



Rabobank

Poultry Quarterly Q3 2015

Avian Flu Shuffles the Poultry Trade Deck Chairs

Global chicken monitor*
Q1 2013-Q3 2015f

Whole chicken



Breast meat



Leg quarters



* Chicken price trend for cuts entering global trade

Global market conditions are strong, and the poultry industry is benefiting from ongoing bullish market fundamentals, with balanced supply in most regions, high beef prices and low feed costs. With China as a major exception, the industry is profitable in almost all major regions in the world.

Worsening global economic conditions have little negative impact on the poultry industry due to its value position relative to beef and pork. In many markets (such as Brazil, Thailand, Indonesia, India and Russia), consumers have traded down from expensive red meat products to cheaper poultry, which is lifting per capita consumption.

Avian influenza (AI) remains a major concern for the global industry, with new outbreaks in most regions in the world except Australia and South America. However, the number of outbreaks has been lower in the previous months, and this offers the industry in these regions some time to recover.

Global trade volumes reached 2.8m tonnes in Q2, matching last year's record high, with major changes in trade streams as Brazil and Thailand took over big volumes from the US (due to AI restrictions and a strong US dollar), Argentina and China (due to food safety concerns). Prices for legs have been under heavy pressure in the US, while chicken feet prices in China are sharply increasing. Rabobank expects this trend to continue under current volatile trade conditions. FX volatility will have an ongoing strong impact on global trade.

The outlook for late 2015 and 2016 is bullish, as feed prices are still expected to remain at low pricing levels and global breeding stock supply will be very low in countries with AI-related import restrictions, such as China and South-East Asia. The situation in China is made more interesting, as it is coupled with historically low pork supply. The spread of AI to key US chicken production areas is a major wild card for the industry outlook.

Global poultry markets: avian influenza outbreak to hit regional markets

US

- Strong margins despite avian influenza trade bans
- Bullish domestic market compensates weak export markets after AI-related export restrictions
- AI expected to re-emerge in the fall—key broiler production areas in the south-eastern US will be at risk



Brazil

- Weak local economy leads to trading-down effect, lifting poultry consumption
- Trade flows reach all-time highs due to favourable real against US dollar and trade restrictions on many key competitors



EU

- Strong market conditions with healthy market balance and restrictive supply growth
- Weak euro compensates negative impact of AI-related trade restrictions on exports
- Imports down further 7%, especially from Brazil, although Thai imports are up



China

- Some improvement in poultry markets due to increasing pork prices
- Fragile conditions with ongoing oversupply of DOC and weaker economy
- AI-related low breeding stock will lead to market upturn in 2016



Russia

- Improved performance due to lower feed costs and price support from high beef and pork supply
- Prolongation of export ban and wheat tax
- Consolidation process to continue



Rest of the world

- Mexico: industry recovery with high fertile egg imports
- South Africa: better margins challenged by rising imports
- Thailand: fragile performance, record-high exports
- India: well performing industry with lower feed costs

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Published by the Global
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Team.

Lead authors:
Nan-Dirk Mulder
Chenjun Pan
Will Sawyer

For a full list of authors, see
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Global outlook

The margin outlook for the global poultry industry is still strong, with ongoing strong fundamentals like continuing high beef prices, low feed costs and strong demand (see Figures 1 and 2). This has led to a situation in which industries in almost all major production areas in the world are profitable.

The current worsening of economic conditions—especially in emerging markets in Asia and Latin America—has little serious negative impact on the chicken industry. Chicken is the cheapest meat protein, and consumers logically shift from more expensive proteins like beef and pork to chicken in times of economic downturn. This sort of trend is currently visible in Brazil, Thailand, Indonesia, India and Russia.

The US industry is still making record-high profits, but export-focused companies have started feeling the negative impact of trade restrictions set by trade partners. The EU and Mexican industries are currently doing relatively well, whereby the Mexican industry benefits from some oversupply of breeding stock in the US due to trade restrictions in Asian countries. This gives them some room to recover production faster than

expected. The Russian and South African industries are benefiting from restrictions set on imports. Both industries have therefore seen an upswing in their local markets. In the case of South Africa, the AI-related restrictions are slowly easing, and this will challenge the industry performance in the longer term. The pending opening for US exports will further challenge the outlook of the industry. The Russian outlook is improving after the prolongation of the sanctions on exporters like the EU and the US, and the wheat export tax. This will support margin levels in the next months.

Global trade has been heavily impacted by AI and exchange rate volatility. Although global trade volumes have again achieved the record-high levels of Q2 2014 (2.8m tonnes), market shares of major exporters have changed markedly (see Figure 4). The market share of the US has especially declined after a 7% drop in exports in the previous quarter, compared to last year, but Chinese (-7%) and EU exports (-3%) in Q2 were also relatively weak compared to last year. The big winners over this period were Brazil and Thailand. Brazil took over several of the lost US markets in Asia and especially China, while Thailand gained market share from Brazil in Europe and replaced a significant part of the former Chinese exports in Japan, due to food safety

Figure 1: Global whole chicken and chicken cuts markets (USD/100kg), Q1 2013-Q3 2015

		2013				2014				2015			Change
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q2-Q3
Whole chicken	<i>Brazil wholesale</i>	192.3	154.8	146.3	159.8	141.3	142.9	148.3	144.3	123.6	112.0	98.0	-13%
	<i>EU wholesale</i>	255.3	257.5	264.1	258.3	264.4	267.7	254.7	229.8	210.3	209.4	214.3	+2%
Breast meat	<i>EU import price Brazil</i>	334.3	309.0	328.3	309.0	322.6	303.9	296.7	283.8	257.5	257.5	253.7	-7%
	<i>EU import price Thailand</i>	325.4	322.0	352.1	350.8	357.7	348.9	339.9	345.6	328.4	340.3	331.2	-3%
Leg quarters	<i>US leg quarters, North-East</i>	113.6	116.4	113.2	95.5	94.0	95.0	108.4	100.8	87.0	76.2	57.6	-24%
	<i>Japan import price</i>	206.7	196.7	200.4	218.8	191.5	191.8	203.8	210.0	180.2	172.9		
	<i>Russia wholesale</i>	346.7	328.8	313.4	318.8	288.9	288.1	307.1	234.4	195.6	225.6	181.9	-19%
Feet	<i>China import price</i>	141.1	143.5	135.8	135.8	144.9	143.3	149.1	149.6	160.0	220.2		
Processed chicken	<i>EU import price Brazil</i>	368.1	380.9	351.7	361.0	356.0	357.5	333.9	323.6	302.3	301.6	306.9	+2%

Source: Rabobank analysis based on Eurostat, FAO, national statistics, UBABEF, USDA, 2015

Figure 2: Global live broiler and feed ingredient monitor, Q1 2013-Q3 2015f

		2013				2014				2015			Change
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q2-Q3
Live broilers USD/kg	<i>EU</i>	1.24	1.23	1.23	1.17	1.21	1.22	1.15	1.05	0.94	0.95	0.95	0%
	<i>Brazil</i>	1.42	0.94	1.19	1.15	1.03	1.00	1.07	1.02	0.82	0.75	0.75	+1%
	<i>China</i>	1.47	1.28	1.37	1.42	1.35	1.46	1.60	1.34	1.28	1.18	1.16	+7%
Grains & oilseeds	<i>Wheat (USD/bushel)</i>	736	694	650	655	617	650	528	556	524	504	515	+2%
	<i>Corn (USD/bushel)</i>	715	662	499	430	453	480	359	372	385	365	375	+3%
	<i>Soymeal (USD/tonne)</i>	420	433	445	429	447	480	395	368	338	315	335	+6%

Source: Rabobank Agri Commodity Market Research Outlook, Eurostat, FAO, national statistics, UBABEF, 2015

concerns on Chinese supply in Japan. The strong export demand for products from Thailand and Brazil has offset the relatively weak local market conditions for the industries in these countries, but there are still concerns as to whether some key competitors will return to these markets faster than expected.

In line with the changes in global trade, prices for poultry cuts have been very volatile. Especially chicken leg prices have dropped sharply in markets that are open for US supply, as US exporters have taken significant price concessions on their trade to gain market access in new markets in order to replace closed markets. However, prices for chicken feet in China are rising sharply as the local market experiences a tighter situation after the disappearance of US supply. This offers new opportunities for exporters who can sell directly into China or via Hong Kong. Global breast meat prices are keeping relatively high levels and are a driver of the relatively healthy performance of the poultry industry in the EU and the US.

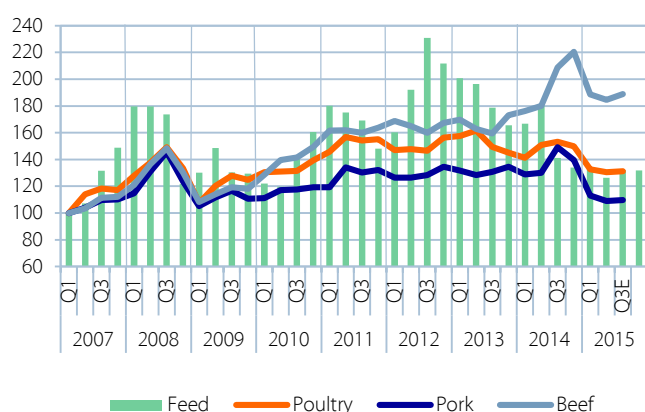
The biggest exception in the bullish global market environment is China. The industry is still struggling with a shrinking market situation in which consumers moved away from chicken to red meat after several food safety scandals and AI outbreaks. The market conditions are now slightly improving, especially because of higher prices of pork, but conditions are still fragile. This tough market situation has resulted in ongoing declining import levels (also partly due to trade restrictions), but also a sharp decline in export volumes, whereby the loss of a significant part of the high-value processed chicken exports into Japan and Thailand is concerning. The longer-term outlook is better, but improvement will be driven by expected low pork supply and the consequences of the restrictions on imports of

breeding stock from the US and EU. This will lead to a very tight Chinese meat and poultry market later this year and especially in 2016. Such a market situation should be beneficial for the local industry, especially at the farm and breeding levels. But whether processors are able to benefit is uncertain, as upward pricing power will be limited under current worsening economic conditions. A tight meat and poultry market will be beneficial for traders with access to the Chinese market.

Looking further forward, the outlook is expected to remain strong, as major fundamentals (i.e. feed costs, beef price, demand) are expected to remain bullish for poultry.

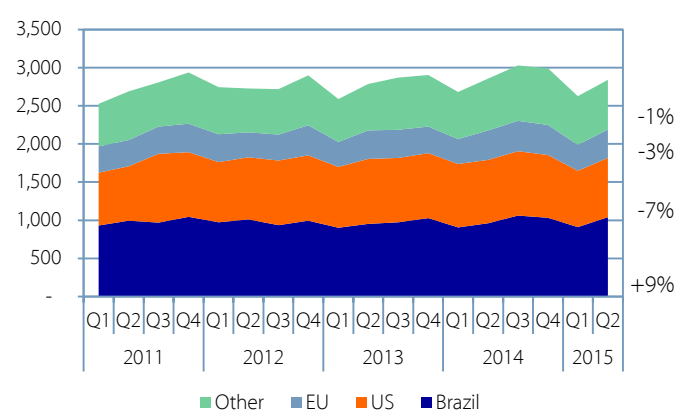
AI will remain a major concern for the coming years, and the industry needs to work together with local governments and international organisations to adjust their industry structure and business models to be prepared for a situation of ongoing pressure from disease outbreaks. AI will be a major source of volatility in the coming period, and in the short to medium term, the expected short supply of breeding stock, especially in Asia, will have a big impact on local and global markets. Global poultry meat trade will keep growing, but trade streams and prices will remain volatile. Countries like Brazil and Thailand are expected to further benefit from these situations, as long as they can stay free of AI. Returning exports from currently closed regions in the US and the EU could again cause a lot of volatility in trade streams. Exchange rate volatility, and especially an expected strong US dollar, will have an ongoing impact on trade streams with a challenging position for US traders.

Figure 3: Global broiler, beef and pork prices vs. feed cost monitor, Q1 2007–Q2 2015*
index, Q1 2007=100



Source: Bloomberg, FAO, local statistics, Rabobank, 2015

Figure 4: Rabobank global poultry trade monitor, 2011-2015
thousand tonnes



Source: Bloomberg, national statistics, 2015

Regional outlooks

United States

The US poultry industry continues to experience good margins, despite the export bans caused by the largest outbreak of AI in US history, as indicated by the robust margins reported by the publicly traded producers. The three publicly traded poultry producers reported average operating margins of 13.5% for Q2, which is the best performance for that quarter we have seen in the last decade. This performance is indicative of the continued strong domestic demand for chicken, as well as the material improvements in operating performance they and the rest of the industry have made in recent years (see Figure 5).

The key question for the back-half of 2015 and into 2016: to what degree will AI impact exports—and possibly supply—this fall? With the movement of the virus (from the US West Coast at the end of 2014 to the Midwest in early 2015) being driven by the seasonal patterns of migratory birds, the reoccurrence of the virus this fall as birds migrate from the northern Midwest to southern states seems almost inevitable. While we do expect AI to reemerge this fall, we are hesitant to assume that it will materially impact poultry supply as it has in the turkey and table egg industries this year.

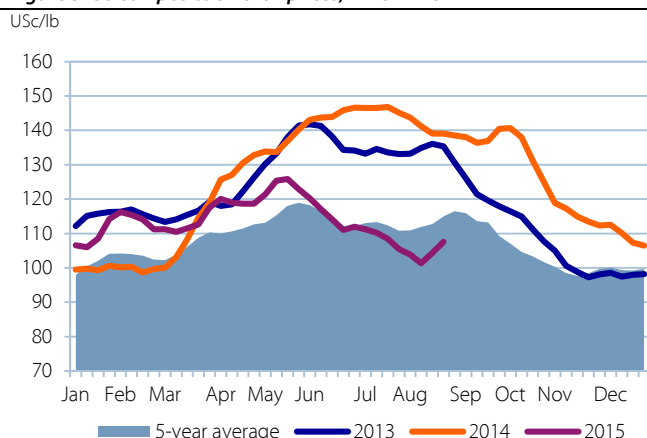
In the northern Midwest—where the virus impacted dozens of table egg and turkey farms—chicken producers did not show a single case. We do not necessarily attribute this to better biosecurity practices, but to species and industry factors in broilers that significantly reduce the risk of infection including: shorter life cycle; smaller farm size, reduced on-farm labour; and reduced depopulation time. We see all of these factors working

to reduce the risk of an outbreak if and when AI moves into the key broiler production region of the US South-East. While we see the risk being lower for broilers, the losses would still be detrimental to producers, and thus the need for heightened biosecurity practices across the poultry sector is evident.

Even though the supply impact of AI is most apparent in the turkey and table egg sectors, the trade impact can be clearly seen in US exports. On a volume basis, exports are down nearly 9% in the first half of the year, which may not seem like a lot. But when you take into account that leg quarter values today are half of what they were a year ago, the stress in US poultry exports is clear. This is partly due to the fact that the US dollar has strengthened by between 20% and 25% against most major currencies, and even more than that against the Brazilian real. To make matters worse, many of the US' chief trade partners have banned US product outright, or banned product from the states where cases of AI have been found. It has been two months since the last cases of the virus, which could lead to the end of some of the trade bans. This would help improve trade volumes. However, we do see a reasonable probability of the virus reemerging by early Q4, making the reopening of markets short-lived.

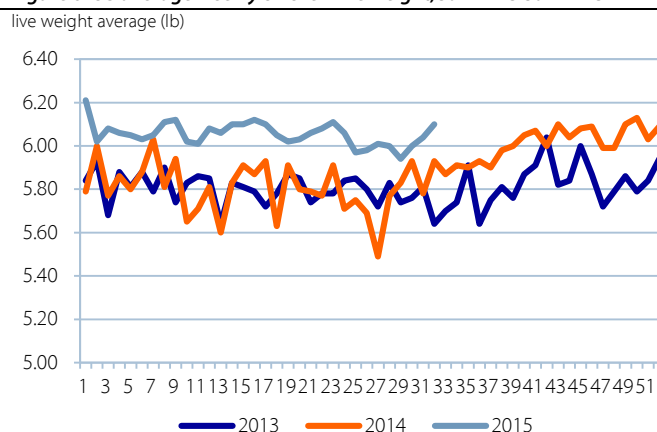
We expect the rate of production growth seen in the first half of 2015 to continue in the back half. In 1H 2015, poultry supply increased 4.2%, with an almost equal split between increased bird weights and numbers (see Figure 6). With recent trends in eggs set and weights, the indications are that the rate of growth will continue. Still, the lingering question is whether the reemergence of AI this fall and winter will lessen any of that planned supply growth.

Figure 5: US composite chicken prices, 2013-2015



Source: USDA, 2015

Figure 6: US average weekly chicken live weight, Jan 2013-Jan 2015



Source: USDA, 2015

Mexico

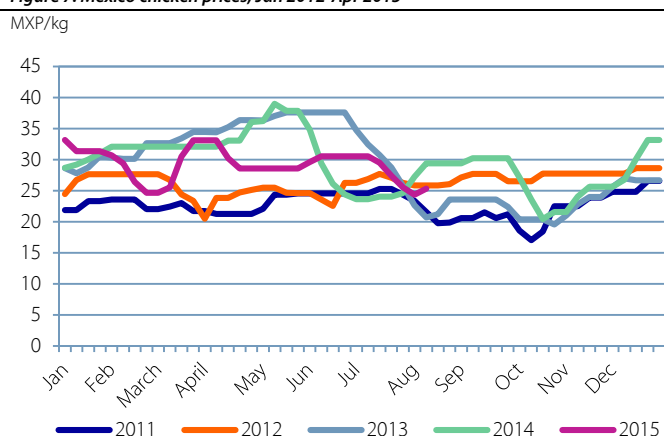
Mexican chicken production continues to rise at a fast pace, and will likely exceed our old expectation of 1.9% growth for this year. Industry consensus is anticipating annual growth above 2.5% at the end of the year. There are three factors supporting that increment. First, the grandparent and parent stocks began to fill in the gap that AI generated. Second, fertile eggs and day-old chick imports rose 40% and 70%, respectively, during the first half of the year. Third, live broiler weights at slaughter have increased, yielding 3.2kg, up from an average of 2.8kg to 3kg.

The Mexican chicken production chain remains highly dependent on imports. This year, we expect more than 25,000 tonnes of fertile eggs will be imported. As a result, at the end of the year, around 25% of meat production will come from imported fertile eggs, up from 15% last year.

Chicken supply remains ample. In addition to the rise in production, chicken imports have increased. During the first five months of the year, fresh and frozen chicken meat imports have increased 25% and 3%, respectively, over a year ago. During the same period, leg quarter imports rose 25% annually.

Chicken consumption is growing at a slow pace due to the availability of cheap pork in the past three months. The chicken industry did not reply to this adequately, and as a result, chicken meat prices have underperformed, declining only 1% over a year ago (see Figure 7). We expect consumption to rebound towards the end of the second half of the year, as we anticipate pork prices to rise.

Figure 7: Mexico chicken prices, Jan 2012-Apr 2015



Source: GCMA, 2015

Brazil

After a weak start in 2015, Brazilian poultry prices have finally sustained levels above the average of last year's. In July 2015, the wholesale chilled chicken price in São Paulo was around 2% above July 2014 in inflation-adjusted terms (see Figure 8). This has happened on the back of high beef price levels during a difficult year in the Brazilian economy, which has encouraged a change in consumers' behaviour towards cheaper meat options, resulting in a strong domestic consumption of chicken.

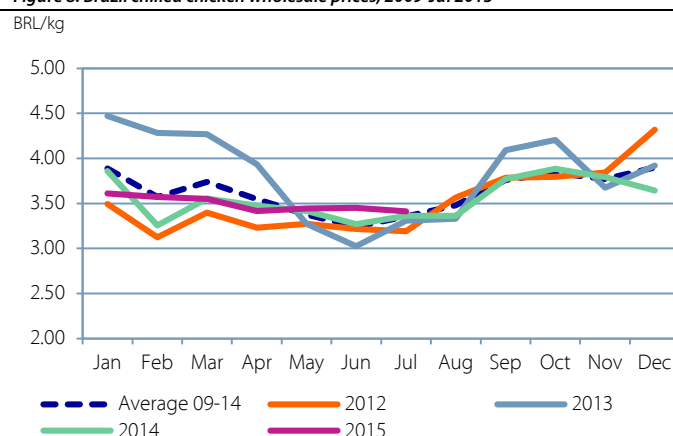
In addition, during the first seven months of 2015, Brazilian poultry exports were more than 5% above those of the same period in 2014. It is important to mention that this significant growth in exports has taken place in different parts of the globe. To put it into perspective: during this period, South Korea increased its poultry imports from Brazil by 100%, compared to the same period in 2014. Additionally, Brazilian poultry exports to Russia increased by around 83%, and to China by around 41% (see Figure 9).

Saudi Arabia—the largest destination for Brazilian poultry—also increased its imports by 16%, which means an additional volume of 60,600 tonnes during this period to that country alone. Brazil has been benefiting from both a weak currency and the international scenario, with competitors facing serious trade challenges in dealing with AI.

On the other hand, other important destinations have decreased their Brazilian poultry imports. During the period of January to July 2015, exports to the EU declined by 7.5% and to Hong Kong by almost 25%, compared to the same period last year.

However, Brazilian poultry exports have found different places to continue their growth path. An important sign that Brazil is

Figure 8: Brazil chilled chicken wholesale prices, 2009-Jul 2015



Source: Bloomberg, 2015

better positioned in the international market has been sales to Mexico, which have already reached more than 17,000 tonnes during the period of January to July 2015.

Regarding the domestic market: despite the weak Brazilian GDP performance this year—anticipated to decline between 1% and 2%—poultry consumption is expected to increase between 3% and 4% in 2015. This dynamic has been a result of the high beef price levels that have encouraged increased chicken consumption.

Looking forward, prices are expected to continue above average levels during 2H, assuming that the ratio between beef and poultry will continue to benefit poultry consumption. Moreover, Brazilian poultry exports are also expected to continue to grow as a result of the weak real against the US dollar, coupled with the AI trade challenges competitors face.

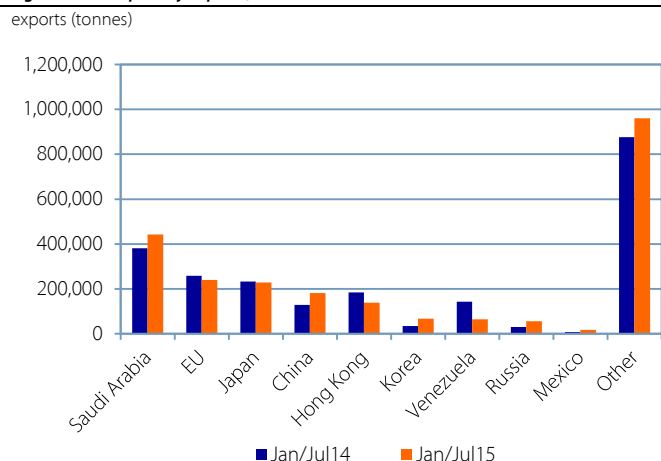
EU

The poultry market is relatively strong, with a good balance between supply and demand (see Figure 11). Domestically, EU demand remains strong, with relatively high breast meat prices. Some parts of the EU (i.e. the Netherlands, Germany, the UK, Italy and Hungary) have been challenged by restrictions on exports from regions with AI outbreaks earlier this year. The negative trade impact is compensated by a weak euro, which increases the competitive power of EU exporters, and further compensated by some shifts in trade from banned regions in north-western Europe to open markets in southern Europe.

Although total export levels remained relatively stable over the first half of 2015 (only 1% growth), prices of exported products for EU exporters increased, from EUR 1.38/kg in 2014 to EUR 1.47/kg in 2015. Exports to the EU's number one export destination, South Africa, are recovering (although still 12% below 2014 levels) after a weak Q1, due to AI-related export restrictions on north-western European trade. The lower export volumes to South Africa are well compensated by better exports to African countries—Benin (+8%), Ghana (+49%), Gabon (+40%) and Congo (+37%), the Philippines (+128%), Saudi Arabia (+10%) and Ukraine (+29%).

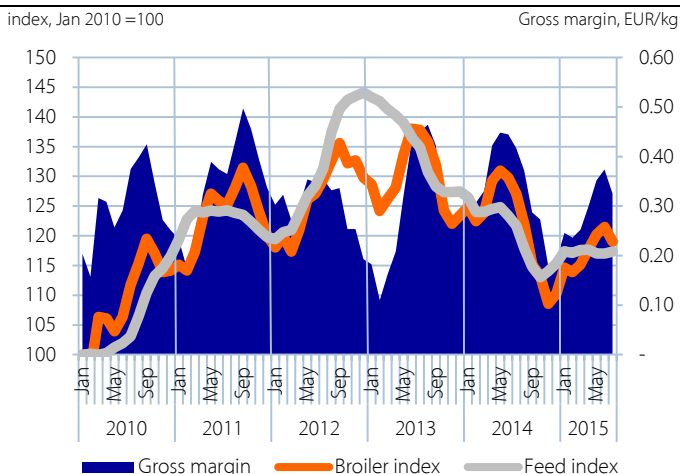
EU imports show an ongoing declining trend similar to previous years, with import volumes 7% down, compared to the last first half of the year. Within this declining import market, we see further substitution from Brazilian supply (-22%) to Thai supply (+17%). Ukraine has now become the number-three exporter to the EU, with total exports of 16,000 tonnes.

Figure 9: Brazil poultry exports, Jan-Jul 2014-2015



Source: SECEX, MDIC, 2015

Figure 10: North-western European broiler, feed price and margin trend, Jan 2010-May 2015



Source: Bloomberg, 2015

Total EU production in Q2 was 2% larger than the same quarter in 2014 (see Figure 10). This underlines the stage in which the EU industry is recovering from very tight market conditions in Q1 (with 0.9% less chicken, compared to last year) as a result of AI culling.

The acquisition of Moy Park, the UK's leading poultry company, by JBS from Marfrig was a major event for the EU in Q2. This is a new step in the EU consolidation trend, which means the entrance of the world's biggest meat-and-poultry company in the EU poultry market. JBS also owns large poultry businesses in Brazil, Mexico and the US.

Margins are still relatively strong in the EU poultry sector, and we expect this trend to continue in the next quarters (see Figure 11). The balanced market situation has helped the industry to pass on the temporary increase in feed prices during June/July.

The outlook for the EU poultry industry remains relatively strong. The key fundamentals (i.e. market demand, supply growth discipline, price position compared to red meat and feed costs) for the EU poultry industry are expected to remain strong. AI remains one of the major wild cards for the outlook, as does an expected tight corn supply in the EU. If the EU is forced to buy from the world market, it will impact costs, as an ongoing weak euro makes imports relatively expensive.

The risk of AI outbreaks in Europe might increase again in the next few months, when the weather becomes cooler. Any new outbreaks could affect market conditions in the EU, especially for exported products. The potential negative impact can be offset by ongoing strong global conditions for poultry, with lower feed grains prices and an expected balanced supply/demand situation in the EU, with strong local demand and limited supply growth.

Russia

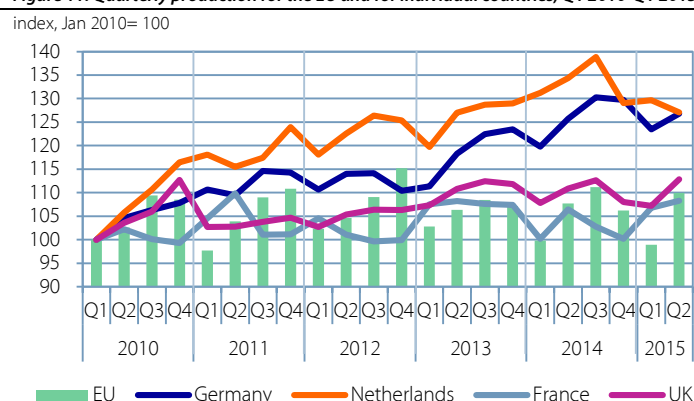
The Russian poultry sector is recovering after a weak start to 2015 (see Figure 12). Domestic poultry prices have stabilised after a steep fall (-8%) between December 2014 and April 2015. This better market situation for the industry has been driven by relatively better demand for poultry during the summer months and price support from ongoing expensive beef and pork, for which prices are still near record-high levels in Russia. The news that the Russian government expanded the sanctions on several big potential exporters for another year has also supported price levels in Russia.

From a cost perspective, feed prices have fallen sharply in Q2, especially due to better weather conditions for Russian wheat production and the prolongation of the wheat export tax, which will keep wheat prices in Russia affordable.

These more favourable market conditions are pushing margins up again, and this is a welcome relief after the weaker quarters seen earlier this year. The better conditions have led to a new investment wave in the Russian poultry industry, with the biggest step set by CP, who announced the acquisition of Severnaya poultry, while Rosagro entered the poultry industry via the acquisition of Mikhailovsky Broiler, a company from Russia's far east.

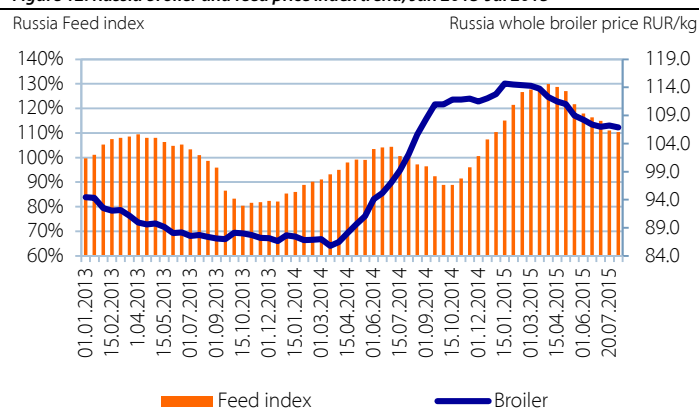
The outlook for the industry is positive. It should be able to benefit from the improved conditions, with ongoing high beef and pork prices, and better than expected local grain supply. The major downside is Russia's economic situation, with weakening exchange rates, which make imported products like grains, genetics and equipment more expensive. On the positive side, demand should benefit from poultry's favourable price position. This is why we believe the expected 8% expansion should be adequate to keep margins at an acceptable level.

Figure 11: Quarterly production for the EU and for individual countries, Q1 2010-Q1 2015



Source: Eurostat, EMA, Igreca, Defra, Rabobank, 2015

Figure 12: Russia broiler and feed price index trend, Jan 2013-Jul 2015



Source: Rostat, 2015

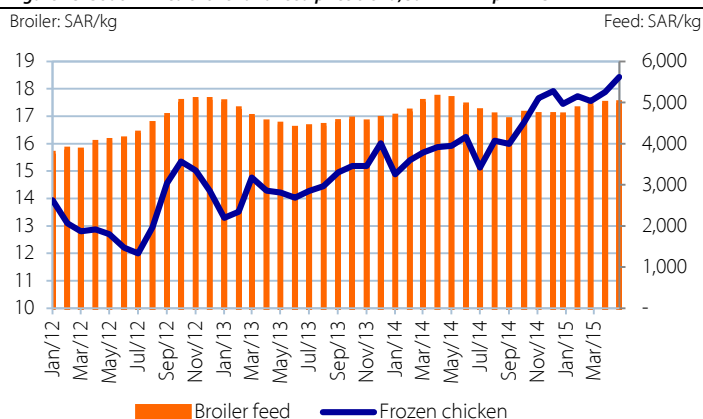
South Africa

The South African poultry industry is still performing well. Prices for poultry meat are currently around 10% above last year's levels, while feed prices have increased less (8%), compared to the same period last year. This favourable market situation is still a follow-up of the restrictions on imports from north-western Europe due to AI outbreaks earlier this year. This has resulted in—especially in the first months of 2015—a relatively tight market situation in South Africa, with steep rising prices.

The market situation has now turned after a reopening of imports from the EU, with a sharp increase of imports over the last four months (see Figure 13). Total import volumes for 1H 2015 reached the highest level in many years. This should have had a significant impact on margins, but the ongoing restrictive supply growth in South Africa has kept markets in balance. The poultry industry has reduced supply between Q2 2014 and Q1 2015 by 1% to 2% per quarter. Several poultry facilities have been closed in this period, while others are running at a lower capacity utilisation level. The better market conditions have encouraged the industry to expand production in Q2 and Q3 by 1.5% and 0.8%, respectively, but this is still in line with market balance.

The industry outlook is less bullish than in the previous months. If import volumes keep growing, it will lead to oversupply. The agreement to reopen poultry imports between South Africa and the US (which still has to be worked out) is an additional concern. Under these uncertain market conditions, a restrictive supply growth of the industry is important in order to at least keep markets in balance.

Figure 13: South Africa broiler and feed price trend, Jan 2012–Apr 2015



Source: SAPA, 2015

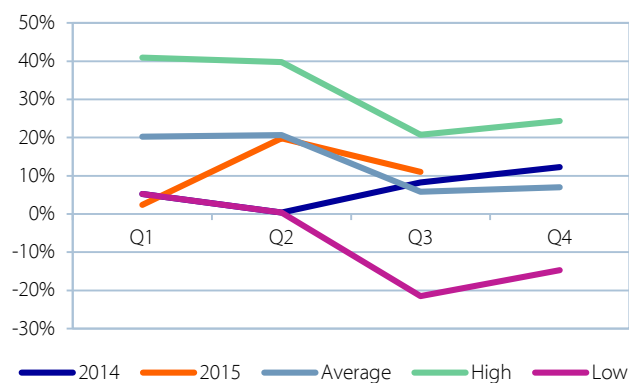
India

The Indian poultry industry has performed better in Q3, despite usually weaker market conditions in this period due to various non-meat consumption occasions. The poultry price remained steady through the first half of Q3 and held at INR 80/kg before softening down to INR 60/kg in August. Despite high prices in early Q3, the overall average price remained at similar levels to last year (see Figure 14).

Driven by the higher live bird prices in Q3, profitability remained above the average of the last five years for a similar period. However, margins are expected to come under pressure by the end of Q3. For the remainder of the year, demand pick-up will remain sluggish, driven by a slower economy. Also, soymeal prices softened throughout Q3, but corn prices started firming up. The growing corn belt in the south needs better rain in order for the expected large crop to materialise, which would eventually cool down prices. Soymeal prices stayed soft due to a large carry-over of soybean stocks from the previous year and improved planted acreage for the current crop season. With no real threat to the crop at the moment, India could start the 2015/16 marketing year with more than 10m tonnes of soybeans. This would probably push India to export soybeans to the world market—but with current high price levels in India, prices need to be reduced to be in line with international markets.

The poultry supply situation was helped by higher mortality in the summer months (May–July), which made supply relatively tight. Looking forward, the industry will see improved demand in Q4, coupled with softer feed prices. Oversupply risk has been reduced, but has not completely gone away. Despite slower demand, the industry could grow at 4% to 5% in 2015.

Figure 14: India indicative operating margins, Q1 2014–Q3 2015



Source: ALIC, 2015

China

China's poultry prices have had many ups and downs in recent months (see Figure 16). Entering July, poultry prices started to pick up, driven by the rising pork prices. However, the upward trend is greatly pressured by the weak market and the adequate supply. Dressed chicken price at the wholesale market was USD 2/kg, up 10% compared with the previous month, but still 10% lower than the same period in 2014. The performance of each segment along the supply chain varies greatly. Breeding business is still below the break-even point, as DOC prices in 2015 have mostly been lower than production cost. Actually, the prices of DOC have fluctuated wildly in recent months, reflecting supply and demand's different views on the market. Compared with breeding, the farming sector is improving profitability, as the DOC price is low and feed grain price is also weak. Slaughtering and processing has had mixed performance. Players based on spot market tend to have better performance than integrators or companies having fixed offtake contracts.

While the weak poultry market is starting to show some positive signs, a real turnaround of the market situation has not yet been seen. The economic slowdown and AI outbreaks continue to pressure the poultry market. Fortunately, there will be more positive factors in the coming months. The pork supply shortage and the strong pork prices are expected to continue, and will favour cheaper poultry demand. Moreover, the peak season for meat consumption is just around the corner, with the approaching National Day and Mid-Autumn Festival in September and October, respectively. Moreover, following the ban of US poultry products in January 2015, China sharply decreased imports of grandparent stock in the first seven

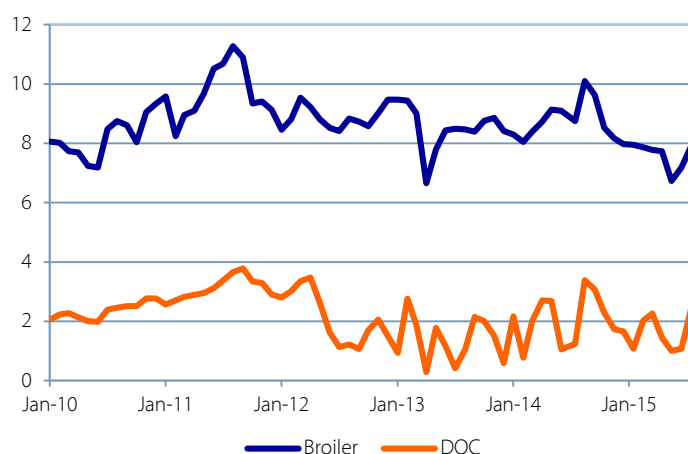
months of 2015. The imported volume of white-feathered grandparent stocks was 326,500 sets, down 40.2% compared with the same period of 2014. For the whole year of 2015, the imported volume is forecast to be 600,000 to 700,000 sets, down between 42% and 49% compared with 2014. This will result in great shortage of grandparent stock, followed by poultry supply in 2016. Therefore, poultry prices are expected to stay at high levels from September 2015 throughout 2016.

AI continues to impact the market. In August, there were two new AI cases reported in two provinces. This resulted in the culling of close to 100,000 birds in the affected region, even though it is not very common for the AI virus to spread in very hot weather. Disease remains the long-term issue for China's poultry industry. Consumers in regions in which live bird markets used to be the major distribution channel still need some time to adjust to fresh and chilled poultry products.

In the first half of 2015, imported poultry products (excluding breeders) decreased by 5% YOY, to 207,000 tonnes in total (see Figure 16). In terms of product category, imports of frozen chicken feet and other frozen cuts have decreased by 19% and 22%, respectively, while imports of chicken wings have increased by 30%. Brazil has become the largest supplier to China, after the ban on US poultry imports.

Figure 15: China DOC and live chicken price Jan 2011-July 2015

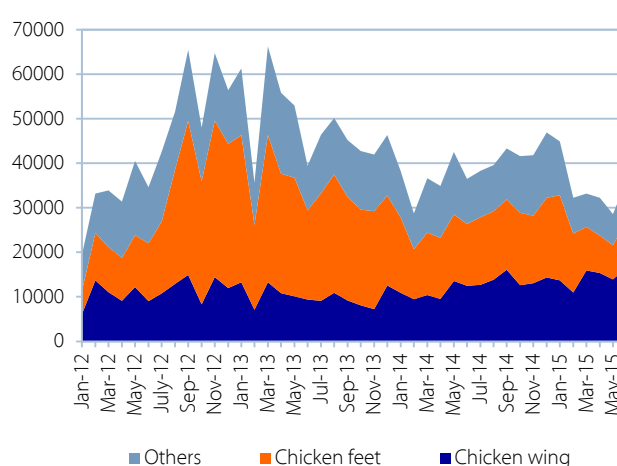
CNY/kg



Source: MOA, Rabobank, 2015

Figure 16: China poultry imports, Jan 2012-Jun 2015

monthly imports (tonnes)



Source: China Customs, Rabobank, 2015

Japan

Japanese market conditions remain strong, based on strong fundamentals, with ongoing high demand for imported chicken, beef and pork, and limited domestic supply growth (see Figure 17). Imported bone-in leg prices in Japan have increased 5% in Q2 2015, compared to Q1, while breast meat prices went up by 8%. Domestic Japanese demand for chicken keeps rising, with a 5% increase in demand over the first half of this year, which is a consequence of consumers shifting from expensive beef to the cheaper poultry.

The limited domestic supply growth has kept Japanese stock levels at historically low levels. Under normal conditions, supply would have been compensated by increasing imports. Although imports are currently at record-high levels in Japan—with a total volume of 440,000 tonnes over the first half of 2015—this has not led to a significant improvement of the stocks in Japan. The high import volumes have been a pretty unique achievement, as trading houses have been shifting supply from China to Thailand in response to rising food safety worries about Chinese supply after several food safety scandals in the previous years.

The outlook for the Japanese poultry sector remains positive. The strong demand for chicken in Japan supports both the local industry (fresh chicken) and import demand (frozen products). High competitive protein prices, together with low stock levels, provide the industry ongoing pricing power, and this should pay off in ongoing strong margins. Brazil and especially Thailand are well positioned to benefit from these bullish market conditions, and exports are expected to remain strong in the next months.

Thailand

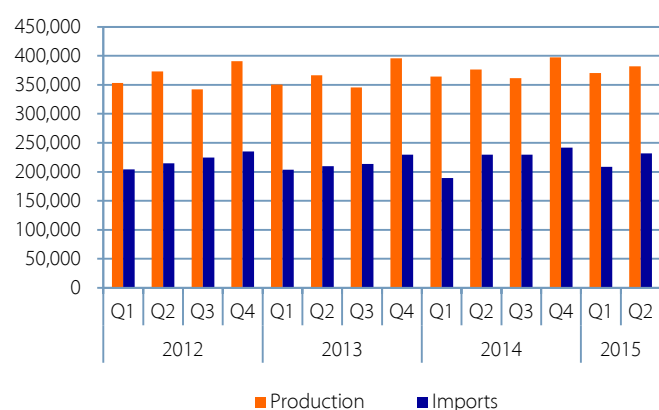
The Thai poultry industry has had an exceptionally strong second quarter of 2015, due to a very high level of exports to Japan, in particular. Several Japanese importers further substituted imports from China to Thailand, and this has led to a 43% higher export volume to Japan over the first half of 2015. Total Thai export volumes have increased 64,000 tonnes, to 325,000 tonnes, of which 44,000 tonnes went to Japan, 10,000 tonnes went to the EU and 9,000 tonnes went to other destinations. Demand for raw chicken is strong, and total raw chicken export volume from Thailand has grown by 85% over the first half of 2015, to 103,000 tonnes, thanks to the reopening of imports by Japan last year. The export of processed meat has grown by 8%, to 222,000 tonnes.

Local market conditions are less bullish due to weaker economic conditions and falling prices for competitive proteins like shrimp and pork. This limits the pricing power of the Thai poultry industry in the local market (see Figure 18).

Average margins for the Thai poultry industry are still challenged, but improving with support of the bullish export markets. In the coming period, export markets should be the driver for margin recovery, but weak local markets and ongoing abundant supply limits pricing power. The recent depreciation of the Thai bhat could support Thailand's export power in the industry, and this should support further margin recovery.

Figure 17: Japan domestic supply, Q1 2012-Q2 2015

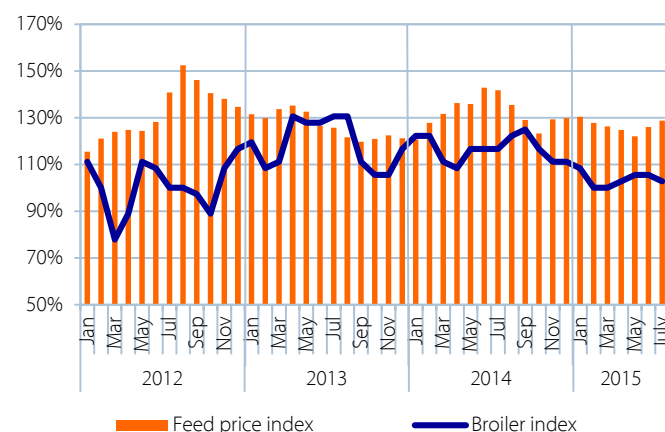
monthly imports (tonnes)



Source: Bloomberg, 2015

Figure 18: Thai broiler-to-feed price monitor, Jan 2009-Jul 2015

index, 2009=100%



Source: Bloomberg, 2015

Indonesia

Industry prices increased significantly in Q3 on the back of improved demand due to the Ramadan in July (see Figure 19).

Poultry prices have increased by 14% in Q3. The industry profitability was further supported by the lower feed prices.

Margin pressure softened, but still remains, despite recent months showing positive margins driven by lower feed prices and higher bird prices. One of the key reasons for the increase in poultry price was the rise in beef prices, which makes poultry more attractive to consumers.

DOC price remains below levels seen earlier this year. Although they have increased by 20% since June, prices still remain 15% lower compared to Q2 2014. Lower prices are also a signal of supply remaining strong in the DOC market. The industry still has overcapacity and needs to maintain supply discipline in the coming months. Feed prices finally corrected by 14% from Q2 to Q3, supporting the producers.

Demand for chickens is expected to stay stable in Q4. However, overcapacity still exists in the market, and excess placement negatively impacts industry margins. Many industry players have come under margin pressure over the last year, which could help in lowering placements by players.

The Indonesian government has reduced the corn import quota to 3m tonnes, against last year's 3.1m tonnes. According to the industry, this will result in the escalation of domestic corn prices as demand remains higher. Although the global outlook for feed grains is expected stay at a lower level, domestic corn price could remain firm due to government regulation.

Figure 19: Indonesia chicken price, Jan 2013-Aug 2015



Source: Bloomberg, 2015

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

Global strategist – Justin Sherrard
justin.sherrard@rabobank.com

Europe – Nan-Dirk Mulder
nan-dirk.mulder@rabobank.com

Europe – Gorjan Nikolik
gorjan.nikolik@rabobank.com

Europe – Albert Vernooij
albert.vernooij@rabobank.com

Europe – Lian Heinhuis
Lian.heinhuis@rabobank.com

US – Don Close
don.close@rabobank.com

US – Will Sawyer
william.sawyer@rabobank.com

Brazil - Adolfo Fontes
adolfo.fontes@rabobank.com

Mexico – Pablo Sherwell
pablo.sherwell@rabobank.com

Northeast Asia – Chenjun Pan
chenjun.pan@rabobank.com

Singapore – Pawan Kumar
pawan.kumar@rabobank.com

Sydney, Angus Gidley-Baird
Angus.baird@rabobank.com

New Zealand – Matt Costello
Matthew.Costello@rabobank.com

far.rabobank.com

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