

Potential Contract Growers Face Important Decisions



Mississippi is one of the top poultry-producing areas in the United States. In fact, the state ranks fifth in the nation in broiler production and is headquarters to the nation's largest table egg company. Just under 2,000 poultry growers make poultry the largest agricultural commodity in the state, with \$2.7 billion paid to farmers in 2013 and another \$2.1 billion in wages and salaries paid to 28,000 employees (MPA, 2014). As a result, Mississippi is a major supplier to U.S. and world poultry markets, and the state and its residents continue to benefit from this agricultural powerhouse.

As demand for poultry products increases, additional growers continue to be needed by the industry. There is a strong demand for poultry products, due in part to poultry's popularity and versatility as a protein source and in part to hardships facing the beef and pork industries. Because of this demand, several Mississippi poultry companies are currently looking to add additional square footage to their housing facilities in Mississippi. This is good news for anyone interested in building chicken houses or considering purchasing a farm and getting into the chicken business.

However, because of the expense and long-term investment associated with building new houses or purchasing an existing poultry farm, and the unique structure and requirements of contract production, potential growers should thoroughly understand financial and managerial obligations associated with such a large undertaking. Do not invest in housing, land, equipment, or any other aspect related to poultry production unless you have written assurance from a poultry company that is willing to offer you a contract to grow birds. Potential growers have important items to consider when deciding on poultry production as a farming enterprise.

How the Poultry Industry Works

Let's look at three of the most important items facing anyone considering getting into the poultry business. These include:

1. **the structure of the poultry industry,**
2. **availability of an integrator, and**
3. **understanding a broiler production contract.**

Commercial poultry production is usually concentrated in a somewhat small area surrounding a company's feed mill and/or processing plant (perhaps within a 35–50 mile radius). The U.S. poultry industry is vertically integrated, meaning that all or most production aspects (pullet, breeder, and broiler flocks, hatcheries, feed mills, and processing plants) are owned by individual companies (*integrators*). An integrator contracts out growing of pullet, breeder, and broiler flocks to independent growers and provides growers with birds, feed, medication, technical service, and management advice. Growers provide land, poultry houses, labor, equipment, utility costs, and operating expenses. Field service technicians employed by the integrator visit contract farms weekly to provide technical advice and assist growers with flock management. For a new grower unfamiliar with commercial poultry, **there is much to learn**, and service technicians are vital to helping growers master feeder and drinker management, lighting programs, air quality, heating and ventilation systems, litter quality, controller programming, mortality management, and other areas.

There are many more broiler growers supporting each division or complex than there are pullet or breeder hen growers; although each segment is vital to the complex's or division's success. Broiler growers are paid per pound of sellable meat produced as determined by the integrator at harvesting/processing of the flock. Decisions on when a flock is placed and harvested, numbers of birds placed per flock, numbers of flocks placed per year, and downtime between flocks are made by the integrator, as are all feed formulation, processing, and marketing decisions.

All **mortality disposal is the responsibility of the grower**. Mortality losses will be a daily occurrence in every house from placement until harvest and will require daily attention. However, under normal conditions, the majority of the losses will occur within the first 2 weeks after placement and will have only a limited effect on overall flock performance at harvest. Mortality is most often handled by composting or incineration. In certain areas of the country, freezing may also be an option. **Litter and waste management decisions are also the grower's responsibility**, but these decisions should be made based on integrator input

regarding litter depth needed on the floors to successfully manage the flock, cleanout schedules, downtime between flocks, and so forth.

Growers must sign a production contract that allows them to grow birds for an integrator. A potential grower must have an integrator willing to offer a contract before attempting to borrow money, build or buy a farm, or proceed further. Find a lender you are comfortable with and one that knows and understands the agricultural lending process (and preferably the commercial poultry industry). You will need to provide several items to secure an agricultural loan (Williamson, 2014), including:

- financial statement
- income tax returns (most likely from the past 3 years)
- records (history, description, balance sheet, income statement, etc.)
- off-farm income/expenses
- input expenses
- collateral
- short- and long-term goals/projected financials

Other items that may also apply, depending on the lender and the situation, include (Williamson, 2014):

- purchase agreement/sales contract
- purchase quotes/construction estimates
- nutrient management plan
- DEQ permit
- copy of driver's license
- 1099s for the past 3 years on existing farming operations

Lenders will require a letter of intent from an integrator before starting a loan application. At certain times, an integrator may not need additional growers and may place potential growers on a waiting list. If this happens, a potential grower may seek out another integrator (if one is available in the area). Otherwise, he/she must wait for an offer from the initial integrator before taking additional steps.

Before deciding to raise broilers, do your homework and thoroughly understand what you are getting into and the kind of commitment it will take on your part and that of your family. Realize that chickens do not care about weekends, holidays, wedding anniversaries, or family vacation schedules. They must be cared for each and every day that they are on the farm. In addition, taking care of broiler chickens is not an 8–5 Monday–Friday job; it is a 24/7/365 job if you are going to be successful. There will be things that break down and require your attention from Sunday morning through Saturday night and everywhere in between.

If you decide you are willing to make the necessary commitment, then it is time to

1. seek out and find a lender you are comfortable with,
2. thoroughly examine the integrator's contract language,
3. understand expectations of both the lender and the integrator,
4. accept the risks and responsibilities, and
5. **ask questions of everyone** (lenders, integrators, dirt work contractors, builders, electricians, plumbers, well drillers, poultry equipment companies, and especially other poultry growers that are familiar with growing birds).

The importance of visiting with other growers cannot be overstated. If they have grown birds for a few years or longer, they will have no doubt seen everything associated with growing birds. Input from other growers is extremely valuable. You are likely on the verge of making a million-dollar or more investment and you need straightforward, honest answers. Other growers have been where you are now, and they can help you see all sides of raising chickens. In addition to asking questions, shop around and compare prices. Integrators will likely allow you several options on equipment, contractors, and so forth, so take advantage of this and price-check each option.

The Production Contract

In the business of modern poultry production, the production contract is the engine that pulls the train, so **MAKE SURE you understand it line by line!** The contract is a legally binding document (usually several pages long) written, in most cases, by general counsel representing the integrator. However, it is for the protection of both the grower and the integrator, and it spells out the responsibilities and obligations of each party. Review the contract structure carefully for items that may require additional clarification, and seek your own legal counsel for guidance if you are unsure about what you are committing to or the meaning of certain legal terminology. You must clearly understand what is expected of you and then decide if you are willing to commit to those expectations. Again, know what you are getting yourself and your family into. Information is power, so don't skimp when it comes to understanding the contract.

Contract production has **advantages and disadvantages** to both the grower and the integrator. Advantages to the grower include these:

1. hatching, harvesting, processing, and marketing are handled by someone else,

2. protection from huge variations in market price and volatility (for both feed grain and processed chicken products), and
3. a reasonably predictable cash flow based on average performance as spelled out in the production contract.

Advantages to integrators include:

1. a stable, readily available square footage of production capacity based on the number of houses on contract farms and
2. less initial capital investment because the growers own the land, poultry houses, and equipment where the birds are raised.

Because integrators are not out the extra expense of owning additional land, poultry houses, and the necessary farming equipment (tractors, decaking machines, windrowing equipment, etc.), they are better able to maximize use of their own equipment (processing plants, hatcheries, feed mills, transportation fleet, etc.) to reduce overhead costs.

However, integrators must accept risks associated with volatile markets and potential high feed and low chicken prices, as well as some growers that may not always be high-quality managers. In addition, recent years have seen a growing emphasis and concern from consumers and customers regarding animal welfare programs that integrators must satisfactorily address to maintain customer contracts.

Growers incur a high fixed cost to purchase land and build houses or buy an existing farm, and give up some control of management decisions as agreed to in the contract. Another possible disadvantage is that growers are the sole responsible party for waste management practices and for following environmental regulations that may have state and federal implications.

Potential growers should pay particular attention to parts of the contract that deal with payment calculations, duration and termination of the contract, specific production and management practices growers are expected to follow and the consequences if these practices are not followed, and facilities and equipment requirements and upgrades. Each of these areas has the potential to significantly affect monetary returns.

Despite perhaps not being an ideal format, the contract system has served the poultry industry and its growers well for more than 60 years. The contractual partnership has been a win-win-win for integrators, growers, and consumers, the latter having been assured of an ongoing supply of quality poultry products at relatively low prices (Cole, 2000).

Even though it is very detailed and specific, **the contract doesn't cover everything**, and it is important to account for all the "what ifs" that may not be addressed. Consider carefully every possible detrimental scenario, such as a hurricane or tornado destroying the farm, unforeseen increases in fuel costs, cutbacks in broiler placements by the integrator (fewer birds per flock or fewer flocks per year), politically motivated bans or sanctions on poultry exports, and weakening demand for poultry products from either the U.S. or world markets. Any of these factors could have a negative impact on your bottom line. However, to grow broilers on a large commercial scale, and not just as a backyard hobby, working with an integrator is mandatory. Doing it on your own is not an option today.

Most integrators use some form of **competitive ranking system** to calculate grower pay based on an average production cost per pound for all flocks sold during a set time span, usually the same week (Cunningham, 2009). Most growers will be either above or below the average specified in the contract. Above-average growers receive payments above the contract average, while below-average growers receive less-than-average contract payments. These payments are often tied to feed conversion of the flock because feed is roughly 70 percent of the cost to produce a flock of broilers. Therefore, there is an incentive for growers to strive to have the lowest (best) feed conversion possible.

The section of the contract that describes **payment calculations is usually the most challenging for growers to understand**. The contract indicates the average cents per pound paid for each pound of sellable product and how that average is calculated. However, it is possible to make above- or below-average pay depending on how well a flock performs in relation to all other flocks sold during a particular week. This type of system typically places all growers that sell similar-size birds during the same week at the same processing plant into groups. Each grower's performance is then compared to the group, and payments to growers are made based on that individual's performance relative to the group. In this type system, a grower's management and husbandry skills play a large (but not total) part in determining his/her compensation. In addition, regardless of your management skills, your compensation may vary depending somewhat on circumstances that are beyond your control. For example, if you are an above-average grower marketing the same week as several below-average growers, your compensation may likely be greater than if you are marketing with several other above-average growers. There may also be incentives (housing upgrades, new-construction clauses, etc.) that can result in additional income.

Important Little Things

Don't overlook little things (and their associated costs) like upkeep of roads, loading pads, storm water drainage, and so forth that are a grower's responsibility. Also, to provide easier access for feed delivery, chick delivery, and live haul drivers, some integrators do not allow a closed gate entering the property. This may require additional fencing or a cattle guard if you plan to have other livestock (cattle, horses, goats, etc.) on your farm. Visit with power and other utility providers in your area before picking a building site. If your operation will be in a very rural setting, getting power lines run to your site may be a major undertaking. As a safety precaution, there must be no overhead power lines near or directly above poultry houses. Utility lines must be buried near the chicken houses, and this may incur added expense.

Will you have access to natural gas or be restricted to propane as a fuel source? Natural gas is usually less expensive, but many rural areas do not have access to natural gas, making more expensive propane the only fuel source option. Will you purchase water from a rural/city water supply, or will you need to drill one or more wells? As a precaution, many integrators require two (or more) separate water supplies. If you drill wells and the water has a high or low pH, high iron content, or high bacteria levels, will you need to install a gas chlorination and/or chemical pump system to make the water useable for poultry?

Summary

Keep all these things in mind as you decide if poultry production as a farming enterprise is right for you and your family. Include the family in the decision-making process because broiler production will affect every member of the family. Ask questions of integrators, lenders, dirt work contractors, well-drillers, building contractors, utility providers, equipment manufacturers, and growers who have been in the business for a while. Take notes and get things in writing. Commercial broiler production is a big investment that requires a long-term commitment. With an investment of this size, you don't want to make a mistake. Become educated on what will be expected of you and what it takes to be successful as a commercial broiler grower. Opportunities exist if you are willing to do what is necessary to be successful. With the current strong demand for poultry products and several integrators in Mississippi currently seeking additional growers, now is an excellent time to consider commercial poultry production.

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