PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

The Smithfield deal

On Wednesday, May 29, 2013, the Chinese meat products firm Shuanghui International announced its acquisition of Smithfield Foods. Smithfield controls 26 percent of US pork processing capacity and 15 percent of US pork production.

Smithfield reports that “under the terms of the agreement, which has been unanimously approved by the boards of directors of both companies, Shuanghui will acquire all of the outstanding shares of Smithfield for US$34.00 per share in cash. The purchase price represents a premium of approximately 31 percent over Smithfield’s closing stock price on May 28, 2013, the last trading day prior to today’s announcement.”

In addition Shuanghui will assume Smithfield’s net debt. The value of the transaction is estimated by Smithfield to be US$7.1 billion.

As we began to consider the impact of this transaction on various stakeholders, a number of questions began to run through our heads.

At first glance, it appears to be a good deal for the stockholders of Smithfield. They will receive a bonus of approximately $8.00 per share if the deal goes through. If the Smithfield board of directors control enough shares there should be no problem from stockholders. Otherwise given other recent acquisitions, it remains to be seen if other bidders for those shares will come forward in the belief that the total value of Smithfield is greater than $7.1 billion.

Smithfield asserted that the sale would be good for US producers because it would increase the export market for US pork. It could be expected that increased exports would increase the income of US pork producers and guarantee them a stable market. On the other hand, the new owner could increase Smithfield’s internal pork production thus reducing slaughter capacity for producers without a contract. That could put negative price pressure on independent pork producers with no place to slaughter their pigs.

Like with pork producers, the impact of the sale on US consumers could be positive or negative. If pork exports to China increase faster than production, US consumers could see a shortage of pork and an increase in the price. But if the goal of Shuanghui is to access cheap exports for Chinese consumers, US consumers could benefit as well, though producers and/or workers could see reduced income.

Though the stated purpose of the purchase is so that Shuanghui can supply the Chinese market with safe, high-quality pork, one wonders if there is more to it than that. Once Shuanghui gets their production in China up to US standards, will they want to turn the pipeline around and ship pork the other way? A June 3, 2013 article in the New York Times reported that prior to the deal, Shuanghui’s chairman, Wan Long, had said: “Our goal is to be the biggest in China, and the leading meat supplier in the world.” Long gave no specifics on the production configuration or trade pattern that he had in mind.

Many of China’s purchases are for raw materials like ore, scrap metal, and soybeans that can be further processed in China, providing employment for their population and products to export, creating a positive balance of trade for China. In this case they are talking about allowing the further processing to remain in the US. Are we missing something?

Given the difference between the wages and costs in the US and Brazil and Brazil’s potential for expansion, why didn’t they purchase a Brazilian firm? Is it Brazil’s transportation infrastructure? Is it the quality reputation of US production?

In addition to securing food for the future, is the potential Smithfield deal also part of a general Chinese policy of making strategic worldwide investments as means of benefiting from the economies and strengthening political allegiances with the US and other countries? The substantial investments made by China in countries around the globe will be the focus of a future column. As we know in the case of the US, China has quite a stash of accumulated dollars from years of a negative balance of trade on the part of the US to purchase productive assets. With the Smithfield investment as an example, they get the profits that used to go to domestic investors and pork to boot.

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Originally published in *MidAmerica Farmer Grower*, Vol. 34, No. 23, June 7, 2013
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