



Cover Story / By Kim Spence and Marcia Taylor

Last of the Independents

How packer contracts leveraged a pork empire

Today's meat industry leaves independents at the mercy of volatile markets. That's why survivor Jerry Hostetter sees his packer contract as life insurance for the next time hog prices hit \$8.

Jerry Hostetter could have been a statistic of the 1990s' hog debacle. In the past seven years, the pork industry lost 87,000 producers—half of its operators.

Rightly or wrongly, many of those who exited blame packers for their demise. In contrast, Hostetter, a runner-up in the Top Producer of 2002 Awards, sees himself as living proof of the benefits of packer contracts. "I've always taken the position that I wouldn't mind missing \$50 to \$55 hogs. My risk was being put out of business if the price hit \$8," he says.

Ironically, Congress may be poised to slap meat processors with stringent bans on vertical ownership or control of livestock as part of the next farm bill (see next story). But Hostetter believes that he—and hundreds of other Lancaster County, Pa., farmers—wouldn't be in business without those relationships. "I'm not an unusual case," he says. "Other producers can still get their start this way."

In 10 years, the 40-year-old has leveraged a modest 1,400-sow partnership on rented ground to management of more than 56,000 sows and \$100 million worth of pork production annually. He personally owns only 25% of that volume, however, and manages the bulk for Alliance Farms, a weaned and feeder-pig cooperative, and for Hatfield Quality Meats and Wenger Feed, his packer and feed supplier.

"I couldn't have done this on my own," admits Hostetter, the youngest of 12 children in a Pennsylvania dairy family. But the lesson of his career is,

"what keeps my packer in business keeps me in business. It's that simple."

Interdependence—between feed mills, packers, farrowers and feeders—may be politically incorrect in the Midwest, but it is a necessity for survival in packer-deficit regions like the Northeast, says Hostetter.

"Independents without a packer contract are at the mercy of the market today. And as the industry has segregated farrowing from the finishing function, sow units without long-term contracts for weaned pigs could be increasingly vulnerable, too. Eventually the system will evolve where contracts connect farrowers to finishers to packers. Call it interdependency or co-dependency, but it's how we will exist on the East Coast."

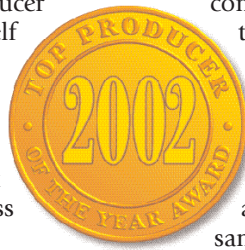
Hostetter's father was considered progressive by his Mennonite community when he built a 74-cow dairy and milking parlor in 1960. It took three workers nearly three hours to complete the milking. "Dad had

to use technology to figure out how to feed a family of 12," says Hostetter. "We have to learn how to be more productive with less today, because consumers are only willing to pay us the same price that our fathers and grandfathers received. So we've got to make up the difference with better facilities and management."

Scale and technology require capital levels Hostetter's father would never have envisioned, however. But Philip Clemens, chairman of the Clemens Family Corporation, the parent company of Hatfield Quality Meats, believes contracting has the ability to take risk out of the market for all sectors of the meat complex.

A shortage of quality animals forces the nation's 10th largest packer to rely more heavily on contracts to assure production, Clemens says. "Contracts take the highs out of the market for producers, but it isn't a win-lose proposition. In 1998, when prices hit 100-year lows, a lot of producers hadn't managed risks. Those who didn't aren't with us today."

Clemens likens the relationship between a packer and a contractor to that between a running back and a lineman in football. "If the lineman feels the running back is getting all the



PROFILE: Jerry Hostetter, 40 Ephrata, Pa.

FAMILY: Raised as youngest of 12 in a Mennonite family; Jerry and wife Anita are parents of four children.

OPERATION: Ownership or management of more than 56,000 sows, with 1 million pigs produced annually in eastern Pennsylvania, Colorado and Illinois. Hostetter personally owns JDH Farms, which includes 11,200 sows in seven farrow-to-feeder units. Twenty-five to 30 farmers finish the hogs under contract. JDH markets 224,000 pigs annually. The fastest-growing segment of his business is Hostetter Management Company, which manages Alliance Farms, a Midwest co-op, and Pleasant Valley Farms, owned by Pennsylvania-based Hatfield and Wenger Feed. That generates another 45,000 sows and 900,000 pigs marketed annually.

HISTORY: Began working right out of high school on his father-in-law's 500-sow operation, but left to sell feed and hog equipment in the late 1980s. Sales kept him on the road too much. So with backing from a packer and feed company, he and a brother-in-law launched their own 1,400-sow farrow-to-finish operation on rented land in 1991.

BUSINESS LESSONS: Find partners willing to share your risks, even if you must sacrifice market tops in the process. Don't waste time attempting to predict market prices. Focus on what you can control: input costs, labor and production. Use both internal and external benchmarks to make sure you measure up in your industry.

LABOR TIPS: People count. Pick good employees and put them in the position to succeed. Hostetter is a "master of motivation," says Jim Ensz, chairman of the board of Alliance Farms, whose profit rebounded under Hostetter Management. "He believes that people responsible for day-to-day operations need fair financial compensation, but they also have to want to be there."

COMMUNITY SERVICE: Serves on local hospital board and promotes Habitat for Humanity. Supports refugee and missionary work through church.

HOBBIES: Played on several national championship fast pitch teams. Golf and business partners call him a fierce competitor. "He is always out to win, but honorably."

glory, he can choose not to protect him on the field," says Clemens. "Sure the running back will be battered, but the lineman will be out of a job. Our attitude is that if you block the opposition, I'll carry the ball and we'll both get a bonus in the end."

Teamwork. Jim McPeak, president of Rochester, Minn.-based Babcock Swine, credits Hostetter's attitude for his rapid growth. "Jerry caught on very early that things had changed. Packers were calling the shots to fit a retail market, and if he was to be successful, he had to figure out how to be part of this vertically integrated system," McPeak recalls. "Jerry understands that his role doesn't stop when weanlings leave the farrowing house door. His job ends at the pork case in the supermarket, and anything that interferes with getting that superior product there is a problem Jerry tries to solve."

For example, Hostetter has not battled the medical community for criticizing subtherapeutic use of antibiotics in animal feed. The Food and Drug Administration has already attempted to ban some classes of animal antibiotics used in humans, on the premise that antibiotic overuse in meat and poultry may increase the risk of human drug resistance. While Hostetter isn't convinced he can make money producing the antibiotic-free pork that may eventually be demanded by regulators, he is conducting several trials at his packer's request.

Locking in shackle space with a packer may have been Hostetter's most prescient move. A 2000 study by the National Pork Producers Council indicates that nearly three-fourths of all hogs either are sold under some type of marketing contract or are

packer owned. Nationwide, spot-market purchases dropped from 44% in 1997 to just 26% three years later.

Some fiercely independent producers may bristle at the prospect of prearranged packer pricing. Hostetter sees it as life insurance for years like 1998 and 1999, when the average pork producer lost \$15 and \$9 a head, back to back. Many unprotected producers watched a lifetime of equity vanish in months.

As a beginning farmer only a decade ago, Hostetter needed to show bankers he could show weather market swings. "I couldn't have done it on my own. No bank was willing to absorb the risk I was taking," he recalls. "They ran all the scenarios of what would happen if market prices collapsed to historic lows the first year in business, when I was fully leveraged. Back then, nobody had seen hogs below \$32 per cwt. for decades. And in each case, they said if prices went to that level, you're out of business."

A contract with Hatfield eliminated that risk for the banks, since it guaranteed that prices would range between a set minimum and ceiling. Hostetter also approached his feed supplier for a commitment to stick with him if things got rough.

"If I learned anything from the bloodbath of 1998, it was that the safeguards we put in place worked," he says.

Besides risk management, Hostetter believes part of his rapid expansion comes from his ability to focus solely on production. He believes that most

feed companies own hogs so they can run their mills at capacity, but that gives them little incentive to be low-cost producers. Many grain belt producers fall into the same bad habit by owning hogs only to add value to their \$1.80 corn, he argues.

Conversely, Hostetter, who doesn't raise an acre of corn, wants to produce

a salable hog with great feed conversion. That makes sense since feed accounts for 65% of pork's production costs.

When Hostetter first shared his performance records with creditor Wenger Feed in the early 1990s, President Barry Shaw wanted to know whether he could achieve those same re-

sults if he took on managing Wenger-owned hogs. Hostetter Management Company was born in 1993.

Yardsticks. "Pork producers on the East Coast have to perform in the top 15% in the country," Hostetter adds. "Otherwise, we can't compete with areas that enjoy lower feed costs."

To make sure he continues to achieve that goal on all of his enterprises, Hostetter subscribes to an independent benchmarking service. Agrimetrix, a Virginia-based benchmarking firm, conducts a twice-yearly production study on powerhouses such as Seaboard Corporation, The Pork Group (Tyson), Cargill, Iowa Select Farms, Farmland Industries, Goldsboro Milling, Land O'Lakes and Prestage Farms. Notes Hostetter, "It's a good cross-section of who I'm competing against."

Change within the food industry remains a fact of life, he says. Rather than sweat about swings in hog prices, Hostetter is convinced that his time is best spent concentrating on what he can impact: input costs, labor and production. "Too many people lose sleep over where the market's going to be," he says. "I work on the margins."

At this point, Hostetter considers expansion of the management company his most likely growth option. "I'm not looking to go hog wild on ownership," he says. "The market risks are too great." ■

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Fewer Free-Market Hogs

Percentage of U.S. hogs procured by pricing method

	1997	Jan. 1999	Jan. 2000
Spot market purchases	43.4%	35.8%	25.7%
Total non-spot market purchases	56.6	64.2	74.3
Fixed price tied to a futures market price	2.9	3.4	8.5
Fixed price tied to feed price	5.3	9.8	12.3
Window, risk sharing	3.1	4.6	4.6
Formula other than above	39.1	44.2	47.2
Other (packer owned, internal transfer)	6.1	2.3	1.7

SOURCE: UNIVERSITY OF MISSOURI; NPPC

