

HANS CONTINENTAL SMALLGOODS

SUBMISSION TO

AUSTRALIAN PIG INDUSTRY INQUIRY

8th October 2004

Dr John Hatton

0407655385

This is Hans Continental Smallgoods Pty Ltd submission to the Productivity Commission Inquiry into the Australian Pig Meat Industry.

In this submission we wish to address the following matters:-

1. An assessment of the impact of imports and resulting injury and whether:
 - ✓ Trade measures such as tariffs or quotas would benefit the Australian Pig Industry relative to other forms of assistance;
 - ✓ A case exists for the imposition of provisional safeguards;
 - ✓ Australian Pork Industry survival is impacted by imported product being supported, subsidised or dumped;
 - ✓ Grounds exist for a Productivity Commission investigation into safeguards;

2. **Building an Internationally competitive industry through Supply Chain efficiency. The following areas will be discussed however the report in the APL Australian Pork Industry Restructure Plan (13th August 2004) outlines a more comprehensive approach.**
 - ✓ Feedstuffs – Need to be competitive with other countries but can not source grain, proteins and concentrates at international prices;
 - ✓ Genetics- Not able to import genetic material;
 - ✓ Investment in breeder housing structure;
 - ✓ Systems to measure lean meat yield with traceability to select better yielding livestock;
 - ✓ Capital into processing plants to improve productivity.

3. **Support for export market development – find efficiencies and effectiveness in marketing and market development.**
 - ✓ Provide export incentive to develop markets particularly for the offal and lower value cuts;
 - ✓ Explore new markets including EU and USA;
 - ✓ Continue to support the markets into Japan and Singapore.

4. **Support for domestic market development.**
 - ✓ Drive fresh pork sales from 8% to 15% of fresh meat consumption.

5. **Training and education – for pork industry personnel.**
 - ✓ Production management training across the supply chain;
 - ✓ Lean manufacture and supply chain mapping.

Company Background

Integrated Ham, Bacon and Smallgoods Company with interests in

- Pig raising (Burnett Pork Alliance BPA at Mundubbera, Queensland);
- Slaughter and Boning (Swickers, Kingaroy, Queensland);
- Smallgoods Manufacturing including branded and private label products. (Wacol, Colmslie, Kingaroy and Blacktown).

Ownership:

The company is wholly owned by Japan Tobacco.

History:

Hans Continental Smallgoods commenced operations in 1956.

In 1989, Hans van der Drift sold his company with a turnover of \$30million to Asahi Chemicals, a Japanese based company with a view to exporting the Hans Brand of products to the Asian market.

In 1999 Asahi Chemicals sold off their extensive interests in food to Japan Tobacco, who continues to diversify their business interests into food and pharmaceuticals.

Hans purchased a 40% share in Swickers Ham and Bacon Factory in 2002.

In 2003, Hans continued to expand with the purchase of the smallgoods division of OSI International Foods.

- **Extent of Business Activity**

Number of employees:	1,400
Number of domestic pigs processed:	16,000 per week slaughter 8,000 per week boning
Size of Operations:	Servicing the Australian market
Capital Investment:	\$150million

- **Market Focus**

HANS focuses on three significant components of the business that uses pig meat.

1. Domestic production of Ham Bacon and Smallgoods using meat sourced from domestic pigs and imported meat from Denmark and Canada

2. Export Meat Programme with a significant market in Japan as well as other growing markets in Asia especially HK, Taiwan and Korea.
3. Domestic fresh meat sales supplying Supermarkets and Food Service

- **Impact of Imports on the Australian Pig Meat Industry and Specifically on Our Business**

Imports can be divided into a number of individual meat categories and needs to be understood in the context of each category and the impact on the Australian Pig Meat Industry.

The categories are subject to the relative demand by the market but Hans usage would in most circumstances except for trim, be indicative of the of import requirements of the total market.

The categories are

1. Pork leg meat mainly sourced from Canada
2. Pork Middles mainly sourced from Denmark
3. Pork Trim mainly sourced from Canada
4. Pork Loins mainly sourced from Canada

Imports make up a considerable part of our raw material supply for our business and are necessary to maintain a competitive position in the market. Over the last few years imports have been cheaper than domestic meat. With a strengthening exchange rate we would expect that it would remain so.

With the introduction of imports the smallgoods manufacturer has been released from utilising a whole carcass to selecting specific cuts from the import market. This in turn has released the retailers from marketing cooked products with volumes and prices set by the domestic market.

Ultimately the fresh trade is still yoked to the whole carcass utilisation but the cooked market is not. As less meat is required from the domestic market for smallgoods, this in turn puts downward pressure on local prices.

This leads to major distortions in raw material pricing with most processors spending considerable time and energy analysing the import market looking at exchange rate movements, seasonal marketing of pork products from Canada and Denmark plus the new entrants soon to emerge. This is then compared to the domestic market looking for seasonal advantage particularly in the winter months away from the Christmas demand.

Long term contracts with suppliers with locked in prices and volumes are available with imports and for those with considerable capital, investment buying is also a possibility.

Naturally Hans has learnt to manage this situation however it is also aware of the injustice of importing subsidised raw materials to the detriment of the local farmers. We are not arguing that imports should be banned as the current market could not be fully supplied by local suppliers and the political reality is that we continue to export many primary products to sensitive political markets from which we import pork meat. We do however recommend that safeguards be put in place.

The following tables highlight the implications of a cheaper imported product and the necessary Hot Standard Carcase Weight that an Australia bacon pig needs to be competitive. This is then engineered back through the supply chain to establish the EBT for the sale of a domestic carcase.

A representation of the current scenario is pasted into this report however the excel spreadsheet file is also presented to the commission to establish more accurate data sets and calculate a sensitivity analysis comparing imported meat prices and their impact on the local pig market. These numbers are general in nature and require a more detailed analysis for any final report.

**Table 1: Comparison of Imported Meat Market Prices
converting at Breakeven to a Domestic Hot Standard Carcase Weight Price**

Boneless Meat	Current Imported Price A\$/kg	Ratio to Australian HSCW Price	Equivalent Domestic HSCW Price	Average Imported Price 2003	
Imported Middles	\$ 4.80	2.16	\$ 2.22	\$ 4.82	
Imported 3pc leg	\$ 5.50	2.44	\$ 2.25	\$ 4.27	
Imported Shoulder 85cl	\$ 3.30	1.49	\$ 2.21	\$ 2.95	
Weighted Average HSCW Price			\$ 2.23		

Boneless Meat	Current Domestic Meat Price	Imported Price A\$/kg	Differential A\$/kg	Kgs	Savings
Middles	\$ 5.20	\$ 4.80	\$ 0.40	20	\$ 8.00
Leg Meat	\$ 6.00	\$ 5.50	\$ 0.50	13	\$ 6.50
Shoulders 85cl	\$ 3.60	\$ 3.30	\$ 0.30	7	\$ 2.10
Differential per pig				40	\$ 16.60
Differential per kilo			8.71%		\$ 0.42
Total Kilos Imported into Australia				60,000,000.00	
Savings using Imported Meat					\$ 24,900,000.00

Table 2: Weaner Costing

% On Sales	Description	A\$/pig	Weight Kilos	\$/kg HDCW
	Weaner Costing			
	Revenue			
100.00%	Sale Price	\$ 80.00	10	
	Expenses			
32.36%	Feed cost breeder & weaner	\$ 25.89		\$ 2.59
2.40%	Piggery direct	\$ 1.92		\$ 0.19
17.58%	Piggery staff	\$ 14.06		\$ 1.41
2.00%	Piggery Service	\$ 1.60		\$ 0.16
0.10%	Piggery vehicles	\$ 0.08		\$ 0.01
4.99%	Piggery veterinary	\$ 4.00		\$ 0.40
1.00%	Piggery maintenance	\$ 0.80		\$ 0.08
7.66%	Over heads	\$ 6.13		\$ 0.61
6.19%	Administration staff	\$ 4.95		\$ 0.50
0.75%	Overhead vehicles	\$ 0.60		\$ 0.06
8.32%	Lease pigs	\$ 6.66		\$ 0.67
0.53%	Freight	\$ 0.43		\$ 0.04
83.88%	Total Operating Costs	\$ 67.11		\$ 6.71
16.12%	EBITDA	\$ 12.89		\$ 1.29
6.59%	Depreciation	\$ 5.27		\$ 0.53
9.52%	EBIT	\$ 7.62		\$ 0.76
5.39%	Interest	\$ 4.31		\$ 0.43
4.13%	EBT	\$ 3.30		\$ 0.33

Table 3: Grow-out Costing

% On Sales	Wks	Description	Rate	A\$/pig	Weight Kilos	\$/kg HDCW
		Revenue				
		Prime Pig Price				\$ 2.23
100.00%		Average Sale Price	-\$ 0.10	\$ 166.17	78.00	\$ 2.13
		Expenses				
48.14%	6	Weaner Price		\$ 80.00	11.95	\$ 1.03
37.03%		Feed	\$ 293.00	\$ 61.53	210.00	\$ 0.79
10.11%	16	Contract Feeding	\$ 1.05	\$ 16.80		\$ 0.22
0.48%		Freight	In	\$ 0.80		\$ 0.01
1.56%			Out	\$ 2.60		\$ 0.03
0.30%		Animal Health		\$ 0.50		\$ 0.01
0.12%		Marketing Fee		\$ 0.20		\$ 0.00
1.47%		Levy		\$ 2.44		\$ 0.03
1.50%		Improvac		\$ 2.50		\$ 0.03
1.20%		Paylean		\$ 2.00		\$ 0.03
101.93%	22	Operating Cost		\$ 169.37	78.00	\$ 2.17
-1.93%		EBITDA		-\$ 3.20		-\$ 0.04
0.48%		Depreciation		\$ 0.80		\$ 0.01
-2.41%		EBIT		-\$ 4.00		-\$ 0.05
2.32%		Interest		\$ 3.85		\$ 0.05
-4.73%		EBT		-\$ 7.85		-\$ 0.10

The tables above illustrate that imported meat at the current market price is relative to a HSCW for prime bacon of \$2.23/kg. Paying this for carcasses under the current feed market would result in a loss of \$7.85 per pig.

- **Options to Improve Global Competitiveness of the Australian Pig Meat Industry and Our Business**

The Australian industry suffers from a number of supply constraints. Its' competitors are large, efficient and politically adept at gaining or preventing access to significant markets.

Superficially, the Australian industry should be very competitive in the world market with a large land area, some environmental flexibility compared with overseas, a large local grain supply and significant proximate domestic and export markets.

Unfortunately the industry suffers from a supply chain malaise. It needs to be Effective (Doing the right thing) and Efficient (Doing things right). On both measures it suffers from an unclear supply chain strategy.

Support for this approach needs to come from government as it does in other parts of the world. A from "small things big things grow" philosophy will not work without the government and industry putting together a supply chain package carefully targeted at the market and the cost to market.

Changing the market is certainly not simple but should be pursued vigorously. (Major domestic and international retailers and foods service users, however, do not take advice easily.)

The cost to market or **CODB** (Cost of Doing Business) is unquestionably an area for considerable opportunity and is summarised below

1. Feedstuffs:

The largest input cost at nearly 40% of grow-out costs and 32% of breeder costs. Poor reliability in feed supply severely restricts the ability of a pig grower to plan future production

A number of areas exist for investigation

The first is price; subject to the vagaries of season, exchange rate, international and domestic markets. Being a large continent often a huge variation exists in the cost of feedstuffs between regions, for example SA and Qld, depending on seasonal conditions.

An investigation is recommended for the government to set up a reserve price for grain with a variance account related to the market to smooth the significant variation in grain and protein costs across Australia.

The second is the limitation on competitive imports of grains and proteins into Australia.

An investigation is required into the latest methods of safely importing feedstuffs into Australia

Additionally Queensland growers need an easily digestible direct from farm protein. Chickpeas, lupins and other digestible legumes are grown in the southern states.

Researched to find some equivalent tropical and temperate varieties is needed.

2. Pig Genetic Improvement

It is generally accepted that some overseas genetics is superior to Australian particularly in meat and fat characteristics.

It is recommended that the importation of genetic material be investigated taking into account the latest advances in testing techniques for transmissible disease detection.

It is also recommended that superior domestic genetics be investigated.

By way of illustration let us consider the importation of middles from Denmark.

These middles while being very competitive on price are also unquestionably superior in meat quality with significantly more meat in the belly area. I.e. the slicing yields off imported Danish middles are often between 15% and 20% superior to the Australian product.

This is in part due to two main factors. The first is the superior genetics leading to improved meat yield in the belly portion and the second is a superior grading system that more accurately represents the quality of the carcass.

To make the point, let's first examine a day in the life of a smallgoods manufacturer.

A 100 metric tonne order for A grade bacon middles arrives from a retailer

Using imported middles with a cut yield between 75% and 92% with an average of 80%.

- He orders 125 metric tonnes of raw materials (middles) expecting to make 100 metric tonne of A grade and 25 metric tonne of B&C grade bacon.

Using domestic middles with a cut yield between 45% and 75% with an average of 70%.

- He orders 142 metric tonnes of raw materials (middles) expecting to make 100 metric tonne A grade and 42 metric tonne B& C grade bacon.

Already the imported offers the better alternative as the B&C grade product is more difficult to sell.

Unfortunately the situation deteriorates when the local middles yield 50% after a poor quality batch arrives.

Now the costs are skyrocketing.

- An addition 58 metric tonnes of raw material are procured and processed to meet the original A grade order
- He now has 100metric tonnes of B&C grade to sell.
- Plus other products are sidelined while the extra cooking is completed
- Bottlenecks appear in other parts of the factory.
- Products are delivered late after losing 3 days with the re-order
- Storage goes up,
- Freight escalates etc

Ultimately this is an incentive to use imports.

3. Advanced Carcase Grading Systems and Traceability

The illustration above is also a reflection of the poor means of measuring carcase quality.

“If you can’t measure it you can’t manage it”

It is generally agreed that the current P2 measuring system for pig carcass assessment is inaccurate and does not reflect the needs of the ham, bacon and smallgoods market.

It is recommended that more advanced grading systems be introduced to more accurately reflect meat yield of the pig carcase.

To complement the grading improvements listed above, traceability of the carcase is required from factory to farm.

It is recommended that full traceability be investigated through the supply chain using RFID or similar technology to provide the necessary data to improve the management of pig production leading to advances in processing performance.

4. Breeding Herd Building Design

Australia in the main suffers from higher temperatures for pig growing than in our import supplier markets.

The major implication of severe temperature variation is the summer infertility evident each year and the subsequent loss of production.

This compares with Canada and Denmark where facilities are required to be heated.

Pig Stats states that 21 pigs are weaned per sow per year in Australia. The commercial herd in Denmark averages 25 to 27 weaners per sow per year: The extra 6 pigs at almost no additional cost to the pig breeding unit.

Providing farmers with assistance to air-condition the breeding sow operations would significantly improve reproductive performance.

Building costs are also considered to be much higher in Australia compared with Canada.

It would be valuable to research why this is so.

5. Slaughter and Boning Facilities

Efficient slaughtering facilities to export standard are vital for a healthy supply chain. Capacity utilisation of current facilities is a vital component of industry profitability.

Slaughter and boning facilities

Continued investment in staff training and development

Offal recovery

Investment in facilities to continue to value add offal especially with the growing Asian market.

Rendering recovery

Investment required in modern recovery technology

- **Other Issues Relevant to The Sustained Profitability of Our Business**

It is said that government is not likely to bet a “billion (beef) to make a million (pork)” however unless some action is taken the industry will collapse and with it the livelihoods of many agricultural communities.

**Table 1: Comparison of Imported Meat Market Prices
converting at Breakeven to a Domestic Hot Standard Carcase Weight Price**

Boneless Meat	Current Imported Price A\$/kg	Ratio to Australian HSCW Price	Equivalent Domestic HSCW Price	Average Imported Price 2003	
Imported Middles	\$ 4.80	2.16	\$ 2.22	\$ 4.82	
Imported 3pc leg	\$ 5.50	2.44	\$ 2.25	\$ 4.27	
Imported Shoulder 85cl	\$ 3.30	1.49	\$ 2.21	\$ 2.95	
Weighted Average HSCW Price			\$ 2.23		

Boneless Meat	Current Domestic Meat Price	Imported Price A\$/kg	Differential A\$/kg	Kgs	Savings
Middles	\$ 5.20	\$ 4.80	\$ 0.40	20	\$ 8.00
Leg Meat	\$ 6.00	\$ 5.50	\$ 0.50	13	\$ 6.50
Shoulders 85cl	\$ 3.60	\$ 3.30	\$ 0.30	7	\$ 2.10
Differential per pig				40	\$ 16.60
Differential per kilo			8.71%		\$ 0.42
Total Kilos Imported into Australia				60,000,000.00	
Savings using Imported Meat					\$ 24,900,000.00

Table 2: Weaner Costing

% On Sales	Description	A\$/pig	Weight Kilos	\$/kg HDCW
	Weaner Costing			
	Revenue			
100.00%	Sale Price	\$ 80.00	10	
	Expenses			
32.36%	Feed cost breeder & weaner	\$ 25.89		\$ 2.59
2.40%	Piggery direct	\$ 1.92		\$ 0.19
17.58%	Piggery staff	\$ 14.06		\$ 1.41
2.00%	Piggery Service	\$ 1.60		\$ 0.16
0.10%	Piggery vehicles	\$ 0.08		\$ 0.01
4.99%	Piggery veterinary	\$ 4.00		\$ 0.40
1.00%	Piggery maintenance	\$ 0.80		\$ 0.08
7.66%	Over heads	\$ 6.13		\$ 0.61
6.19%	Administration staff	\$ 4.95		\$ 0.50
0.75%	Overhead vehicles	\$ 0.60		\$ 0.06
8.32%	Lease pigs	\$ 6.66		\$ 0.67
0.53%	Freight	\$ 0.43		\$ 0.04
83.88%	Total Operating Costs	\$ 67.11		\$ 6.71
16.12%	EBITDA	\$ 12.89		\$ 1.29
6.59%	Depreciation	\$ 5.27		\$ 0.53
9.52%	EBIT	\$ 7.62		\$ 0.76
5.39%	Interest	\$ 4.31		\$ 0.43
4.13%	EBT	\$ 3.30		\$ 0.33

Table 3: Grow-out Costing

% On Sales	Wks	Description	Rate	A\$/pig	Weight Kilos	\$/kg HDCW
		Revenue				
		Prime Pig Price				\$ 2.23
100.00%		Average Sale Price	-\$ 0.10	\$ 166.17	78.00	\$ 2.13
		Expenses				
48.14%	6	Weaner Price		\$ 80.00	11.95	\$ 1.03
37.03%		Feed	\$ 293.00	\$ 61.53	210.00	\$ 0.79
10.11%	16	Contract Feeding	\$ 1.05	\$ 16.80		\$ 0.22
0.48%		Freight	In	\$ 0.80		\$ 0.01
1.56%			Out	\$ 2.60		\$ 0.03
0.30%		Animal Health		\$ 0.50		\$ 0.01
0.12%		Marketing Fee		\$ 0.20		\$ 0.00
1.47%		Levy		\$ 2.44		\$ 0.03
1.50%		Improvac		\$ 2.50		\$ 0.03
1.20%		Paylean		\$ 2.00		\$ 0.03
101.93%	22	Operating Cost		\$ 169.37	78.00	\$ 2.17
-1.93%		EBITDA		-\$ 3.20		-\$ 0.04
0.48%		Depreciation		\$ 0.80		\$ 0.01
-2.41%		EBIT		-\$ 4.00		-\$ 0.05
2.32%		Interest		\$ 3.85		\$ 0.05
-4.73%		EBT		-\$ 7.85		-\$ 0.10