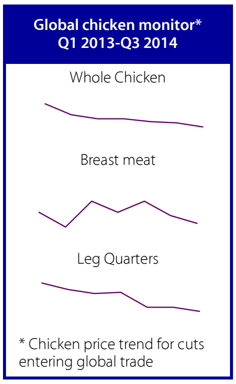
Poultry Quarterly Q3 2014

Russian ban won't derail bullish margin outlook



Further margin expansion is expected in nearly all major poultry production regions for the remainder of 2014, driven by strong poultry demand, high prices of competing proteins and the expectation of lower feed costs.

The Russian ban is not likely to alter the global outlook, but trade streams will shift sharply, with Brazil coming through as the leader and the EU and US fighting for new markets in Africa, Asia and some Eastern European markets. Prices for legs and Mechanically Deboned Meat (MDM) will fall sharply.

The local Russian and South African poultry industries will face sharp increases to prices as they operate under tight market conditions with demand likely to fall. Margins will grow significantly, but the exact level will depend on the possible establishment of a price ceiling by the Russian government.

The Russian ban will have limited impact on US and EU poultry industries as strong local fundamentals and declining feed costs will compensate for lost export volumes. The US industry will remain at record high margins, while EU industry margins will also be healthy.

Asian poultry markets will see market recovery. Supply discipline in China will support higher prices and margin recovery, despite ongoing food safety concerns and disease issues.

Global poultry markets: Bullish outlook, shifting trade streams

US: Record high margins 

- Measured supply growth
- Well-balanced market conditions
- Strong breast meat prices, lower leg prices

Brazil: The big winner of Russian ban 

- Exports drive positive outlook
- Russia exports to grow by 150,000 tonnes
- Domestic markets pressured

EU: Margin improvements 

- Strong demand, high breast meat prices
- Low EU supply, less imports
- South Africa and Russia restriction to affect trade

China: Recovery on low supply 

- Fragile recovery on low supply
- Fewer avian flu outbreaks
- Food safety scandal to affect QSR market

EMEA and rest of South America

- Russia and South Africa bullish on trade restrictions
- Argentina: Industry affected by downturn
- Middle East: Supply expansion in Saudi, and UAE

Rest of Asia:

- Japan: Low stock and China import concerns
- Thailand: Recovery driven by better Japanese demand
- India: Fragile recovery

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Global outlook

The global outlook for the poultry industry is bullish for the remainder of 2014. Strong fundamentals will promote further margin improvements in almost all regions of the world. Worldwide supply of chicken is relatively tight, while competing meat prices (i.e. beef, pork) are increasing due to low supply (see Figures 1, 2 and 3). This will provide a strong base for margin improvement, especially as the outlook for grain prices indicates further declines into 2015, driven by the positive harvest outlook for grains and oilseeds (see Figure 2). Average broiler and poultry cut prices will fall in Q4 in line with falling feed prices, but will remain high enough to keep margins strong. Fewer reports of avian influenza H7N3 (AI) outbreaks in heavily affected markets, such as China and Mexico, will provide the poultry industry in these markets a chance to move to margin recovery.

The big events for 2H are the recently introduced restrictions on global poultry trade by Russia and South Africa. Russia has banned all poultry meat, amongst other food products, imported from the US, EU, Canada, Australia and Norway, while South Africa has imposed high import levies on imports from EU membership countries, including the Netherlands, Germany and the UK, affecting almost 50% of total imports. The consequence will be a shift of 520,000 tonnes in global poultry trade (annual base, 5% of global trade volume), from which 340,000 tonnes are coming from the Russian ban and 180,000 tonnes are due to the safeguard in South Africa.

The big winners of these restrictions on trade will be Brazil, together with the local industries of Russia and South Africa, where margins will rise significantly. Consumption in South Africa and Russia may decline as prices will increase sharply in these markets. The only country which could potentially substitute some of the lost imports is Brazil. Projections indicate that it would be able to supply an additional 150,000 tonnes to Russia. Other countries such as Argentina, Chile or Thailand only have limited ability to expand their exports into Russia. We do not see other countries expanding their export volumes significantly into South Africa as most key exporters, such as Brazil and the US, already have restrictions on imports in South Africa. Therefore, the consequence will be a loss of around 350,000 tonnes in global trade volume for the next year. Exporters in the US and EU will compete to find alternative markets, and this will affect price levels, with prices for legs and MDM expected to fall. Africa, the Middle East and Asia will be on the radar for exporters, while some volumes might be moved to indirect channels for Russia via Belarus and Kazakhstan.

We do not believe this will have significant impact on the local US and EU poultry industries, as market fundamentals are relatively strong, especially in the US where the industry is again heading to record high margin levels. Exports to Russia represent only 8% of total US exports, while Russia and South Africa represent 20% of total EU exports (6% and 14% respectively). Strong fundamentals will keep white meat prices high, while dark meat prices may come under some pressure, but not at such a level that will affect margins seriously.

Figure 1: Global whole chicken and chicken cuts markets, USD/100 kg

		2013				*2014*			*change*
		Q1	***Q2***	***Q3***	***Q4***	***Q1***	***Q2***	***Q3***	***Q2-Q3***
Whole chicken	*Brazil wholesale*	192.3	154.8	146.3	159.8	141.3	142.9	138.5	-3%
	EU wholesale	255.3	257.5	264.1	258.3	264.4	267.7	263.0	-2%
Breast meat	*EU import price Brazil*	334.3	309.0	328.3	309.0	322.6	303.9	298.0	-2%
	EU import price Thailand	325.4	322.0	352.1	350.8	357.7	348.9	331.0	-4%
Leg quarters	*US leg quarters, Northeast*	114.2	117.0	113.9	96.1	94.6	95.0	95.0	0%
	Japan import price	206.7	196.7	200.4	218.1	191.5	191.8	185.5	-3%
	Russia wholesale	346.7	328.8	313.4	318.8	288.9	287.9	305.5	+9%
Feet	*China import price*	141.1	143.5	135.8	135.8	144.9	143.3	142.0	-1%
Processed chicken	*EU import price Brazil*	368.1	380.9	351.7	361.0	356.0	357.5	355.0	-0.5%

Source: Eurostat, FAO, national statistics, UBABEF, USDA, 2014

Brazil will be the big winner, and prices and margins in the industry have already increased significantly since the introduction of the Russian ban. This is a welcome situation for the industry after a period of suffering exports and weak domestic demand due to the economic situation in Brazil. Argentina will only be able to partially benefit from the new market opening, as the industry will mainly be focused on the domestic market as the result of a weak economic situation and uncompetitive exchange rates.

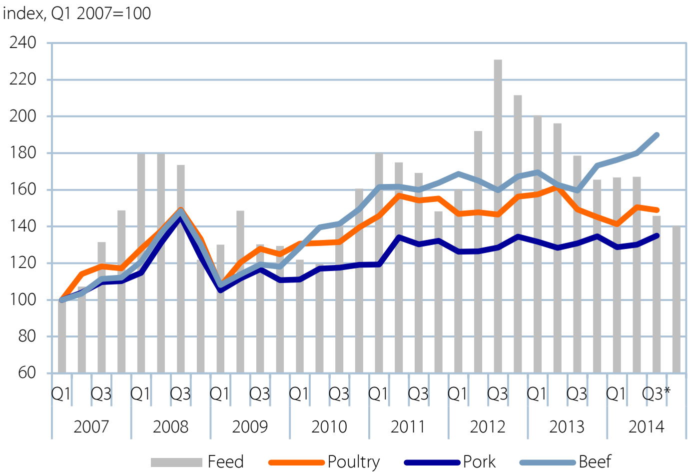
The market conditions in Asia are also turning more positive. Japan is benefiting from a stronger yen and tight local inventories. The weaker performing industries in 1H (China, India and Thailand) are now also improving, with poultry prices in China rising from the lower broiler parent stock levels. However, markets remain fragile and recent food safety scandals will again affect the Western food service market. It is Thailand who will benefit from the ongoing food safety problems in China. The Japanese government is now imposing stronger controls on Chinese imports while some processors and restaurants are shifting their sourcing from China to Thailand.

Figure 2: Global live broiler and feed ingredient monitor, Q1 2013-2014f

		2013				2014				change
		Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q2-Q3
Live broilers USD/kg	*EU*	1.24	1.23	1.23	1.17	1.21	1.22			
	Brazil	1.42	0.94	1.19	1.15	1.03	1.00			
	China	1.47	1.28	1.37	1.42	1.35	1.46			
Grains & Oilseeds	*Wheat (USD/bushel)*	736	694	650	655	617	650	560	545	-14%
	Corn (USD/bushel)	715	662	499	430	453	480	370	350	-23%
	Soymeal (USD/tonne)	420	433	445	429	447	480	405	340	+16%

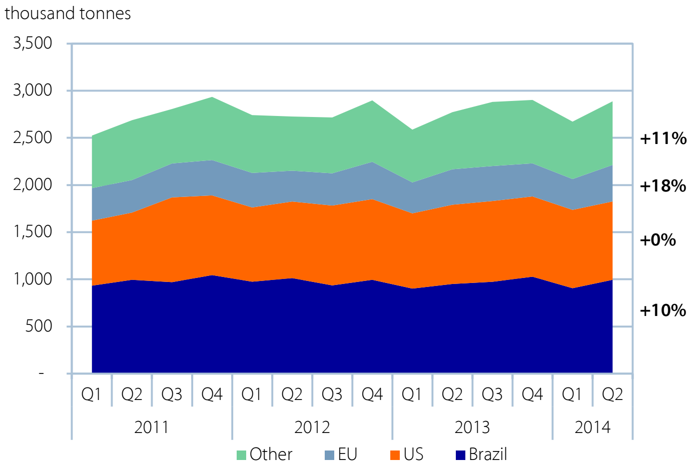
Source: Eurostat, FAO, national statistics, UBABEF, USDA, 2014

Figure 3: Global broiler, beef and pork prices versus feed cost monitor, Q1 2007–Q4 2014f



Source: Bloomberg, FAO, Local statistics, Rabobank, 2014

Figure 4: Rabobank global poultry trade monitor, 2011-2014



Source: Bloomberg, National statistics, 2014

Regional outlooks

United States

US poultry prices continued their seasonal climb in Q2 2014 (see figure 6), driven by higher breast meat values, which peaked above the USD 2/pound mark by the July 4th holiday. Breast meat prices have declined about 7% since then but remain above levels of a year ago, helping to support the overall poultry complex. Dark meat values have been more stable, with leg quarter prices hovering around USD 0.50/pound since March, and at a level similar to this time last year.

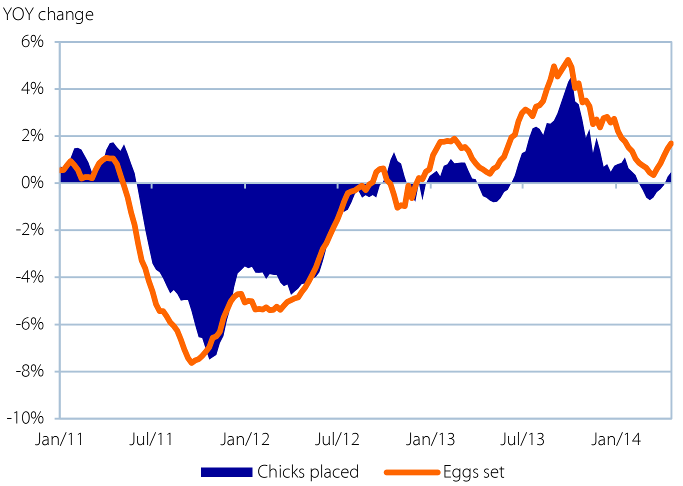
After a strong start to 2014, profit margins for the publicly traded US producers remained strong in Q2 at 10% to 11% on an EBIT basis. Current indications are that Q3 could be even better given the 15% decline in feed costs since the end of Q2, as corn prices have fallen below USD 3.50/bushel and meal prices below USD 450/tonne. As an indication of the bullish sentiment, Tyson Foods, the largest US chicken producer, expects EBIT margins of 10% which will be driven by lower feed costs and strong demand in fiscal year 2015, which ends in September.

The major question for the remainder of the year is how Russia's recently announced one year ban of US chicken, in addition to other food products, will impact US chicken prices, primarily leg quarters. Russia is relatively small to the US chicken industry at 8% of US chicken exports or about 1.5% of US chicken production, but is more significant to the US leg quarter market at 14% of leg quarter exports. We expect leg quarter prices to be weak throughout the remainder of 2014 and could very well test the USD 0.40/pound level, a 20% decline from current prices. The impact on prices will largely depend on the ability of US producers to find new homes for the leg quarter volume, which are likely to be Mexico, the Middle East and the Caribbean.

Exports up to June have been mostly in line with last year as growth in shipments to Mexico, Taiwan and Georgia have offset declines in volume to Russia and Canada. Mexico continues to grow in its share of US exports, accounting for 21% of volume YTD and now three times more than any other country.

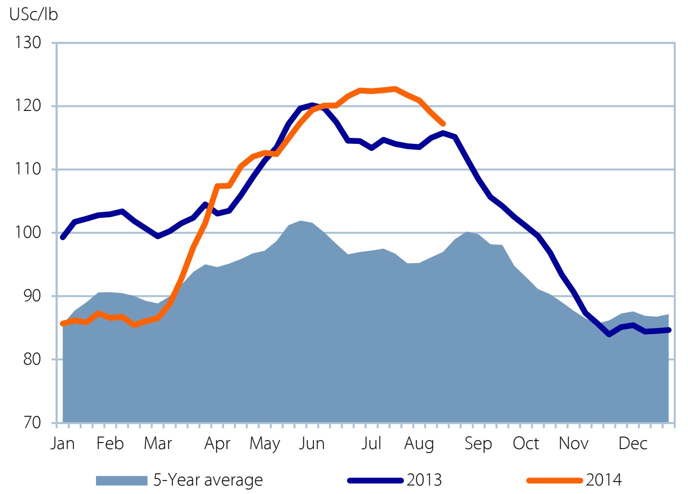
Supply growth so far this year has been quite measured, with chicken production increasing just 1.5% up to June, entirely driven by increased bird weight. We expect this level of supply growth to continue in 2H as leading supply indications of chicks placed (see figure 5) are flat to slightly raised compared to levels a year ago. Looking to 2015, we expect a larger increase in poultry production as the breeder herd rebuilding by US producers over the last 18 months finally drives supply growth. We expect chicken production to increase 3% in 2015, with most of the growth taking place in 2H. With another year of lower US beef production, coupled with uncertainty as to whether US pork producers will be hit by another round of PEDv, we expect chicken demand domestically and in the export markets to remain strong in 2015, driving another year of favourable profit margins.

Figure 5: US change in chicks placed and eggs set, Jan 2011-Jan 2014



Source: USDA, 2014

Figure 6: US composite chicken prices



Source: USDA, 2014

Mexico

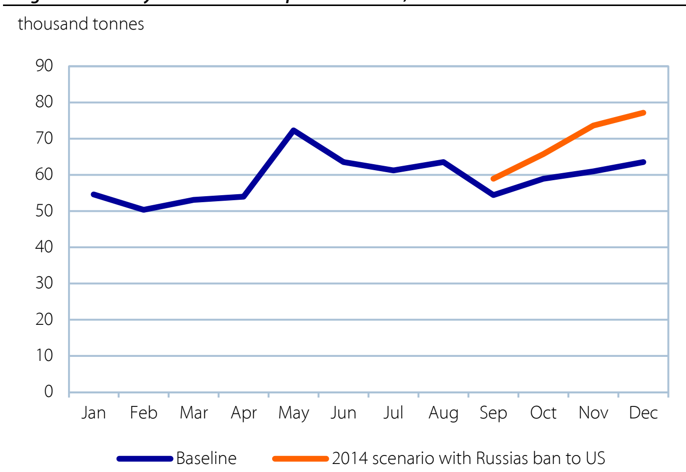
Mexican chicken production rebounded in March and April as producers tried to capture positive margins in the market. Despite bullish market fundamentals, the industry is still struggling to deal with ongoing AI, as it continues to disrupt the domestic poultry supply chain. Over the past few weeks, a significant number of parent broilers have died or have had to be culled. As a result, August production deteriorated, and we expect production to remain sluggish in Q3 and heavily challenged during Q4. Therefore, we continue to hold our previous expectation for production growth at 1.3% over levels a year ago, which will mean a very tight market again this quarter. As a result, retail prices skyrocketed in August; breast meat prices increased 20% to a historic record high of USD 8.5/kilogramme. Chicken leg quarters and chicken paste in the form of nuggets or burgers are becoming important protein alternatives to consumers. YTD chicken leg quarter imports have increased 12%, while chicken paste imports have increased 4.6% over levels a year ago.

We expect chicken prices to remain strong throughout the rest of the year. However, the Russian import ban, particularly on US chicken meat, could have a negative impact on Mexican prices, as imports from the US could increase sharply. Some of the lost US export volume could find room in Mexico, bringing domestic prices down sharply in the months to come. Earlier this year, we expected total Mexican chicken imports from the US to be at 715 thousand tonnes, but this could go up to 750,000 tonnes after the Russian ban on US chicken (see figure 7).

Brazil

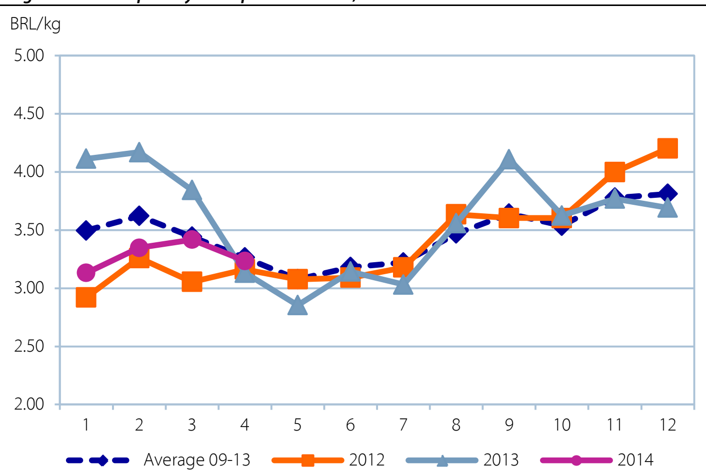
The Brazilian domestic poultry market is currently being affected by a relatively weak domestic demand due to a squeeze on consumer spending power (resulting from lower income growth and persistently high inflation). Prices at the start of Q1 had therefore been relatively low but started to grow from early July, up almost 10% as a consequence of increasing prices of competing proteins, especially beef, and also due to expectations for continued export growth. Given that grain prices should continue to decline, the overall outlook for the Brazilian poultry market in 2H 2014 is generally positive. Brazil´s total poultry meat exports increased slightly, up 0.6% by volume in 1H 2014 versus 1H 2013 (see figure 8). Nevertheless, in July, exports increased 8.3% over the same month of last year. Looking forward, the industry is optimistic about 2H export volumes, especially due to the Russian ban on EU and US exports. The industry is expected to be able to increase exports to Russia an additional 150 thousand tonnes. Other markets have also been increasing imports from Brazil. For instance, during 1H 2014, exports of poultry meat to Mexico started to gain strength. Although this represented only a very small part of total exports during the period, it is a sign that Brazil is gaining more space in the international market. Big companies will adjust their supply to the domestic market in 2H and prioritise exports. Rabobank expects that this scenario will help poultry meat prices to rebound in the coming months, possibly reaching last year's levels by late Q3 (see figure 8).

Figure 7: Monthly Chicken meat imports in Mexico, 2011-2014



Source: GCMA, 2014

Figure 8: Chilled poultry meat prices in Brazil, 2009-2014



Source: Bloomberg, 2014

Argentina

Poultry production in Argentina saw a 3% YOY reduction in the first five months of the year, after having closed 2013 with an annual growth of less than 1%, considerably lower than the 10% annual average for the past decade. The recent performance is a consequence of lower industry margins due to an overvalued exchange rate, high domestic inflation and government-controlled retail prices. Domestic consumption contracted by 2% for the same period, as a result of a general economic slowdown and continued inflation, despite the government's attempts to control prices for food such as poultry.

Exports contracted more than production for the same period, decreasing by 9% in volume and 3% in value (see figure 9). The main export destination for Argentine poultry is Venezuela (which accounts for more than half), followed by China and Chile. Evidence of the complicated situation that the poultry sector is in is highlighted by the fact that the second largest poultry company filed for corporate reorganisation under Chapter 11. Several other smaller players are in a similar situation. We expect the rest of the year to continue to be difficult for the sector, with the economy in recession but local costs still increasing by more than 35% YOY. The only relief might come with the expected further depreciation of the Argentine peso. However, the movement so far has not been enough to offset the domestic problems.

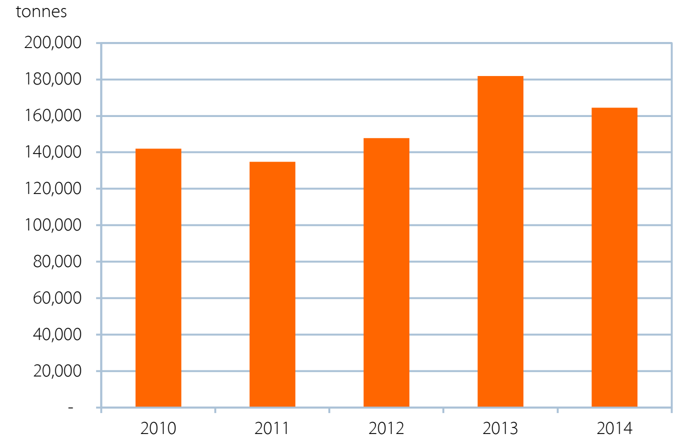
EU

The circumstances for the EU chicken market continue to remain relatively strong, driven by a combination of high demand for poultry and limited supply. Average live broiler prices in Q2 have been around 3% below last year's levels, but a particularly strong decline in feed prices in Europe (around 10% below last year's level) has helped farmers in the EU gain healthy margins (see figure 10).

Demand in the EU remains strong, as consumers tend to prefer the cheaper broiler meat over expensive pork and beef products. This is driving prices of breast meat to relatively high levels. International demand for EU poultry meat is also relatively strong, despite the expected loss of Middle Eastern export sales. Total export volume over 1H was roughly in line with 1H 2013 level of 700,000 tonnes. The EU has been able to replace export volumes to the Middle East with exports to Africa (Benin, South Africa) and Asia (Philippines, Hong Kong). As most of these markets buy lower value products, the value of EU exports declined 7%, though this was also partly caused by lower international prices than last year.

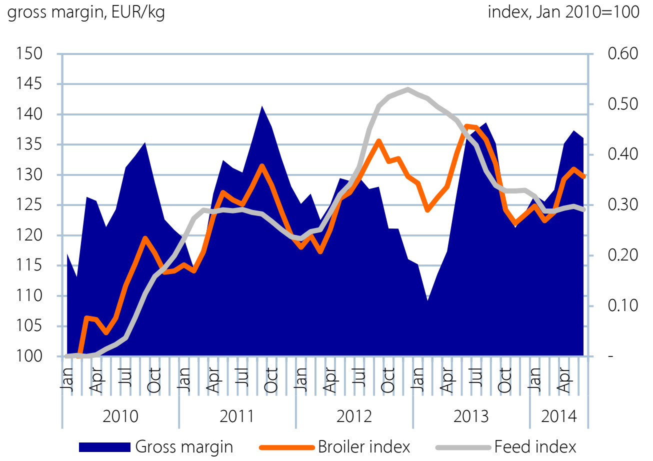
The outlook for the EU market is strong. We believe that the industry will continue to benefit from a relatively tight market (see figure 11) and high international prices for poultry and competitive meats. Supply remains restricted due to limited availability of hatching eggs, but demand is expected to remain strong. This will pay out in ongoing high prices for breast meat. The biggest support for the industry will be a further expected

Figure 9: Argentina monthly exports, 2012-2014



Source: Magyp, Ministery of Agriculture, 2014

Figure 10: Northwest European broiler, feed price and margin trend 2010-2014



Source: Eurostat, EMA, PVE, Igreca, Defra, Rabobank, 2014 decline in feed prices. EU grains and oilseed prices dropped sharply during the summer months (EU wheat prices dropped 20% since May to EUR 135/tonne, while soybean prices dropped 10% to EUR 380/tonne) and are expected to fall further in 2H. These price reductions have started to flow through to the supply chain and will result in ongoing lower feed prices in the coming months. Margins at the farming level continue to remain strong, mainly driven by relatively stable live broiler prices and declining feed costs (see figure 10). Although the months of July and August have shown some seasonal slowdown due to the holiday season, demand for poultry remains relatively strong in the EU and is supporting the relatively high white meat prices in the EU.

One concern is how the industry will adjust to the new restrictions on EU exports set by South Africa (special safeguard levies on Dutch, German and UK exports) and by Russia (ban on poultry meat imports for one year). These markets represented around 20% of the EU's export volume over 1H 2014, especially for leg quarters and MDM. We expect EU exporters to shift export streams to Africa and Asia (Philippines and Hong Kong) as they have already successfully begun to over the last two years. As export streams adjust, price pressure on these product categories can be expected, but this will not be significant enough to alter the bullish outlook for the industry.

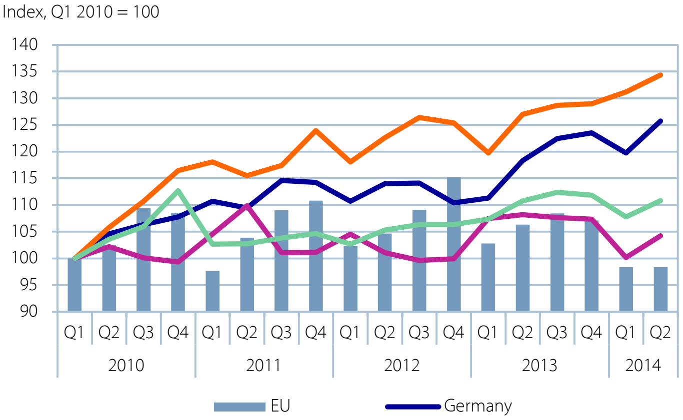
Russia

After one year of disappointing performance, the Russian poultry industry is again operating under very bullish market conditions. Russian broiler prices increased 20% between March and July (see figure 12) and the outlook for Q4 is significantly more bullish since the introduction of the import ban on products from the US, EU, Canada, Australia and Norway.

The price hike in Q2 was caused largely by the banning of pork products from the EU after the reporting of ASF cases in Eastern Europe. The EU pork exports represented 12% of total domestic supply in Russia before the ban, and alternative exporters have not been fully able to replace the EU volumes. This has resulted in a tight Russian meat market, with sharply increasing pork prices (20%, see figure 13) as consumers shift to cheaper broiler products. The profitability improved significantly in Q2, despite an ongoing increase in domestic feed prices (+10% in Q2, see figure 12). This feed price increase differs from global trends and is despite an expected good crop harvest in Russia of, for example, 57 million tonnes of wheat. The main reason for this is the weak Russian ruble, which pushes grain exporters to export against competitive prices and leaves domestic supply relatively more expensive. Vertically integrated protein companies with their own land banks will benefit under this current market environment.

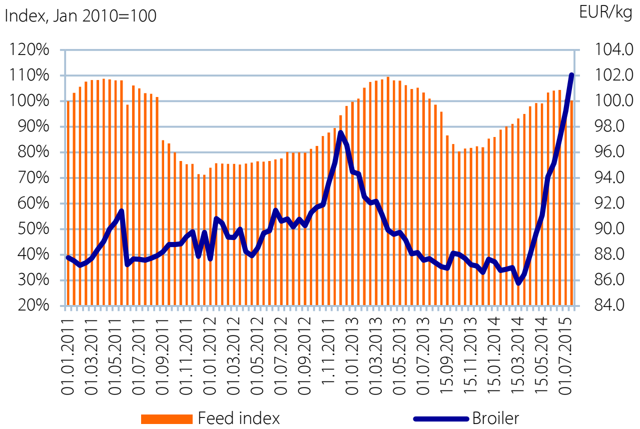
The outlook for the Russian poultry industry is very bullish in 2H after the recently implemented one year ban on poultry products from the US, EU, Canada, Australia and Norway. These

Figure 11: Quarterly production for the EU and for individual countries, 2010-2014



Source: Defra EMA, Eurostat, Itavi, PVE, 2014

Figure 12: Russia broiler and feed price index trend, Jan 2011-Jan 2014



Source: Rostat, 2014

countries (mainly the US and EU) together represented 8% of Russian domestic supply, and the lost volumes of 350,000 tonnes will only be partially replaced by Brazil (from 50,000 tonnes to 150,000 tonnes).

The Russian industry should also be able to increase production to full capacity and, together with new capacity currently entering the market (like Akashevskaya and Donstar), this could further help to replace the lost export volumes. However, we do not believe it could fully replace the lost imports from the US and the EU. The consequence will very likely be a 2% to 3% reduction in consumption over 2H because of the lack of availability of chicken. This pressured demand, together with the already pressured demand in the pork sector, will likely mean a very bullish market situation in the meat market in 2H. The additional impact of the ban on the pork and beef markets will be limited as the EU and US were already banned in the pork sector and the EU represents only a minor part of imports in the beef sector, while the US was already banned. The main impact will come from the ban on Canadian pork (2%) and EU beef (1%).

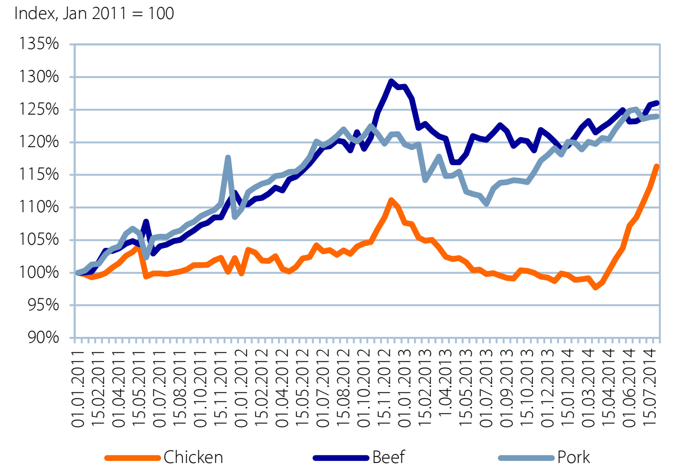
The level at which prices will increase will depend on the government's reply to the market situation, and if they will implement price ceiling mechanisms in the market, which is currently being discussed with the industry. The final impact will also be determined by the level in which trade streams will move exports to informal routes via Belarus and Kazakhstan. Upcoming new projects, which are expected to come into the market in 2H 2014, might further relieve the impact of the ban.

South Africa

The South African poultry industry has also been hit by large volumes of imports during Q2, but thanks to a reduction in domestic production (-1.6% compared to Q2 2013), the total market impact has been lower as this occurred during the large oversupply periods of 2013. The industry has been anticipating the long period of pressured margins by reorganisation via plant closures or by mergers and acquisitions. This has resulted in a more balanced market situation in South Africa, along with an improvement in industry efficiency.

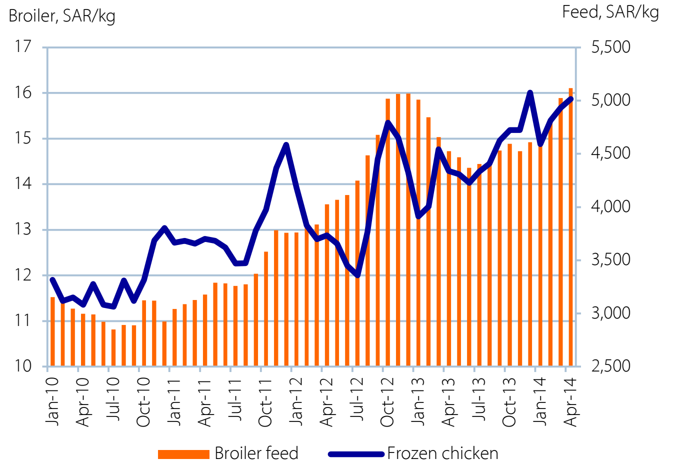
This better market balance in South Africa has pushed prices up from less than SAR 15/kilogramme to SAR 16/kilogramme (see figure 13). This did not fully pay off by resulting in better margins as feed prices also increased by 600 SAR/tonne over the same period, due to a tight domestic corn supply. The outlook for the South African poultry industry is bullish for 2H on lower than expected feed prices and less imports. In particular, the implementation of anti-dumping tariffs on imports from the Netherlands, the UK and Germany of roughly between 22% and 70% will reduce imports significantly. These three countries have been responsible for 46% of the imports in South Africa over 1H. Total imports in South Africa are expected to fall significantly in 2H. Other potential supplying regions, such as Brazil and the US, have limited room to replace EU exports, as they have already been affected by anti-dumping measurements. The outcome of these new anti-dumping regulations will be higher local prices. South African industry will benefit from better margins, as grain prices will also drop further.

Figure 12: Russian meat prices, 2011-2014



Source: Rostat, 2014

Figure 13: South Africa broiler and feed price trend, 2010-2014



Source: SAPA, 2014

China

Entering Q3 2014, Chinese consumers' concern over AI is fading, as limited new cases have been reported. Poultry markets are showing signs of recovery, with increasing prices in both live bird (CNY 10/kilogramme in Aug, up 20% YOY) and retail price (CNY 19/kilogramme, up 20% YOY) (see figure 14). Day old chick (DOC) prices have shown stronger growth, from CNY 1.7/bird in March to CNY 5/bird in August, showing the relatively tight supply of DOC in the market after self-regulated initiatives.

The self-regulated initiatives have been imposed by the alliance of white-feathered bird companies, which consists of over 50 top poultry companies. One of the initiatives is to substantially reduce production capacity within the whole industry. As a consequence of this initiative, imports of pure-bred chickens in 1H decreased sharply by 40% YOY, to 500,000 sets. The alliance decided in June that a 10% further reduction would be made in July and August in order to strengthen the effect of the initiative. These reductions have had a positive impact on market recovery, driving prices to enter an upward trend since the beginning of Q3. However, whether the initiative can last longer term is still questionable. This will require the joint effort of all the participants within the industry.

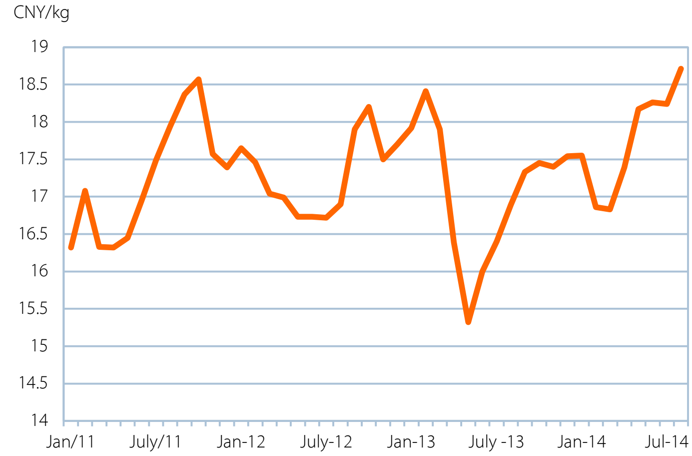
Other than self-regulated supply, another important driving force for poultry prices is the price of pork. The poultry price movement is always associated with pork price, as poultry is the major substitute for pork in China. Entering July, pork prices started to climb due to the large sow liquidation in Q1 and Q2. Strong pork prices are expected to last through the rest of 2014 and into early 2015, due to the combined factors of peak season and tight supply. This will give poultry prices strong support in the coming months.

Although China's poultry market has been hit by many food safety issues in recent years, the recent scandal related to expired meat found in a plant of one QSR supplier seemed to have a limited impact on the consumers' perspective of poultry products in general. However, the scandal did have a very negative impact on the performance of Western-style QSRs. As the affected plant also supplied the Japanese market, the suspension of the operation drove QSRs to turn to other regions such as Thailand for supply. This had a positive impact on Thailand's poultry industry, which has been experiencing difficulties due to oversupply.

Farming profitability has improved greatly due to rising market prices. The profit margin was CNY 1.8/bird in the week of August 11, a great improvement compared with CNY 0.03/bird in early April. However, as feed prices are expected to rise in 2H 2014 due to the continuously rising minimum procurement price for corn, the farming profitability will have limited room for further improvement.

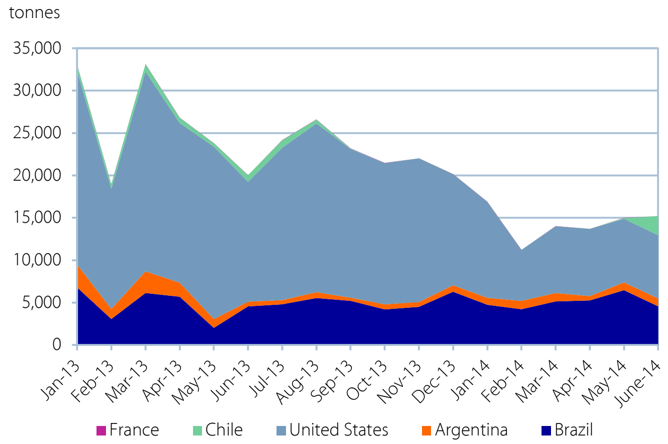
In 1H 2014, imported poultry products decreased 30% YOY to 217.5 thousand tonnes (see figure 15). Brazil and the US remain the major suppliers, altogether accounting for 92% of the total. In terms of product category, frozen chicken feet decreased sharply by 47% YOY, while chicken wing imports remained strong, with a slight increase over the previous year.

Figure 14: Chicken meat price in China, Jan 2011-2014



Source: CAA,MOA, 2014

Figure 15: China monthly chicken feed imports by country



Source: CAA, 2014

Japan

The Japanese poultry industry still operates under bullish market conditions Local supply is still relatively tight due the depreciation of the Japanese yen, which has made imports relatively expensive (see figure 16). This has particularly affected raw chicken imports which fell to a new low of 190,000 tonnes in Q1 2014; the lowest quarterly import level since 2010. The result of this is very low stock levels in Japan, and in Q2 their trading houses were forced to import poultry (230,000 tonnes) to restore some stocks in the country. Trading houses now pay around JPY 230/kilogramme for legs, 10% below Q1 prices but still significantly more than in Q2 2013 (+10%).
Local producers benefit from the tight local market situation via higher local prices. This has not stimulated production expansion as Japanese monthly production is still moving around the long-term level of 55,000 tonnes.

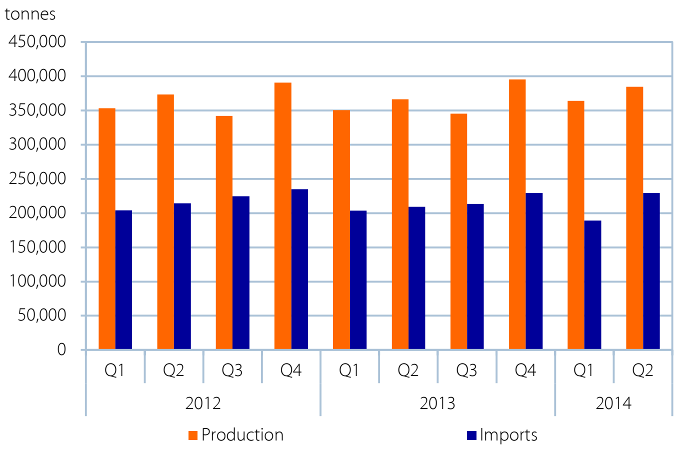
The outlook for the industry for 2H remains bullish with ongoing low stock levels in the industry and limited impulses from the local industry to expand. Local price levels will generally remain high, further supported by an ongoing weak yen, which will keep imports relatively expansive. The downside to the weak yen is high feed prices in Japan.

From a trade perspective, a further shift in sourcing from China to Thailand can be expected after the recent food safety scandal in China. This has pushed the government to impose stricter controls on chicken imports and some companies, such as McDonald's, have shifted their sourcing entirely to Thailand.

Thailand

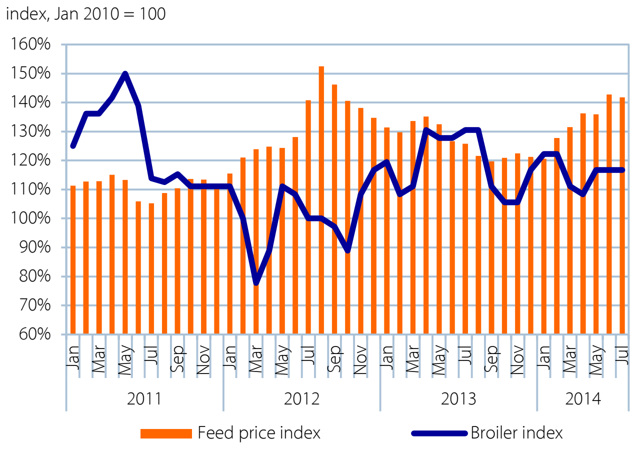
The Thai chicken industry performance is still affected by oversupply after the return of Saha Farms to the market, while export volumes were disappointing, especially in Q1, with almost 10% less exports than last year (see figure 17). Q2 market conditions were significantly better and a sharp increase in export volume of 145,000 tonnes has led to a new record 1H export volume of 275,000 tonnes. Japan has driven this growing demand for Thai chicken after the opening of the market for Thai raw chicken earlier this year, and by the problems in China, such as animal disease outbreaks and food safety issues.
The outlook for the Thai industry is increasingly more bullish, driven by an improved position in the Japanese market and higher pork prices in the domestic market. The recent food safety scandal in China has pushed the Japanese government to raise controls on imports and food processors, and restaurants chains are now shifting sourcing from China to Thailand. We therefore believe that the industry should be able to reach their 570,000 tonne target, even taking into account the relatively weak EU demand for Thai chicken.
This stronger international demand for Thai products, together with high prices for competitive proteins such as pork, will provide the Thai industry with some room for margin recovery. Some expected relief in feed prices in line with international expectations will be an additional support for the industry. A key wildcard will be disciplined supply management by the Thai industry. Previous bullish market conditions were destroyed by overambitious supply expansion.

Figure 16: Japan domestic supply 2012-2014



Source: Alic, Rabobank 2014

Figure 17: Thai broiler price versus feed monitor, Jan 2011-July 2014



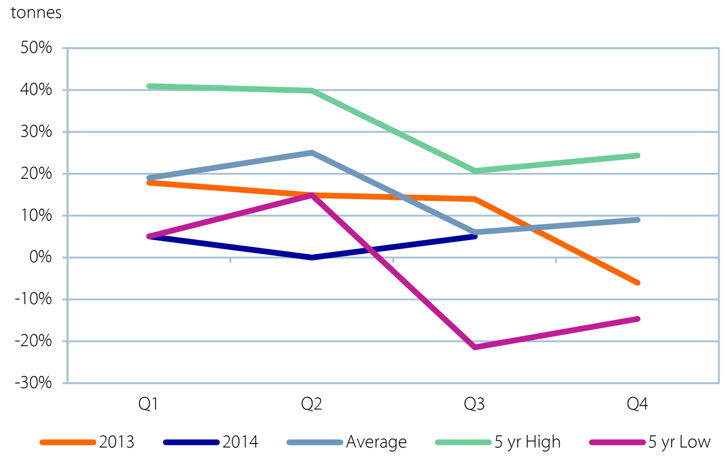
Source: Bloomberg, Rabobank, 2014

India

The performance of the Indian poultry industry was difficult in Q2, with minimal positive margins (see figure 18). The outlook for Q3 margins is better, despite the traditional low consumption levels in August and September due to several religious festivals. Improved prices as a result of better managed production levels, together with a decline in meal prices have kept the profitability positive and just marginally below the five-year average. Demand in Q3 will remain subdued due to further religious festivals. However, better demand can be expected in Q4.

In July, the Indian government allowed duty-free imports of soymeal, which will last until 31 December. However, due to the lengthy process, it is unlikely that significant volumes will move despite Indian domestic soymeal prices maintaining a premium of more than USD 150/tonne over CBOT Soymeal price. The current crop planting has been 10% lower than last year but crop production can still surpass last year's 11 million tonnes provided the weather stays supportive until the harvest. Improved crops and a correction in the global soymeal market could suppress domestic meal prices, creating favourable conditions for the industry in Q4. Corn prices are also expected to ease under the influence of a global decline in prices. Lower feed prices could help industry growth in Q4. However, to achieve annual growth of 8% while maintaining profitability in 2014 would be a challenge.

Figure 18: Indian poultry operating margin, 2013-2014



Source: CLFMA, NCDEX, Rabobank, 2014

In an interesting development, the Indian Ministry of External Affairs has suggested allowing the duty-free import of American chicken legs (currently India has 100% duty on frozen cuts) as one of the considerations in return for the US allowing Indian basmati rice, pomegranate and table grapes. Although currently there is no decision on this, such a move could on the one hand be seen as a benefit to QSR and modern trade, but on the other, poultry producers and the wider industry will be wary of it.

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