

2013 Annual Sheep Industry Review

Prepared by the American Sheep Industry Association for the
for the American Lamb Board

March 2014



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Executive Summary

2013 was a year of transition and promise for the U.S. sheep industry. Lamb prices started the year sluggish, with minimal early-year gains and little promise of recovery. By late summer, however, a turning point occurred. The industry had produced an excellent, current lamb offering through the year and feedlot supplies were low. Prices began to rise sharply.

The industry was poised for a fall run unlike we've seen before. Typically the largest volumes of feeders trade in early fall, but with a corresponding depression in prices. This year, feeders traded in droves yet prices strengthened. In September alone, over 83,000 feeders moved in direct trade, 40-percent higher year-on-year and 72-percent higher than its 5-year average for the month. Lower corn prices and tight inventory fueled higher feeder lamb prices. By the end of 2013, feeder lamb prices saw a 73-percent jump from the year's low in July. Higher feeder lamb prices and the upcoming December holidays pushed auction slaughter lamb prices higher, up 39 percent from the year's low.

As feeder and slaughter lamb prices charged upward in late 2013, there was some concern that the 18-percent gain in the meat market was not keeping pace. Would there be repercussions whereby packer lamb purchases slowed and slaughter and feeder lamb prices crashed?

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Lamb packers will store some product in freezers, but will be eventually forced to pass higher costs onto retail and foodservice. In turn, and with some lag, retail and food service will eventually pass higher costs onto consumers. The U.S. Department of Agriculture forecasted that grocery shoppers will pay as much as 3.5% more for meat this year, compared with a 1.2% increase in 2013 because higher meat prices raise expenses for retailers, (Bloomberg, 2/26/2014). This is good news for the sheep industry.

There were indicators in early 2014 that retail sales were strong and restaurant growth was slow, but expanding. However, there was still an underlying concern: what will happen when retailers/foodservice pass higher lamb prices onto consumers? How high can retail prices go before consumer push back? If lamb prices rise and quality is excellent, will there be a push back? The February 2014 cutout value was just 11% shy of the 2011 record high prices that turned consumers away. This year can be different. If the industry is able to maintain its excellent lamb quality and consumer incomes continue to grow, lamb demand can remain strong even as prices strengthen.

Lamb Imports Up in 2013

In 2013, total lamb supplies increased by 7 percent, half of which were imports. Lamb imports increased 14% year-on-year. 2013 was a year for breaking records in Australia's sheep industry. Lamb slaughter was record high, as was lamb production and lamb exports. It is anticipated that production will contract this year, however, analysts forecast that exports will grow – taking a record share of total production. The weak Australian dollar gives its export lamb industry a competitive advantage, helping to boost demand.

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Production Unchanged; Lower in 2014

In spite of a 1-percent contraction in sheep and lamb inventory heading into 2013, U.S. commercial slaughter was up 6% in 2013 to 2.314 million head. However, a 6-percent drop in slaughter weights to 135 lbs. left lamb production unchanged year-on-year at 150.3 million lbs.

The expansion in slaughter might be explained by the maturing and thus gradual assimilation of nontraditional lamb supplies –that often fall outside federal radar – into the commercial market. Increasingly, lamb producers that might have once slaughtered on farm or sold live and direct at the farm are selling to local restaurants and grocers. We are likely to see this trend continue into 2014. The Livestock Market Information Center (LMIC) forecasted in early March a 1-percent expansion in slaughter numbers in 2014.

Increased commercial slaughter will not come from increased sheep numbers for inventory was down again in 2013. In January 2014, the U.S. Department of Agriculture reported that the sheep and lamb inventory was down 2.3% to 5.21 million head. Texas, the largest sheep state saw a 6% increase in inventory; however, California – the second largest sheep state – saw a 4-percent contraction.

2013 was the driest year on record for California, with reservoir and groundwater levels falling to historic lows. Producers feeding lambs through to the spring and summer will be challenged. Dry alfalfa fields likely prompted an early sell-off of lambs or early hay feeding – at high prices.

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Meat Market Played Catch Up

In 2013, the cutout fell \$44/cwt., or 13% to \$297.19 per cwt. The cutout was handicapped by the 15-percent weakening of the rack, but supported, in part, by the shoulder. The cutout weakened from January through September 2013 before it turned around and climbed through the end of the year. Carcasses were also lower in 2013 by 13% at \$261.23/cwt. Carcasses stayed flat for the first eight months of the year before seeing any gain.

2014 is all About Margins

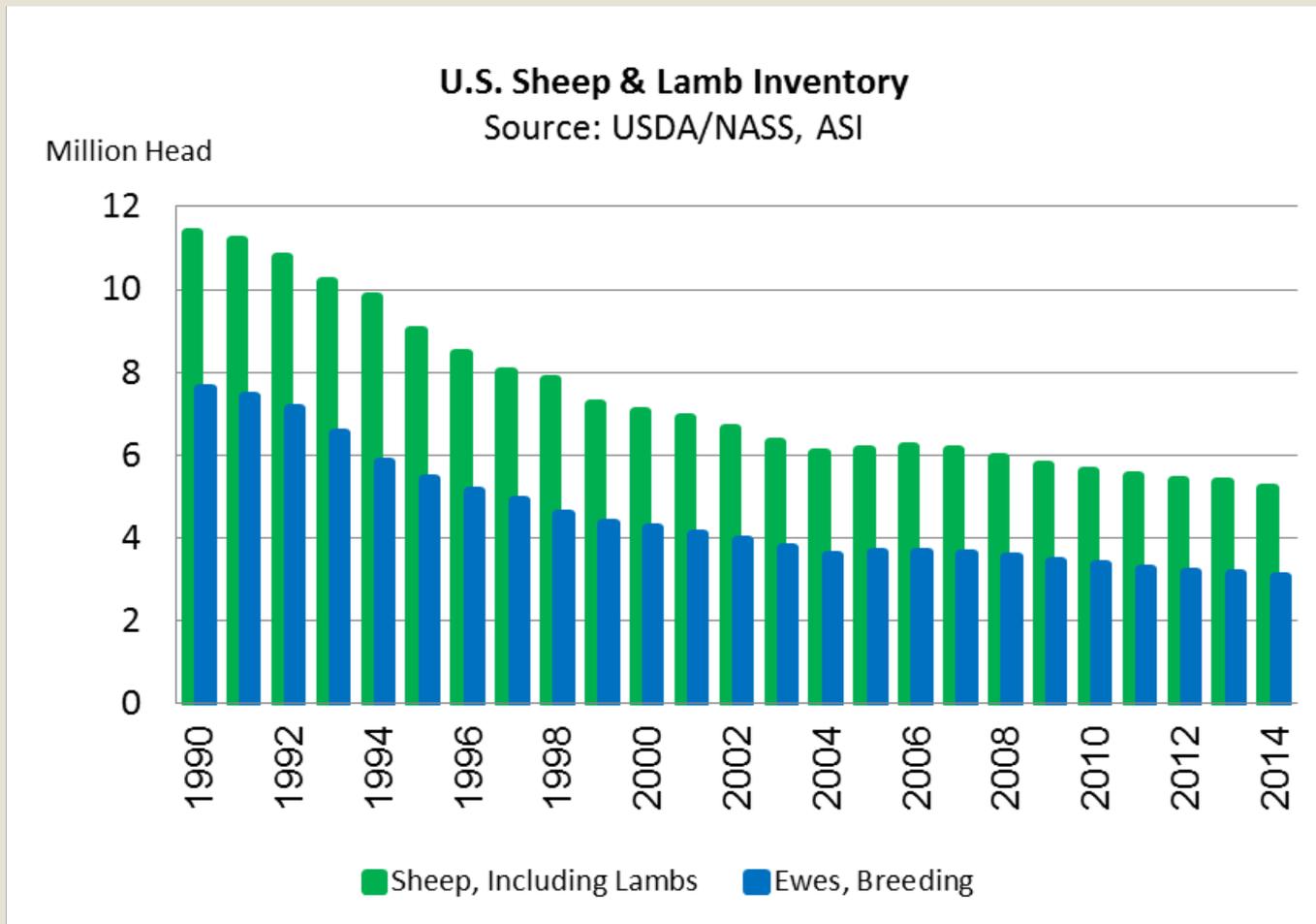
As 2014 gets underway margins of lamb producers, feeders and packers will steer the course. For the first time in a very long time, estimated margins of feeders and packers were positive indicating an opportunity to build stocks and reinvest in the industry. After at least two years, feeder margins were back in the black at the beginning of 2014. In mid-2012, feeders were losing up to \$66 per cwt. per head. By late 2013, with lower corn and some relief for alfalfa, that margin had jumped to \$27 per cwt.

Lamb packer margins fell through 2013 as supplies tightened and input prices rose. Through the year, the live to cutout price spread ranged from \$17 to \$96 per head. As the industry heads into Easter we will see whether cost increases can be passed onto consumers.

I. Inventory

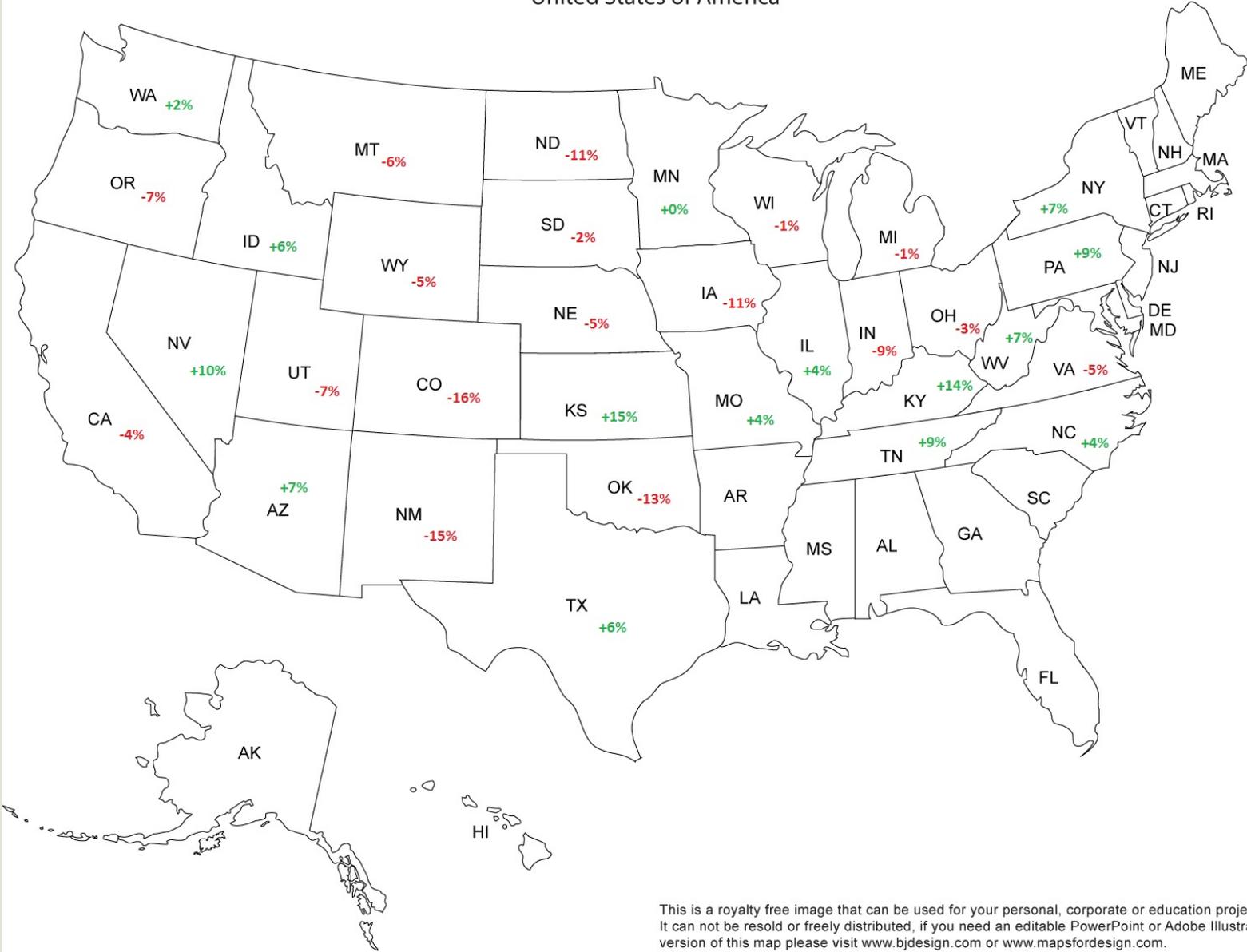


Sheep & Lamb Inventory Down 2.3% to 5.21 Million Head



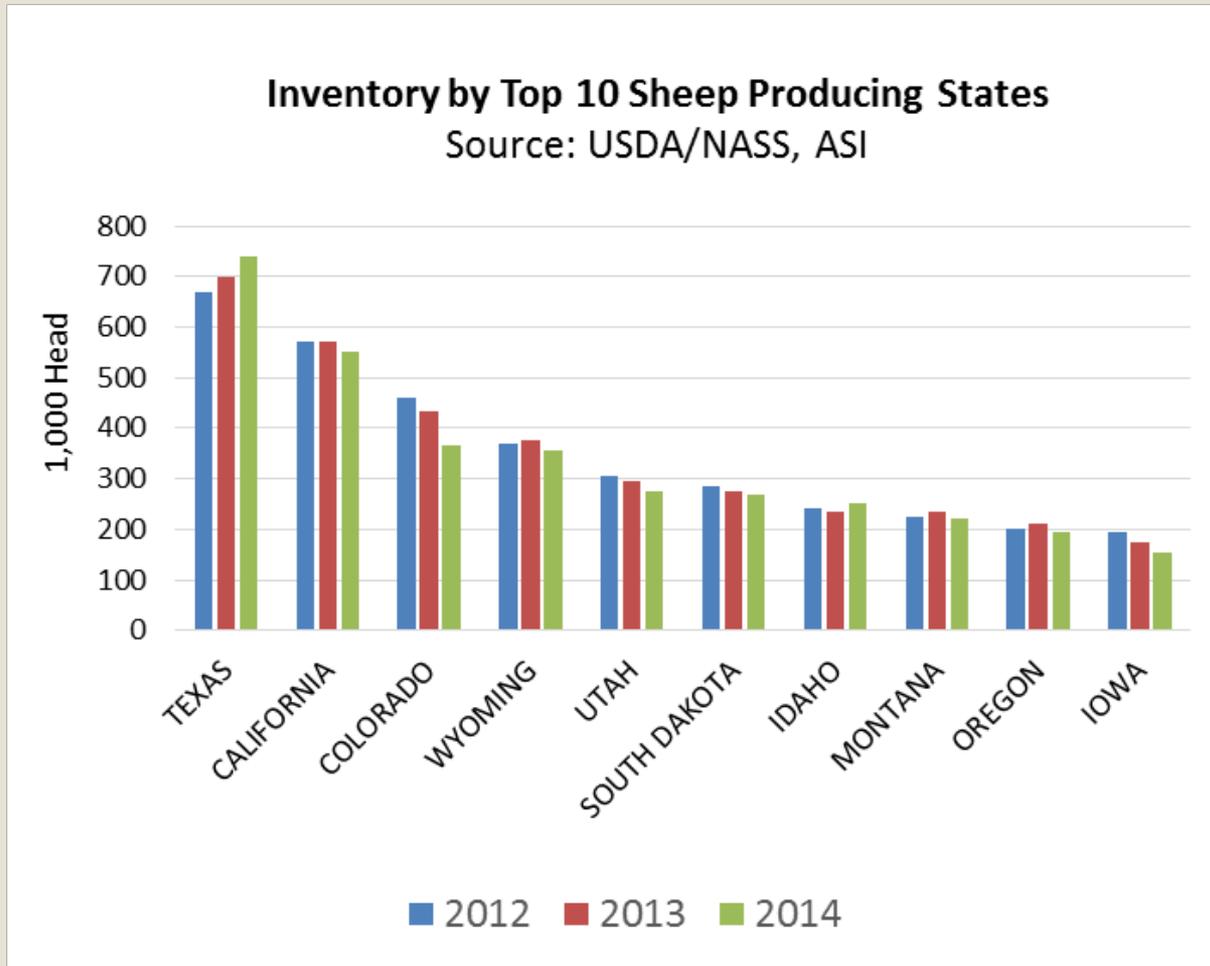
Pockets of Growth

United States of America



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Largest Sheep States Saw Mixed Growth Trends



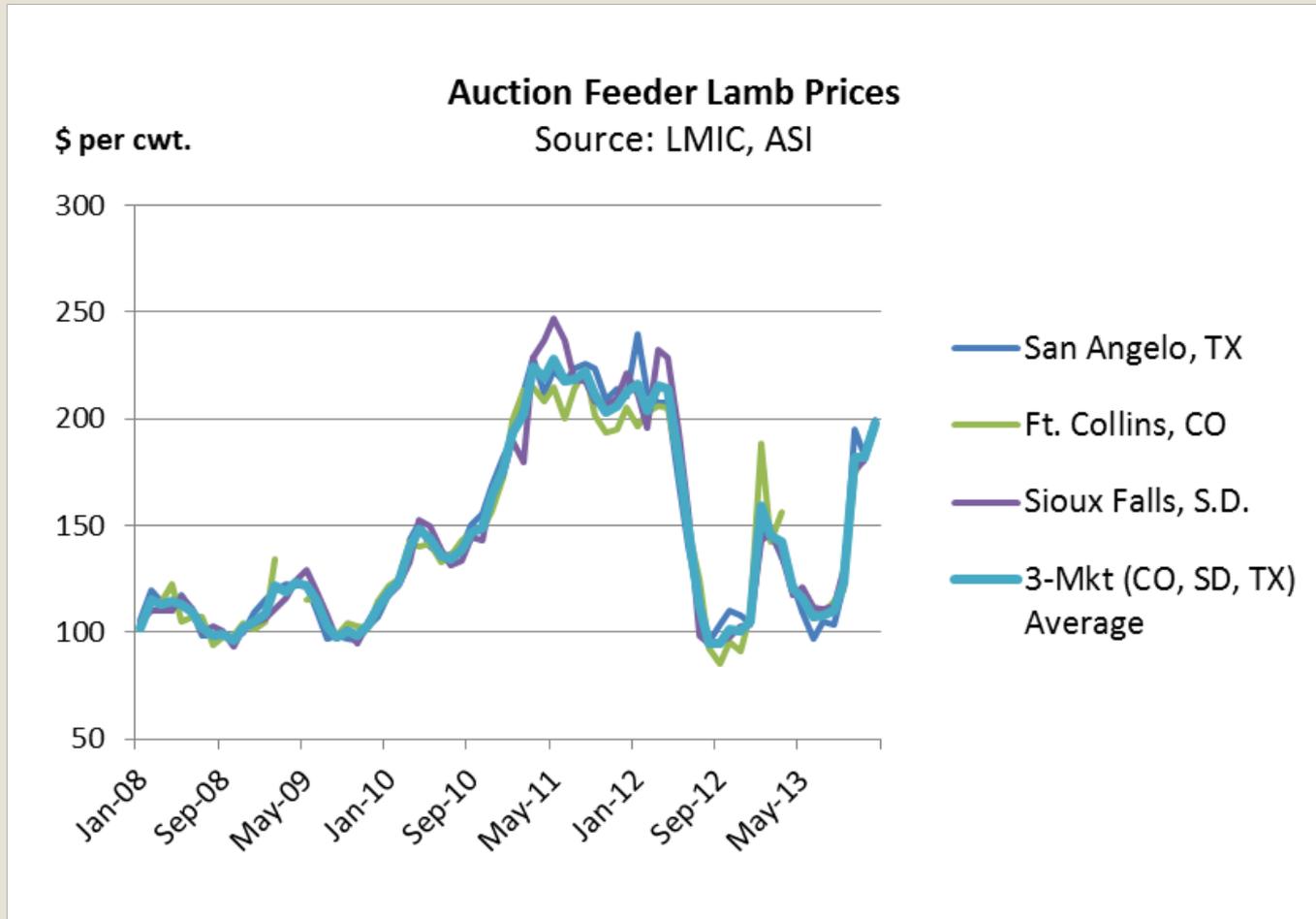
II. Feeder and Slaughter Lamb Market Trends



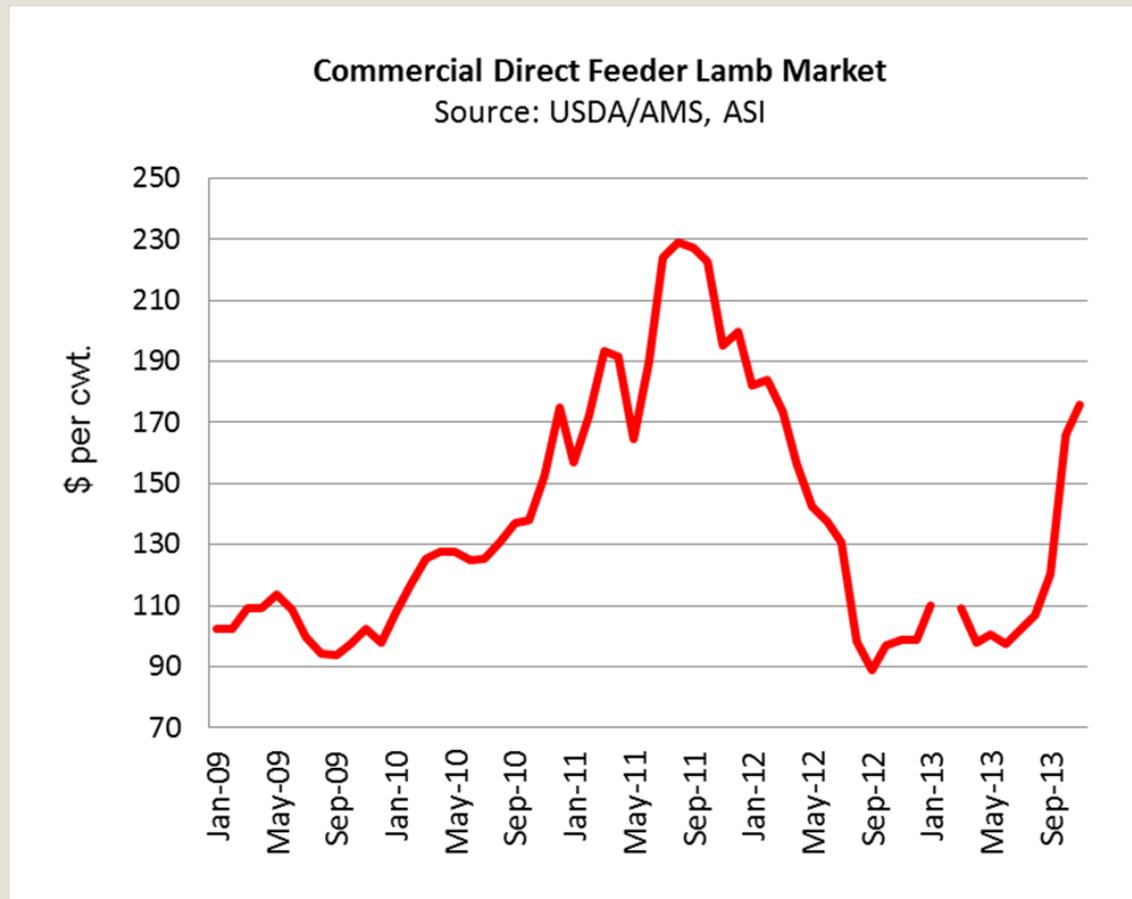
Auction Feeder Lamb Prices (60- to 90-lb.) Weakened Year-to-Year, But Gained Sharply in the Second-Half of 2013

- The 3-market feeder lamb auction price fell 5% in 2013 to \$141.07/cwt.
- Markets included San Angelo, Ft. Collins and Sioux Falls.
- However, prices jumped 84% between June and December 2013 to \$197.06/cwt.

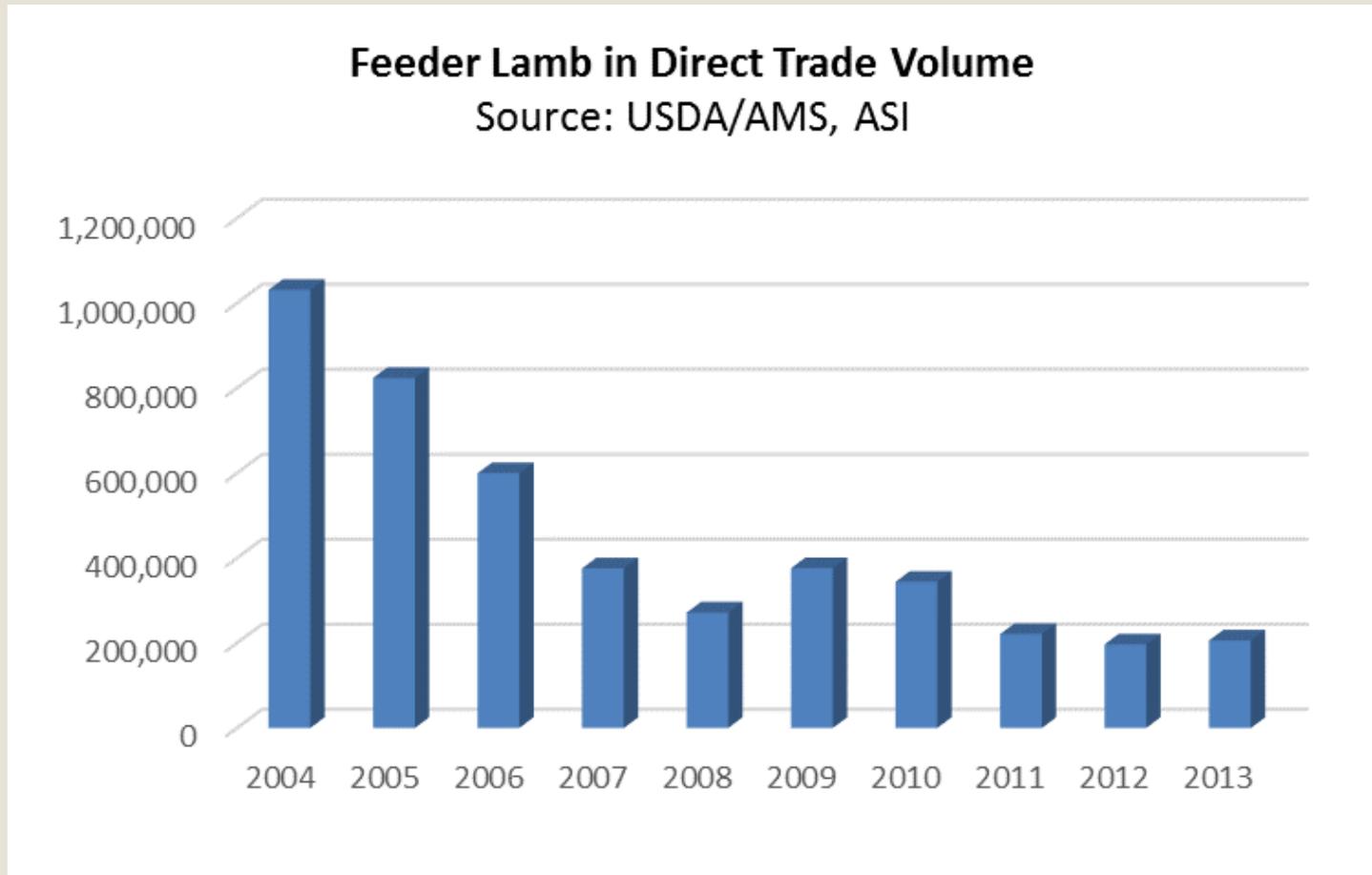
Prices jumped \$90/cwt. from the summer to year's end



Feeder lambs in **direct trade** averaged \$123.94/cwt., down 9% annually & 11-percent lower than its 5-year average.



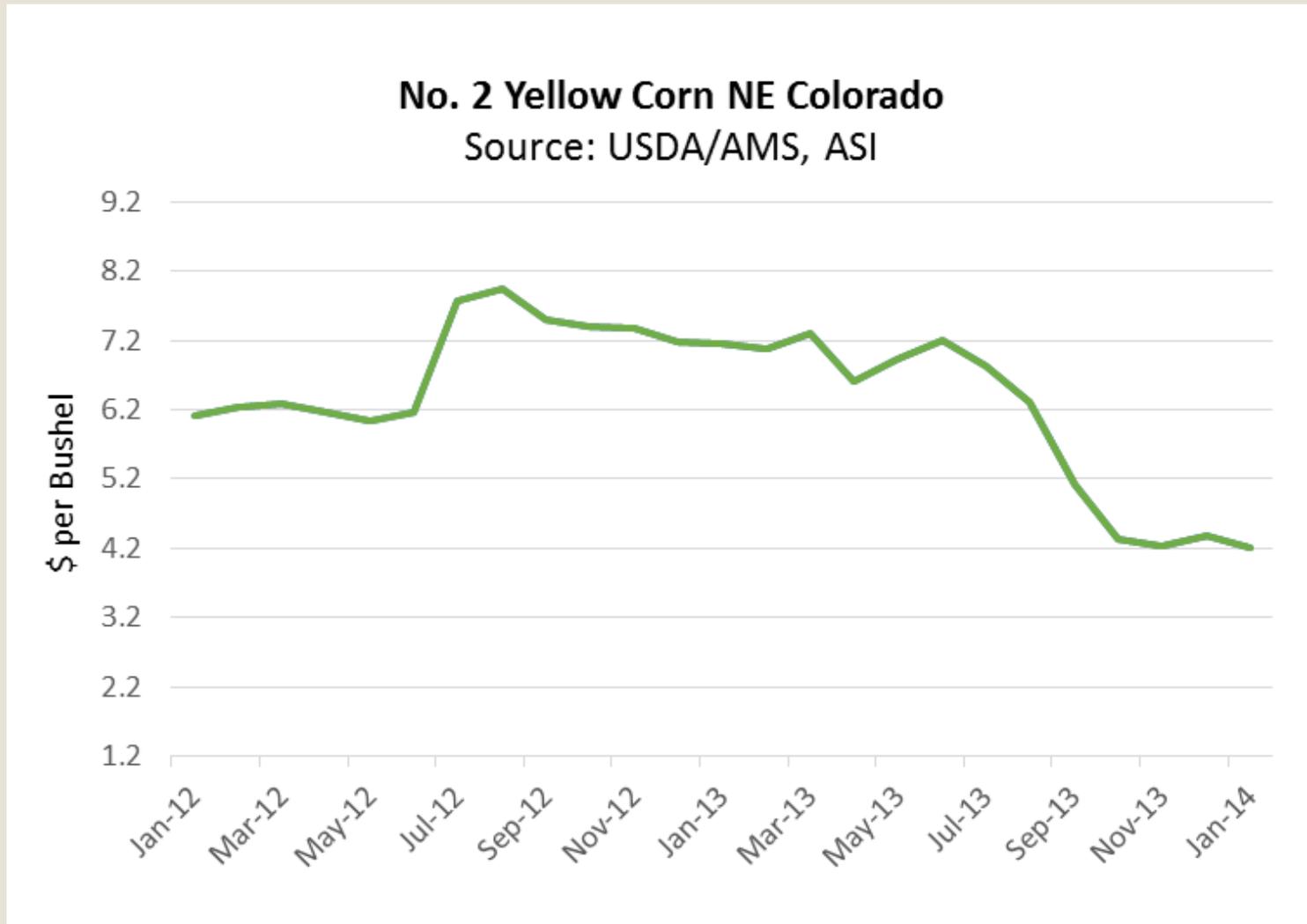
Volume of feeders in direct trade saw a 4-percent increase in 2013 to 205,625 head.



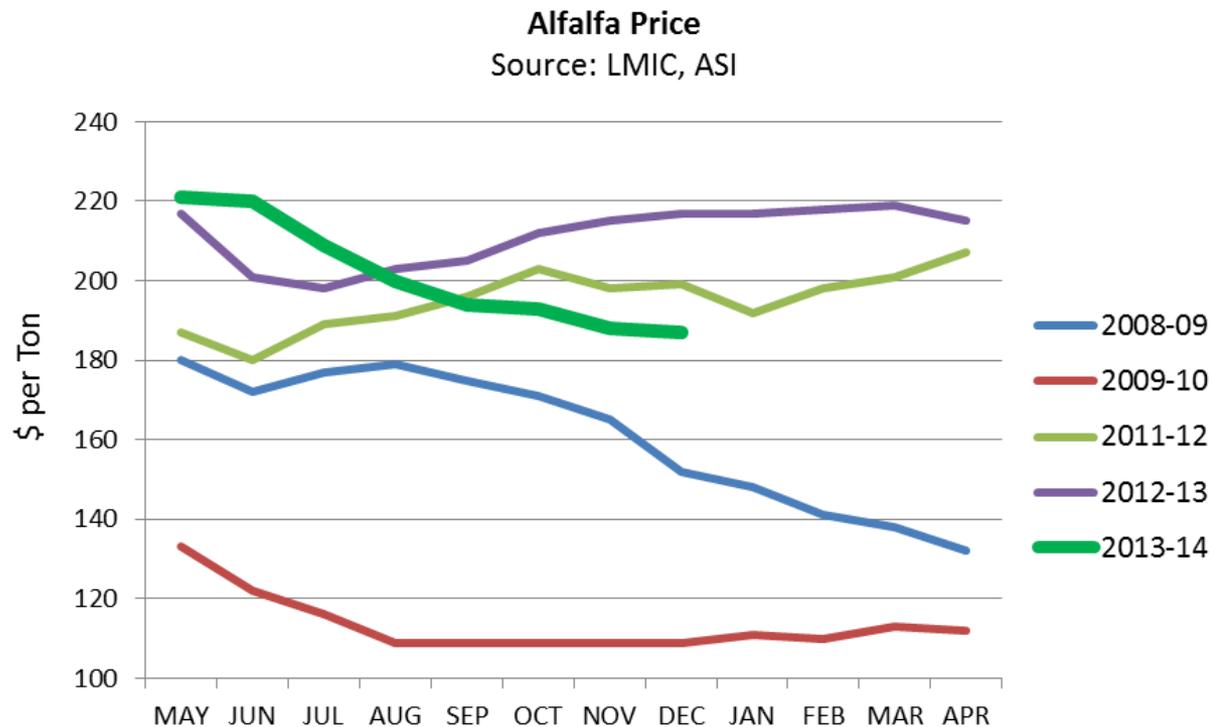
Price of Corn Dropped Sharply In Late-2013

- Corn averaged \$4.31 per bu. in Q4, down 29% quarterly and down 41% year-on-year (USDA/AMS, 1/2014).

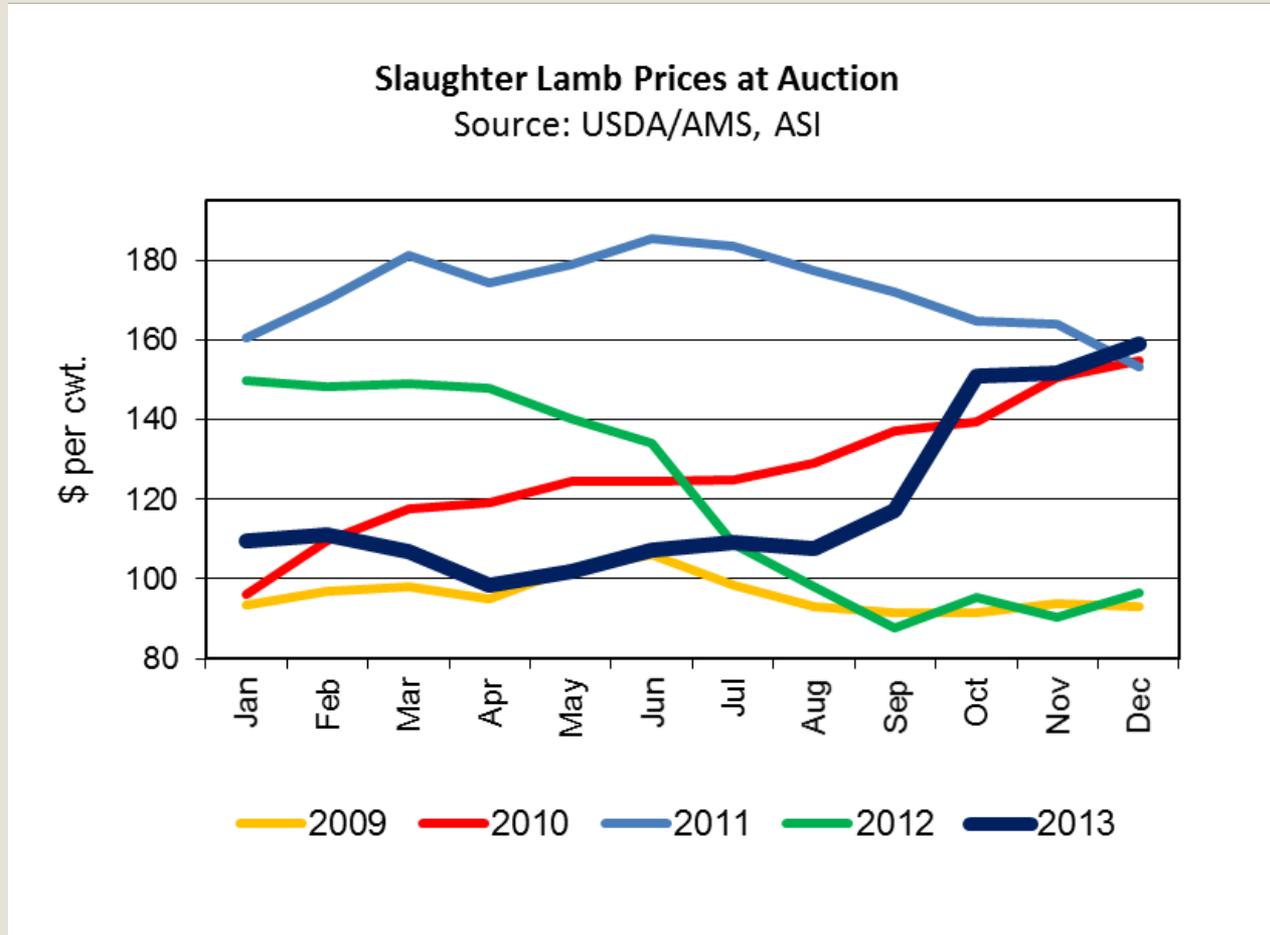
Corn Began to Fall in June



Alfalfa averaged \$199.67 per ton in the first nine months of its 2013/14 marketing year beginning May, down 5% year-on-year



At \$119.28/cwt., Auction Slaughter Lamb Prices 1-Percent Lower Year-on-Year and 6-Percent Lower from 5-year Average



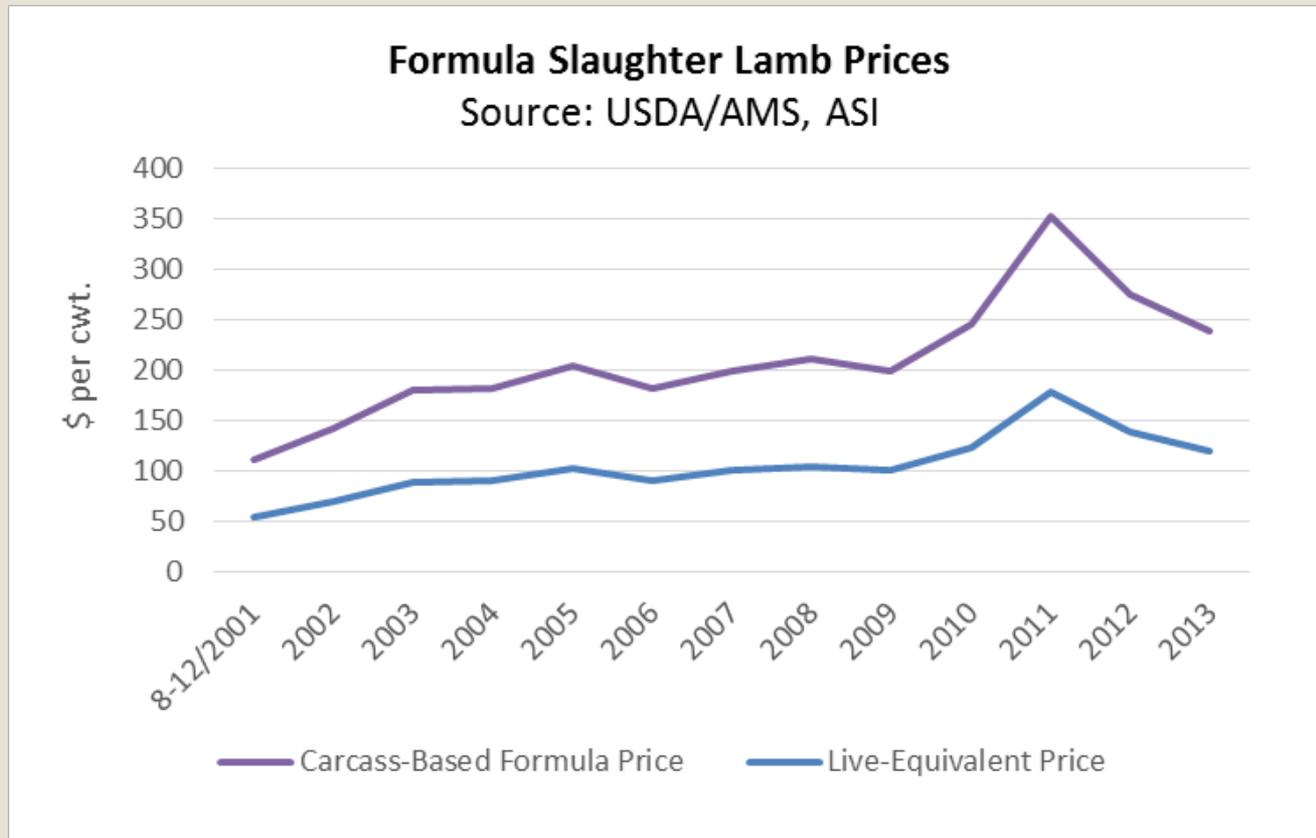
Auction Slaughter Lamb Price Rebounded 37% Since its 7-Year Low in Aug. 2012

Auction, Live Slaughter Lamb Prices

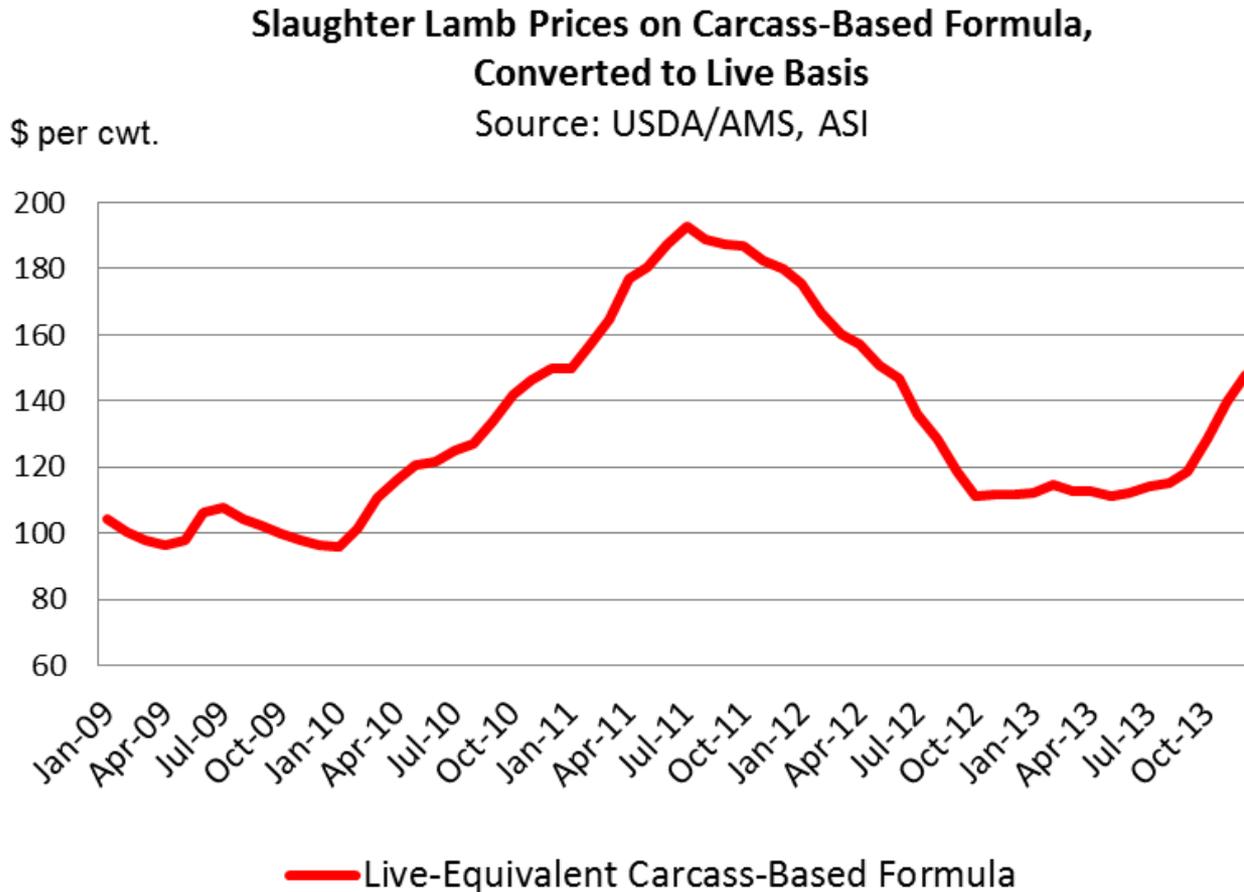
Source: USDA/AMS, ASI



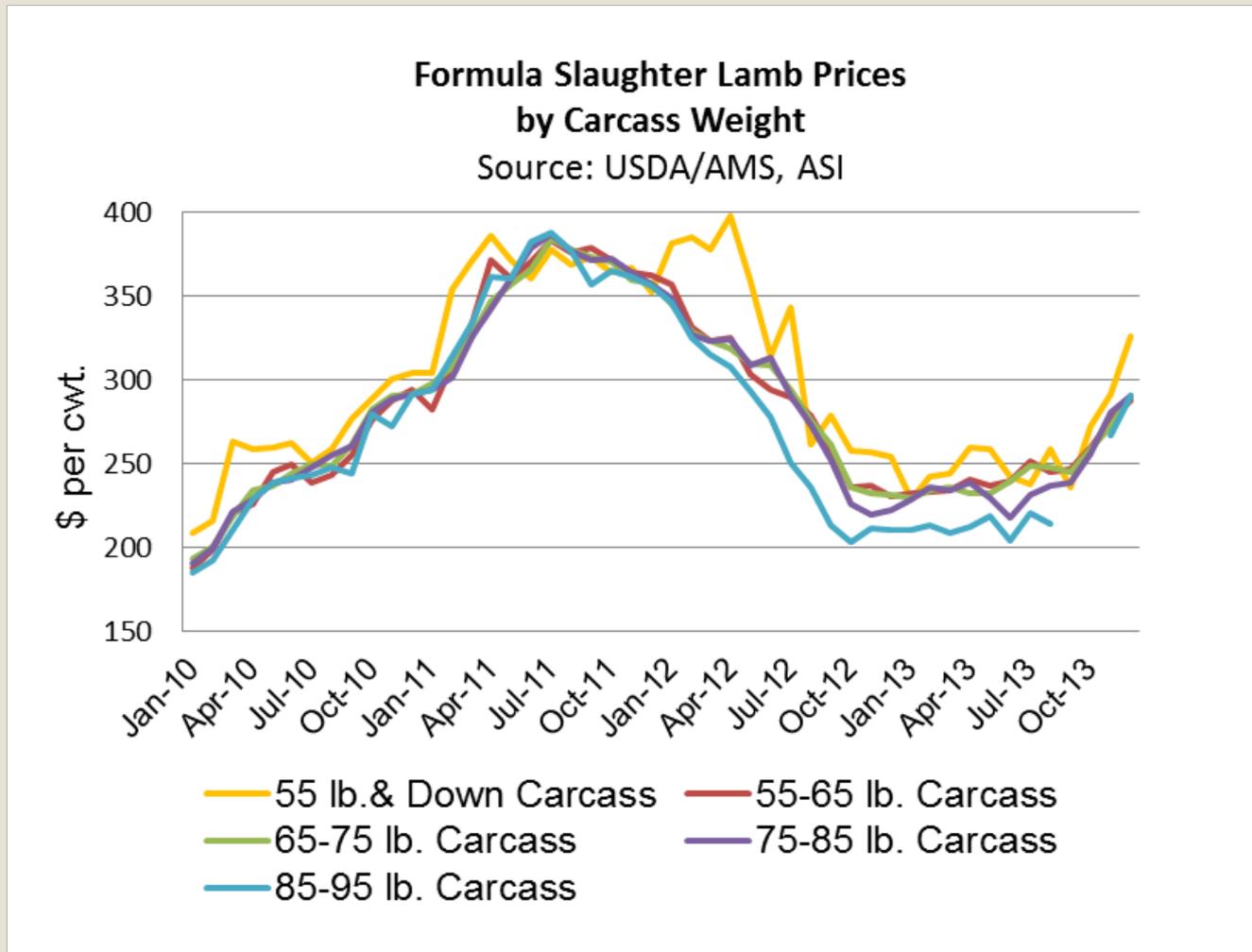
Slaughter lamb prices on a carcass-based formula averaged \$239.37/cwt. (\$120.05/cwt. live-converted), down 13% annually.



Prices Rebounded 33% Since October 2012's Stabilization



Prices by Weight Trended Together; Heaviest Carcasses No Longer in the Mix



Live, Negotiated Prices Top Formula Prices

- Slaughter lambs in live, negotiated sales averaged \$125.38/cwt. in 2013, down 4% year-on-year.
- 2013 weights were 140 lbs., -0.16% from 2012.

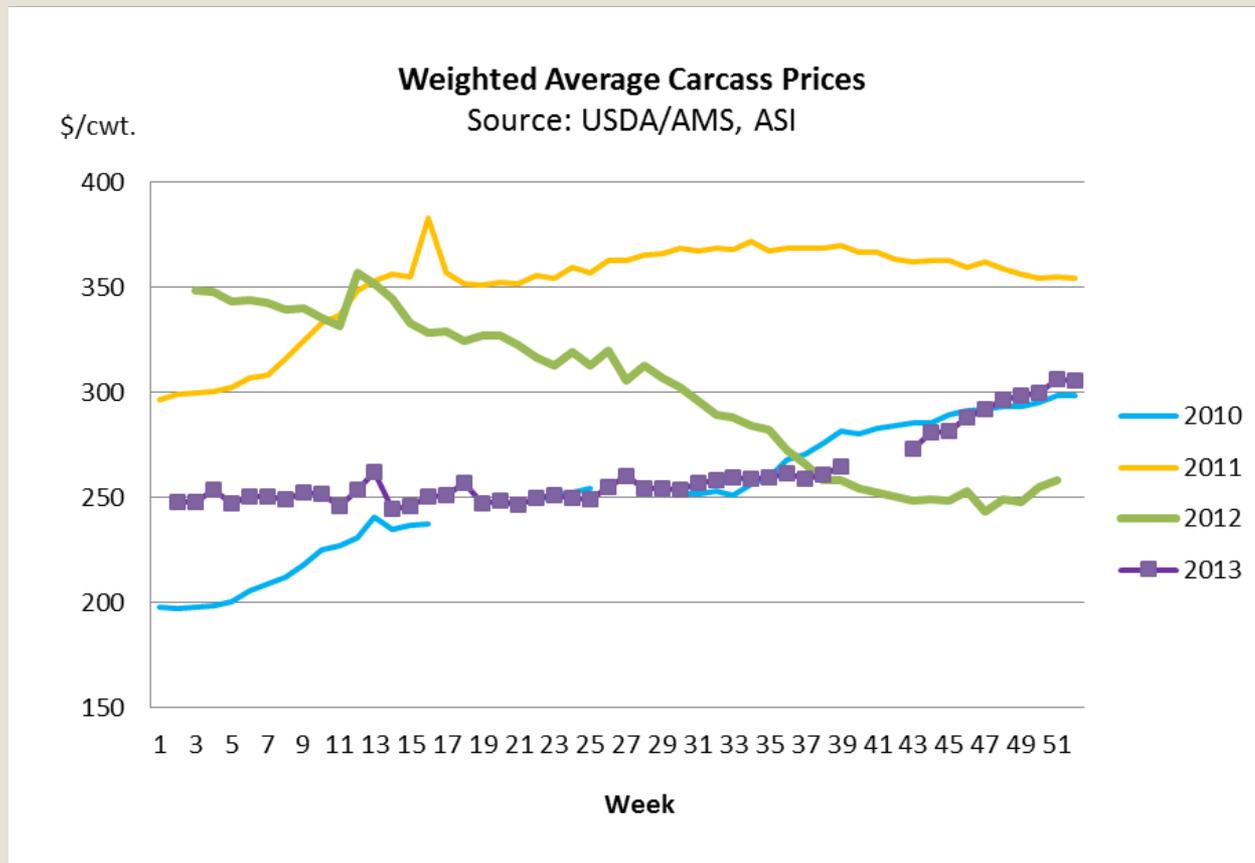
III. Carcass and Boxed Lamb Market Trends



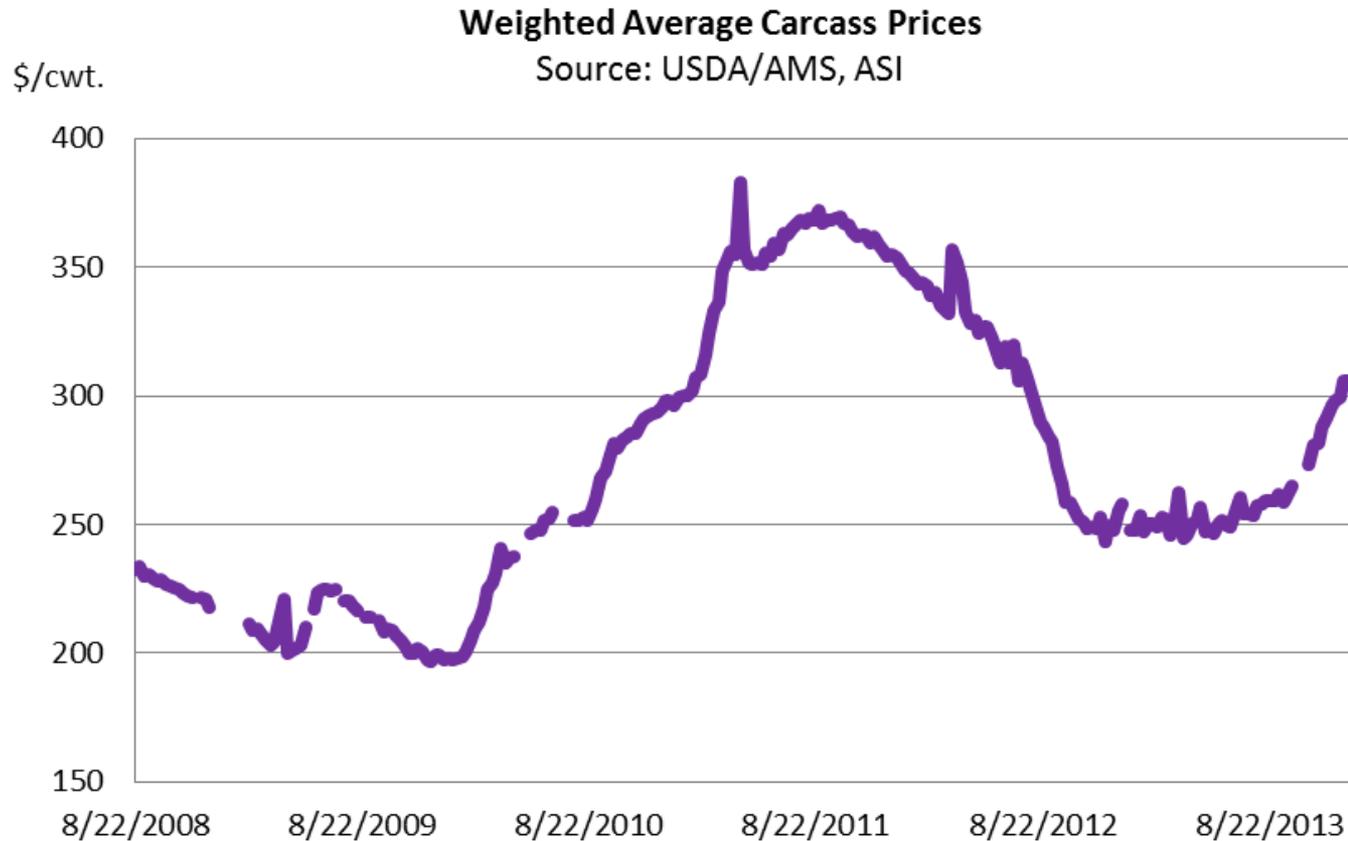
300.56
261.23
-0.13084

Carcasses Lower Year-on-Year, but with Late-2013 Gain

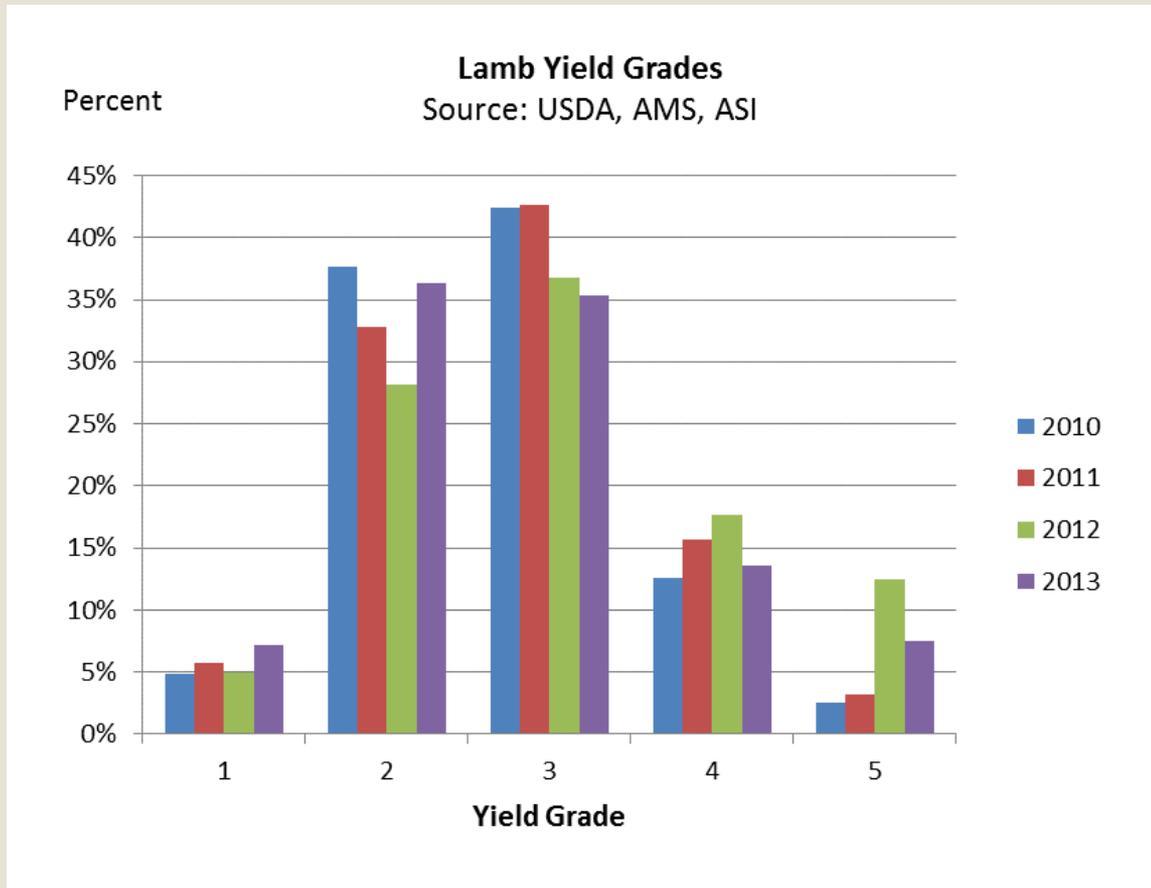
- Weighted average carcass price averaged \$261.23/cwt. in 2013, 13-percent lower year-on-year.



Carcass Rebounded 26% from its Late-2012 Low



YG 1s (Minimal Back Fat) Up in 2013 with Very Current Market



Carcasses Trimmer: YG 4s and 5s Came Down

- Yield Grade determination is positively correlated with heavier slaughter lambs.
- Yield Grade 4 & 5 in lbs. was 21% of total slaughter in 2013 – down from 30% in 2012.

Yield Grades for Federally Inspected Lamb and Mutton

Percentages, Fiscal Year

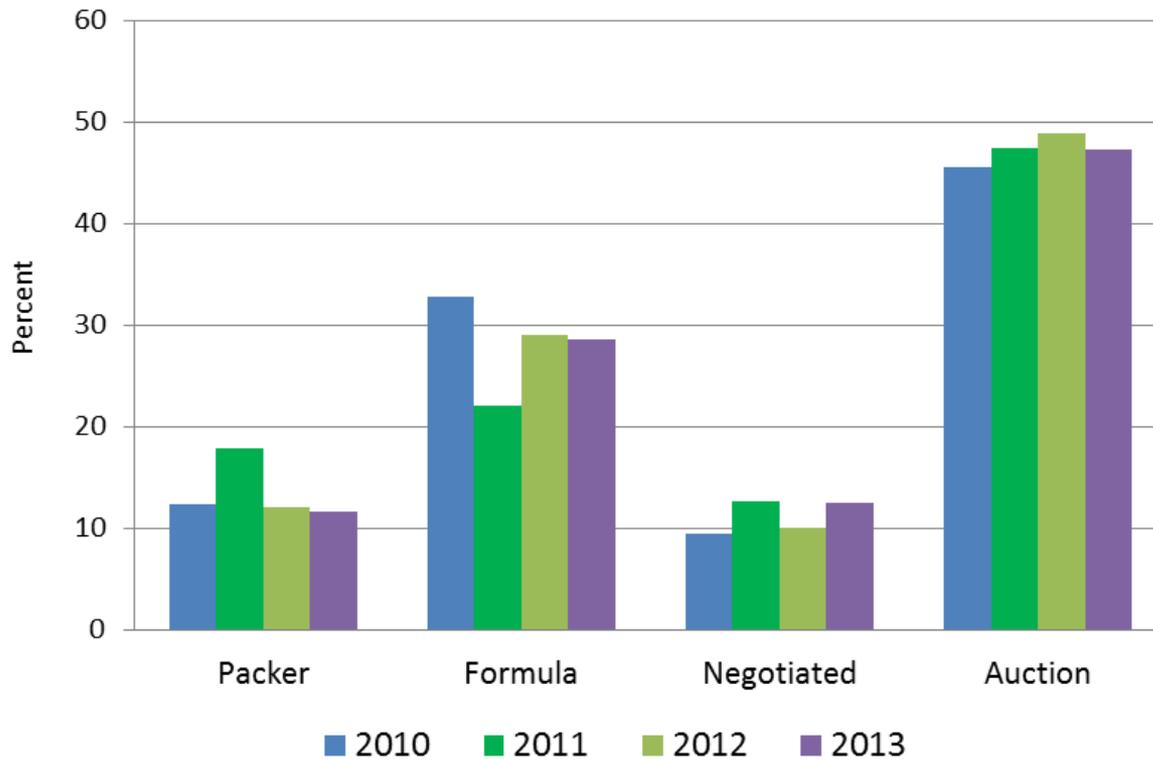
Source: USDA, AMS, Livestock and Seed Division.

	YG1	YG2	YG3	YG4	YG5
2008	5%	31%	47%	14%	3%
2009	4%	34%	45%	14%	4%
2010	5%	38%	43%	13%	2%
2011	4%	27%	49%	17%	3%
2012	5%	28%	37%	18%	12%
2013	3%	31%	47%	15%	4%

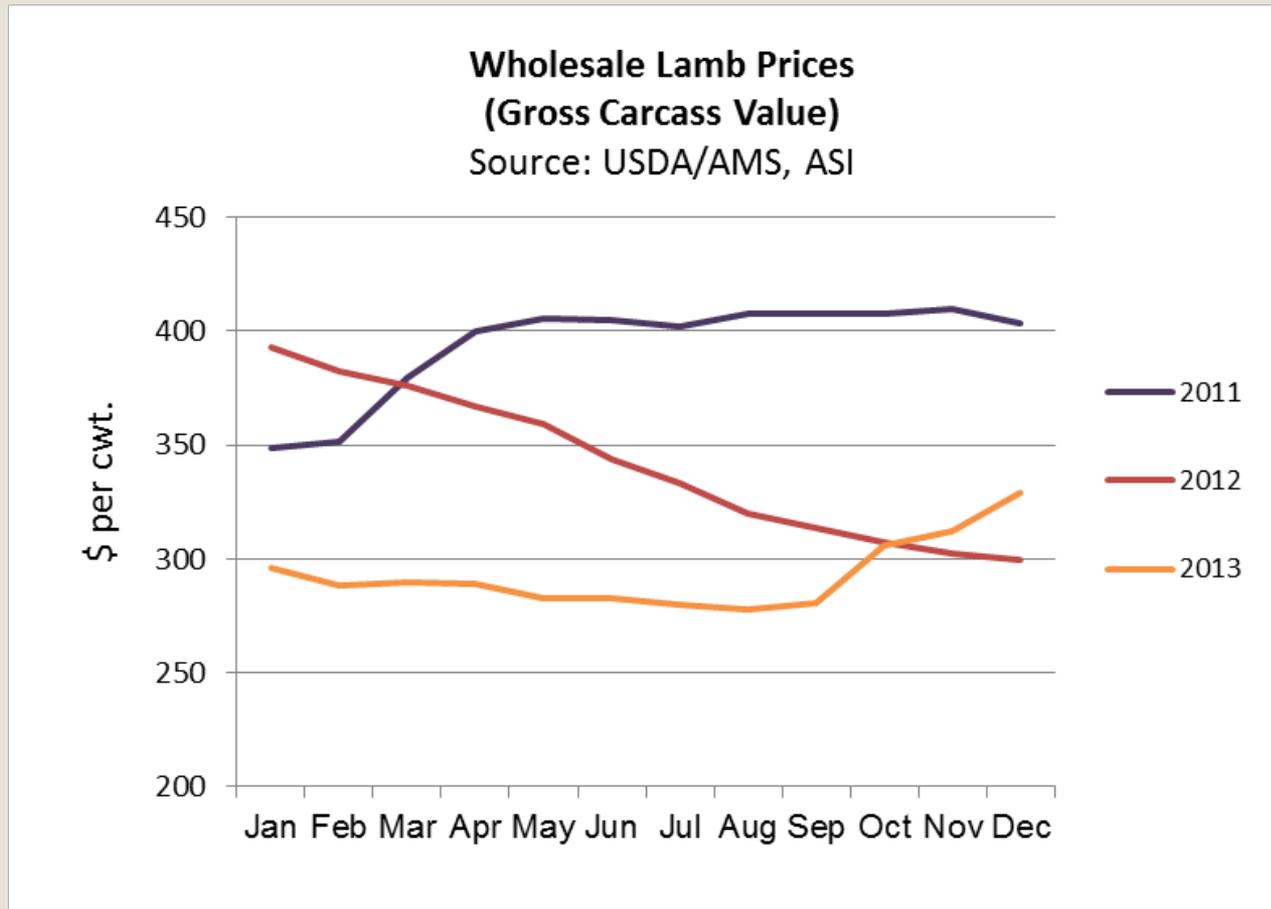
Formula Sales -- Offering Premiums and Discounts for Quality -- Down in 2013

Estimated Commercial Marketing Shares

Source: USDA/AMS, ASI



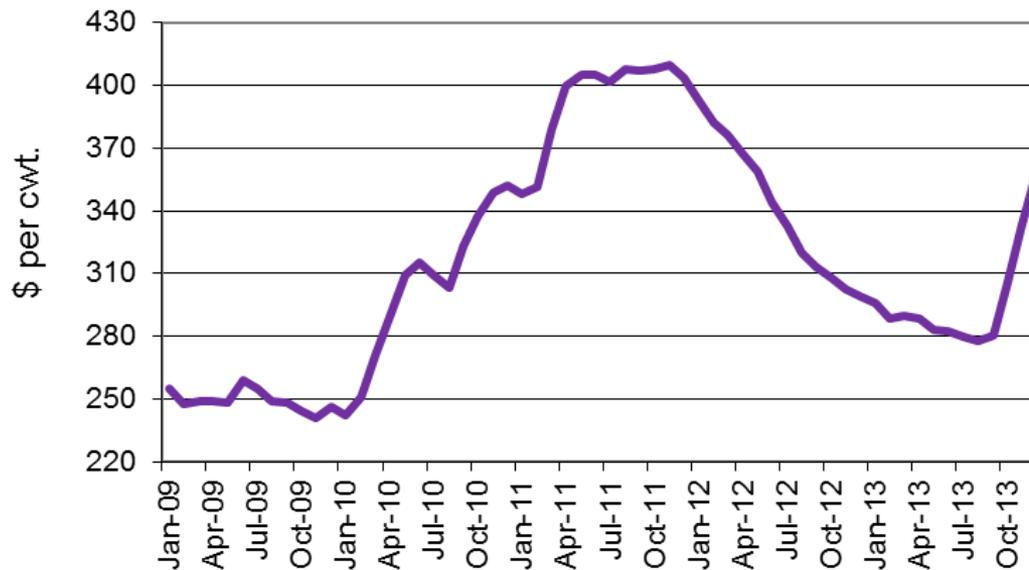
2013 Gross Carcass Value (Wholesale Average) Down Annually by 13%



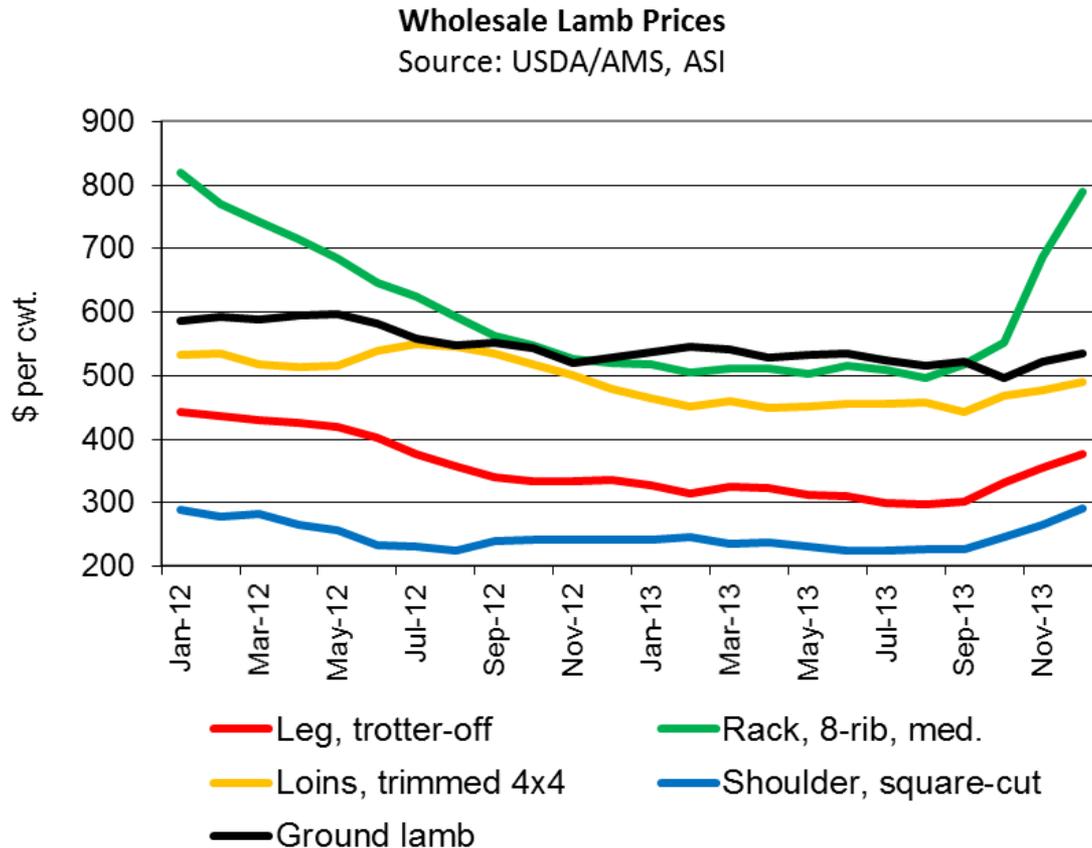
By the end of December, the gross carcass value was still 20-percent lower than the Nov. 2011 record high.

Gross Carcass Value (Wholesale Lamb) Prices, 2009-2013

Source: USDA/AMS, ASI



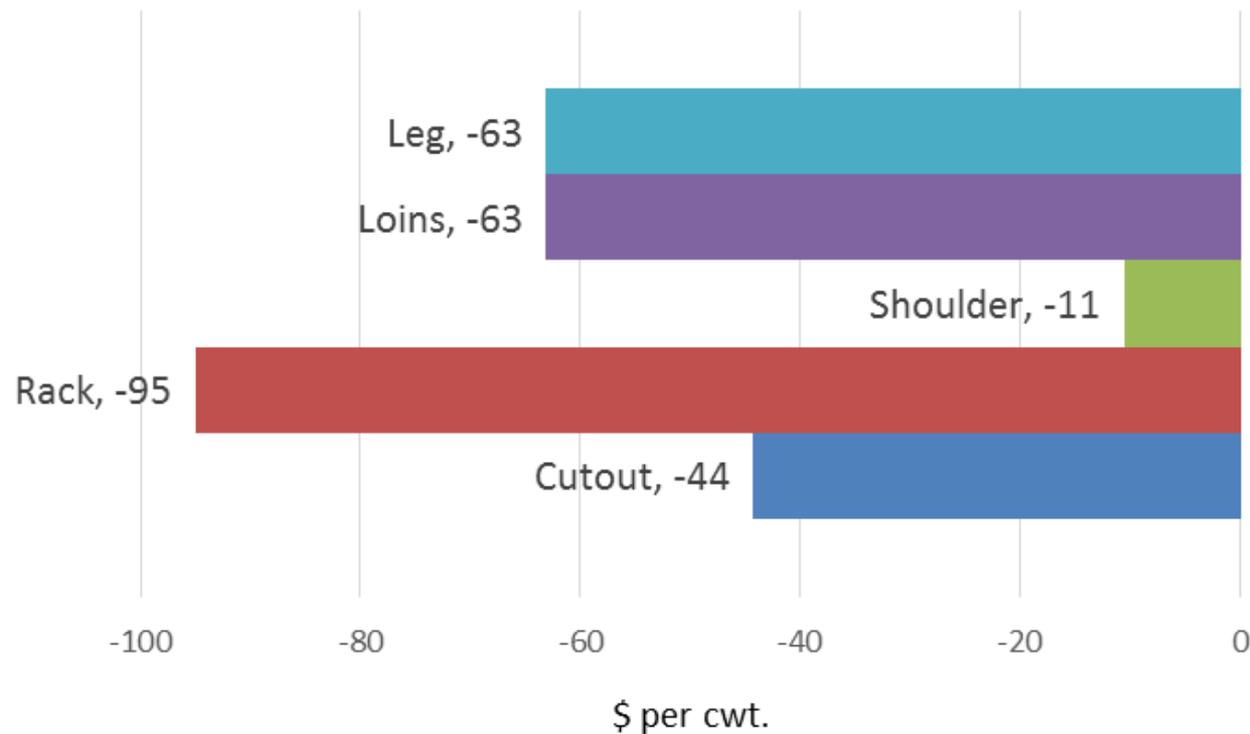
Lamb Primals Relatively Steady Over Past Year, but with Year-end Gain



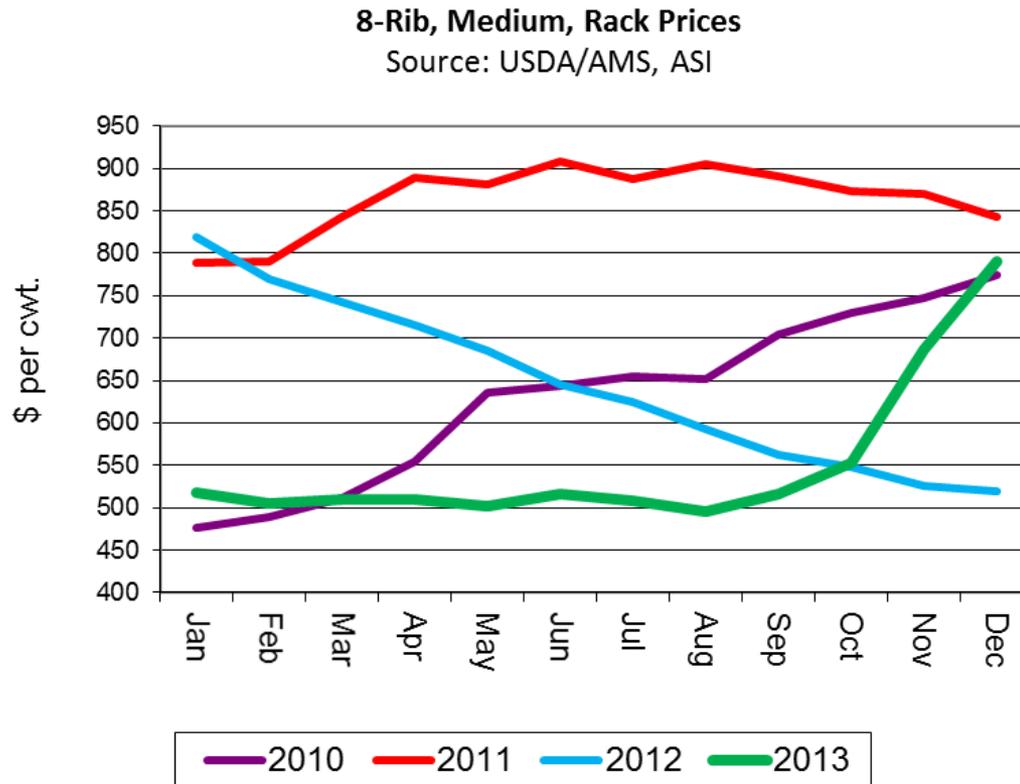
**In 2013, the cutout fell \$44/cwt.
--It was supported by the shoulder.**

Change in 2012-2013 Cutout and Primal Prices. \$/cwt.

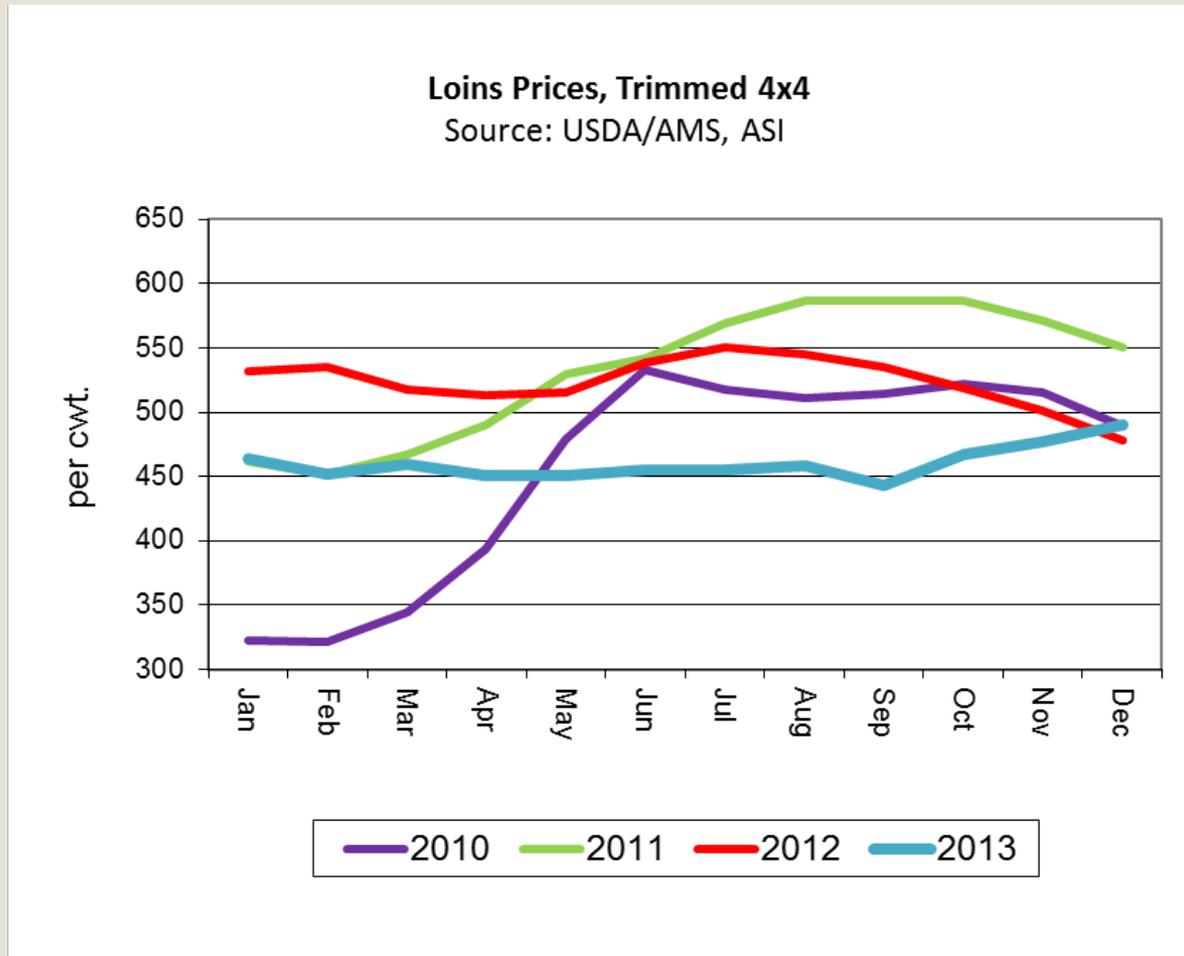
Source: USDA/AMS, ASI



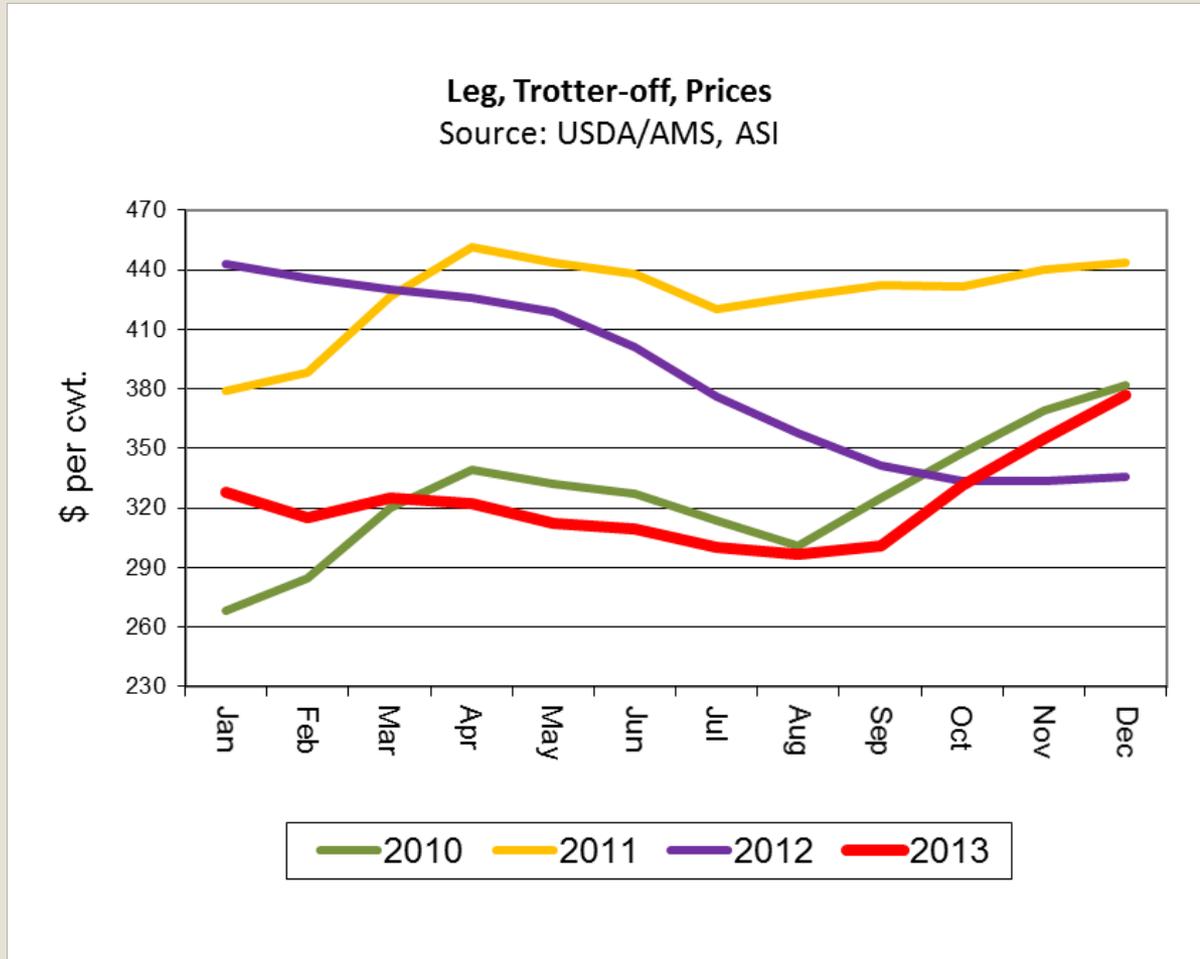
The rack averaged \$550.79/cwt. in 2013 down 15% year-on-year.



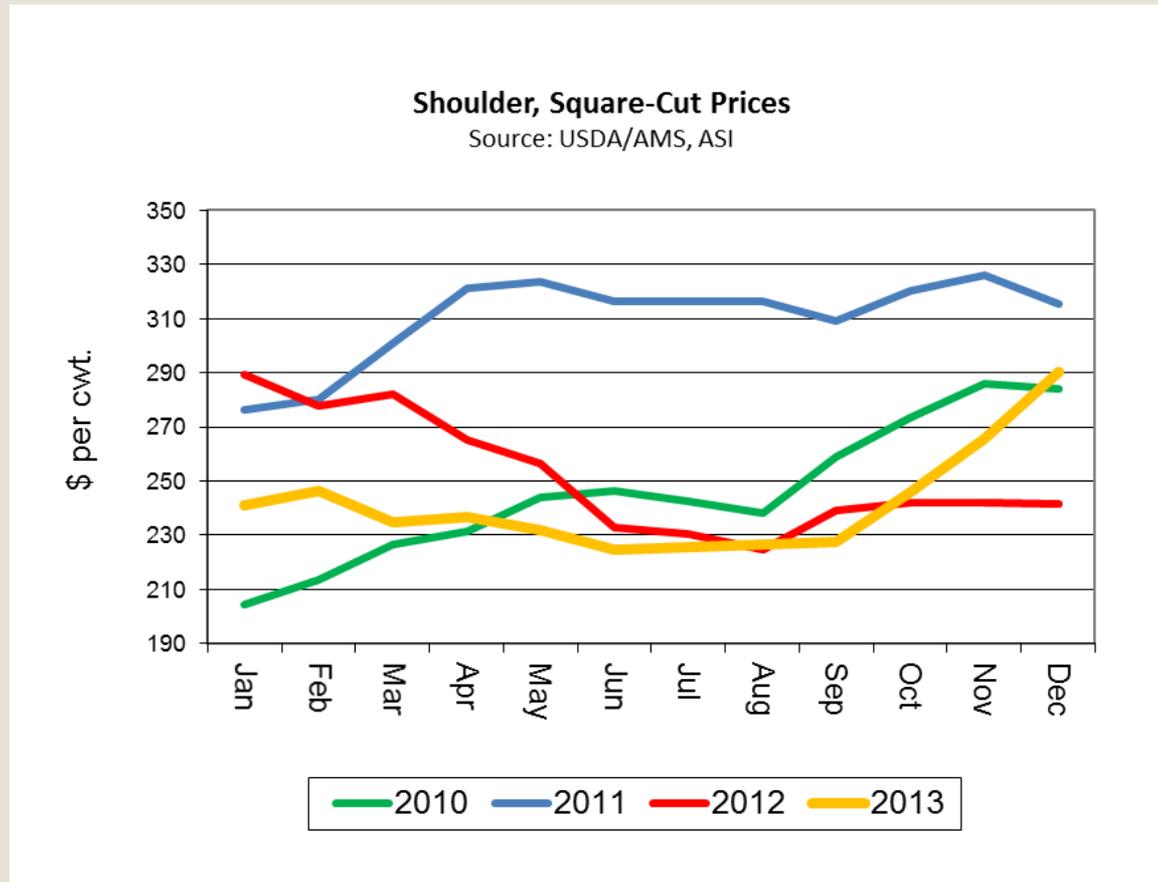
Loins, trimmed 4x4, averaged \$460.27/cwt., down 12% year-to-year.



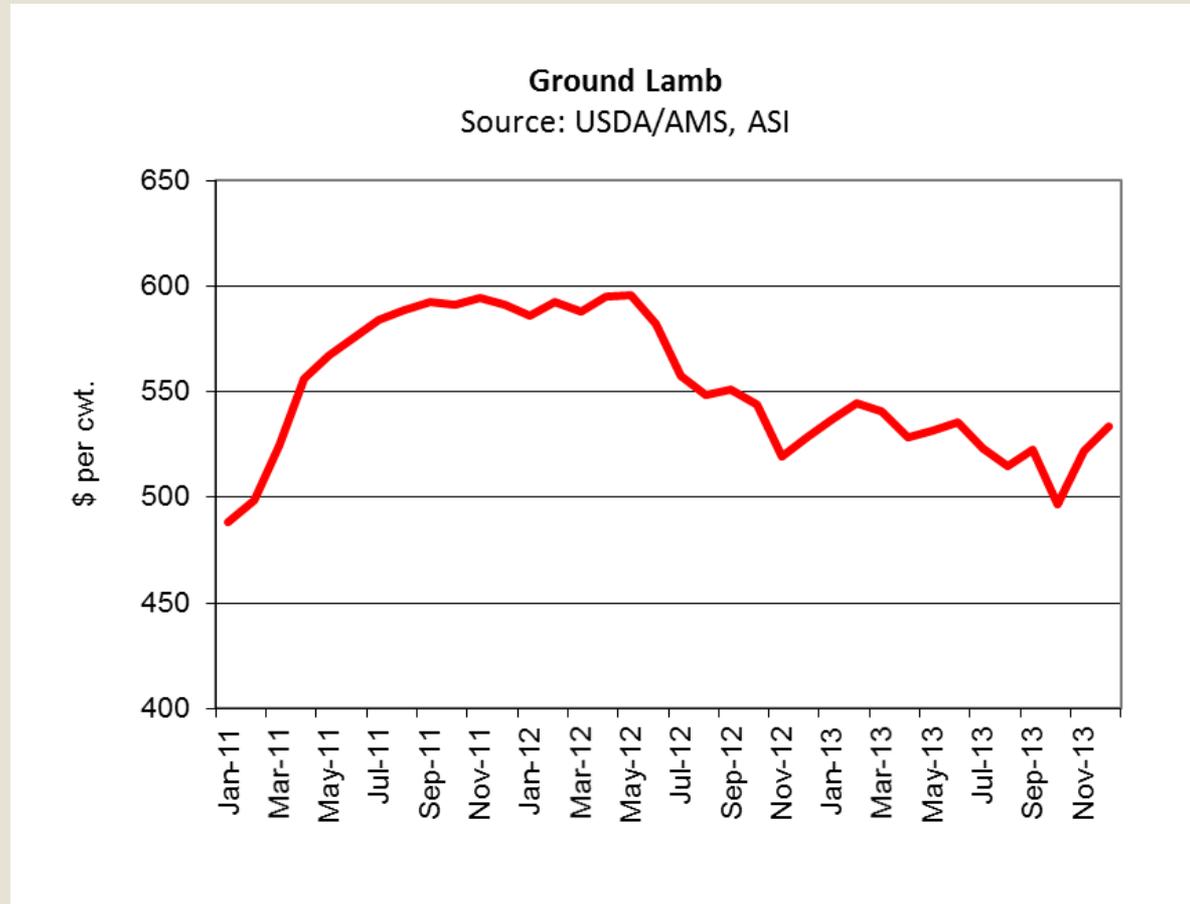
The leg averaged \$322.82/cwt. in 2013, down 16% year-to-year.



The shoulder averaged \$241.30/cwt. in 2013, down 4% annually.



Ground lamb averaged \$530.90/cwt., down 6% year-on-year.



IV. At Retail & Food Service



Food Service Sector Growth Down in Late 2013

- The National Restaurant Association reported a volatile, yet expansionary foodservice sector in 2013.
- The end of 2013 set the stage for 2014 growth:
- “With improving macroeconomic factors as a tailwind going into the new year, Larry Miller, founder and chief executive of the monthly MillerPulse report, projected a modest 2-percent increase in industry-wide same-store sales for 2014,” (*Nation’s Restaurant News*, 1/15/2014).

Retail Feature Activity Down in 2013

- Lamb feature activity was down 1% in 2013 annually according to the USDA Agricultural Marketing Service.
- Average lamb feature prices across years saw a 5-percent weakening to \$6.56 per lb. – albeit feature activity and cuts offered across years not held constant.

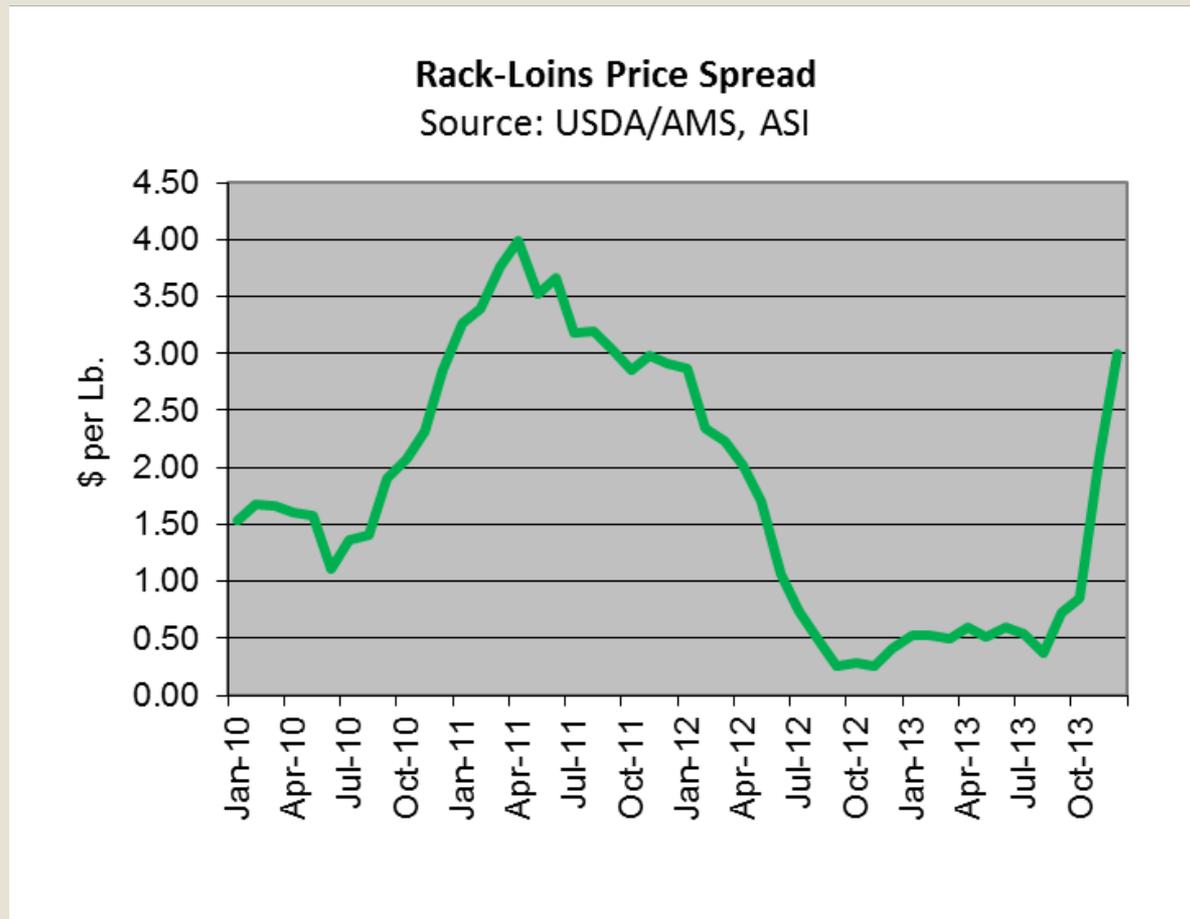
Retail Featured Prices Lower on Popular Cuts

	2012	2013	% Change
Boneless leg	\$7.72	\$7.04	-9%
Loin chops	\$9.17	\$8.84	-4%
Shoulder blade chops	\$5.04	\$4.96	-2%

V. Price Spreads



The rack-loin price spread averaged \$0.91 per cwt. in 2013, down 6% year-to-year, with a range of \$0.53 to \$3 per cwt.

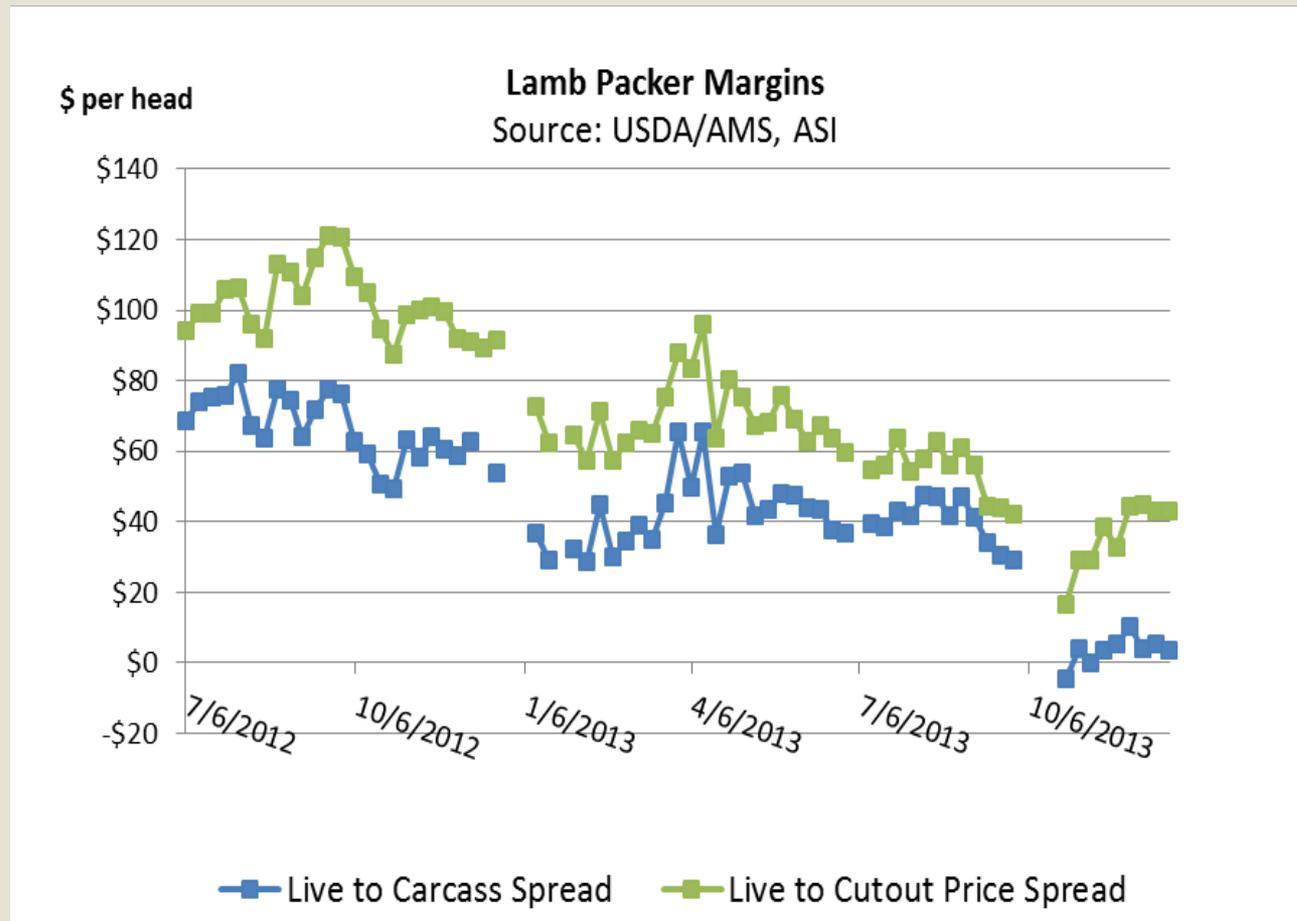


Understanding Packer Spreads

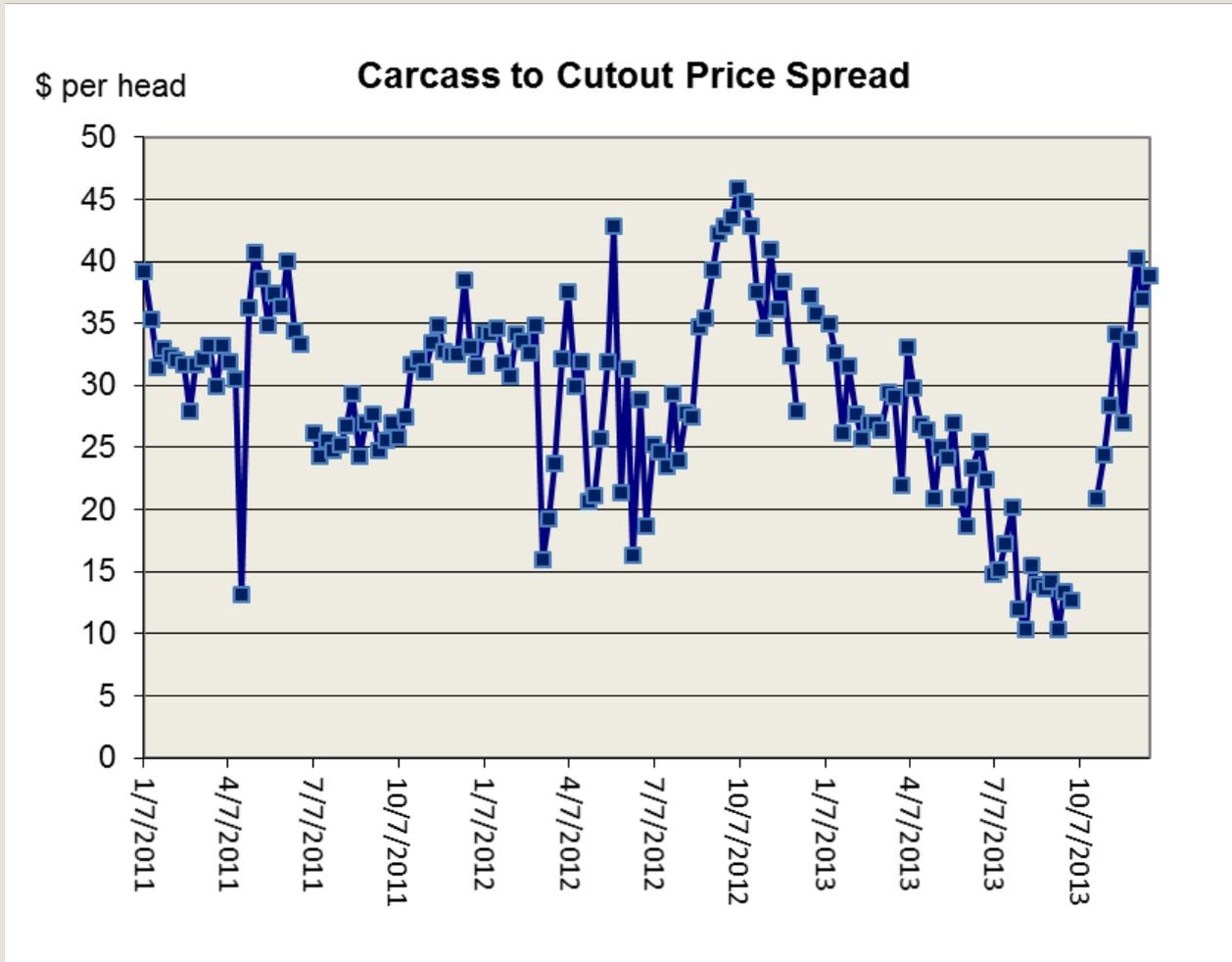
- Packer price spreads do not include any costs of processing.
- Packers also sell carcasses, to the processing industry and to one another.
- The price spreads assume that all that is processed sells and no allowance is made for cold storage tonnage.

Packer Spreads Narrowed in 2013

-- Live to carcass spread was \$34 per head, down 43% and live to cutout was \$58 per head, down 36%.



Carcass to cutout spread was \$24 per head in 2013, down 23% annually.



VI. Pelts



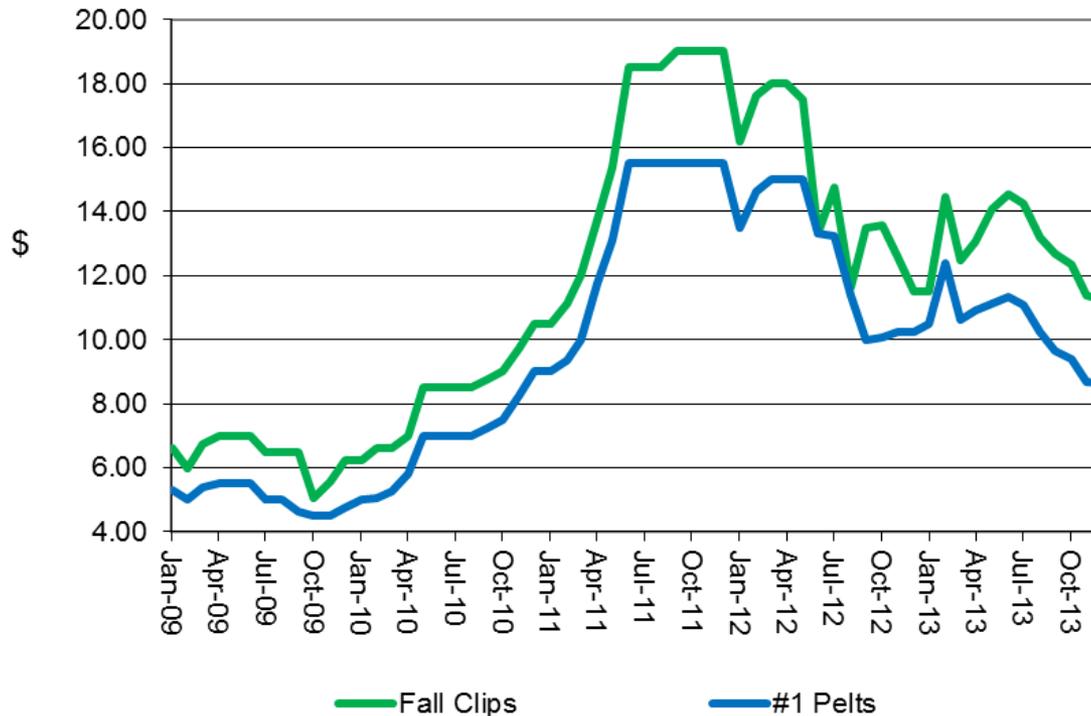
Pelts Down Year-on-Year

- Fall Clips were \$12.64 per piece in 2013 down 13% year-to-year.
- No. 1 pelts were \$10.04 per piece, down 19% year-to-year.
- Lower pelt values might be due to Australia's record-high 2013 slaughter.

Pelt Values Dropped Seasonally in Late-2013

U.S. Packer-Paid Pelt Prices

Source: USDA/AMS, ASI

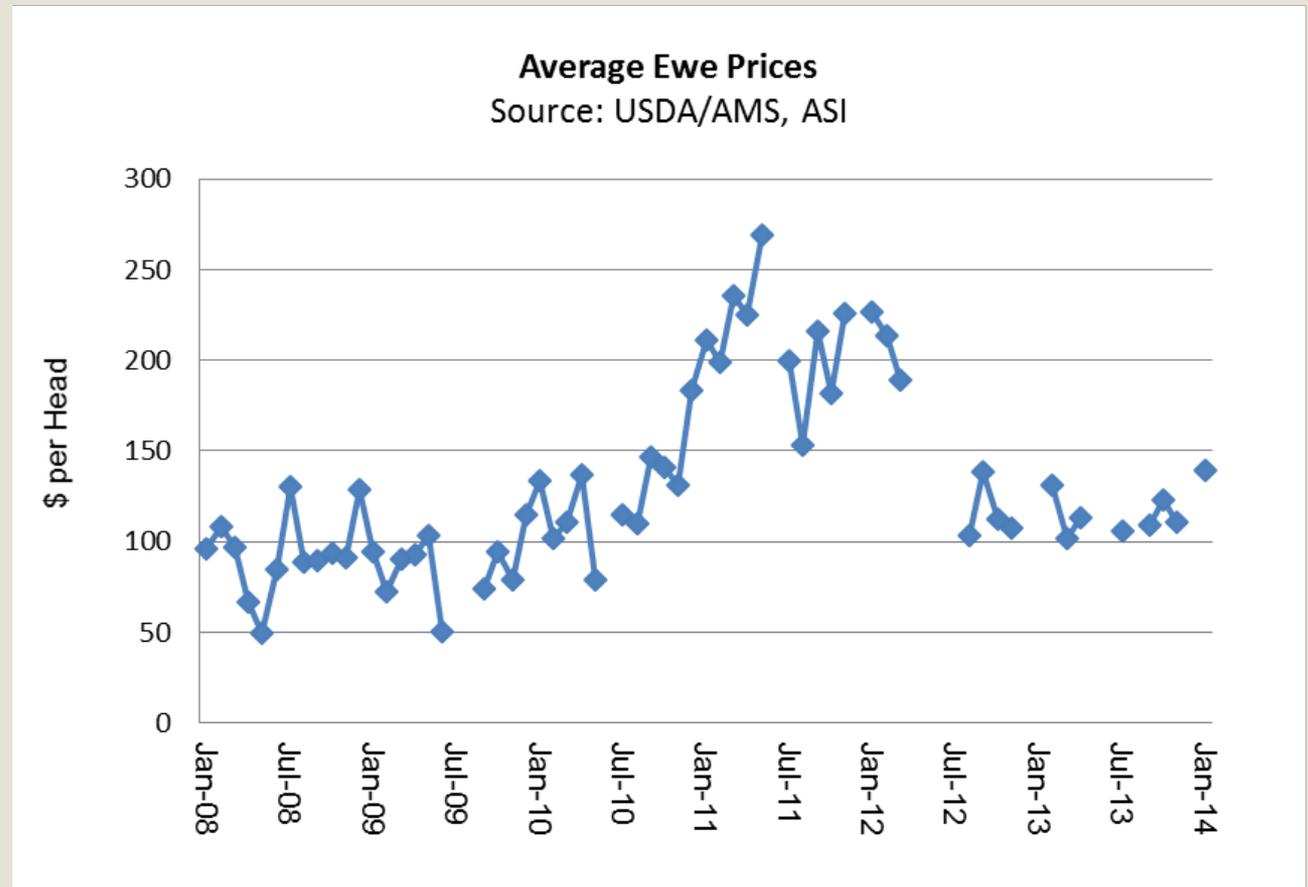


VII. Replacement Sheep



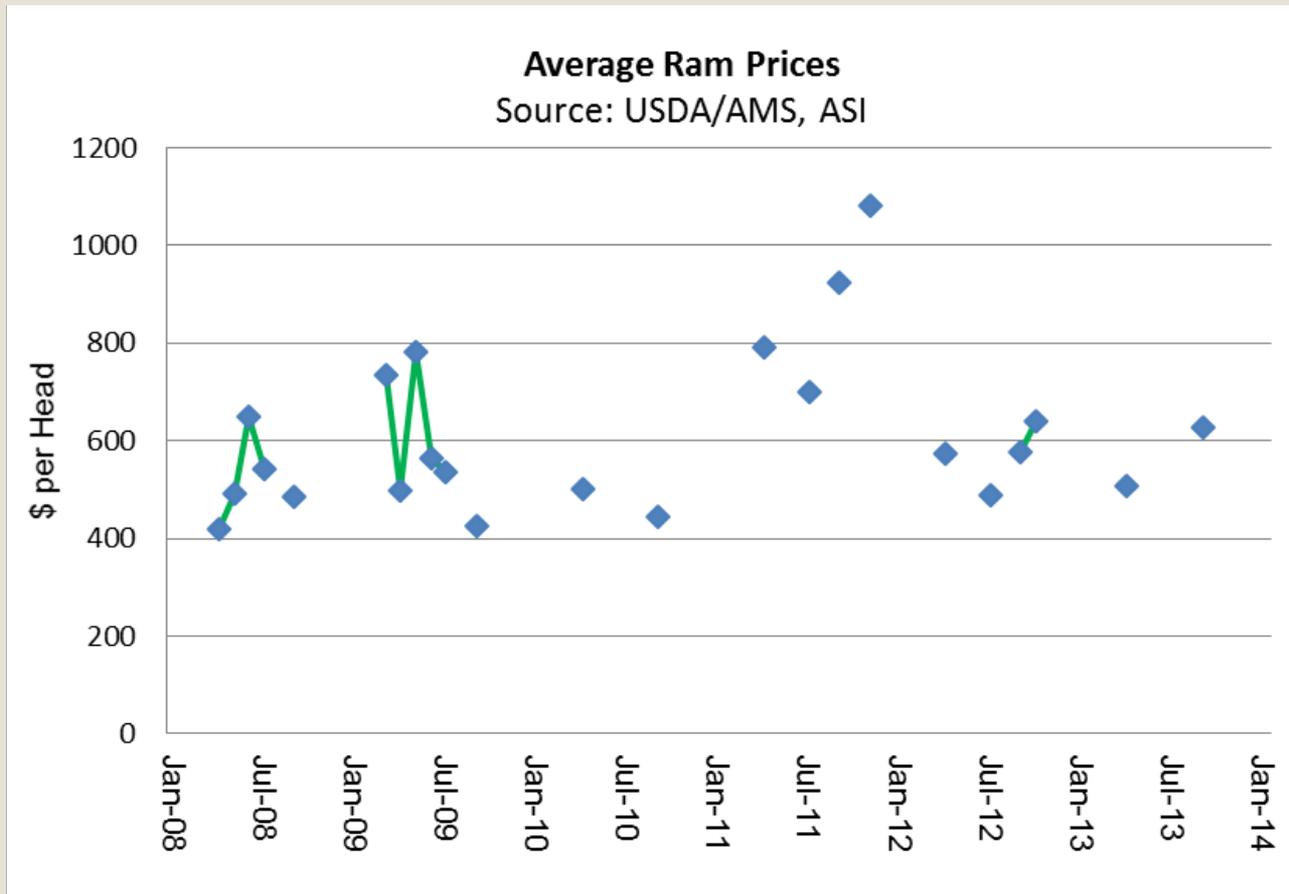
Ewe Lambs Weakened 34% in 2013

-- Ewe Lambs \$122 per head; Yearling Ewes \$170; 2-4 years \$138; 5-6 years \$99 per head; Aged Ewes \$71 per head.



Rams Dropped by 4%

--Black Face \$508 per head; White Face \$648 per head; Cross Bred \$470 per head



VIII.

Domestic Production and Trade

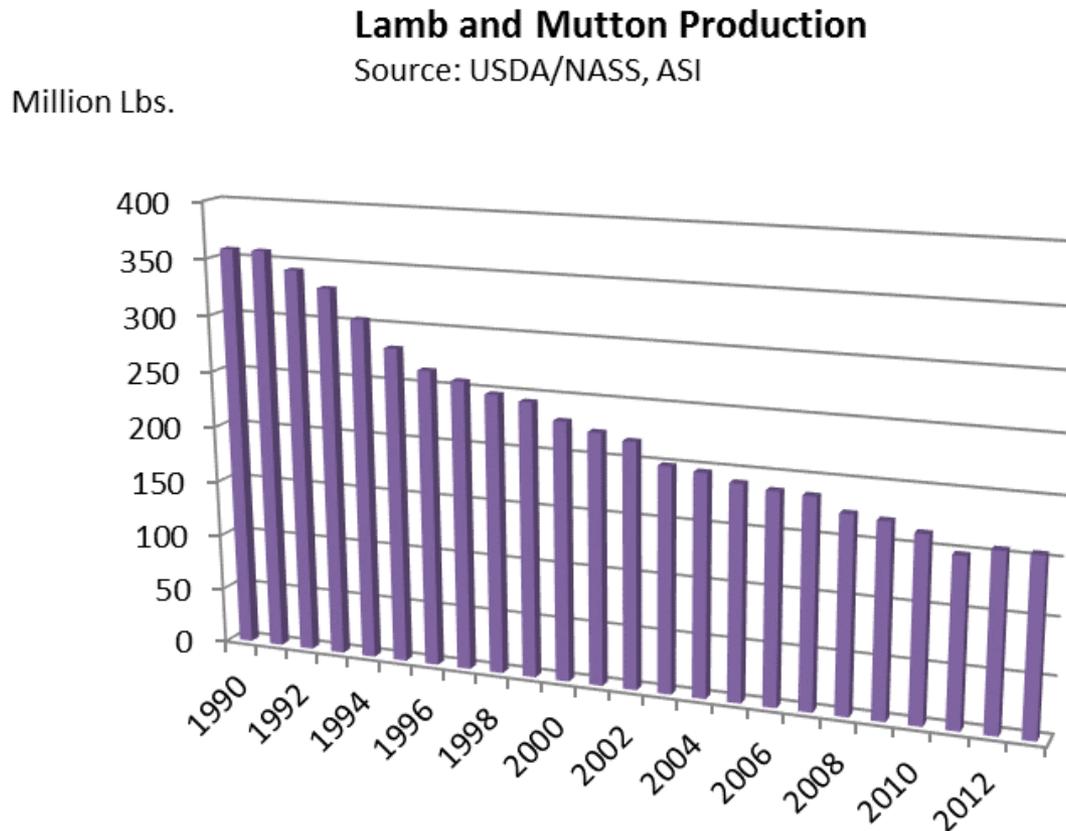


Donald Macleod, Stornoway, Scotland, 2010.

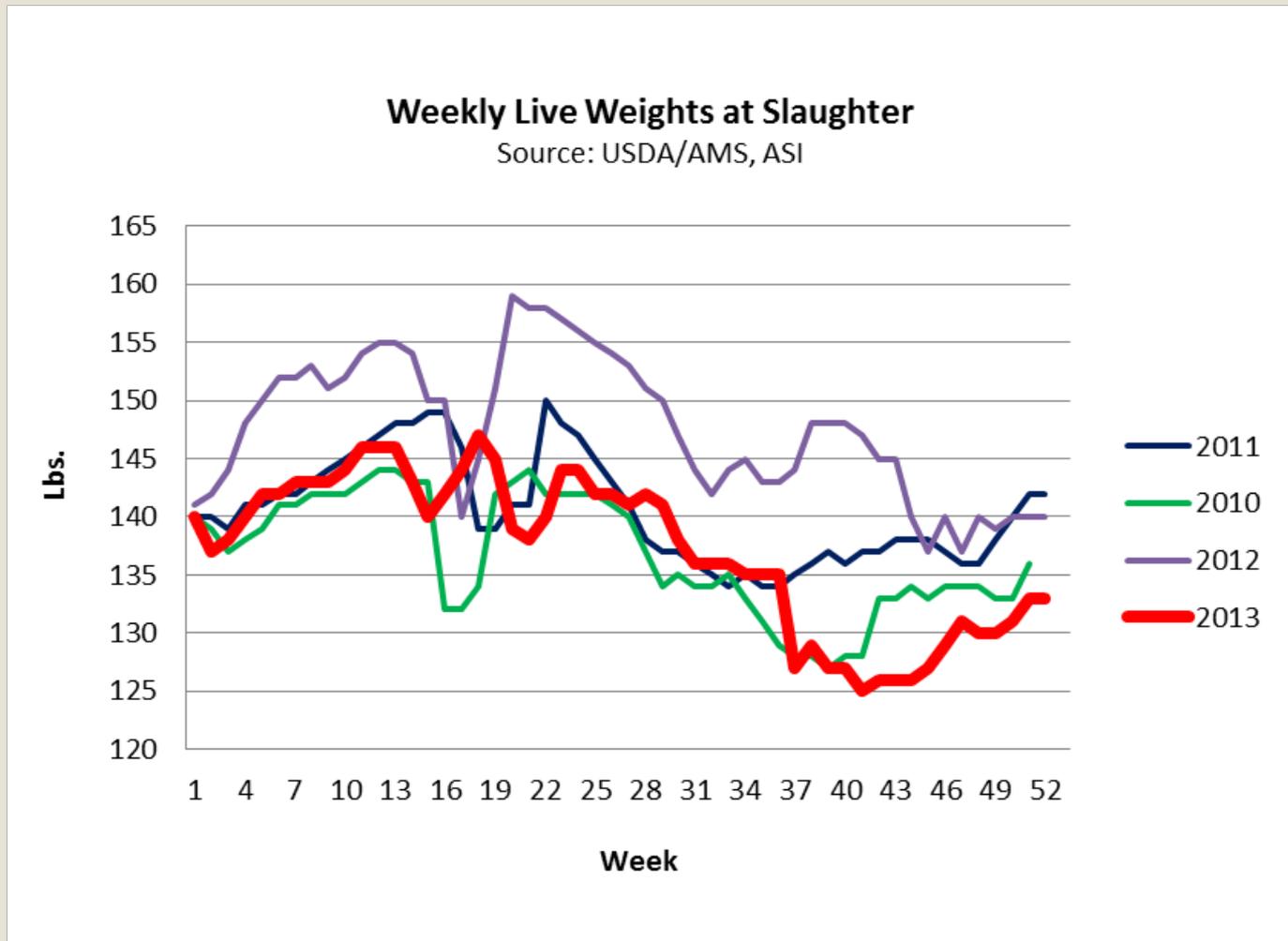
Higher slaughter and lower weights in 2013 translate to nearly-constant production.

- In 2013, commercial slaughter was up 6% to 2.314 million head.
- Slaughter weights were down 6% to 135 lbs.
- Estimated lamb production was 150.3 million lbs., unchanged from 2012.
- Commercial lamb and mutton production was 156 million lbs., 0.3% lower year-on-year.

In 2013 production was down only 0.3%; a stabilization trend not seen since the early 1990s

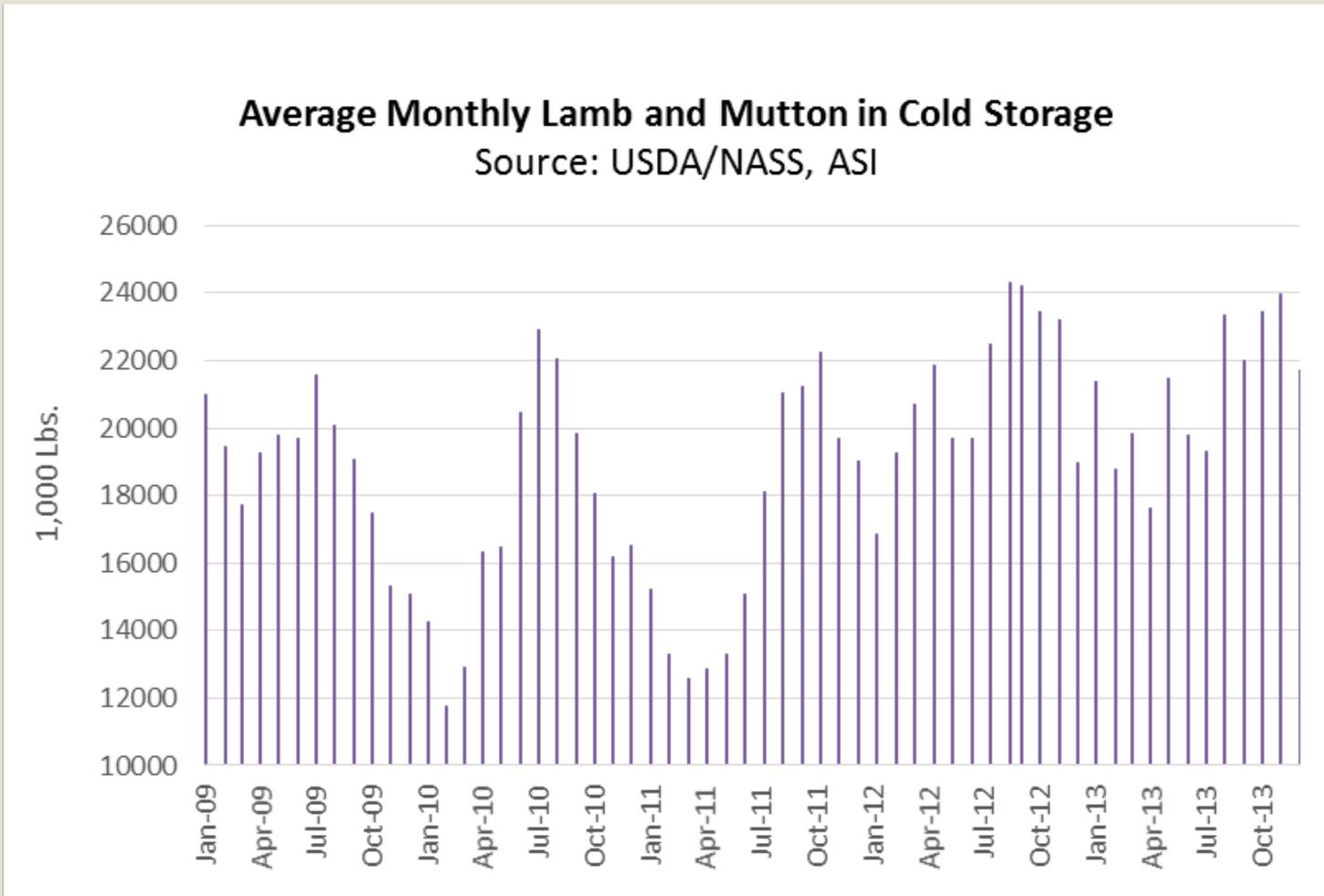


Slaughter Weights in 2013 Averaged 137 lbs., Down 37% Year-on-Year



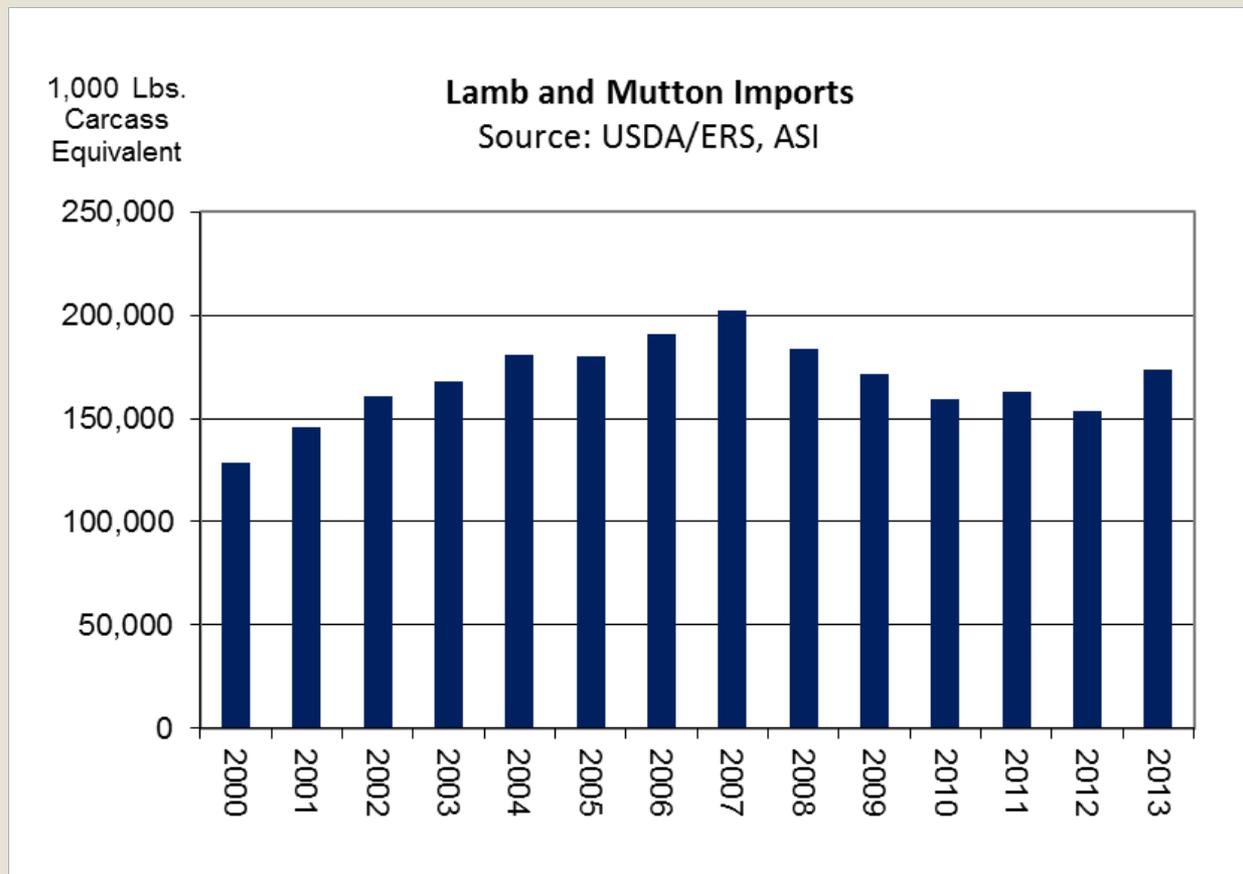
Cold Storage Averaged 21.06 Mill. Lbs. per Month in 2013, down 1% from 2012's Average

- Recall that some portion of cold storage is imported product.

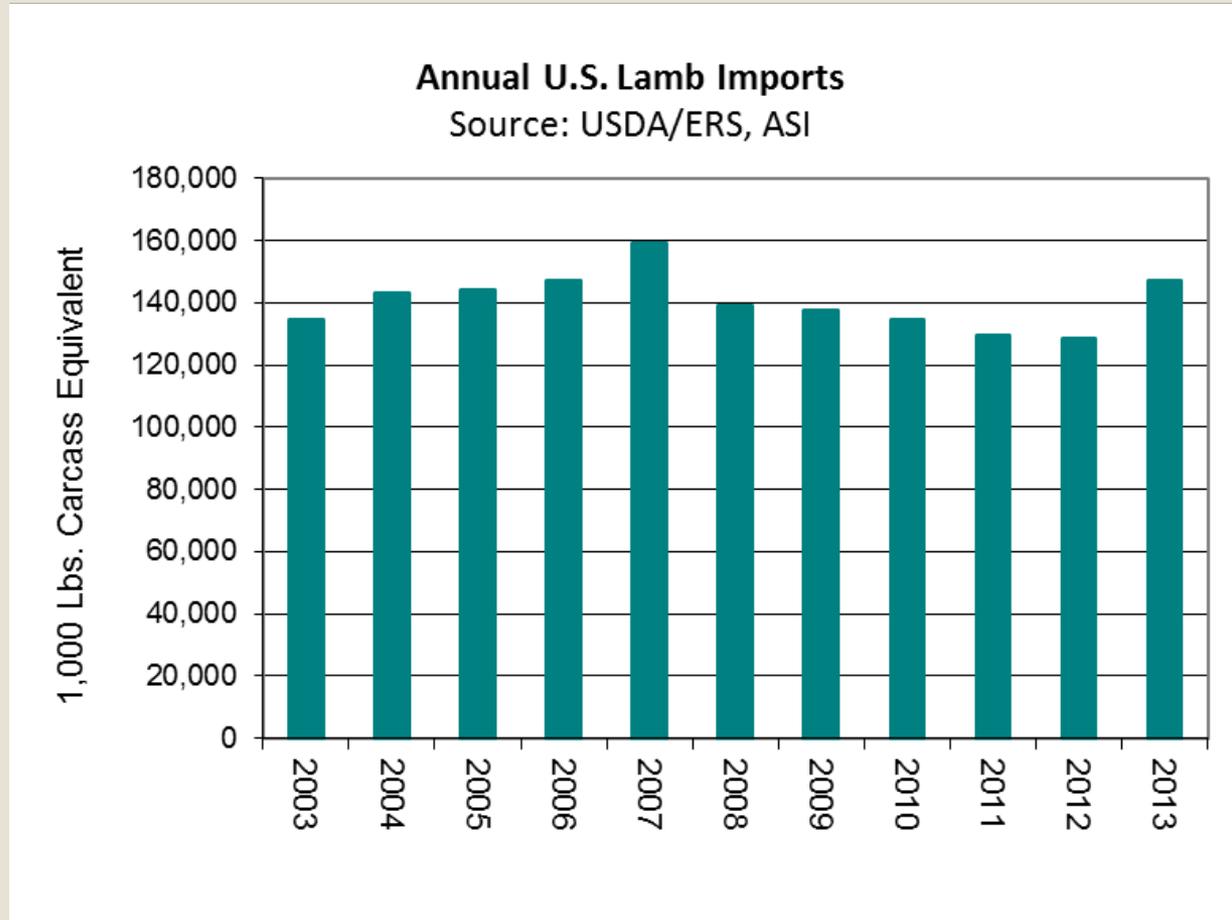


Lamb and Mutton Imports Higher

At 173.3 million lbs., lamb and mutton imports in 2013 were 13% higher year-on-year.



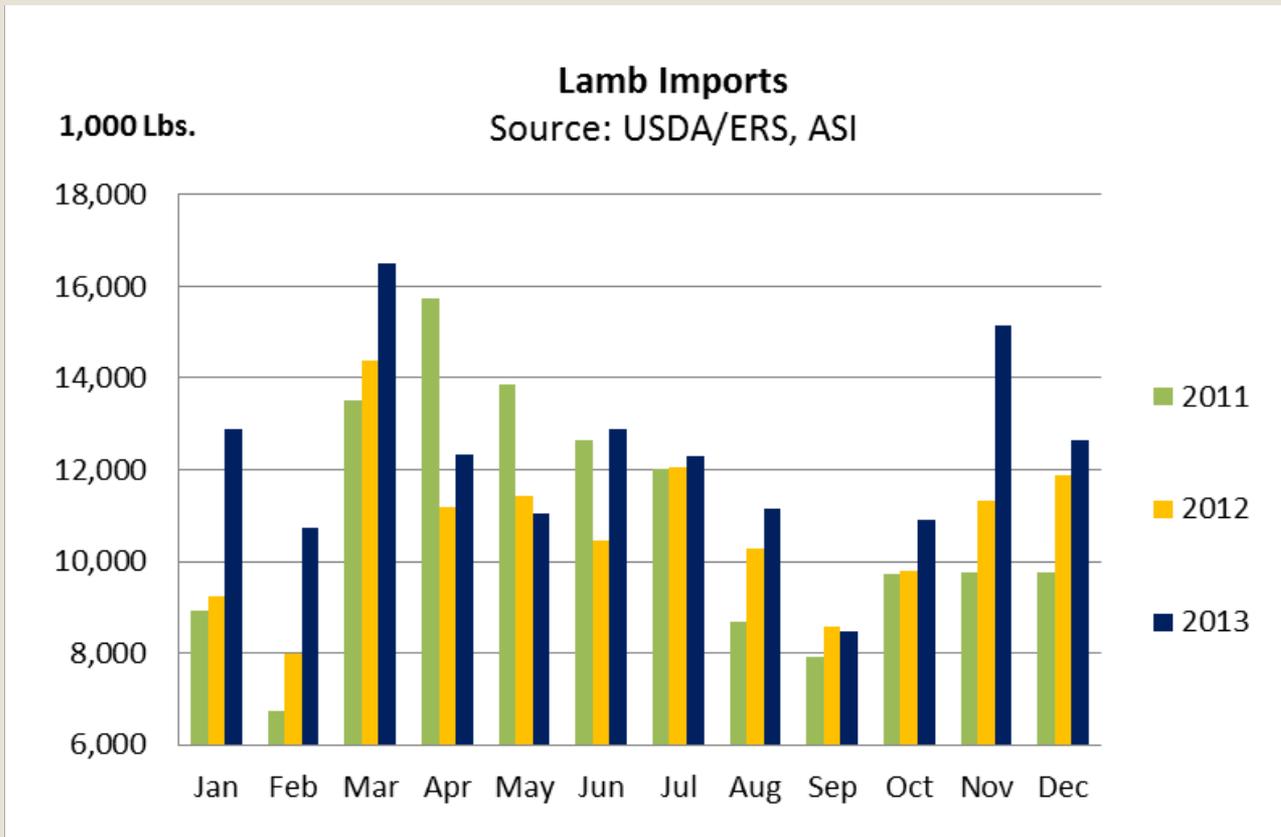
Lamb Imports Totaled 147 Mill. Lbs. in 2013 – Up 14% Year-to-Year



Australian Lamb Exports Record High in 2013

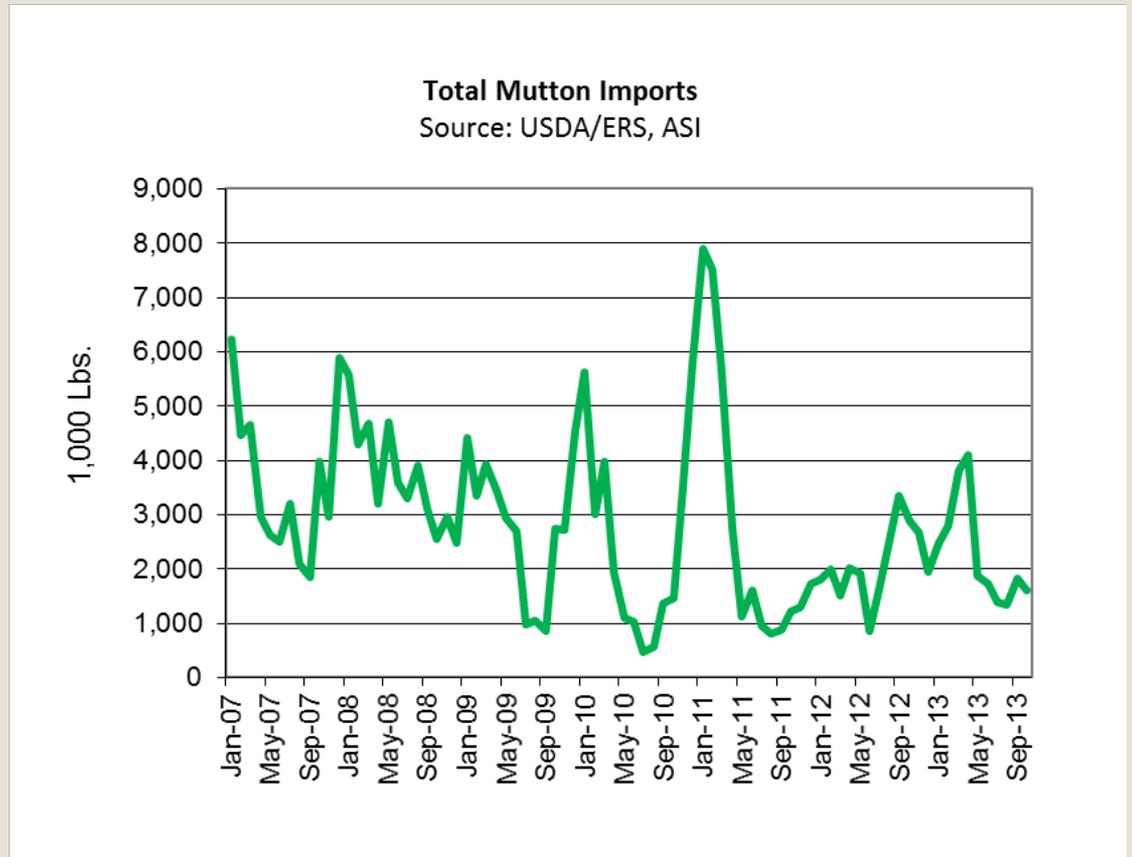
- “Driven by 12 months of elevated lamb turnoff, combined with strong international demand, total Australian lamb exports reached a record 213,715 tonnes, up 13%, on the previous record set in 2012,” (Meat & Livestock Australia, 1/2014).
- “The U.S. remained Australia’s most valuable export market in 2013, as total shipments reached 39,179 tonnes, up 7% year-on-year and largely consisted of higher valued chilled cuts.”

Monthly Year-to-Year Lamb Imports Mostly Higher

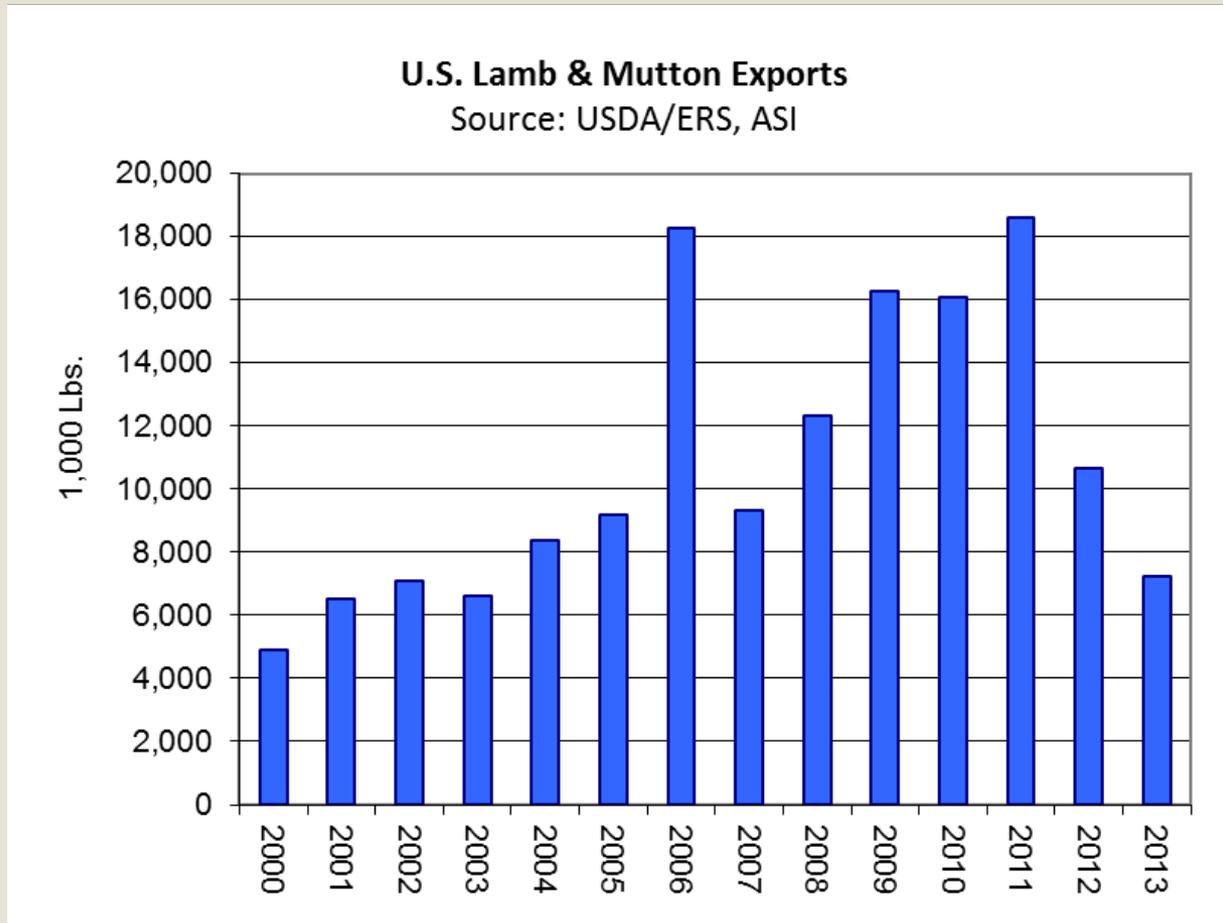


Mutton Imports Higher Year-on-Year

- At 26.2 mill. lbs., mutton imports were 5% higher in 2013.
- Mutton imports from Australia were 19.8 mill. lbs., up 15% year-to-year.
- New Zealand mutton imports were down 26% to 5.8 mill. lbs. in this period.



2013 Lamb Exports Jumped 119% in 2013 to 752,000 Lbs.; Mutton Fell 37% to 6.5 Mill. Lbs.



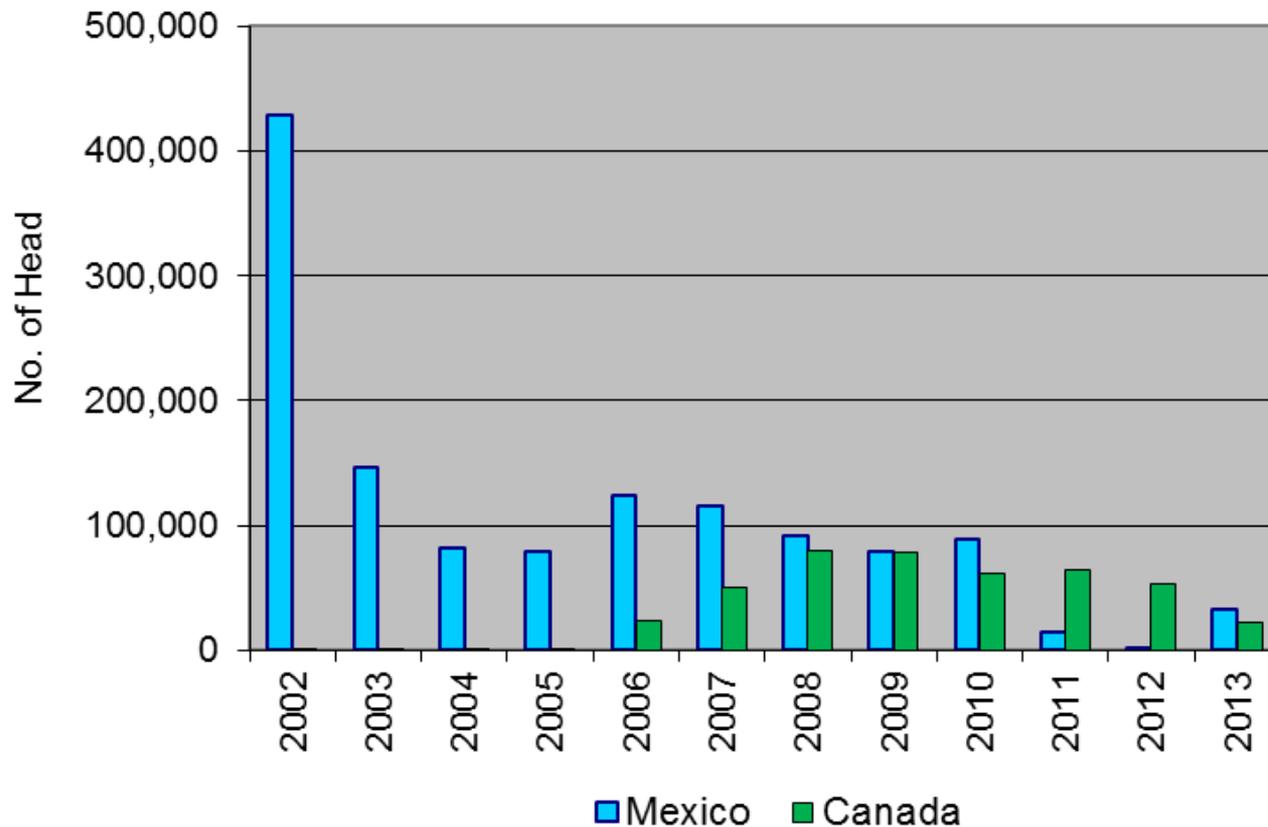
Total Live Sheep Exports Down 2% Year-to-Year to 54,496 Head

- U.S. live sheep exports to Mexico were 32,520 head, 100 times the 2012 volume.
- At 21,910 head, live exports to Canada were down 59% year-to-year.

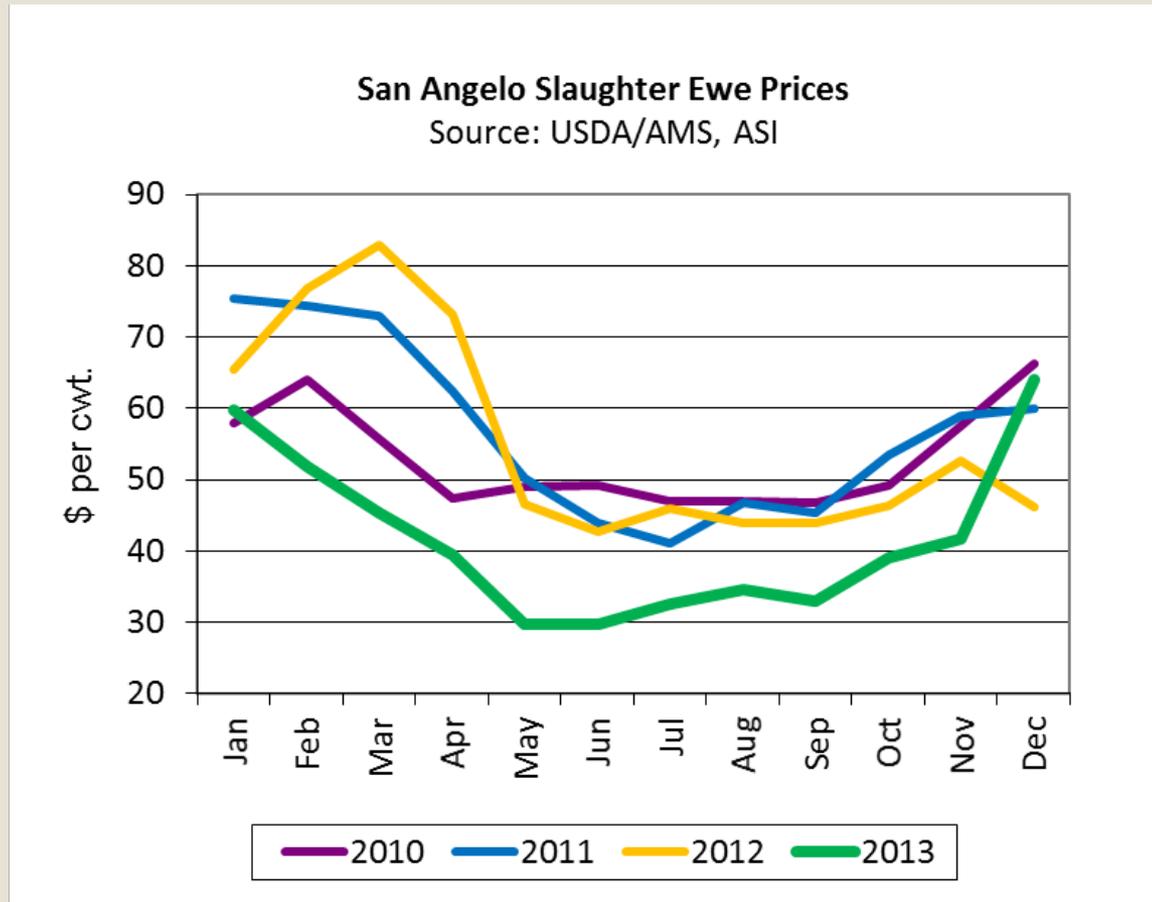
Live Trade to Mexico Rebounded in 2013

Live Lamb & Sheep Exports

Source: USDA/ERS, ASI



Cull Ewe Values Lost 25% at San Angelo to \$42 per cwt.



IX. Nontraditional Market



ASI



Andrew, 2006.

Nontraditional Market Significant Segment of U.S. Sheep Industry

- The nontraditional market is often characterized by a lighter-weight lamb, around 100 lbs., but very variable depending upon customer.
- The nontraditional market is mainly comprised of lambs sold direct to consumers.
- Some nontraditional lambs are processed by state inspected plants and even some FI plants.

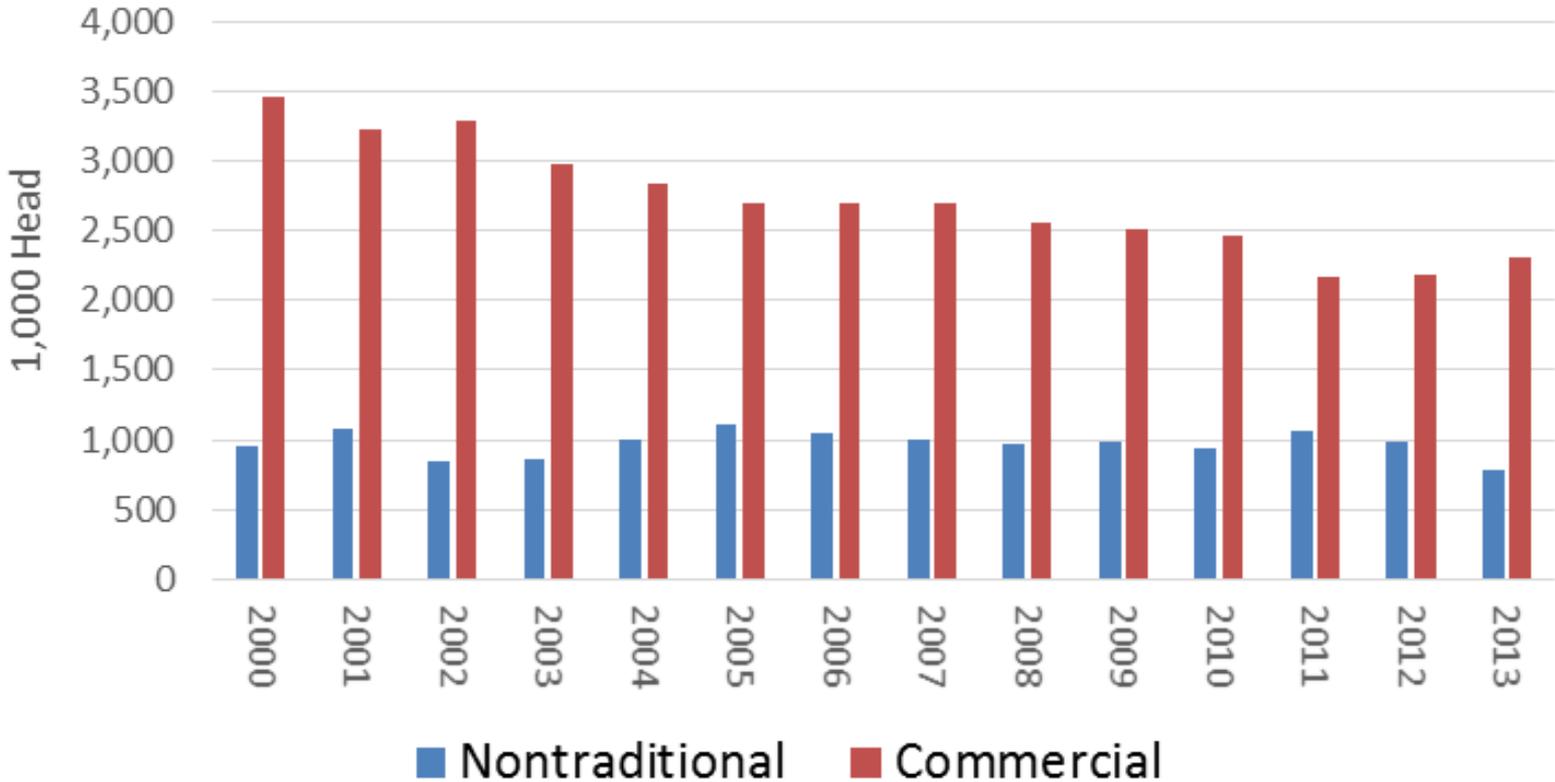
Is the Nontraditional Market Contracting?

- It is estimated that the volume of lambs channeled through the nontraditional market fell from 31% of all lambs traded in the U.S. to 25% in 2013.
- This is evidenced by stable commercial production numbers and a narrowing in the discrepancy between lamb crop and commercial slaughter.
- There is evidence that direct-to-consumer “intermediate sales” to restaurants, grocers and schools is growing and thus more likely captured by federal data.

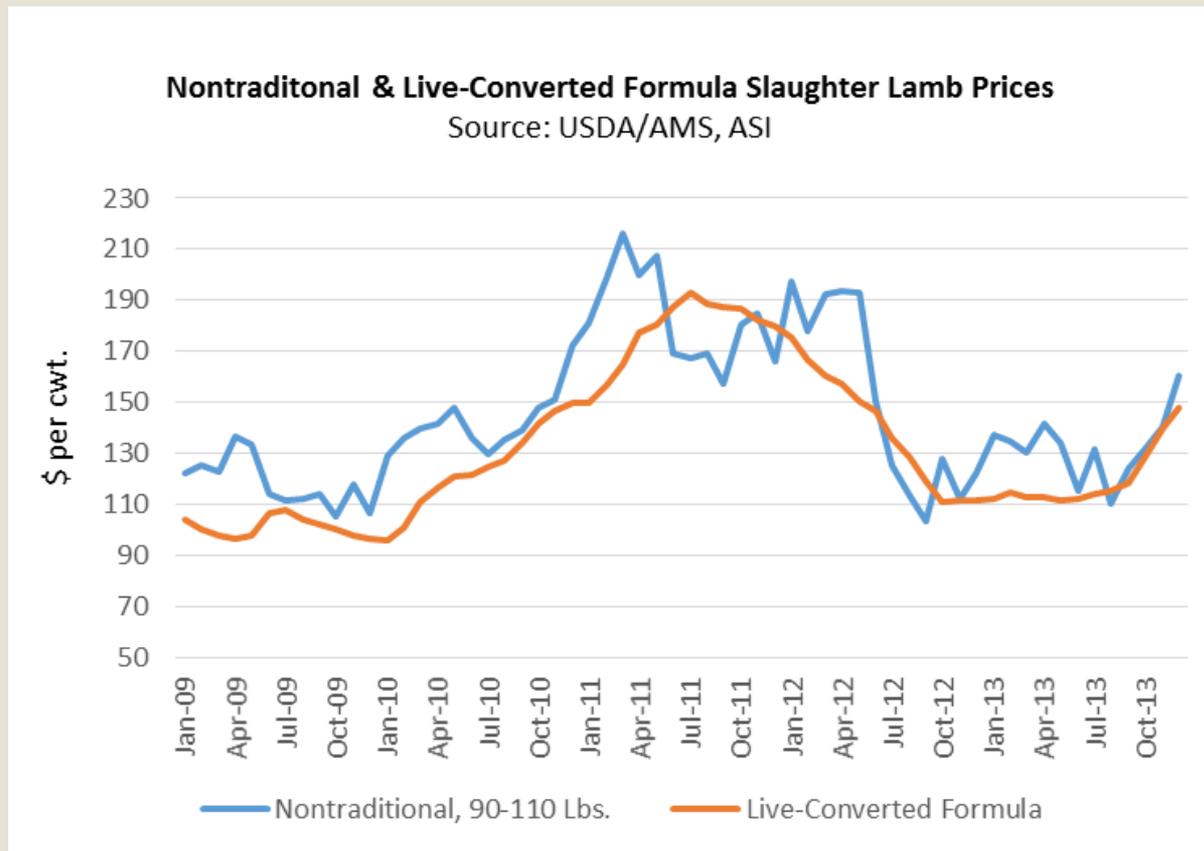
Nontraditional Market Share Contracted

Commercial & Estimated Nontraditional Markets

Source: USDA/AMS, USDA/NASS, ASI



Nontraditional (New Holland) Lamb Market Prices Mirror Commercial Market



X. Total Lamb and Mutton Availability



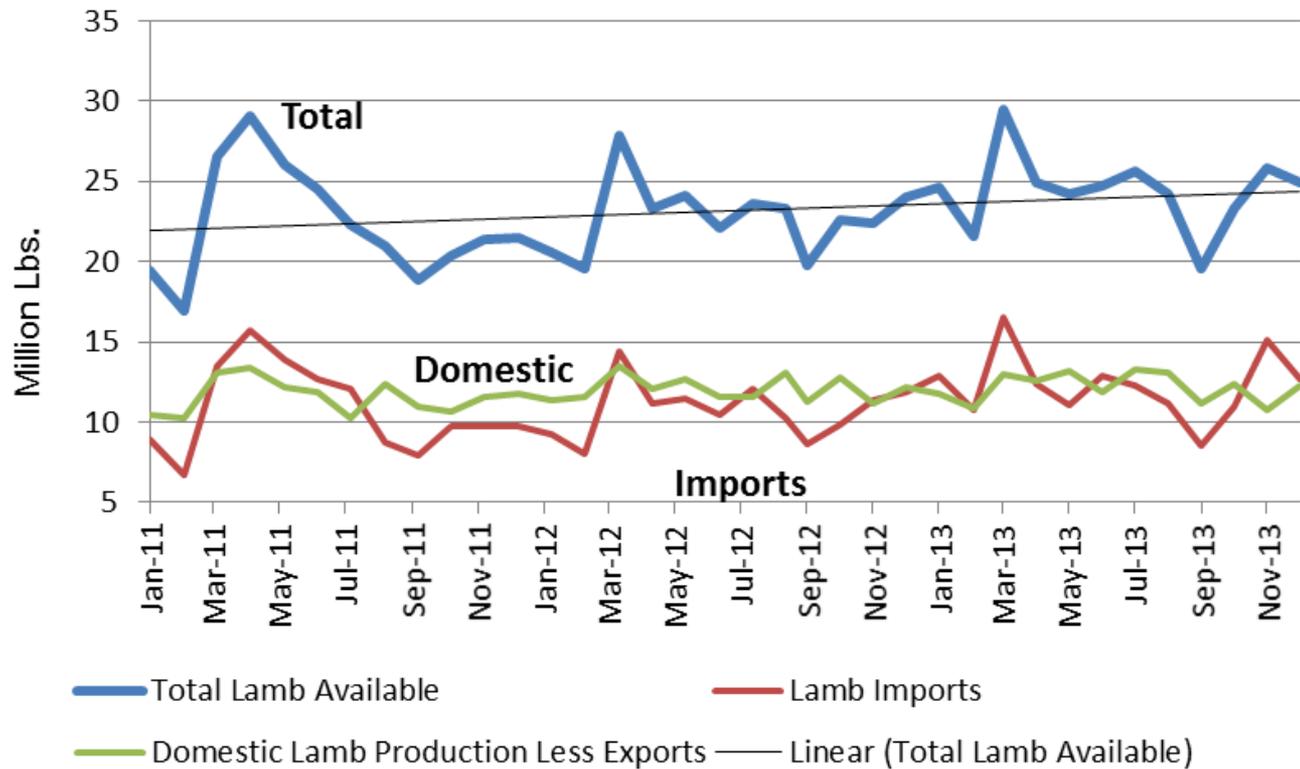
Boosted by Imports, Total Lamb Availability Up 7% Year-on-Year

- In 2013, total lamb availability (imports plus domestic production, subtracting exported lamb) was 292.97 million lbs., up 7% year-on-year.
- In this period, U.S. domestic commercial lamb supply was up 1% to 145.96 million lbs. compared to a year ago.
- Imports were up 14% year-to-year to 147.01 million lbs.
- Note: These figures do not include the nontraditional market estimated volume.

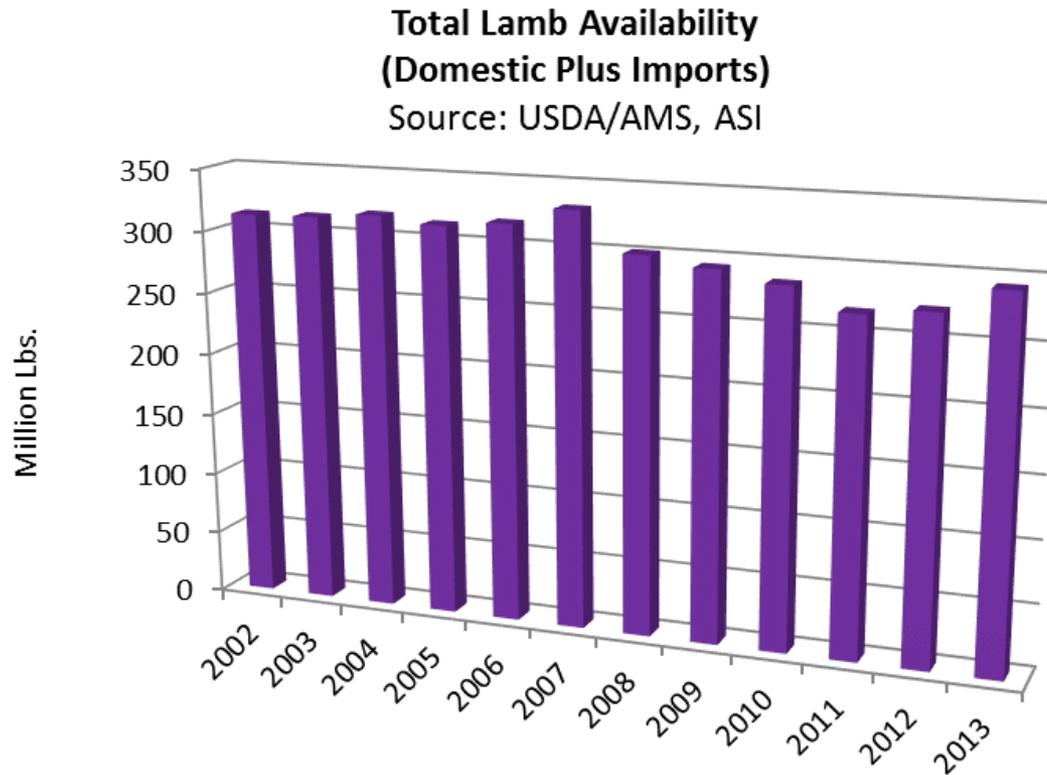
Total Lamb Availability Trending Up

Domestic, Imported & Total Lamb Availability

Source: USDA/AMS, ERS, ASI



Total lamb availability up for 2nd consecutive year; 7-percent higher in 2013.



U.S. Lamb Market Share: 50%

◦ In 2013:

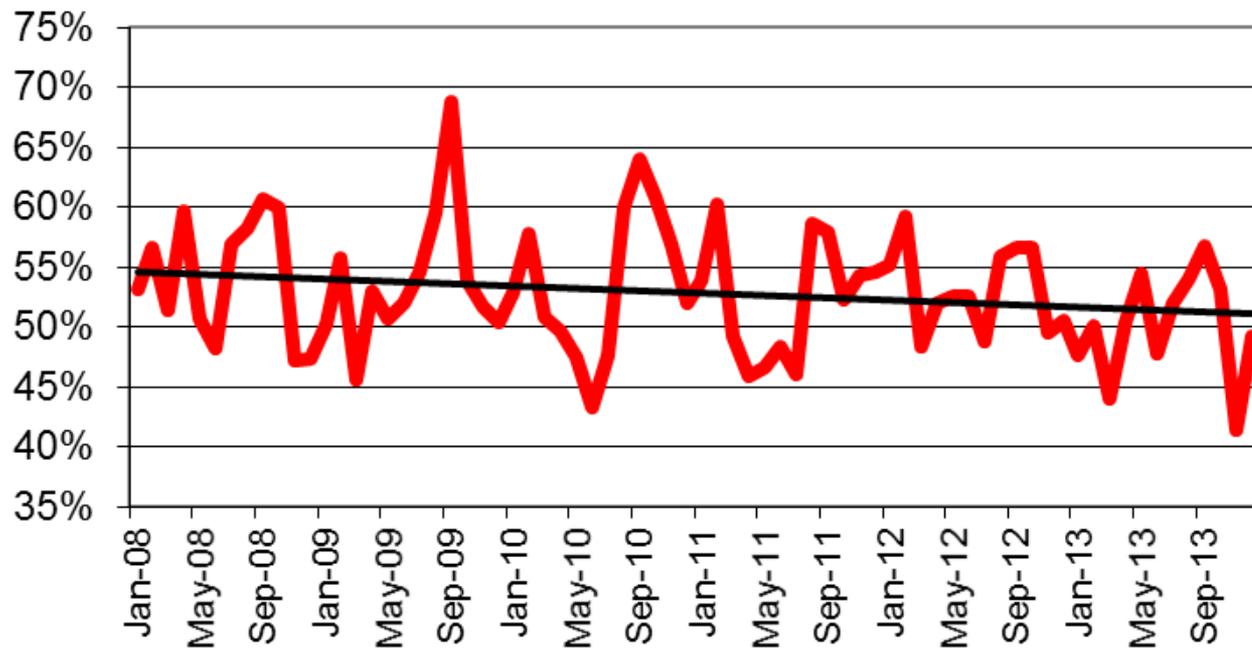
Domestic lamb market share was 50%,
down from 53% year-on-year.

Domestic lamb & mutton market share
was 46%, down from 50% year-to-year.

Domestic mutton market share was 25%,
down from 32% a year ago.

Domestic Share of Lamb Market Contracting, Challenging Growth

**Share of Domestic Lamb
in Total Lamb Availability**
(Imports plus domestic production, incl. exports)
Source: USDA, ASI



XI. Imported Product Price Comparisons



Domestic & Imported Cuts not Identically Specified: Challenges an “Apples to Apples” Comparison

- U.S. Commerce data only offers broad cut categories.
- There are limitations to USDA/AMS/MRP import data:
 - Confidentiality measures can sometimes prohibit price reporting.
 - The volume threshold might not be met if smaller importers/reduced volumes are imported.

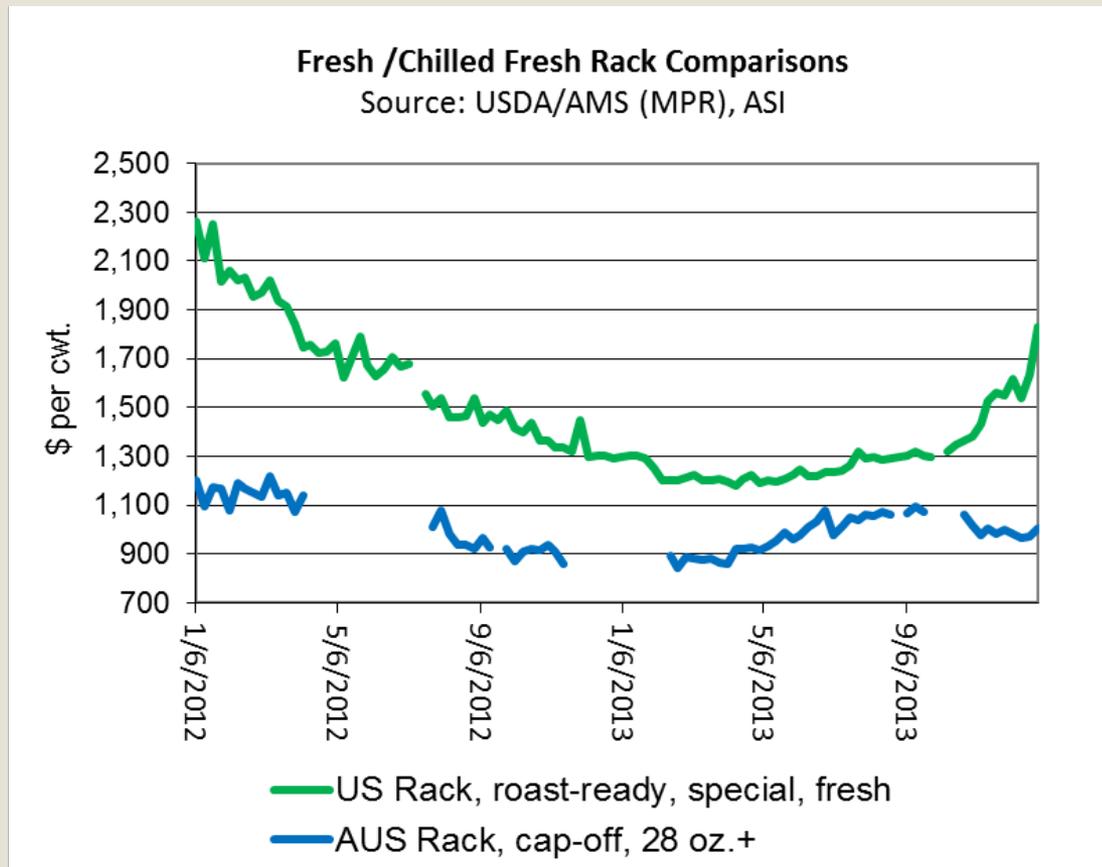
Price Comparison with Imports is Tricky

Caveats:

1. Imported product might be sitting in cold storage and not competing directly with domestic product at a specific time period.
2. Imported product is lighter weight.
3. Prices reported in Commerce data could have been established in forward pricing.

U.S. – AUS Rack Price Spread Narrowed, then Widened in 2013

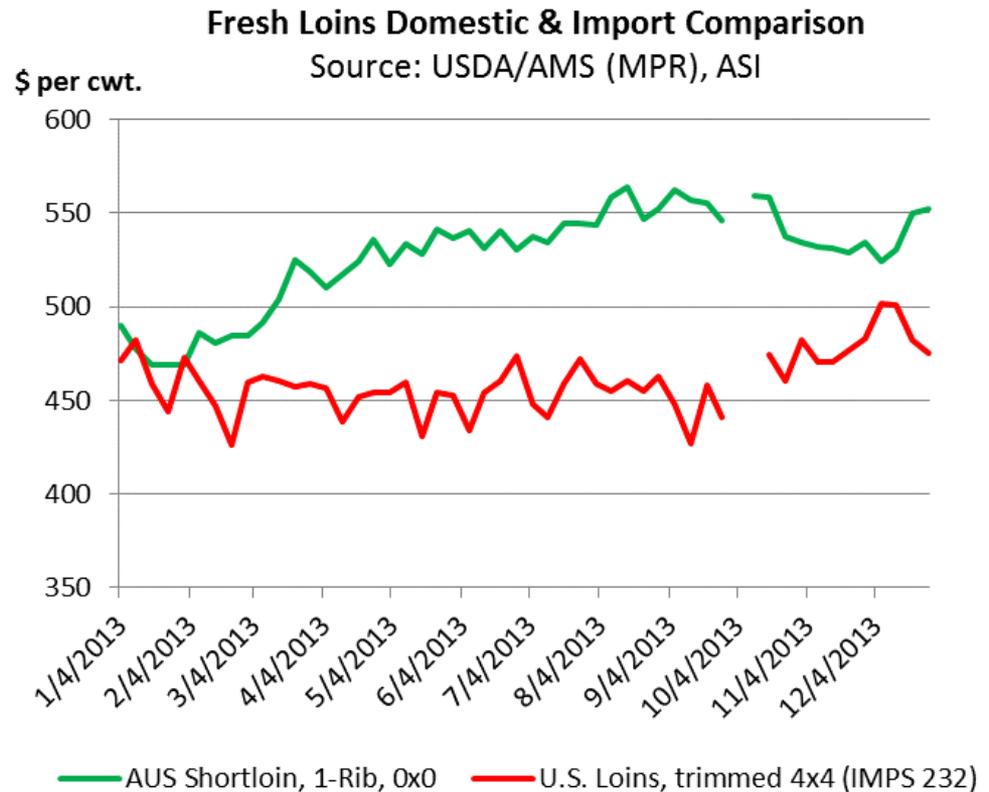
	AUS Rack, cap-off, 28 oz.+	U.S. Rack, roast- ready, special
2012	\$1,037	\$1,652
2013	\$980	\$1,308
% Change	-6%	-21%



*Note weight differences: U.S. rack 1.5-3.0 lbs. and imported rack 28 oz. +, not a perfect comparison, but useful as a snapshot.

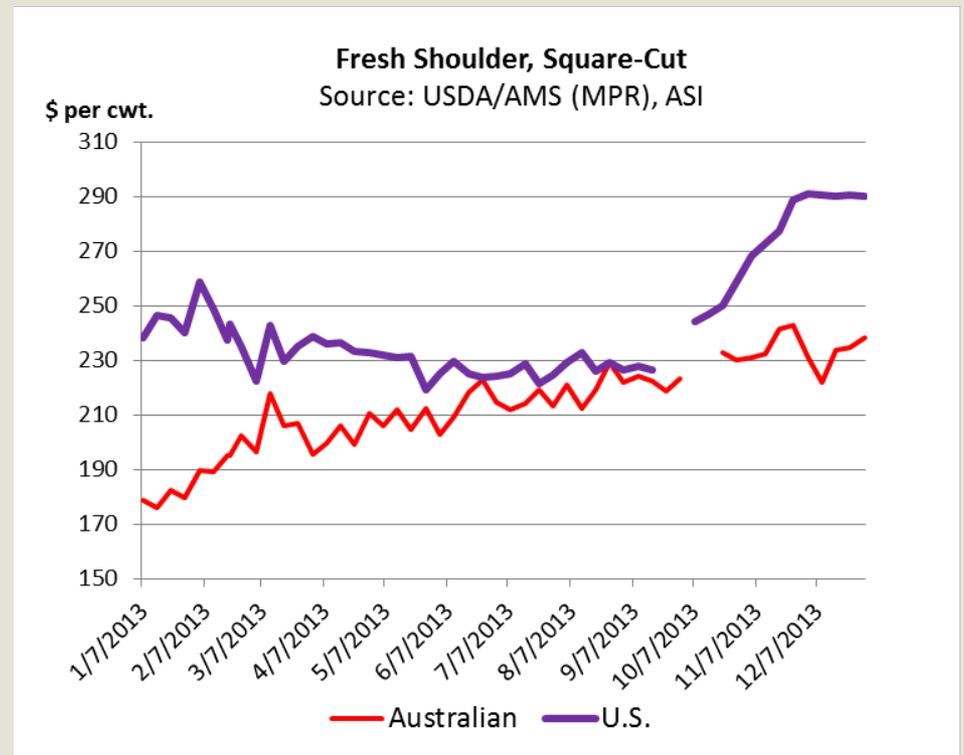
U.S. Shortloin Competitive against Imports

	AUS Shortloin, 1-Rib, 0x0	U.S. Loins, Trimmed 4x4
2012	\$504.87	\$523.47
2013	\$528.85	\$460.27
% Change	5%	-12%



U.S. Shoulder Competitiveness Declined in Late 2013

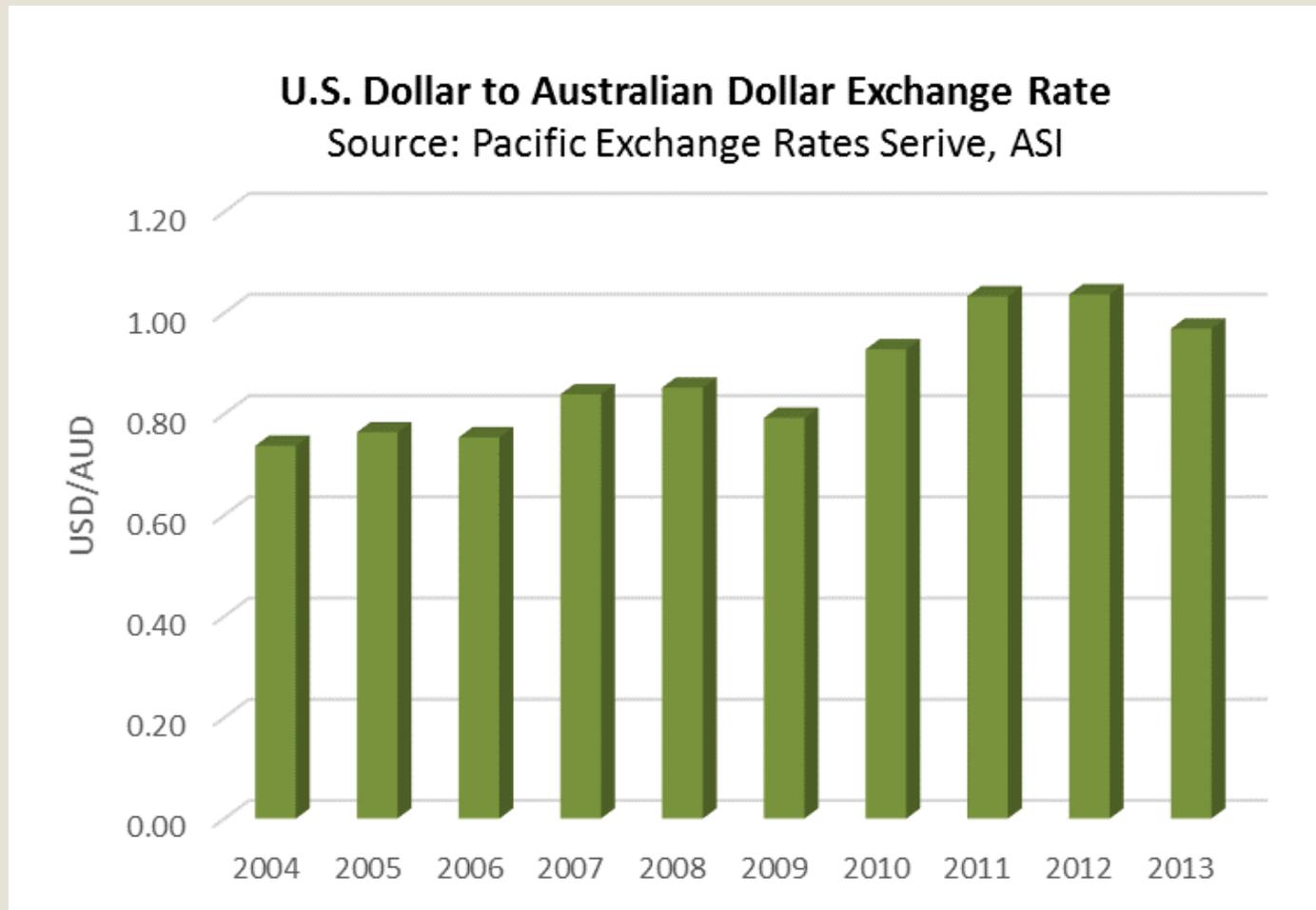
	AUS Shoulder, Square-cut	U.S. Shoulder, Square-cut
2012	\$188.58	\$251.90
2013	\$212.70	\$241.30
% Change	13%	-4%



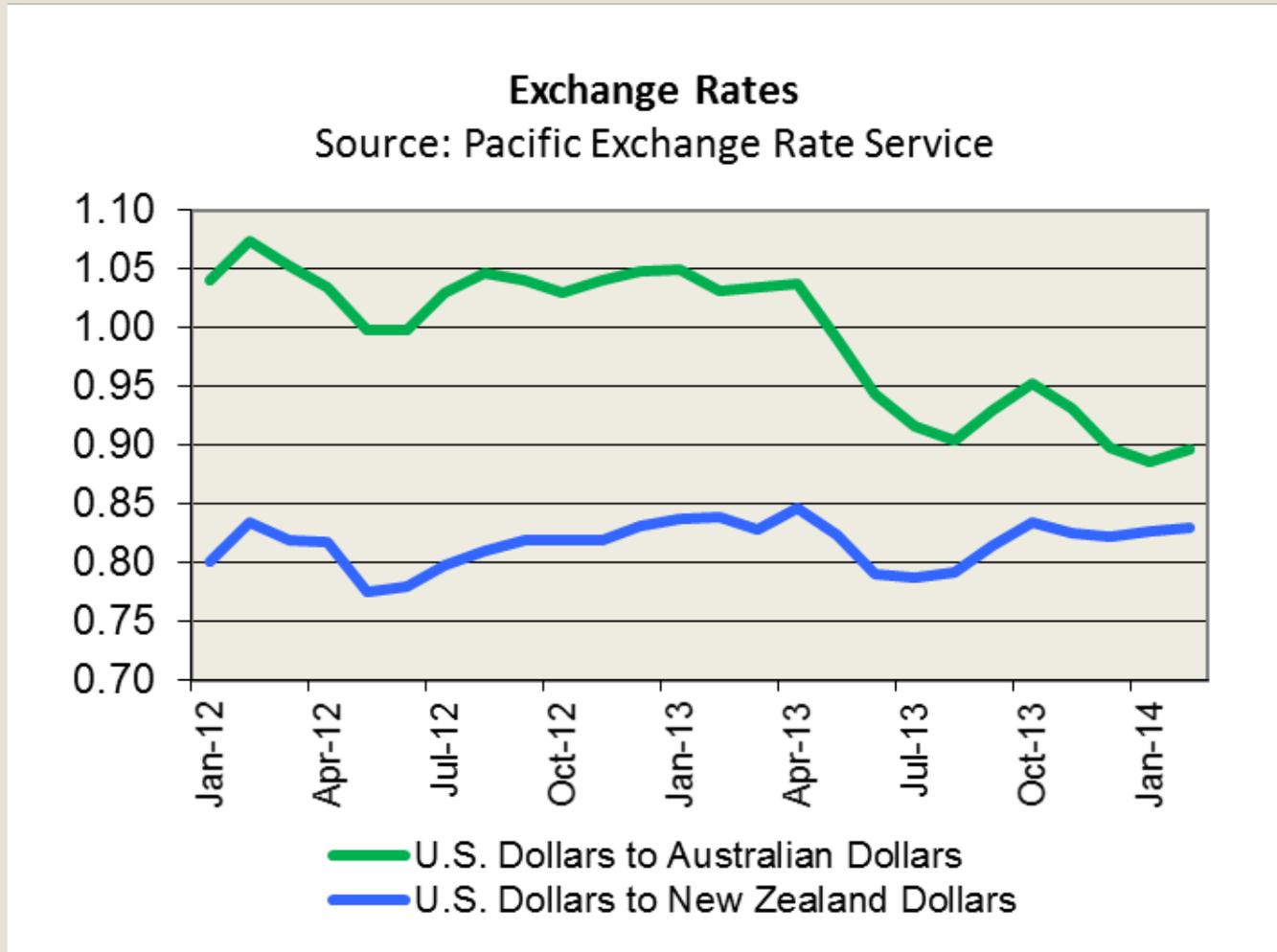
XII. Exchange Rates



In 2013 the US\$ Gained 14% Against the A\$; Imports More Competitive



Australian Dollar Depreciated in 2013



XIII. Price Projections and Outlook



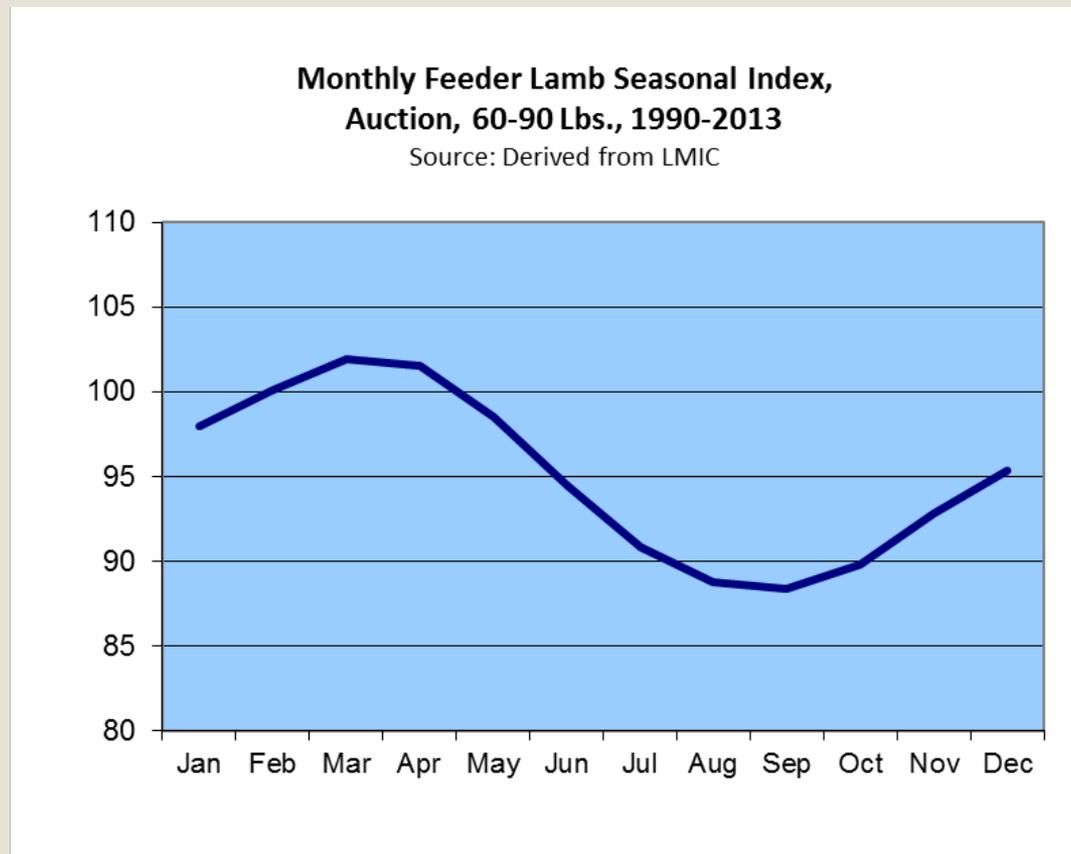
Higher Feeder and Slaughter Lamb Prices Forecasted for 2014

- After years of price volatility, lamb prices should stay steadier this year, and strong.
- In early March, LMIC expected slaughter lambs on a carcass-weight basis to range from \$320 to \$328 per cwt. (about \$162/cwt. live) in 2014, 34-percent higher than a year ago.
- LMIC forecasted 60-90 lb. feeder lambs to range from \$215 to \$228 per cwt., up 57%.

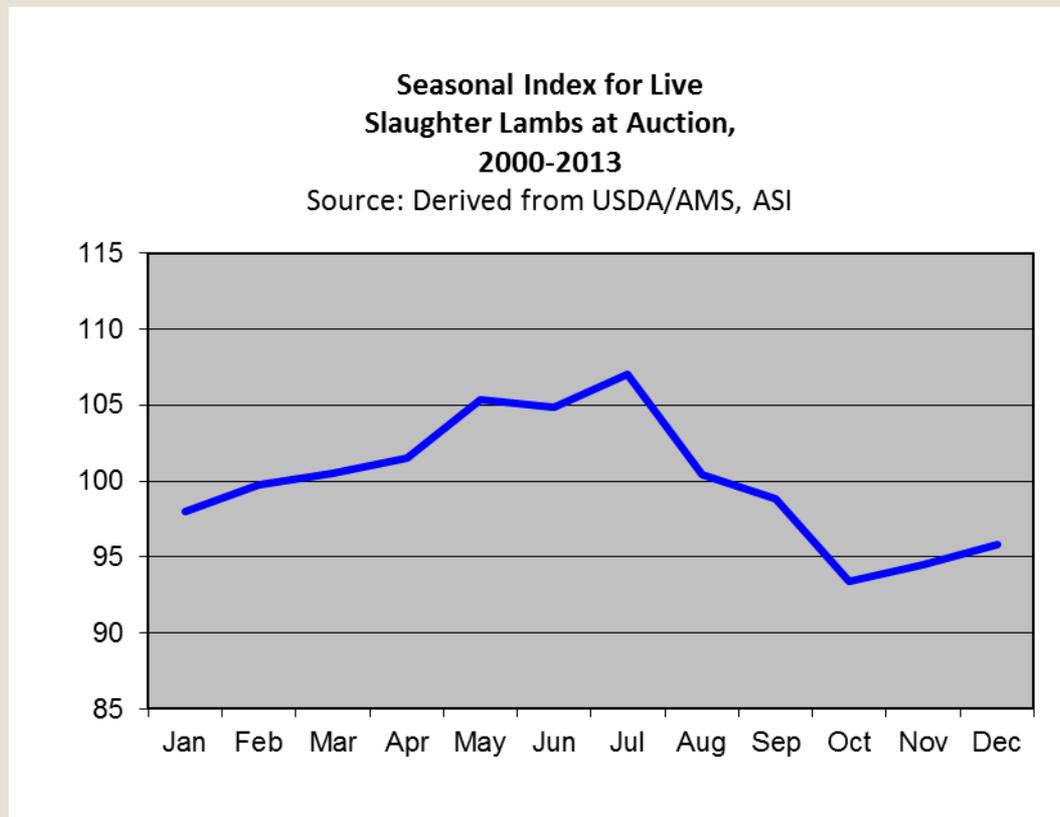
Seasonal Index Lends Predictive Insight

- Price trends--up or down--depend on which factor dominates, supply or demand.
- When feeders come to market in the fall and supplies increase, prices tend to weaken, but can be pulled up by holiday demand needs.
- The index shows the average relationship of prices in each month to the average for the year. An index of 105 means prices are 5% above the annual price average.

Strong Seasonality Expected to Persist in 2014:
Feeder lamb prices forecasted to rise in the first-half of the year, fall in the third quarter and rise again toward the year's end.



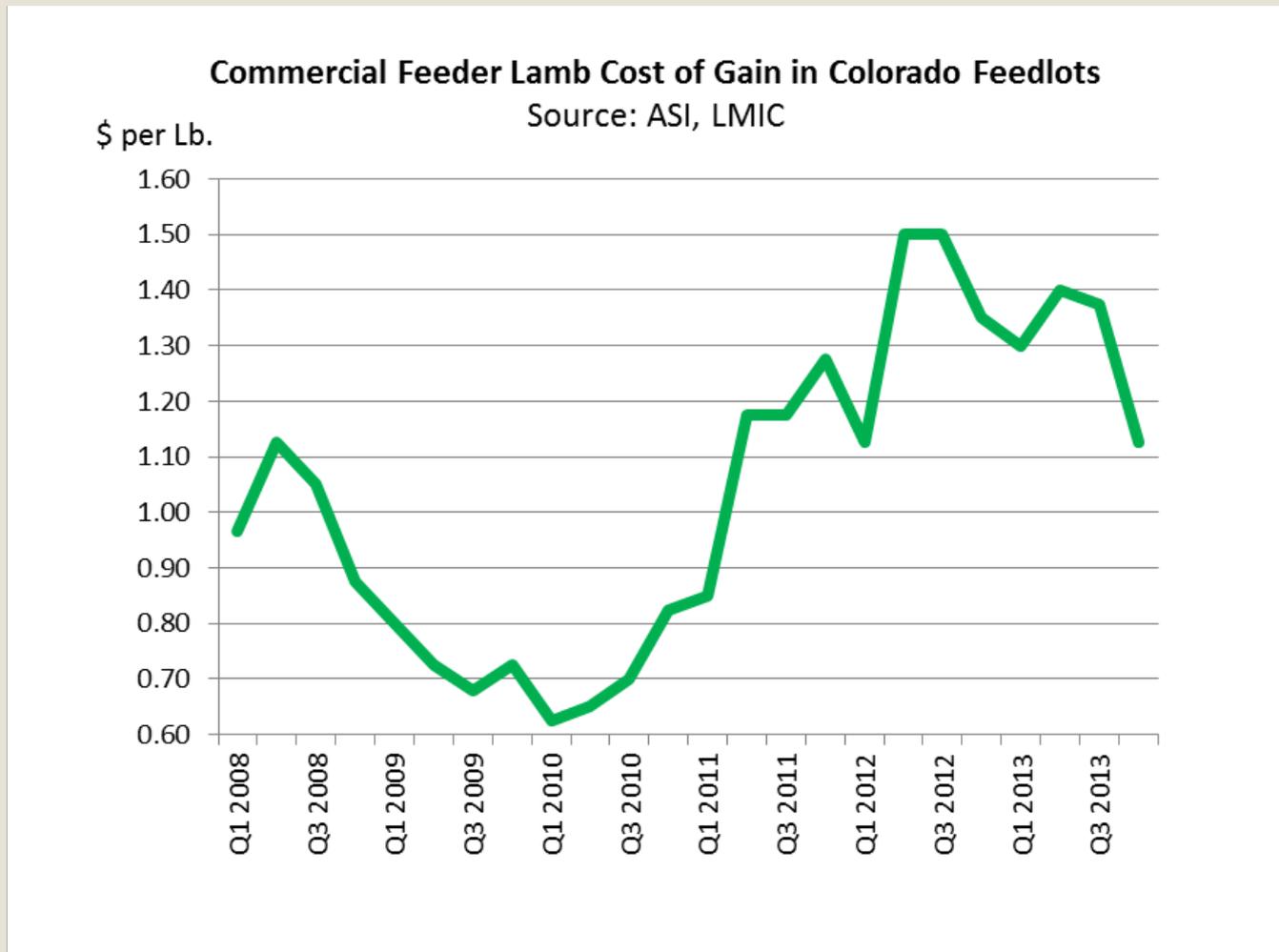
Slaughter lamb prices at auction predicted to gain through mid-2014, weaken into the third quarter before strengthening late in the year.



Break-Even Analysis

- Many feeders were in the red for the past three years, but higher slaughter lamb prices by the third-quarter 2013 put some feeders in the black.
- Recall the breakeven analysis is only one snapshot of feedlot marketing.
- Cost of gain fell from an estimated year-high of \$1.50 per lb. to an annual low of \$1.10 per lb. in 2013.
- Some feeders saw cost of gain fall below \$1 in late Q4.

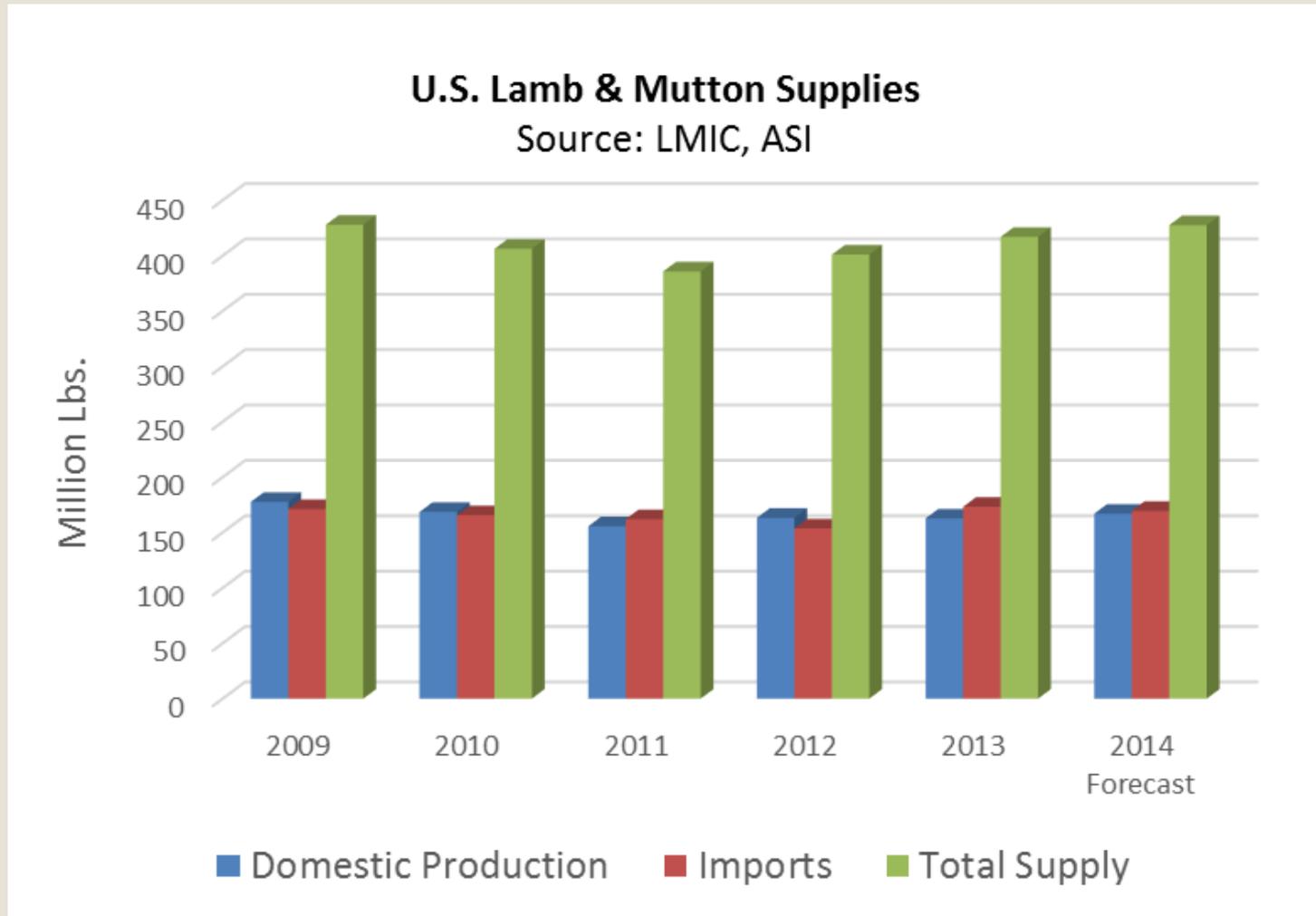
Cost of gain fell 5% annually in 2013 to \$1.30/lb.



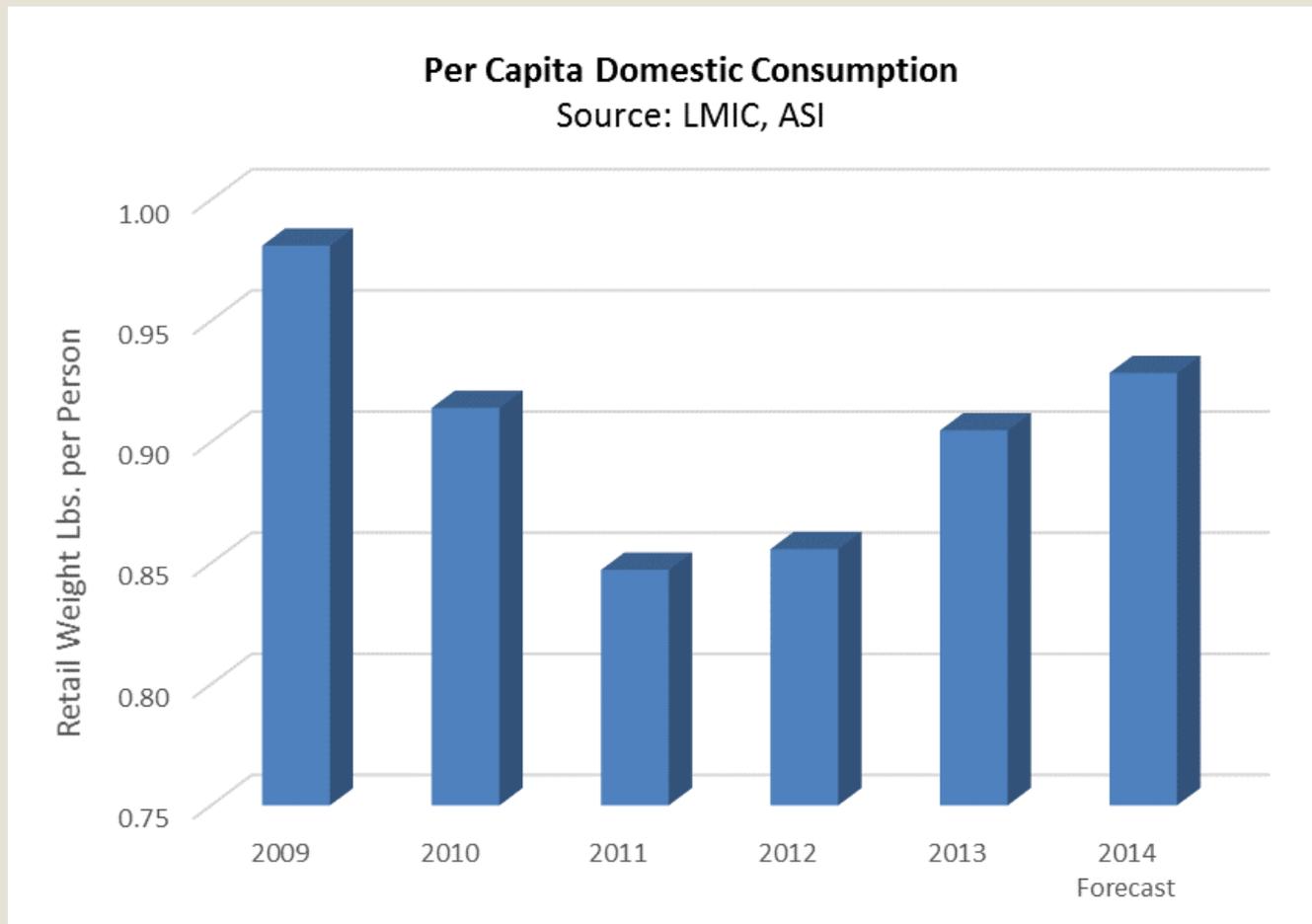
LMIC Forecasted Domestic Supply Expansion in 2014

- LMIC estimated in early March that domestic production could increase 2.5% to 166.7 million lbs.
- LMIC forecasted that imports could fall 4% to 166.5 million lbs.
- Total supply is forecasted to be up 1.7% in 2014 to 424.2 million lbs. (Carry-over stocks account for the difference.)

LMIC Forecasted 2014 Total Supply Expansion



In 2013, per capita lamb and mutton consumption was up 6% and forecasted to expand another 3% in 2014.



Forecasted 2014 Imported Lamb Uncertain

- LMIC forecasted a 4-percent contraction in lamb and mutton imports this year into the U.S.
- Meat & Livestock Australian anticipates its lamb exports to the U.S. will expand by 7 percent in 2014 (an 8-year high) (Meat & Livestock Australia, 1/2014).
- Australia's forecasted export growth assumes a larger share of contracted lamb production (down an estimated 4%) will be exported.
- New Zealand most likely will face a supply contraction in 2014 due to a drought-induced contracted lamb crop, limiting its export growth.

Meat & Livestock Australia reported on 2014 Australian lamb exports to the U.S.

- Chilled Australian lamb exports to the U.S. expected to increase in 2014 (Meat & Livestock Australia, 1/2014).
- Continued Australian high-value lamb imports to the Northeast U.S., “where per capita lamb consumption is almost double the national average.”
- In 2014, the Australian lamb leg is expected to continue to be the largest volume export cut to the U.S.
- In 2013 there was a large increase in “assorted cuts” – packages of three or more primals.

Positive Growth Expected at Retail and Foodservice, but not without Uncertainties

- In early-2014, the *Daily Livestock Report* commented that at least in the short-term, retail meat sales remained strong, but questioned sales once retailers raise retail prices, (2/28/2014).
- USDA projects that grocery shoppers will pay up to 3.5% more for meat this year, compared with a 1.2% increase in 2013 due to higher meat prices, (Bloomberg from USDA, 2/26/2014).

National Restaurant Association 2014 Forecast

- “Driven by a stronger economy and historically high levels of pent-up demand among consumers, restaurant-industry sales are expected to hit a record high in 2014,” (NRA, 12/2013).
- In inflation-adjusted terms, industry sales are projected to increase 1.2% in 2014 (12/2013).
- “Although this will represent the fifth consecutive year of real growth in restaurant sales, the gains remain below what would be expected during a normal post-recession period due to a range of challenges,” (12/2013).

Producer/Feeder Profitability up in 2014?

- Producer profitability is up for many with lower feed costs.
- Feeder lamb prices higher, hay below \$200 per ton and extreme drought areas shrinking nationally.
- However, a historic drought in California has eroded grazing pasture and threatened much-needed water for raising sheep.
- USDA forecasted corn at the farm gate could range from \$4.05 - \$4.75 per bu. in its 2013/14 marketing year (12/2013).

While Producers/Feeders Profit, Returns Less Certain at Wholesale and Retail

- Global meat consumption growth is forecast at a modest +1.5% (International Meat Secretariat, 1/2014).
- U.S. economic recovery since 2008 “Great Recession” slower than expected.
- Since the end of the recession, the U.S. gross domestic product (GDP) has grown at a rate of only 2.1% annually and is not expected to exceed 3% through the decade (Bureau of Labor Statistics, 12/2013).
- “There is a continued cautiousness of the meat sector, with serious consumer and retailer price resistance,” (International Meat Secretariat, 1/2014).

What will happen when
retailers/foodservice pass
recent higher lamb prices
onto consumers?



February 2014 cutout value
was just 11% shy of the 2011
record high prices that turned
consumers away. This year
can be different.