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Niman Ranch—a natural meat processor case study

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1. Introduction

In the spring of 2000, Mr. Mike McConnell, co-owner of Niman-McConnell, LLC a.k.a. Niman Ranch, a San Francisco Bay area meat processor, had just informed a major customer that they would have to reduce their next contract for pork loins by at least 50% or raise prices substantially. Niman Ranch had lost a substantial amount of money on the last contract and did not want to repeat the situation.

Niman Ranch supplies upscale restaurants and grocery stores in the San Francisco Bay area and over the last few years, as far away as New York and Atlanta, with gourmet-quality beef, pork, and lamb. Niman Ranch prides itself in offering the highest quality "natural" meat products produced from livestock raised on family farms. When it comes to caring for and feeding the livestock they have contracted, Mike states; "costs are not a consideration, quality is everything." Niman Ranch contracts with family farms to raise their animals in a natural environment without the use of drugs or hormones. In order to compensate the family farmers for the more expensive production process Niman Ranch pays more for these livestock than the going commodity price. Niman Ranch balances this approach by selling their meat products at about a 100% premium over regular meat products. Niman Ranch has not experienced a shortage of customers for its loin cuts, despite its pricing policy. Its customers almost universally agree the Niman Ranch meats are higher quality, more natural, and tastier than other meats and worth the extra price. Most of the customers also agree with Niman Ranch's philosophy of contracting with family farms and compensating them for the extra costs of raising the animals in a humane manner. In fact Niman Ranch is so committed to the family farm philosophy that Mike likes to say that his company is the processing and marketing operation for about 100 family farms.

Still, Mike McConnell's job is to figure out ways to make a profit. The meat processing

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business requires that all the animal be sold at as high a price as possible in order to cover costs (See IBP and the U.S. Meat Industry, Harvard Business School Case #9–391-006, Brown and McNinch). Niman Ranch pays higher than commodity prices for its beef, pork and lamb and sells the loin and other prime cuts at a substantial premium, but from 30% to 80% of the remaining carcass is being sold at lower commodity prices.

In the past Niman Ranch grew only as fast as the whole animal could be sold. This strategy has worked well with the beef and lamb portions of the business. In 1998 Niman Ranch was given an opportunity to supply 20 Fresh Fields grocery stores in the eastern U.S. with pork loins. Fresh Fields is owned by Whole Foods and both are upscale grocery chains specializing in top quality products, many of which are organically produced. Fresh Fields approached Niman Ranch to supply them with pork loins after the Sierra Club accused their then pork supplier of being a pork factory responsible for polluting the environment and treating animals cruelly. Mike McConnell knew this opportunity would not last, so he took advantage of it. Unfortunately, the contract has thrown the pork portion of the business out of balance and Niman Ranch has found itself with an over supply of bacon, hams, and other pork products that have been sold at commodity prices, which are below the company's cost.

2. The Niman Ranch story

Niman Ranch was founded in the early 1970s by two friends: Bill Niman, a rancher and Orville Schell, a journalist. Niman graduated from the University of Minnesota with a B.A. in Anthropology in 1967 and began raising cattle in 1970 on a ranch in Bolinas, California he co-owned with Schell. They began marketing the beef to San Francisco Bay area restaurants under the name Niman Schell.

In 1978 Schell wrote a book entitled, "Modern Meat; Antibiotics, Hormones and the Pharmaceutical Farm," in which he described in detail the levels to which agribusiness' "mass production" of meats had sunk in the pursuit of profits. He delineated the industry's dependence on chemicals, growth hormones, and feed additives to alter the natural growing process and produce bigger, heavier cattle and hogs, faster-but at what risk to health and taste, and at what cost of cruelty to the animals' (www.nimanranch.com/our-story). In contrast, Niman Schell raised their animals humanely, with care taken to have livestock lead stress-free lives. Niman Schell used only breeds known for flavor, and fed them only the finest natural feeds. Their reputation for superior tasting meat and ethics spread rapidly. They began working with other family farmers and ranchers who shared their commitment to quality, the environment, and humane treatment of livestock.

In 1996 Schell was named Dean of the University of California at Berkeley, School of Journalism. Niman bought Schell's interest, restructured the company's debt, renamed the company Niman Ranch, and sold 49% of it to Mike and Marilyn McConnell. The company is now called Niman-McConnell LLC, dba Niman Ranch. Shortly thereafter Rob Hurlbut, a former marketing manager with Nestle, joined the company as operations and marketing manager. Niman Ranch acquired its first processing plant with the help of the new capital infusion and lines of credit from the Bank of the West and the city of Oakland. The company also introduced the first in a series of processed products for the retail market.

Mike McConnell became a co-owner of Niman Ranch in 1997. He had graduated cum laude from Yale University in 1966 and taught in India from 1966–7 with the Fulbright program. He has also been a founding board member of two high-tech educational nonprofits, the New Media Centers, and Highway One and is also on the National Council of the World Wildlife Fund. Between 1977 and 1989, Mike was in senior positions with Computerland Corp. He started as a franchise salesperson with a three store chain and rose to V.P. Marketing, V.P. Operations, Executive V.P., to President of a new international division. He joined SuperMac Technology, a small Macintosh peripherals company in 1989. During his tenure as CEO, SuperMac sold off some of its business, raised venture financing, held a successful Initial Public Offering (IPO) and follow-up offering and increased revenues five-fold. As Visioneer CEO, starting in 1994, he raised an additional round of venture capital, increased revenues nearly ten-fold, and held a successful IPO while the company became the acknowledged leader in the desktop scanning market.

Rob Hurlbut became a co-owner of Niman Ranch in July, 1997. He has extensive experience in purchasing, marketing and building brands for food products. Rob graduated from Harvard University in 1986 with a B.A. in Psychology. Between 1986 and 1992 he was an Associate Vice President at Dean Witter Reynolds, where he codeveloped a business specializing in trading coffee and cocoa futures and options. Rob then joined Nestle Beverage Company as Director of commodity risk management with responsibility for purchasing and hedging the price risk of over $700 million in raw materials. He then became marketing manager for a $160 million nondairy creamer division where he developed and introduced successful new products.

Today, Bill, Mike, and Rob along with a team of, butchers, packers, office staff, and drivers, are fulfilling the vision upon which the company was founded-to bring the best possible meat to customers while practicing the highest standards of animal husbandry and environmental stewardship. Niman Ranch has developed a network of sustainable family farms owned by ranchers known personally by Bill Niman and his staff. These farms and ranches treat their animals with dignity and respect, and raise them, by agreement, free range on grass and natural feeds, without steroids, subtherapeutic antibiotics, or other artificial growth hormones. In keeping with this philosophy the company contributes a portion of its profits to organizations such as the World Wildlife Fund, Farm Aid, and the Chez Panisse Foundation through its Niman Ranch Foundation (www.nimanranch.com/our-story).

3. Beef production details

Niman Ranch beef cattle are raised on about 35 different ranches in northern California, Oregon, and Montana, including Bill Niman's ranch on the Bolinas coast of California. The cattle are primarily Black Angus and Hereford breeds, and depending on the ranch, are born in both spring and fall to make sure there is a constant supply of cattle for the feedlot. The calves are pastured with their mothers for at least 6 months and then weaned. They continue to be pastured for up to another year and enter the feedlot at about 15 to 18 months of age and weigh from 700 to 900 pounds.

The feeder cattle are purchased from the ranches throughout the year when they appear to

be ready for finishing. The formula used by Niman Ranch to purchase the feeder cattle is based on the highest price for feeder cattle in the northwestern United States as reported by CattleFax plus 6 cents per pound.

The feeder cattle are fed a free choice ration of barley, corn, wheat, soy meal, sugar beet pulp, cane molasses, and hay. Mike says the ration was formulated several years ago by a nutritionist to produce the tastiest beef and is not changed when ingredient prices change. The feeder cattle are not crowded into pens, as is typical, and are given abundant shade and acclimatized to being around people. They also take longer to reach market weight; about 4 to 6 months, whereas other feedlots feed to have their cattle reach market weight in as little as 3 months. This slower process and additional care further adds to Niman Ranch's costs.

Niman Ranch has a 1,000 head capacity feedlot at Petaluma, California and has recently leased a feedlot in Nampa, Idaho, which has a capacity of several thousand head. The feedlot at Nampa will use the same ration, amount of straw per pen, and stocking rate per pen as the Petaluma feedlot does. The Idaho location was chosen for expansion because its climate is good and it is closer to most of the feeder cattle and feed sources thereby reducing transportation costs.

Once the cattle reach market weight they are transported to and processed as humanely as possible at a facility contracted by Niman Ranch. The cattle are given more room in the transport truck and are treated with respect and dignity at the processing plant. Niman Ranch personnel accompany them to the slaughter plant and right into the chute so they stay calm. Originally the cattle were processed at a plant in Petaluma, but growth from 1,700 head per year a few years ago, to 3,500 head in 1999, to a projected 4,000 head in 2000 necessitated a move. Currently Niman Ranch is processing in Nampa, Idaho.

The carcasses are cut into primal cuts, chilled, not frozen, aged for a week, and transported to Niman Ranch's own processing facility in Oakland, California where the loins are further aged for 4 to 5 weeks for extra tenderness. Periodic shipments are also taste tested at the Oakland plant. Butchers and packers then further process the primal cuts into steaks, roasts, hamburger, and other beef products. Currently almost all the carcass is sold in the premium markets, the rest has to be sold into the lower priced commodity market. The remaining bones are donated to the Oakland Zoo.

4. Pork production details

The hogs used by Niman Ranch are raised free range, that is, pastured out doors or kept in deeply bedded pens, treated humanely, and fed natural feeds including corn and soy meal on about 65 family farms in Iowa and California. Exhibit 1 outlines Niman Ranch's approval by the Animal Welfare Institute (AWI) and its husbandry standard for pigs which Niman Ranch requires their hog farmers to follow. The hogs are not supplemented with antibiotics or artificial growth stimulants of any kind. The hogs are bred naturally producing about 20 piglets per sow per year, which is slightly less than the 20 to 25 piglets per sow per year usually averaged in confinement barns. The pregnant sows are left to build their own nests either under shelter or not. Farrowing crates are not used. Once the piglets arrive shelter is brought to the litter to protect them from the sun. The piglets take longer to reach market weight and are often marketed at heavier weights than conventional confinement systems.

The formula used by Niman Ranch to purchase the hogs is based on the local market price on the day of sale plus 6 cents per pound, with a floor price of 40 cents per pound. During the 1998 down turn in pork prices Niman Ranch contracted farms were receiving an average of 43 cents per pound for their hogs whereas the local market price was as low as 8 cents per pound. In addition Niman Ranch has entered into a 50–50 partnership agreement with the hog farmers in the form of Niman Ranch Pork LLC (NRP). Niman Ranch and the hog farmer each contribute $1 per hog marketed to NRP and this money is used to finance the lag time between the live hog purchase and sale of the pork. Participating farmers will be able to buy Niman Ranch shares at a 15% discount if and when an IPO is made.

The hogs are transported to and processed humanely at a contracted plant close to most of the farms in Iowa. They are given more room in the transport truck and Niman Ranch personnel are present at the slaughter plant to make sure they are treated humanely. The carcasses are cut into primal cuts and shipped fresh, never frozen, to Niman Ranch's own processing facility in Oakland, where they are taste tested and further processed into chops, loins, hams, and other pork products. Currently about 50% of the carcass is sold in the premium markets, the rest has to be sold into the commodity market. About 25,000 hogs were processed by Niman Ranch in 1999 but the number will be lower in 2000 if premium markets cannot be found for more of the carcass.

4. Lamb production details

Niman Ranch lambs are raised on several sheep ranches near Rio Vista, California on the northeast corner of San Francisco Bay and others in the western U.S. to ensure a constant supply. The California lambs "graze on natural rain-fed grain in the late winter and spring, then move to clover fields as the grains begin to dry out and finally on to a blend of corn and alfalfa" (www.nimanranch.com/lamb). Until recently, Niman Ranch has purchased lamb at a fixed premium price based on a size grid, that has stayed unchanged for several years, because the participating family farms have wanted it that way. Now the group of farmers have expanded and lamb purchases are moving to a market premium program similar to the hog program. The lambs are transported to and processed humanely at a San Francisco Bay area plant. They are given more room in the transport truck and are treated with respect and dignity at the processing plant. The carcasses are then shipped fresh, never frozen, to Niman Ranch's processing facility in Oakland, where each shipment is taste tested and further processed into chops, racks, legs, and other lamb products. Currently about 75% of the carcass is sold in the premium markets, the rest, has to be sold into the commodity market. About 5,000 lambs were processed by Niman Ranch in 1999 and this has been rather consistent for the last number of years.

5. The processing plant in Oakland

Niman Ranch moved to its current processing plant on 12th street in Oakland in 1997. The plant was a vacant former meat packing facility that had not been used for some time. Niman

Ranch was able to secure a $1 million low interest loan from the city of Oakland to refurbish the plant, get it operating again, and hire local people to work in it. The plant was never designed as a slaughter facility and could not be refurbished into one due to size and location restraints. The plant was retrofitted to handle the beef, hog, and lamb primal cuts. There are also storage facilities for further chilled aging. The final processing into individual cuts is done by staff specifically trained in proper butchering techniques. There are several packaging machines for the final products, but no cooking, pickling or sausage making is done in the facility. In the spring of 2000 part of the parking lot was taken over by temporary refrigerated storage lockers.

Niman Ranch currently employs about 62 people full time including about 20 butchers, 20 packers, 7 drivers, and 10 office staff at the Oakland processing plant. In addition, there are 2 staff members in Iowa to oversee the raising, slaughtering, and taste testing of pork. There are also 2 staff members at each feedlot in Petaluma, California and Nampa, Idaho. Finally, there is a sales person in Chicago and another in Seattle who work on a commission basis. The butchers work in the plant dissecting the carcasses down to portions, for example individual steaks and pork chops. The packers package the products and organize orders. The drivers deliver the products to the customers based on an assigned delivery route that changes daily. The office workers coordinate the logistics including the acquisition of primal cuts, the processing and delivery of products, the payments to the farmers and slaughter plants and the collecting of money from the customers.

Most of the employees have been hired from the local area and put through a rigorous training program specific to their job with the company. Mike appeared to be on a first name basis with most of the employees and morale was quite high in the spring of 2000. The average wage in the plant is $10 per hour based on a 40 hr week. Butchers average $12.50 per hour. Overtime is paid time and a half and has been a regular occurrence over much of the last 3 years averaging about 5 hr per employee per week. The fleet of 7 refrigerated trucks are leased at a cost of $600 per month each and can be added to or reduced as needed.

6. Supply chain management

The logistics of running Niman Ranch may be even more complicated than that of the huge transnational Iowa Beef Packers (IBP). Primarily IBP deals with meat as a commodity and buys it live through the auction market system without knowing how, specifically, the animal was raised and primarily processes the carcass to the boxed stage of wholesale cuts. Also, most of IBP's customers are meat wholesalers and retailers that deal in high volumes and expect good quality, but not excellence. Niman Ranch on the other hand deals with three livestock species and makes sure the livestock are raised on family farms and ranches according to its rigorous standards. Then it contracts slaughtering facilities to process the animals and monitors the slaughtering facilities with their own staff to make sure they are killed humanely. Next, it coordinates delivery of the primal cuts to their own plant, taste tests all shipments to guarantee quality, and further processes primal cuts to small serving sizes and other meat products. Finally, it coordinates delivery of many relatively small and mixed orders to upscale restaurants and grocery stores, all of which demand excellence, and are located all over the U.S. All this is done out of a single crowded office that appears to need

at least twice as much space, more computers and phones, and significantly more staff. Mike estimates that all of this costs about $42.00 per hog and considerably more per head of cattle. He has heard that IPB costs are about $12.00 per hog.

7. The customers

Niman Ranch's customer list includes about 77 restaurants that primarily serve Niman Ranch meats, 65 San Francisco Bay area, 8 Seattle, 2 Boston and 1 each in New York City and Madison, Wisconsin. The list is even longer for those restaurants that often feature Niman Ranch meats and includes restaurants in Atlanta, Boston, Chicago, Des Moines, New Jersey, New York, Phoenix, Philadelphia, Portland, Santa Fe, and Seattle. In addition to restaurants, customers can buy the full line of Niman Ranch products from the plant in Oakland and from 4 San Francisco Bay area retailers including Webvan, an internet grocery purchasing and delivery service, and Woodlands Markets. A selected range of Niman Ranch products are also available at 16 San Francisco Bay area retailers, 5 New York City retailers and 16 Fresh Fields stores in the Washington, Baltimore, and Philadelphia area. Niman Ranch products are also available through the prestigious Williams-Sonoma mail order catalogue. For the month of February, 2000; Webvan purchased over $128,000 of products, followed by Fresh Fields at over $68,000, and Trader Joe's at over $57,000. These three companies were Niman Ranch's biggest customers that month.

Niman Ranch's reputation is even more widespread than it's customer list. Exhibit 2 summarizes just a few of the stories that have been written in both the main stream press and food and restaurant industry journals about Niman Ranch. As indicated earlier, the company has also been endorsed by the Animal Welfare Institute. Finally, Niman Ranch has no written contracts with its customers, everything is done on a respected relationship basis.

8. Beef slaughtering facilities

Slaughtering facilities have been a recurring problem for Niman Ranch. Beef volume has outgrown the Petaluma plant and a long-term suitable facility that can handle the continually increasing volume has been difficult to find. However, Mike feels the problem has been solved with the recent locating of a high quality beef slaughter facility near the feedlot in Nampa, Idaho. Mike has stated that Niman Ranch is happy with its arrangements for the slaughtering of lamb and hogs and is not considering any changes in the near future.

9. Need to sell the whole animal

Mike McConnell stated in the spring of 2000, Niman Ranch's main problem is selling the whole animal at premium prices. Currently about 50% to 100% of the carcass is being sold at premium prices. Most of the front-ends of the animals, usually containing the less tender meat, are being sold at commodity level prices. Mike has stated that, "the price of loins can't

go high enough to cover the cost of selling the rest of the animal at commodity prices." He also says, "that new customers have to agree to take 50% percent of their order in nonloin cuts, if not, Niman Ranch will not contract with them." Further to this, Niman Ranch's commissioned sales people are also being paid double commissions for contracts that include products of nonloin meat.

In the meantime, Niman Ranch has contracted 3 or 4 sausage and prepared meats manufacturers do develop recipes that can use these less tender cuts in whole form or as ground meat. By the spring of 2000 Niman Ranch was launching Pastrami and breakfast link lines. Niman Ranch contracts the making of the sausages and specialty meets to others but ensures that their quality control standards are met. Mike also has several chefs of current restaurant customers working on recipes that will use the other cuts. For example, in March, around St. Patrick's Day, Niman Ranch sells a large number of briskets as corn beef. Finally, Niman Ranch also has a contract with Trader Joe's and Andronico's, upscale grocery store chains, to supply bacon. The bacon is not "natural" as such, as it contains nitrites, but is more flavorful than many other brands and has recently become Andronico's best selling bacon.

10. Financial performance

Exhibit 3 presents the annual net income statements for Niman Ranch from 1995 to 1999. As can be seen sales have increased dramatically over the 5 year period rising a total of 351% from 1995 to 1999. Gross profit has stayed relatively constant between 35% and 42% of sales. Operating expenses have risen 426% over the same time period, but part of this rise is due to an accounting practice. Exhibit 4 outlines the notes to the financials and begins by explaining how the accounting of cattle feed costs affects the income statement. When cattle feed is not capitalized; earnings before income taxes, depreciation, and amortization (EBITDA) as a percentage of sales is between 5.8% and 3.2% but drops to (2.3%) in 1999. When feed is capitalized; EBITDA as a percentage of sales is between 5.9% and 3.3% but drops to only (0.6%) in 1999. Even with the capitalization of the feed the financial performance of Niman Ranch in 1999 is not good and reflects the problem of not selling the whole animal at premium prices. Mike feels Niman Ranch's EBITDA as a percentage of sales should be around 8%.

Exhibit 4 also explains how the balance sheet (not provided) is adversely affected by the valuing of the cattle on feed at cost. It then details the two subsidiaries of Niman Ranch, Niman Ranch Properties LLC and The Niman Ranch Pork company LLC. Finally, Exhibit 4 details how the interest expenses is calculated and what the owners draw from the company. Mike says that the equity of Niman Ranch has been close to zero over the last few years.

Exhibit 5 presents an 11 year financial summary for IBP, the largest beef and pork processor in the world. As can be seen IBP's EBITDA as a percentage of sales has been between 0.0% and 3.6% over the 11 years between 1988 and 1998. Exhibit 6 presents a 3 year financial summary for Smithfield Foods, another large meat processor. Again, as can be seen EBITDA as a percentage of sales for Smithfield Foods has been between 2.4% and 4.8% for the 3 years in question. If IBP and Smithfield Foods are representative of the meat processing industry, and they may very well be, Niman Ranch has the potential to out perform the giants of the meat processing industry, but first has to address its poor financial performance.

11. Questions

What short-term tactical maneuvers would you suggest Mike McConnell do to solve the current negative profit problem?

What long-term strategic plans would you suggest Mike McConnell and the Niman Ranch board come up with to solve the current negative profit problem?

Explain supply chain management in the Niman Ranch context. What are the major variables and how are they handled? How does their supply chain enhance their profits?

What is the market for "natural" meat products?

Can and should Niman Ranch expand?

Exhibit 1: Animal Welfare Institute (AWI)-approval and husbandry standards for pigs

1.1. Awi Quarterly-Summer 1999: Niman Ranch: AWI approved good for the pigs, the family farmer and the community, by Diane Halverson

To help end mistreatment of farm animals, the Animal Welfare Institute is supporting the Niman Ranch Company and its network of family hog farmers who follow humane husbandry criteria developed by the AWI. AWI's criteria require that all animals be allowed to behave naturally. Unlike the crated sows on factory farms, the sows in the Niman Ranch program have freedom of movement, allowing them to fulfill their instinctive desire to build a nest when they are about to give birth. Unlike the factory farm pigs housed on concrete slats over manure pits, Niman Ranch pigs are raised on pasture or in barns with bedding where they can live in accord with their natures, rooting for food, playing and socializing. AWI's criteria require that the participants in the program be independent family farmers, that is, the farmer must own the animals, depend on the farm for a livelihood and be involved in the day to day physical labor of managing the pigs. This requirement helps to ensure that pigs are raised in modest numbers, making it easier to know and manage the animals as individuals.

Niman Ranch, which buys the pigs and markets the meat, also forbids feeding or otherwise administering hormones or antibiotics and prohibits the feeding of by-products. Unlike factory farmers, humane farmers in the Niman Ranch program do not rely on antibiotics to mask clinical manifestations of disease or to promote growth; therefore, they do not contribute to the devastating problem of antibiotic resistance among humans.

Paul Willis, the farmer who inspired AWI's involvement in the program, keeps 200 sows and their offspring on pasture or in barns bedded with straw on his Midwest farm. Niman Ranch rewards Willis, and farmers like him, by paying them a premium price. Niman Ranch products are available at 200 fine restaurants in California, at Trader Joe's stores in the West, at Whole Foods stores in northern California, and through the Williams-Sonoma mail order catalogue. Additional markets are being developed nationwide. In a 1995 Opinion Research Corporation survey, 93% of the adults surveyed believed that animals should be treated humanely, even when being raised for human consumption, and three-fourths opposed confining sows in crates, laying hens in battery cages and veal calves in crates. The Niman Ranch program gives a growing number of such consumers an opportunity to reject meat

derived from pigs raised in animal factories and assists in the preservation of humane family farms, thereby helping to set a humane standard in raising of animals for food.

1.2. Animal Welfare Institute (AWI)-approval and husbandry standards for pigs

General. Housing for animals shall be designed to allow the animal to behave naturally.

Housing shall be sufficiently spacious to allow all animals to lie down in full lateral recumbence at one time and to move freely.

Pigs are active, social animals by nature, and close confinement in crates is prohibited unless briefly required for vaccination, feeding, marking, or veterinary procedures or in the rare event that a sow may savagely attack her piglets, and then only temporarily until the sow is calm.

Pigs should have continuous access to pens bedded with straw or chopped corn stover, or pasture or dirt yards in which they can root, explore, play or build nests. Substitutes for straw or corn stover may be used only with the approval of the Animal Welfare Institute. Straw is the preferred bedding for farrowing sows and their nursing piglets.

Even when bedding is not needed for warmth, straw or other approved material shall be provided to hogs that do not have continuous access to pasture or dirt. The bedding shall be provided in quantities sufficient to give the hogs material in which to play, explore and root.

Pigs housed out doors shall have continuous access to shelters that protect them from the heat, wind, cold or rain. Adequate straw shall be provided to keep pigs comfortable in cold weather. In the case of pigs loose-housed in groups in deep-bedded systems, there shall be a sufficient amount of litter to create a deep litter bed in which composting can start and be sustained to provide warmth and destroy pathogens.

New buildings shall be constructed with windows or openings that let in daylight.

The equipment and fittings in buildings and other premises that house pigs shall be so designed that they do not inflict injuries or entail risks to the health of the animals. The fittings and other equipment shall not prevent the animals from behaving naturally, nor unwarrantably limit their freedom of movement or otherwise cause them stress.

Persons who transport live animals shall attend to the animals and take the necessary steps to ensure that the animals are not injured or caused to suffer during loading, transport and unloading.

Hot prods or electric shocks shall not be used on the animals. “Boar bashing” shall be prohibited.

The animals’ living quarters shall be cleaned by procedures that ensure satisfactory hygiene. The surfaces of deep litter beds shall be kept dry and be of good hygiene quality.

Pigs shall be given sufficient space to keep dunging and lying areas separate from eating areas.

The routine use of subtherapeutic antibiotics, hormones or sulfas to control or mask disease or promote growth is not permitted. The feeding of animal products to pigs is not allowed.

Animals shall have a feeding plan that will guarantee a sufficient, varied and well balanced diet. Animals shall have access to their feed as long as is necessary for them to satisfy their feed requirements. Animals shall have free access to water.

In the event a pig suffers accidental injury on the farm, the animal shall receive individual treatment designed to minimize its pain and suffering. Ill and injured animals shall not be transported in the same compartment with healthy or uninjured animals.

If the injury is serious enough for the animal to be slaughtered it shall be euthanized on the farm.

In addition to meeting the above criteria, each farm shall be a family farm, that is, an individual or family member must do all of the following: a) own the hogs; b) depend upon the farm for its livelihood; c) provide the major part of the daily labor to physically manage the hogs and the rest of the farm operation. This shall not prohibit networking among family farms as long as all criteria listed herein are adhered to be each and every member of the network.

Exhibit 2: What the press has to say about Niman Ranch

2.1. New York Times (Marian Burros, "Pork with a Pedigree")

Last week, for only the second time in my life, I tasted-pork so delicious it needed no seasoning beyond salt and pepper. Both times the meat was superior heirloom pork, suffused with a bright, clean flavor, with none of the unpleasant after taste pork often has. Not coincidentally, both pieces came from pigs raised in a manner vastly different from that of ordinary supermarket pork. . . .

The pork I had last week, . . . sold under the brand Niman Ranch, which is known for its fine beef, . . . had first been described to me . . . in terms of its environmental soundness rather than its taste.

Most pork today is leaner than in the past, but in the process of breeding out the fat, the flavor went, too. The low fat content also means that the pork becomes tough very quickly when it is cooked. And the factory pork releases a lot of liquid in cooking because the animals have been given hormones, which increase their weight through fluid retention. The Niman Ranch pork remains tender and releases little liquid. . . . Once again, small is beautiful.

2.2. San Francisco Chronicle (Robin Davis, "Taster's Choice")

Today's panel tasted eight New York strip steaks, which many consider their favorite steak. Surprisingly, the Prime steaks scored too low to rate. Despite uniform seasoning and preparation, there were definite differences in flavor.

Niman Ranch . . . was the favorite by almost 10 points over the next closest brand. It also scored high enough to make Taster's Choice Hall of Fame for products garnering 89 points or more.

Niman . . . attributes his meat's flavor to the older age of his cattle (they're usually slaughtered at 2 years instead of the industry standard 15 months). . . . They have been fed longer, which contributes to the development of flavor.

2.3. Bon Appetit' (Bon Vivant)

Some of the best pork we've had comes from Niman Ranch in northern California. Free-range and hormone-free, it is succulent and tender, and is an excellent choice for Christmas dinner.

2.4. Voque (Jeffrey Steingarten, "Prime Time")

We should consume beef infrequently, but when we do, we should buy only the most tender, rich, juicy, and flavorful beef we can afford, and grill it over fire.

Beef consumption has in recent years been shrinking at home as it rises at the steak house. One obvious explanation is the low quality of supermarket beef. As one USDA official confided to me, "At the supermarket level, it's hard to find something you want to take home." . . . But you can buy them through mail order. The Niman [Ranch] steaks . . . are excellent, and come from steers raised without hormones or antibiotics, a rare practice in today's beef business."

Exhibit 3: Niman ranch 1995–1999 income statement

	1995	1996	1997	1998	Preliminary 1999
Beef Sales			$1,952,777	$2,370,744	$3,240,150
Pork sales			624,504	1,413,027	3,425,680
Processed			370,032	1,243,710	1,621,727
Lamb, other			1,21,908	1,074,966	1,348,806
Total sales	2,747,993	3,325,773	4,069,221	6,102,477	9,636,363
Cost of meat	1,749,065	2,089,872	2,357,729	3,768,384	6,220,057
Gross profit	998,928	1,235,901	1,711,493	2,334,091	3,416,309
Gross profit % of sales	36%	37%	42%	38%	35%
Operating expenses ranch (excl. feed)	101,760	148,712	179,246	189,595	255,110
Feed (for current level of sales)	166,027	283,745	446,165	522,436	682,655
Feed (for future expansion—capitalizable)			75,329	76,000	164,562
Plant	328,889	380,705	454,362	713,112	1,285,067
Delivery	120,713	116,127	122,446	265,430	472,872
Sales & marketing	8,563	10,734	65,416	68,084	178,605
Office	55,928	74,899	90,419	109,585	188,595
G&A	81,402	118,584	125,274	259,957	448,817
Total operating expenses	863,283	1,133,507	1,558,660	2,204,198	3,676,285
Operating income	136,648	102,395	152,832	129,894	(259,977)
Depreciation	53,390	75,324	56,262	60,000	60,000
Amortization			300		
Other income	24,592	6,629	11,652	63,334	37,949
Interest expense					
Line of credit/loan	50,874	6,815	23,839	98,592	152,668
Tompkins loan			31,200	29,733	28,403
Schell loan restructure			106,979		
Net income	55,976	26,885	159,859	4,902	(463,099)
NI w/feed capitalized	55,976	26,885	235,188	80,903	(298,537)
EBITDA	160,240	109,024	164,481	193,228	(222,028)
EBITDA as % of sales			4.0%	3.2%	(2.3%)
EBITDA w/feed capitalized	160,240	109,024	239,810	269,228	(57,466)
EBITDA w/feed capitalized as % of sales	5.8%	3.3%	5.9%	4.4%	(0.6%)

Exhibit 4: Notes to the financials

4.1. Expensing versus capitalizing feed costs

As an LLC, the company has operated with the goal of producing minimal taxable income for the owners. One key result of that is the decision not to capitalize feed costs. All cattle are carried on the books at cost. For steers born on our own breeding herd, this is $0. For steers purchased and put out to pasture, this could be as low as $450. For steers bought at 800+ lbs. and put directly into the feedlot, this may be as much as $700. Each month, we spend between $60 and $65 per head on cattle feed. This increases the value of the cattle, but it is not reflected on the balance sheet; the feed is treated as an expense.

Bank of the West currently loans us up to 50% of the commodity market value of our cattle. We produce a report for them each month showing the difference between that number and the value per the balance sheet. On December 31, 1999, the market value was $684,721 while the balance sheet value was $548,989. This was an understatement of $135,732, or nearly 25%. Since our cattle are among the finest cattle on feed in the country, this still understates the actual market value of the cattle, were they to be sold at auction. Obviously, they are worth even more when sold as Niman Ranch beef.

On the financials, we show the effect of this practice on the bottom line in two locations: Net Income with Feed Capitalized, and EBITDA with Feed Capitalized.

4.2. Affiliated companies

Niman Ranch is the d.b.a. for an LLC, Niman-McConnell LLC. The company has two subsidiaries.

Niman Ranch Properties LLC was created to purchase our plant (so that Bank of the West could have first position on all parent company assets), and the mortgage holder can have first position on the property. Niman-McConnell LLC owns 99+% of Niman Ranch Properties, LLC, with Bill Niman, Mike McConnell, and Rob Hurlbut each holding a $100 interest.

The Niman Ranch Pork Company LLC is owned half by Niman Ranch and half by the farmers who supply us with pork. Initial capital was provided by the State of Iowa; the company's function is to finance the growth of our pork business by paying hog farmers for their hogs on the day after the hogs are slaughtered, while giving Niman Ranch 6 weeks to pay for them. It holds a credit line from a Thornton, Iowa bank and is capitalized by $80,000 from the State of Iowa and by a $1 contribution from both the farmer and from Niman Ranch for each hog that is purchased.

The Pork Company operates at break-even, building its costs into the price it charges Niman Ranch. The Property company does the same, passing on its cost of borrowing to Niman Ranch, who pays it rent. In 1998, Niman Ranch Properties LLC purchased a building in the Potrero area of San Francisco and began converting it to a processing plant. After extensive planning and preparation work, our growth required us to find a temporary home and we moved to a vacant meat processing plant in Oakland. While estimates on the cost of completing the San Francisco conversion rose beyond $2 million, the City of Oakland offered a $1.2 million financing package at below-market interest, if we purchased our leased

space and relocated to Oakland. The cost of purchase for this space was below $1 million and we were able to finance half of it through the seller, thus allowing $700,000 of the financing to be used for renovations, equipment purchases, and general working capital. The cost of cancellation of the San Francisco project (the building has now been sold) was somewhat more than $300,000.

The results of both companies will be consolidated on Niman-McConnell's published financials but are not included in the internally produced operating P&L.

4.3. Interest expense

The company has operated heretofore on the personal capital of its owners and its borrowing power. The company currently has two loans from Bank of the West totally $1.5 million. In addition, the City of Oakland, using HUD funds, has agreed to loan the company $600,000 at 3.5% interest for working capital (a certain percentage of this must be used for plant and equipment.) Another loan of $600,000 has been made to Niman Ranch Properties LLC at 7.5% interest, to purchase and renovate the Oakland processing plant (see above). As of March 15, these loans are 75% drawn down, and will be completely drawn down as plant equipment currently on lease is bought out and turned into collateral for the remaining disbursements. The business plan assumes no change in borrowings other than the full draw-down of these HUD/Oakland loans. Clearly, additional capital will reduce borrowings and thereby, interest expense.

4.4. Owners draw

Not included in company expenses is a $3500 per month draw taken by Mr. Niman and Mr. McConnell. Mr. Hurlbut is salaried ($6000 per month); his salary is included in G&A.

4.5. Teaching note

The case deals with long and short run strategic management and supply chain management. A "natural" meat processor is incurring financial problems due to expanding its production to meet the specialized needs of a major customer. The firm is having trouble selling the rest of the animal at premium prices. The firm's supply chain management through contracting with farm suppliers is described, but breaks down or is not as well developed on the customer side. Long run and short run strategic management issues come into play because the firm has decided to drop the specialized contract with the current major customer and not take on any new customers unless they make a commitment to buy a balanced line of cuts.

4.6. Positioning the case

The case can be positioned in several places throughout the agricultural economics and agribusiness undergraduate and graduate curriculum. First, the case can be used in senior undergraduate agricultural economics and agribusiness tactical and strategic management

Exhibit 5: Eleven-year financial data for IBP Inc. and subsidiaries (thousands, except for net sales, earniiies from operations as a % of per share data, property, plant, &, equipment, total assets, stockholders' equity, and capital investment)

FOR THE YEAR:	1998	1997	1996	1995	1994[1]	1993	1992	1991	1990	1989	1988[1]
OPERATIONS:											
Net sales (millions)	12,849	13,259	12,539	12,668	12,075	11,671	11,128	10,388	10,185	9,129	9,066
Gross profit	662,208	442,892	443,582	604,068	460,109	258,666	236,791	134,063	209,095	179,053	22,290
Selling, general. & admin. exp.	288,473	216,176	120,674	123,972	112,772	84,197	76,349	72,993	84,395	75,781	80,419
Earnings from operations	373,735	226,716	322,908	480,096	347,337	174,469	160,442	61,070	124,700	103,272	141,871
Interest expense, net	43,213	38,002	3,373	20,784	38,448	43,212	51,826	58,817	48,973	48,047	41,243
Earnings before inc. tax, extra. items, & acctg. chnges	330,522	188,714	319,535	459,312	308,889	131,257	108,616	2,253	75,727	55,225	100,628
EBITDA + extra. items, & acctg. chnges as a % of sales	2.6%	1.4%	2.6%	3.6%	2.6%	1.1%	1.0%	0.0%	0.7%	0.6%	1.1%
Income taxes	125,700	71,700	120,800	179,200	126,600	53,800	45,000	900	27,400	19,900	38,300
Extraordinary loss[2]	(14.815)	—	—	(22,189)	—	—	—	—	(5,980)	—	—
Accounting change[3]	—	—	—	—	—	12,626	—		—	—	—
Net earnings	190,007	117,014	198,735	257,923	182,289	90,083	63,616	1,353	42,347	35,325	62,328
Depreciation and amortization	100,821	92,292	73,910	83,771	54,183	50,714	53,071	55,997	49,824	43,791	41,912
Amortization of intangible assets	25,405	17,638	8,780	8,768	9,260	8,070	8,941	8,649	8,558	8,556	9,486
Capital expenditures, incl. subsidiary, purchases	245,692	458,816	170,664	160,626	135,841	74,212	35,511	24,605	118,619	111,966	78,093
Weighted average common shares outstanding	92,485	92,651	94,688	94,745	94,870	94,989	94,747	94,657	94,643	94,650	94,708
DILUTED EARNINGS PER SHARE											

Exhibit 5
(Continued)

FOR THE YEAR:	1998	1997	1996	1995	1994[1]	1993	1992	1991	1990	1989	1988[1]
Earnings before extra. items, acctg. changes	2.19	1.25	2.07	2.92	1.90	0.81	0.67	0.02	0.50	0.37	0.66
Extraordinary loss	(0.16)	—	—	(0.23)	—	—	—	—	(0.06)	—	—
Accounting change	—	—	—	—	—	0.13	—	—	—	—	—
Net earnings	2.03	1.25	2.07	2.69	1.90	0.94	0.67	0.02	0.44	0.37	0.66
Dividends per share	0.10	0.10	0.10	0.10	0.10	0.10	0.15	0.30	0.30	0.30	0.30
Market price per share of common stock:											
High	29.44	26.00	29.00	33.63	17.75	13.00	10.25	13.13	10.88	8.88	7.88
Low	16.56	20.38	22.50	14.56	11.31	8.75	7.19	6.44	7.44	7.00	5.63
Last	28.94	20.75	23.88	25.25	15.13	12.69	8.75	7.31	10.44	7.69	7.81
AT YEAR END:											
Working capital	231,003	207,109	540,903	427,241	359,238	336,668	329,727	238,163	234,441	182,419	220,698
Property, plant, & equipment, net (millions)	1,072	1,017	816	727	651	589	554	577	613	639	472
Total assets (millions)	3,008	2,839	2,175	2,028	1,866	1,539	1,499	1,451	1,525	1,353	1,325
Short-term obligations	144,047	194,222	646	615	355	177	6,000	25,111	41,001	35,970	10,670
Long-term obligations	575,522	568,281	260,008	260,752	361,760	460,723	510,900	509,901	507,028	416,296	402,351
Stockholders' equity, (millions)	1,401	1,237	1,204	1,023	781	613	534	483	511	497	490
Capital investment	2,142	1,962	1,605	1,386	1,251	1,172	1,127	1,063	1,090	971	949
Common stockholders' equity per share	15.15	13.35	12.71	10.80	8.23	6.45	5.64	5.10	5.40	5.25	5.18

[1] Fiscal year consisted of 53 weeks.

[2] Extraordinary loss on extinguishing of debt, net of applicable income taxes.

[3] Cumulative effect of change in accounting for income taxes.

Source: (www.ibpinc.com Financial Statements.)

Exhibit 6: Annual income statement for Smithfield Foods 1997–1999 (all dollar amounts in million except per share amounts.)

	Apr 99	Apr 98	Apr 97
Revenue	3,775.0	3,867.4	3,870.6
Cost of goods sold	3,299.0	3,522.1	3,585.5
Gross profit	476.0	345.3	285.1
Gross profit margin	12.6%	8.9%	7.4%
SG&A expense	295.6	219.9	191.2
Operating income	180.4	125.4	93.9
Operating margin	4.8%	3.2%	2.4%
Total net income	94.9	53.4	44.9
Net profit margin	2.5%	1.4%	1.2%
Diluted EPS	2.32	1.34	1.17

classes as an example of a business experiencing short-term financial troubles while having a solid long run strategic plan. Secondly, the case is a good example of supply chain management and how it is implemented in a specialized industry. Thirdly, the case could also be used in classes dealing with a major problem faced by the meatpacking industry, that is, selling all the animal at the highest price possible. Finally, the case is an excellent example of a company filling a niche in the market and meeting the needs of a section of consumers that want high quality, natural products that support family farms.

4.7. Possible answers to questions

What short-term tactical maneuvers would you suggest Mike McConnell do to solve the current negative profit problem?

When reviewing the final draft of the case Mike McConnell added a note, which read: "We are making good progress. Losses this quarter will be ¼ of 1st quarter's and we have some great deals in the pipeline.

Management's focus is on

1) end meat sales,
2) end meat sales, and
3) end meat sales.

We are taking on no new customers who can't buy a balanced line of cuts." Mike McConnell's note is probably the best answer to this question and the second one as well. Sell all the products produced from the animals at the highest possible prices. Mike also mentioned that they were not renewing the contract with the grocery chain in the east unless they too decided to take additional cuts of the hog rather than just the loin. The high quality of the Niman Ranch products probably requires contracting with buyers for certain quantities of all products. Marketing these high quality products without contracts is too risky and expensive and given the products relatively short self life would result is products being sold for lower prices.

What long-term strategic plans would you suggest Mike McConnell and the Niman Ranch board come up with to solve the current negative profit problem?

Find customers that are willing to pay premium prices for the nonloin cuts of the animals. This will mean concentrating on end meat sales and developing premium products from these nonloin cuts. It also means not contracting more animal production until the contracts for meat sales have been agreed to.

Explain supply chain management in the Niman Ranch context. What are the major variables and how are they handled? How does their supply chain enhance their profits?

Supply chain management in the Niman Ranch context includes contracting with hog farmers in Iowa, and cattle and sheep ranchers in California, Oregon, Washington, Idaho, and Montana, a cattle feedlot in Idaho, and a slaughter plant for hogs in Iowa, cattle in Idaho, and sheep in California, as well as transportation companies to deliver the meat to its processing plant in Oakland, California. In addition to this, Niman Ranch requires the farmers and ranchers to raise their animals in a prescribed fashion. All of this contracting and delivery of meat has to be timed to meet the requirements of its customers and not exceed the capacity of its Oakland processing plant. The farmers and ranchers that contract with Niman Ranch have to supply animals throughout the year. This is a accomplished easily with the hog farmers as they normally have animals ready for slaughter throughout the year. The contracted cattle are from a mixture of herds that calf in either the spring or the fall, thereby allowing the feedlot to be filled with a wide range of sizes and thereby market maturity throughout the year. The sheep ranchers have different lambing times throughout the year as well.

A major part of Niman Ranch's problem is the breakdown of the supply chain after it produces its products. Niman Ranch has contracted with its animal producers to produce a complete animal in a very specific manner, but has only contracted with its customers to buy part of the animal at premium prices. It is more difficult to coordinate a supply chain from the bottom up than from the top down. That is to say, it is more difficult for a producer to coordinate its customer's purchases, in this case Niman Ranch coordinating its customer's purchases for all types of high quality meat products, than for a customer to coordinate its supplier's products, in this case Niman Ranch's contracts with farmers and ranchers. Niman Ranch has to find ways to complete the entire supply chain before it can realize its full potential. It either needs commitment from its current customers to take other products at premium prices or new customers to take these other products at premium prices.

The supply chain means everything to Niman Ranch's profits. In fact the breakdown or lack of development of the supply chain after Niman Ranch, that is, with its customers, has caused it to loose money. A complete supply chain will allow Niman Ranch to secure a profit in the future and have both satisfied suppliers and customers.

What is the market for "natural" meat products?

This question has no wrong or right answer and is designed to stimulate discussion. The students may want to talk about the difference between "natural" and "organic." Note that Niman Ranch products are "natural" not "organic" because they allow their farmers and ranchers to treat their animals with antibiotics if they become sick. Nimam Ranch's niche is high quality, excellent taste and assistance to "family" farms and ranches. This market is probably highly reliant on large wealthy urban areas such as the San Francisco Bay area, Los Angeles, Seattle, and the Boston-Washington corridor; however, this accounts for more than 100 million people and will grow in the future.

The students may also want to talk about food safety issues, the sustainability of family farms, and the role of the Animal Welfare Institute and similar organizations in the food system. Food safety is becoming a greater concern with many people. The perception that "natural" and "organic" foods are safer is very real and has become a selling point. As incomes and wealth rise the percentage of income spent on food is lower and these people become more conscious of other issues relating to their food, such as safety, the sustainability of the family farm, and animal welfare.

Can and should Niman Ranch expand? The expansion question returns to the tactical and strategic plan in questions 1 and 2, in that Niman Ranch must find customers for premiums meat products made from nonloin cuts. If these markets can be found and contracted, the processing facilities will have to be expanded as the Oakland plant is at or very near to capacity. All this will require an inflow of significantly more capital, most likely requiring additional owners. An Initial Public Offering may still be a few years away.

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