



Rabobank

Rabobank Poultry Quarterly

Outlook for Global and Regional Markets

Rabobank International

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- **Rabobank maintains its forecast for moderately improving market conditions for poultry meat, with ongoing price support from high beef and pork prices and a further slowdown in feed price cost increases.**
- **Key wildcards for the rest of the year will be regional supply discipline to keep margins balanced, global trade developments (which were very weak in Q1 2013) and the impact of avian influenza virus H7N9.**
- **H7N9 is currently having a big impact on the Chinese industry. The long-term impact of H7N9 outbreaks and the Q4 2012 antibiotics scandal will be further modernisation of the supply chain in China and other Asian countries, and a gradual further decline in the importance of wet markets and backyard production.**
- **Weak global trade as a consequence of slowing economies is currently affecting international exporters, especially in the United States (US) and the European Union (EU), while Thailand has successfully gone against this market trend by gaining better access to markets and from buyers in Japan due to concerns over Chinese supply. Global trade will recover seasonally in the coming months but will still be pressured by the economic situation.**
- **The major consolidation and new expansion projects were focused mainly on the EU and Russia in the first months of the year. South African players have tended to expand further into Africa, but more activity is expected in poorly structured markets in 2013.**

Global outlook

The outlook for the global poultry industry is again slightly positive but is highly dependent on the local supply and demand balance and the fragile outlook for feed prices. The industry could also benefit from ongoing high prices for competitive meats (i.e. pork and beef).

On a regional basis, the industry is doing a good job of keeping markets balanced. Supply continues to be a key issue. Countries such as Brazil and the US currently have fairly well-balanced markets and are therefore well positioned to benefit from a stable to slightly declining outlook for feed costs. Brazil has a potential cost advantage due to the current widening gap between local grain

prices and CBOT, which are expected to flow through the cost structure as we move through the year. The unbalanced Thai market of 2012 has improved due to better market access for Thai export products and the weak position of China due to food safety and animal disease problems. India has recovered from a weak 1H 2012 and avian influenza (AI) outbreaks in Q4 2012, and supply is in balance with demand, resulting in relatively good margins.

Ongoing challenges to rebalance supply with demand exist in regions such as the EU and South Africa. Improving markets and lower imports in South Africa have not been enough to return to healthy margins. The EU industry is on its way back, but further supply reduction will be necessary in the next few months to achieve adequate profitability.

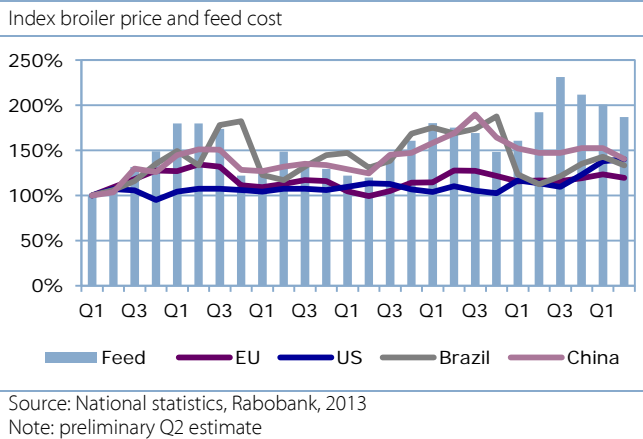
Global trade is currently sluggish as a consequence of weak global economic conditions and reached its lowest level since 2011. However, midyear levels tend to be better and some improvement in export volumes can be expected, which is positive for exporters such as the US, Brazil, the EU and Thailand, with Thailand the best positioned to gain further market share.

In addition to H7N9, another major factor for the Chinese market is that hog prices and the profitability of hog production have plummeted. Based on spot market prices, hog farmers in China could be losing USD 30-USD 40/head. If hog herd liquidation occurs, this would be bullish for prices as the biggest factor affecting chicken prices in China is pork prices.

Global overview

The global poultry market is currently benefiting from slightly improving market conditions as the recently stable to slightly declining trend in feed prices is helping the industry improve margins after the relatively weak performance in most parts of the world in 2012 (see *Figure 1*). Those regions which have succeeded in rebalancing supply with demand are now benefiting from higher margins as of 2012.

Figure 1: Global broiler price and feed cost monitor, 2007-2013

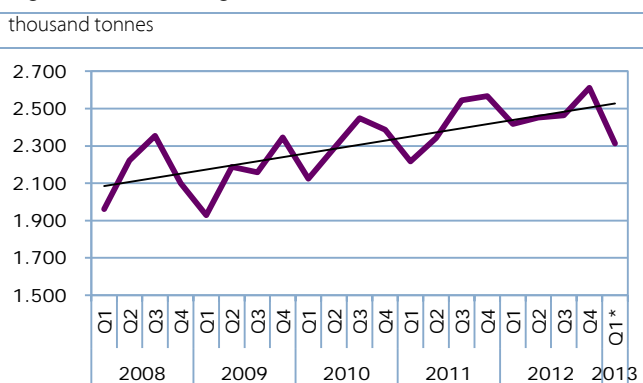


Apart from China, poultry industries in other countries, such as the US and Brazil, are currently performing better with a relatively healthy supply and demand situation, which limits the impact of a weak international trade situation on margins. In addition, the Thai industry has greatly improved after a very weak performance in 2012 as a consequence of large oversupply and is benefiting from strong demand for poultry products in the EU and Japan.

The EU is still the weakest performing industry as it is still challenged by relatively high feed prices combined with abundant supply. The Russian industry is facing negative pressure on the high margins of 2012 due to competition with cheaper red meat and higher feed prices, but margins are still acceptable and the outlook appears promising with a relatively good grain crop.

Global poultry trade was very sluggish in Q1 2013, with global trade falling to 2.3 million tonnes, its lowest level since 2011, and 4.5% lower than Q1 2012 (see Figure 2). The EU and China have especially been affected by this slowdown in global trade, while Thailand has been the only country able to expand its trade (+18%). The Thai industry is thereby benefiting from the weak competitive position of China—their main competitor—due to the antibiotics scandal as well as the expansion of Thai import access in the EU.

Figure 2: Rabobank global trade monitor, 2008-2013



Imports of poultry have gone down in key regions such as the Middle East, South Africa and China/Hong Kong, whereby in the case of China/Hong Kong, the shift from Hong Kong re-export to direct China imports continues.

H7N9 avian influenza outbreaks in China and Taiwan

The biggest global challenge in the poultry industry is currently the wave of H7N9 outbreaks in China, which occurred directly after the Chinese industry was hit by an antibiotics scandal in Q4 2012. Although the H7N9 virus is low pathogenic and is not directly damaging poultry production (making it difficult to trace) it has a considerable indirect impact on the industry as the virus has been transmitted to more than 130 humans, of which more than 30 have died. From this perspective, the virus appears to be deadlier to humans than the H5N1 virus, which has already been spreading throughout the Asian poultry industry for ten years. This has caused deep concern for human health and the government has been trying to find answers to stop the spread of the disease, closing down wet markets near to areas where human cases have been traced. The deep concern among consumers has resulted in a reduction of poultry meat consumption, significantly lower prices for poultry products and some reduction of breeding. The challenge for China, Asia and the rest of the world will be to reduce the spread of the virus in the coming months. So far, only one case has been found outside of China in Taiwan. Optimum monitoring and biosecurity are key elements to reducing the spread, and it can be expected that this driver, along with the earlier antibiotics scandal, will lead to expedited modernisation of the value chain, further reducing the importance of backyard products and wet markets.

The most direct impact impacts of the H7N9 outbreaks on the global markets are a weaker position of Chinese exporters in their main export market Japan, as well as greater concerns among consumers buying products from wet markets. This could also lead to a shift in the consumption behaviour of consumers in Asia as they shift to more modern distribution channels.

Industry overview

Similar to Q1, Q2 has shown limited industry activity regarding new greenfield projects or consolidation. The most significant activity took place in the EU and Russia; Moy Park will take over the responsibilities of all European Marfrig business, which means they will also expand into red meat, while Plukon Royale acquired the bankrupt Belgian chicken company, Lintor Verbinnen. The biggest moves in Russia were the announcement of Miratorg setting up a large-scale poultry project in central Russia, and Cherkizovo acquiring a further processed meat plant.

Feed price outlook

The outlook for grain and oilseed meal costs is a key success factor for the financial performance of the industry in 2013. Rabobank's January Agri Commodity Monthly expects grain and oilseed complex prices to remain bearish with a strong production recovery taking shape (see Figure 3). While there is a long way to go before the 2013/14 crops will reach the market, the first production hurdle for the year has been cleared in South America, and major recoveries are also expected in the US and the Black Sea region.

Figure 3: Rabobank quarterly average price forecasts, Q2 2012-Q1 2014

	Q2 12	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14
Wheat (CBOT) US\$/bu	641	871	846	739	700	680	660	680
Wheat (Matif) EUR/tonne	211	259	264	245	250	204	197	205
Corn US\$/bu	618	783	737	715	650	580	550	530
Soybeans US\$/bu	1,426	1,677	1,484	1,450	1,400	1,275	1,175	1,225

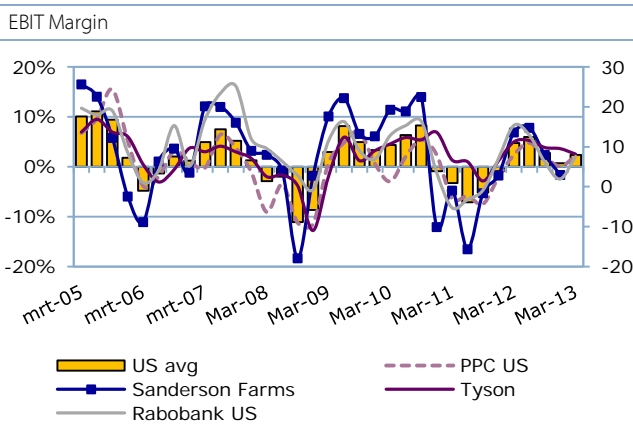
Source: Bloomberg, Rabobank, April 2013

Regional outlook

United States

Good supply discipline and even better price discipline is providing the US chicken sector with good profitability in a seasonally weak period despite last year's drought, which caused a big increase in feed input costs (see Figure 4). Pilgrim's Pride reported 4.3% gross margin for US chicken in the March quarter and Tyson Foods reported 2.5% in operating margin for its chicken operations.

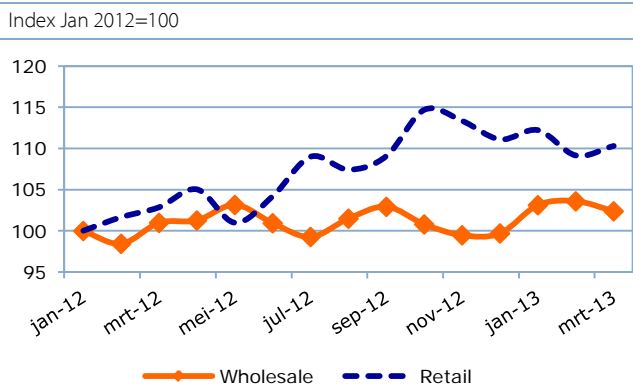
Figure 4: US chicken industry margins



Source: Bloomberg, USDA, 2013

We believe that central to the improved performance by the industry is management at the two largest companies, Tyson and Pilgrim, which represent slightly more than 50% market share. Another indicator of sector strength is how the industry has been able to increase whole sale prices at an increased rate relative to retail prices (see Figure 5). We believe this reflects a power shift within the value chain.

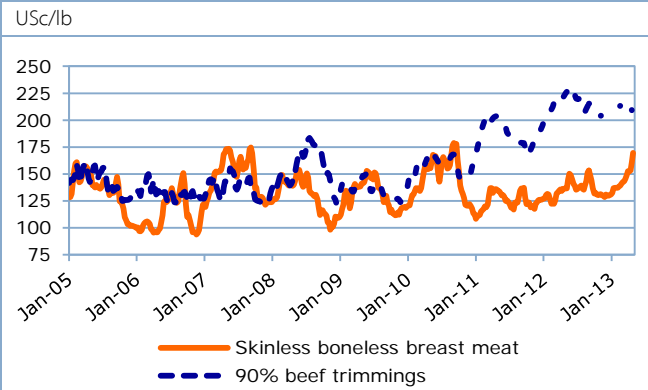
Figure 5: US wholesale versus retail chicken prices, Jan 2012-Mar 2013



Source: Bloomberg, USDA, 2013

While chicken prices are up, beef prices are up even more (see Figure 6). We believe that in these times of economic weakness, affordability becomes more important, and chicken is becoming more affordable than beef.

Figure 6: US chicken breast meat versus 90% beef trimless. Jan 2005-Jan2013

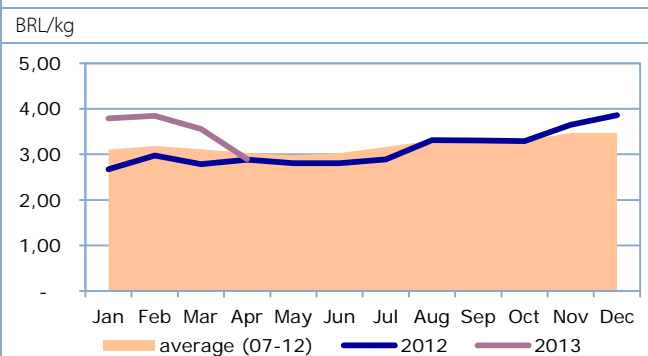


Source: Bloomberg, USDA, 2013

Brazil

After holding up relatively well during the first two months of 2013, whole poultry prices in Brazil lost ground and closed April at BRL 3.4/kg, down 12% over last February, but up 24% YOY (see Figure 7). Year to April, the average price was 40% higher than year-ago levels. Such an increase in prices has happened in spite of the sluggish pace of exports, suggesting the strategy to discipline production has been successful. Last January, poultry production in Brazil amounted to 964 thousand tonnes, 16% below 2012 levels. A countercyclical stable beef price is also a factor minimising the space for a more pronounced fall in poultry prices.

Figure 7: Wholesale chicken prices Brazil, 2012-2013



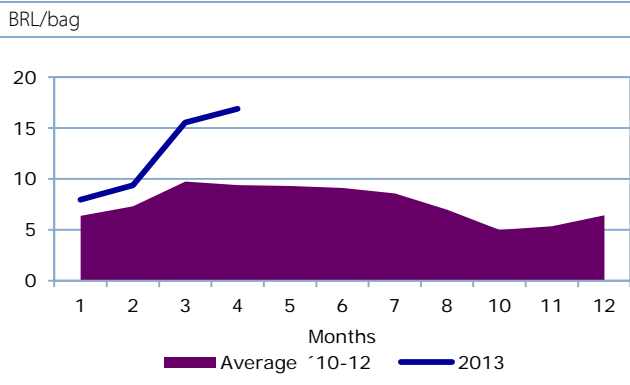
Source: CEPEA, 2013

Poultry exports amounted to 320 thousand tonnes in March, up 21% MOM but still down 12% YOY. In the year to March, the total amount exported was 7.5% below the same period last year. Such a reduction was largely influenced by weak sales to Venezuela and South Africa, which more than offset the increase in exports to Japan and Saudi Arabia. The good news for exporters is that the average export price is running well above 2012 levels, with values in March 25% higher in Brazilian real when compared to the same month last year. This reflects a combination of a weaker Brazilian currency and higher international poultry prices (in US dollars) in the period.

On the costs side, companies have benefited from the market arrival of the summer crops for both soybeans and corn, which along with the ongoing logistics constraints have pressured domestic prices down. It is worth highlighting that the difference between domestic and CBOT prices has widened more than the average for the period, enhancing Brazilian cost competitiveness worldwide (see Figure 8). But companies are not fully feeling the

effects of reduced feed costs, as they usually carry a three-month stock of feed.

Figure 8: Differences between soybean prices at CBOT and Rio Verde (GO) in Brazil, 2010-2013



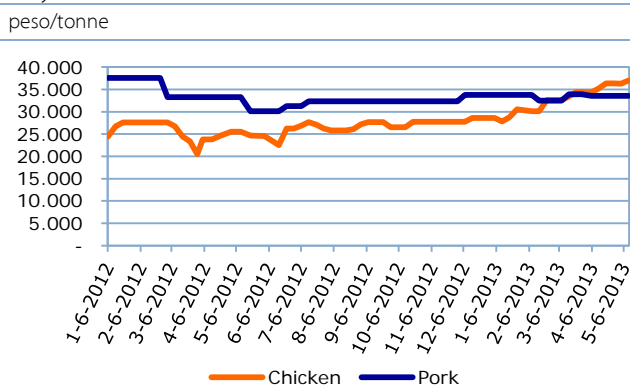
Source: Bloomberg, Rabobank, 2013

Going forward, prices will probably obey the seasonal pattern and decrease. But if exports remain weak, the extent of such a decrease will heavily depend on the sector's ability to control production. The industry already started to signal a modest expansion as the day-old chicks (DOC) production in February (latest number available) was 1.8% higher YOY.

Mexico

Mexico continues to be vulnerable to high pathogenic avian influenza (HPAI) outbreaks. This year, the AH7N3 virus has been detected on 21 farms in the state of Jalisco and 25 in the state of Guanajuato. Most of these farms belong to Bachoco (Bachoco currently owns 800 farms nationwide and has the highest market share, 38 percent, followed by JBS with 14 percent and Tyson with 12 percent).

Figure 9: Mexican pork and chicken price trend, Jan 2012-May 2013



Source: Rabobank with GCMA, 2013

Aside from these outbreaks, the industry is also going through a consolidation process and is making investments to improve infrastructure and technology. Thus, despite the outbreaks and the reduction in the flock, Mexican poultry meat production may struggle, but will likely see a level similar to last year of 2.96 million tonnes.

Producers' margins have been very tight as feed costs (70% of Mexican live broiler costs) have remained on the upside, while additional costs, such as biosecurity to eradicate AI, have increased (see Figure 9).

This year, per capita consumption will drop to 30.8 kg, compared to 30.9 kg over a year ago, as prices have increased as a result of the outbreaks. The highest peak was reached in December 2012, with chicken prices surpassing pork prices, thus negatively affecting consumption. The Mexican government is now running media campaigns to promote chicken consumption.

As a result of the outbreaks and the increase in prices, the Mexican government is not imposing trade restrictions on chicken leg quarters at the moment. Total imports are expected to reach up to 650 thousand tonnes versus 630 thousand tonnes in 2012. Last year, Mexico's imports totalled around USD 1 billion and we expect a similar level to be reached this year.

The Mexican poultry sector has conquered some international markets, but is still trying to get access to Central America and Asian markets. We expect exports of around 7 thousand tonnes, down from 9 thousand tonnes in 2012.

Argentina

In 2012, Argentina's poultry production reached 1.9 million tonnes, up 9% and completing an entire decade of positive growth. The growth trend continued for the first two months of 2013, with production up 0.7%.

Exports closed at 340 thousand tonnes (22% increase YOY) in 2012, surpassing beef exports. Venezuela was the biggest market (29%), followed by Chile (12%) and China (11%). In the first two months of 2012, exports grew by 19% with respect to the previous year.

Domestic consumption also increased by 6% in 2012. Going forward, growth in production will have to be channelled mostly through export markets (since the domestic market is close to reaching its saturation point) although an appreciated exchange rate may make this task difficult.

Costs of production, particularly for labour and energy, have been increasing as a result of domestic inflation. Most of the increase in costs has been translated into higher domestic prices, thus limiting the impact on margins.

For 2013, we expect production to continue growing, and input prices are forecast to decrease from 2012's record highs. Domestic inflation will continue to pressure margins, particularly since we expect some price controls given an electoral year. However, lower input costs should provide some relief.

Companies in the sector have been investing in increased capacity, partly aided by subsidised government financing.

Chile

Looking ahead into 2013, Chile's poultry sector is expecting production growth around 4%. In terms of margins, the industry expects some improvement on the back of lower input prices and some price correction at the retail level (domestic).

Even though Chile will impose a 9.7% import tariff surcharge on Argentine corn imports (last year a 10.8% surcharge was imposed on Argentine cracked corn imports) the industry expects lower corn costs on the back of global production increases.

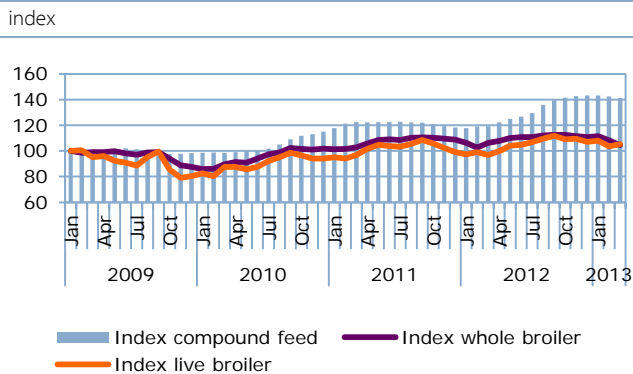
Following last year, after the closure of Agrosuper's pork project (Freirina), the domestic market saw a material increase in pork supplies, which put pressure on domestic poultry prices at the retail level (particularly breasts and legs). Since Agrosuper has finished

slaughtering its pigs in Freirina, the pork burden should decrease, releasing the pressure on domestic poultry prices.

EU

The EU poultry industry is currently recovering from the weak 2H 2012, when margins were negatively affected by high and increasing feed prices and EU supply was too high (see Figure 10). Prices for compound feed slightly declined (-5%) between January and April 2013 but are still at historically high levels, while margins are still under the breakeven level for many farmers.

Figure 10: EU broiler and feed price index, 2009-2013



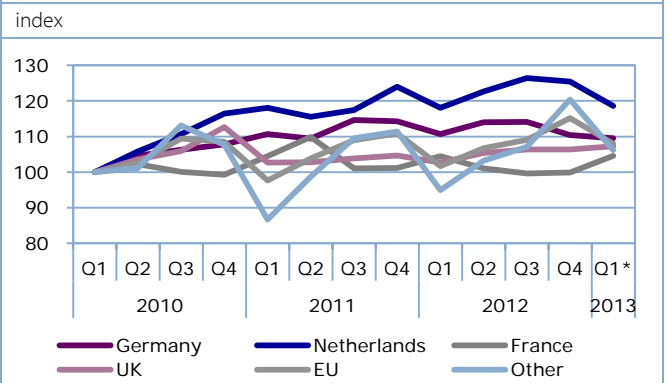
Source: Eurostat, EMA, Rabobank, 2013

Market conditions for poultry meat are improving due to high EU beef and pork prices. Prices for leg meat have remained relatively good during the first months of 2013 and have recently benefited from improved demand from eastern Europe. However, breast meat prices have been relatively weak—partly affected by the relatively cold start of 2013—but have recently started to recover in line with better seasonal demand during the summer months. The improvement in demand is welcomed by the EU chicken industry, as it will help to better value the chicken carcasses. Interesting and important to note is that prices for EU frozen chicken filets are increasing as a consequence of more expensive Brazilian frozen chicken exports. The higher prices will encourage industry players to sell some of the frozen chicken products which are currently in cold storage facilities.

The EU's production of broiler meat showed a seasonal reduction in supply in Q1 2013, a period in which poultry demand is traditionally lower (see Figure 11). The Netherlands, Germany and some eastern European countries reduced supply, while France and the UK slightly increased supply. However, the total supply reduction is currently not enough for the industry to rebalance markets.

The European Commission has recently published their 2013 outlook which indicates a 0.6% increase in poultry production over 2012 with a further shift to broiler meat (+0.7%), while turkey meat production will again decline (-0.6%). Most growth is expected to take place in the UK (+2.4%) due to a growing demand for British products as well as the strong pound sterling. The Netherlands (+0.9%) and Germany (+0.4%) will only see limited growth, while production in southern Europe (Spain -2% and Italy -1%) declines as a consequence of the economic crisis.

Figure 11: EU quarterly broiler production index by EU Member State and for total EU, 2010-2012



Source: EMA, 2013

EU poultry exports have been relatively weak in Q1 2013, down 8% in Q1 2013 compared to the same period in 2012. Therefore, the EU has not benefited from a relatively better competitive position due to the weaker euro. The EU's weak exports can partly be explained by a weak global market for poultry meat in Q1 2013, but EU exporters lost comparatively more market share than competitors such as the US and Brazil, especially in export markets such as Hong Kong and Africa.

Total EU poultry imports have remained at a high level similar to that seen in 2012. This is an interesting fact as market access has been significantly expanded since a mid-2012 return of Thailand as a raw salted-chicken exporter and due to the recent introduction of new poultry quotas in the EU. Thailand has benefited from this greater market access with 54% more exports in the first months of 2013 compared to last year, but quotas are still not fully utilised. Brazil continues losing market share to the EU, with exports down 14% compared to the first months of 2012.

From an industry perspective, the most important news has been MoyPark's takeover of parent company Marfrig's European activities of Saera, Keystone and Marfrig. This will mean that MoyPark's traditional focus on poultry will expand into beef and pork and will now become pan-European.

Plukon Food Group acquired the bankrupt Lintor-Verbinnen Group, a leading Belgian poultry processor. The acquisition will further consolidate the poultry industry in Belgium where Plukon Food Group will become the leading player.

Over the next year and a half, the Dutch industry will need to invest in a new dedicated supply chain to meet its supermarket covenant to supply 100% of its chicken via the new scheme 'kip van morgen' [chicken of tomorrow] in 2015. This concept is the first in the world in which a chicken industry has agreed to increase standards for supplying chicken to all of its supermarkets.

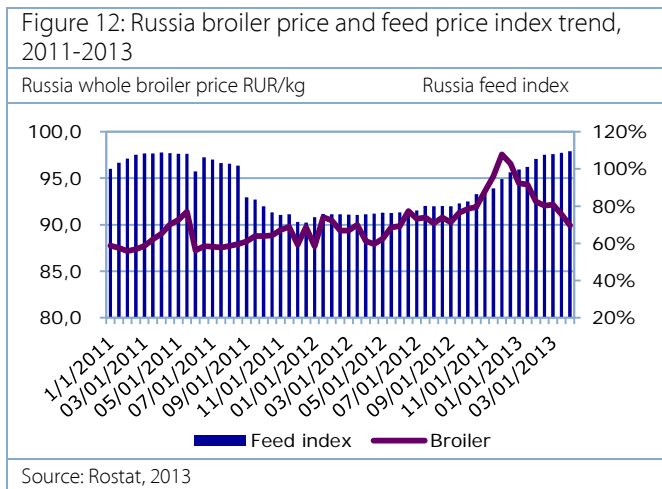
The outlook for the EU poultry industry remains challenging. Although some macro trends are moving in a positive direction and margins are showing some necessary improvement, keeping the markets balanced will be key to growth in the industry.

The current improvement in chicken demand and better prices for fillet and leg meat, are signs of improving demand conditions. Feed prices are still decreasing slightly and futures markets indicate some further price relief, although low global stocks-to-use levels make any feed price outlook very fragile. Hatching egg prices are currently high, reflecting weaker supply with relatively good export demand and therefore less availability in the EU market. If supply

can be kept limited, these factors should help the industry to return to healthy profits.

Russia

Russia's poultry industry margins have been negatively affected by relatively weak market circumstances in Q1 2013. Although average broiler prices over Q1 have been higher than in Q1 2012, prices have shown a declining trend, while feed prices have slightly increased (see Figure 12). The industry does not receive price support from beef (-8%) and pork (-15%) as these prices also showed a declining trend in Q1 2013.



One of the main problems for poultry producers in Russia is inadequate pricing power to pass on the high feed costs. High Russian feed wheat and corn prices were still increasing until March, although some price stabilisation—and in the case of corn, some price relief—took place. These price movements can be explained by the transition from the very tight supply and inventory situation in 2012/13 to the better outlook for the Russian winter crops in April/May.

Russian poultry supply is high and still growing quickly, with many new projects coming into production. Markets have been following supply growth, but have not been enough to keep price momentum recently.

It is positive that imports showed a seasonal decline in Q1 2013 which has helped to relieve some pressure from the domestic Russian markets (see Figure 13). Price competitiveness of local Russian chicken is currently good against relatively expensive imported frozen chicken quarters.



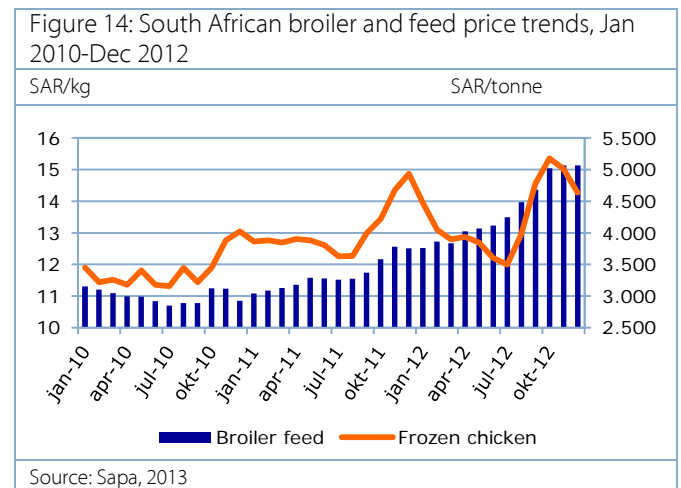
The Russian poultry industry is still in expansion mode, with increasing interest in investment in poultry from the pork industry (e.g. the recently announced investments of Miratorg in large-scale vertically integrated poultry production in the Bryansk region in central Russia. In addition, Cherkizovo has recently announced the acquisition of the further processed meat company Dankof in the Liptsk region, which illustrates the move to higher value segments in the Russian meat industry. The ongoing fast growth of modern distribution is favourable for the poultry and meat industry,, which has again been underlined by McDonald's recent announcement to expand the number of restaurants in Russia by 150 in the next three years.

The outlook for the Russian poultry industry for the rest of the year looks more promising, with a rebound in Russian wheat production due to easing drought conditions and 88% of Russian winter crops in good or satisfactory conditions as of 10 April. Feed costs are therefore expected to decline somewhat in the next period, while competitive pork prices are expected to increase in the coming period as follow-up of the good seasonal demand from the 'shaslick' season in Russia during summer months. However, the industry should make sure that production keeps following the rising demand of chicken in the next period, which is already challenging due to the expansion, which is expected to come into production in the next period.

South Africa

The pressured market conditions for the South African market are continuing and chicken prices followed the declining trend which already started in November 2012, reflecting worsening market conditions (see Figure 14). Ongoing high pressure from imports has pushed the South African industry to ask again for higher import protection in April after its earlier request was declined in January.

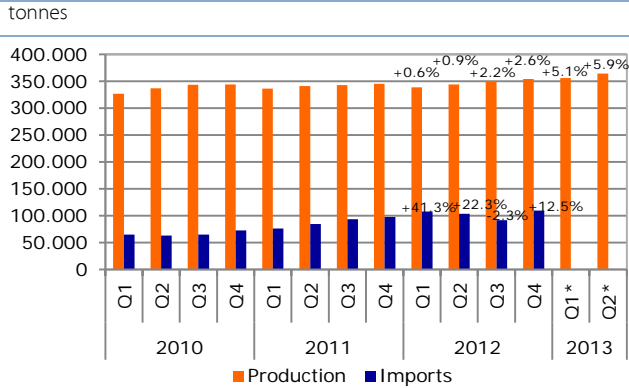
A big problem for the South African industry is the declining broiler price with ongoing high feed prices. Although the longer term trend of increasing feed prices stopped and prices are tending towards a flatter trend, current broiler price levels are adequate to cover high feed costs. The only segment in the South African market which keeps a certain acceptable price level is the tiny, premium fresh-chicken segment, which is currently only 4.7% of the market. The more mainstream frozen chicken prices have again fell in the first period of 2013 by 7%.



One of the main problems for the South African industry is the oversupply situation in the domestic market. Although poultry is the preferred meat in the South African market (around 60% of

consumption) and the poultry market is still growing (an expected 3% growth for 2013), the increasing imports volumes from the EU, Brazil and Thailand, but also weaker supply discipline in the local industry, have resulted in an oversupply situation.

Figure 15: South African supply (production and import trends), 2010-2013e



Source: SAPA, . 2013

A concerning development is the recent production expansion in South Africa. During 2012, the industry was relatively disciplined in expansion with below 1% average quarterly growth levels in 1H 2012, but this has turned since mid-2012, with first production growth levels of 2%-3% per quarter over HY2 to more than 5% growth levels for Q1 and Q2 2013 (see Figure 15).

Although imports tended to be slightly lower over the first months of 2013, the growth will be faster than demand development in South Africa (with an expected 3% growth over 2013) and will therefore be a concern for profitability for the next quarters.

The high and growing share of frozen meat is one of the main challenges of the South African industry as it underlines the increasing price sensitivity of consumers in South Africa since the start of the economic crisis. This changing consumer behaviour also makes consumers more sensitive to imported products, which tend to be cheaper in the current market conditions compared to local supply. The lower fresh chicken preference in South Africa also makes the industry more sensitive to imports as fresh chicken will be very difficult to ship into South Africa from places such as Brazil and the EU and should therefore be a safe market for the South African industry.

The chicken industry's difficult market position could negatively impact the South African economy as the poultry industry is one of the main sectors in the South African food and agri sector, responsible for around 20% of the sector's production value and employing 48,000 people. The industry has already warned that if these ongoing difficult market circumstances continue, the industry will have to cut jobs in the period to come. Industry margins are very much under pressure and Rainbow Chicken and Country Bird have recently published weaker economic results.

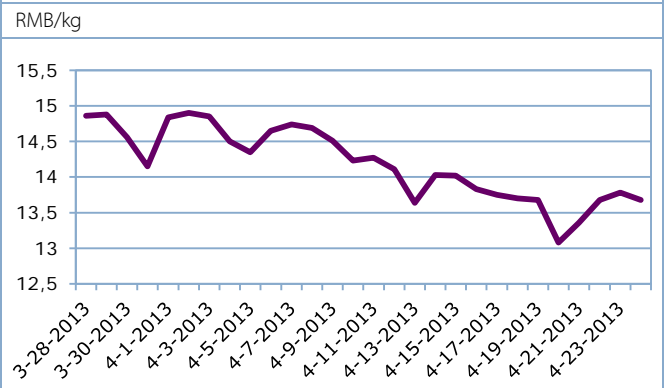
The South African poultry industry is currently refocusing its position in the changed market conditions with ongoing high feed prices and more pressure from imports. The general trend is a move towards higher value segments as well as improvements in efficiency of operations. The move to higher value segments is not easy as price competition has become a major element in the South African market due to the economic downturn.

China

Since the first official announcement of H7N9 on 31 March, the disease has heavily impacted China's poultry market, which had already been in a very weak position for two straight months. Farmers commenced large scale slaughtering of birds and no replenishment was made as they adopted a wait-and-see attitude. Breeders were hit the hardest. Figures from the China Animal Agriculture Association (CAAA) showed that direct economic losses for broiler breeders have exceeded RMB 3.7 billion (USD 593 million). Slaughterers reduced the procurement price and volume of live birds as market demand fell to an extremely low level. As a whole, China's poultry industry suffered losses amounting to RMB 10 billion (USD 1.6 billion) in the three weeks after the first case of H7N9 was confirmed, according to the CAAA.

After continuous decline, poultry prices are now stabilising with a slight rebound due to very low supply (see Figure 16). However, the yellow-feathered broiler market has been more negatively impacted by this incident than white-feathered broiler. Live bird markets, particularly in the affected areas, have been closed down. Those markets were mainly selling yellow birds before.

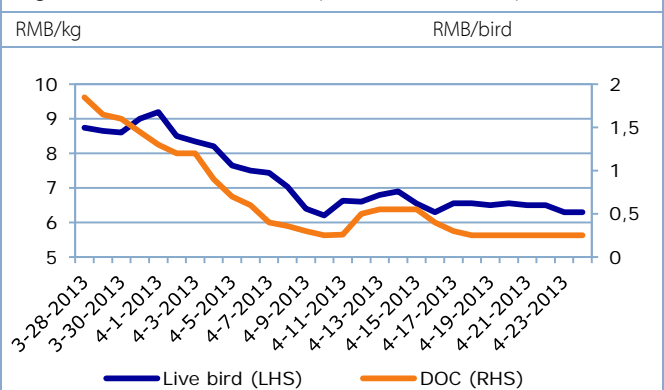
Figure 16: Chicken meat wholesale price, Mar 2013-Apr 2013



Source: CAAA, MOA, 2013

DOC prices remain low, suggesting that farmers have no incentive to increase stock. DOC prices have decreased by more than 80% in the past three weeks. Live bird prices decreased by 30% on an average basis (see Figure 17). In the affected areas, such as Jiangsu, the wholesale price of live birds hit the low of RMB 3-RMB 4/kg on 15 April, only one-third of the price before the outbreak. As of 24 April, there were some signs that live bird and DOC prices were stabilising.

Figure 17: DOC and live bird prices, Mar 2013-Apr 2013



Source: CAAA, MOA, 2013

Egg prices have experienced a smaller decline in comparison to poultry meat. The wholesale price of eggs was RMB 6.5/kg, down 20% compared with prices in late March.

So far, the local governments of affected areas, such as Shanghai and Zhejiang, have released policies to support the poultry industry.

Under Shanghai's subsidy standard announced on 10 April, poultry breeder farms can get RMB 15 (USD 2.4) for each breeder bird they have kept in stock between 1 April and 30 April. The policy aims to stop a further decline in breeder production and to keep production capability at a certain level.

The Shanghai municipal government is also purchasing chickens from farmers at a set price to help them offset losses, and is also paying back poultry merchants for slaughtering their stocks at no less than 50% of the birds' market value

The Zhejiang provincial government issued a similar policy on 16 April, giving subsidies to affected farmers, breeding farms and processing firms.

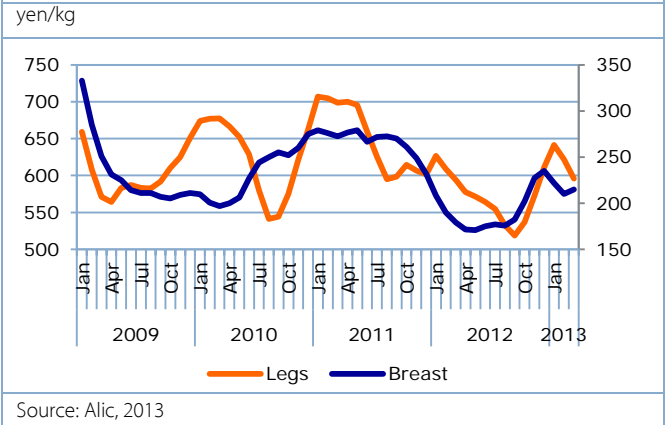
As of 23 April, China confirmed a total of 108 human cases of H7N9 infection, 22 of which have died. However, the panic among consumers has declined to some extent, as the pace of growth of new cases of infection has slowed. As the Chinese market is currently experiencing a shortage in supplies of chicken and eggs, with reduced fear and the stabilisation of the H7N9 virus in the region, we would expect a strong rebound in prices for poultry products once consumers start to return to their normal dietary habits.

Poultry consumption habits have been changing as consumers shift from buying live birds at wet markets to buying chilled poultry products at supermarkets (even the sales of chilled poultry have decreased sharply). Some traditional chicken dishes, such as white cut chicken, are disappearing in restaurants, as they are barely cooked and may carry the virus. The changes in consumption behaviour may be long-term, and the white feathered chicken will gain market share at the expense of yellow chicken following this incident.

Japan

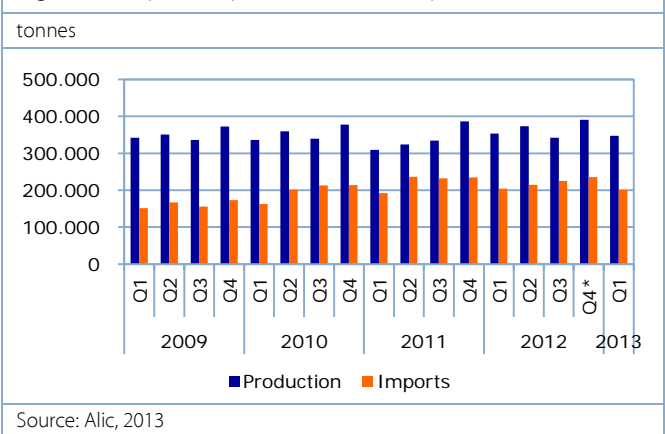
Performance of the Japanese poultry industry in Q1 has been affected by relatively sluggish demand for meat in general, with a negative trend in chicken consumption (-4%), pork (-2%) and beef (-9%). Despite this weak demand, Japanese chicken prices have remained at reasonably good levels, with still higher than Q1 2012 levels but slightly lower than the seasonal peak of December 2012 (see Figure 18). Ongoing high import prices have also been supported by a strong yen.

Figure 18: Leg and breast wholesale prices, Jan 2009-Mar 2013



Japanese domestic supply in Q1 declined 2% compared to Q1 2012 (see Figure 19). Both domestic production and imports were lower than in the same period last year, but still adequate for Japanese trading houses to rebuild some stock, which has been quite welcome for meat traders as strong demand in Q4 2012 resulted in lower stock levels in Japan.

Figure 19: Japanese production and imports, 2009-2013



Japan's total imports declined 4% in Q1 2013 compared to same period in 2012; the trend towards further processed imports and fewer raw chicken imports has continued, with 3% more processed chicken imports and 9% less raw chicken imports. The Thai poultry industry is the biggest winner from the increase in processed poultry meat imports and is seeing its market share grow on the back of Chinese exporters. Japanese traders tend to prefer Thai imports over China's because of the recent Chinese antibiotics scandal and the H7N9 AI outbreaks.

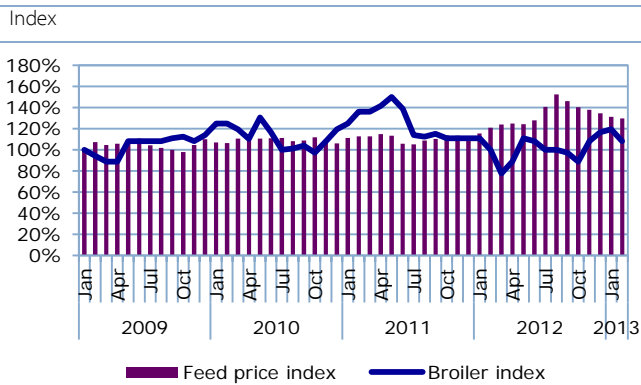
The outlook for the Japanese industry remains challenging. Stock levels have recently gone up and have already affected recent Japanese prices. Seasonally lower chicken demand in Japan during summer months will urge the industry and trading houses to keep supply low, especially as demand for red meat also tends to be low. This competitive market situation means that traders to Japan will face pressured demand also as a result of the strong yen. Demand for processed meat will remain relatively strong, with Thailand perfectly positioned to supply Japan due to Chinese food safety and disease problems. Thai poultry exporters also benefit from a lower import levy for chicken compared to Chinese exporters due to the Japanese-Thai trade agreement.

Thailand

The Thai poultry industry has recovered from its very weak performance in 2012 due to oversupply. Aggressive pricing by Thai poultry companies during 2012 helped the industry expand domestic demand and develop further exports to Japan and the EU, and more importantly, to new markets such as Korea and the Middle East.

The industry has benefited from ongoing good demand for poultry in Thailand and in international markets in Q1 2013. Costs have declined thanks to lower feed prices compared to Q3 and Q4 2012 (see Figure 20). However, domestic feed price relief recently stopped, while broilers prices went down due to some supply expansion.

Figure 20: Thai broiler versus feed price trend, 2009-2013



Source: Bloomberg, National statistics, 2013

Thai broiler exports are expected to continue the growth of the previous years and could reach a level not far from 600,000 tonnes. The current weak competitive position of China due to the antibiotics scandal and the H7N9 AI outbreaks will affect their position in the Japanese market. The market share of Thailand has recently improved in this important and long-term growing market. Exports to the EU also offer room for growth. In 2013, Thailand received several new quotas to export processed poultry products to the EU, and these and the salted breast meat quotas are still not fully utilised.

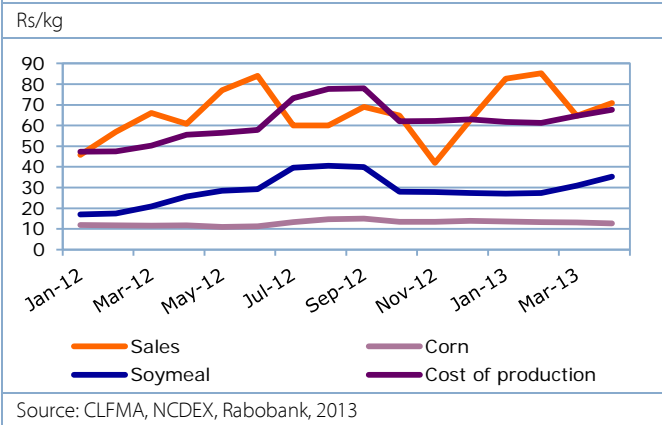
The outlook for the Thai poultry industry is therefore improving thanks to export growth as a strong base and ongoing good demand in the domestic market. Although all major export markets for Thai products (e.g. Japan, the EU as well as other countries) will grow, the importance of the EU for the Thai poultry industry is expected to grow even more as a consequence of the better market access for Thai poultry products.

Restricting production growth will be key for the industry to avoid the very weak situation of 2012 in which it was also too ambitious and optimistic in its short-term market potential.

India

Poultry price levels were good in Q1 2013, reaching historical highs of more than INR 90/kg. This was according to expectations, since the industry was coming back from the impact of AI in Q4 2012, which had made the market short of placement. However, a softening of prices occurred in March as placement increased, but prices started to recover again in April. The market is currently well balanced in terms of placement and demand, although profitability in Q1 was still below the four-year historic average. Poultry demand will continue to remain strong in Q2 with the holiday season setting.

Figure 21: India broiler, corn soymeal and cost price monitor, 2012-2013



Source: CLFMA, NCDEX, Rabobank, 2013

Due to good winter crops, domestic corn prices declined by 8% since the beginning of 2013 (see Figure 21). The benefit of reasonable poultry prices and a decline in corn prices was negated by an increase in soymeal prices. Domestic soymeal prices erupted to INR 38,000/tonne (USD 700/tonne) from INR 27,000/tonne (USD 500/tonne) in February 2012, driven by shipments to Iran. If the trend continues, the industry will continue to face challenging times due to higher soymeal prices. For the new soybean crop, the government has proposed an increase in minimum support prices for soybeans of 15% YOY. The increased support prices should result in higher production, but the new crop benefit will only be reflected in Q4 2013. If demand/supply balance is not moderated correctly, Q3 could prove to be the most challenging part of the year.

One interesting development is that the government has clarified that genetically modified soymeal imports are allowed into India. The industry has approached the government to keep the duty on oil meals at zero, which was reduced from 15% in August 2012 to zero as of 31 March 2013. With escalating domestic prices, the industry has started contemplating the option of importing meal given that world prices are much lower compared to Indian prices.

Industry performance

The current industry performance trend shows some slightly improving conditions as a consequence of a more stable to declining feed price trend all over the world (see Figure 22 and 23). Companies that operate in markets in which the industry has been able to rebalance its supply according to demand trends show some healthy margins. This is especially the case in the US and Brazil, where companies have been reporting better performance in the chicken industry. Markets in these countries are relatively well balanced in a traditional weak season such as Q1 2013. Although not yet reflected in 2012 financial results, the industry in Thailand is starting to be on its way back, with relatively good global demand for its products as a consequence of more market access and a weak position of its main competitor, China. The weakest performing industries can currently be found in South Africa and China. The South African industry is still being hit by cheaper Brazilian and EU imports flooding the market, while it is also currently in expansion mode. The consequence is an ongoing oversupply situation in South Africa with very narrow margins for the industry. The situation in China is difficult as consumers have moved away from buying chicken from wet markets due to the H7N9 cases. This has resulted in oversupply, falling prices and

breeding stock clearing in the market and will affect margins of Chinese chicken companies in Q1 and Q2 2013.

The outlook for the global chicken industry performance again depends very much on how the industry will be able to balance its markets. Although feed price outlook is promising, the key ingredient for healthy margins is a balanced local market situation, which often means disciplined supply management by chicken companies. The market outlook for the US and Brazilian industries remains good for the next few months as the supply situation tends to be in relation with demand. Importantly, the global market for chicken trade will recover from a very weak Q1 2013. The situation in Europe might improve somewhat with the EU outlook slightly improving from a bit more balance in supply and more promising feed markets, while the Russian industry should benefit from a relatively good crop outlook for the spring harvest. In the case of China and the rest of Asia, how the H7N9 AI outbreaks further develop will be very important. If the outbreak remains isolated in the current areas of China (and one case in Taiwan), it can be expected that later in the year markets will start to recover and the supply situation may become very tight. If the virus spreads further throughout China or Asia, the situation could become very challenging for Chinese and other Asian companies, and prices could remain at lower levels for a longer period.

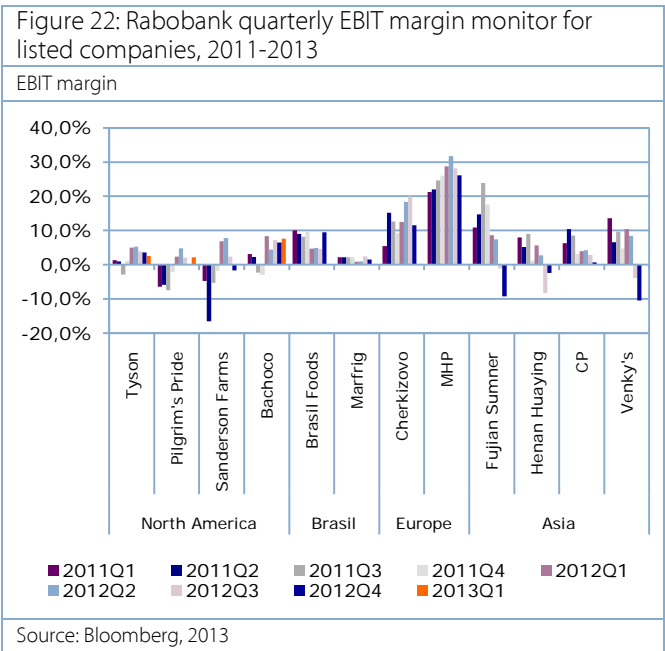


Figure 23: Poultry comps

	Ticker	Price	EPS			P/E			EBITDA		EV/EBITDA		Net debt	Net debt/LTM EBITDA
			2011	2012e	2013e	2012e	2013e	EV	2012e	2013e	2012e	2013e		
Tyson	TSN	24.75	USD	1.91	2.07	2.51	11.9	9.8	10,474	1,825	2,038	5.7	5.1	1,361
Pilgrim's Pride	PPC	11.21	USD	0.72	1.40	1.33	8.0	8.4	4,005	617	592	6.5	6.8	1,097
Sanders on Farm	SAFM	62.59	USD	2.35	3.83	5.27	16.4	11.9	1,577	208	262	7.6	6.0	133
Brasil Foods	BRF	49.72	BRL	0.94	2.03	2.73	24.5	18.2	25,031	1,920	2,337	13.0	10.7	3,411
Marfrig	MRFG	6.5	BRL	-1.37	0.59	1.00	10.9	6.5	6,396	1,165	1,337	5.5	4.8	4,647
Bachoco	IBA	34.66	MXN	3.60	3.50	3.80	9.9	9.1	1,424	289	297	4.9	4.8	-198
Charoen	CPF	30.75	THB	1.17	2.10	2.62	14.6	11.8	13,039	1,014	1,187	12.9	11.0	4,490
DaChan Food	3999	1.08	HKD	0.07	N/A	N/A	N/A	N/A	222	N/A	N/A	N/A	N/A	28
LDC	LOUP	94.08	EUR	6.91	8.11	8.11	11.6	11.6	1,076	234	255	4.6	4.2	22
Venky's	VNKY	556.9	INR	43.72	N/A	N/A	N/A	N/A	107	N/A	N/A	N/A	N/A	19
Cherkizovo Group	CHE	10.45	USD	5.19	2.24	2.73	4.7	3.8	1,679	307	340	5.5	4.9	859
MHP	MHP	18.85	USD	2.77	2.57	3.35	7.3	5.6	3,076	486	576	6.3	5.3	1,045

Source: Bloomberg, 2013

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