

Rabobank Pork Quarterly

Outlook for Global and Regional Markets

Rabobank International

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- Global pork market softens to more normal levels
- Asian imports are good but not as great as in 2011
- Pork trade continues to be disrupted
- A seasonal upswing is expected in the Northern Hemisphere in Q2 2012
- Price levels will remain elevated in 2H 2012 but economic development and China imports are the main wildcards

Global Overview

Rabobank expects stable, slightly pressured global hog prices in Q2 2012, with a modest recovery in the second half of the year. The 'success' of the grilling season in the Northern Hemisphere and prospects for Asian imports will be the key determining market factors as we move through 2012. As always, producers will need to monitor crop production developments as we remain in a 'no margin for error' feed supply situation.

Global hog prices have softened in recent weeks to the extent that the Chinese government announced in late April that it has initiated procurement for its frozen pork reserves. However, hog prices are still high by historical standards in order to offset high feed costs. With Chinese hog prices projected to rebound at the end of the year, the prospects remain positive, with supply discipline in the key export markets essential to support elevated price levels. Longer term, our view is that growth in global meat protein consumption will continue to lag income and population growth in important emerging markets, raising volume risks to processors and price risks to buyers, from processors to consumers.

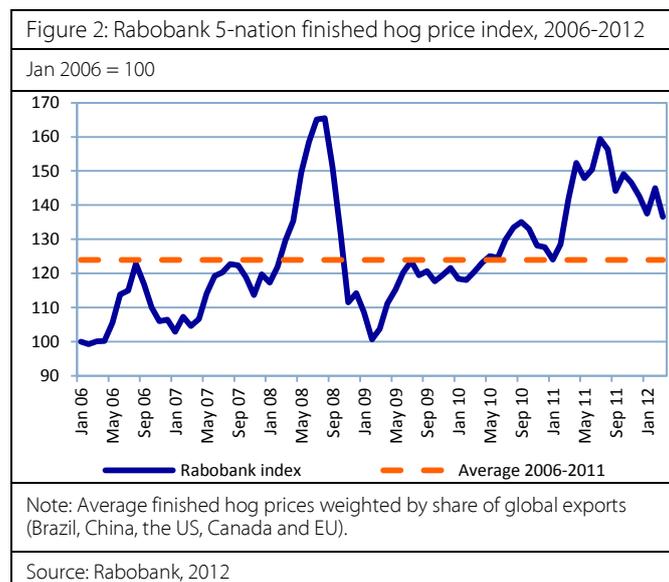
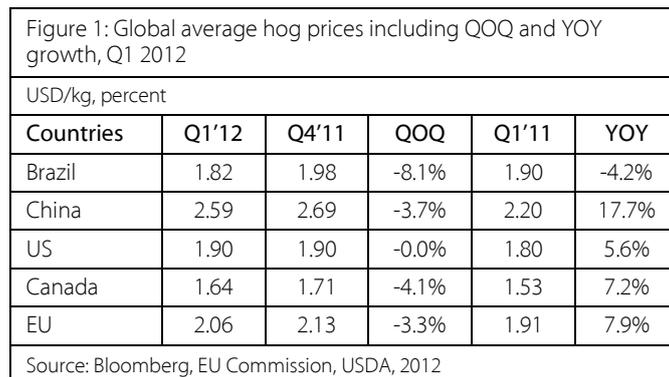
In line with expectations, the Rabobank 5-nation finished hog price index continued its declining trend in Q1 2012 with a 4.3% lower price level in March compared with December 2011 and 14.3% lower than the latest peak in July 2011 (see Figures 1 and 2). A recovery in Chinese production and a commensurate reduction in imports have been the main drivers, along with slightly higher than expected global production.

The global pork market is returning to a more 'normal' situation now that the disease-related Asian import surge is fading. This is mainly impacting the United States (US), where the buoyant export growth experienced in 2011 has stopped, which reflects the declining pork prices in China. Remarkably, exports from the European Union (EU) continued to perform strongly with an increase of 17% in Jan-Feb 2012 compared with Jan-Feb 2011 and just a slight decline (-1.5%) compared with Nov-Dec 2011, but here also some pressure can be expected in the coming months.

Trade disruption continues to play an important role in the global industry. The fact that Brazil still is not allowed to export

pork to Russia and the strength of the Brazilian real are the primary reasons for low Brazilian pork prices. Falling pork prices have also caused farmers in South Korea and Taiwan to protest against imports. In South Korea, the government has reduced the quota-free import volume of bellies from the US by 50,000 tonnes to 20,000 tonnes. In Taiwan, protests started after pork imports were allowed from countries where ractopamine is legal and the discovery of ractopamine residues in domestic pork has resulted in a large decline in demand and has put prices under pressure.

In 2H 2012 the primary driving forces in the market will be production declines in Europe against production growth in the US and the potential for herd liquidation in China. Overall, we currently expect a stable market barring major new events, including crop market developments.

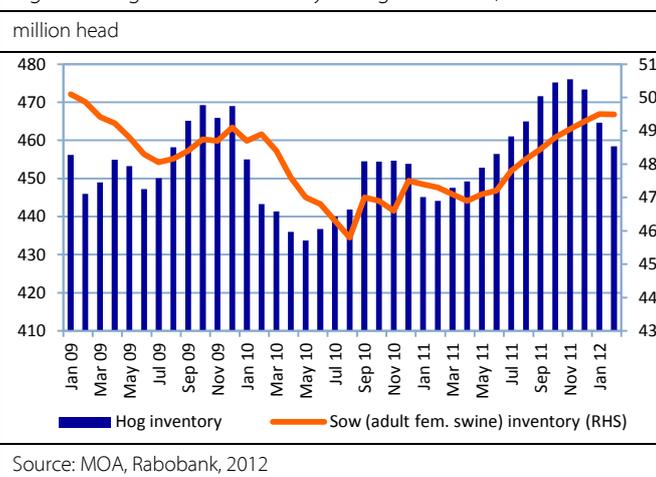


Regional Updates

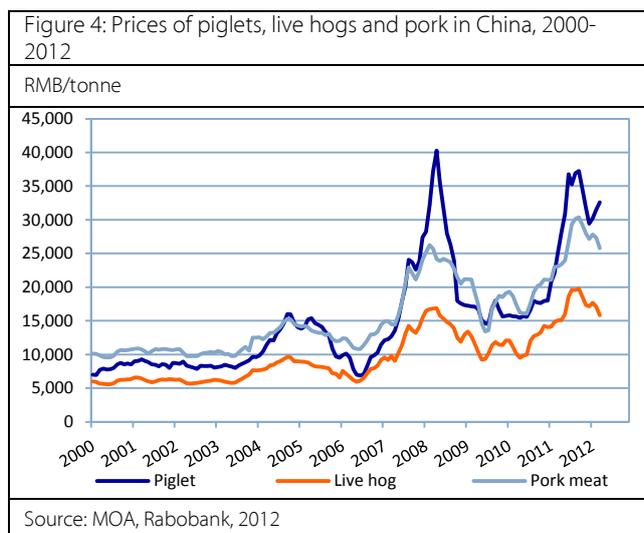
China

- Chinese pork supply continues to recover from the 2011 drop, with 3.8% growth in the first two months of 2012 compared with the same period of 2011. Although the hog inventory decreased for three consecutive months from December 2011 onwards, the sow inventory rose until January 2012 (see Figure 3). This shows that producers held a positive view on 2012 market potential and therefore increased herd replenishment rates. The rising piglet price against the falling hog and pork prices in February and March 2012 supports this argument as farmers procure piglets to build up stocks. Rabobank believes that the decrease in hog inventory in the past three months was mainly due to the impact of disease rather than economic disincentive. Because of the disease-related piglet shortage in early 2012, hog supply is expected to be tight in May and June given the four month growth cycle. Consequently, hog and pork prices will likely rebound in the near term. The disease situation is now abating, helped by the spring weather, and the piglet supply is gradually recovering.
- Gross margins on the farming side are shrinking due to falling hog and pork prices (USD 17/head in mid-April) and strong feed prices. This is 70% lower than in the same period in 2011 and 85% lower than the record high of USD 120/head seen in July 2011. In contrast to the falling hog prices, cost of production continues to rise because of rising feed prices, the higher cost of oil and more expensive labour. Small farmers will continue to leave the market due to cost pressure and expectation of higher market risks. However, due to the rapid expansion of large hog farms, the recovery pace of the hog supply will be only slightly affected by the departure of small farmers.
- The new 12th Five-Year Development Plan for the Meat Industry issued by the Ministry of Industry and Information Technology on 24 February 2012 focuses on the establishment of a cold chain distribution system. Currently, the cold chain is underdeveloped; less than 20% of total meat can be transported and distributed via a cold chain. This is the main bottleneck for the further development of the meat industry and one of the most important causes of food safety issues. The government's aim is to improve the cold chain distribution ratio to 30% and the cold chain transportation ratio to 50% of total meat by 2015.

Figure 3: Hog and sow inventory changes in China, 2009-2012



- In the week of 20 April, the National Development and Reform Commission (NDRC) announced that the Chinese government has initiated the procurement of a frozen pork reserve to stabilise the pork price and prevent losses on the farming side as the current hog-to-corn price ratio is around 5.8:1. When the hog-to-corn price ratio falls below 6:1, similar initiatives will be implemented in the future. Compared with the previous macro control instruments in 2009, this new initiative will increase the volume of the pork reserve at both national and local levels. Another adjustment is that the government will release the pork reserve when the hog-to-corn price ratio goes above 8.5:1 to avoid further price rises. This ratio was not included in the 2009 controls. The new policy not only takes account of farmers' interests, but also protects the welfare of urban low-income residents.
- With the continuous recovery of pork production, it is expected that hog and pork prices will generally trend downwards, with periodic fluctuations, in the remainder of 2012 (see Figure 4). It is likely that prices will fall 15% to 20% in the summer, the low season for meat consumption, compared with the average level in 2011. Decreasing hog prices will reduce the profitability of farming and slow down hog herd replenishment and recovery in the following winter. This will result in another rebound in hog prices in the next peak season of consumption, which will be Q4 2012 and early 2013.



- With demand weaker recently, our outlook for profitability for both the producer and packer segments has declined modestly through the end of the year, but we still expect margins to be in the black. The two most closely watched factors affecting profitability for the rest of 2012 will be the fate of the corn and soy crops, and prospects for exports, especially to China.



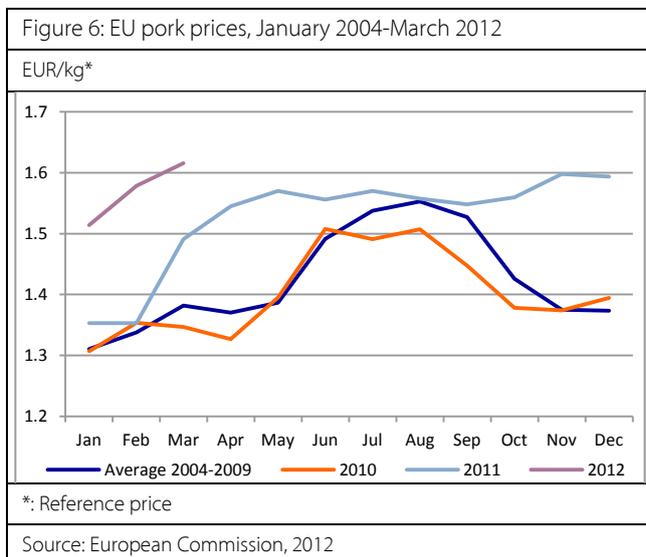
United States

- Hog prices have dropped sharply in recent weeks, by about 10% and close to 25% from the highs last autumn (see Figure 5). Hog prices are still high by historical standards, as required due to high corn and meal costs. The biggest issue is probably exports, which seem to be normalising after last year's strong exports to Korea, China and Japan. This is especially true in bellies, a product with a high preference in South Korea and which is also a big foodservice item. Foodservice demand in the US remains lacklustre, impacted by weak economic growth and rising gasoline prices. Demand at retail also seems to be softening.
- With the decline in hog prices, both spot and futures, producer profitability has declined, and the ability to lock in summertime profits has fallen precipitously. In January, producers could have locked in profits of over USD 20/head for this summer. Now it is barely breakeven.
- Packers are absorbing some of the weakness in demand as cut-out prices have dropped more than live hog prices. Packer margins have dropped sharply in recent weeks and may be in the red even after accounting for offal, ham conversion, and higher margins on exports.
- The USDA's March Hogs and Pigs report showed little signs of herd expansion, with the breeding herd up only 0.6%. We believe producers remain cautious as we still have a 'no margin for error' corn and meal cost situation and as producers understand how dependent the market has become on exports, which can be volatile and unreliable. Given what is going on in the markets today, their caution clearly has been well placed. In fact, farrowing intentions in the March Hogs and Pigs were down for both the March-May and June-August time frames. Despite close to flat breeding herd and farrowing intentions, we expect pork production to maintain YOY increases of about 2% due to productivity improvements.
- Overall protein supplies remain tight in the US and globally which should be supportive to pricing. YTD US animal protein production is down 2.7%, with pork up 1%, beef down 3.4%, and chicken down 5%. Beef production will decline further as we move through the year. Chicken production will come up against production declines that began last autumn as we hit this autumn, so YOY comparisons will level out.

EU

- EU hog prices resumed their rising trend in February after the normal decline after the end of year holiday season and reached EUR 1.62/kg in March, an increase of 11% YOY (see Figure 6). Main drivers were the slightly lower production by an estimated 0.5% Jan-Mar, and continuing strong export performance (+17% Jan-Feb 2012/2011). Compared with the last two months of 2011, exports dropped by 1.5%, with the 7.3% decline to China largely compensated by the 3.8% increase to Hong Kong, resulting in a 1.7% drop to both countries combined.
- Slaughter numbers have been mainly down in northwest Europe while growing in southern Europe where the large integrators more than offset the decline observed at the smaller, independent producers.
- With the seasonal peak in combination with the approaching European Championship Football in June and London Olympic Games in July and piglet prices on average 19% higher in March compared with both December 2011 and the average from March 2006-2011, all signs are positive for hog prices to rise further in Q2. However, wildcards are retailer resistance to these higher prices, pressured consumer purchasing power and possible export pressure.
- The high piglet prices show the impact of the decline of the number of sows by 3.4% at the latest herd inventory of 1 December 2011. With the number of 'gilts not yet covered' down by 5.1% on that date, hog production can be expected to be under pressure for the remainder of the year. Rabobank forecasts a decline of EU pork production of 1% over 2012 as a whole. This will support continued elevated price levels, which are needed to cover the continuing high feed costs.
- Into 2013, the main question is the impact of the partial sow stall ban on the number of sows in 2H 2012. With currently about 60% to 70% of sows compliant, the fact that just nine member states have announced they will be 100% compliant by 2013 and the strict enforcement

announced by the European Commission, pressure on sow numbers can be expected. However, the current high piglet prices are encouraging the farmers who intend to cease their activities by 2013 to continue production until the end of 2012. This implies that EU pork production will not be further impacted before 2H 2013.

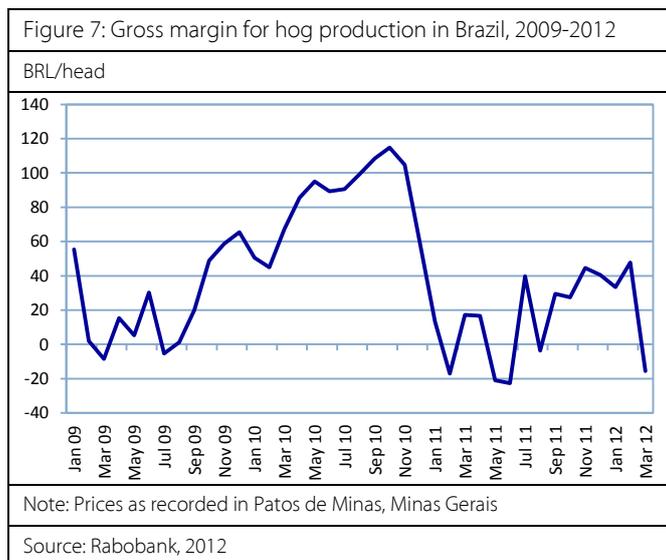


Canada

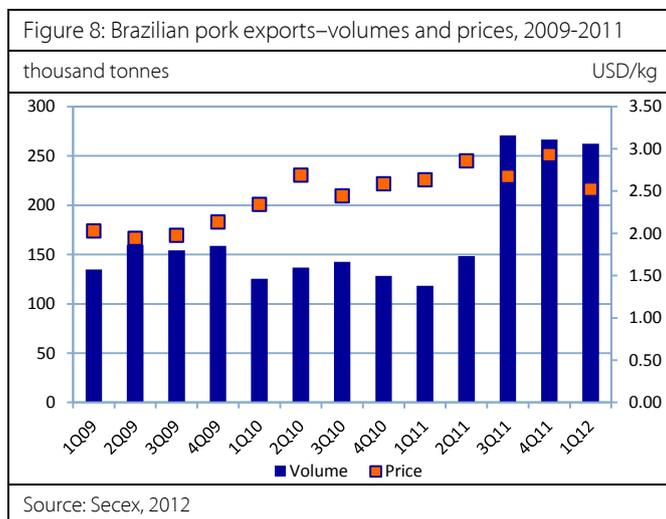
- Canada's breeding herd remains flat relative to year-ago levels at 1.3 million head. The sow herd has hovered around this level since the beginning of 2010 and is likely to remain there for the foreseeable future. Future production growth will require export growth, which is unlikely to materialise while Canada is forced to contend with a relatively weak US dollar. Canadian producers, however, have gained a relative feed cost advantage as ethanol demand has increased the basis in the US.
- Canada's overall pork exports are forecast to decline by 1.8% in 2012, while its imports are forecast to increase by 5.4%. YTD (January–February) pork trade with the US has heavily favoured the US. Canada's exports to the US are up 9.6% YTD, while imports from the US are up 38.1%. Retailers in Canada are looking for alternative suppliers to the consolidated Canadian industry.

Brazil

- Brazil pork and hog prices have decreased by 14% since the beginning of the year despite the significant rise in exports (+5% YOY). The weak local demand and increase in supply have weighed especially on prices, while domestic consumption was also negatively influenced by low beef and poultry prices and by the Easter season, the period in which pork consumption usually goes down. On the supply side, farmers increased their offers in an attempt to diminish losses as a result of low hog prices combined with the ongoing high feed costs (see Figure 7).



- The scenario was slightly brighter on the export side, with international sales in Q1 growing by 5% YOY in spite of the Russian ban on Brazilian pork and the difficulties in selling to Argentina (see Figure 8). This rise in exports was mainly driven by the increase in sales to Hong Kong (+54% YOY) and Ukraine (+346% YOY), with the latter possibly being used as a gateway for Brazilian pork to Russia. Although the amount exported rose, the prices received went down by an average 3% from last year's levels, which, coupled with the still strong Brazilian currency, ultimately compromised export profitability



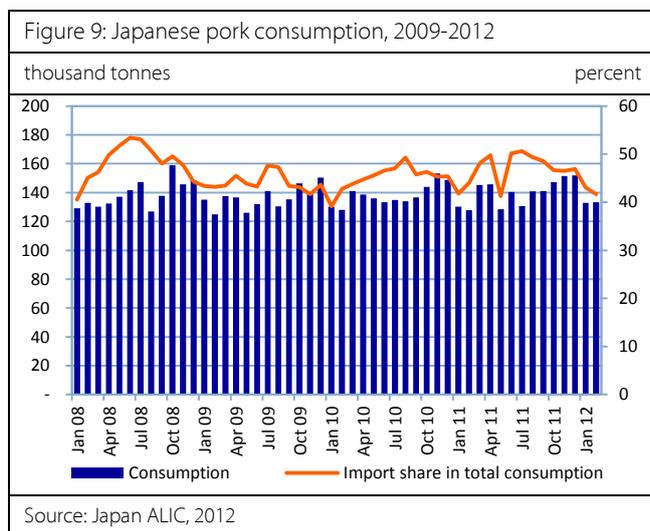
- For Q2 2012, pork and hog prices are anticipated to remain weak as the projected low beef price (resulting from higher supply) continues to weigh on these products. However, a further significant decrease may be limited by a possible reduction in hog supplies from independent producers combined with strong exports. The latter may accelerate even more if Russia finally lifts its ban on Brazil as expected by the sector in the near future. In addition, the expected increase in poultry prices will help to set a floor for pork and hog values. Under these circumstances, margins for both independent producers and packing companies should remain pressured as grain values are set to remain high at least until the arrival of the second corn crop in

Brazil. However, companies focused on processed products will be in a better position than their counterparts whose sales are concentrated on fresh pork.

- For Q3 and Q4, pork and hog prices should slightly recover from Q2 levels on the back of the anticipated increase in cattle and beef prices (that is also expected to be modest) and the seasonal rise in demand. Additional fuel may come from a possible acceleration in exports in the wake of an increase in the number of plants allowed to export to China. Currently only three plants are allowed to export but another four are about to be granted an export permit.

Japan

- Despite the current difficult economic situation in Japan and the fact that the demand for premium product has not recovered, pork consumption increased for January and February 2012 by 266,000 tonnes (+3%) compared with the same period last year (see Figure 9).
- This development was even more surprising given that retail prices were flat, with domestic loins selling at JPY 2,500/kg (USD 31/kg) and imported loins at JPY 1,600/kg (USD 20/kg) and despite declining wholesale carcass prices (Tokyo Market). The 2012 wholesale March price for average grade dropped to JPY 324/kg (USD 4/kg), 15% lower than last year.
- The lower prices did not deter imports, with volumes already reaching 132,000 tonnes in the first two months of 2012, 10% more than the same period last year.
- Given current market signals, it is likely that pork demand gained momentum against more expensive beef, and that 2012 imports may rise above the five-year average of 760,000 tonnes.

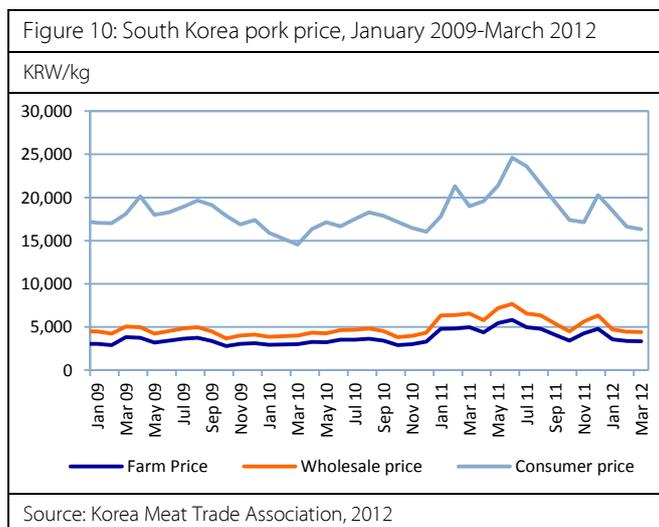


South Korea

- South Korean hog inventory continues to recover and has now reached 8.1 million head as of December 2011, a 4% increase from Q1 2011. However, this growth is slower than the 6% experienced in Q3 2011. We believe it is unlikely that South Korea will recover to the pre-crisis level of 9.8 million head in the near future.
- The combination of production recovery, a sluggish economy which pressures consumption and high import

levels has resulted in a drop in South Korean pork prices of about 20% in Q1 2012 compared to Q1 last year. This also means that unsold volumes were added to cold storage inventories (see Figure 10).

- Strong farmer protests channeled by the Korea Swine Association (KSA) resulted in the reduction of the previously agreed volume of 70,000 tonnes of tariff-free pork belly imports from the US down to 20,000 tonnes. KSA represents 90% of South Korean pig growers. Given rising feed costs, the South Korean government will have a hard time maintaining farmers' profitability and containing consumer price inflation. Moreover, the government agreed to earmark KRW 100 billion (USD 88.7 million) for buying up pork when the price falls below production cost.

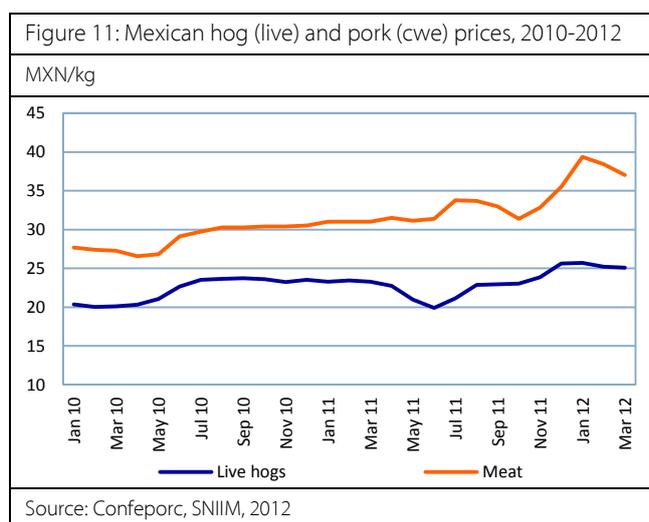


Taiwan

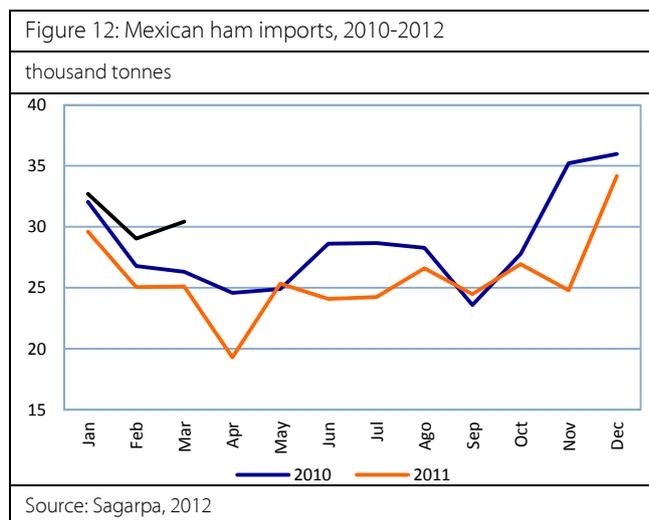
- The Taiwanese pork industry has been experiencing one of its worst crises ever since ractopamine residues were found in domestic pork. As a consequence, consumers are shifting to imports, which are considered safer. Ironically, these imports may also be from countries where ractopamine is used legally. For example, the EU has banned pork imported from the U.S due to the use of ractopamine among other things. Despite strong controversy and protests by farmers, the government (or retail) has not made a statement at this stage to stop the import and sale of pork which may have been treated with ractopamine.
- Meanwhile, Taiwanese pork prices have dropped by almost 30% to TWD 50/kg (USD 1.7/kg) since December 2011. At current prices, farmers lose an estimated TWD 15/kg (USD 0.5/kg) per animal, given high production costs. Despite government assurance measures to stimulate demand, the country's pig farmers worry that pork prices might remain low until mid-2013.
- According to the Taiwanese pig farm association, about 50% to 60% of the country's pig farmers may go bankrupt by the end of 2012 if this situation does not improve. This could reduce the current herd size of 6.3 million head to 4 million. If such a scenario materialises, the supply shortage will be filled by massive imports.

Mexico

- During 2011, consumer pork prices in Mexico increased 4.6%, more than poultry prices, which rose 3.5%. The upward trend in pork prices has continued in early 2012, pushing Q1 2012 average prices 9% over year-ago levels. In Q1, carcass prices increased 23.4% while hog prices went up 8.5% (see Figure 11).



- The increase in pork prices during 2012 has given strong incentives to increase imports. Just to illustrate, in Q1 2012 ham imports (the most relevant Mexican pork meat import) increased 15% YOY (see Figure 12). This upward trend is in contrast with 2011 pork imports, which dropped around 10% YOY.



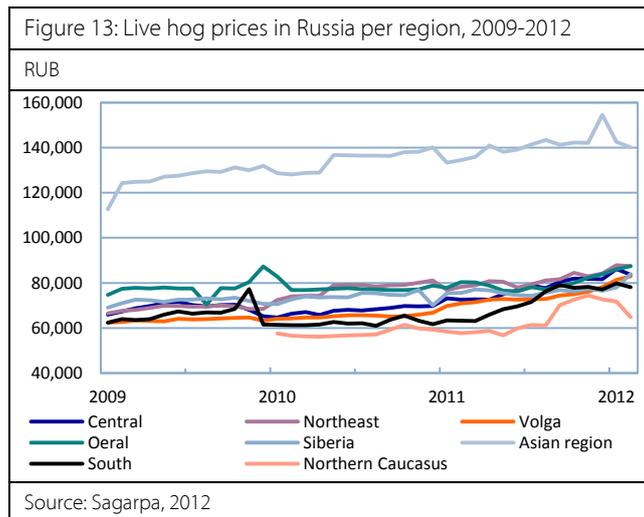
- The increase in imports during 2012 has eliminated some price pressure. At the end of March, consumer pork prices decreased and have stayed relatively flat throughout April. For 2012, we expect pork prices (at the consumer level) and hog prices to increase around 5% to 7% YOY. Furthermore, if feed costs continue to lose momentum, pork producers will face a profitable year.
- For Q2 2012, we expect a pork production increase of around 0.57% YOY. For the full year, we expect 0.7%

production growth, reaching 1.19 million tonnes versus 1.18 million tonnes in 2011.

- In 2012, economic growth and price dynamics will revive pork per capita consumption, allowing it to show a marginal increase. This year we expect total domestic consumption to reach 1.776 million tonnes, versus 1.746 million tonnes in 2011.
- Mexican pork is gaining access into international markets such as Japan, South Korea and the US. During 2010 and 2011, Mexican exports grew consistently around 10% each year. Furthermore, in April, the Chinese government certified five Mexican meat producers which will begin exporting pork meat to China.

Russia

- The continued spread of African Swine Fever (ASF) reduced the growth of Russian pork production in 2011 to 3.9% compared to the 6.9% CAGR from 2005 to 2011. As a result, hog prices increased gradually in all regions with the highest growth in Asia supported by strong Chinese import demand (see Figure 13)



- With strong domestic demand, Russian imports increased by 40,000 tonnes to 946,000 tonnes (+ 3.3%). The continued ban on Brazilian product created opportunities for alternative suppliers, mainly the EU and Canada, which increased their market shares by 6% to respectively 52% and 16%. ASF mainly affects backyard farms and outdated agricultural enterprises the share of in total inventory dropped by 3% to 30% of the total 17.3 million head inventory.
- The ratification of the WTO accession by Russian officials, which is expected to take place this summer, will reduce the in-quota rates to zero and out-of-quota to 65% from the current 15% and 75%, respectively. As of 2020, the tariff will be replaced by a general flat rate of 25%. This implies that the Russian accession will not have a relevant impact on pork imports and prices in the coming years. In combination with the reduction of the quota in 2012 by 70,000 tonnes to 430,000 tonnes, import pressure will remain limited, which will be positive for domestic production.

- With tariffs for live hogs to fall from 40% to 5% after WTO accession, Russian live hog imports from the EU may increase sharply. However, the ban on live imports from the EU for alleged veterinary health concerns on 2 March can be seen as an example of protectionist measures that may take place going forward. In addition, Russia has announced in advance of joining the WTO that it plans to renegotiate a higher tariff and has suggested that it will use the WTO safeguard mechanism when live imports surge after accession. Due to inconsistencies in its commitments and statements, it cannot be assumed that Russia will resume live imports after accession.
- Until WTO accession, Russian pork prices will remain elevated with slower but growing domestic production with the potential for live animal imports.

to capture back some of the lost ground with a resulting positive impact on the shares. The exception is China, where the combination of low supply and food safety scandals by two processors resulted in a more or less stable share performance after a steep decline in 1H 2011.

In Q1 2012 this development continued with the relatively unexpected drop in Chinese pork prices towards the end of the quarter. The resulting decline of US exports had an immediate impact on processors in China and North America.

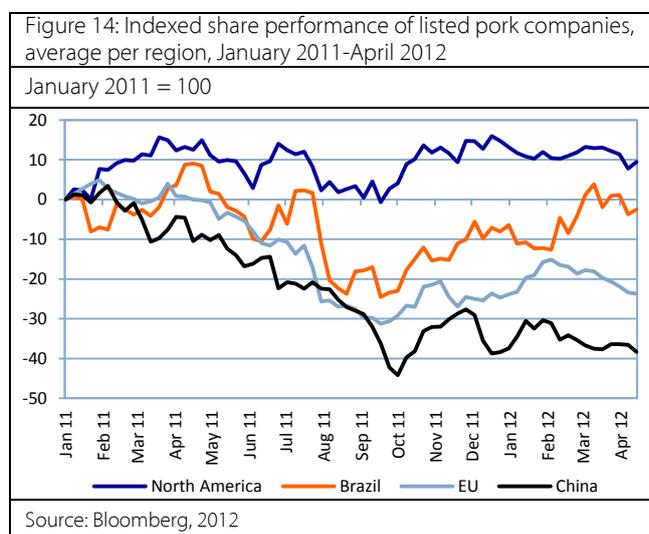
Pressure on pork processor margins can be expected to continue in Q2 2012. In the US and China this will be due to the continuing difficult export performance, while in the EU, processors will not be able to forward part of the elevated pig prices.

Chile

- In Q1 2012, Chilean pork exports reached USD 95.6 million, which is a 10% increase in value and an almost 12% increase in volume, or nearly 26,000 net tonnes, compared to the same period in 2011. Remarkably, during this period, exports to Russia underwent an almost threefold increase in volume, reaching 2,900 net tonnes and a 228% increase in value, totalling USD 7.8million.
- Due to the start-up of Agrosuper’s Huasco project in December 2011, the country’s sow herd increased by 15,000 head, resulting in an additional 4,100 tonnes of pork per month. This has triggered a notable squeeze in the domestic hog prices, which decreased by circa 30% between December 2011 and April 2012. On the other hand, it seems that retailers are not lowering pork prices, under the auspice of ‘protecting’ the price of beef, which is, in most cases, imported directly. This implies that producers are going through a hard period with continuing high costs.

Industry comments

For most pork processors, 2011 was a relatively disappointing year with margin pressure due to the difficulty of passing on the high prices. Especially during spring and summer this resulted in squeezed margins, as confirmed by the pressure on share performance in all regions globally (see Figure 14).



With more or less stabilising prices towards the end of the year and an even stronger focus on efficiency, processors were able

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