Rabobank

Rabobank Beef Quarterly

Outlook for Global and Regional Markets

Rabobank International

Authors

Guilherme Melo
Guilherme.Melo@rabobank.com
Don Close
Don.Close@rabobank.com
David C. Nelson
David.C.Nelson@rabobank.com

www.rabotransact.com

Rabobank expects global beef prices to again set record levels in 2013 as supply growth will be minimal and demand growth will continue, albeit at a slower pace given slow economic growth.

- Rabobank Global Cattle Price Index dropped 2% in November from Q3 levels
- Rabobank Beef Forex Index averaged 2% above Q3 levels
- Global beef production to remain constrained in 2013
- Scenario for packers in the Northern Hemisphere is challenging due to tight supplies
- Supply discipline in the poultry and pork industry may be a bullish factor
- Players in South America will find a better environment

Figure 1: Global average live cattle prices

USD/kg

	Nov 2012	Q3 2012	Nov 2011	% Nov 2012 x Q3 2012	% Nov 2012 x Nov 2011
Uruguay	2.08	1.96	2.02	6%	3%
Australia	1.79	2.03	2.16	-12%	-17%
Brazil	1.57	1.59	2.01	-2%	-22%
US	2.70	2.50	2.18	8%	23.6%
Argentina	1.63	1.75	2.01	-7 %	-19%
Canada	2.79	2.84	3.08	-2%	-9%
NZ	1.94	1.92	1.70	1%	14%

Source: Bloomberg, USDA, MLA, CEPEA, INAC, IPCVA, OCA, 2012

Global Overview

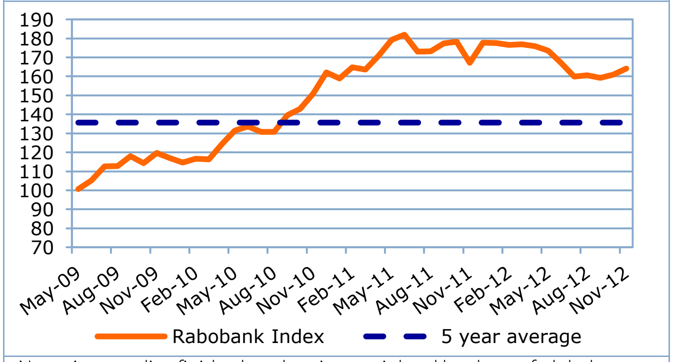
Current scenario

As anticipated in our Q3 edition, the beef market has been characterised by a slightly larger global supply, driven mainly by the natural recovery of herds in Brazil, Argentina and Australia. This combined with a relatively lethargic world economy has weighed on prices across the globe *(see Figure 1)*. Among the most important cattle exporter countries, prices only went up in local currencies in the US and New Zealand. Nevertheless, these increases may not be high enough to offset the recent spike in costs, with the placements of cattle on feed in the US being cut.

In November, Rabobank's Global Cattle Price Index dropped 2% from Q3 levels *(see Figure 2)*. This was mainly driven by the decline realised in Brazil, Australia, Argentina and Canada, which more than offset the rise seen in the US and New Zealand. The strengthening of the greenback against many currencies combined with the weaker demand across many important countries is also a factor behind the downtrend in global cattle prices denominated in US dollars. In a year-over-year comparison, the Index is beginning December down 11% from where it began in November 2011.

Figure 2: Rabobank 7-Nation Finished Cattle Price Index

Jan 2006=100



Note: Average live finished cattle prices weighted by share of global exports (Brazil, Australia, Argentina, Uruguay, US, Canada and New Zealand)

Source: Rabobank, 2012

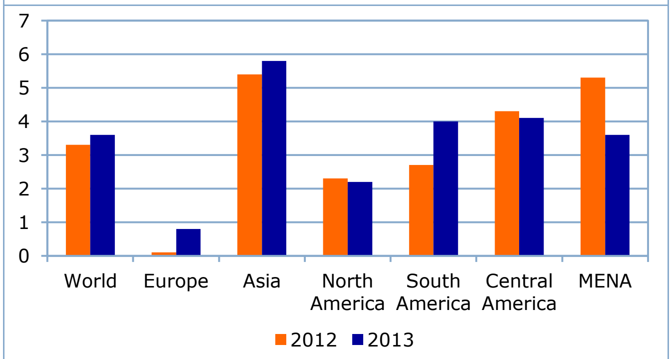
Outlook

For 2013, Rabobank expects to see global supply hovering around 2012 levels, with possible minor ups and downs being determined by the extent to which the increase in Southern Hemisphere production—still driven by Brazil, Australia and Argentina—will outpace the reduction in Europe and the US.

On the demand side of the equation, the broader picture points to another year of relatively weak consumption on the back of the still sluggish economy as world GDP is expected to grow only slightly in 2013 *(see Figure 3)*. The scenario is worse where production is set to decrease (e.g. North America and Europe), which tends to pose additional pressure for beef companies located in these regions to pass on cattle prices to consumers. Additionally, as such countries rely on grains to feed their animals, they are likely to see a reduction in their competitiveness in the international market.

Figure 3: GDP growth per region, 2012-2013

percent



Source: IMF, 2012

On the other hand, companies located in South America, particularly in Brazil, should benefit from the herd recovery and the acceleration of the economy, which offer processors an opportunity to increase/sustain their margins.

Nonetheless, headwinds for the South American industry will probably blow from the Middle East and North Africa, where companies are likely to face a tougher environment for expanding exports in 2013. This reflects the uncertainties resulting from political and economic changes after the Arab spring and ongoing internal conflicts, which are also contributing to weakening activity.

A bullish factor for the industry as whole is the strong need for supply discipline in the poultry sector. Poultry production cuts are likely to come about, driven by negative margins in the wake of severe feed cost increases. To the extent that this increases poultry prices, it may also benefit the beef industry as the gap between beef and chicken prices narrows and possibly shifts demand towards beef.

Regional Updates

Brazil

Live cattle prices in Brazil increased by 4% between October and November, on the back of the seasonal dry period combined with a relatively limited supply from feedlots, where placements did not grow as much as anticipated in the face of high grain and fed cattle prices. However, beef prices underperformed cattle values and posted a rise of only 1% in the same period. It is worth pointing out that in spite of the mentioned increase in live cattle prices, prices fluctuated around 6% below last year's levels.

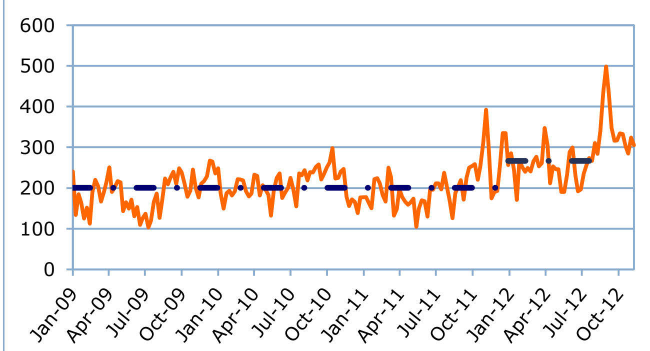
Tailwinds for the industry have continued to blow from the international side, with the volume exported rising sequentially quarter-over-quarter, boosted by the increase in sales to Chile and Egypt, and the depreciation of the Brazilian real (BRL), which enhanced the attractiveness of the product exported. In October, the Brazilian industry exported around 100 thousand tonnes, up 11% MOM and 35% YOY, the highest monthly volume since July 2010. In November, the volume exported went down from the peak seen in the month before to 83k tonnes, but was up 14% YOY. Exported prices in USD have also picked up again in October and November, rising 5% from Q3 levels, which combined with the depreciated currency made average prices converted into BRL increase by 3% over Q3 and 6% YOY. Under this scenario, margins for beef packing companies still look fairly positive and are well above last year's levels (*see Figure 4*). The scenario is even better for those companies that have managed to maximise the participation of exports in total sales. At this stage, it is worth remembering that the three largest beef companies account for the more than three quarters of total Brazilian exports, while accounting for only 35% - 40% of the total slaughtering capacity installed in Brazil.

Indeed, the Q3 earnings reports issued by Marfrig, JBS and Minerva showed significant improvement in their beef business margins. In the case of JBS, EBITDA margins increased by 290 bps YOY. For Minerva, the rise was even larger, increasing 310 bps from last year's levels. Marfrig also delivered a good margins increment (up 270 bps YOY).

For 2013, Rabobank expects supply of live animals in Brazil will remain at reasonable levels, and our first estimates point to an increase in beef production of 3% over 2012. Although supply should increase, the room for a further decrease in live cattle prices is limited as supply of beef from the rest of the globe is set to remain stagnant—helping to boost demand for Brazilian beef—and production of poultry and pork (substitutes) will slow as a result of the high grain prices.

Figure 4: Brazilian beef packers' gross margins, Jan 2009-Oct 2012

BRL/head



Source: Rabobank estimates, 2012

United States

While weather has been the determining marketing influence in the US over the past 18 to 24 months, it may only be a warm up for the market developments in 2013. Currently, the entire central US cattle feeding area is under severe to exceptional drought conditions.

Beef cow and heifer slaughter rates for 2012 are certainly suggesting that producers have been positioning to the best extent possible to sustain and prepare for expansion. Unfortunately, weather conditions continue to thwart any meaningful expansion efforts. While cow calf and stocker operators are struggling with short feed and roughage supplies, row crop farmers across the central Corn Belt have increasing concerns because there has been no meaningful soil moisture recharge during the fall. While there is still potential to recharge soil moisture during the spring, the risk of another year of drought for row crop production is escalating.

For 2012, beef cow slaughter has been down 13% from 2011 and 3% below the five year average. Dairy cow slaughter has been up 6% YOY and 9% over the five year average. Combined cow slaughter has been down 5% from 2011 and up 2.5% over the five year average. With any stability or improvement in the weather, cow slaughter rates are expected to sharply decline in 2013 and provide a base for the first possible evidence for the next cycle of herd expansion in 2014.

Feeder cattle prices in 2012 have posted a strong counter seasonal price pattern. Prices were counter seasonally strong in Q1 2012, driven by tight cattle supplies and what was the expectation for a large corn crop and lower feed grain prices. The LFTB issue in early March, followed by the rapidly developing drought situation in the corn crop, caused a surge in feed grain prices that resulted in a steep counter seasonal price break in feeder cattle prices during the summer. For Q4, prices have been surprisingly strong given feed prices and the sustained losses to cattle feeders. Tight supplies of feeder cattle have been the underlying price support.

The feeder cattle market is sitting in an exceptionally explosive situation. If weather conditions hold or erode to a point that the 2013 corn crop is threatened, feeder cattle prices will trade dramatically lower and renewed liquidation of cattle numbers will be expected. At the same time, normal to favourable weather conditions for the spring and summer, that recharge pasture conditions and assure restored feed grain supplies, would cause feeder cattle prices to easily trade at all-time record high price levels.

2012 has been an exceptionally difficult year for cattle feeders. Short feeder cattle supplies and excess feeding capacity within the industry has cattle feeders in a difficult position, and the drought-reduced corn crop and sharply higher than expected feed prices have caused heavy losses to cattle feeders throughout the year.

Due to sustained losses and continuing short feeder cattle supplies, placement of cattle into feed yards has been below year ago levels in 9 of the past 11 months and lower each of the past 5 months. As a result, fed cattle supplies will show a noticeable decline starting shortly after the first of the year and are expected to show escalating declines in supply through the spring grilling season at a minimum.

Just as in the other sectors of the beef complex, cattle feeding will be dictated by weather conditions in 2013. Additional dry weather will force increased numbers into feed yards, and another year of weather-reduced feed supplies would force a degree of rationing that would be prohibitive to feeders.

Fed cattle prices are expected to close Q4 with prices near the USD 125 price level. Rabobank forecasts Q1 and Q2 2013 prices to trade at a base just under USD 130, with spring highs in the USD 140 to USD 145 price level.

Retail beef prices have posted several new record highs during 2012. To date, consumer demand for beef has held remarkably well. It will be critical to see if consumers stay committed to beef with additional record prices expected in 2013.

Rabobank's estimate for Q1 2012 beef production is 5.84 billion pounds, down 7% from a year ago, with Q2 production estimated to be 6.15 billion pounds down, or 5%. The steep production declines are the combined effect of smaller numbers of cattle on feed and even to lighter average carcass weights that are the result of forced grain rationing and a levelling effect of industry acceptance rates for beta-agonist products.

EU

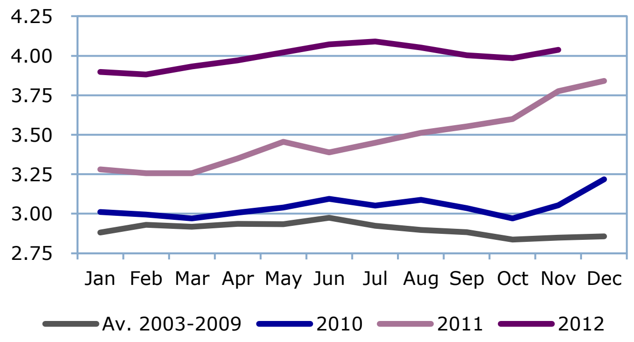
After almost two years of continuously rising prices, which resulted in a high of EUR 4.09 per kg in July, EU beef prices have levelled off in recent months (*see Figure 5*). It seems that EU beef prices have found a new equilibrium at around EUR 4 per kg for prime beef (young bulls). Supplies have been stable as declining slaughter numbers have been offset by declining exports and consumption (*see Figure 6*). However, as prices rose again in November, and with expectations for this to continue, it is clear the supply situation remains very tight.

The stabilisation of beef prices occurred despite the continuing decline in slaughter numbers, which were 4.0% lower in May-August after the 5.0% drop experienced in the first four months of the year. This reflects the ongoing tight availability of cattle in the EU. This situation will not change in 2013, with the EU forecasting an 8.0% decline in cattle slaughter numbers in the first half of 2013 and 0.5% in the second half.

In addition to the continuing battle for cattle, the biggest challenge for the EU beef industry in 2013 will be the ability to pass on higher prices to customers. With EU beef consumption down 3.3% and exports down by 18.0% in Jan-Aug, and without any signs that the economic crisis will fade in the near future, demand for high-priced prime beef will remain under pressure. Rabobank forecasts EU beef prices to continue to trade around the EUR 4 level.

Figure 5: EU beef prices

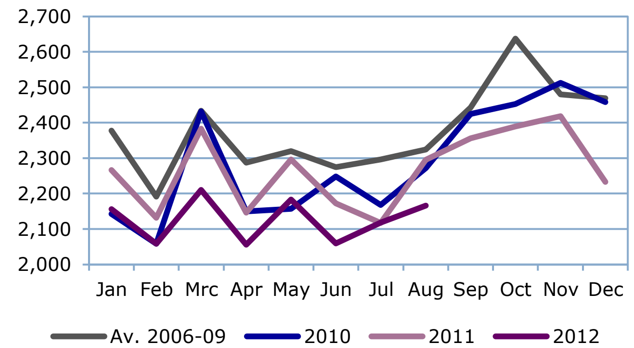
EUR/kg/CWE



Source: European Commission, 2012

Figure 6: Slaughter numbers in the EU

thousand head



Source: European Commission, 2012

Australia

Prices across the Eastern Young Cattle Index (EYCI) and feeder steer categories saw some initial support in July and August due to reduced supply availability, but were followed by declines of 14% and 13% through to November. The subsequent declines were the result of a seasonal increase in throughput and slaughter, particularly in Queensland. The EYCI is 16% below the same time last year and at the lowest level since February 2010.

Australian manufacturing beef prices for exports to the US continue to move higher as the seasonal cow slaughter in the US begins to decline. With total exports to the US up 40% on the same time last year.

Beef production in Australia increased 3% over Q3 2011 and was the largest Q3 production in five years. This was a result of slaughter numbers increasing year-on-year and carcase weights being maintained at the record highs of the last 18 months.

Lower cattle prices are leading to increased export volumes. October was a record month of exports for Australia, with exports to China (7,524 tonnes) for the month almost equal to the entire volume shipped in 2011 (7,754 tonnes). This record was again improved upon in November, with exports reaching 7,955 tonnes, and growth looks likely to continue with expected strong demand from the middle class.

Exports to both Japan and Korea (45% of Australia's total exports) continue to remain below 2011 levels, with Japan down 7.5% year-to-date and Korea down 20%. Australia continues to face strong competition from the US in both of these markets. In Japan, the appreciation of the Australian dollar combined with a weak USD and an aggressive US marketing campaign continue to make US product more attractive.

In Korea, imports from all countries are down (aside from Canada, who has only re-entered the Korean market this year). Imports are down as a result of increasing domestic inventory, with the domestic herd increasing 72% in the last decade. Incentives from the Korean government for producers to slaughter 'lower performing' cattle should begin to be felt soon, with some recovery in imports to be seen in late 2013.

Australian production is forecast by Rabobank to continue to increase at a rate of 2% in 2013—a result of producers continuing to rebuild herds and favourable conditions early in 2012. Prices are not expected to improve in Q4 2012 as demand is expected to be stagnant, with processors booked through to the year end and the prospect of re-stocker competition at the saleyard being limited unless forecast rain is received.

Prices in 2012 have been strongly affected by weaker demand in key markets such as Japan and Korea. This subdued demand is expected to continue into 2013 and will be heavily dependent on the competition from the US, which is also facing supply availability issues.

The bright spot for 2013 remains the US demand for manufacturing beef, with imported 90CL prices currently trading at record highs. This is also reinforced by the forecast that US cow slaughter is expected to be down in 2013 relative to 2012.

Argentina

In the first nine months of 2012, slaughter in Argentina totalled 8.5 million head, which represents a 3.8% increase with respect to the previous year. Beef production also showed a moderate increase (3.2%), but was lower than the increase in slaughter due to a falling slaughter average weight. The increase in slaughter and the higher participation of females show that the trend towards heifer retention for herd expansion is slowing as a result of lower cattle prices. For 2012, beef production is expected to be around 2.6 million tonnes, 2.4% higher than the previous year but still almost 20% lower than what it was before the huge liquidation of 2009. For 2013, production will grow moderately (4%), as a result of this year's increase in slaughter.

Most of the production has been sold domestically, with an increase of 7% in local beef consumption for the first nine months of the year. By contrast, exports showed a decrease of 30% in terms of volume, and represented only 7% of total production. Historically, beef exports in Argentina had represented approximately 15% of total production.

The sharp reduction in exports is due to an unfavourable exchange rate, which, in addition to a 15% export tax, makes Argentinean beef less competitive even at a time of increasing world demand and prices.

After having the biggest non-completion of the Hilton quota in history in 2011/12, the quota allocations for 2012/13 were made early. However, three months after the start of the Hilton year, shipments are only 50% of what they should be to comply with the quota.

Industry margins for packers continue to be extremely tight due to the scarcity of cattle and the increase in the cost of local inputs as a result of high inflation.

Unless there is a change in the exchange rate in the coming year, which would allow exports to resume their competitiveness, the production will continue to be sold almost exclusively domestically, thus depressing the local cost of cattle and reducing incentives for producers to increase their herds.

New Zealand

The North Island Bull Indicator lifted 5% against 2011 figures and remained steady in Q3 2012, finishing September at NZD 404c/kg.

Slaughter rates in New Zealand remained almost on par with last season, with figures down only 1.5% for the same month last year. Q3 traditionally sees a seasonal decline in cattle available for slaughter. Slaughter rates in Q4 should lift as the seasonal slaughter cycle begins, enabling New Zealand to be well placed to meet the expected increase in demand for manufacturing beef from the US. Exports to the US are already 2% above 2011 figures. New Zealand's aggressive marketing campaign in China continues to see results, with exports up 150% season-to-date.

The largest decline in exports was for those destined to Indonesia. The dramatic decline (down 50% season-to-date) is as a result of the Indonesian government continuing to limit permits through their push for self-sufficiency. This situation is not expected to change in Q4 2012 nor is there expected to be an improvement in 2013.

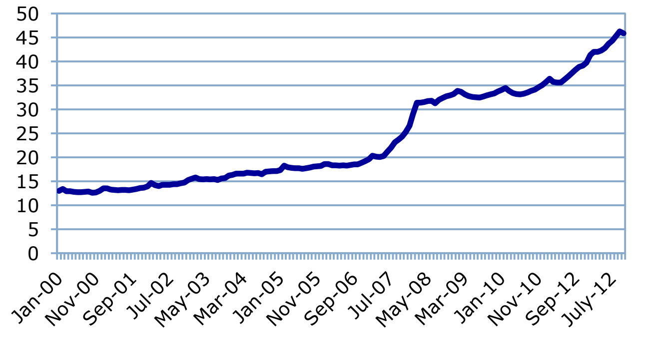
NZ beef production will be boosted through 2013 by a return to more typical seasonal conditions, and therefore, normalised rates of dairy cow culling versus 2012. The favourable mating period, milk prices and feed availability that occurred are unlikely to be repeated through the 2012/13 season, which combined with the larger dairy herd will provide additional cows for processing.

China

In China, a tight supply situation continued in Q3 2012, resulting in sharply higher prices (up 21%) (see Figure 7). As winter is the high season for beef consumption, prices are expected to increase further in Q1 of 2013.

Figure 7: Beef retail price in China

RMB/kg



Source: MOA, 2012

Production profitability improved further with rising prices. The average gross margin in the key production areas reached USD 230 per head in Oct/Nov, up 40% compared to Q2 of 2012, according to Rabobank estimates. Slaughtering profitability improved at a slightly slower pace, reaching USD 100 per head, up close to 40% during the same period. Profitability for the wholesale and retail segments remains stable.

Despite improving profitability, farmers are demonstrating little enthusiasm to expand herds. High upfront investment, a long production cycle and disease risk are inhibiting industry investment. In addition, better job and income opportunities elsewhere are reducing labour availability, especially for small producers. Absent investment, Rabobank expects the tight cattle supply situation to continue for the foreseeable future, maintaining high prices through 2013.

However, large scale production is experiencing some expansion. New investments are flowing towards operations with a vertically integrated model, which in most cases covers breeding, fattening, feed production, slaughtering and even foodservice. For instance, Dalian Snowdragon Beef Co., Ltd. announced in early November that it decided to make a new investment in Shandong Province, where it would establish demonstration farms with production capacity of 10,000 cattle in the total. The product will be targeted towards the high-end market. Considering the strong demand for quality beef meat in China, Rabobank believes the expansion trend of large scale production will likely continue in the coming years.

China's imports of frozen and fresh/chilled beef increased sharply in Q3, up 190% compared to Q2. Total imports in the first three quarters of 2012 increased by 66% compared with the same period in 2011. The major suppliers include Australia, Uruguay, New Zealand and Brazil. Shipment from Brazil increased sharply in Q3. This is probably due to the depreciation of the real and the improved supply situation in the Brazilian market. Australia remains the sole supplier for fresh and chilled beef meat. Imported meats are mainly distributed via traders and wholesalers and end up flowing into high-end restaurants and hotels in Beijing and Shanghai.

Mexico

During 2012, beef production has stalled as cattle became scarce and expensive. Feeder cattle prices have increased more than 20% over year-ago levels. However, beef companies were able to almost completely pass on higher cattle costs into higher beef prices. Rabobank forecasts 2012 beef production to increase only 0.6% YOY. In 2013, we expect a drop in production due to tight supply fundamentals, down 1.79 million tonnes or 1.3% YOY.

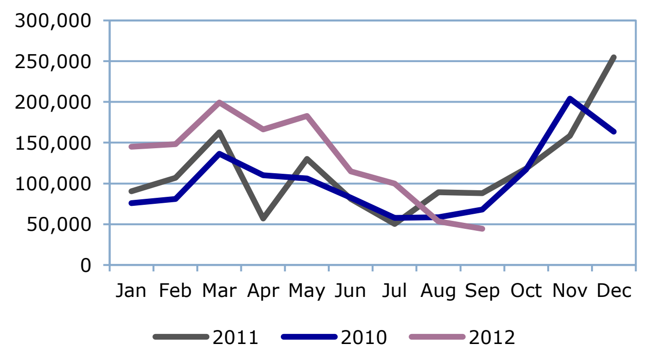
As a result of higher meat prices, beef consumption has slowed into the end of the year. Rabobank forecasts domestic per capita consumption of 16.6 kg in 2012, versus 16.9 kg in 2011. In 2013, we expect consumption per capita to be at 16.5 kg as production is constrained, and to remain strong at least during the first half of the year.

Due to herd liquidation and some improvements in competitiveness, Mexican beef production is expected to increase 33% YOY, reaching a maximum high of 197 thousand tonnes. We expect another increase of 230 thousand tonnes in 2013. However, imports for 2012 are expected to reach 295 thousand tonnes, up 11% YOY. We anticipate an increase in 2013 as domestic production is expected to decline.

In 2013, we anticipate the Mexican beef sector will continue operating under severe pressure as the cattle herd continues to contract. Beginning cattle inventory is estimated at 18.5 million head (versus 21.4 in 2011). Rabobank forecasts year-end 2013 cattle inventory of 17.4 million, the lowest level seen in 40 years.

Figure 8: Mexican cattle exports

head



Source: WTA, SAGARPA, 2012

Uruguay

The number of animals slaughtered in Uruguay dropped seasonally in Q3 2012 but rose 7% YOY. However, year-to-date total slaughter is running 9% below 2011 levels.

Driven by growing beef production, exports continued to perform well. Volume exported in Q3 2012 was 9% higher than the same period last year. Year-to-date exports are up even more (12% YOY). However, export prices, denominated in US dollars, continued to decline, falling 1% from Q2 and 5% YOY.

Cattle values also lost ground and closed Q2 marketed at levels 8% below the end of Q1 and 13% down for the same period last year. This was a direct result of the declining export prices and larger supply of animals ready to be slaughtered.

For 2013, Rabobank expects to see an increase in Uruguayan beef production, driven by the ongoing cattle herd recovery after the severe drought of 2008/09 and the lower live cattle exports in 2010/11, which tends to increase the supply for domestic slaughter.

Japan

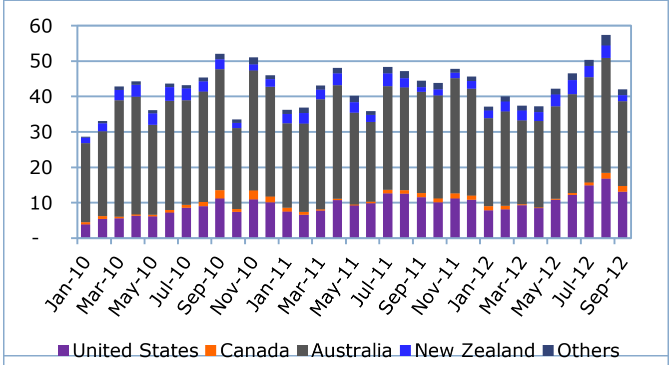
A combination of strong imports during Q3 2012—up 7% YOY to 149,700 tonnes—and sluggish consumption led to a build-up of inventory to a recent peak of 110,000 tonnes. Imported beef usually represents the bulk of inventories, but it is currently at an abnormally high level of 96,000 tonnes, 15% higher than last year.

Weak demand coupled with high inventory has driven beef prices downwards. Sirloin beef prices, for instance, have decreased 3% since the beginning of this year. Such a scenario will probably result in reduced imports in Q4 2012, and will temper the typical seasonal slaughtering peak in Q4.

In terms of import market share, the historical gap between Australia and the US has narrowed. Although Australia remains the largest origin for Japan, its market share has dropped significantly, moving down from 78% in January 2010 to 57% currently. This has resulted from a shift back towards the US, which has shown an increase in share from 14% to 31% within the same period (see Figure 9). US exports to Japan will be constrained due to tight domestic supplies in the near term, but could benefit from Japan's lifting of the maximum age of cattle from which beef is imported, from 20 months to 30 months.

Figure 9: Japanese imports by origin

thousand tonnes



Source: xxx

South Korea

Slaughtering rates continued to increase on the back of the ongoing herd liquidation; up 18% YOY and representing a 12 year record.

Strong domestic production coupled with relatively weak demand for beef caused a reduction in imports, which declined 10% YOY in Q3. Jan-Sep imports are down 18%, compared to 2011 when imports were elevated following concerns related to FMD.

Indonesia

Australia shipped 86,385 head of cattle to Indonesia during July and October, which is close to the 90,000 head quota for the second half of the year (July to Dec 2012). It is expected that the live cattle export has ground to a halt until new import quotas for 2013 are released. The quota for boxed meat also appears to be exhausted as there are reports of cases of Australian beef getting stranded at the port of Jakarta due to restricted imports. Jakarta feed manufacturers are running far below capacity, which we expect to continue until new quotas are issued.

According to Indonesia's Director General of Livestock and Animal Health, 2013 imports will be limited to 14% of domestic consumption, in line with their goal of reducing the figure to 10% by 2014. The Ministry is planning for 80,000 tonnes of beef imports in 2013, out of which, 60% will be in the form of live cattle, and 40% will be from boxed meat. This would translate to imports of 267,000 live cattle, a reduction of close to 9% over 2011. The boxed meet quota will be about 30,000 tonnes, which implies a 13% reduction over the previous year. The exact quota is expected to be issued by Indonesia's Economic Coordinating Ministry by mid-January 2013.

Domestic beef prices have risen by 12% from January through the end of October. Prices are likely to remain elevated given the severe supply constraints. Some price relief may come in the form of farmers looking to monetise their herds through liquidation in order to capture the elevated prices.

Rabobank International

Rabobank Food & Agribusiness Research and Advisory Animal Protein Global Sector Team Analysts

US – David C. Nelson
David.C.Nelson@rabobank.com

US – Don Close
Don.Close@rabobank.com

Argentina – Paula Savanti
Paula.Savanti@rabobank.com

Brazil – Guilherme Melo
Guilherme.Melo@rabobank.com

China – Chenjun Pan
Chenjun.Pan@rabobank.com

China – Jean-Yves Chow
JeanYves.Chow@rabobank.com

EU – Albert Vernooij
Albert.Vernooij@rabobank.com

Mexico – Pablo Sherwell
Pablo.Sherwelll@rabobank.com

Australia – Sarah Sivyer
Sarah.Sivyer@rabobank.com

Singapore – Pawan Kumar
Pawan.Kumar@Rabobank.com

www.rabobank.com