.

In the future, I would like to see security interest language written into many of the wean pig agreements that are currently now leaving the sow farm in an unsecured creditor position. I believe that a UCC filing, which is a legal document filed with the Secretary of State, can be placed to define the buyer and seller relationship. That would be the same if the buyer bought a tractor on credit with John Deere. Filing, simply sets up a buyer and seller relationship that defines the owner of the pigs until they are paid for. In the event there is a default, this simply and clearly names the owner of the pigs. The document further protects the sow farm from unnecessary delays in payment such as holding unpaid pigs as leverage in a negotiation on terms or specs.

I anticipate an increased dollar amount for the increased age as we have seen this demand pushed for a 21 – 23 day old pig and as we see wean-to-finish operators recognize the benefit of this larger pig, 15 pound pigs, plus at arrival the wean-to-finish barn is chopping off weeks from their marketing end for slaughter groups. The benefit I currently see is around \$0.75 per pound over ten pounds some even using a \$1 per pound starting at 12 pounds. I would anticipate that there is opportunity for this to increase. . . and that both parties will continue to see the benefit of these pigs achieving 15 pounds at 21 days . . . and as sows continue to wean more pigs and provide an even distribution of litter size and pig quality.

**SARAH:**

How do we devise a way to better deal with market fluctuations so it is fair to all parties?

**BILL:**

Both parties in the future may have to accept more variability and pricing. I have worked with most of our clients in the past to try to stabilize a level and predictable pricing. However, it may be necessary for the sow farm operator to withstand more variation in their pricing for the wean pig buyer to stomach a higher price wean pig is in good times . . . sharing in this profit with the sow farm operator as you forecast management of margin on the slaughter pig. There has been a trend toward more aggressive margin management whereby we have to fix our futures pricing allowing for corn and soybean meal to be fixed either by the individual producer or by using futures. I believe that the wean pig could very well fall into the same margin management. We know that the market itself is highly variable especially from June into December and it may be necessary for that wean pig operator to accept some more variation as well throughout that 12- month time period. CME Lean Hog Futures allow the sow farm owner to price protect just as they do for the wean-to-finish operator or for the farrow-to-finish operator. Most weaned pig sellers do not price protect with futures contracts, but it certainly is available.

**SARAH:**

Ok, Bill, wrap up this topic for our listeners. What is the take home?

**BILL:**

In final summary, I am happy to see that many of our wean pig buyers and seller arrangements withstood this extreme volatility and frustrating times from 2007, 2008, and now even in 2009. We are still struggling to balance the needs and all parties, but I believe the best producers and healthy pigs make this process much easier to withstand. As markets improve into 2010, we should be able to sustain profits at all levels and keep all pork sectors productive and improving.

**SARAH:**

Jim, can you bring us back to the U.S. now and comment from the buyer perspective? Where do our current weaned pig contracts fail buyers? And if we are acting as a consultant to a buyer, what should we be on the lookout for? What do you see working best for both parties?

**JIM:**

Thanks, Sarah. That's very interesting material. As I think about wean pig contractual value even from the buyer's perspective, it certainly is not one of the easiest challenges that we have as an industry to address. This business model is always fraught with challenges in aligning everyone's interests to achieve the common goal of providing the right product to our end user.

As a buyer, when I think about structuring wean pig contracts, it is always better if it is a long-term agreement. Certainly, the sow business is a long-term commitment and we need long-term agreements back and forth to provide all the right incentives. Secondly, if I really think about this, I need to make sure that as a buyer I have control of both genetics and weaning to those pigs.

**SARAH:**

The G-word, Jim. This can be a tricky subject.

**JIM:**

Yes, but as we think about things that make pigs value over the long haul, genetics certainly ranks first. Which genetics is best? Well, it certainly depend on which market those pigs are being delivered into, but consistent high quality genetics are certainly essential for long-term profitability of the person feeding the pigs. There are multitude of creative ways to structure an agreement. One alternative might be pricing the pig so that as the buyer I would bear all the boar cost in the pig. This would reduce the upfront cost of the pig, but would allow, me, as the buyer to select and implement the correct genetics regardless of cost. There may be an incentive for me to use boar x instead of boar y because it creates value even though it costs more to the sow farm. We are all mutually incentivized in this type of relationship to put our best boars for the right business model in place.

**SARAH:**

Interesting concept, what else?

**JIM:**

The second big area that I would be concerned about in creating a pricing mechanism that will survive over the long haul is how do we ensure that we have the right weaning age of pig? For years, contracts have had a weight bonus because that's really easy to measure, right; we run the truck across the scale. But weight without age is a really somewhat limited value. So what I mean by that? What I mean is that not all 12 lb. pigs are created equal. Age, really because of the maturation of the immune system and the development of the gut, has significant value. So let me reemphasize that, age independent of weight, particularly because of the development of the immune system and the gut of the pig has significant value, which is independent of weight. In my experience, that weight component probably does not particularly result in a lot of added pounds at market. So if you have 1 lb. heavier pig at weaning with modern genetics it is probably a 1 lb. heavier pig at market. Unlike really previous estimates, there is not a multiplier effect from weaning weight to market weight with these modern genetics. I think that we have to keep that in mind, that certainly not mainstream thought process, but age not weight, is probably important. In early models, I think we had weight and age confounded and we really didn't get those sorted out.

**SARAH:**

Ok that is a little different than Bill's perspective, so expound on that Jim. From your perspective what should be the root of added value?

**JIM:**

That means that I want to know the age of the pigs are and I really want them as old as I can. We know that immune systems mature significantly after 18 days of age. So the pig's own immune system, not his maternally derived antibody or maternally derived immunity it gets from its mom, but his own immune system significantly matures after 18 days of age. Practically, what does that mean? Well, if you go back and look at Roger Main's thesis work that he did several years ago here, it would suggest that 21-

day-old pigs really even 24-day-old pigs have significant more valuable to the production chain, so that's the global value from conception to market, than does a 16 to 18-day old pig. If you think about that and creating total change value, we need to structure the contract to ensure that we have a consistent and known age for that pig as we deliver into the wean pig buyer to create the most value.

**SARAH:**

Anything we've missed, Jim?

**JIM:**

So Sarah, as a veterinarian, I would be amiss if I do not talk about health. I really think that the challenge with health is that it is a really dynamic conversation that naming a specific health status is really certainly difficult. I think it is an area where both parties must be fundamentally committed to maintaining health stability understanding that there will be blips, but it is stability over the long haul that fits the goal. We can get that done that certainly creates value for the wean pig buyer.. So I would probably write that we probably ought to be PRRS negative and have a low prevalence of mycoplasma – certainly that is nice. However, as we go back and look at performance records, particularly where we can create single-sourced batches of pigs, the incremental differences in productivity between those pigs that have little bit of disease and those that don't are really over shadowed by the differences in value between genetics in those pig ages at weaning.

So in conclusion, I think buying pigs is really a business model that will always be fraught with a lot of challenges. We struggle in aligning interest in both the pig feeder and the sow producer, but maybe with really long-term, well thought out strategies, one can achieve a mutually beneficial relationship. It's one more step of how do we virtually integrate chain and we just need to think in those manners.

**SARAH:**

OK, that's a lot to think about. Thanks so much Dr. Lowe, Dr. Hollis! You've helped me make my action points.

From what I've heard, I've pulled together four action points for myself as a swine vet. 1) The weaned pig agreements of the past are gone and we need to work to put together agreements that work good for both the sow farm and the system receiving the pig. In the future, we all may have to accept more variability in pricing. 2) As an industry, we need to work out the impact of the leverage that the buyer has back to the seller on which pigs get paid for. Does a third party need written into the relationship or can this be worked out in advance? Future agreements will have this spelled out differently where both parties know up front the business deal that is being done and are responsible for their share of the security in those animals. 3) Also, in the future, buyers need to continue to have more input on genetic sire and wean age. 4) Both parties must be committed to maintaining health stability over the long haul and both parties need to be committed to improve performance.

I appreciate the information I learned in this Podcast. It will make me a better swine vet.

To get more action points from the field, tune into our next P's in a Pod where we talk about county eradication of PRRS. Dr. Dyneah Augsburg is heading up this idea for Carthage Veterinary Service in Hancock County. She will share with us her plan of attack and barriers she is currently working through. Dr. Connor and Lowe will talk to us about the information's application to us as swine vets and we'll come back to you with another list of action points for yourself and for the farm. Drive safely and have a great day!