



Rabobank

Beef Quarterly Q2 2014

Supply and demand nicely balanced

The global beef market is experiencing a relatively balanced supply/demand situation due to the drought-driven supply increase in Australia, temporarily higher production in the United States (US), and continued strong demand for beef in key importing markets such as China and the US.

Q3 prospects for beef are very positive, with strong price level forecasts driven by limited supply after the current supply boost, strong import demand and high prices for competing proteins, especially for pork due to porcine epidemic diarrhea virus (PEDv).

The wildcards are rainfall, which is key for supply from Australia and, to a lesser extent, the US and Brazil, **and consumers**, who will be key for the acceptance of higher price levels.

Availability of feeder cattle as well as rising production costs will limit production expansion across the globe into 2015, supporting an ongoing strong outlook for primary producers in contrast with continuing tight circumstances for processors.

Availability of beef key to improving competitive position going forward

Seasonal US price pressure starting with fed cattle numbers rising



In the US, high feedlot placements between September 2013 and February 2014 will increase supply during the summer, with the peak coming in July to August and likely resulting in additional price pressure. This will be followed by tightened supply and strengthening prices towards the end of 2014.

Strong exports and World Cup to support firm prices in Brazil



The discovery of a new atypical case of BSE in Mato Grosso in Q2 has had a limited impact on exports. This was because the main destinations, Russia and Hong Kong, did not limit imports and Brazil's major export players still have the option to continue exporting from other states.

Rainfall the deciding condition for Australian supplies and prices



The outlook for a drier winter throughout eastern and southern Australia will likely support high processing volumes moving forward. The turning point will be sufficient rainfall, which will trigger considerable herd rebuilding and likely higher cattle prices.

Continuing tight supply supports Chinese import growth



Chinese beef imports continued to surge, rising 34.2% during January to April supported by strong demand, lower import prices and strong supply from Australia and New Zealand.

Rabobank International

Food & Agribusiness Research and Advisory

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Global outlook

The global beef market will regain its positive momentum in Q3, once the current, temporarily higher supply has worked through the system. This will likely support further strengthening of prices—resulting from tighter supplies of competing proteins, especially pork due to PEDv—towards the end of 2014 (see Figures 1 and 2).

The main wildcards for the start of these positive developments are rainfall in Australia and to a lesser extent the US and Brazil, where continuation of the drought will push more cattle through the system, Indonesian import development during the July Ramadan festivities, and Chinese imports towards the high season at the end of 2014. In addition, the relatively high prices might result in consumers trading down to pork and poultry.

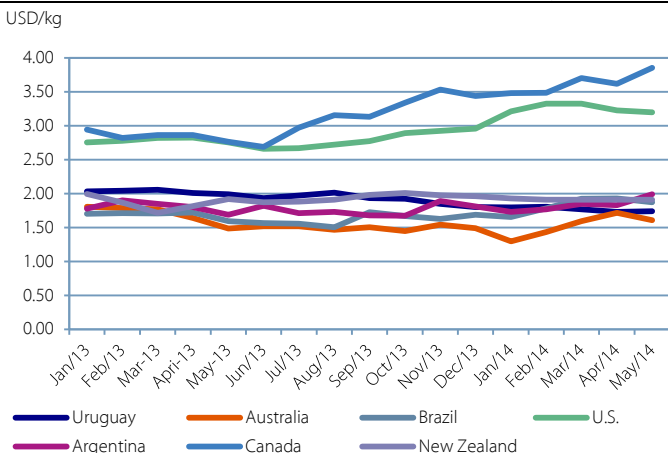
The continuing positive market fundamentals will be positive for producers' margins. However, longer term, the likely lower availability of feeder cattle and high production costs might limit the possible upside. For processors, the current stabilisation gives them room to regain margins, but prospects are less positive due to the approaching tight supply in most production regions.

In the US, the higher feedlot placements occurring between September and February have started to enter the market. This will continue until August, when supplies are expected to tighten and prices to recover.

In Australia, the drought-induced supply boost will continue until rainfall has improved pastures sufficiently to start herd rebuilding. Until then, supply will be firm and prices under pressure. In Brazil, supply increased after difficult seasonal conditions in Q1, which supported strong export growth despite the bans due to the discovery of a new atypical case of bovine spongiform encephalopathy (BSE) during Q2. With strong export growth, up 15% in 2014, and the World Cup in progress, prices will remain high.

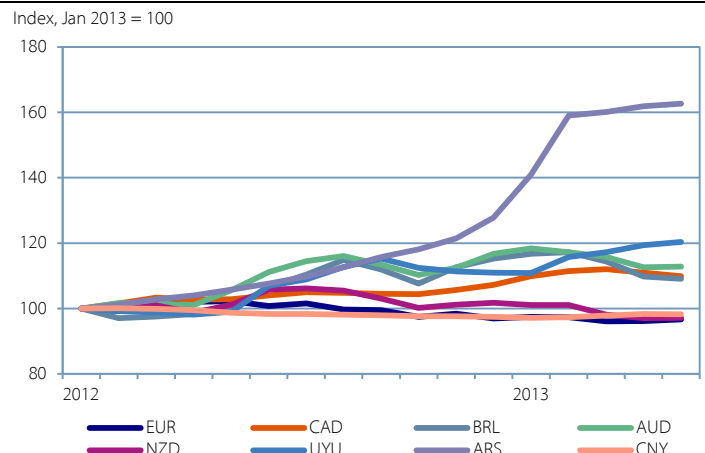
Imports to China continued to grow, but the 380% surge experienced last year has subdued to a still very strong 34.2% increase between January and April. The decline compared to last year is mainly the result of strong availability of pork. Despite some weakening, beef retail prices are still 12% higher YOY, which is remarkable as Q2 is the low consumption season. Indonesia's sufficient live cattle imports have resulted in a balanced supply-demand situation stabilising prices, which will prevent an escalation of beef prices as experienced in Q3 2013, despite the start of the festive month in July. The increase in live cattle from Australia and higher boxed beef imports have helped ease Indonesian retail prices.

Figure 1: Live finished cattle prices in exporting countries, Jan 2011-May 2014



Source: Rabobank, 2014

Figure 2: Index exchange rate development against USD



Source: Oanda, Rabobank, 2014

Regional outlooks

US

After exploding into all-time record price levels during Q1, the US cattle and beef markets have subsided a bit during Q2. Fed cattle prices peaked in the last week of March in a range of USD 152.00/cwt to USD 154.00/cwt and eased to the still record level of USD 144.00/cwt to USD 146.00/cwt for Q2 to date (see Figure 3). Prices eased on beef production levels, holding at the high end of earlier projections with some slowdown in consumer spending in reaction to the higher prices.

Going forward, seasonal price pressure is starting to weigh on the market along with expectations that more fed cattle will be making their way to market very soon. Feeder cattle placements for the period of September through February were 563,000 head higher YOY, with the largest increase in January and February. Given an expected 175 days on feed, the offerings of fed cattle during the summer are expected to be above year ago levels, with the brunt coming in July and August.

Our earlier price projections were for a summer low in the range of USD 138.00/cwt to USD 142.00/cwt. While we are not ready to make any major adjustments to the price forecast, there is growing concern that prices during the brunt of the summer could see additional pressure for a short period of time.

For the year to date, fed steer slaughter is only 1% below year ago levels, heifer slaughter is down 7%, showing the beginning

of heifer retention, for a combined fed slaughter decline of 3%. At least for the summer marketing period, we expect to see weekly fed slaughter rates much closer to year ago levels—potentially exceeding this level for a brief period. Once the supply of summer fed cattle are worked through the system, supplies are expected to tighten and prices will strengthen through the fourth quarter of 2014 and the first quarter of 2015.

Year to date, beef and dairy cow slaughter is down 12% and 11% YOY, respectively, showing that US cow/calf operators have stopped liquidating females and are retaining female inventory. Making this retention even more impressive is that this has taken place with the continuation of dry to drought conditions throughout a great deal of the cow/calf production areas. Currently, 52% of US beef cows and 47% of dairy cows are located in areas of dry to drought conditions.

At the time of writing, there have been some glorious rains over some of the driest areas—primarily Texas, Oklahoma, New Mexico and Colorado. Unfortunately, the drought areas in California, Kansas and Nebraska have yet to receive any meaningful precipitation. While the current rains are providing tremendous help, the overall dry weather continues.

Feeder cattle and calf prices continue to push into new all-time record highs in the upper USD 200 to mid-USD 210 range, up USD 65/cwt YOY, with no easing in prices seen so far (see Figure 4). Seasonally, feeder cattle prices will make a modest price correction in May before trending higher from mid-June through August, inevitably resulting in increased price volatility.

Figure 3: US fed steer price

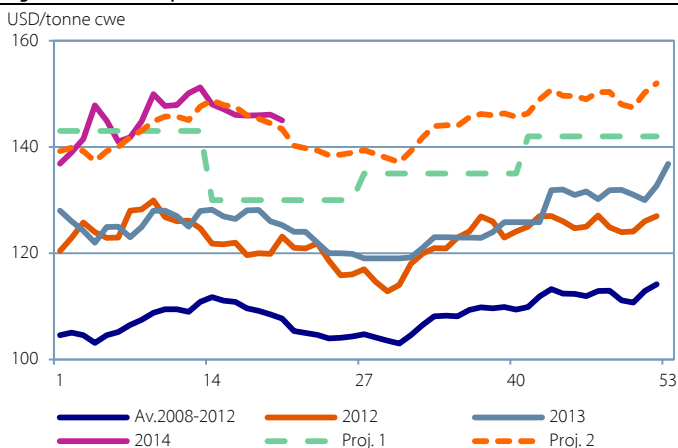
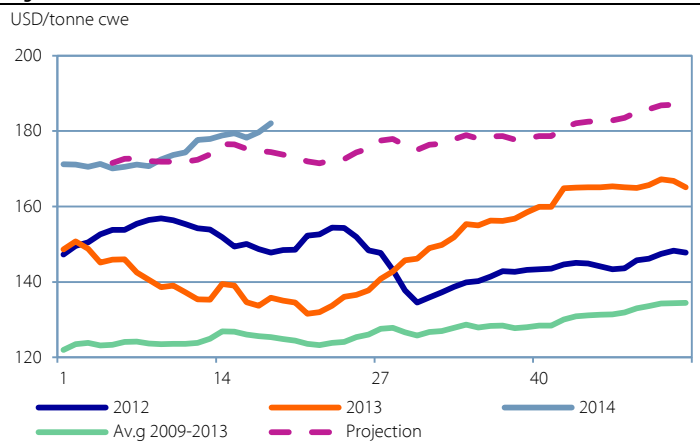


Figure 4: US CME feeder index



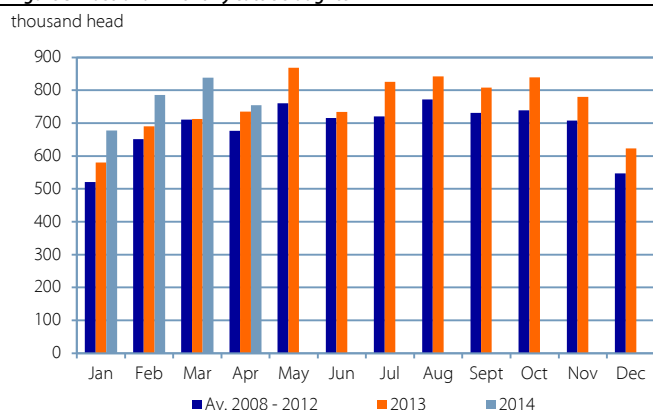
Australia

Total Australian cattle slaughter during the first four months of 2014 increased 12% YOY on the back of dry conditions throughout Queensland and poor conditions across northern New South Wales. The continued flow of cattle has seen an extra 337,000 head slaughtered in the first four months of 2014, compared to the historically high slaughter experienced over the same period of 2013 (see Figure 5).

Despite the high processing volumes, average prices remained above year ago levels throughout April and May. The eastern young cattle indicator (EYCI) increased 15% or AUc 44/kg during April and May 2014 compared to the same period last year, averaging AUD 3.44/kg cwt. Saleyards prices have come under severe pressure due to the increased supply, especially across Queensland. However, prices have been assisted by strong export demand as well as positive autumn conditions throughout large parts of southern Australia, which has seen good condition cattle coming to market.

One positive development given the extensive run of challenging seasonal conditions has been the very strong international export demand for Australian beef. Boxed beef exports have reached record levels throughout the first five months of 2014 on the back of increased slaughter. March and May saw the highest ever monthly total beef and veal exports from Australia. Total boxed beef exports for the first five months of 2014 increased 17% or 69,480 tonnes shipped weight (swt) compared to the same period in 2013. The majority of the increase has come from strong US demand (now Australia's largest single market) with exports increasing 46% or 38,823

Figure 5: Australian monthly cattle slaughter



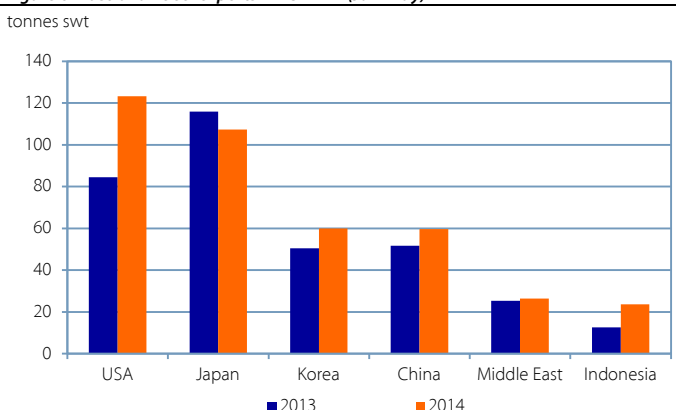
Source: ABS, Rabobank, 2014

tonnes swt YOY, to 123,300 tonnes swt. Further growth has been recorded in Indonesia (up 11,097 tonnes swt), Korea (up 9,523 tonnes swt) and China (up 7,860 tonnes swt YOY). These strong export volumes are expected to continue throughout 2014 due to strong international demand from the US, Korea and China. However, this will be dependent on rainfall and seasonal conditions, particularly throughout Queensland (see Figure 6).

Demand for live exports in 2014 remains strong led by large volumes destined for Indonesia. In the first quarter of 2014, a total of 248,800 head of live cattle were exported from Australia, compared to 132,422 head during the same period last year. This strong demand saw live steer prices out of Darwin reach record highs. Indonesian light steer prices averaged AUD 2.30/kg in March, compared to lows of AUD 1.50/kg in May of 2013. Demand has slowed over the last month, with prices reportedly around AUD 2.10/kg as Indonesian feedlots begin to fill and an influx of boxed beef enters the market.

However, both the short and medium term outlook for supplies and prices is dependent on one thing, rainfall. The increasing likelihood of an El Niño event eventuating will place further pressure on stocking levels and farmgate returns. The outlook for a drier Southern Hemisphere winter throughout the majority of eastern and southern Australia will likely lead to continued high throughput levels and will keep downward pressure on struggling north eastern markets.

Figure 6: Australian beef exports 2013-2014 (Jan-May)



Source: DAFF, Rabobank, 2014

Brazil

In Q2 2014, the Brazilian beef market was tested by both the discovery of a new atypical case of BSE in Mato Grosso and the growth in production costs. These two factors could result in margin reduction, particularly in feedlots.

Positive is that the timely reporting of the atypical case of BSE to the OIE assured Brazil's credibility and demonstrated a good sanitary control of the herd to the international authorities. This allowed Brazil to keep its status of 'insignificant risk' to the disease. However, the case was sufficient to result in some embargoes from countries such as Egypt, Peru and Iran, but only on the meat supplied from Mato Grosso.

The Brazilian authorities have assured that these restrictions will not affect Brazilian beef exports, since major export players have the option to continue exporting from other states. In addition, the authorities have been working to bring down the embargoes by testing about 50 animals in Mato Grosso, with all cases showing negative results for the disease. As a consequence, the OIE confirmed that Brazil does not present a risk of an outbreak of BSE.

Thus, exports remain strong and the main importers of Brazilian beef, such as Russia and Hong Kong, have not shown any restrictions. In addition, Brazil is still waiting for the outcome of negotiations with the USDA for opening the US market for Brazilian fresh beef, and they are also waiting for the reopening of the Chinese market, as both countries are experiencing

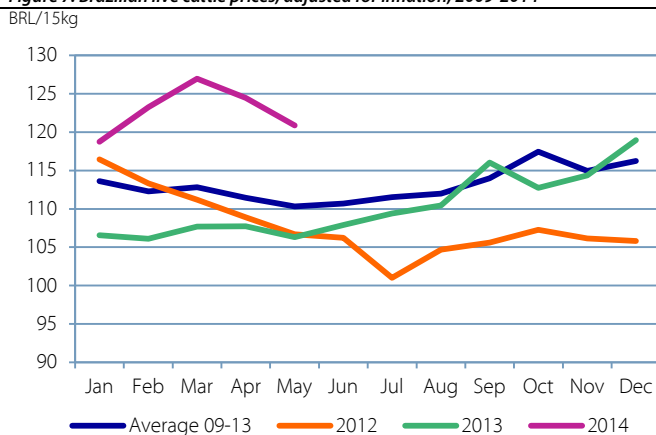
internal supply problems. According to the Brazilian Beef Exporters' Association (Abiec), both should happen in the coming months.

Therefore, Rabobank expects that exports this year will grow about 15% compared to last year, resulting in firm prices on the domestic market. Prices will also be boosted by the World Cup event, which will accelerate domestic consumption. In a recent survey conducted in São Paulo and Rio de Janeiro, almost half of respondents who stay at home to watch the games said they would eat barbecue.

The increase in exports this year and high prices in the futures market brought the expectation of an increase in the number of animals confined. However, the rising costs, leads us to believe that the increase in feedlot numbers this year should not be as large as previously expected, but will still be high at around 8% over last year. It is important to point out that only 10% of Brazilian cattle slaughter is from a feedlot, demonstrating the high growth potential in the coming years. Big players in the sector, such as JBS and Minerva Foods, believe that the Brazilian cattle industry is going through a time of intensifying technology that naturally raises the use of feedlots.

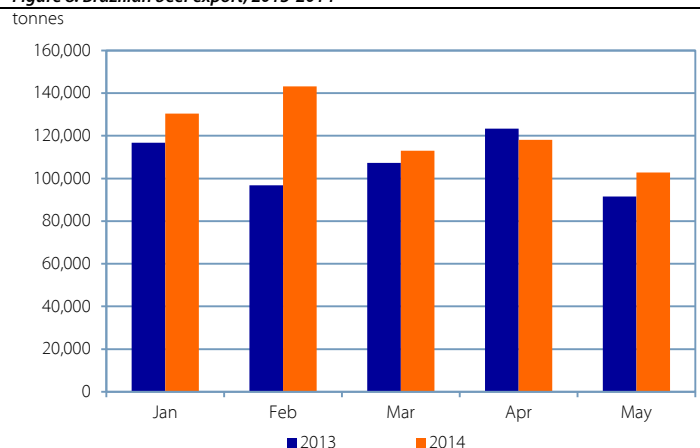
Live cattle prices have slowly decreased as the supply of beef increases in Brazil. However, given the input of the World Cup, the dry season in the Brazilian winter, as well as strong international demand, Rabobank expects prices to recover in Q3 and Q4, and should again exceed BRL 125/15 kg (see Figures 7 and 8).

Figure 7: Brazilian live cattle prices, adjusted for inflation, 2009-2014



Source: CEPEA, 2014

Figure 8: Brazilian beef export, 2013-2014



Source: ABIEC, Rabobank, 2014

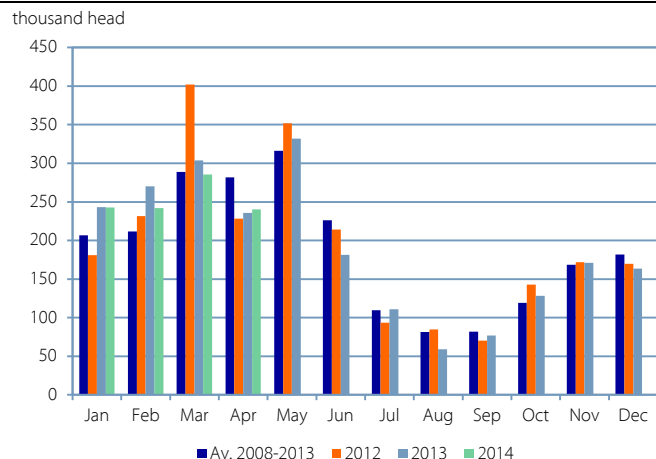
New Zealand

The fundamentals for the New Zealand beef industry remain positive moving into winter, with tightening supplies combined with strong demand supporting both farmgate and export prices. Headwinds continue to come from a high exchange rate and the sustained run of higher supplies from Australia, both forecast to remaining challenging in the coming months.

Total cattle slaughter during the first four months of 2014 declined 4% on the same period last year, to just over 1 million head (see Figure 9). The overall fall was underpinned by a decline in cow slaughter (412,488 head), which fell 15% YOY over the same period. High dairy prices and better seasonal conditions compared to the drought during the first five months of 2013 have encouraged a greater retention of cows. North Island bull price averaged NZD 4.15/kg cwt at the start of June, 5% higher than the same week last year and the highest average price since the start of 2012. There is likely further upside in prices as supplies tighten heading into winter and demand from the US, as well as robust demand from China, remains strong.

International demand for New Zealand beef during the first four months has been strong. Despite slaughter levels during the same period falling and an exchange rate that has continued to rise to uncomfortably high levels during 2014, overall exports and average export returns have increased. Shipments for the first four months of the year reached 163,599 tonnes swt, slightly higher than the same period last year. Overall average export returns have remained relatively steady throughout 2014.

Figure 9: New Zealand cattle slaughter numbers, 2008-2014



Source: New Zealand Meat Board, 2014

Canada

The Canadian cattle market has been very unusual for the year to date. Early in the year, Canadian cattle on feed totals were running as much as 10% above year ago levels. Currently, the Canadian cattle on feed total is running 8% above year ago levels. At the very same time, year-to-date feeder cattle exports to the US are currently running 44% above year ago levels, and earlier in the year were running as much as 64% above year ago levels. The bottom line is that the available supply of cattle outside the feed yard are being used at an abnormally fast pace. It is simply not possible for the exports and placements to continue at the year-to-date pace. In fact, both feeder cattle shipments to the US and feed yard placements are expected to post sharp declines during the second half of the year. The escalated use of the Canadian feeder cattle and calf supply has been driven by a number of factors. Firstly, the record price levels in the US have been drawing a lot of cattle, and secondly, the extreme winter weather caused very expensive cattle maintenance and feeding conditions. Finally, the unexpected consequences of the revised US mCOOL rules have caused an increase in shipments of feeder cattle and a modest to slight reduction in the shipments of fed cattle into the US. Prices for Canadian cattle have been as attractive as in the US.

Year-to-date shipment of Canadian cows into the US is 6% below year ago levels, suggesting that just like in the US, cow/calf producers have received the economic signal that supplies of replacement cattle of all weight categories are exceptionally tight and will remain in short supply, encouraging producers to start the expansion process.

Argentina

Cattle slaughter and production for the first four months of the year were slightly down by 0.2% and 1.1%, respectively, compared to the same period last year (see Figure 10). Although there are no official numbers for April and May as of yet, the contraction sharpened in Q2 as heavy rains throughout the period prevented the movement of cattle out of the farms. The scarcer supply supported higher cattle prices in Q2, which reached ARS 16/kg (USD 2/kg).

The difference between the contraction in slaughter and production is due to the fact that average weight at slaughter continues to decline as production is mostly destined for the domestic market, which favours lighter animals.

Beef exports for the first four months were approximately 35 thousand tonnes, 17% lower than the previous year and representing only 6% of total production. With only one month left for the closing of the Hilton Quota year, it is estimated that the target will be missed by 10 thousand tonnes (a third of the total quota allocated to Argentina).

The poor performance of exports continues to be the combined result of an uncompetitive exchange rate, a 15% export tax and the cumbersome process of obtaining export rights.

For H2, we expect production to increase seasonally, while demand will weaken as a result of the generally recessive economic environment. Cattle prices in H2 are thus expected to fall (in real terms) from the levels seen in H1.

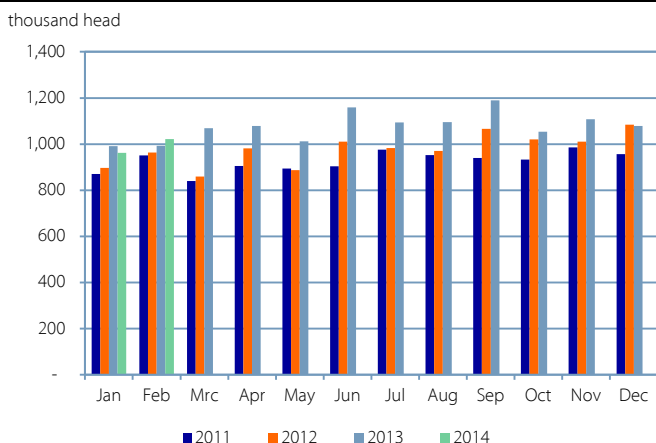
China

Tight supply continued in Q2 of 2014. As Q2 is usually the low season for meat consumption, beef retail prices have weakened since March, decreasing from CNY 63.87/kg in January to CNY 62.59/kg in May (see Figure 11). Although the prices are under slight seasonal pressure, the average retail price across the country remains at a high level, still 12% higher than the same period of 2013.

In terms of profitability spreading along the supply chain, Chinese beef farmers' profits in April 2014 decreased to CNY 1,242.2/head (each head equals 500 kg), down 24.4% compared with Q1. Slaughtering profitability increased marginally to CNY 744.2/head (up 4.5% compared with Q1).

China's beef imports reached 101,000 tonnes in the first four months of 2014, an increase of 34% YOY, but lower compared to the astonishing growth of 380% in 2013. However, even with this volume, beef imports to China are historically very high if compared to volumes prior to 2013. The average import price of frozen beef in the first four months was USD 4,368.25/tonne, down 6% YOY. This is due to the temporary sufficient supply from Australia. In the first four months of 2014, Australia remained the biggest beef supplier to China, accounting for 52.7% of the total import volume, up 50% YOY. Uruguay is still ranked second, with the imported volume of 23,912 tonnes rising 27% YOY.

Figure 10: Argentina monthly slaughter numbers, 2011-2014



Source: Rabobank based on IPCVA, 2014

Figure 11: China beef retail price, 2007-2014



Source: MOA, CAAA, 2014

Mexico

The combination of bearish feed costs, better pastures and high beef prices has given Mexican beef producers the incentive to vertically integrate operations to increase beef production. However, we expect this expansion to be marginal as the cattle herd remains constrained. At the end of this year, we anticipate beef production to increase 0.9 percent over a year ago, reaching 1.824 million tonnes.

Improvements in beef cattle margins encourage feeders to rebuild their inventories. Despite the current pressures on cattle availability we expect beef cow final stocks to grow 0.4 percent over a year ago. Most of this growth will come from new public and private repopulation projects and some cattle acquisitions from the dual-purpose operations. In addition, we expect cattle exports to the US to decline for second year in a row as Mexican feeders continue to compete for cattle against the US. In 2014, we anticipate cattle exports at 950 thousand head, down from 1 million head exported last year.

The expected marginal increase in beef cattle will not dilute the pressures on prices as the rest of the herd, particularly the dual purpose cattle, will continue to diminish.

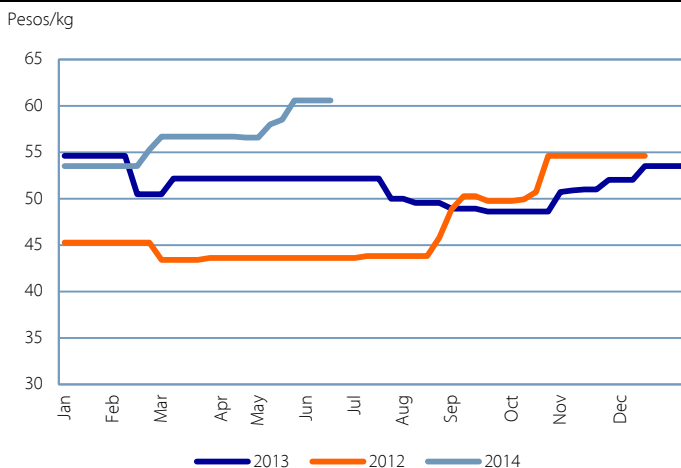
During the second quarter, cattle prices increased around 7 percent versus last quarter and rose 13 percent over year ago prices. Despite prices reaching historical highs, we believe prices have the potential to increase even further (see Figure 12).

Beef consumption remains lethargic as prices continue on the upside reaching record highs. Per capita consumption is anticipated at 15.8 kilogrammes, down from 15.9 kilogrammes in 2013. However, this decline is finding a floor as prices of other proteins, such as pork and chicken, remain strong.

Regarding trade, Mexico announced that it will open its border to US beef and by-products coming from any age slaughter cattle in that country. As a result of the tightness in US beef production, we do not expect any significant increase in exports to Mexico. At the end of this year, we anticipate Mexican imports at 171 thousand tonnes, up from 164 thousand tonnes over a year ago.

Beef exports are expected to remain sluggish as domestic prices remain stronger than prices paid in other markets, such as in the US. In addition, exports to Russia remain uncertain. At the end of the year, Mexican beef exports are estimated at 121 thousand tonnes, slightly up from 117 thousand tonnes last year.

Figure 12: Mexican beef carcass price, 2012-2014



Source: Statistics Mexico, 2014

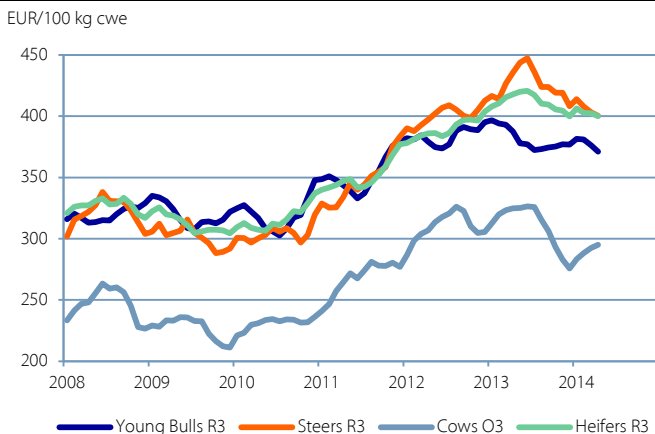
EU

In the EU, different developments can be observed between southern Europe (France, Italy, Spain, Portugal, Greece, Cyprus and Malta) and the rest of the EU. In southern Europe, slaughter numbers in the first quarter (-6.5% January to March) continued the decline of the last few years, which resulted in prices in the mentioned countries remaining stable compared to last year. In contrast, slaughter levels in north-western and eastern Europe increased by 4.0% and 2.7%, respectively, resulting in double-digit price declines in Ireland and Sweden. Total EU slaughter declined 0.8% to 6.1 million head, with production back 0.4% to 1.77 million tonnes.

With Ireland the leading exporter in the EU and despite growing exports (+10.5% January to March) and declining imports (-4.8% January to March), prices remained under pressure across the EU (see Figure 13). Only cow prices increased due to lower availability (-2.3%) both seasonally and in preparation for the quota abolition in April 2015.

EU beef prices are expected to stabilise around the current levels into the summer, with some potential upside later in the year due to the combination of stable supply, continuing strong export demand and relatively high-priced competing proteins.

Figure 13: EU beef prices by category



Source: European Commission, 2014

Indonesia

Indonesian beef prices in Q1 averaged IDR 98,500/kg, 13% higher than the previous year and 5% above Q4 2013 (see Figure 14). In Q2, prices have stayed flat compared to Q1, largely driven by good feeder cattle supply in Q1.

Although at the moment, supply seems to be plentiful and prices are under pressure in the live cattle market, supply and demand would balance out and demand will catch up to clear current inventories given that we are approaching festive month in July. There is no immediate upward pressure on meat prices and at this time we do not expect beef prices to spike up in Q3. This is in contrast with past years when the Ramadan festival period resulted in sharp price hikes.

First quarter live cattle imports jumped 147% to 137,000 head. With the Ramadan festival approaching, starting on the 28 June, Indonesia issued import permits for 273,000 cattle in Q2, up 71% over Q1 permit numbers. However, licenses will likely not be fully utilised given the strong imports in the first quarter and the current well supplied market with full feedlots. Strong Q1 supply pressured the live cattle market by 10% to 15%. However, this is not yet reflected in meat prices. Rabobank expects 2014 live cattle imports in Indonesia could surpass 700,000 head against total import of 454,152 head in 2013, an increase of 54%.

Beef import volume almost doubled to 47,700 tonnes YOY. This will likely stabilise prices throughout 2014, with some possible further pressure if demand softens as witnessed in Q1.

Figure 14: Indonesia Wholesale Beef price



Source: Ministry of Trade of the Republic of Indonesia, 2014

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