



Rabobank

Rabobank Poultry Quarterly

Outlook for Global and Regional Markets

Rabobank International

Authors

Nan-Dirk Mulder

nan-dirk.mulder@rabobank.com

Chenjun Pan

chenjun.pan@rabobank.com

Will Sawyer

william.sawyer@rabobank.com

www.rabotransact.com

- **Global broiler prices declined 6% in Q3 after reaching an all-time high in Q2 as the onset of lower cost feed brought increased production.**
- **In a reversal from trends of the last five years, profit margins for producers in the Western Hemisphere outperformed their counterparts in the Eastern Hemisphere during Q3 as well as most of 2013.**
- **Producers in the Americas enjoyed another quarter of favourable margins as tight supplies of competing proteins kept prices high and lower corn and soy meal prices drove more favourable feed costs. EU producers follow this trend with some delay**
- **Conversely, profit margins in Asia, Russia and South Africa improved in Q3 but remain far below the good times of 2010 and 2011 as excess supply and disease outbreaks hampered demand.**
- **The global poultry trade increased in Q3 in line with seasonal patterns to levels consistent with 2012 and 2011. The slower economic growth in the BRIC countries in the last year has caused poultry imports to plateau at 2011 levels.**
- **The outlook for Q4 and 2014 is generally bullish, driven by the tailwind of sharply lower feed costs and tight global supplies of pork and beef.**
- **Longer term, a number of major poultry producers have announced green field capacity expansion plans in the United States, Thailand, Russia and China in response to the growing consensus view of less volatile grain prices in the years to come.**

Global outlook

Global poultry fundamentals for 2014 look positive, with cost relief coming from lower feed costs, high prices of competing proteins and recently improved export volumes (see Figures 1-4). Having said this, the challenge is to keep markets balanced. Key Asian markets China and India are in the midst of a supply glut because of weak demand following food safety and animal disease issues (China) and slower economic growth (India). Early indicators for 2014 reflect better conditions for both markets as supply levels tighten, but in

the case of Thailand, a big concern will again be oversupply, especially if the currently unused capacity of Saha Farms restarts.

The outlook for the European Union (EU) is encouraging, with the latest projections for 2014 indicating growth of 0.6%, which should be in line with EU demand. Under such circumstances, the industry should be able to benefit from favourable market conditions with tight pork and beef markets and lower feed prices.

Conditions in Russia and South Africa are improving after a weak 1H 2013 and should continue to improve next year. Russia will benefit from price support from the local government, while the South African industry will enjoy new safeguards from Brazilian imports, however, the optimism is tempered by large and growing imports from the EU.

The robust profitability in the Americas (see Figure 5) of the last few quarters is expected to continue in 2014, with poultry pricing benefiting from tight supplies of pork and beef, although the recent slowdown of Asian demand may cause a new challenge for the industry.

Global trade volumes will grow again in 2014 but remain below historic growth rates (around 1% to 2% growth instead of 3% to 4%) due to slower economic growth in the BRIC countries, which have been the engine of global poultry trade in recent years. Some relief might come from new, pending trade agreements, especially those between the EU/Ukraine and the EU/US. Trade sources fear that the EU/Ukraine trade agreement might negatively affect trade with neighbouring Russia.

Animal disease and food safety issues will continue to be major issues in 2014. The poultry industry in China has not yet recovered from the outbreak of the H7N9 strain of avian influenza (AI) this spring, which has put consumption growth under pressure. In Mexico, the industry is rebuilding domestic supply but there is a lingering risk that AI will reappear this winter as temperatures fall.

In western markets, especially north-western Europe, animal welfare concerns are yielding stricter standards such as the 'chicken of tomorrow' project for retail in the Netherlands. Similar programmes are being implemented in Germany and may expand to other markets around Europe.

Figure 1: Global broiler, beef, pork prices versus feed costs monitor, 2007-2013

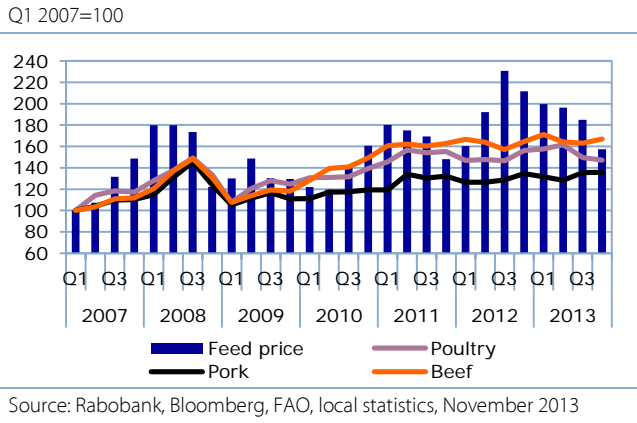


Figure 4: Rabobank quarterly average price forecast, Q3 2013-Q3 2014

	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14
Wheat (CBOT)									
USc/bu	871	845	736	650	650	700	675	650	630
Wheat (Matif)									
EUR/tonne	259	265	244	188	188	195	190	180	170
Corn									
USc/bu	783	736	715	662	499	435	445	450	460
Soybeans									
USc/bu	1,677	1,484	1,448		1,391	1,300	1,285	1,230	1,200

Source: Rabobank, 2013

Figure 2: Rabobank global poultry trade monitor, 2008-2013

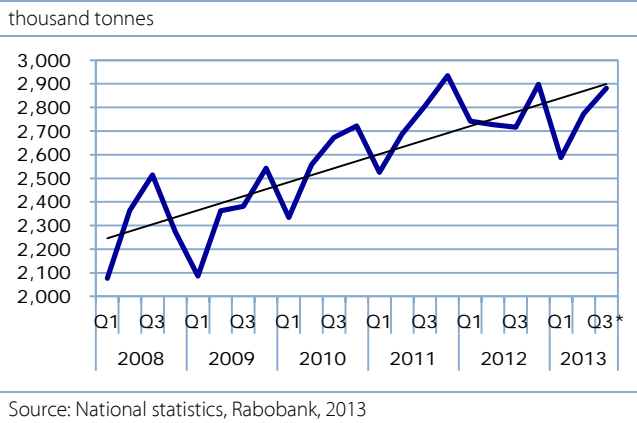


Figure 5: Rabobank quarterly EBIT margin monitor for listed companies, 2011-2013

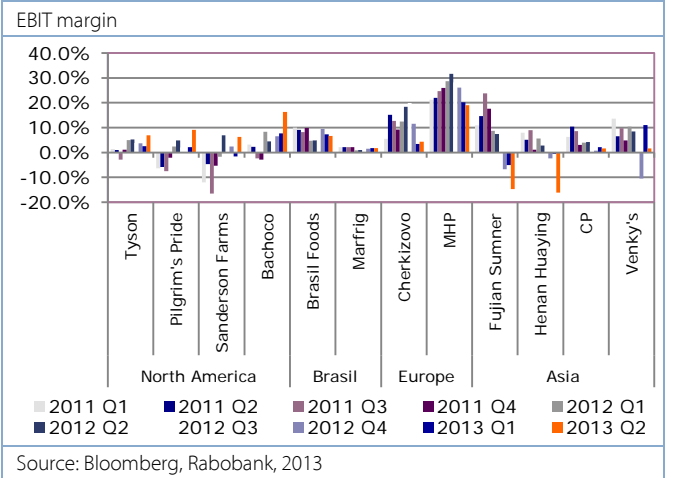
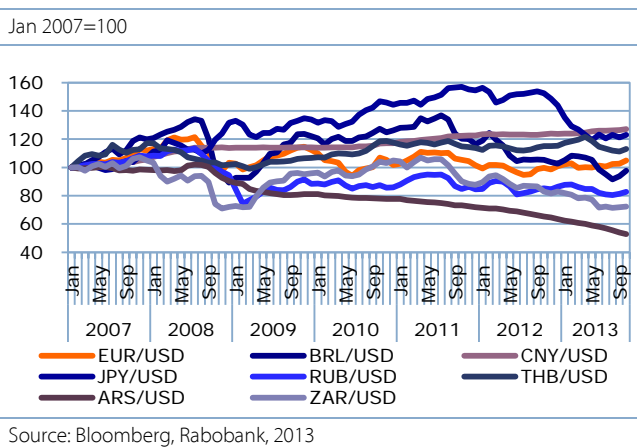


Figure 3: Index development exchange rates, 2007-2013

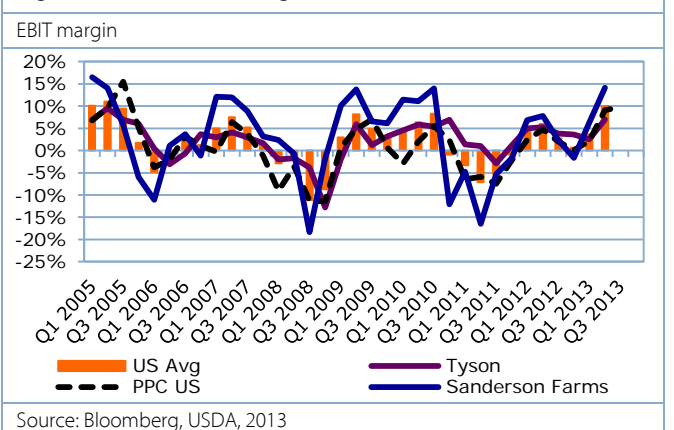


Regional outlook

United States

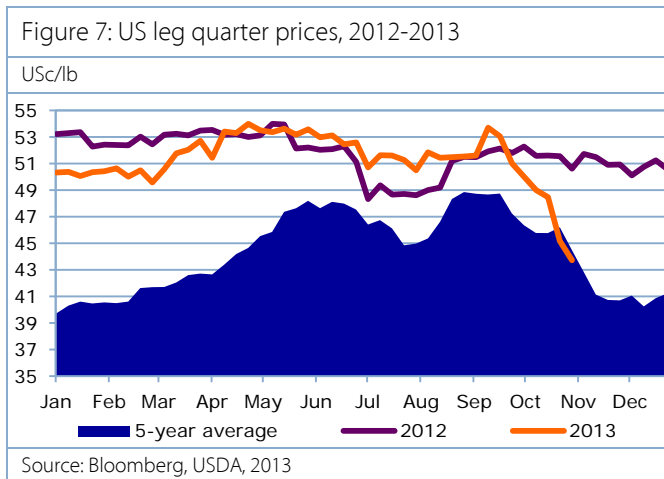
The good times continue to roll on for United States (US) chicken producers and processors. After reaching an eight-year high in Q2, profit margins climbed even higher in Q3, based on the results that Pilgrim's Pride reported on 31 October, with operating profit margins of 9.8% versus 9.1% in Q2 (see Figure 6). Prices during the quarter remained strong as the availability of competing proteins, especially beef, remain in tight supply. US chicken producers have not yet benefited from lower corn and soymeal prices, which will begin to support margins in Q4 and 1H 2014.

Figure 6: US chicken margins, 2005-2013



Prices of chicken wings and leg quarters have started to roll off; down 25% and 20%, respectively, since mid-September, which may

be an early indication of slowing export demand from Mexico (see Figure 7).

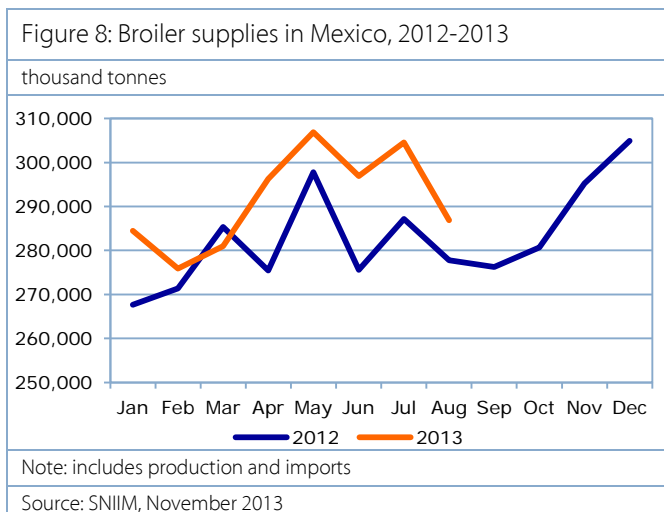


Supplies of pork and beef are not showing signs of a significant increase next year, keeping chicken competitive at both retail and foodservice levels in the domestic market. Profit margins could come under pressure in 2014 if supply growth accelerates from current levels or exports to Mexico decline significantly from 2013 levels.

In the long term, US chicken producers have a more bullish outlook as indicated by plans for the construction of two new facilities. On 1 October, Sanderson Farms (8% of US production) broke ground on a new processing plant in Texas, which had been delayed due to uncertainty around the high price and volatility of grain. In early November, Peco Foods (3% of US production) announced that it is exploring a new plant in Arkansas that could be operational by 2016.

Mexico

The Mexican broiler market is trying to find a new equilibrium after domestic producers overreacted to historically high wholesale and retail prices. From January to September 2013, broiler production increased 2.3 percent over year-ago levels, while imports increased around 11 percent (see Figure 8). Per capita chicken consumption continues to rise, but it has not been able to mitigate the lack of import discipline. In May, chicken imports reached a historical high of over 63 thousand tonnes, an annual increase of 22%.



The oversupply shifted price trends to the downside. From June to October, wholesale prices declined 45% while retail prices dropped

20%. Chicken retail prices have been relatively sticky as chicken remains a competitive protein for consumers.

We expect the Mexican market to rebalance, with production and imports easing through the end of the year. Chicken production is expected to reach 3 million tonnes, up 1.4% over year-ago levels, while imports are forecast at 677 thousand tonnes.

As we expect broiler supply and demand to balance out, prices should be near a bottom. For 2013 and 2014, we maintain our view that prices will ease, but they will remain above pre-2012 outbreak levels. Despite our price forecast, we anticipate positive margins for the industry as production costs have declined.

Brazil

The latest statistics for the number of birds housed in Brazil show a modest 2% increase for January to August 2013 over last year. High grain prices in 2012 prompted a decline in bird numbers, which are now recovering. The profitability of exports has been a driving force for the sector's recovery. Owing to the weakening of the local currency versus the US dollar by around 10% over the same period, the gain in average export prices in local currency terms has been some 20%.

While wholesale prices for frozen chicken dipped in Q2 and early Q3 2013, prices rebounded later in Q3 and were back near 2013 highs by the end of the quarter. This reflects a combination of restricted supply plus firm export demand. In addition, the current high local price of beef has created space for domestic offtake of poultry meat to expand via substitution.

Production costs have declined, driven by lower corn prices, while soymeal prices remain high, which has frustrated producers. Looking ahead, expectations for 2014 are that the export market could become more competitive in some destinations, such as the Middle East, but export volumes are expected to remain steady. Lower costs of production should give room for margins to be maintained even if higher supplies by 2H 2014 were to put pressure on local prices.

Argentina

For the first nine months of the year, Argentina's poultry production tracked above last year's levels, with 2.5% growth. However, the rate of growth is substantially lower than in previous years (approximately 10% for the past two years). This is a consequence of strong increases in local costs, particularly for labour, and a currency that is appreciating in real terms, thus reducing profitability of exports.

Domestic consumption decreased slightly, showing a 1% contraction with respect to 2012. Consumption levels have reached almost 40 kilogrammes/person/year, a level that will be hard to surpass, particularly as beef prices have come down from previous years' peak. Exports increased by 18% in terms of volume for the first nine months of 2013. Venezuela continues to be the biggest export market, followed by Chile and China.

Going forward, lower corn prices should help with profitability, although the industry's biggest problems have to do with domestic inflation and an overvalued exchange rate. We expect these problems to continue to be an issue in Q1 2014.

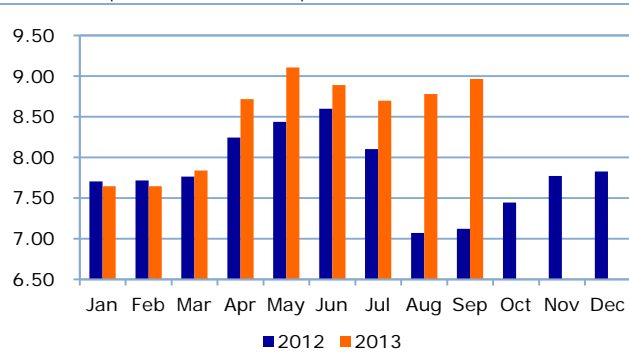
Chile

During Q3 2013, Chile's total poultry production increased by almost 3.5% compared to the Q3 2012, largely on the back of a 4% increase in broiler production, whereas turkey output contracted by 5%. The ratio of the domestic wholesale broiler price to the domestic corn price continued strengthening through Q3, suggesting that industry margins should see material improvement compared to the same period in 2012 (see Figure 9). Stronger margins can be largely attributed to lower input (corn) prices.

In 2013, the US became the largest export market for Chilean poultry, accounting for nearly 30 percent, or USD 63 million, of the export value accumulated through October. The main products exported to the US are frozen boneless chicken breasts and frozen chicken wings.

Looking ahead into Q1 2014, the industry expects slight production growth with slight margin improvement also likely.

Figure 9: Monthly ratio between broiler wholesale price and corn price, Jan 2012-Sep 2013

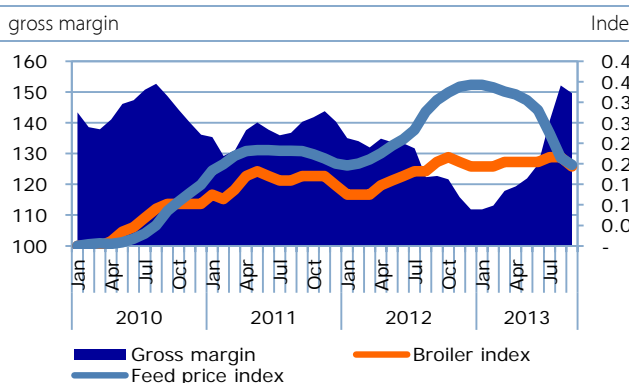


Source: ODEPA, Rabobank, 2013

European Union

EU margins have improved in 2H 2013 due to a combination of ongoing strong demand for chicken, high prices for competing pork and beef, and declining feed costs. This has been the base for a recovery in margins at the farm level (see Figure 10). Profitability has returned at farm level after a very weak 2H 2012 and 1H 2013. Broiler prices started to fall in October, mainly driven by weak seasonal demand and increased supply in the EU (see Figure 11) and especially from Poland, but ongoing lower feed prices helped to compensate lower returns.

Figure 10: Dutch gross margin versus live broiler and feed costs

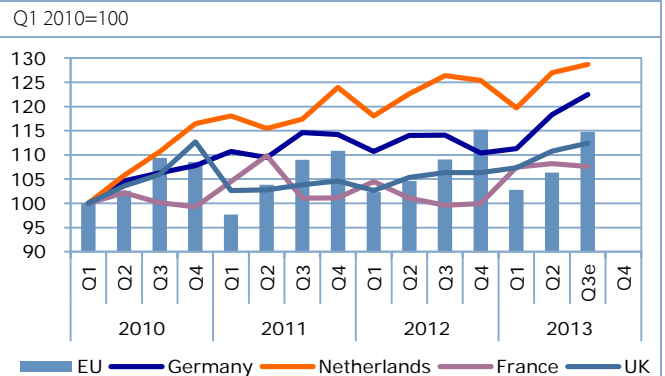


Source: PVE, LEI, Rabobank, November, 2013

Poultry processing companies are still struggling to pass on high broiler prices to retailers as ongoing weak economic circumstances

have pushed supermarket chains to strengthen their price focus. The growth of discounters, such as Lidl and Aldi, throughout the EU has sharpened the price focus of other more premium supermarkets. Exporters to the United Kingdom (UK) are experiencing more difficult trade conditions as a growing Buy British trend is shifting sourcing streams from supermarkets and restaurants to products of UK origin.

Figure 11: EU production volume monitor, 2010-2013



Source: PVE, LEI, Rabobank, November, 2013

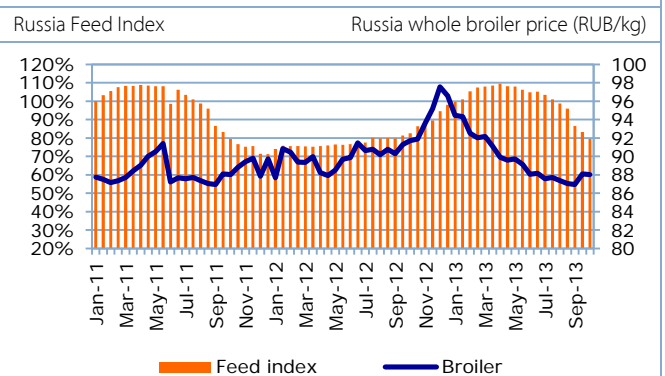
Total EU/third country export volume has increased by 3% over the first eight months of 2013, driven by strong growth in exports to Saudi Arabia and Africa (South Africa, Benin, Congo, Ghana), offset by weak exports to Hong Kong, Russia and Ukraine. Thai exports into the EU continue to rise, and Thailand is making better use of their salted breast meat quota this year compared to last year.

The industry outlook for Q4 and early 2014 looks moderately positive as market indicators reflect a slight further decline in feed costs, while production growth trends will slow (0.6% according EC projections). This will help the industry to at least maintain its current margin level, but the key would be rational supply growth.

Russia

The Russian meat industry had a tough year in 2013. Russian broiler prices declined precipitously until mid-September, when a tighter supply and demand balance helped prices find a bottom (see Figure 12).

Figure 12: Russia broiler and feed price index trend



Source: Rostat, Rabobank, November, 2013

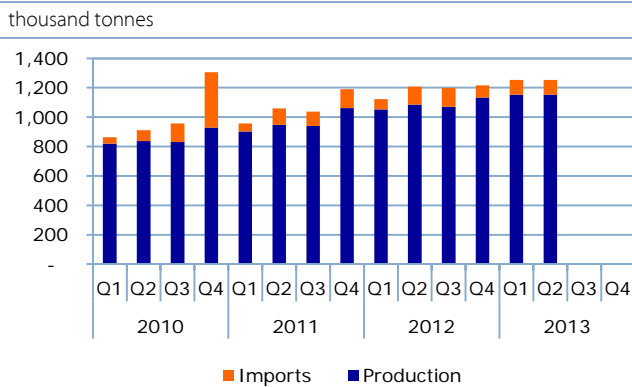
Chicken companies already benefiting from declining feed costs have had profit margins further boosted by payments (which had been previously delayed) from the federal and regional governments for high feed prices. A combination of improved broiler prices, lower feed costs and delayed compensation

payments will help drive high margins in 2H 2013 and very likely into Q1 2014.

From an industry perspective, the biggest change has been the completion of Cherkizovo’s Penza complex, which is helping to expand Cherkizovo’s chicken production in Penza from 60,000 tonnes to 125,000 tonnes.

The outlook for the Russian poultry industry looks favourable, with lower feed costs expected and the availability of subsidies. Supply growth discipline will be the biggest challenge for the Russian poultry industry (see Figure 13). New capacity will enter the market and projections show 4% growth for 2013. This will be the absolute max under current market conditions and will not justify any import growth. Under this growth path, any change in economic conditions or grain markets could affect industry profitability. However, under current conditions, the outlook appears significantly better compared to 1H 2013.

Figure 13: Russia quarterly meat supply, 2010-2013

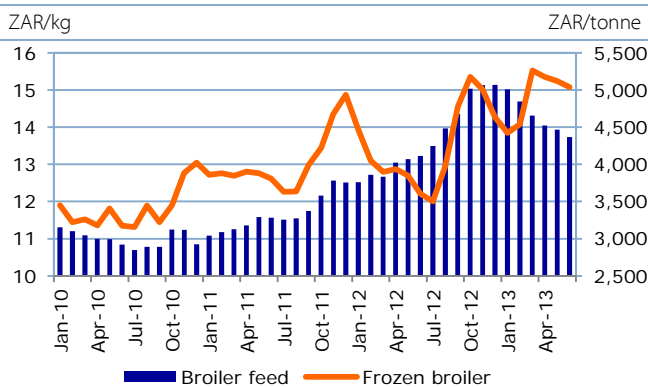


Source: Rostat, FAO, 2013

South Africa

Industry performance in South Africa has improved after a very weak start in 2013, a period in which the market was flooded with cheap imports from Brazil and the EU, while domestic supply remained high (see Figure 14). This situation of oversupply resulted in negative margins for the South African poultry industry for quite some time.

Figure 14: South Africa broiler and feed price index

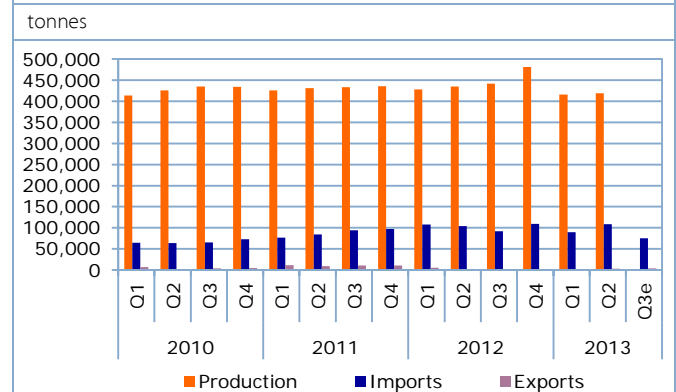


Source: SAPA, Rabobank, 2013

Production reductions in Q1 and Q2 2013 helped to rebalance the markets (see Figure 15). The introduction of higher import tariffs on imports from Brazil initially resulted in further improvement of the market balance in Q3 2013, but importers quickly shifted to the EU.

This has placed new pressure on domestic poultry producers and raised new cries for higher import levies on EU imports.

Figure 15: South African poultry supply



Source: Sapa, Rostat, 2013

The outlook for the South African poultry industry is mixed. The industry is experiencing improved market conditions with less import pressure from Brazilian imports and declining local feed prices, but is still affected by competition from EU imports of frozen chicken cuts. The key issue in the near term will be the domestic market’s ability to balance markets and benefit from improved industry costs due to lower grains costs.

China

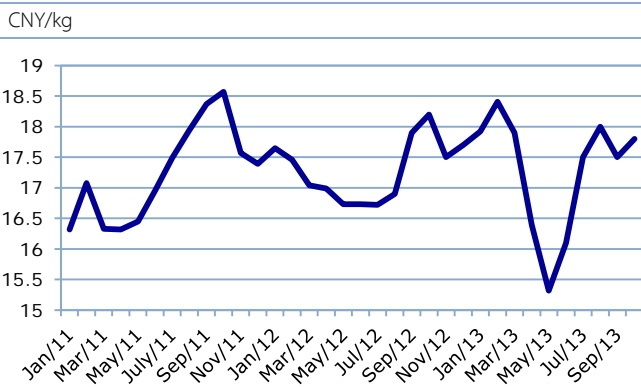
In October, two new cases of humans affected by the H7N9 strain of AI were reported in Zhejiang province. This seemed to be a revival of the previous H7N9 outbreak in March and April, 2013 and aroused a lot of attention from governments across the country. However, there have been no further cases reported since then, suggesting a stable situation without disease outbreak.

Despite the gradual recovery from the trough of AI in April, China’s poultry market remains weak. Broiler prices in the major production regions in October rose slightly to CNY 8.8/kilogramme, up 4.7% from the average prices in September and August. However, the prices of DOC dropped in October, reflecting farmers’ unwillingness to replenish. The farming margin has maintained at a relatively low level, though it rose briefly in September. The average farming margin in the major production regions was CNY 0.5/bird in October, down from CNY 1.3/bird in September. For the rest of 2013, poultry prices are expected to stabilise with a high probability of a slight uptrend due to the arrival of the high season. Over 2014, poultry prices have great upside potential given the sufficient GP and PS breeder supply (as described in the Q3 Poultry Quarterly).

Despite the weak market in 2013, the imports of broiler breeders have been strong (see Figure 16). In the first nine months of 2013, imports exceeded 1 million sets, up nearly 30% YOY. This reflects the continuous expansion of poultry players in China’s market (see Q3 Poultry Quarterly). This trend is more clearly evident with foreign companies, such as CP, Cargill, OSI, Tyson and Nippon Meat Packers, which aggressively expand vertically integrated operations in China.

Although local market demand was sluggish in Q2 and Q3 of 2013 due to AI, poultry imports have been growing. In the first nine months of 2013, imported poultry products (including offal) reached 453,200 tonnes, up 28% YOY. This increase in imports especially benefited Brazil (+20%) and the US (+122%). In terms of product category, frozen chicken paws were at 232,700 tonnes, up 70% YOY, accounting for over half of the total imports.

Figure 16: Chicken meat retail price in China, Jan 2011-Sep 2013



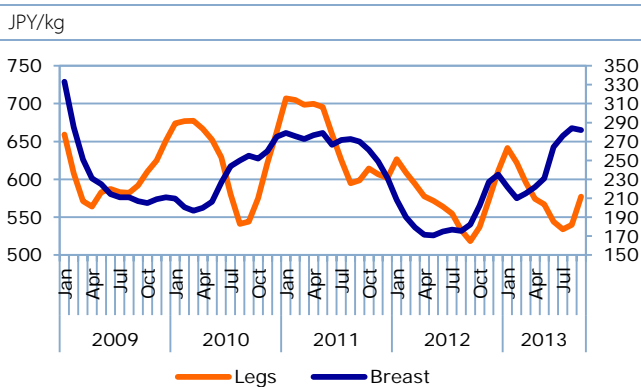
Source: CAAA, MOA, 2013

Japan

The Japanese chicken industry has been affected by a depreciation of the Japanese yen over 2013. This has resulted in a significantly improved competitive position of the local industry compared to imports.

One of the consequences of expensive imports has been a tighter local market situation in Japan, with falling stocks-to-use ratios, which are currently affecting breast meat prices in Japan (see Figure 17). Domestic demand has remained relatively stable in this period of more expensive imports.

Figure 17: Japanese price trend for legs and breast, 2009-2013

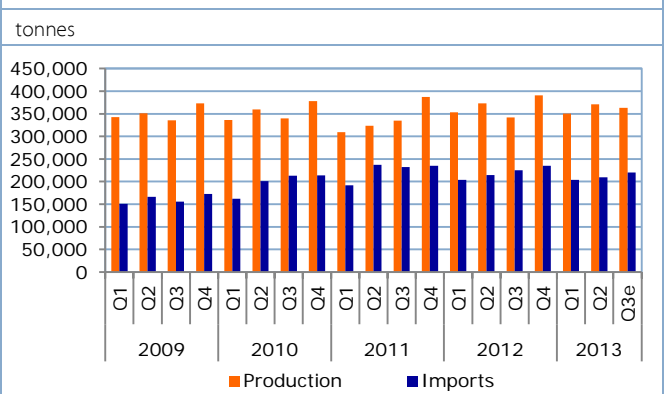


Source: Alic, Rabobank, 2013

From a supply perspective, production levels have remained fairly stable over the first three quarters of 2013 compared to 2012, while imports have come under pressure (see Figure 18). In line with long-term trends, imports have further shifted from raw meat to processed poultry products, with Thailand able to gain market share against China, especially in 1H 2013 when the Chinese industry was hit by H7N9 outbreaks. Chinese supply recovered to a certain extent in Q3 2013 due to Chinese producers' aggressive pricing strategy to regain market share.

The outlook for the Japanese poultry industry is challenging. Local industry players will benefit from a weak Japanese yen, but the whole industry will be tested by strong seasonal demand for poultry and other meat products in Q4 2013. Current low stocks-to-use ratios could indicate some price increases for this period of the year, especially as supply from Thailand is still below 2012 levels—a consequence of the financial distress of Saha Farms as well as ongoing disease threats in China.

Figure 18: Japanese domestic supply, 2009-2013



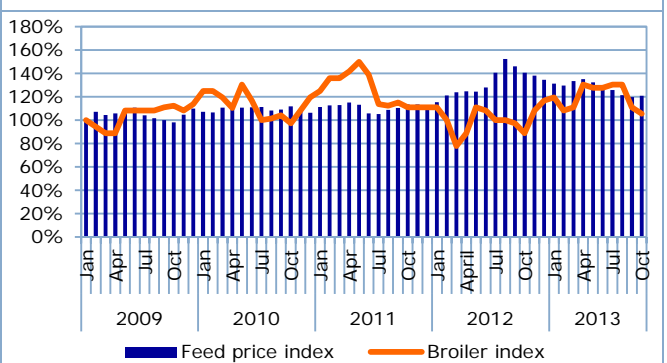
Source: Alic, Rabobank, 2013

Thailand

The Thai poultry industry has benefited from significantly improved market conditions since Q2 2013, mainly driven by the financial distress of Saha Farms, which forced them to reduce production significantly.

High broiler prices combined with declining feed prices helped Thai poultry producers return to healthy margins, but recent price reductions indicate again a relatively fast upscaling of the remaining industry (see Figure 19).

Figure 19: Thai broiler price to feed cost monitor, 2009-2013



Source: Bloomberg, National statistics, 2013

Total Thai broiler exports grew from 255,000 tonnes in 1H 2012 to 261,000 tonnes in 1H 2013. This is faster than other major poultry exporting countries mainly because of strong demand from the EU and smaller importing countries, while exports to Japan are affected by a weak Japanese yen and price competition from China (see Figure 20). The Thai broiler industry continues to believe that exports will grow by 14% in 2013, which implies a significant increase in exports in 2H 2013 to 360,000 tonnes. Rabobank believes this will be difficult to achieve, especially due to the weak Japanese yen in combination with limited Thai supply. Furthermore, Asian economic conditions have somewhat worsened in recent months, and this may affect trade in this part of the world.

Figure 20: Thai broiler meat exports 2012 and 2013: Projection and first half realisation

	2012	2013e	1H 2012	1H 2013
Japan	222,358	240,000	99,688	99,643
EU	239,241	280,000	106,577	125,405
Others	90,763	100,000	48,911	36,297
Total	532,362	620,000	255,176	261,345

Source: TBPE, Rabobank, 2013

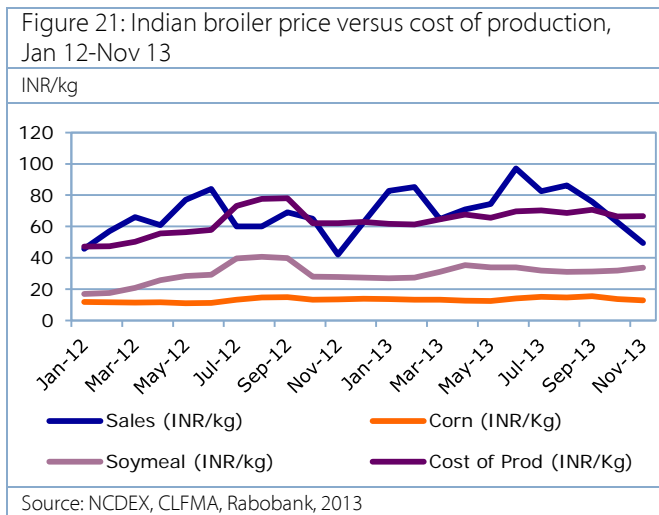
From an industry perspective, beside the financial distress of Saha Farms, the biggest news is Cargill Meat’s announced expansion of its cooked meat plant in Saraburi in Thailand. This investment follows Cargill’s recent investment in building a USD 110 million poultry processing plant in Korat.

The outlook for the Thai poultry industry is generally positive. The industry is benefiting from a tight supply situation with reasonably good demand for exports and strong domestic demand, which should remain strong in the upcoming festival season. The big threat will be oversupply. The recent price reduction might be the first indication of oversupply, so the industry should remain conservative in production expansion. Last year showed how detrimental significant excess supplies can be to prices and margins. This concern could grow if Saha Farms returns to the market. The company is still negotiating a restart and a return could cause a big market turndown for global players.

India

In 2014, the Indian broiler industry is expected to experience its first decline since the global financial crisis. Production could decline this year, driven by hatch holidays and subdued demand throughout the year.

In Q4, cost of production decreased by 5% from the average Q3 cost due to lower corn prices, but the average broiler sales price tumbled by 31%, reducing profitability (see Figure 21). Profitability dipped in Q4 for the first time in the year on the back of slow demand. Rabobank expects prices to pick up going into Q1 2014, but Q4 continues to be challenging. Overall YTD industry profitability remains higher compared to previous years, when the industry was hit hard by escalated feed prices and AI. The Indian broiler industry needs to maintain supply discipline in order to remain profitable in Q1 2014.



With the arrival of the new corn crop, corn prices eased 28% in November from the peak price in September. However, even at these lower prices, Indian corn exports remain challenging, especially with the bearish price outlook for global corn in the coming months. This would keep exports in check and influence the domestic price downwards. Soymeal prices, unlike corn, went up 12% from September lows after the new soybean crop was damaged by rains before the harvest. Current soybean crop estimates are 16% below levels prior to the damaging rains. Soymeal prices are expected to stay elevated as exporters scramble to meet export commitments for the year.

Rabobank International

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

US – William Sawyer
william.sawyer@rabobank.com

US – Don Close
don.close@rabobank.com

Argentina – Paula Savanti
paula.savanti@rabobank.com

North East Asia – Chenjun Pan
chenjun.pan@rabobank.com

Australia – Sarah Sivyver
sarah.sivyver@rabobank.com

New Zealand – Matt Costello
matt.costello@rabobank.com

EU & Russia – Albert Vernooij
albert.vernooij@rabobank.com

EU – Gorjan Nikolik
gorjan.nikolik@rabobank.com

EU & Russia – Nan-Dirk Mulder
nan-dirk.mulder@rabobank.com

Mexico – Pablo Sherwell
pablo.sherwell@rabobank.com

Singapore – Pawan Kumar
pawan.kumar@rabobank.com

www.rabotransact.com

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