FOOD FOR THOUGHT

SUMMER/AUTUMN 2024

A REGULAR LOOK ACROSS FOOD, BEVERAGE AND AGRIBUSINESS SUPPLY CHAINS

TEN FACTORS IMPACTING FBA IN 2024

The 2020s have already been a hectic decade, with events such as the Covid pandemic, the Ukraine conflict and economic volatility all impacting the global FBA landscape. Away from the headlines, different social, financial and technological developments will all impact stakeholders across the FBA sectors. As companies adapt and implement their strategies over the coming year, we have highlighted ten trends which could impact them.

1. ESG GETS REAL

While businesses across the FBA landscape have been discussing the issues around ESG (environmental, social and governance) for some time, 2024 is likely to the year when the issue increasingly shifts from concept to execution. It will be imperative that businesses move from an understanding of the issues and agreement on targets to measurement and actual implementation. Given that the regulatory ESG requirements are likely to rapidly increase, including the fact that mandatory climate disclosures will commence for some companies from 2024-25 and more companies thereafter, it will be vital that businesses ensure that their ESG strategies are robust and able to withstand regulatory scrutiny. Importantly, where many businesses may now seek external guidance to help, it will also be important for them to do the right amount of due diligence on their advisers.

Globally, a number of major importing countries and regions are likely to expand their implementation of ESG requirements in trade agreements, particularly in Europe, while global commodity companies will increasingly release public targets and disclosures. This will increase the urgency of exporters to evaluate their requirements and capabilities to measure their carbon emissions including their supply chains, or balance whether this could impact their marketing strategies and future sales.

2. BITING INTO THE PROTEIN DEFICIT

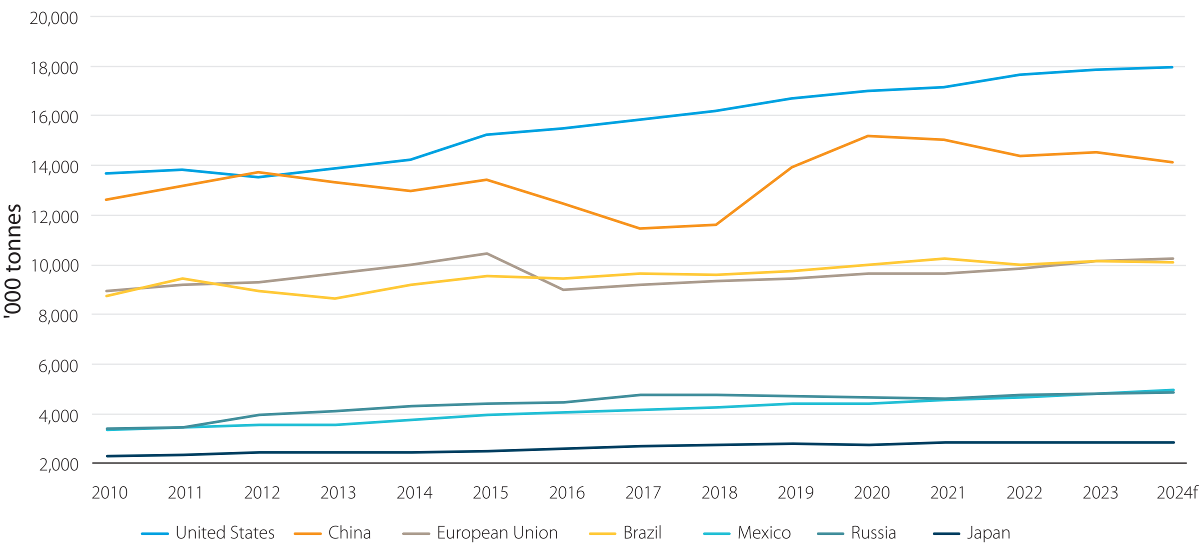
While the positive impact of growing populations with rising incomes on food demand has been discussed for decades, 2024 will see an increasing focus on the challenge of providing enough protein to meet this demand, particularly in Asia, but also globally. This will see an intensifying of different options, including an increase in poultry and aquaculture production, as well as red meat. While animal protein supplies will remain the main focus, the debate around the options for plant-based protein in these markets will undoubtedly continue.

2024 could potentially be a year where the Australian red meat industry – particularly beef – seeks to outpace its competitors delivering into growing demand. On current forecasts, two of its major competitors in the global beef trade space – the US and South America – look likely to see their beef export volumes curtailed by a herd rebuilding process and drier weather respectively.

3. CAPITALISING ON CHICKEN DEMAND

Tied closely to the protein discussion will be an increasing domestic and regional focus on chicken, including production, trade, consumption and R&D. In comparison to other animal proteins, chicken provides a relatively self-contained and rapid-turnover production model, which

WORLD'S LARGEST CHICKEN CONSUMERS 2010 - 2024F



Source: USDA, ANZ

provides reliable output, and with technological advances, a comparatively safe and quality meat in countries where these features are rapidly gaining importance. Both chicken companies and investors will be watching this industry, seeking to capitalise on growing domestic and Asian opportunities.

4. WEATHER REIGNS AS FOOD PRODUCTION DISRUPTOR

A very wet start to 2024 including the monsoon and weather cycles over Northern Australia reminded the industry that weather remains unpredictable.

Farmers and producers are constantly looking for weather signals on whether to plant crops, hold livestock or sell animals. In particular, the plunge in cattle prices in 2023 (largely in preparation for a forecast dry period which barely eventuated) and the public debate which followed around the link between retail and saleyard meat prices highlighted the impact of the weather on the overall food supply chain. Across most domestic food sectors, industry players will be paying close attention to the weather forecasts throughout 2024, adding their own experienced interpretation, and planning their strategies around any impact on supply volumes and availability, as well as pricing.

5. AN M&A FEAST IN FBA

In 2023 and into 2024, there has been a feeling among some in the FBA investment space that after a decade of growth prior to Covid, some investors were taking step back to re-evaluate their strategies, including their focus sectors, geographies and returns. At the same time, the ongoing geopolitical volatility, combined with the continuing post-Covid recovery in capital flows could well see an increased focus on investment in the wider Australian FBA space, including in areas such as feed, protein and infrastructure. At the same time, the industry looks set to see a strong year of M&A activity in 2024, driven by factors including the competition for FBA assets to take advantage of demand growth, moves by larger FBA entities to gain efficiency though vertical integration, institutional investors looking for diversification, as well as potential divestments as businesses rethink their core strategies.

Notably, 2023 saw several large ticket, market-defining transactions across grains, red meat, dairy and aquaculture. Whilst global demand to purchase high quality assets remains, that wave of transactions has seen industry consolidation continue to the point where there are increasing fewer large valuable assets available for purchase.

In the absence of owning the physical fixed asset, one outcome of this position is that more long-term offtake contracts may emerge this year, as customers seek to secure their supply of the commodity or end product into their distribution channel, rather than integrating upstream through M&A.

6. AGTECH NAVIGATES FIELDS OF CHALLENGES

For agtech, is 2024 the year that this industry could go through a period of rationalisation? There is no question that the industry continues to provide the opportunity for food producers to massively boost their production and efficiency, particularly in the face of the ongoing labour shortage. At the same time, the Australian agtech landscape is a very crowded one, with a relatively small domestic market of potential clients, particularly the large-scale customers who are most likely to adopt the new technologies. The rapid developments around ChatGPT , and the potential usage of similar technologies for agtech could also see a rapid change in this sector, which may leave some players behind.

7. CONSUMER CHECKOUT CHOICES IMPACTED BY VARYING PRIORITIES

With every year, and with gradual demographic and social changes, the factors which impact the F&B buying behaviours of consumers also shift. For many companies in this sector, the challenge is pre-empting these changes, and adapting their products and practices accordingly.

In 2024, many consumers will be juggling a range of factors. They will increasingly be seeking healthier products; they will be looking for products which reflect their own sustainability values, and products which have some degree of being "niche" or premium. In addition – and perhaps most importantly in 2024 – they will be searching for products which they see as affordable and providing value, as they closely evaluate their household budgets in tougher economic times.

8. INTEREST RATES REALITY BITES

After the series of interest rate rises over the past two years, the general consensus is that there is likely to be little change over 2024, with the reasonable possibility of a rate cut later in the year. For FB&A companies who showed a stronger appetite for debt in the last decade, this has focussed their attention on potentially deleveraging their balance sheets. Coming at the same time as subdued consumer behaviour in some areas, this could result in outcomes such as asset divestments, postponed projects, and layoffs.

More positively, however, many companies have strong balance sheets and will see the forecast for relative rate stability over the coming year as an opportunity to reset their medium to long term strategies. As executives and boards become comfortable with value and rates of return, companies may well feel more secure in making long term investment decisions.

9. INDIA OFFERS A SPICY MIX OF OPPORTUNITY AND RISK

While India has been the "next big thing" in global FB&A for a few years, it is notable how few companies in the sector have made the decision to learn more about the opportunities and challenges from the country and its 1.4 billion people. As India modernises, while rapidly expanding its global influence, 2024 is likely to see many FBA businesses rapidly educating themselves on the country, including spending time on the ground to experience it first-hand.

Just as they did with China around thirty years ago, companies will be looking to answer questions including:

- What FBA products the consumers of India's growing middle class will – and won't – demand more of?
- How India's regulatory changes could impact everything from trade to global markets?
- How India's major FBA players, as well as investors, could look to partner domestically, as well as expand globally?
- How to understand more around India's complex legal and bureaucratic processes?
- Where new opportunities may lie in India's growing global diaspora?

10. MULTIPLE ELECTIONS WILL SHAPE THE FBA LANDSCAPE

Even without unexpected events, 2024 will be a busy year for geopolitics, with elections already scheduled in around 58 countries, each of which will impact the global FBA landscape to some degree. In particular, the elections in the US, the UK, the EU, Indonesia and India are all likely to see governments and their opponents in these countries seeking to highlight the issue of food to a degree. In almost every country, the farming community is seen as a very important voting bloc, both due to their numbers, as well as their importance to domestic food production, while wider populations are also swayed by parties who can assure them around food supply certainty. As a result, it is likely that in these countries and in the EU, there could well be moves to increase tolls such as domestic production subsidies, re-examine import barriers where they compete with domestic producers, and use whatever influence it takes to grow their own export markets. For major FBA exporting with less global political clout – particularly Australia and New Zealand – this could see them having to compete harder for market access or face new tariffs, a situation which could require a re-examination of their trade strategies.

In Australia, despite the next Federal Election not being due until around May 2025, parties will be looking to refine their regulatory strategies and policies well ahead. For the FBA landscape, this could see an acceleration of legislative changes and reviews, particularly around areas such as emissions, water and market pricing.

SALEYARDS VERSUS STEAK PRICES

A recent notable topic of discussion on Australian food supply chains has focused on the relationship between the price of cattle in saleyards, and the retail price of beef, particularly in supermarkets. This debate is far from a new one and seems to resurface every few years. Over recent weeks and months, the discussion around the issue, particularly in the political and media arenas, has been a major impetus behind the Australian Federal Government directing the Australian Competition and Consumer Commission (ACCC) to conduct an inquiry into the supermarket industry.

NOTABLY, IN 2006, THE THEN FEDERAL COALITION GOVERNMENT REQUESTED THAT THE ACCC "EXAMINE THE PRICES PAID TO FARMERS FOR LIVESTOCK AND THE PRICES THAT AUSTRALIAN CONSUMERS ARE PAYING FOR RED MEAT".

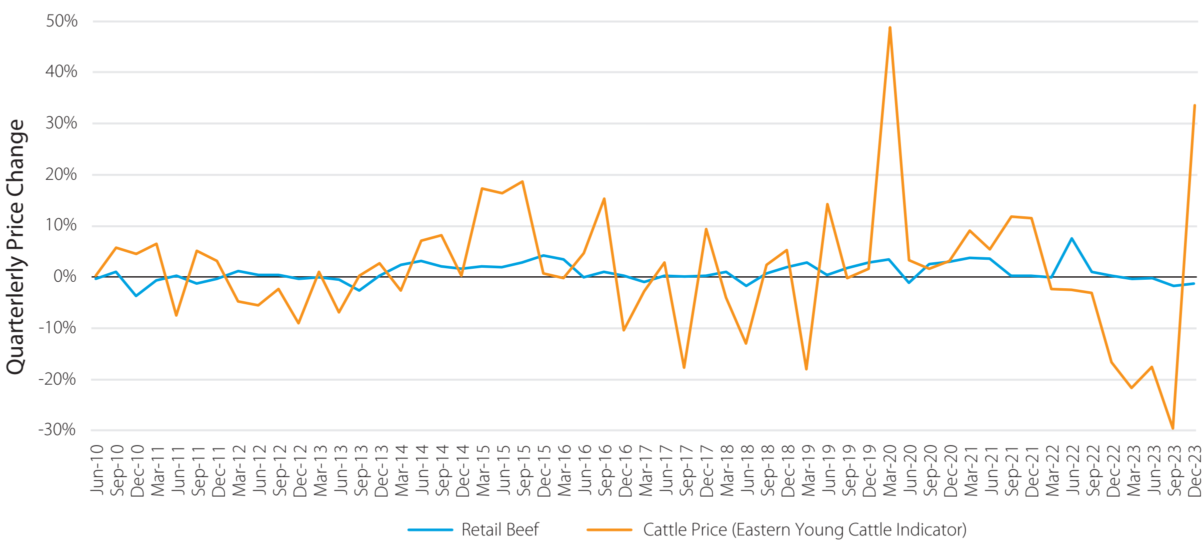
While the current inquiry will stretch out over the coming year, it is useful to look at a few of the factors impacting the relationship between cattle prices and retail beef prices.

Firstly, the comparison between the two price levels is an inexact science. The most regularly used benchmark for cattle prices to compare to beef prices is the saleyard price for the trade steer, a young male cow up to around 400 kg and 18 months old. It is important to remain mindful that saleyard cattle prices aren't just a reflection of the price being paid for cattle to be directly processed for meat but are also impacted by the volume of activity of farmers buying to restock their own operations, as well as feedlots buying to fatten cattle.

If the latter two are relatively quiet, then the overall cattle price may look lower than the more specific price being paid for cattle to process.

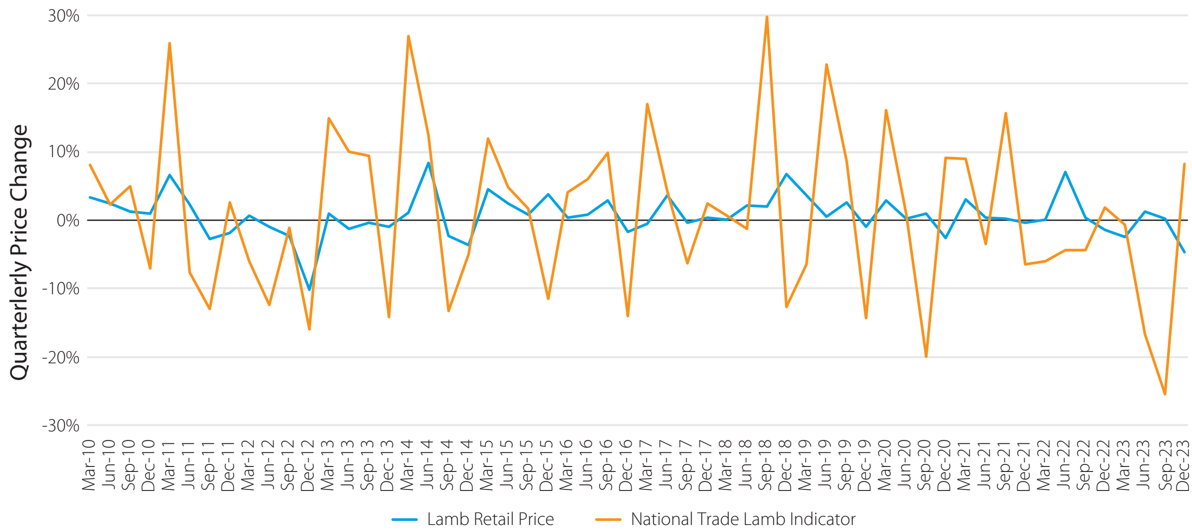
Also importantly, the major supermarkets are increasingly sourcing the cattle they need directly from particular farmers, rather than from the saleyards, so may be paying a different price than the market indicator. These offtake relationships allow the supermarkets to have greater certainty around supply, as well as consistency of meat quality.

RETAIL BEEF PRICE VS CATTLE SALEYARD PRICE % QUARTERLY CHANGE



Source: MLA, ANZ (Note: the retail price is the average over each three months, while the EYCI is the average price of each third month)

RETAIL LAMB PRICE VS LAMB SALEYARD PRICE % QUARTERLY CHANGE



Source: MLA, ANZ

Comparing a saleyard cattle price to a consumer beef price simplifies the complexity of the supply chain between the two points, and the areas which will be subject to their own cost pressures.

For example, the process may include:

- Purchase of live animal
- Finishing to specification
- Transportation to abattoir
- Slaughter and boning
- Transportation to processing plant (for preparation of case-ready meat) or distribution centre (for in-store butcheries)
- Ageing and storage
- Transportation to stores
- In-store butchery preparation
- Refrigeration and display
- Sale to customer

Each of these stages is subject to its own cost pressures, which can be particularly pronounced in a period of both high inflation and high energy costs, which can reduce margins for a number of stakeholders along the chain.

Cattle prices, for example, can be particularly volatile as a result of different climatic conditions. As the charts show, while prices can fall reasonably strongly when farmers prepare for possible dry weather by offloading stock and increasing supply, they can also rise even faster, as farmers restock their herds in good weather.

Notably, after cattle prices shot up when the drought broke in early 2020 and continued to rise for around two years as producers restocked, retail beef prices rose only marginally.

In the ACCC's 2006 report, it was estimated that the price of the cow accounted for just over 50 percent of the retail cost, processing-related costs to around 13 percent, and retail costs (including slicing and packaging) to just over 30 percent. As such, if the price of the animal goes down, while other supply chain costs go up, the impact on the retail price could be minimal.

Even looking at lamb, as distinct from beef, the data shows that there is a similar marked difference between the volatility of the saleyard price versus the retail price.

From a marketing angle, there is also a certain consumer psychology advantage for the beef industry of prices remaining at roughly the same level. While steak and beef products are part of the weekly shopping basket of most Australian households, they are not as much of a staple product as milk or bread. As such, shoppers are still likely to put some thought into whether they will buy steak or choose an alternative product – such as chicken or pork.

Arguably, consumers have become accustomed to paying a reasonable price for steak, and they know that in exchange for this price, they are receiving a product of high nutrition, quality and safety.

If steak prices were to decline markedly, the question is whether many more shoppers would choose to buy it. There would certainly be some, although arguably many households are already reasonably fixed in their meat buying habits.

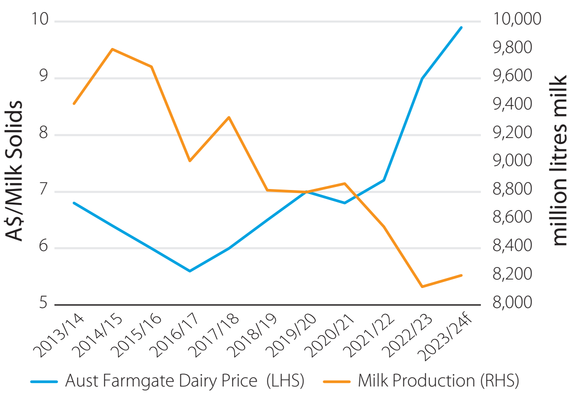
However, if, after that decline, steak prices were to rise sharply again, then it is likely that a greater number of shoppers would have a serious think about whether to keep buying it, or to shift their meat buying habits to the cheaper options of chicken and pork. As a result, steak could lose a reasonable amount of that hard-earned market share and find it difficult to get it back.

SECTORS IN FOCUS - DAIRY PROCESSING

Calls are growing in Australia's dairy processing sector for a re-examination of the pricing system under which companies secure their most important input – milk. Whatever the outcome, the issue is likely to have a marked impact on the dairy landscape, and ultimately on the products available to consumers.

Under the current system, every June, Australia's dairy companies arrive at a final minimum farmgate price (per kg/milk solids) which they will pay to their particular farmer suppliers. Both parties must adhere to this price for a full year.

AUST FARMGATE DAIRY PRICE VS MILK PRODUCTION



Source: ABARES, Dairy Australia, ANZ

This scheme – the mandatory dairy code of conduct – was launched in 2019, following the collapse of the dairy processor Murray Goulburn, citing factors including a weakening of exports to China, declining milk production, and a strengthening Australian dollar.

At that time, a number of dairy farmers were not only hit with a sudden farmgate price reduction, but also required to pay back earlier overpayments.

Following that, the dairy processors, producers, together with industry groups and government, worked together to create the current structure, with a view to creating certainty for dairy producers, allowing them far greater opportunity to enhance, expand and de-risk their operations.

For the dairy processors, however, changes to the dairy landscape, especially around rapidly declining domestic milk supply as well as growing import competition, have continued to see margins tighten.

Particularly due to declining availability of milk supply, dairy processing companies have had to compete even harder with each other to secure adequate columns of milk, pushing farmgate prices up even further.

At the same time, changes in imports have meant a surge in competition in the Australian market, particularly from New Zealand, in staple products such as butter and cheese.

At a wider level, some argue that changing the system could see Australia's milk production fall to a level where the country – particularly non-dairy producing regions – could become increasingly import reliant.

The current dairy code of conduct is currently subject to a review, which is now scheduled to be completed by 2026, and the period in the meantime will likely see ongoing concerns raised by all major players.

Australia's dairy farmers argue that the nature of their business model means that they require a reasonable degree of price certainty to not only remain viable, but to innovate and grow. This is particularly the case for the upgrading of many on-farm dairies, which will require investment for modernisation, especially to adapt to lower labour availability.

Without this certainty, they argue, an ongoing strong decline in milk production may not only be irreversible, but of immense damage to the processing sector.

In contrast, the dairy processors would argue that no other major agri offtake sector is subject to an annual fixed price and that the current system does not allow them to adapt to fluctuating global markets, which can move relatively quickly based on import demand and competitor conditions.

Importantly, retailers – especially supermarkets – want certainty of supply, given that milk and other dairy products are among their most staple consumer items. As a result, they will need to look long-term at their options, including whether to increase their direct relationships with dairy farms to guarantee milk availability, or whether to increasingly integrate up the supply chain, through acquiring their own processing facilities.

Finally, consumers will also play an influential role in the industry's direction, including whether they show an ease in buying imported dairy products (or even have an awareness of different products' country of origin), and whether they would be prepared to pay a premium for Australian dairy products, if the need required.

THE FAO ROADMAP - WHAT MIGHT IT MEAN FOR BUSINESS?

Many people will be aware of the United Nations Climate Change Conference – otherwise known as COP 28 - which took place in the United Arab Emirates in late 2023. The gathering, which was attended by around 70,000 people, was primarily aimed at seeking agreement by governments to limit temperature increases and combat the impacts of climate change.

As part of COP 28, the United Nations Food and Agriculture Organisation (FAO) launched a report entitled the "Achieving SDG2 Without Breaching The 15 degree C Threshold: A Global Roadmap". (SDG2 refers to the second of the UN's Sustainable Development Goals, which were created in 2016 – that goal in particular aimed at ending global hunger).

While COP28's major outcomes around reducing phasing down fossil fuels and funding energy transition received substantial coverage, the messages of the FAO's Roadmap were less widely reported.

Importantly, however, for many stakeholders in the FBA sector, it will be useful to have some knowledge of the report, as it may well have an impact on a number of entities across the food supply chain over coming years.

The FAO report focusses on two major goals – eliminating global hunger and malnutrition, while concurrently promoting climate action in a bid to keep within the 1.5 degree threshold. The 1.5 degree threshold is part of the 2015 Paris Agreement, under which almost every country in the world agreed to work towards ensuring that by 2100, the world's average surface temperature will have risen by no more than 1.5 degrees C above pre-industrial (i.e. 1850 – 1900) levels.

In setting a plan for achieving its goals, the report contains a number of timelines and recommendations. The timelines, which are set out in five-year steps, aim to ultimately abolish hunger by 2050. In terms of climate action, the timelines set out a series of targets around reducing Carbon Dioxide, Nitrogen and Methane emissions, with the ultimate goal of global agrifood systems becoming a net carbon sink by 2050.

The report then outlines 120 distinct proposed actions, aimed at working toward these goals, broken down across ten different areas of Livestock; Fisheries and Aquaculture; Crops; Enabling Healthy Diets For All; Forest and Wetlands; Soil and Water; Food Loss and Waste; Clean Energy; Inclusive Policies; and Data.

So how could this report potentially impact companies and stakeholders across the FBA landscape?

The report is likely to be used as a major reference in the formulation of policy around the ten detailed areas – all of which impact the food and agri supply chain to some degree. Given the analysis and specificity of its recommendations, as well as the fact that it emanated from the UN, it is likely to be both highlighted and used by politicians, the bureaucracy, industry and interest groups, the media and others.

It is also likely that, given its long-term goals, the report is likely to remain relevant, and in use, for a number of years.

In terms of domestic policy and regulation impacting agribusinesses, whether in Australia or other countries, the report's content could well find its way into legislation in a number of ways. For example, governments may look to align their policies and regulations with those in the roadmap, particularly as a way of demonstrating their commitment to achieving global goals and sustainable development objectives. Governments may also use the reports objectives as a basis for introducing new incentives for companies and farmers to transition to new practices or meet new regulatory requirements, or to boost research and development funding.

For Australia, this could hypothetically play out in a range of ways. For example, the report's benchmarks around livestock could impact farming practices and even livestock numbers, but could also see a boost in livestock genetic research. Similarly, for cropping, the report may see an increase in funding for research, while also advocating increased crop diversity. Further down the supply chain, the report's actions around areas such as diet and food waste may potentially have some impact on the food processing and retail sectors.

Internationally, given the history of countries such as those in Europe to adopt similar benchmarks, there is a potential for the report's content and goals to become part of future trade agreements, as well as for import policies by some countries. For companies exporting to particular markets, this could well mean that some of the report's recommendations become conditions around trade access and tariffs, or changes to conditions around compulsory certifications.

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