Rabobank

Rabobank Beef Quarterly

Outlook for Global and Regional Markets

Rabobank International

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- **The Rabobank Global Cattle Price Index improved by 6% since June, driven by lower-than-expected supply in the main exporting countries and strong Asian demand.**
- **Packers' margins are pressured in most regions by consumers' resistance against elevated prices and competition from other proteins, which have kept the market from reaching its full potential.**
- **Exchange rate movements continue to play an important role and are currently favouring exports from Argentina and Brazil.**
- **Supply will remain tight, especially in 1H 2014, driven by lower feed costs, induced herd rebuilding in the US and the pulling of cattle forward in Brazil and Argentina, which will continue to support strong prices.**
- **The recent announcements to (re-)open import markets will benefit beef trade going forward.**

Global Overview

Current scenario

In line with expectations, the Rabobank Global Cattle Price Index improved further in H2 2013. Supported by both continuing strong Chinese import growth and lower-than-expected supply in the main export markets, cattle prices were mainly positive. However, the market has been unable to reach its full potential due to consumers' resistance against high prices in the United States (US) and the European Union (EU), still two of the main beef markets. In addition, exchange rate movements have impacted the competitive position of exporters, with the rapidly increasing attractiveness of Brazilian and Argentine beef leading to a surge in exports (*see Figures 1, 2 and 3*).

Cattle prices increased in most countries and especially in Argentina, Brazil, the US and Canada. However, in Argentina, the 3.5% increase in beef prices was still substantially below the level of inflation and currency depreciation, which have been negatively impacting packers' margins. Brazilian prices surged due to strong export demand resulting from the depreciation of the real and continuing limited feedlot supplies. In the US and Canada, record prices were reached, with lower feed prices resulting in strong signs of herd rebuilding.

In Oceania, weather conditions continued to impact beef markets. In Australia, the arrival of much-needed rain has not yet resulted in a decline in slaughter numbers, while in New Zealand, slaughter dropped by 11% YOY between August and October, due to conditions improving after the drought in the first part of the year.

China has become increasingly important in global beef trade, with frozen beef imports to China increasing seven and a half fold from January to October 2013 to 237 thousand tonnes, supported by the declining average import price, which fell to USD 4.22/kilogramme. In contrast, Chinese beef retail prices continued their climb, reaching CNY 62.5/kilogramme in November 2013, a 25% increase YOY. Australia remained the main supplier to China with over 50% of the market, but Uruguay (25%) and Brazil are catching up.

Figure 1: Global average live cattle prices

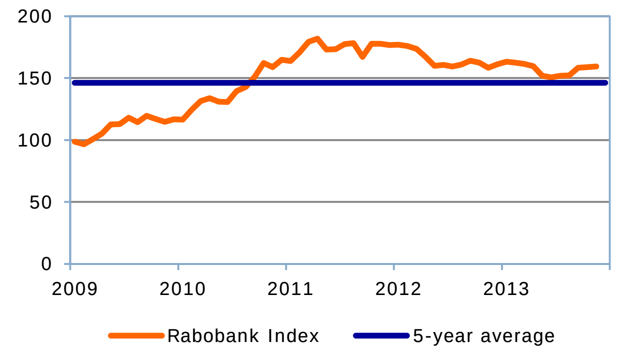
live cattle prices (USD/kg)

	Nov 2013	Q3 2013	Nov 2012	% Nov 2013 x Q3 2013	% Nov 2013 x Nov 2012
Uruguay	1.87	1.97	2.02	-5%	-7%
Australia	1.54	1.50	1.79	3%	-14%
Brazil	1.63	1.60	1.57	2%	4%
US	2.92	2.72	2.82	7%	4%
Argentina	1.89	1.71	1.63	11%	16%
Canada	3.12	3.09	2.83	1%	10%
NZ	1.98	1.92	1.94	3%	2%

Source: Bloomberg, CEPEA, INAC, IPCVA, MLA, NZX Agrifax, OCA, USDA, 2013

Figure 2: Rabobank 7-Nation Finished Cattle Price Index, Jan 2009-Nov 2013

Jan 2009=100

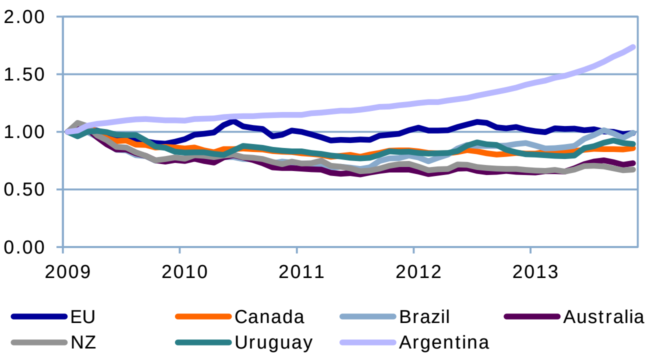


Note: Average live finished cattle prices weighted by share of global exports (Brazil, Australia, Argentina, Uruguay, US, Canada and New Zealand)

Source: Rabobank, 2013

Figure 3: Index exchange rate developments against USD, Jan 2009-Nov 2013

Jan 2009=100



Source: Rabobank based on Oanda, 2013

Outlook

For 1H 2014, we expect further upside for the global beef market, with cattle prices remaining elevated in most regions. The main question in many regions remains where to source sufficient beef supplies. With herd rebuilding as the first priority globally, supported by improving climate conditions and moderating feed costs, global beef production will increase only slightly and is expected to decline sharply in key markets like the US. The main demand wildcard will be consumer resistance to high beef prices and the growing availability of competing animal proteins due to the improved margin outlook as feed prices tumble.

US feeders and packers will face additional challenges to source enough cattle and beef, especially in light of the fact that live cattle imports will be pressured lower due to the new US Country of Origin Labelling (COOL) legislation passed in November. This legislation has already led to Tyson's announcement that it will no longer accept cattle raised and fed in Canada, which immediately pushed up supply of fed cattle offerings in Canada this quarter. In Mexico, local competition for feeder cattle will increase due to improved domestic feeding margins and growing beef exports. Finally, competition to the US for Australian beef imports from Asia will likely continue, further tightening the US market, especially for lean beef.

We expect China's importance and influence on the global beef market to continue to expand in 2014. China's imports of both frozen and chilled beef are expected to increase further, driven by the shortage of beef in the domestic market, reflected in record high retail prices. Rabobank forecasts that the value of the Chinese markets will grow in excess of 10% annually over the next three years.

A number of recently announced trade deals will also come to bear in the beef market over the coming months and years, including commitments to reopen closed or impeded markets for beef imports and the Trans-Pacific Partnership, which set goals to improve trade between five beef-exporting countries. The removal of trade barriers will be positive for global beef trade and, combined with lower feed costs, should support renewed investment in the global beef industry. The most remarkable agreements are as follows:

- Canada will be granted a duty-free import quota to the EU of 35,000 tonnes of fresh/chilled beef and 15,000 tonnes cwe of frozen beef after ratification of the deal, which is expected in 2015.
- The Trans-Pacific Partnership Agreement between New Zealand, Australia, California, Mexico and the US, which combined account for one-third of global beef production and approximately half of global beef exports, signed a declaration with the goal to eliminate all beef related tariffs and barriers between the countries in the near future.
- The opening of markets in the US, Canada, Japan and China, among others, for European beef and veal. These markets were still blocked due to the BSE outbreaks at the beginning of the century.

In addition, other talks are continuing in an attempt to further lower trade barriers, such as negotiations to allow US beef exports to China.

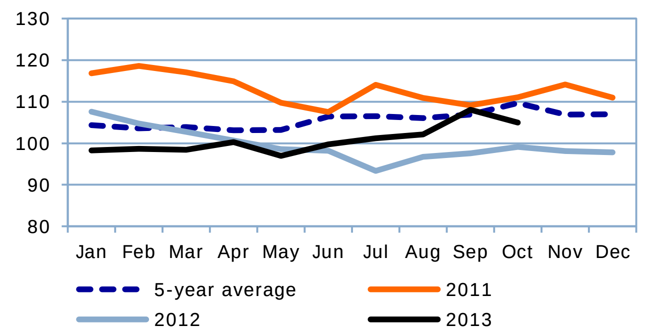
Regional Updates

Brazil

Finished cattle prices in Brazil averaged BRL 108 in Q4 2013, 13% above the same quarter last year, and 5% above Q3 prices (*see Figure 4*). Prices have been increasing as a result of feedlot supply being lower than expected and increased demand from the exporting sector.

Figure 4: Live cattle prices in Brazil adjusted for inflation, 2011-2013

BRL/head



Source: CEPEA, 2013

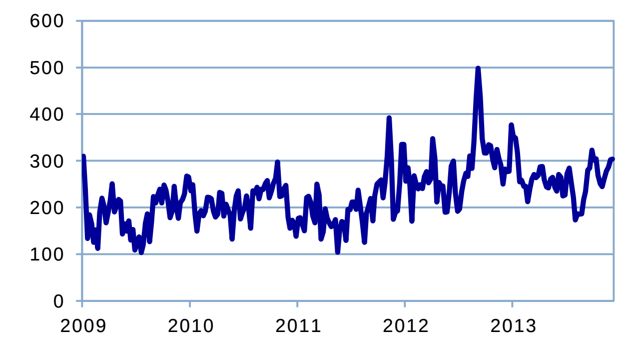
According to IMEA, confinement levels in Mato Grosso dropped by 9.3% in 2013, the second consecutive year of a reduction in confined cattle numbers. The main reason cited by producers was cost increases. On the other hand, slaughter levels in Mato Grosso are reaching historical highs, fuelled by strong export demand.

The Brazilian real has been losing value, with a depreciation of 16% year to date. This has translated into lower prices in US dollars, and increased competitiveness of exports. Fresh beef export prices in November averaged USD 4,656, the highest level of 2013, but still below 2012 levels. According to the Brazilian beef exporters association (ABIEC), in the first nine months of 2013, beef exports were up by 19% YOY, with January to November exports reaching USD 6 billion, a 5% growth YOY and a historical record. Hong Kong was the main export destination, growing by 71% YOY, followed by Russia, where restrictions on fresh beef imports from nine Brazilian plants were lifted in October and November. Exports to Venezuela and the Middle East also increased.

Beef packing margins in Q3 trailed significantly below the previous year, mostly as a result of uncommonly high results in Q3 2012 (*see Figure 5*). However, results improved by 23% in Q4 2013 compared to the previous quarter as a result of a recovery in carcass prices.

Figure 5: Domestic Brazilian beef packers' gross margins, Jan 2009-Sep 2013

BRL/head



Source: Rabobank, 2013

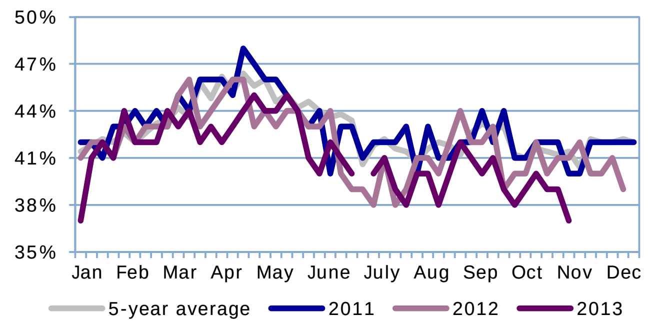
United States

During the recent quarter, the US cattle market has been an exception as fed cattle, feeder cattle, calves, replacement cows and packer cow prices have all reached new all-time record levels. While price action has been record breaking, market momentum has been relatively flat and, when measured against the anticipated potential due to tightening supplies, the market seems to have fallen short of its potential. Price limitations have been driven by consumers' resistance to current high retail prices and competition from other animal proteins as feed costs decline and production expectations improve.

Spurred by the combination of record-high calf prices and improved weather conditions that are allowing producers to start implementing herd expansion plans, the evidence of herd rebuilding is rampant. Weekly average beef cow slaughter during the first half of 2013 posted a 2% increase over 2012, but in the second half of the year to date it is down 14% from a year ago. On top of the reduction in weekly beef cow slaughter, the breakdown of heifer sales in weekly feeder cattle sale barn receipts shows a moderate retention of heifers during the first half of 2013 and a record low retention of heifers in the sale barn mix for the second half of the year (*see Figure 6*).

Figure 6: Heifers as percentage of total feeder cattle sales, 2003-2013

percent



Source: USDA, 2013

As we approach the year's end, quality cow/calf pairs are selling in a range of USD 2,000 to USD 2,500 with outside sales in excess of USD 3,000. Quality calf and feeder heifers that are destined to return to a breeding programme are selling for an up to USD 10.00/cwt premium over feeder heifers and are selling at prices that in some instances are a premium to feeder steer prices.

While hay stocks have largely been replenished and pasture and range conditions are improving, the severity of the winter weather and the arrival of timely rains in the spring will be critical in sustaining the momentum of herd rebuilding that is defining the market as 2013 comes to a close. Cow and heifer retention started late in 2012 and early in 2013 before the resumption of dry conditions forced many of those retained heifers into the feed yard.

Fed cattle prices are currently trading in a range of USD 132 to USD 134, which is a new all-time record price level. We expect fed cattle prices are likely to level off early in 2014. However, given the tight availability of market-ready cattle, any complications from severe winter feeding conditions could stimulate a rally. Once past the post-holiday season and through the winter, fed cattle prices are expected to reach new record price levels towards the spring. Fed cattle prices will be targeting a new high range of USD 135 to USD 140 in this window.

Canada

The Canadian cattle market has been robust. Just like in the US, all classes of cattle are trading at record price levels. Both feed grain and hay supplies have been restored, providing lower feed costs and comfortable feed stock inventories.

As a result of the lower feed prices, cattle-on-feed inventories have recovered to historical averages. At the same time, exports of feeder cattle to the US have been huge. Year-to-date shipments of feeder cattle to the US are up 111% over a year ago. The increased shipments have been driven not only by the record feeder cattle prices in the US, but also from an attractive currency swap. Currently the Canadian dollar is 0.94 to the US dollar.

Canadian fed cattle slaughter is running well ahead of a year ago. In November, as a result of the implementation of new US COOL rules, Tyson Foods announced they would no longer accept cattle raised and fed in Canada to be processed in the US. As a result, there has been a larger supply of fed cattle offerings in Canada this quarter.

While the US has implemented the new COOL requirements in an attempt to meet WTO requirements, the final outcome is far from resolved. Both Canada and Mexico have filed claims with the WTO stating that US labelling requirements are still discriminatory and have placed a request with the WTO to implement countervailing tariffs on US products.

Despite the implementation of COOL late in the year, year-over-year imports of Canadian slaughter cows are up 58%. The increase is the result of a Quebec cow processor that closed late in the fourth quarter of 2012. The cows that were being processed at that facility are now being channelled into the US. While the flow of those cows is expected to continue, the year-over-year adjustment is expected to balance in 2014. We expect the Canadian cattle market to remain strong, with additional record prices expected in 2014.

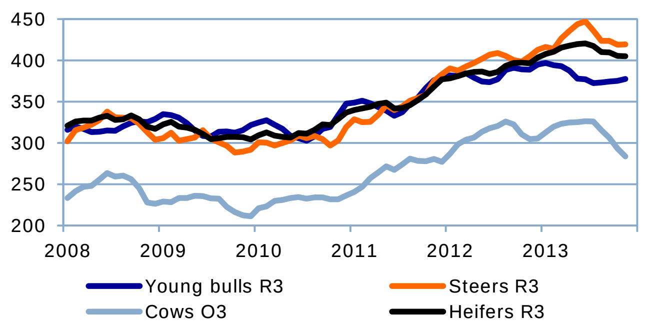
EU

EU prime beef prices stabilised at a slightly lower price point in 2H 2013 after having reached record levels in May 2013 (*see Figure 7*). With both supply and demand declining, the elevated price level is resulting in an increasing number of consumers refraining from consuming more beef. The European Commission forecasts a drop in beef consumption in the EU-15 of 2.2% in 2013, after the declines experienced in 2011 (1.0%) and 2012 (1.7%). In line with the impact of the economic crisis, 2013 beef consumption in the last few years is especially under pressure in southern Europe, with Italy (-5.6%), Portugal (-5.3%) and France (-2.1%) expecting large drops. In the UK, the impact of the horse meat scandal resulted in a forecast decline in beef consumption of 3.9% in 2013.

Remarkably, despite declining EU cow slaughter numbers (January to August -5.9%), cow prices plummeted 13% since the last high in June due to milk farmers retaining cows supported by the high milk prices and looming milk quota abolition in May 2015 and consumers trading down to cheaper cuts. Next to some seasonal impact from growing supplies in the autumn, this also shows some unexpected demand easing.

Figure 7: EU beef prices by category, 2003-2013

EUR/100 kg cwe

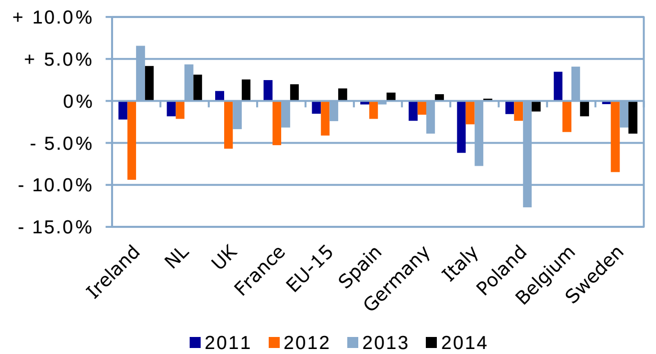


Source: European Commission, 2013

EU-15 beef production will decline 2.4% in 2013, after decreasing 1.5% and 4.1% in 2011 and 2012, respectively. While there will be growth in Ireland, the Netherlands and Belgium, it will not be sufficient to compensate for the decline experienced in France, Italy, Germany and Poland. For 2014, based on the development of the herd last June, the EU Commission forecasts a modest recovery of production (1.5%) in 2014 (*see Figure 8*).

Figure 8: Change in beef production in EU countries, 2011-2014f

percent



f=forecast

Source: European Commission, 2013

With the looming introduction of the first measures of the new Common Agricultural Policy (CAP) in 2014, the first impact on the EU beef industry can be observed. With the farmers' income support moving from a production to a hectare-based system, including some redirection between the old and new member states in 2014, and the dairy quota abolition in May 2015, prime beef supplies are expected to come under pressure in favour of dairy-based beef. This development is already visible in Ireland, where the number of calves bred from dairy sires increased 36,000 head (5.5%), while calves bred from beef sires dropped 83,000 head (7.3%) from January to June 2013. This will challenge the EU beef industry to source sufficient prime beef and might result in some processor consolidation across Europe.

Australia

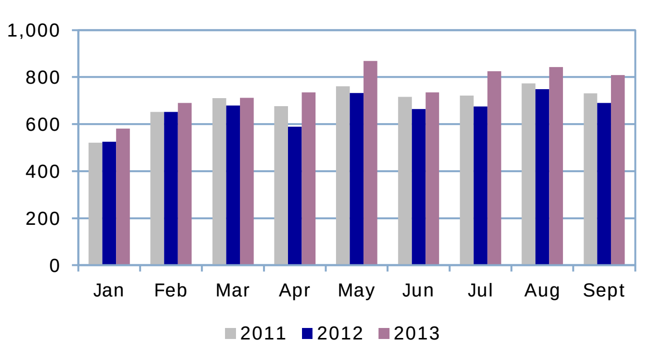
Much-needed rain across large areas of northern and eastern Australia has caused cattle prices to improve in the recent weeks. The benchmark Eastern Young Cattle Indicator increased AUD 35 cents/kilogramme cwt in November on the back of strong rainfall, to finish the month at AUD 325.25 cents/kilogramme cwt. This is 2% below the same time last year.

The prediction of a drier-than-normal summer for large areas of Queensland is of concern to the industry. The Bureau of Meteorology (BOM) has forecast that the entire eastern half of Queensland is expected to face a drier-than-normal summer (December 2013 to February 14), with a 30% to 40% chance of exceeding its median rainfall for the period. This will put further strain on an industry that is already under pressure and is hoping for rain to assist prices and herd rebuilding efforts.

High slaughter levels have continued throughout 2013, with approximately 8.2 million head forecast to be slaughtered by the close of the year (*see Figure 9*). This will result in a production increase of 6% or 127,000 tonnes (cwt) relative to 2012.

Figure 9: Australian cattle slaughter, 2000-2013

thousand head



Source: ABS, Rabobank, 2013

On the back of this increased production, 2013 exports continue to break records with the total 2013 volume already surpassing the total for 2012. The record export volumes have been driven by the tough seasonal conditions of 2013 and the drought-induced slaughter, while also being assisted by strong international demand globally. Export numbers continue to be driven by rising exports to key markets. Through the end of October 2013, exports to China have increased 107,640 tonnes swt or 623%, the Middle East is up 27,837 tonnes swt or 109% and Korea is up 16,047 tonnes swt or 14%.

Exports to China are forecast to remain strong in 2014 but will also be met with China looking to diversify its supply base as Australia currently makes up close to 50% of imports. Australia will see strong demand from the US because US production and, more importantly, cow slaughter will be down, which will impact lean beef supply directly.

Despite some bumpy international relations in recent weeks, Rabobank expects Indonesian demand for Australian live exports to increase into 2014. Prices have already started to rise significantly as a result of tightening supply in northern Australia, with live light steer prices ex-Darwin jumping 27% between August and October.

Argentina

Beef production in Argentina increased by 13% and 10%, respectively, during the first nine months of 2013, compared to the previous year. The difference in heads slaughtered and total production has to do with the fact that average weight has been dropping. Lighter cattle are favoured by the domestic market and supply has responded to that preference.

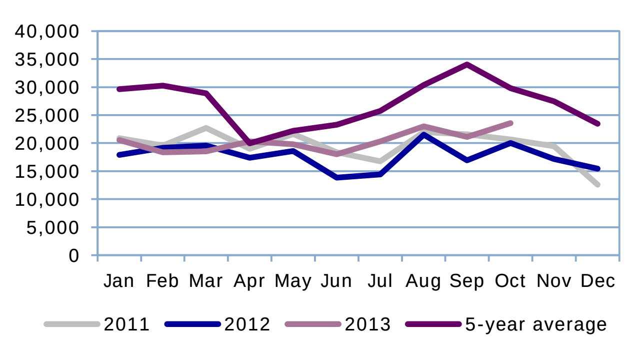
Steer prices decreased 12% in the first nine months of 2013 in US dollar terms, compared to the same period last year. However, in the local currency, prices increased by a mere 3.5%, which is substantially below inflation levels and currency depreciation.

Export quantities increased 9% YOY in the year to October, as September exports showed strong performance of almost 20 thousand tonnes cwe (41% YOY growth), but dropped to 15 thousand tonnes in October (18% YOY decrease) (*see Figure 10*). Overall, we expect total exports for 2013 to be close to 200 thousand tonnes cwe, an 8% growth YOY. This value continues to be among the lowest of the past ten years.

Domestic consumption continues to grow, with average per capita consumption 8.7% above last year in the first ten months of the year.

Figure 10: Argentina beef exports, 2000-2013

tonnes



Source: IPCVA, 2013

New Zealand

Weather conditions varied throughout New Zealand during the spring. Large parts of the North Island experienced above-average hot and dry conditions, while higher-than-average rainfall has feed and water supplies well-placed for most of the South Island heading into the summer. Although certain parts of the country require a decent amount of rainfall heading into the summer months, the outlook of greater-than-average rainfall for these regions of the North Island is encouraging.

After reaching its lowest point in around 12 months, the New Zealand dollar has since climbed from the lows in July, rising from USD 0.778 to 0.827 at the end of November. The high currency continues to erode returns at the farmgate, and while average prices remain above year-ago levels, prices have remained relatively flat, falling from a yearly high of NZD 407 cents/kilogramme cwt to settle at NZD 399 cents/kilogramme cwt as of early December.

At the completion of the New Zealand processing season (October 2012 to September 2013), total slaughter increased 10% or 200,000 head YOY to 2.29 million head. This rise was the direct result of the 200,000 head increase in cow slaughter (mostly in the dairy herd), with the majority processed between October 2012 and February 2013. Slaughter between August and October 2013 declined 11% YOY to 264,286 head. Beef supplies will continue to rise throughout the remainder of 2013 into 2014 as they do seasonally, but they will be lower in comparison to 2013.

With slaughter volumes lower during the three months to October, total exports also fell over the same period, but only marginally. Total shipments declined 2% YOY to 49,841 tonnes swt. Exports for January to October remained 5% higher YOY at 313,976 tonnes swt, with the growth attributed to higher shipments to the US (up 6% to 149,794 tonnes swt) and China (up 418% to 32,528 tonnes swt).

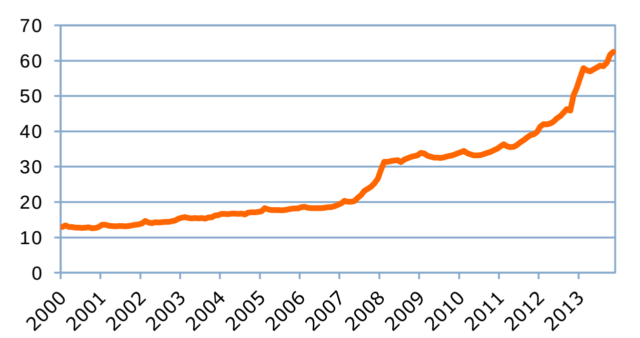
At present, New Zealand's average export returns to China are higher than to the US. While China's ability to pay more than traditional markets in the long term is somewhat unknown, from January to September 2013, average export values to China (NZD 5.29/kilogramme) have increased 10% YOY, while returns to the US (NZD 5.28/kilogramme) declined 3% over the same time. This suggests that Chinese demand for New Zealand products is strong, as export returns have increased in line with higher export volumes. Demand from the US for lean beef is expected to be strong throughout 2014, as cow slaughter and overall beef production is forecast to be much lower in comparison to 2013.

China

In China, the tight supply situation continued in Q4 2013. Entering November, beef retail price increased slightly due to the arrival of the high consumption season. The current average retail price across the country increased by 9.3% compared with the average price in 1H 2013 (*see Figure 11*). Compared with November 2012, the beef retail price increased 24%, reaching USD 10.25/kilogramme.

Figure 11: Chinese beef retail price, 2000-2013

CNY/kg



Source: CAAA, 2013

As production output has been flat and even decreased, prices have surged. We expect the value of China's beef market to grow in excess of 10% annually over the next three years.

It is estimated that the beef output in 1H 2013 decreased by 5% compared with the same period of 2012.

As of the last week of August, production profitability increased to CNY 1,663/head (each head equals 500 kilogrammes), up 30% compared with Q2 2013. Slaughtering profitability remained stable at CNY 520/head. In the meantime, the retail segment remains profitable due to the rising prices.

Since the end of 2012, China's beef imports have seen astonishing growth. The import volume ascended every month, taking advantage of a declining purchase price. In the first 10 months of 2013, imports of frozen beef surged seven and a half fold compared with the same period in 2012, reaching 236,645 tonnes. The average import price decreased by 8.8% to USD 4.22/kilogramme compared with the same period in 2012. Meanwhile, exports of frozen beef dropped 60.4% due to the tight domestic supply and high local prices.

Australia remained the biggest beef supplier to China, accounting for 50.85% of China's total import volume in the recent ten months. Uruguay is catching up rapidly due to its competitive prices, with its market share rising to 24.54% during the same period, making it the second largest supplier to China.

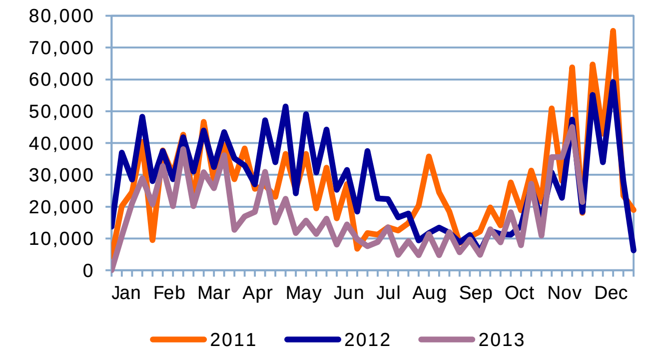
Imports of frozen and chilled beef are expected to continue rising in the coming year due to the shortage in the domestic market. As production costs for China's beef products are rising and the supply is tight, exports of beef products will continue to decrease in the coming months.

Mexico

Mexican cattle exports to the US continue to decline as seasonal conditions improve in Mexico on the production side. Year-to-date (January to November) exports dropped around 35% over year-ago levels (*see Figure 12*). At the end of this year, livestock shipments to the US will drop under 1 million heads, significantly below 1.5 million heads exported in 2012.

Figure 12: Mexican cattle export to the US, 2000-2013

head/week



Source: Rabobank, 2013

For 2014, we maintain our expectation that cattle exports to the US will continue a downward trend. Despite US cattle prices being on the upside, increasing up to 9% OYA, the Mexican cattle industry, particularly feeders, will compete for that cattle as they are anticipating better margins. Better margins are expected because pasture conditions have improved to pre-drought levels, feed prices continue on the bearish side and cattle and beef prices remain strong.

Furthermore, some integrated beef producers will also be competing for cattle as they have found ways to compete abroad, particularly against the US beef industry.

Official data confirms our expectation that beef production in Mexico is declining in 2013. We expect production to be around 3.4 percent lower compared with 2012. However, as some conditions on the production side improve for the industry, particularly feeding costs, we anticipate a marginal increase in beef production for 2014.

The challenge will remain on the consumption side as relative retail prices have sent per capita consumption of beef to its lowest levels in history at 15.3 kilogrammes per capita. In 2014, we do not see an improvement in consumption. Despite the expected growth in the economy, we anticipate that middle-class consumption will plateau.

Despite access to the Asian markets remaining a challenge for Mexican beef, the industry is gaining market share in the US. Mexican beef exports to the US will keep growing at a positive rate.

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