

Canadian Chicken Market Report

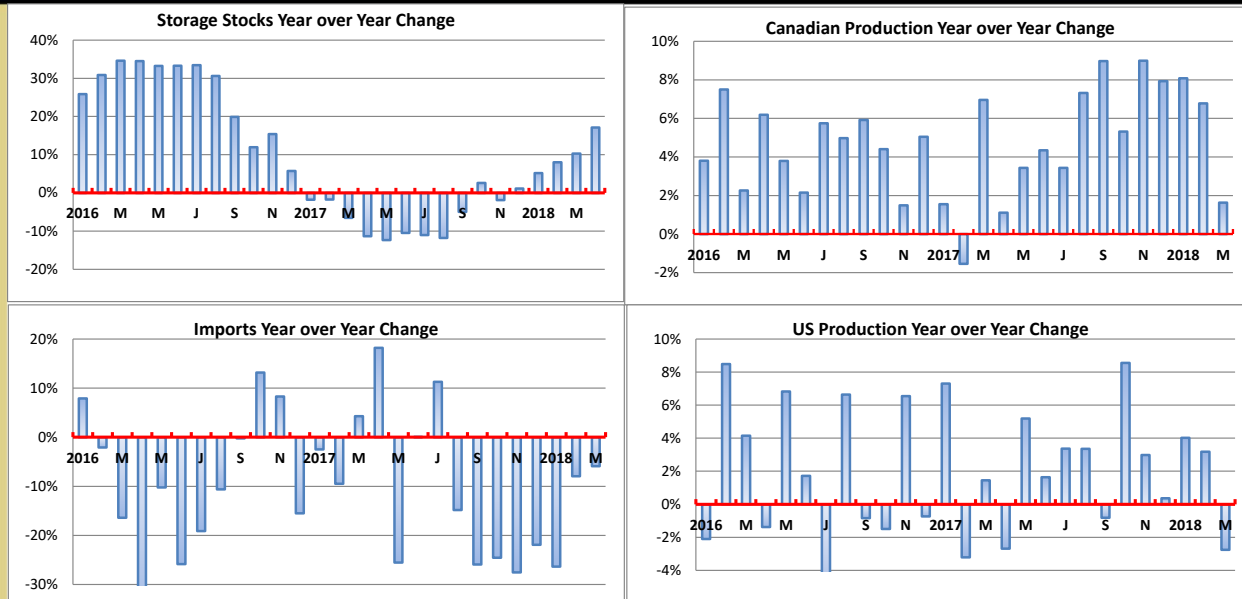


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Market Analysis and Consulting Inc.

Make Informed Decisions

April 2018



The Market Argument

Canadian Chicken Prices through July 2018

The Bullish Case

1. Demand for chicken remains very strong
2. Margins at retail are positive.
3. Chicken is competitive against beef.
4. There is strong pricing momentum going into late spring/summer
5. U.S. exports are picking up steam which will boost the entire poultry complex.
6. The weak C\$ will boost domestic price levels.
7. The market is absorbing increased import quantities.
8. U.S. exports are expected to be robust.

The Bearish Case

1. U.S. production is increasing at a faster pace.
2. Beef has grabbed the featuring lead.
3. Stocks are very high in both Canada and the U.S.
4. Retail prices are increasing.
5. There are large quantities of competing meats.
6. Production increases into July are slated to be very high relative to normal.

Excellent demand continues to be the key factor. With that said supplies of chicken and competing meats will be ample. The breast should underperform seasonal norms.

Current Chicken Market Conditions

Market Factors					
	Canada			United States	
% Change Yr over Yr	March	12 Month		March	12 Month
Production	2	6		-3	2
Storage Stocks (Latest)	17	-1		14	6
Imports	-6	-14			
Exports (Mar)				0	0
Egg Sets	0	4		3	3
Chick Placements	4	5		1	2
Breast Prices	0	9		5	11
Wing Prices	-8	0		-15	8
Leg Prices	3	7		5	16
Beef Cutout Value	-1	3			
Pork Cutout Value	-16	1			

Forecast Follow-up

In the January edition of this report the forecast for December through April was as follows:

“...Wings and legs will slide tepidly lower while breasts should begin a slow seasonal climb in April. The forecasts are very dependent on strong demand continuing to hold.”

The breast did better than I expected, climbing by 9% from December through April compared to the 5% I forecast. Wings collapsed compared to December, which I did not see coming. Legs fell roughly as I expected.

GRADE ON THE CALL: “C.” I got the direction right on the leg and the breast so I give myself marks for that.

Canadian Market Commentary

The overall chicken market has been solid, or flat depending on perspective. The value of the total cutout has been at or higher than last year’s levels through the first four months of the year. On the supply side the industry is close to getting caught up to where it could have been in terms of combined supplies of fowl and broiler meat, post-clampdown on the imports. Chicken demand has been excellent and an ongoing highlight of the industry. Foodservice demand or traffic has been subpar in the late winter and that is a cause for concern, but the expectation is that it will turn with the better weather.



Breast pricing is making buyers nervous as spot prices are right where they were last year before they exploded. Demand has been good though and retailers have been aggressive on feature price points.

Wings have been very disappointing as spot market prices have collapsed. Stocks are very large and the blame has to be placed on poor foodservice conditions. Foodservice has not been what was expected for a variety of reasons including the minimum wage.

Legs have performed better than expected given supply levels. The product has seen its share of features in various forms which likely helped. Legs are seen as a potential problem in the coming months but so far they are clearing. Good export performance by U.S. processors has helped the leg complex remain firm.

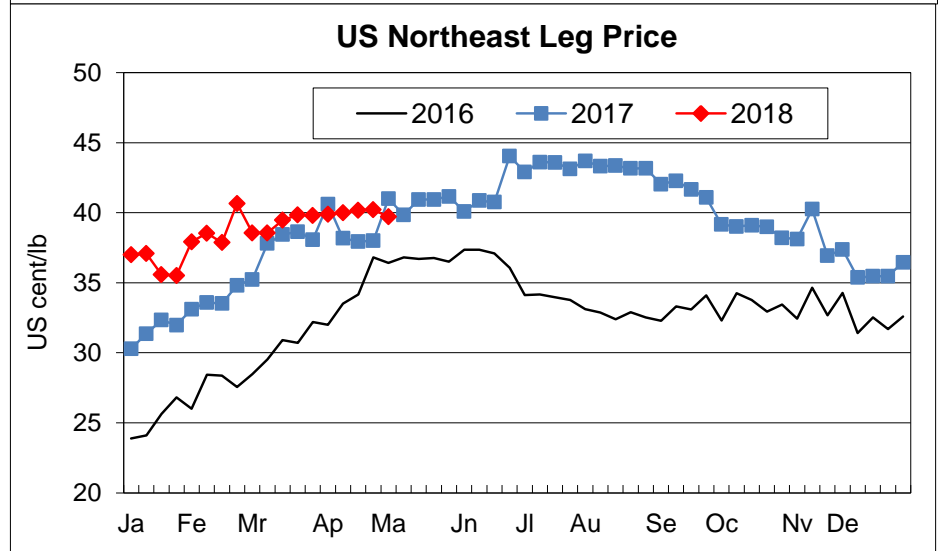
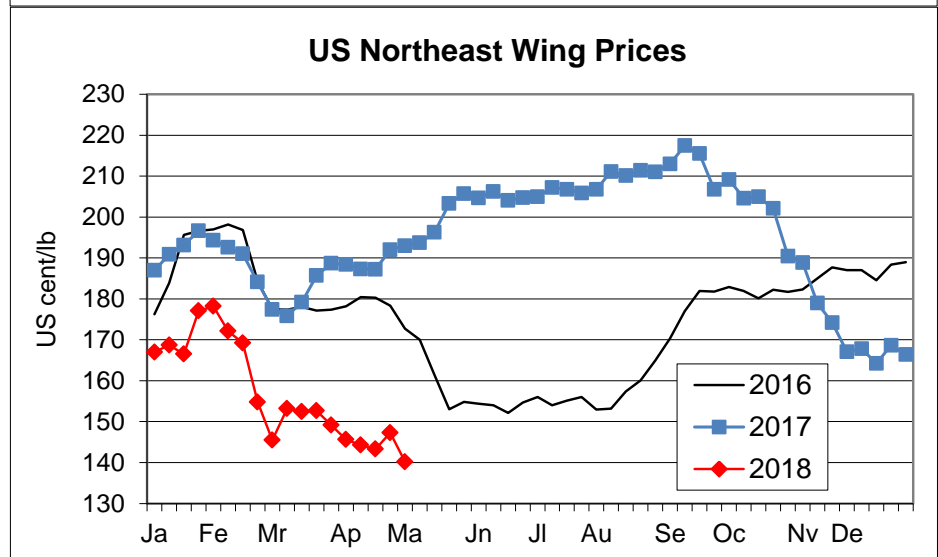
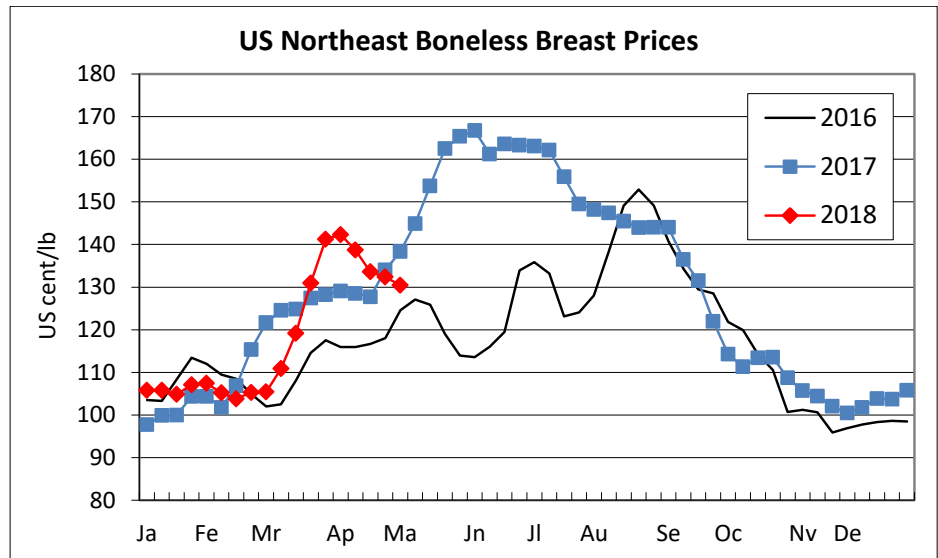
U.S. News Watch

- **Tyson Foods** announced last week that its wholly-owned subsidiary, Tyson Ventures, has co-led a \$2.2 million investment in Future Meat. The company says the world's growing population has a taste for protein, and the traditional methods won't always be able to satisfy the demand. (Marketwatch.com, May 9).
- **Tyson Foods** reported second quarter results on May 7. Total sales were \$9.8 billion while operating income was nearly \$500 million, up 7.6% and down 12% respectively. Chicken sales were \$3 billion, up 2% while chicken operating income was \$231 million, down slightly from last year. The company said that sales volume was saw strong demand along with the incremental volume from the AdvancePierre acquisition. Average sales price increased for the second quarter due to sales mix changes. Operating income remained strong "as we benefited from \$37 million and \$23 million, respectively, of Financial Fitness Program cost savings, in addition to positive impacts from incremental AdvancePierre results and slightly lower feed costs, partially offset by increased labor, freight and growout expenses and one-time cash bonus to frontline employees of \$51 million incurred in the second quarter of fiscal 2018."

Looking ahead the company says that "Based on current futures prices, we expect an increase of approximately \$100 million in feed costs in fiscal 2018 compared to fiscal 2017. For fiscal 2018, we believe our Chicken segment sales volume will grow approximately 3-4%, and adjusted operating margins should be similar to fiscal 2017 at around 10%.

- Separately, Tyson says that it is passing along increased transportation costs to consumers. In a May 7 conference call with reporters, Tyson Foods CEO Tom Hayes was asked if he anticipated any softening of demand as a result of those increased costs. "[The consumers] are not going to find themselves with monstrous increases. For us, we don't believe there is going to be a tremendous demand disruption in any of our products, based on any of our brands, but also the categories we play in are hot categories. They continue to grow and we feel like the consumer will pay the freight costs, and it should be relatively low to them," said Hayes, adding that any increases will likely be "even hardly noticeable." (wattagnet.com, May 7)

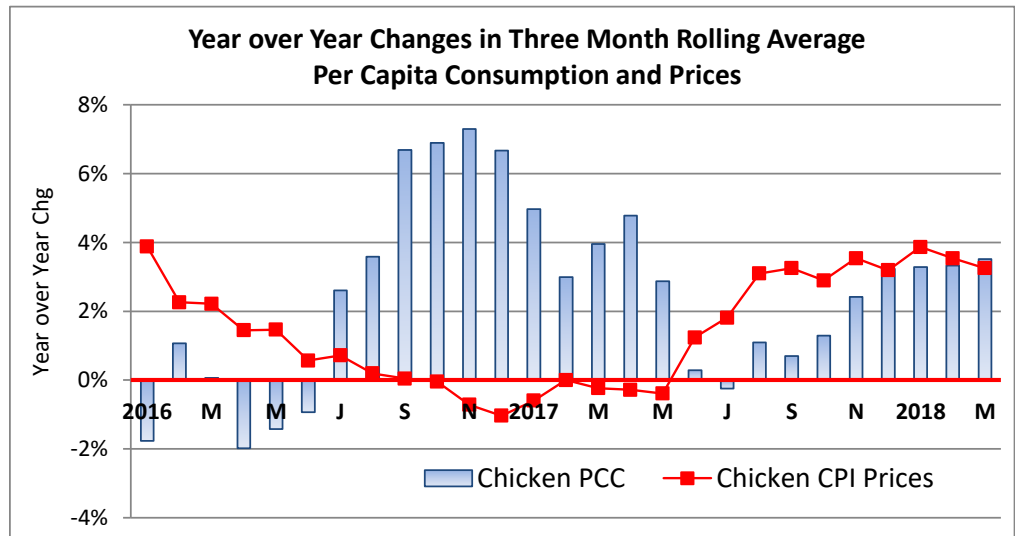






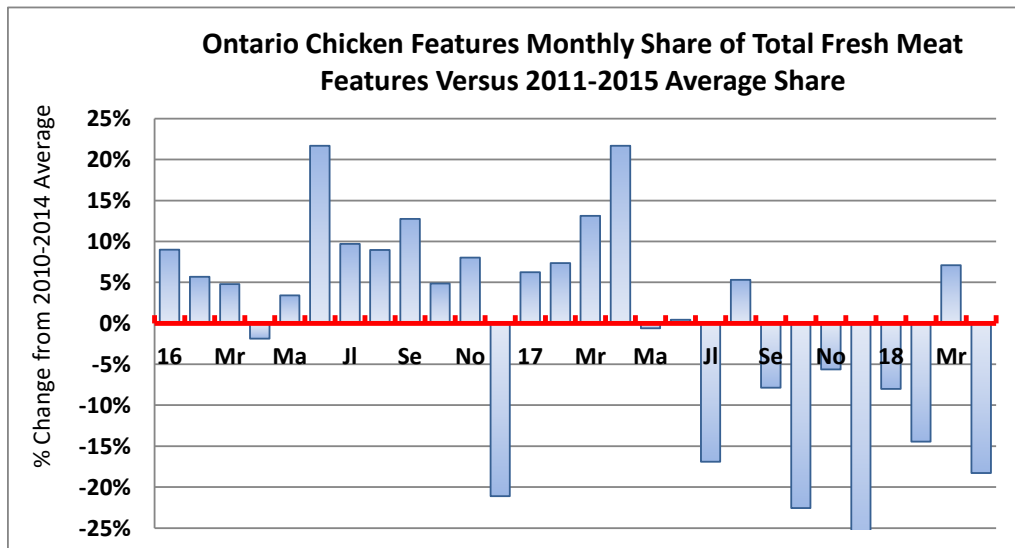
Chicken Demand

Consumption and Consumer Pricing



- The Canadian Consumer Price Index for chicken increased by 3% in March 2018 (latest) compared to the same month last year.
- Consumption is increasing despite higher prices.
- Total demand in March was stronger than in 2017. Based on my estimates, first quarter chicken demand has been very strong.

Features



- Ontario chicken meat features share of total meat features during April was less than the 2011-2015 average. Beef ads seem to be taking control and are at the top of the grocer pecking order.
- Features share continues to struggle and that might be because of how high prices got during mid-to-late 2017. Grocers may have changed featuring plans due to last year's price levels. With that said, the features that have been posted on the front pages have remained very aggressive with boneless breast typically at \$3.99 or less.

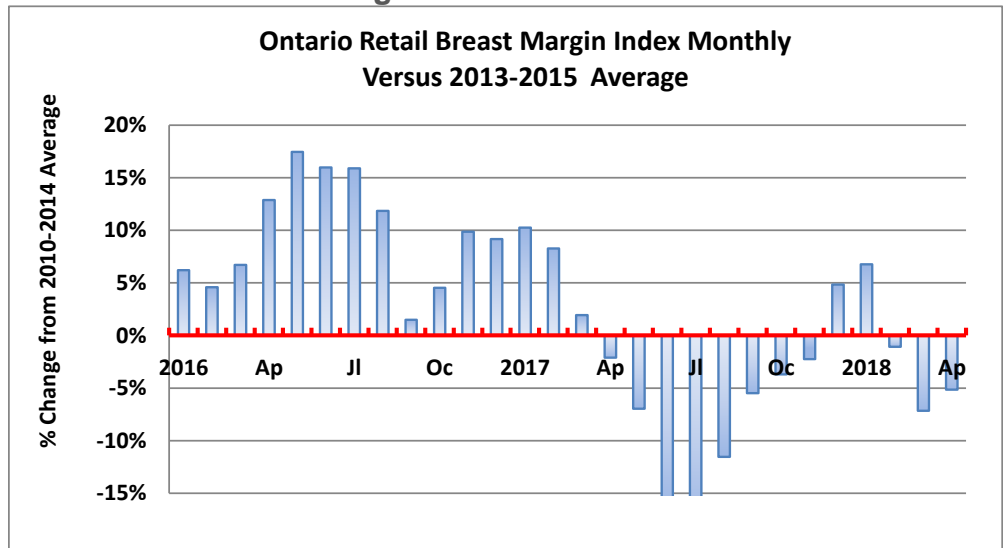




In addition whole birds have been featured at less than two dollars. Even features in the west have been aggressively priced which is not often the case.

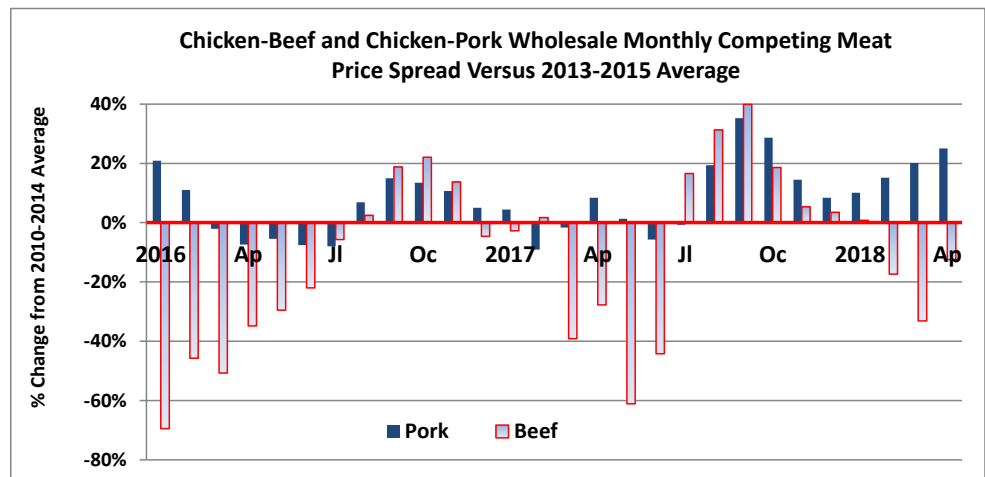
- One interesting point of note however is that in early May Loblaw Ontario featured boneless breast at over \$5. That is a new everyday price in certain markets. It is a low everyday price but it is unusual for the front of a flyer. It may be a signal that they are easing back on price wars.

Retail Chicken Breast Margins



- Grocer breast margins tipped below average again in March and April. The challenge was the firming breast price at wholesale and steady to weaker retails.
- In terms of retail margins, pork margins are very strong and beef is also profitable.

Chicken Versus Competing Meats

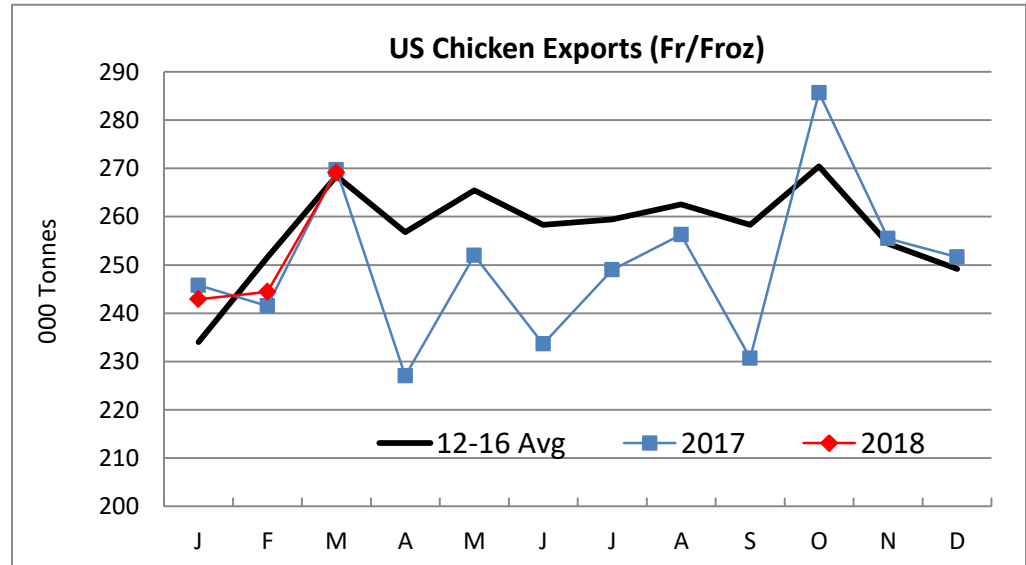


- Chicken pricing was running sharply higher than pork, relative to the 2013-2015 average in recent months. That is, at the processor level chicken prices are running stronger than normal relative to pork.
- Beef prices increased into April at the processor level and provided chicken with a pricing advantage.





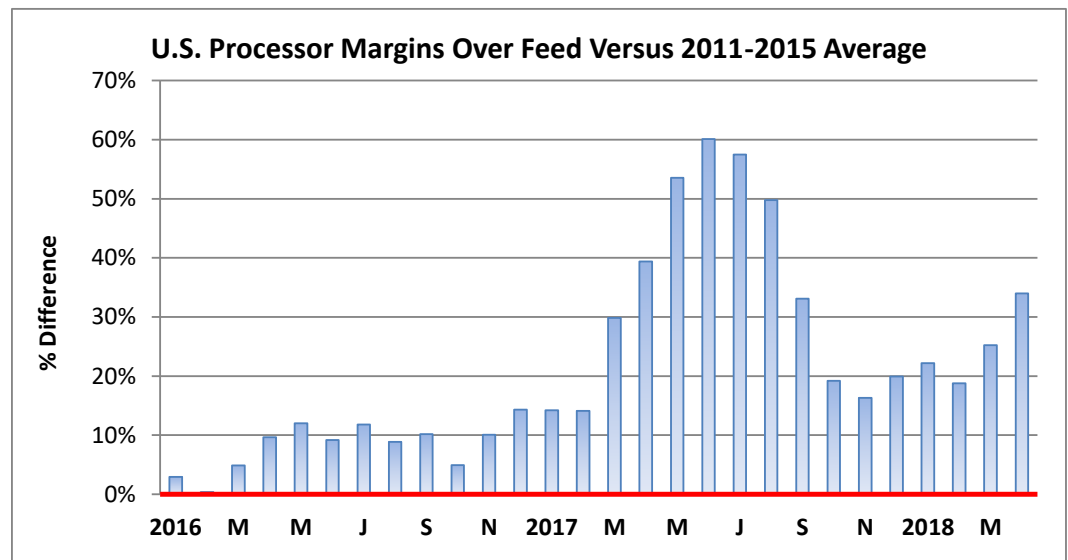
U.S. Exports



- Chicken exports from the U.S. were unchanged in March (latest) compared to last year for the same month.
- Rolling 12 month export tallies are steady compared to the previous 12 months.
- Broiler exports comprised 17% of U.S. broiler production in March compared to 16% for the 2017 annual average and the 2012-2016 average of 18%.
- Global leg quarter sales values were US\$869/tonne or \$0.39/pound in March. The value last year the same month was \$761/tonne. Exports are helping leg prices.

Processor Performance

U.S. Processor Margins



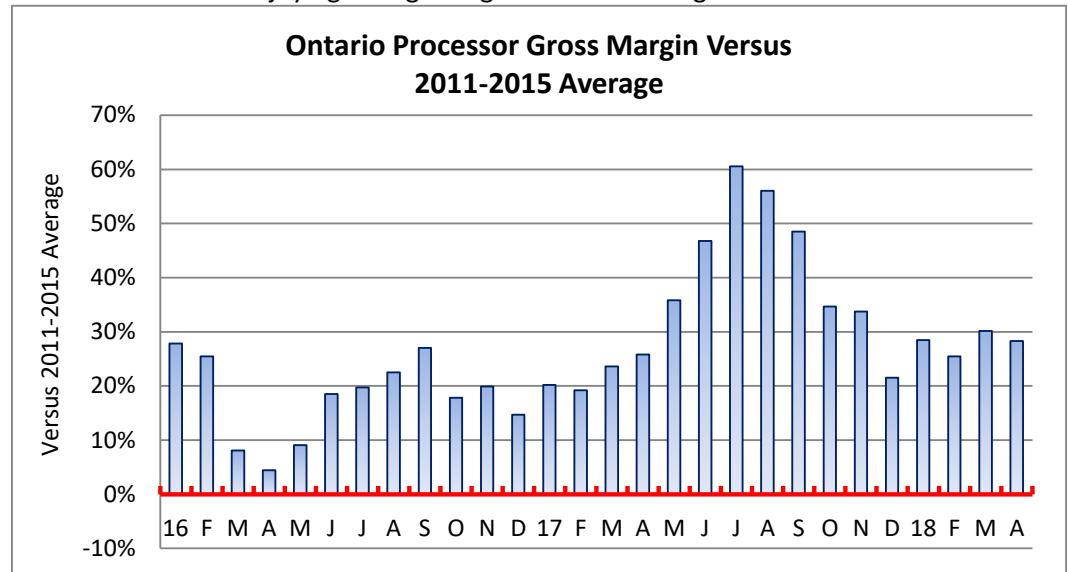
- U.S. margins increased again in April and remain well above the 2011-2015 average.
- U.S. grain costs have moved sharply higher in March and April.



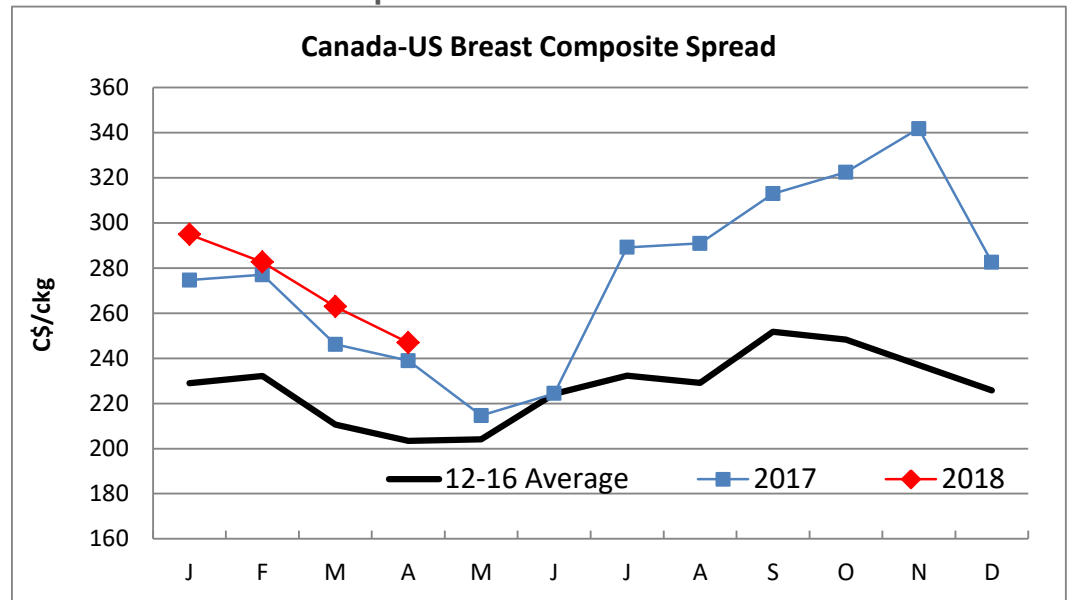


Canadian Processor Margins

- Live bird costs were down 2% in April compared to last year.
- Spot chicken cutout values were flat in April vs. the same month in 2017.
- Processing gross margins on spot transactions are 2% more than last April.
- Processing margins are stable and are well above the average of 2011-2015.
- Processors are enjoying a long string of excellent margins.



Canadian-U.S. Breast Spreads



- The spread between Canadian and U.S. breasts composite (bone-in and boneless average) is seasonally declining but remained above average in April.
- The wide spread reflects the fact that the Canadian market is much stronger than norms versus the U.S. market.

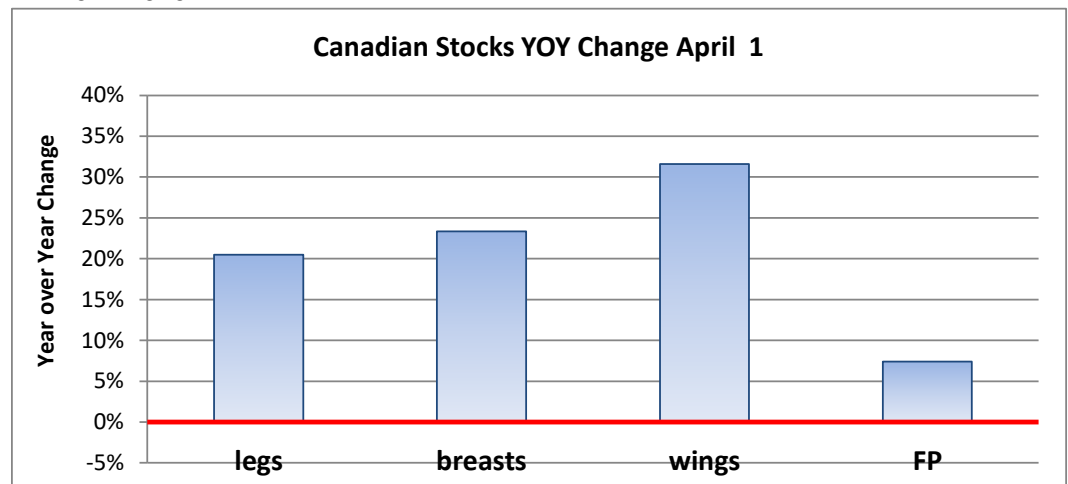




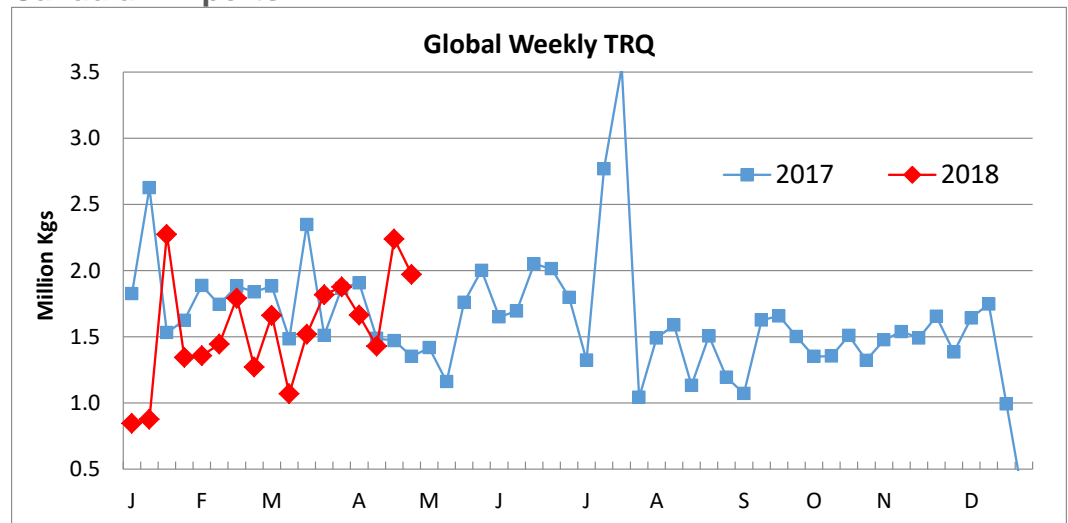
Canadian and U.S. Supply

Canadian Production and Stocks

- Canadian production was up 2% in March and is running up by 6% during the past 12 months compared to the previous 12 months.
- Total fresh supplies of both chicken and fowl are running about 3% more than year ago levels as of the most recent three months.
- The industry over-produced allocations again in period A-148, ended March 17. Production was over allocations by nearly 2% which is significant. It was the third period in a row of over production after under-producing for much of 2017.
- Total stocks level jumped 17% on April 1.
- Wings, breasts and leg stocks are all above last year and well above the average of 2012-2016.



Canadian Imports



- March imports of all chicken products, including further processed, were down 6% compared to 2017. The 12 month rolling average was down 14%
- TRQ imports are running well below last year but close to pro-rata in April.
- Lower levels of imports are a reflection of the big production increases and the weaker dollar.





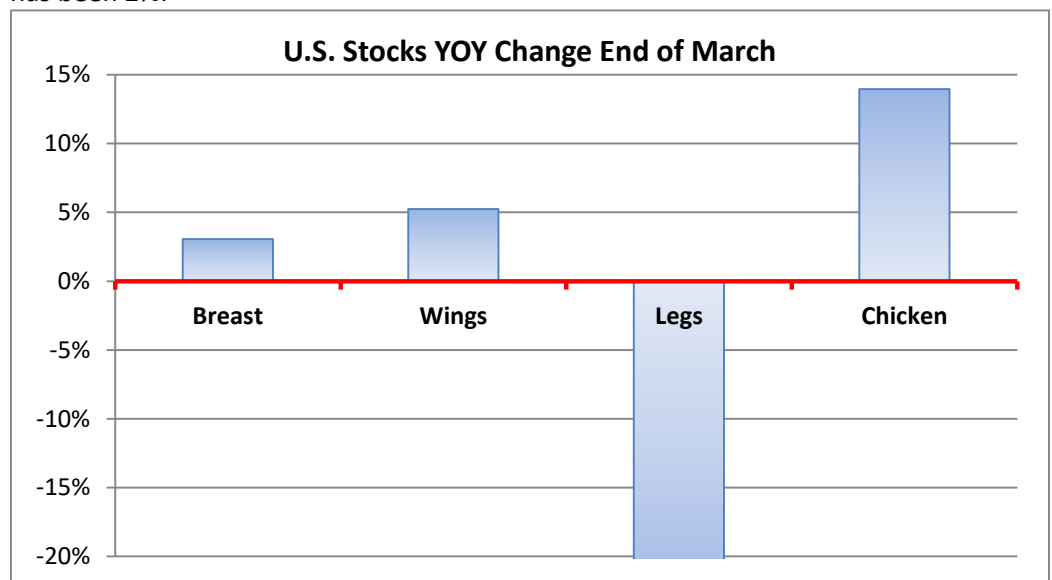
- There were significant quantities of Brazilian imports in April and they helped to increase the total volume of imports (reasons behind this have to do with ongoing production issues in Brazil. This may not repeat itself in a consistent manner).
- Fowl imports are 9% above year ago levels during March.

TRQ Value Trends

- TRQ values have steadied at a level that seems to convert well, but, it does require support at the currency level and the supply chain level (fresh via USA and Frozen from off-shore partners).
- Quota values trended around \$1.60-1.65 during March and April.

U.S. Production and Stocks

- March production was down 3% from last year while the rolling 12 month increase has been 2%.



- Chicken stocks were up 14% as of the end of March. The total has been trending sideways at very high levels for the past six months. Most of the increases have been in the “other” parts category.
- Breast stocks have been trending higher for the last several months.
- Wings stocks are above year ago but are at fairly average levels.
- Legs stocks moved lower for five months in a row. Leg stocks are below average.

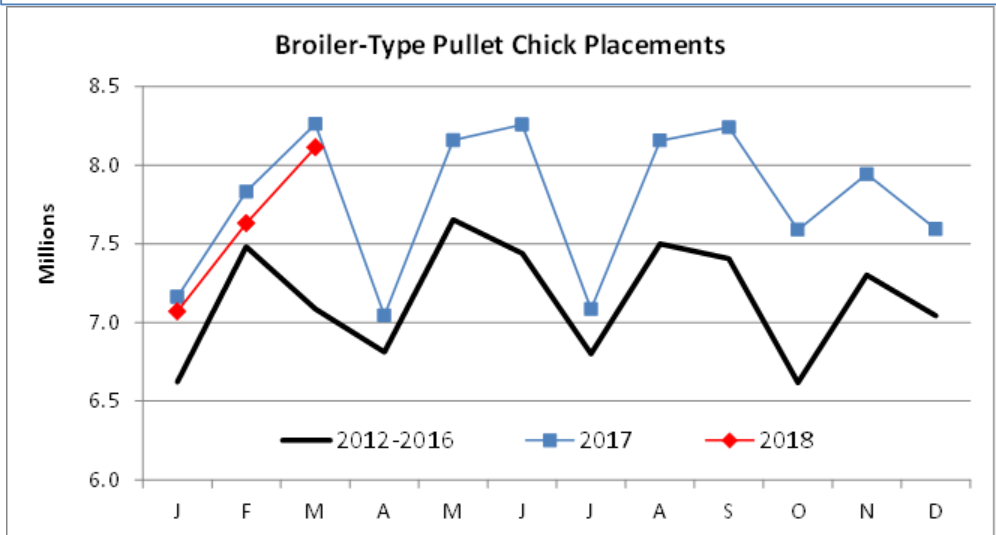
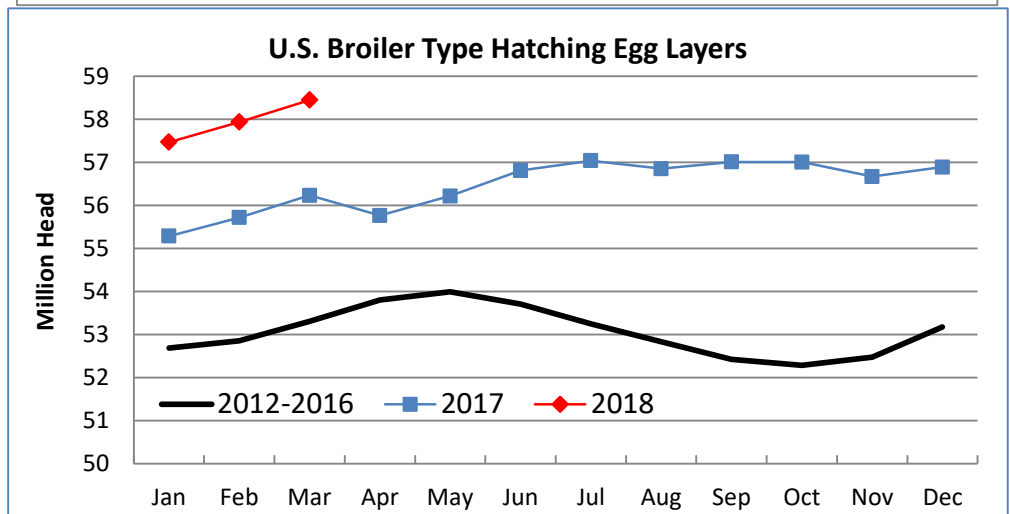
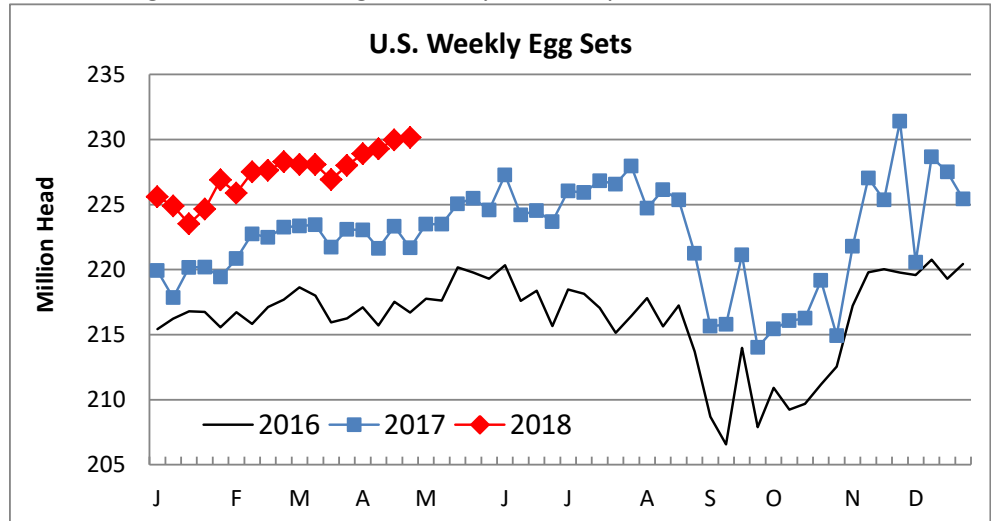
U.S. Egg Sets and Placements

- March eggs set and chick placements have been running 3% and 1% higher respectively versus 2017.
- Over the previous 52 weeks eggs set have run 3% above year ago levels while chicks placed are running 3% higher.
- Broiler-type hatching egg layers increased by 4% in March. The hatching egg layer flock is up 4% for the latest 12 months vs the previous 12 months.





- Placements of broiler-type pullet chicks for future domestic hatchery supply flocks during March 2018 were down 2% from March 2017. The broiler-type pullet chicken flock rolling 12 month average is steady with the previous 12 months.



Canadian Chicken Price Forecasts

Competing Meats

Production and Pricing of Beef and Pork			
% Change Year over Year	Q1' 18	Q2' 18	Q3' 18
North American Beef Production	3	4	3
North American Pork Production	4	3	4
Canadian Wholesale Beef Prices	1	-4	-2
Canadian Wholesale Pork Prices	-11	-4	-7

- Both pork and beef production will be ample in the coming quarters.
- Beef pricing will begin to fall below year ago levels in the coming month.
- Both beef and pork are seeing excellent demand.
- Beef and pork should provide strong competition for chicken in Q2 and Q3.

U.S. Chicken Forecasts

Production

- Egg sets, pullet placements and layer inventories in the second half of 2017 and early 2018 indicates that production increases in the second and third quarters should be up by 3%.
- USDA has the second and third quarter production up by 2%.

Exports

- USDA Economic Research Service is forecasting exports to be 8% higher in the second quarter and 6% higher in the third.
- If the USDA is right about the exports, it is going to have positive impacts on pricing through the chain.

U.S. Prices

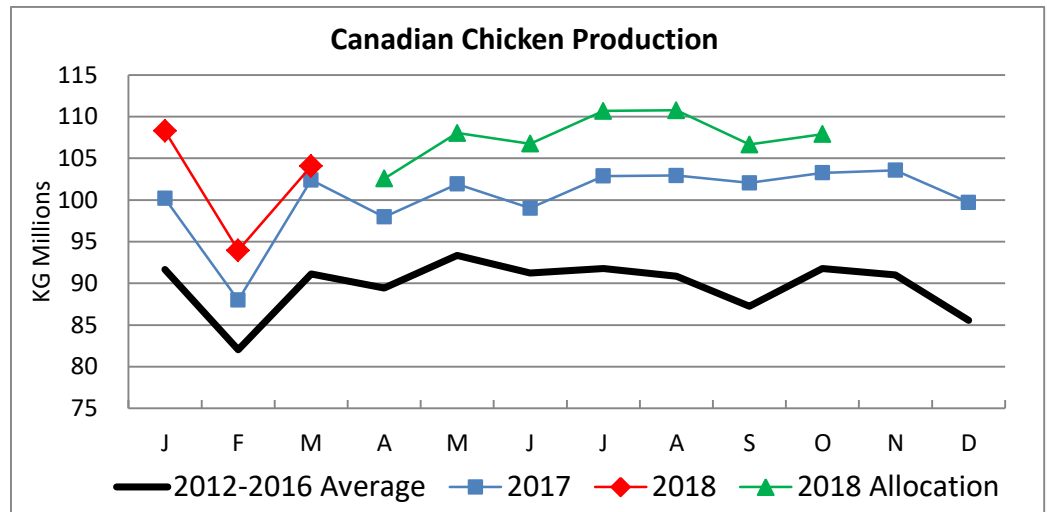
- Boneless breasts went too far too fast and eased back in April. Prices should get to \$1.50/lb by July.
- Wings continue to struggle but are likely scraping a bottom at \$1.40. Watch for \$1.50 by July as it trends sideways in June at about \$1.40.
- Legs have been remarkably resilient at \$0.40 the last couple of months. They will move slowly higher to hit \$0.42 in the next three months.

Canadian Forecasts

Production

- Total allocation for A-149 (March 18 to May 12): 4.7%. Domestic allocations: 3.8%.
- Total allocation for A-150 (May 13 to July 7): 7.8%. Domestic allocations: 7.0%
- Total allocation for A-151 (July 8 – Sept 1): 7.6%. Domestic allocations: 7.0%.
- Total allocation for A-152 (Sept 2 - Oct 27): 4.5%. Domestic allocations: 3.5%.





Average daily volume of fresh supplies (allocated production plus normal seasonal import flows) during June and July 2018 are forecasted to increase about 7% relative to the average daily supplies in February and March. Normally, on average during the past decade, supplies increase by 3% over that time frame. That means that the production change from the March to July period is going to be significantly above normal for that time of year.

Imports

- Seasonally total imports including processed tends to increase from April through June, before easing a little into July.
- This year production is ample and stocks are building but demand is good and the breast spread over the U.S. is wider than average. Those conflicting forces should result in a normal pull on TRQ imports over the next two months.

TRQ Values

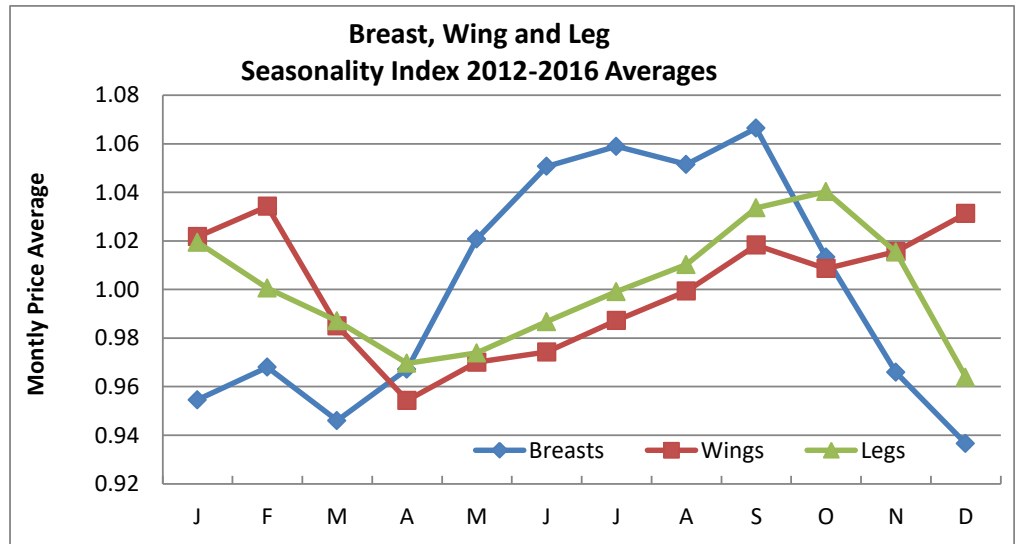
The TRQ value, as mentioned, is running about \$1.65/kg and I believe it will hold steady (+/-5cent) for the rest of May. There should be a bump in the TRQ value come June/July (possibly \$1.70), but that is all I can see happening. There is simply too much length in supply, too much uncertainty and too risky to be long on anything.

Price Seasonality of Main Cuts

The following is a summary of the HISTORICAL seasonal changes in pricing from 2012 through 2016 for Canadian breasts, wings, legs and the total composite from *March through July*:

- Breasts: +12%
- Wings: 0%
- Legs: +1%
- Composite Cutout: +6%





Forecasts for Main Cuts

The industry continues its adjustment to the changes brought by the clampdown on the bogus fowl imports. The question now is when or if the industry is over the supply shortfall created by the clampdown. Based on the total supplies of fowl and broiler meat using imports and production totals it likely is very close to being in the rearview mirror, if it is not already. In other words, the big production increases of recent periods have probably brought the industry back to normal at least in the second quarter of this year. The question then becomes if the industry is at or near a normal supply trajectory, then how will it absorb the big production increases of the summer.

Another important issue is demand. Chicken demand has been rock solid and supporting the entire cutout from breasts to legs. At the same time competing meat production is going to be huge. In addition, it appears that retailers have turned the number one feature spot over to beef. Beef has gained featuring priority in the big feature months of May and June. The bottom line is that the industry needs demand to stay robust to support seasonal price level trends.

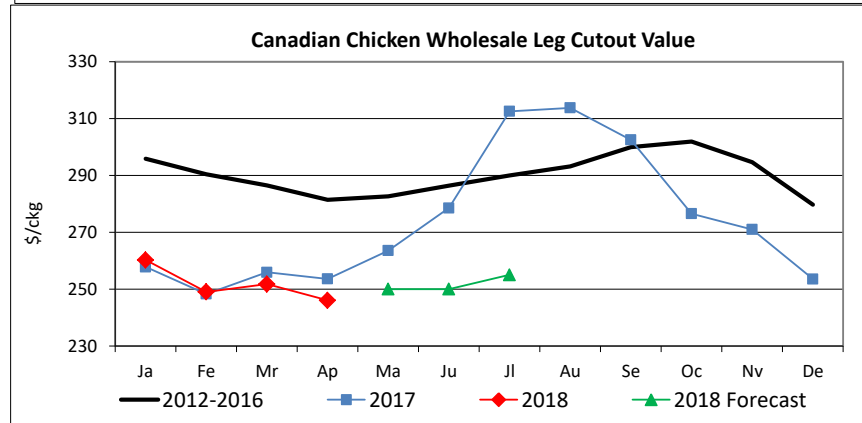
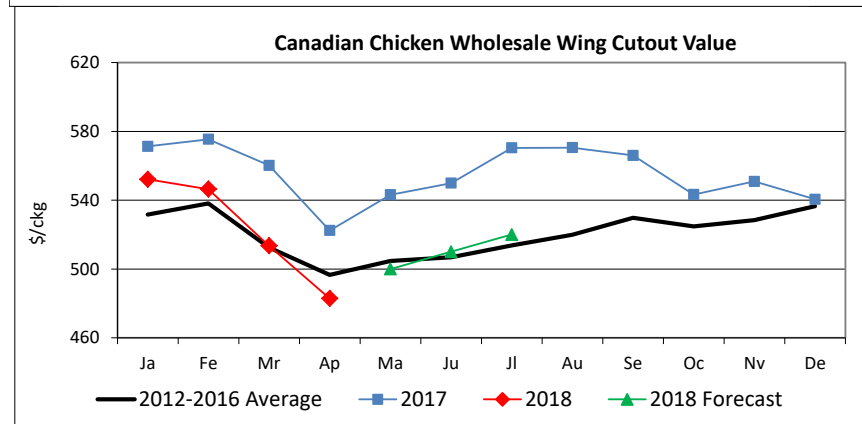
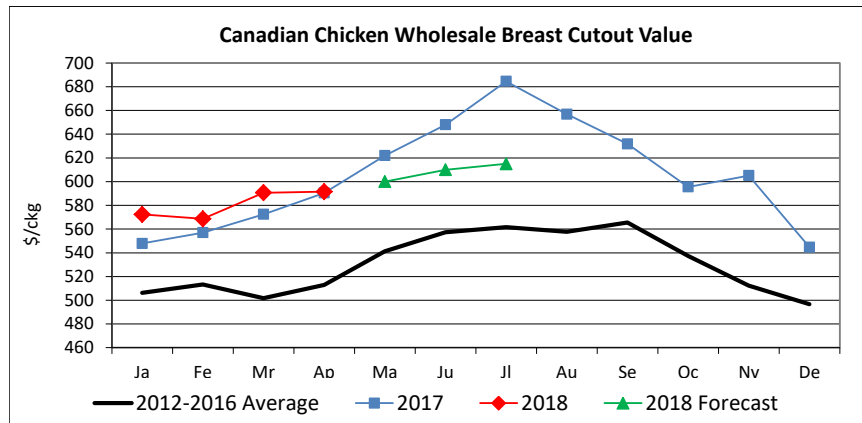
The following are the forecasted price directions for the primary chicken cuts and the composite for *March through July 2018*.

- **Breasts: +4% (much weaker than seasonal norms)**
Breast meat is on a strong undertone. Support will come from the weak dollar and good demand. At the same time, the U.S. is no longer on fire and the breast will be tempered by large supplies of chicken and competing meats.
- **Wings: 1% (right around seasonal norms)**
Wings are going to increase eventually it is just a matter of when and by how much. For now I am playing it safe and calling for a seasonal increase. That is likely to be conservative as buyers see value they will jump.
- **Legs: +1% (right around seasonal norms)**
This could be an optimistic call. The leg is very vulnerable with the increased production. The strength last summer was due to the breast substitution. That is not likely this year.





The graphs below show the trends in the Canadian leg, wing and breast cutout complexes for 2017, 2018, the average from 2012-2016, and the forecast for May through July 2018. The data and forecasts on the graphs are based on the CFC index values, not actual prices.



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