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Global Poultry's Investment Reality in the Covid-19 Era

Strengthening Business Models in a Challenging Period of Rapid Change

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Contents

Investing in the Covid-19 Era: Three Different Stages	2	Stage 2: How to Position Your Business?	5
Stage 1 Impact: Big Global Disruption	2	Stage 3: A Post-Covid-19 Investment Perspective	6
Stage 2: Dual Markets and the Road to Recovery in 2021	4	Winning in the Poultry Industry in the Covid-19 Era	10

Summary

Covid-19 is disrupting business in ways the global poultry market had never planned for, creating new areas of opportunity and risk. The impacts of Covid-19 are spread very unevenly between regions and between companies.

We have identified three stages of Covid-19's impact on the global poultry industry:

- Stage 1 – Covid-19 Disruption (2020): Significant disruption in markets, trade, and supply chains, with bigger differences in performance between companies than ever seen before.
- Stage 2 – Dual-Market Road to Recovery (2021): More big impacts, which global and regional industries will experience this year.
 - Ups and downs of the pandemic in 1H will lead to ongoing impacts on channels, with peaking retail and online demand and low foodservice demand, especially during lockdowns. Conditions will start to gradually recover when Covid-19 becomes a bit more controlled in 2H 2021 and into 2022 as vaccinations become more widely used. This all happens in a context of high and volatile feed costs.
 - From a demand perspective, there will be a dual-market trend defined by consumers with high spending power driving up demand for premium products at retail on one side and by price-focused consumers who've been economically affected by the pandemic on the other side.
 - Key themes for investors during stage 2 will be market positioning, cost control, procurement, and supply management. Consolidation will also gradually accelerate.
- Stage 3 – The Aftermath (2022): The return of bullish investment opportunities for the global industry in a post-Covid-19 environment, wherein key investment themes will be different than before Covid-19.
 - Poultry demand will be characterized by strong, ongoing demand despite ASF recovery and alternative protein growth.
 - Distribution channels will change, with continuing, robust at-home and online sales, which will also change product mix opportunities.
 - Value chains will become more digital, smarter, and more sustainable, and food and input security will push toward more local supply and pressured trade.

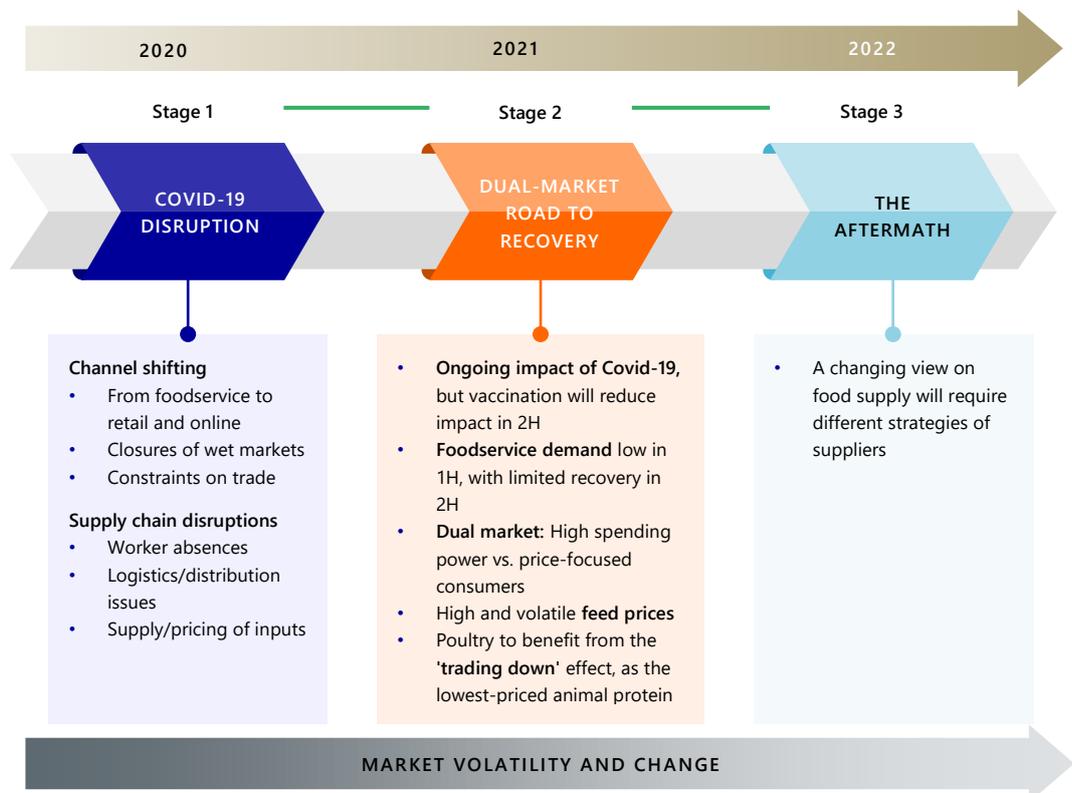
Company leaders and investors need to constantly review market conditions and adjust company positioning to optimize growth and returns. There will be bigger differences between winners and losers, which will lead to a process of accelerated capital investments, consolidation, and internationalization in the coming years.

Investing in the Covid-19 Era: Three Different Stages

The Covid-19 pandemic has had a big impact on the global poultry industry, with huge disruptions in global and local markets since early 2020. This has highly impacted the margins of the global industry, and, on average, there has been a downward pressure on margins, though the differences between companies are bigger than previously seen. We can expect further changes in markets and supply conditions in the short and long term. These big changes will require a constant fine-tuning by investors to optimize their position under changing short- and long-term market conditions. Companies that do this right will be able to outpace the industry and strengthen their individual market position.

The impact on the industry and the required investor focus will change over time. We expect this to happen in three stages, with each stage requiring a different approach by investors from both a strategic and an operational perspective (see Figure 1).

Figure 1: The three stages of Covid-19's impact on the global poultry industry



Source: Rabobank 2021

Stages 1 and 2 are highly impacted by government regulations to reduce Covid-19 infection rates. There is also some indirect impact from ASF in countries where the pork sector has been heavily affected (like China, Vietnam, and the Philippines) or where major exporters are located (Europe, Brazil, and the US). In these stages, we will see big disruptions in markets and channels and a significant economic downturn. Government vaccination programs that started in December 2020 are expected to gradually lead to some market recovery in 2H 2021.

In the post-2021 aftermath (stage 3), we expect a new market reality that will lead to changing investment requirements. Each stage will require a different market approach by poultry companies, and it will happen in a context of big differences in performance between individual companies.

Stage 1 Impact: Big Global Disruption

Covid-19 has been spreading since late December 2019, from Asia (in Q1 2020) into Europe, the Middle East, and Africa (since March 2020), and later into the Americas. The first stage of Covid-

19's impact on the poultry industry was highly disruptive. Governments implemented levels of restrictions on people's movements, including full lockdowns, trying to stop the spread of Covid-19. This led to pressure on local markets, where consumers moved from buying products in channels dedicated to out-of-home consumption to buying more products in channels for at-home consumption. In general, channels like supermarkets and neighborhood markets benefited, and home delivery of food products entered a boom period. In most countries, this led to some short-lived price peaks because of panic buying, but depressed overall poultry consumption and prices. The lockdown in China resulted in a 45% drop in foodservice sales in Q1 2020, while the EU and US saw their biggest drop in Q2, with respective declines of 50% and 42% in foodservice sales.

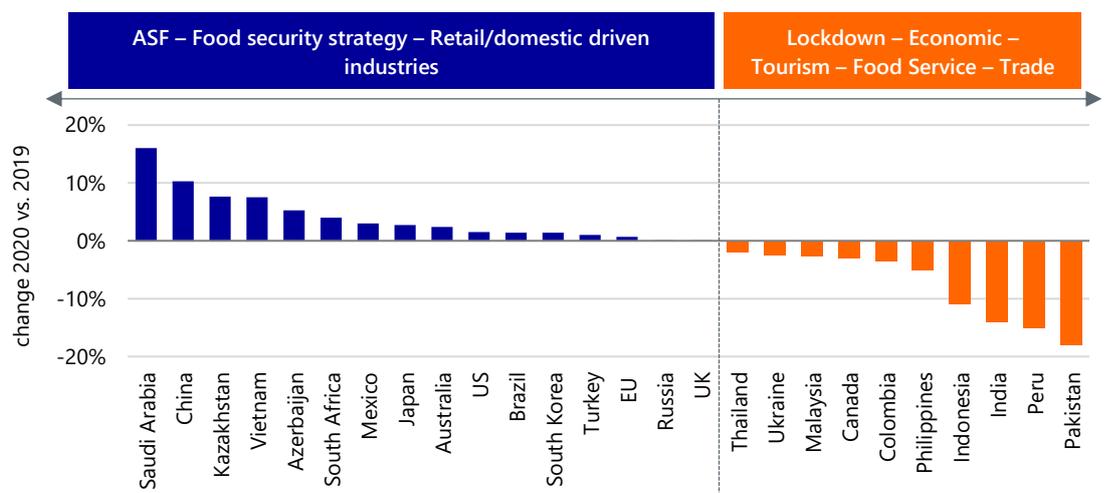
At the same time, we saw big impacts on supply chains, including operational issues at plants with worker absences and logistical issues in distributing inputs to operations within a company and also globally. Some regions in emerging markets, especially in Africa and the Middle East, faced difficulty securing supplies of breeding stock, DOC, and hatching eggs due to airfreight cancellations and border issues. While this stabilized during Q3 and Q4 2020, this situation has come up again more recently due to avian influenza outbreaks in Europe and has led to longer supply disruptions, especially in cases where PS production is involved.

These changes in demand and supply were highly disruptive to poultry markets and had a general pattern of declining demand for poultry, as at-home consumption did not fully compensate for reduced out-of-home consumption. This significantly impacted global markets, with input prices falling especially in the first months following initial Covid-19 outbreaks. Impacts on the global poultry market generally followed the pattern of the virus's spread.

In general, the poultry industry was more affected by Covid-19 than the other protein industries, including pork, beef, and eggs in 2020. The key reason for this is the industry's high dependence on out-of-home channels and in particular on sales to foodservice and wet markets worldwide.

Global traders faced a big drop in foodservice demand, with poultry trade declining everywhere except in Asian markets affected by African swine fever (ASF). Global poultry markets became highly competitive, and prices were constantly low. The impact in some Asian markets was somewhat offset by the effects of ASF on local meat supply. This was especially the case in markets like Vietnam, China, and the Philippines, where prices were relatively high for most of 2020. However, because the industry is recovering in these countries, poultry market conditions have become weaker and will be more challenging in 2021.

Figure 2: Bigger differences in poultry production between countries than ever before in 2020



Source: USDA, FAO, local statistics, Rabobank 2021

The volatility in demand and supply resulted in big differences in production trends between countries and regions (see Figure 2). In general, countries whose local pork industry has been

affected by ASF (like Vietnam and China) have seen more growth in local poultry production. This bullish support for local poultry production has been offset by weaker economic conditions and the impact of collapsing tourism. This is what has been seen in the Philippines and other Southeast Asian countries.

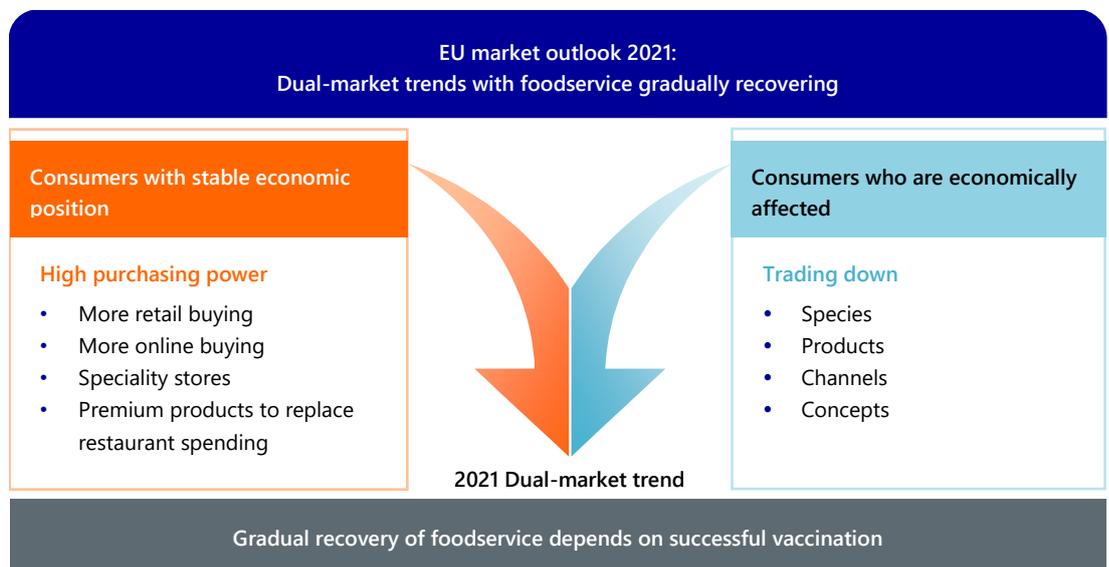
Furthermore, countries with a long-term focus on food security and support mechanisms for local industries still see growth (e.g. Kazakhstan, South Africa, and Saudi Arabia). Also, countries with relatively high import levels and with a local industry focused on retail, like Japan, South Korea, and Mexico, see growth due to the shift from foodservice to retail.

Stage 2: Dual Markets and the Road to Recovery in 2021

In 2021, we expect the ongoing global spread of Covid-19 will significantly impact the market until the virus is gradually more controlled through the introduction of better treatments and worldwide distribution of vaccines like those currently being rolled out. In 1H, we will still see high pressure from Covid-19, which will likely gradually reduce in 2H when vaccination programs become more impactful. This will lead to ongoing pressure on foodservice markets and high sales via supermarkets, neighborhood markets, and online food delivery in 2H, though foodservice will bounce back somewhat in 2H.

Though the highest impact will be experienced in 1H 2021, this market shift is expected to stay at least until 2022, depending on the success of stopping the virus's spread through vaccinations and treatments. Some regions with access to vaccines and strong government programs will likely recover faster than others.

Figure 3: Outlook for 2021 markets: dual-market trends on the road to recovery



Source: Rabobank 2021

Poultry markets are expected to face dual trends (see Figure 3). On one side will be consumers who have kept their jobs or businesses and have increased spending power due to reduced foodservice spending and limited travel. This group of consumers will spend more money in supermarkets, online grocery and foodservice delivery, and neighborhood and specialty stores. They will look for products that they typically buy in restaurants or from places where they usually travel.

On the other side will be consumers who have been economically affected by Covid-19. They lost jobs or businesses and will now be very price driven. These consumers will look for value options in products, retail concepts, and foodservice.

There are also consumers who have been supported by government stimulus payments in many countries. They have been able to stay in the group of consumers with a stable economic position due to these payments. When these payments end, there is a high risk they will fall into the category of economically affected people. These payments are therefore delaying the impact of the 2019 economic crisis on the poultry market.

From a distribution perspective, this will have a significant impact, at least during the period of heavy Covid-19 pressure and lockdowns in 1H. Retail and online grocery will stay robust. There will be strong demand for premium products and retail formats but also strong demand in the value segment of the market, both in channels and products. In terms of products, the economically affected consumer category will focus on low prices and will move to cheaper cuts and products like sausages and frankfurters and away from premium and value-added products like ready meals, free-range chicken, and organic chicken.

Local supermarkets and neighborhood markets will see additional demand, especially during periods of extensive restrictions. In that case, local retail will benefit more, and some premium products may also benefit, as unaffected consumers will have more time to prepare meals and want to treat themselves to some premium products to compensate for fewer restaurant visits.

This split between the consumers who have been economically affected by Covid-19 and those who have not will create both a rise in value-added and premium products and retail formats and, at the same time, a trend of trading down. The middle segment of the market will likely be the most affected. Home delivery is expected to stay strong in this stage. The scope and strength of these dual-market trends will differ among countries. In general, the most economically affected countries in 2020/2021 will see a bigger trend of trading down, while countries less economically affected will see a stronger premium market trend.

This dual-market trend will occur in a context in which feed costs are expected to be high and volatile. Prices for soybeans, wheat, and corn in 2021 are expected to be at levels that are, on average, [40% to 50% above 1H 2019 levels](#) (when prices were still stable) and to move to the highest levels since the 'biofuel' years from 2007 to 2013, when prices rose to historical highs. As production costs will be high and volatile, supply growth discipline will be even more important than in 2020, especially given the strong price-driven trend this year.

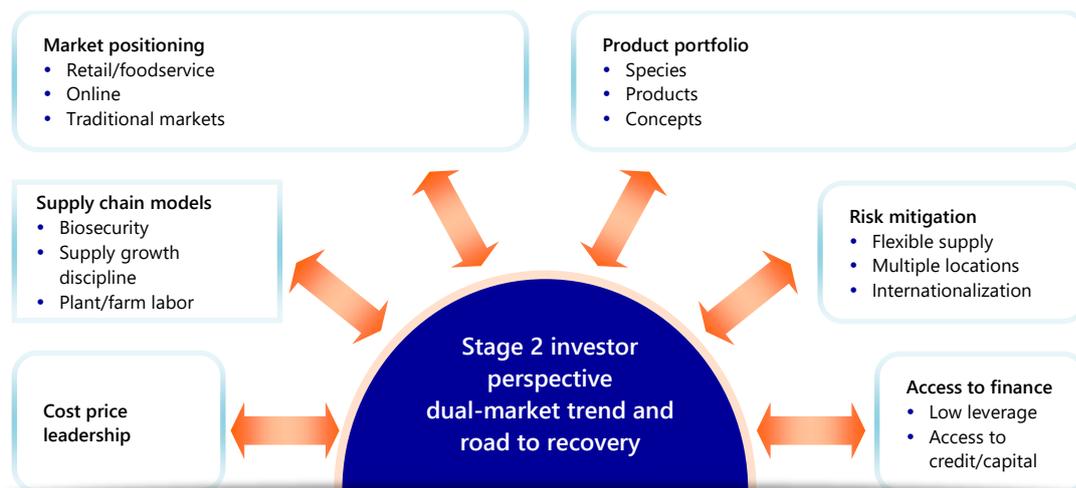
Stage 2: How to Position Your Business

From an investor perspective, it will be important to fine-tune a company's strategy, positioning, and market approach for the highly disruptive and volatile market environment of stage 2 (see *Figure 4*). It will mean an optimal balance between a company's market positioning (sales channels – retail vs. foodservice, online food sales, and sales to traditional markets), its product portfolio (with a special focus on changing consumer confidence, more remote working, and the expected dual-market trend), as well as its supply strategy.

In terms of supply, this will mean optimal biosecurity and plant and farm labor management to reduce potential Covid-19 impacts. It also means a very market-driven supply strategy of constantly managing supply to changing demand conditions in terms of volume, products, and sales channels. A restrictive supply strategy is important, as oversupply will negatively impact price levels.

Markets will stay highly volatile in 2021. This will be a big challenge for any producer in the global poultry industry as it will be difficult to fine-tune production to these constantly changing market conditions. The poultry industry has the benefit of a short production cycle of five to six weeks for regular broiler production, which allows for fast adjustments to changing market conditions. However, the experience in 2020 showed how difficult this can be. In general, consolidated industries tend to be more disciplined than unconsolidated industries. High margin pressure on unconsolidated industries in countries like Poland, the Netherlands, Colombia, Argentina, Brazil, Thailand, and Russia will trigger further consolidation from 2021 onward.

Figure 4: Investors have to fine-tune six drivers of change in their business strategy in Stage 2



Source: Rabobank 2021

As price-driven behavior gradually becomes more prevalent and as markets are expected to shift into and out of oversupply, margin pressure is expected to increase. Well-positioned companies will have low-cost production with a low feed-conversion ratio to offset the expected high feed costs, high levels of risk mitigation in their business model with flexible operations at multiple locations/countries, low leverage levels, and cost price leadership. In combination with a strong market position and product portfolio, they could become winners, especially as this stage could offer exceptional opportunities to invest or consolidate the industry based on long-term drivers led by this market shift as well the oversupply issues in unconsolidated industries.

Stage 3: A Post-Covid-19 Investment Perspective

In addition to the disruptive short-term market impacts in stages 1 and 2, we expect Covid-19 to have consequences for long-term investment opportunities in global poultry out to 2030. We see six major drivers of change in the post-Covid period that will shape the success or failure of global poultry investment strategies (see Figure 5). Some of the changes of stages 1 and 2 will also be important over the longer term, such as more remote working, more online food sales, and a greater emphasis on more local production. These factors have the potential to shape investment flows in the next decade. An additional factor over the longer term is the gradual recovery of pork production in ASF-affected countries in Asia, which will affect local industries (rising competition from pork and possible risks of oversupply) and also global trade (exporters to ASF countries will see declining demand). Global and local investors need to fine-tune their strategies for this new reality, and this will create different investment flows and more consolidation and internationalization.

1. Poultry Markets to Keep Growing Alongside Pork's ASF Recovery and the Rise of Alternative Proteins

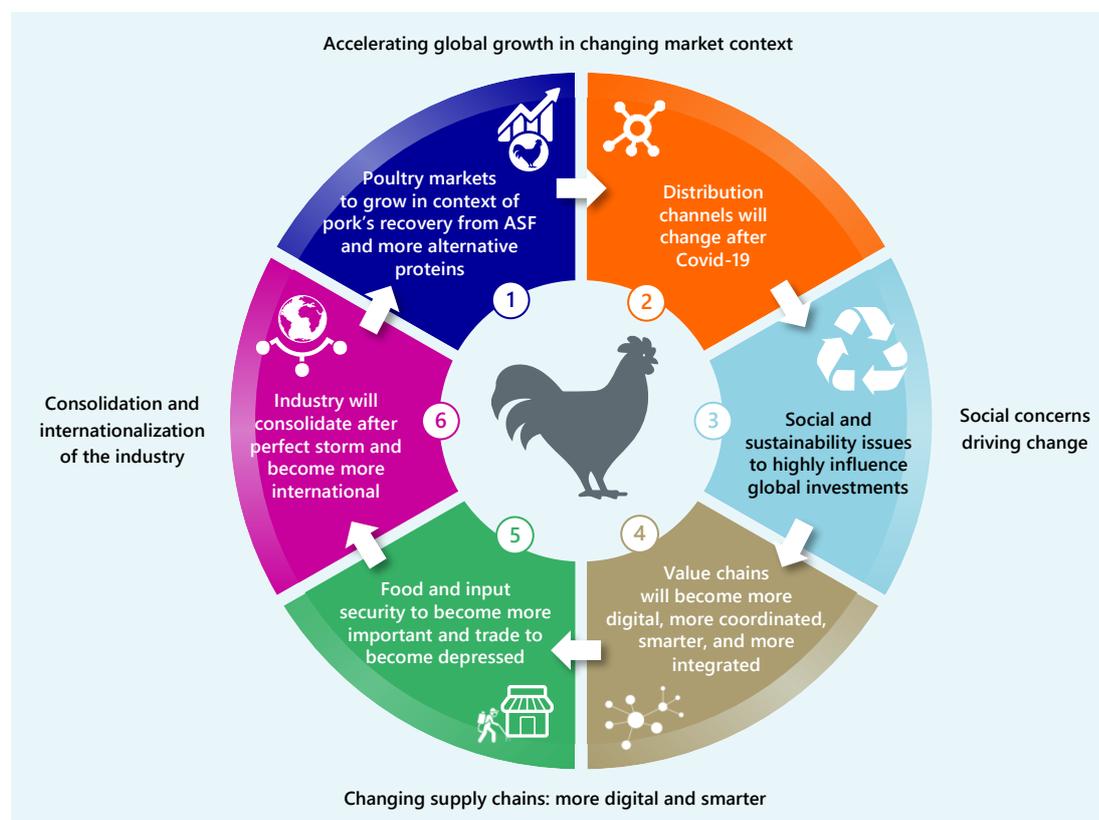
Poultry will remain the world's most popular and fastest growing meat protein with, on average, about 2% growth per year worldwide. More than 85% of global growth will be in emerging markets, especially in Southeast Asia, Latin America, and Africa. This is despite our expectation that ASF-affected countries like China, Vietnam, and the Philippines will gradually rebuild their pork production with more modern production facilities in the period 2020 to 2025. This will push back the poultry industry in these regions and in countries that sell to these regions. In terms of demand competition, the share of alternative proteins will rise, but it comes from a small base (<0.5% of total protein consumption) and will not threaten the overall position of poultry.

As economic growth is expected to recover, incomes will rise again, and this will create additional opportunities for value-added poultry products and markets, which have been growing faster than traditional and fresh poultry in many emerging economies – at rates of 5% to 10% per year. Early adopters of value-added poultry products have an opportunity to establish themselves – and potentially a brand – before retailers become powerful forces in this market segment.

From a market growth perspective, we also expect a further expansion of poultry concepts worldwide, including options for consumers conscious of social issues like animal welfare, environment, health, and local community. This will become a rising opportunity for investors to diversify markets and to create more value in the category.

In this post-Covid period, we see strong growth after the depressed market conditions of stage 2. Some accelerated growth in demand will compensate for the ‘lost’ market growth of the Covid-19 years. Less economically affected consumers will be especially bullish in their expenditures and will likely be prepared to spend more in the early recovery period on luxurious and premium products, restaurant visits, and travel. This will provide the poultry industry opportunities to supply products that fit with this trend and to focus more on dedicated distribution channels.

Figure 5: A post-Covid-19 reality for investors in the poultry industry

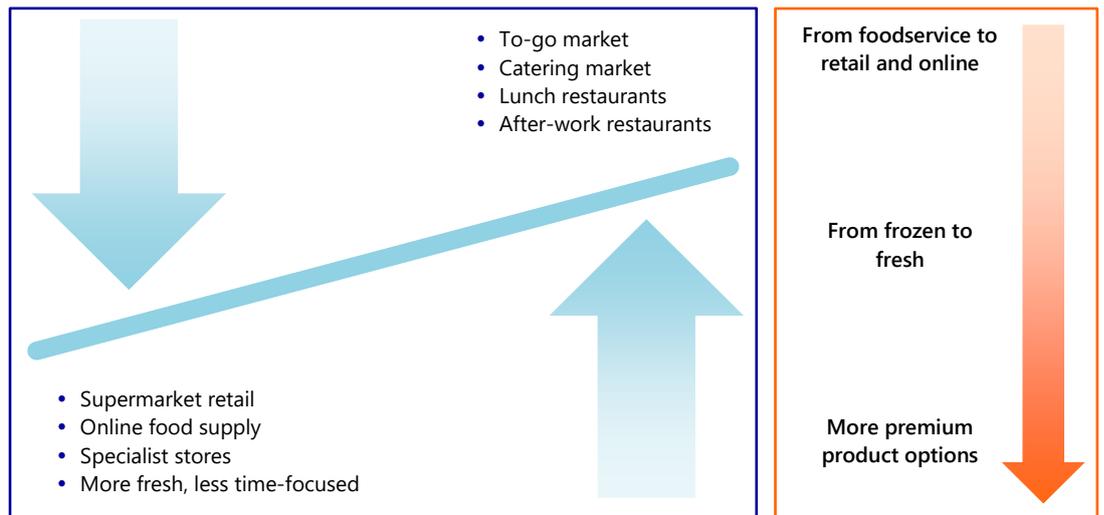


Source: Source: Rabobank, 2021

2. Distribution Channels Will Change After Covid-19

Consumer behavior is changing fundamentally in stages 1 and 2 of Covid-19. Consumers have shifted to at-home consumption, with big drops in foodservice sales. The number of people working remotely has increased significantly in most markets, and this is having an impact on catering service and to-go retail (see Figure 6). Although a return to offices is expected, the share of remote work is expected to have permanently shifted, especially in high-income countries with a high share of white-collar workers. World Bank research has shown that in high-income countries, 23% of jobs are potentially suitable for remote work, while in middle-income countries this figure is 17%, and in low-income countries it is 13%.

Figure 6: Food distribution changes in the Covid-19 era



Source: Rabobank 2021

We have seen also material growth in online food distribution, for example 40% growth in Q2 2020 for Europe and similar or even higher growth in other parts of the world. In addition, grocery retail and restaurants have expanded their home delivery services. We expect the shifts to online grocery and foodservice delivery to have an ongoing impact on overall food distribution.

As the shares of remote work and online food distribution grow, investors need to rethink their market strategy and consider a higher focus on retail and online food distribution. This will mean a higher focus on fresh products and branding, which offer opportunities for local investors. It will also mean depressed global trade, as traded products are typically frozen and dedicated to foodservice.

3. Social and Sustainability Issues to Highly Influence Global Investments

As global demand for food products, including meat and poultry, keeps rising and as resources are finite, attention to social themes will keep rising. We have seen this over the last decade. Themes like sustainability (e.g. the Paris Agreement, sustainable soy, etc.), animal welfare, local community (like employment and social consciousness), and health issues (like food safety, antibiotic use, and zoonotic concerns) will become even more important themes in the post-Covid-19 investment reality. In some cases, these themes can even contradict each other, such as the need for efficiency to reduce environmental footprint contradicting the move to greater welfare and organic standards, which tend to be less efficient converters of feed.

A very direct Covid-19-related factor is the 'support your local community' theme. In some countries, this has pushed back on imports (like South Africa, the UK, and France). Some of this impact will remain beyond Covid-19, as retailers have been using this as part of their marketing strategies. Furthermore, governments' focus on the post-Covid-19 economic recovery could see increased support for local production, boosting local development and economies.

Themes like sustainability, animal welfare, and human health will be in the forefront, leading to changing standards and also to more labeling, such as the labels we have seen on animal welfare-friendly practices and low antibiotic use. Companies will increasingly use these social concerns as building blocks for branding and new product development. They will help the industry to differentiate markets, create higher value, and anticipate changing social expectations.

4. Value Chains Will Become More Digital, Smarter, and More Coordinated

Many of the post-Covid-19 trends will affect poultry value chains. The biggest value chain impact will come from the rise of online food distribution, as it links very well with new technology developments like smart technology on farms, sensor technology, big data tools, and artificial intelligence. This is a perfect trigger to develop digital value chains in the near future, creating opportunities for investors in terms of linking farmers to consumers, with tailor-made marketing and precision health advice for consumers. Digitalized value chains will also allow retailers and foodservice companies to introduce supplier indices based on themes like supply reliability, environmental footprint, animal welfare, and health issues like antibiotic or campylobacter scores. Such developments will impact value chain management and require more coordination and communication. Companies that are at the forefront of these developments can have an early adopter benefit in the market. Branded companies can create higher brand and product confidence among consumers, while private label suppliers can work together with retailers and foodservice companies to create these supply indices in a preferred supplier role.

Another ongoing change triggered by Covid-19 will be the adoption of high biosecurity standards, which were introduced during the pandemic to protect workers. It will likely also mean a further adoption of labor-saving technology and acceleration of robotic technologies throughout the value chain.

5. Food and Input Security to Become More Important With Trade Depressed

The big disruption in stages 1 and 2 has been a wakeup call for governments and investors worldwide. It can be expected that food and input security will be more important in a post-Covid-19 world. Governments will tend to reduce dependence on imports, especially for essential inputs like feed ingredients and genetics, and push industries to become more self-sufficient where possible.

In terms of poultry trade, the longer-term trend of local production growing faster than global trade is expected to continue (see [New Global Poultry Trade Reality](#)). This will happen for poultry production and also for poultry inputs. The example set by governments in Asia and the Middle East to increase self-sufficiency will gradually be followed elsewhere, for example in Africa. Arguments for this move are essentially strategic (low dependence on food imports) and economic (developing local economies). The recent growth of imports in some Asian countries due to ASF is expected to decline again, putting them back to higher self-sufficiency.

Input industries need to follow suit and focus on local production while also internationalizing their model to be able to deliver their inputs closer to these markets. This will mean a further internationalization of the breeding value chain, as well as the animal health and animal nutrition value chains.

These movements are expected to challenge global trade flows and price levels and will require traders to internationalize their business and invest more in local markets than in export hubs.

6. Industry Will Consolidate and Become More International

As the poultry industry will face big changes in the post-Covid-19 world, we can expect changing strategies and investment flows by the local poultry industry and by global companies. The trend toward consolidation and internationalization is expected to continue and even accelerate. There will likely also be more multispecies investments, with poultry companies moving to other proteins, and pork companies into poultry. This trend will happen in emerging markets especially, as we have seen in the past few years. Value-added meat will remain a priority, as it offers good opportunities for branding and as growth and margins tend to be high. Internationalization will accelerate due in particular to the expected slow growth in global trade.

Winning in the Poultry Industry in the Covid-19 Era

The Covid-19 pandemic is creating more change in the poultry industry than we have seen before. From an investor perspective, it will require a constant fine-tuning to changing market conditions, from the volatile and uncertain environments of stages 1 and 2 to the longer-term strategic contexts of the post-Covid-19 world.

These market changes will require many investors to redirect their investments. A lot of future growth will be seen in local markets instead of trade. Industries will get more diversified, via the adoption of new concepts, and will create more value, including more value-added products. The importance of at-home dining will stay high, and this will require companies to change their value chain strategy, especially as adoption of the digital value chain will take off quickly and accelerate. Having said this, foodservice will remain an important channel but in a slightly different format with less office-focused outlets, like catering and lunch restaurants, but more quick-service restaurants, fast-casual restaurants, and delivery. Producers focused on foodservice should prepare their business model for this type of change.

This all will happen in a context wherein the social and sustainability angle will become much more important, meaning companies need to take these changes into account to make the right investments.

This will also mean big investments in the post-Covid-19 reality of the poultry industry, where ongoing strong market growth will allow ongoing greenfield projects, especially in emerging markets. Furthermore, these changes will lead to a significant increase in consolidation/internationalization of the industry, as investment flows are expected to follow the six key post-Covid-19 investment themes.

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