FOOD FOR THOUGHT

SPRING/SUMMER 2023/24

A regular look across food, beverage and agribusiness supply chains

THE BIG PICTURE

The fourth quarter of 2023 continues to see stakeholders across Australian and global food, beverage and agri supply chains evaluating the potential impacts of food inflationary pressures. At the food production level, commodity prices have been largely down, particularly for cattle and sheep meat, as farmers destock, as well as for fresh produce, with improved growing conditions.

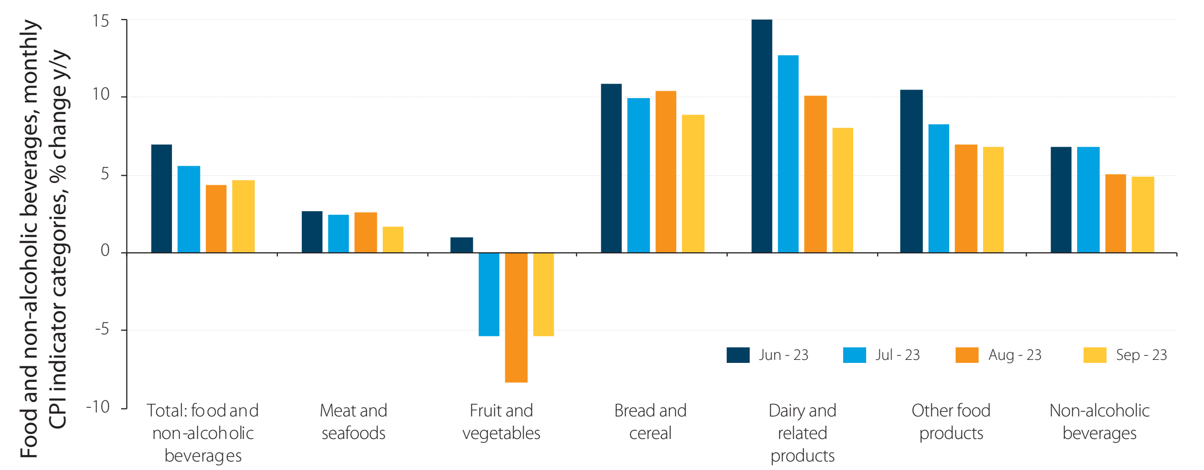
While lower input costs have been welcomed by processing industries, rising costs, especially around energy and labour, have narrowed their margins. For a number of industries, particularly in meat processing, labour shortages continue to be a challenge, although this may start to alleviate in 2024, in the wake of increased immigration levels, post the Covid-lockdowns.

At a consumer level, the impact of wider inflationary pressures, combined with the higher mortgages of many consumers, continues to impact shopper demand for different products. At a retail level, many supermarkets, butchers' shops, groceries and others have reached a point where they need to balance the ability to pass on some of the cost increases of their suppliers, while not lifting prices to a level which will turn away consumers.

Across the board in many countries, consumers are going through a trend seen in previous tighter economic times, where they are likely to more closely examine and rationalise their household food spending. This includes actions such as switching to "plain label" products, moving to cheaper types of meat (such as from steak to sausages and mince) and paring back on "luxury" food items to the household basics.

Given that inflation is forecast to potentially stay high until at least well into 2024, companies at all points of the supply chain will need to factor this into their ongoing strategies.

AUSTRALIAN CONSUMER PRICE INDEX, FOOD & NON-ALCOHOLIC BEVERAGES



Source: ABS, Macrobond, ANZ Research

FROM THE SUSTAINABILITY HUB

As regulations and opportunities, continue to evolve across the sustainability landscape, many companies continue to seek to update their own sustainability strategies. This will be a particular focus heading into 2024 as customers begin to benchmark and measure their sustainability objectives.

In particular, many companies are working on plans to measure and reduce scope 1 emissions (i.e. direct emissions that are owned or controlled by a company) and scope 2 emissions (i.e. emissions that a company causes indirectly, such as from the energy it uses). In addition, companies will be focussing on strategies for measuring scope 3 emissions (i.e. emissions which are not produced by the company itself, but by those entities with which it deals up and down its value chain), a process which will be particularly challenging for protein and grain businesses.

From a financing perspective, there is increasing focus on funding specific sustainability projects, such as bioenergy operations in meat processing companies, solar farms, as well as for upgrading to more efficient equipment across an entity.

From an investor perspective, an increasing number of investor groups are now discussing agricultural carbon projects to convert current cattle properties into soil carbon and regenerative agriculture investments to create carbon credits. There is also a lot of discussion on biodiversity, pasture/herd management and seaweed additives.

RECENT M&A ACTIVITY

In Australia and globally, mergers and acquisitions (M&A) activity and appetite remains strong across all parts of the food, beverage and agribusiness (FBA) landscape. In Australia, there is particular focus on cattle properties, all forms of protein processing, as well as grains. Notable reported and completed transactions includes:

1. Proposed merger of Viterra and Bunge;
2. Malteries Soufflet's bid for United Malt;
3. Minerva Foods purchase of Australian Lamb Company;
4. Paine Schwartz's bid for Costa;
5. Coles purchase of milk plants;
6. Cooke Aquaculture purchase of Tassal and subsequent investment into Barramundi;
7. Pupuk Kaltim's proposed deal to buy Incitec Pivot's fertilizer division; and
8. Louis Dreyfus Company purchase of Emerald Grains.

The impacts of geopolitical volatility, as well as food insecurity fears post-Covid continue to fuel growing investment across the food supply chains. In Australia, significant investment has flowed into chicken/broiler sheds, horticulture, pork and forestry.

FOCUS ON THE FEED INDUSTRY

While much focus continues on the global demand for grain and protein, it is vital to highlight the importance of the feed industry now and the fundamental role it plays in both for those industries.

In any livestock market - whether in a major developed country with large cattle, sheep, poultry and other operations, or a developing country with millions of smallholders – the feed industry has become the focal point for all protein farmers looking to maximise animal productivity and increase weight per beast, bring consistency in consumer products with texture and taste, and ensure ongoing animal health.

The feed industry has grown quietly to become a vital component of Australia's and global protein markets, bringing consistent and reliable protein production, including across beef, lamb, poultry, aquaculture, dairy and eggs. Notably, with pet ownership growing rapidly in many parts of the world, the feed industry is also vital for domestic animals.

Most consumers gain their protein from a number of different species, and can take the consistency of protein on supermarket shelves for granted. Yet behind this animal protein, there has been significant capex and investment incurred in feed to achieve optimal animal health, intestinal absorption, protein growth and tinkering with mineral and vitamin levels.

For many feed companies, their feed recipes are held in the same secrecy and reverence as generational family recipes, encompassing a mix of fine tuning of ingredients including grains, seeds, minerals, and oils.

Each element of feed is tested constantly as it moves from a raw product, through a manufacturing phase and then as a final product. Inputs are tweaked and adjusted to ensure they deliver optimal outcomes, including to animal health and welfare, as well as to overall returns.

Finally, some current industry observations:

1. Animal health and well-being is central to all feed businesses.
2. Feed composition is being used in conjunction with genetics to maximise protein growth rates and accelerate earlier turn-off rates, a process which also provides environmental, social, and corporate governance (ESG) benefits.
3. Consumer tastes and preferences in protein and, particularly around eating quality, are largely determined by feed inputs.
4. A major driver behind Australia's growth in key export markets for products such as such as beef and sheep meat has been the innovative use by feedlots of reliable and consistent feed to match export consumers' tastes.
5. Feed is being used to tackle many sustainability objectives and research, such as by introducing different ingredients incorporating legumes, seaweed and minerals to reduce methane emissions in animals.
6. The feed businesses will be integral to developing and enhancing methods to improve animal health and productivity in large scale farming operations.

The ongoing M&A activity in both the animal protein and grains industries will continue to see these entities focus on opportunities in the feed sector, both around unlocking margins and symmetries, as well as potential integration opportunities

SECTORS IN FOCUS

COTTON - CAUTION AROUND DEMAND

The Australian cotton supply chain is balancing two competing factors – a positive outlook for domestic production, combined with uncertainty around global demand and prices. In terms of production, the industry is coming off the back of a near record crop, and while the El Nino provides some uncertainty around the 2024 production outlook, the current forecasts are for a crop only marginally lower.

Globally, cotton prices remain nervously subdued, sitting at around half of their near record peaks of mid-2022, with caution over the impact of tighter global economic conditions on consumers purchasing cotton products, and how for long this will impact the buying behaviour of cotton processors, particularly out of China.

DAIRY - LOOMING PROCESSING RATIONALISATION

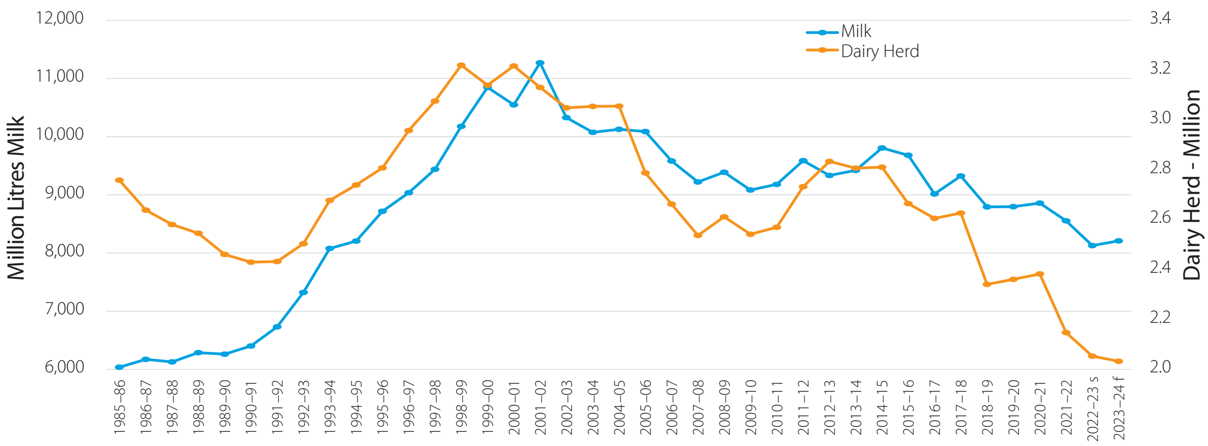
The Australian dairy supply chain continues to be impacted by the ongoing decline in Australian milk production, accompanied by a continuing fall in dairy farmer numbers. In 2023/24, Australia is forecast to produce 8.2 billion litres of milk, down from 11.3 billion in 2001/02. This trend is part of a long-term structural change in Australian farming, as dairy farmers react to issues including labour shortages, as well as the growing opportunities to sell their operations, often for transformation to beef production.

Given the declining level of milk, it was almost inevitable that Australia's dairy processing sector would see some level of rationalisation. In September, Canadian milk processor Saputo announced that it intends to downsize from eleven to five factories in Australia, though did not identify exactly which sites. This development will be closely watched, particularly as to whether any sites are permanently shut down, or whether there is interest by other milk processors or outside investors in acquiring them.

At the same time, attention will continue to focus on whether the supermarket chains may look to integrate further into the dairy supply chain, as has been the case in the US market. While Coles had sought to take ownership of two of Saputo's processing plants in Melbourne and Sydney, an ACCC decision on this has been delayed indefinitely.

Internationally, prices on the Global Dairy Trade rose in October for the fourth consecutive month, following a longer period of subdued ricing. This change is partly due to an influx of buyers, particularly from the Middle East and Europe, seeking to take advantage of lower prices. In addition, the forecast El Nino may be causing the markets concern around global dairy supplies over coming months, particularly from New Zealand and Australia, and seeking to build inventory.

AUSTRALIAN DAIRY HERD VS MILK PRODUCTION



Source: ABARES, ANZ

ANIMAL PROTEIN - PROCESSORS JUGGLE LOW CATTLE PRICES WITH LABOUR CHALLENGES

Across the Australian meat supply chain, the biggest focus continues to around the potential impacts of any extended dry period which may come out of the current El Nino event. The most recent dry period of 2018/19 is still fresh in the minds of many Australian cattle producers, and while dry conditions have yet to impact many regions, many producers are playing it safe by selling excess stock, rather than risk being caught without adequate feed and water supplies. As a result, the strong flow of cattle onto the market, combined with subdued buying by farmers has continued to see prices fall.

In many ways, this trend could be seen as a positive one for the longer-term health of the industry, as it highlights that many of Australia's cattle producers are planning ahead, including ensuring that they keep their best stock on-farm, to maintain the overall herd quality.

At the same time, despite the current concerns around El Nino, the past three years since the drought has seen the overall Australian cattle herd rebuild to a strong level, which should see it able to meet the current strong export demands.

In terms of beef exports, these have risen to around a three year high, driven by the strong availability of cattle, the low AUD, and ongoing strong demand from major export markets, particularly the US, while exports to China also remain strong.

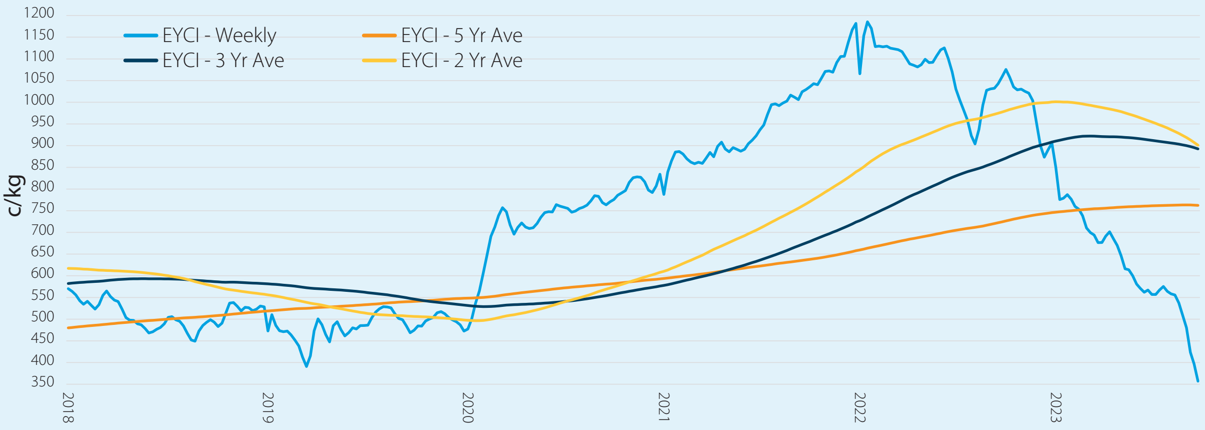
For Australia's meat processors, the current period of relatively lower priced cattle has provided some relief from the record highs of a year ago. At the same time, processors are also continuing to be impacted by a shortage of labour, although there are some feelings in the market that the current forecasts for record immigration level may slightly alleviate this.

In the retail space, the lower price of cattle has gradually flowed on to the price of meat on the shelves, although this has been tempered by inflationary pressures on the other steps in the supply chain. Additionally, the large levels of meat in storage will normally mean that there can be a lag of some months in the price falls reaching the shops.

The beef supply chain will also be closely monitoring the behaviour of consumers, particularly as tighter economic times may cause many to re-evaluate their meat purchases. This could potentially include a shift away from more expensive cuts of meat, as well as from butchers' shops to supermarkets.

Globally, the ongoing decline in the US cattle herd continues to impact world beef trade flows. The US cattle herd is forecast to hit a 60-year low in 2024, and with the country already the world's second largest importer of beef, the increased demand will be good news for major exporters. The rush to fill this demand will be competitive, particularly given that Canada and Mexico are already the largest suppliers of beef to the US, and that Canada in particular is currently going through a herd liquidation process of its own.

EASTERN YOUNG CATTLE INDICATOR VS 2, 3 AND 5 YR AVE PRICE



Source: Meat and Livestock Australia, ANZ

GRAINS & OILSEEDS - STRONG GLOBAL SUPPLY CALMS THE MARKET

After three record harvests in a row, the Australian cropping industry is forecasting a fall of around 30 percent for the 2023/24. While this sounds like a large fall, it would still represent the sixth largest overall crop in history.

The outlook for the overall winter harvest, which is already underway in some regions, remains reasonably uncertain, given that different Australian cropping areas are experiencing varying levels of rain over the spring period.

The uncertainty around the potential impacts of El Nino may be felt not only on the upcoming harvest, but into the crops of 2024/25, as farmers make decisions on what crops they will plant, or whether they will leave some areas unplanted, based partly on the predictions of how wet or dry the season may be.

These impacts are likely to ripple right through the grain supply chain. Given that many farmers may look to stock up on feed, in case it is needed in drier months, it may be that farmers retain more grain on their farms, rather than sending it to grain handlers. A strong demand for feed could also see upward pressure on prices, as well as a focus by grain handlers on delivering feed to traditionally drier parts of Australia.

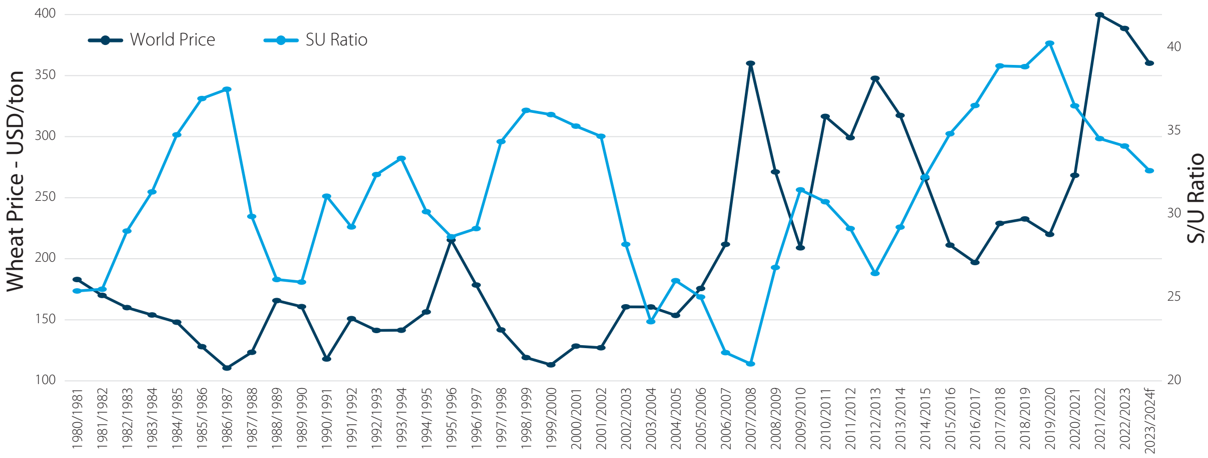
Similarly, industrial users of grain, whether for food, or for products such as ethanol, may look to lock in supplies early, to pre-empt any shortage, although conditions will not reach the levels of 2019, when some major users were forced to import wheat.

For grains handlers, the potential for varied impacts of El Nino on different grain regions in Australia could potentially mean a late-season re-examination of where to allocate resources, not only due to different areas being above or below earlier forecast harvest volumes, but potentially in directing greater volumes of grain than planned across the country. With port access and shipping availability also a discussion point around harvest time, grain handlers will also be looking to ensure that these are locked down as much as possible.

Globally, the general outlook across most crops remains bullish, with the US Department of Agriculture (USDA) forecasting a rise in global production of corn, rice and soybeans, and only a very marginal decline in wheat production. These factors are likely to subdue any major price rises, although the ongoing uncertainty surrounding the situation in Ukraine has the market keeping a watchful eye on developments. While Russia is forecasting a record crop and exports, the market may also be wary of concentration risk.

Further ahead, global grain traders will also be looking toward a recovery in current tighter economic times, and a forecast upturn in grain imports, particularly around feed requirements for a forecast rise in consumption of meat and dairy, particularly in major Asian markets.

GLOBAL WHEAT PRICE VS STOCK TO USE RATIO 1980/81 - 2023/24F



Source: USDA, ANZ

SUGAR PRICES SURGE ON GLOBAL SHORTAGE

Australia's sugar industry is well poised to take advantage of a number of factors currently impacting the industry globally.

In Brazil, the world's largest producer and exporter of sugar, rising global oil prices have seen the country divert more of its sugar away from food and into ethanol, reducing the volume available for export. In India, the number two producer and exporter, dry weather has impacted the country's crops, reducing both production volumes and yields. Faced with a domestic sugar shortage, and the potential that Indian sugar producers look to take advantage of high export prices, the Indian government has temporarily banned exports, further lifting global sugar prices. Similarly, in Thailand, also a major sugar exporter, dry weather has seen production fall strongly.

For Australian sugar producers and sugar mills, this could mean the industry is excellently placed to take advantage of a strong year ahead, both in terms of prices and export demand.

For food manufacturing companies, the high price of sugar could well become a factor in food inflation pressures, given that it is a base ingredient in so many products. Interestingly, for chocolate manufacturers, the pressures may be even stronger, given that cocoa prices have recently been around 45-year highs, due to global supply issues.

CONTACTS

SARA MCCLUSKEY
Head of Diversified Industries – Institutional
E: sara.mccluskey@anz.com

GERRY KARAM
Head of Food, Beverage and Agribusiness – Institutional
E: gerius.karam@anz.com

MATTHEW MANN
Director, Research & Analysis – Institutional
E: matthew.mann@anz.com

MICHAEL WHITEHEAD
Head of Food, Beverage and Agribusiness Insights
E: michael.whitehead@anz.com