

AUSTRALIAN FEEDLOT SECTOR

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AUSTRALIAN FEEDLOT SECTOR – AN OVERVIEW

OVERVIEW

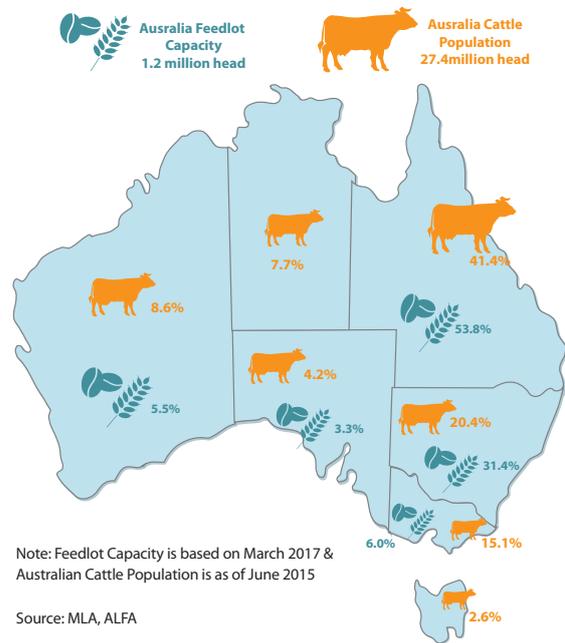
Commercial feedlots first emerged in Australia in the mid-1960s on the Darling Downs in Queensland, primarily to meet overseas demand for a consistent high quality product¹. Since then, feedlotting has evolved into a major industry, with around 400 accredited feedlot operators across Australia, employing over 28,500 people². The gross value of production was estimated at around \$2.5bn in 2014/15².

Although Australia accounts for only 4% of global beef production, it provides over 15% of global beef exports³. This highlights Australia's ability to continuously meet export market specifications and maintain a strong reputation in international markets.

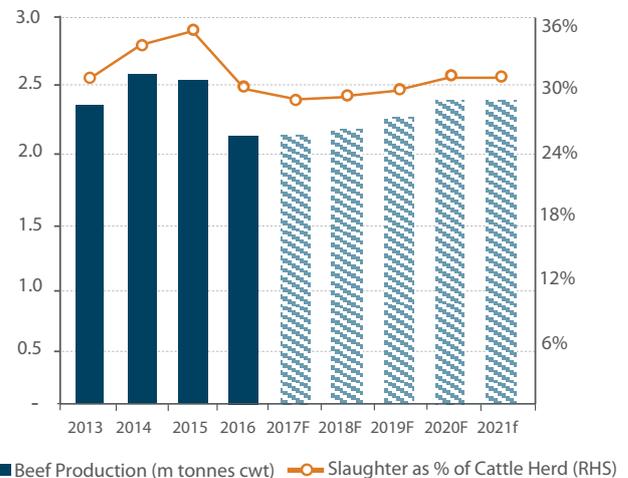
While the majority of beef produced in Australia is grass-fed, feedlots have seen increased cattle influx in the recent past, particularly due to tough climatic conditions. In December 2015, an all time high of near one million cattle were on feed⁴, due to severe drought across eastern parts of Australia, primarily in Queensland and New South Wales – an area which accounts for over 60% of Australia's cattle herd. As conditions subsequently improved, and feeder cattle became harder to procure, numbers dropped by around 20%. However, by March 2017, with grain costs low and cattle being held on feed for longer, the number of cattle on feed again rose above the one million mark.

In terms of overall beef production, Australia's volume fell by around 17% in 2016, with a slight further drop forecast for 2017. Looking ahead, this is forecast to gradually return to 2013 levels by 2020.

Grain-fed beef production accounts for over 40% of total beef production in Australia⁵. While grain-fed beef's share of production varies depending on the cattle cycle (high during liquidation phase and low during herd rebuilding phase), it plays a key role, especially during harsh weather conditions to ensure standard quality specifications. Grain-fed cattle turnoff was estimated at 2.8 million for the year ending June 2016, representing over 30% of total beef cattle slaughter for same period.



Australia beef production & slaughter



Notes:

1. ABS, Australia's beef cattle industry, Year Book Australia – 2005
2. Australian Feedlot Industry Statistics, Oct 2015
3. USDA PSD Query
4. Beef Central website, September feedlot survey shows sharp decline in cattle on feed, November 2016
5. ALFA Media Release Quarterly Survey May 2017
6. ALFA, Submission in response to the Strengthening Australia's Foreign Investment Framework Modernisation Options Paper, May 2015

DROUGHT INDUCED SLAUGHTER REDUCED CATTLE HERD...

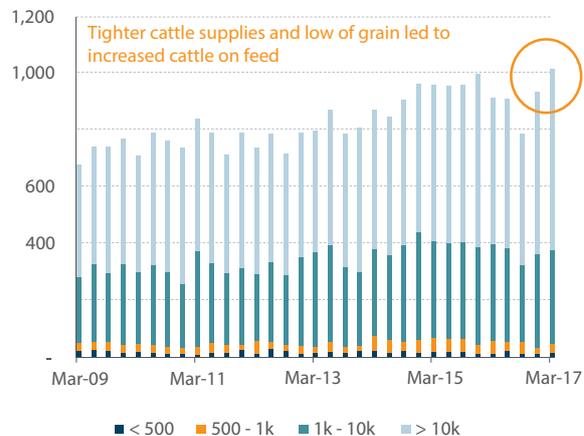
CATTLE ON FEED & EXPORT MARKETS

For beef to be branded as grain-fed, cattle must be fed on a predominantly grain-based diet for a minimum of 60 days in the case of heifers and for 70 days in the case of steers⁷. However, this also depends on end-market specifications and can range up to 120 days⁷, with an industry average of around 95 days⁹. In terms of scale, between March 2009-17, feedlots with capacity between 1k-10k cattle head and over 10k cattle head accounted for 40% and 60% respectively of total cattle on feed⁸.

For Australia's major beef markets, the trends for grain-fed beef have differed. This is particularly the case for Japan and South Korea, traditional major export destinations for Australian beef. In 1975, Australia's domestic feedlot industry suffered a setback when access to the Japanese market was temporarily closed¹. On re-opening, demand from Japan grew steadily, and by 2004, 53% of total cattle on feedlots were destined for the Japanese market. More recently, Japan's share of Australia's grain-fed beef exports has continued to decline, accompanied by a fall in absolute volume basis. Challenging economic times and changing consumer preferences have seen Japanese consumers increasingly moving towards less expensive and leaner beef products from the usual premium (marbled) beef⁷. As a result, Japan's share of grain-fed beef exports reduced from 75% (in 2009) to 55% for Q1 2017⁵. In contrast, South Korea's share of grain-fed exports remained relatively stable, marginally increasing from 13% in 2009 to 17% in 2017¹¹. Other markets, which include the EU, China, Middle East, gradually increased their share of grain-fed beef exports to around 28% by 2017^{10,11}.

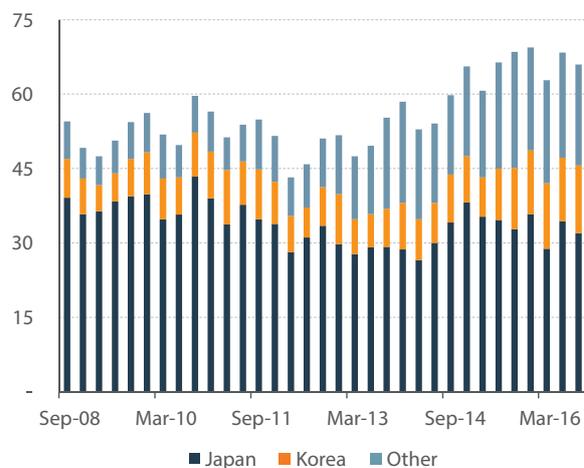
China is the largest of these markets, with an estimated share of 9% of total exports. With its rising disposable incomes and growing middle class population, China is set to account for more exports in the future. The European Union is second largest in this category and accounts for a 7% share⁷. Since the expansion of the grain-fed beef import quota in mid-2012¹⁰, demand has been growing strongly from the region, although given recent economic and political conditions, short term uncertainties may see a fall in demand for the near future.

Cattle on feed ('000 head) by feedlot type



Source: MLA, ALFA

Grain-fed beef exports ('000 swt)



Source: MLA, ALFA, DA

Notes:

- 7. IBIS Research, Beef Cattle Feedlots in Australia, March 2017
- 8. MLA Statistics Database, average is calculated for March 2008 to September 2016 quarterly data
- 9. ALFA, Grass Fed versus Grain fed beef, July 2014
- 10. MLA, Australian Cattle Industry Projections (January & October 2016 updates)
- 11. Data for 2016 is available only till September 2016

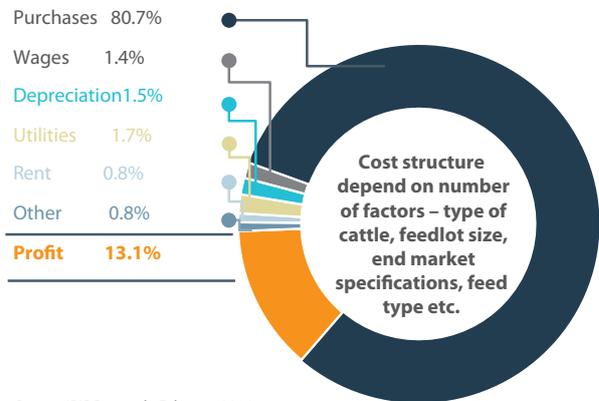
WHICH INCREASED THE INPUT FEEDER CATTLE PRICES

COST STRUCTURE & INPUT PRICES

While cost structures vary from feedlot to feedlot depending on various factors, in general, lot-feeders operate on slim margins. For a typical beef operation in Australia, around 80% of cost structure will be made up of purchases (primarily feeder cattle and grain, though fuel and water permit/licenses also figure strongly)⁷.

Over the past three years, feeder cattle prices have increased significantly, driven by drought-induced culling, thus reducing the profit margins of the sector. For instance, feeder cattle prices increased by as much as 220% over the past decade. Increasing cattle prices have made it expensive to fill a feedlot and led to low capacity utilisation, which decreased to around 65% in September 2016 vs around 84% a year earlier⁶. On the output side, grain-fed cattle prices (Queensland Over the Hooks is used as a proxy) have not increased at the same pace as feeder cattle prices, putting further pressure on the margins. At the same time, lower feed prices have provided some relief to lot-feeders, although given that over two-thirds of total purchase costs are for cattle, this has not been a major benefit. In contrast to high Australian cattle prices, global beef prices moderated in recent years, reflected in the FAO Bovine Meat Index easing from an all time high of 260 in October 2014 to 192 in October 2016¹². Subsequently, however, global beef prices have increased amid reduced cattle availability due to herd rebuilding, which also led to record number of cattle on feed.

Industry cost structure (2015-16)



Source: IBIS Research, February 2016

Weekly prices rebased to Sep 2007 prices



Source: MLA

FAO beef price index

Rebased to 2002-04 prices



Source: FAO Commodity price indices

Notes:

12. FAO Bovine Meat Index is made up of USA: Frozen beef, export unit value, Brazil: Export unit value chilled and frozen beef cuts, Australia: Cow 90CL export prices to the USA (FAS)

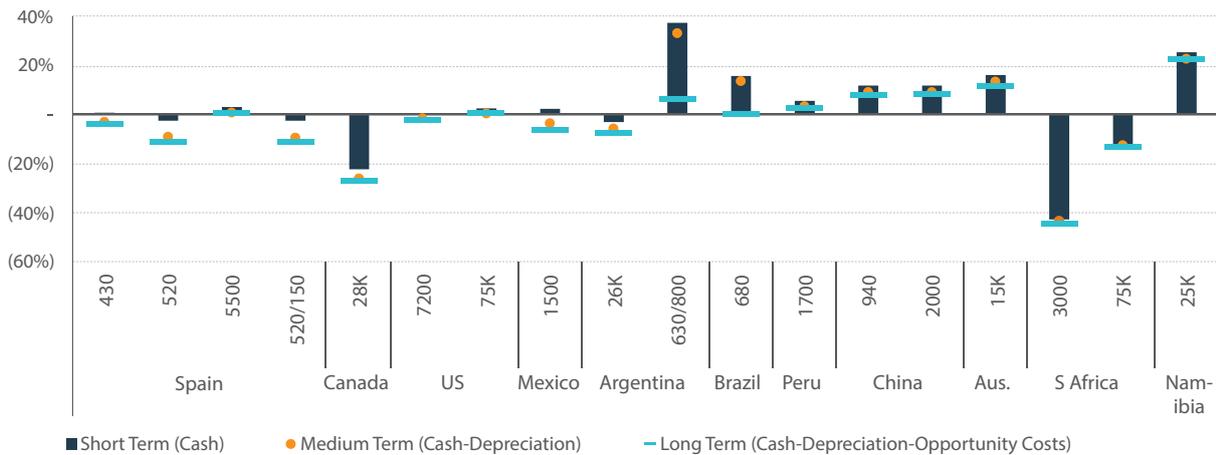
AUSTRALIAN BEEF FEEDLOTS ACHIEVED REASONABLE PROFITABILITY IN RECENT YEARS...

BEEF FEEDLOT PROFITABILITY & CATTLE FINISHING COST BENCHMARKING

In 2016, the MLA/Agribenchmark conducted a benchmarking study of feedlot profitability of Australia, with comparisons to feedlots in different countries. According to the study, at that time Australian feedlots had experienced reasonable profitability, with medium to long term profitability estimated at around 11-14%. In comparison, while Brazilian feedlots were as profitable as Australian ones in the short term (covering cash costs) and medium term (covering cash costs and depreciation), their long term profitability was found to be near zero.

Short, medium and long-term net profit margins for beef feedlots – 2014¹³

Profit as % of gross income



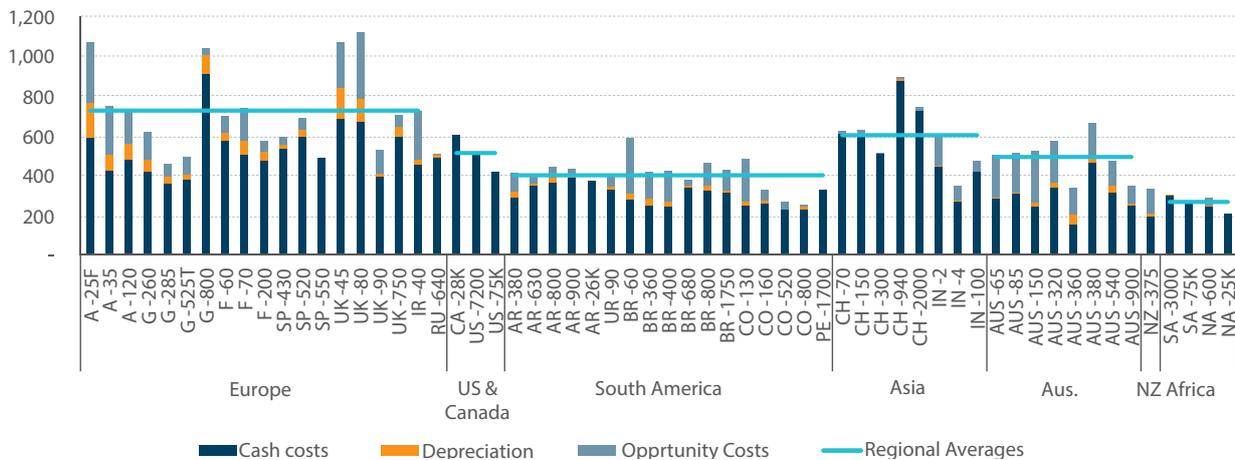
Source: MLA, Agribenchmark

CATTLE FINISHING COST BENCHMARKING

In terms of global cattle finishing cost comparisons, efficient systems exist in Africa, NZ, and South America. In comparison, the high Australian dollar and drought conditions increased the cost of beef production in Australia. In US dollar terms, finishing costs in Australia are ~23% higher than South American feedlots.

Cattle finishing costs in 2014^{13,14}

USD per 100wt



Source: MLA, Agribenchmark

Notes:

13. Farm identification numbers indicate finished cattle sold in respective geographies

14. Countries includes under Europe are A – Austria, G – Germany, F – France, SP – Spain, UK – United Kingdom, IR – Ireland and RU – Russia; countries under South America include AR – Argentina, UR – Uruguay, BR – Brazil, CO – Colombia and PE – Peru; countries under Africa include SA – South Africa, NA – Namibia

LOW COST BASE SOUTH AMERICAN FEEDLOTS REMAIN A CHALLENGE...

BEEF FEEDLOT PROFITABILITY & CATTLE FINISHING COST BENCHMARKING (CONTINUED)

Looking forward, the world's second largest beef producer, Brazil, is increasingly moving towards an integrated crop-livestock systems which may reduce opportunity costs and lead a way to an expansion of the domestic intensive beef production. A low cost base, plus a possibility to reduce opportunity costs, indicate Brazil has significant scope to expand its cattle feedlot sector, which could increase competition to Australia's beef exports in global market.

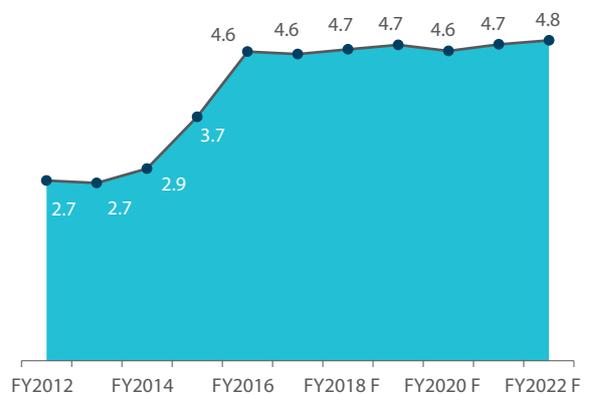
Among the other geographies, European feedlots remain high cost operators, with most not capable of maintaining any short or medium term profitability. Given their additional income in the form of government payments, some farms are able to marginally cover their cost base. In addition, while the US and Canada feedlots have similar cattle finishing costs to Australia, the study found that profitability remained weak.

DOMESTIC INDUSTRY CHARACTERISTICS

In 2015-16, the overall revenue of the Australian beef cattle feedlot industry was estimated at AUD 4.6bn⁷, an increase of 26.7% on the previous year. The growth in revenue from 2014 to 2016 was largely due to high cattle turnoff due to drought conditions.

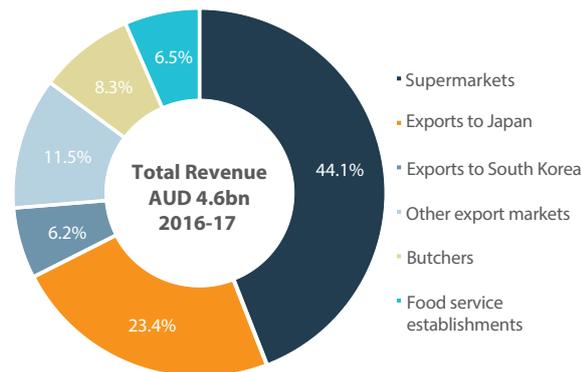
However, with the industry likely to see restocking through 2017, revenue is forecast to slightly decline by around 0.8% and remain stable through to the 2020-21 period⁷.

Beef cattle feedlot industry revenue (AUD bn)



Source: IBIS Research

End markets by share of industry revenue



Source: IBIS Research

An estimated 59% of beef produced from Australian feedlots is utilised in the domestic market, largely through supermarkets⁷. Supermarket demand is largely towards lean grain-fed beef owing to domestic consumer preference of low-fat meat products⁷. Other distribution points include major outlets like butchers and food service restaurants, though the high export market demand for Australian grain-fed beef and increase in dominance of major supermarkets, has seen stakeholders lose market share⁷.

FEEDLOT SECTOR REMAIN AN IMPORTANT CONTRIBUTOR TO AUSTRALIAN ECONOMY...

FRAGMENTED INDUSTRY

It is estimated that around 98% of feedlots in Australia are family-owned, with the remaining 2% owned by vertically integrated processors⁵. These processors account only for ~22% of industry capacity, highlighting the significant portion of capacity among smaller feedlot operators. As such, the top three players accounted for a only around 17%⁷ of revenue. At this time as the Australian feedlot sector continues to go through a period of consolidation, smaller feedlot players are increasingly leaving the sector due to profitability concerns, largely driven by the expansion of larger players (i.e. vertical integration).

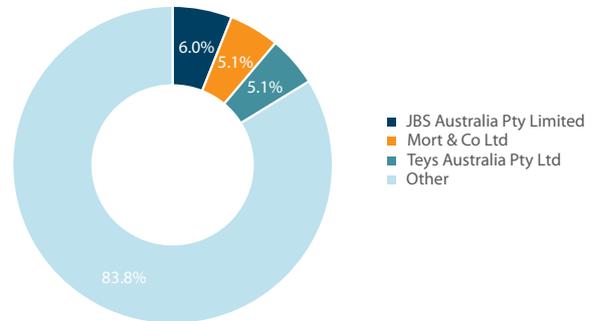
FEEDLOT SECTOR - RELEVANCE TO GRAIN INDUSTRY

Australia's grain and oilseeds production is primarily export focused with nearly 63% of produce exported. The feed industry is the largest consumer of grain and oilseeds in the domestic sector, accounting for around 62% of domestic consumption.

In terms of growth rates, feed demand increased at around 2.3% between 2000/01 and 2015/16, nearly four times the growth rate of exports (CAGR 0.6% over same period).

Feed demand from beef production remains highest among the livestock sectors and is estimated to account for around 27% of total feed used in Australia, although this share increased significantly against the backdrop of rising grain fed cattle turnoff.

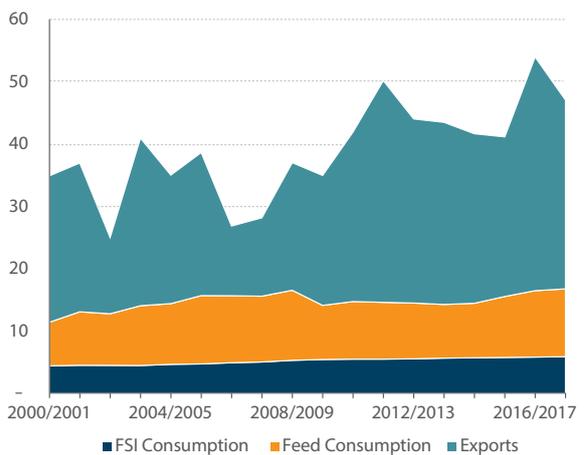
Beef cattle feedlot industry by major players



Source: IBIS Research, March 2017

Grain & oil seeds consumption share estimates

Million MT



Source: USDA PSD

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