

PANDEMIC: Forecasting the Recovery

INTRODUCTION

The conversation around the animal protein commodity sector during the current pandemic has been rooted in the impacts of a significantly contracted foodservice segment and the expansion of retail channels. Related segments within the foodservice sector have been much more negatively impacted, such as the entertainment space, which includes sporting events and concerts, as well as the accommodation and tourism industry, which includes hotels and resorts. For this market overview, we will refer to the foodservice sector as only traditional food establishments and drinking places, or for sake of simplicity, restaurants and bars.

From an analyst perspective, it appeared that the foodservice sector was destined to collapse. And it did, for several weeks. However, a series of remarkable events led to radical and impressive adaptation in the industry—from restaurants and distributors becoming grocery stores and rapid growth in food delivery, to negotiating for outdoor dining on public and unconventional spaces, among many others. Some survived the summer, some did not. Yet, the foodservice industry is still standing, albeit struggling, amidst a pandemic and an ongoing recession. The retail sector, however, remains as strong as ever and poised to remain firm as we head into the winter.

The question going forward is whether the economy has already started to feel the negative effects of the pandemic and to what extent. For example, how much of government spending through the CARES act, and the potential of the HEROES act has or will buffer the negative effects of the pandemic? Which sectors are likely to recover more rapidly than others once things return to some sort of normal? i.e. tourism, wholesale distributors. From this perspective, we can further analyze how this

relates to the food industry. For instance, taking the foodservice sector as a proxy relative to disposable income, we noticed how these two become much more highly correlated during recessions. However, in 2020, though restaurant sales remain suppressed, income levels remain relatively high. What will the impact of a second stimulus be? What happens after that cash injection dissipates? Is inflation just around the corner or is it already happening?

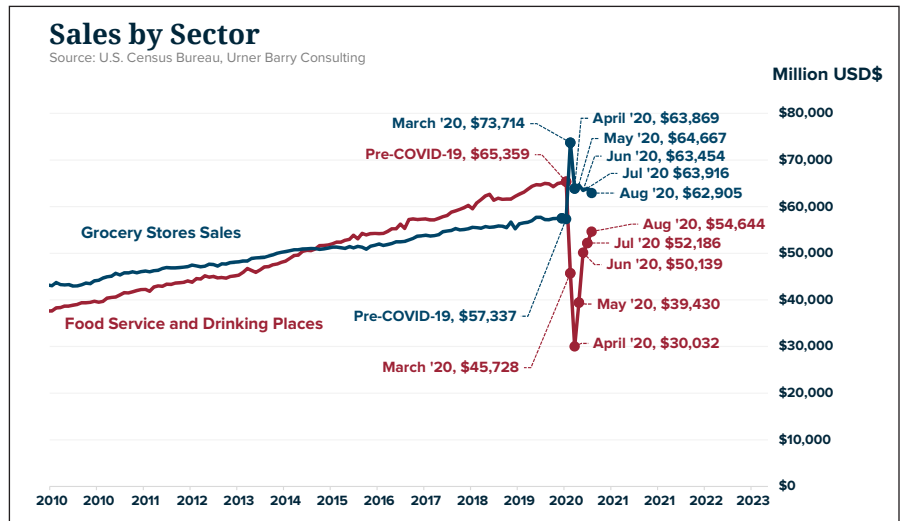


Figure 1. Advance Retail Sales, SA, for Grocery Stores, and Food Service and Drinking Places.
Source: U.S. Census Bureau.

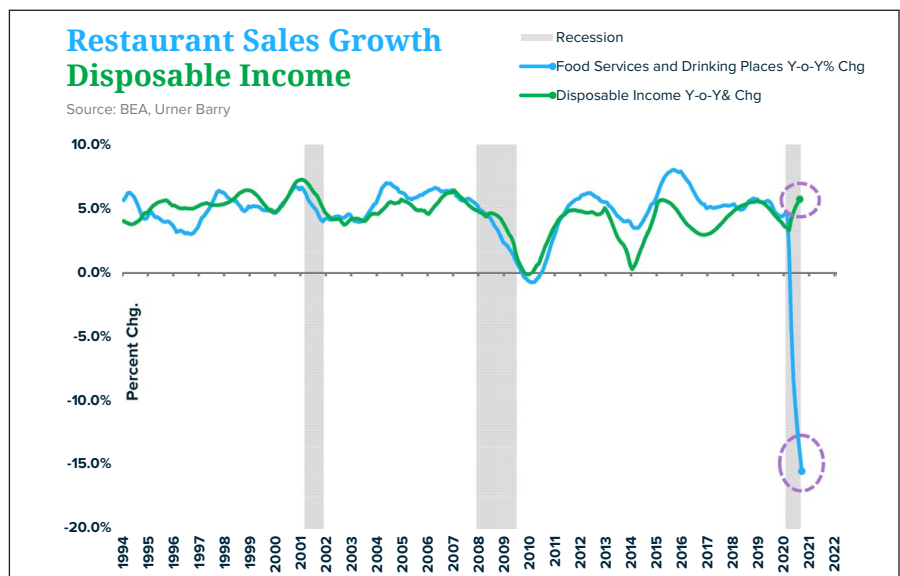


Figure 2. Restaurant Sales Growth and Disposable Income, Y-o-Y Chg, 12 Month Moving Average.
Source BEA, Urner Barry Consulting.

Therefore, it is important to acknowledge that if economic hardship is possibly on the horizon for many more unemployed Americans, **existing animal protein eating habits will very likely change and so will pricing dynamics at the wholesale level.** As such, competitive animal protein prices to the consumer will likely play an important role in the recovery of the current recession.

One of our initial assessments back in May 2020 was the inevitability of high wholesale price volatility. The industry and our group of analysts naturally saw this coming due to the immediate shutdown of the entire foodservice sector, an inelastic demand at grocery stores, and supply imbalances due to processing plant closures both domestically and abroad, among other reasons. When prices came crashing down as soon as the immediate effects of the lockdown were over historical price volatility eased considerably; supplies balanced out as demand stabilized. Out of the main items, only salmon remains above historical volatility levels. All other items, particularly protein staples like eggs, chicken, ground beef, and many pork items, are back at normal levels of historical volatility.

Analyzing each sector's dependence on foodservice, we can see why some seafood items would be relatively more exposed to any potential contraction in this sector, relative to other proteins. Prices of such "other proteins" like chicken, eggs, and beef, have largely returned to some sort of historical seasonal pattern.

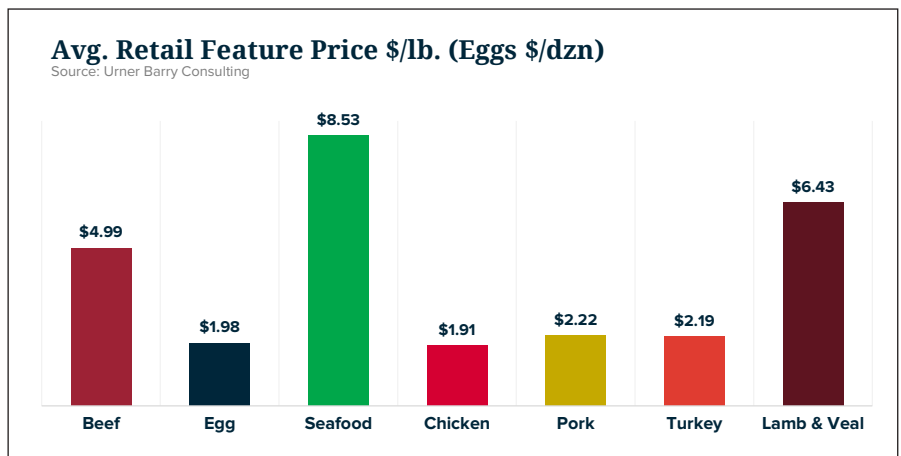


Figure 3. Avg. Retail Feature Ad Price per lb. and dozen for Animal Proteins. Seafood is further broken down in the Seafood section

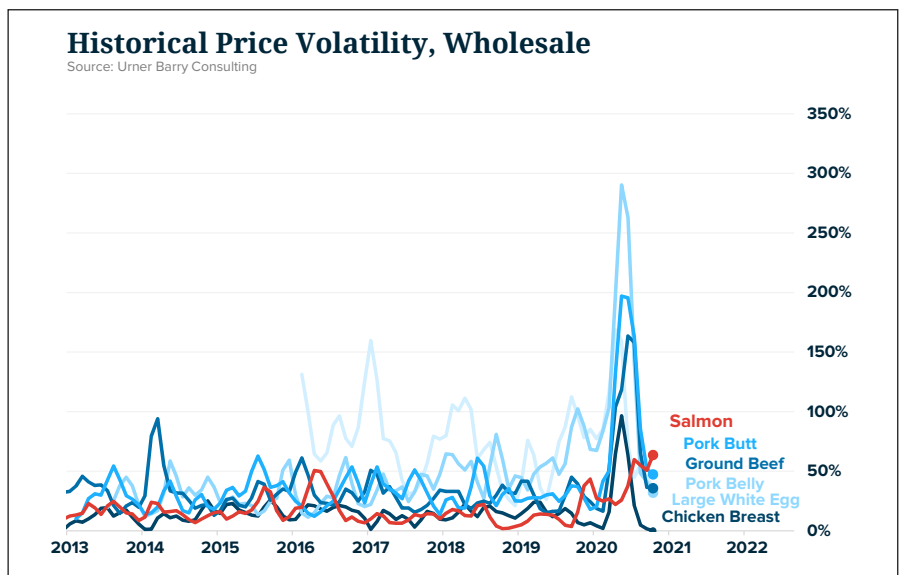


Figure 4. Historical wholesale market price volatility using Urner Barry quotations.

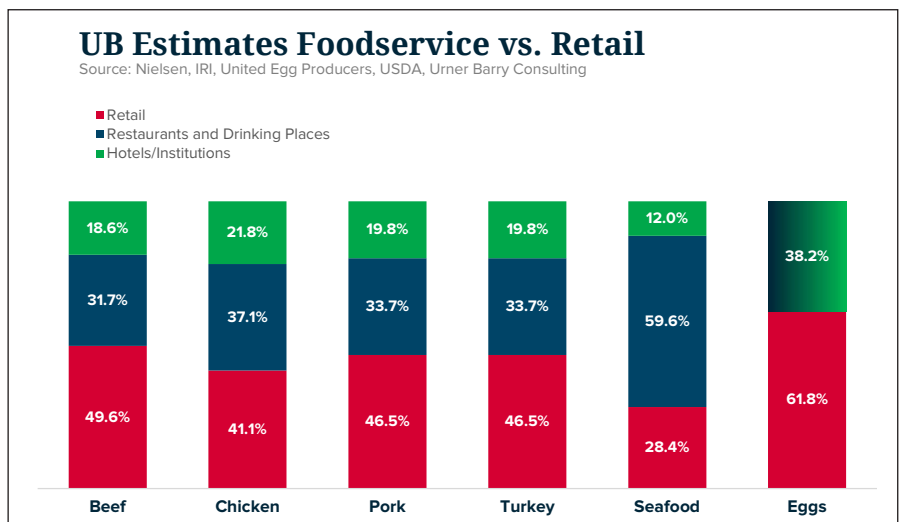


Figure 5. Urner Barry Consulting volume estimate of the Foodservice vs. Retail Share using data from Nielsen, IRI, USDA; data from United Egg Producers is taken as is from unitedegg.com.

EGG MARKET

Production in Q2 decreased considerably (-5.3%) from the previous year, but overall volumes were comparable to those seen during Q2 2018. After analyzing the egg market over the last seven years, a 5% decrease in production would have caused prices to spike, everything else equal. However, when looking at the Midwest Large White Shell Egg quotation, we saw prices falling to levels below those seen during Q2 2018 by about 5%; all this if we take into account the first week of April 2020, which was an anomaly. Yet, if we remove the short-lived price anomaly caused by the lockdown as well as seasonal Easter demand, average prices during Q2 declined by about 18%. Similarly, average prices in 2020 appear to be behaving more like in 2018 and 2017, along with similar production levels.

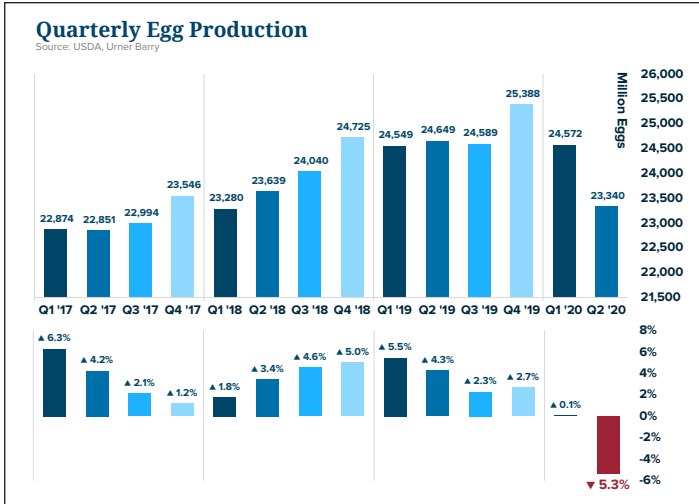


Figure 6. Table Egg Production. Source: USDA, Urner Barry.

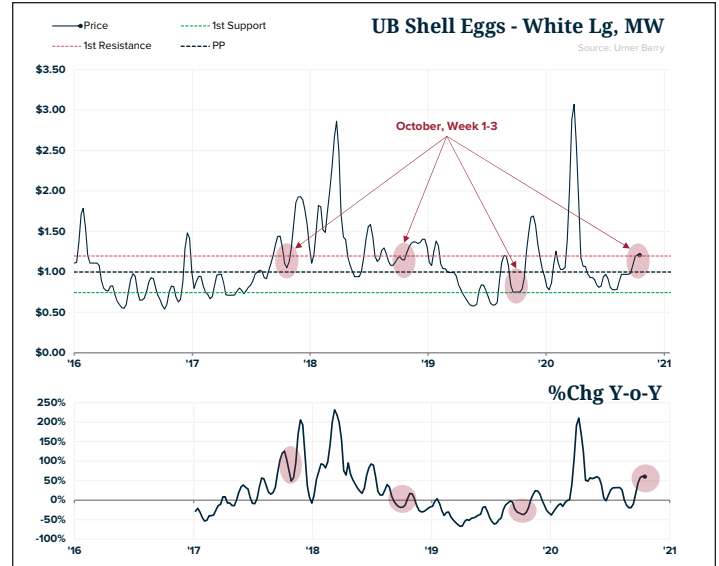


Figure 7. Average prices for Mid-West Large plotted linearly. Source: Urner Barry.

On that note, and reviewing our previous analysis, we noticed that once prices stabilized during the first and second week of April 2020, inventory levels for shell eggs and the number of cases broken recovered thereafter. Although all this makes sense—the fact that cases broken increased once outdoor dining expanded and some states re-opened indoor dining—prices remained relatively steady, albeit comparatively low to the last three years. Currently, the market appears to have lost steam after a short-lived rally—from the last week of September through the second week of October—supported by post-summer retail purchasing. We suspect that the increase in shell egg inventories and a potential decrease in cases broken as we approach winter will place some tamed immediate downward pricing pressure in the upcoming weeks.

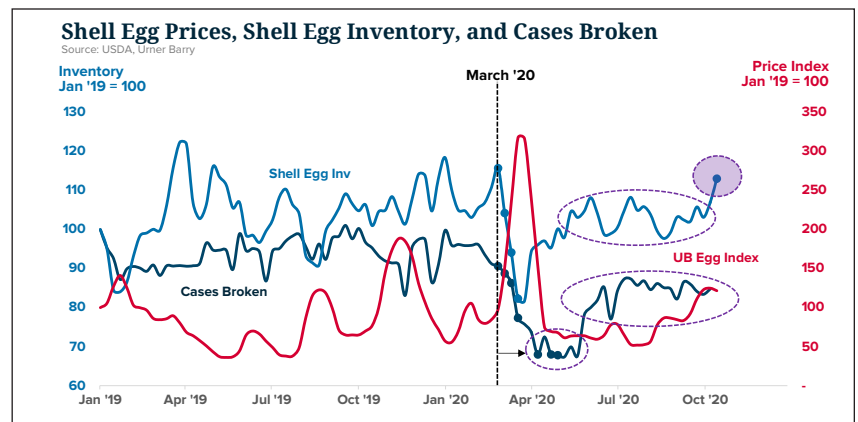


Figure 8. Shell Egg Inventory, number of Cases Broken, and UB Egg Price Index, indexed as a percent change. Source: USDA, Urner Barry.

Egg Market continued from previous page

Nonetheless, eggs will continue to hold an advantage over all other proteins due to their large reliance on retail (grocery) sales. After the initial rush of buying, we slowly saw prices and retail feature ads return to historical averages. Yet, as we head into the winter, the overall retail sector is likely to strengthen and hence provide support to egg prices at the wholesale level.

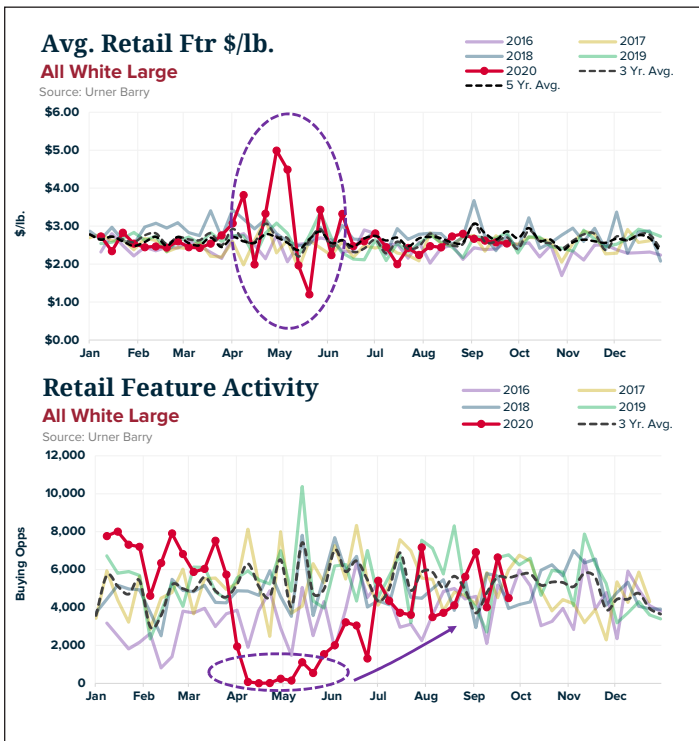


Figure 9. Shell Egg Retail Feature Ads (Buying Opportunities = Retail ad x (times) the number of stores) and Shell Egg Retail Feature Average Price. Source: Urner Barry Consulting.

Finally, eggs are one of the lower-priced animal proteins, and if economic hardships of the pandemic arrive in the next few months, eggs are likely to benefit from consumers trading down to lower-priced alternatives. As such, our view is that egg prices will be supported for the next six months.

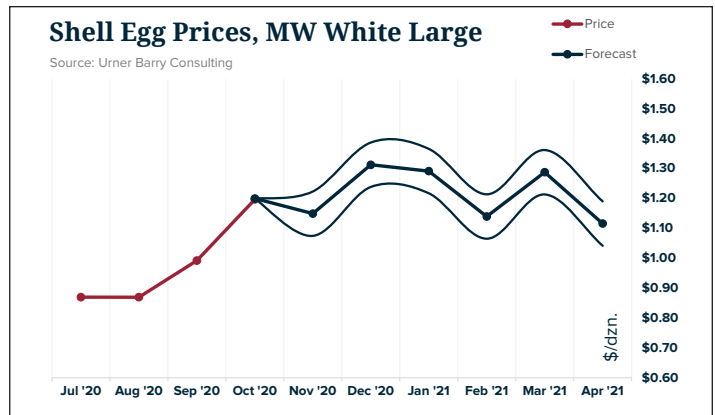


Figure 10. Shell Egg Midwest White Large UB quotation plus Urner Barry Consulting forecast.

CHICKEN MARKET

On the chicken side, it must be prefaced that the industry had been expanding continuously over the last five years. In 2020, the market was already under downward pricing pressure prior and unrelated to the pandemic. Chicken weights continue their week-after-week record highs. This situation has translated into more ready-to-cook chicken (RTC) despite a decrease in the number of young chickens slaughtered compared to 2019.

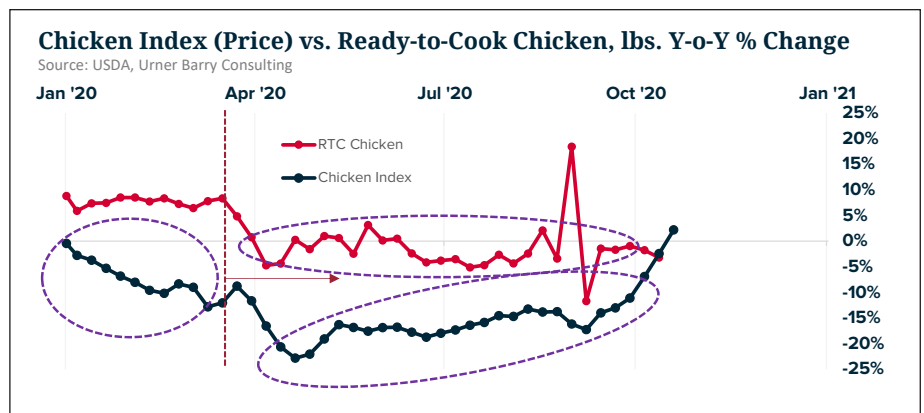


Figure 11. Chicken Wholesale prices using UB price Index vs. ready-to-Cook Chicken. Source: Urner Barry, USDA.

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In very simplistic terms, birds continue to remain on feed longer and are thus gaining weight as slaughter slows down relative to what is available in the pipeline. And while we saw eggs set and chicks placed decline at the initial stages of the pandemic—for obvious reasons—data suggests that it doesn't appear to be much of a slowdown in terms of what is ahead; both eggs set and chicks placed are virtually flat to last year in the post-shock months through October 2020.

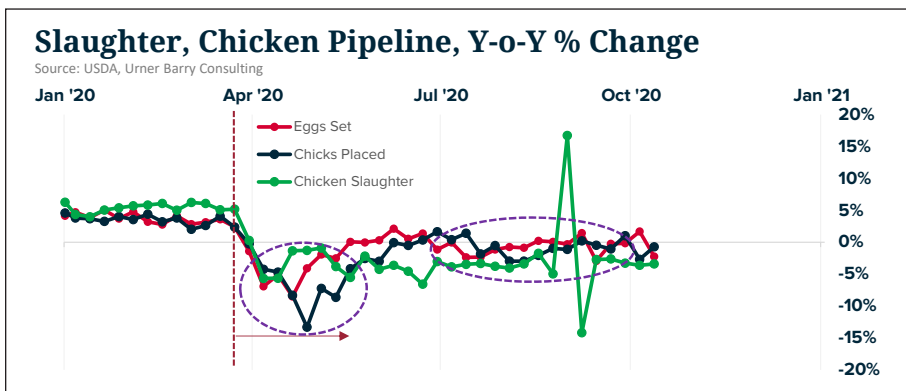


Figure 12. Y-o-Y Change in Slaughter, Eggs Set, Chicks Placed. Source: USDA, Urner Barry Consulting.

Furthermore, export business (particularly to Mexico) has been shaky at best. This is quite important as this country purchases a significant amount of leg quarters and thighs. Unfavorable exchange rates are one of the many reasons. As a result, both sellers and buyers in the U.S. appear to have had—and probably still have—plenty of incentives to run retail features for leg quarters; on one side, sellers need to move this extra volume and offer relatively low prices, and retailers will run promotions and improve margins on low purchasing prices.

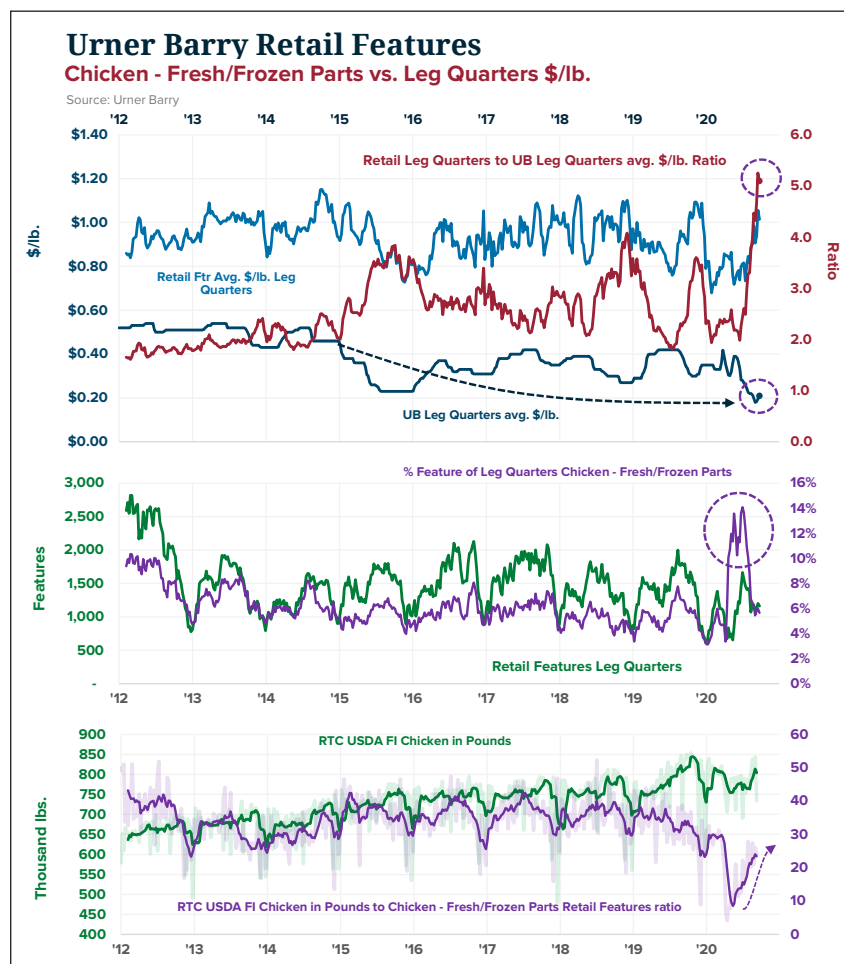


Figure 13. Linear view of retail feature activity and price for Chicken Leg Quarters. Source: Urner Barry Consulting.

As expected on most proteins, chicken sales at the retail sector might not be able to entirely offset the losses from a contracted foodservice sector and reduced exports.

It is likely that the increased ready-to-cook chicken availability will keep wholesale prices under downward pressure while prices to the consumer remain steady at relatively low levels.

It appears obvious that it is presently a buyers' market; and for the consumer, chicken is more of a bargain than in many years' past. Again, if economic hardship is on the horizon chicken, much like eggs, is likely to capitalize on this demand more so than other proteins.

RED MEAT

Both pork and beef experienced sudden spikes as processing plant closures cascaded over the course of several weeks. With that issue seemingly resolved, both markets are returning to regular seasonal production patterns; prices, at least for beef, have also returned to historical averages.

For pork, though, after the market correction during June and July, prices have rallied due to several reasons. Yet, one factor that continues to affect the market is the continued presence of African Swine Fever (ASF). Like the pandemic, the effects of ASF should be assessed as a shock to the market. The rally observed over the past eight weeks, which intensified in September, also comes as a disruptor out of historical seasonal patterns; China and South Korea placed a temporary ban on German pork, and some of that demand shifted towards American pork. This comes in as a positive demand shock, possibly a welcoming occurrence by pork processors to offset a contracted U.S. foodservice sector.

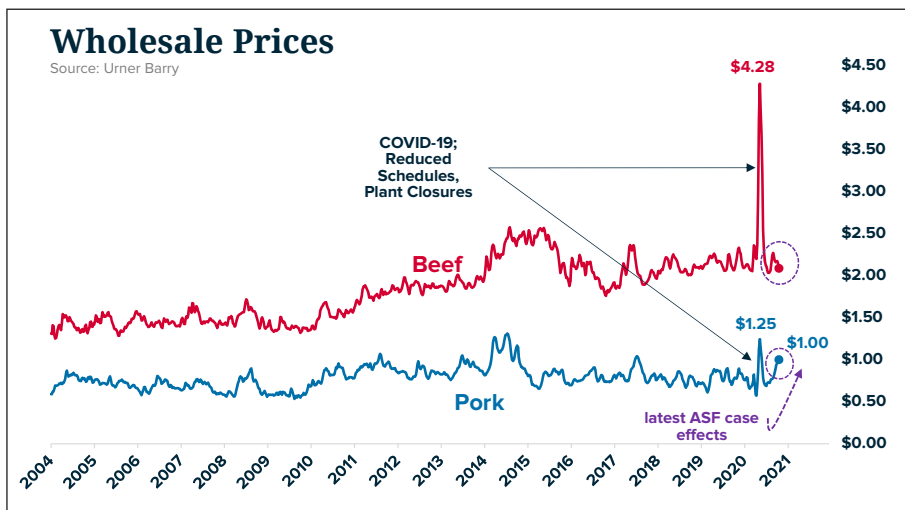


Figure 14. Linear view of wholesale prices using pork and beef cutout indexes. Source: Urner Barry.

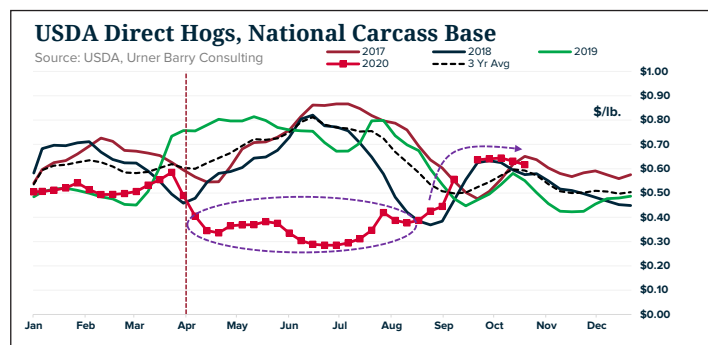


Figure 15. Cyclical view of Hog Prices, Carcass Base. Source: USDA, Urner Barry Consulting

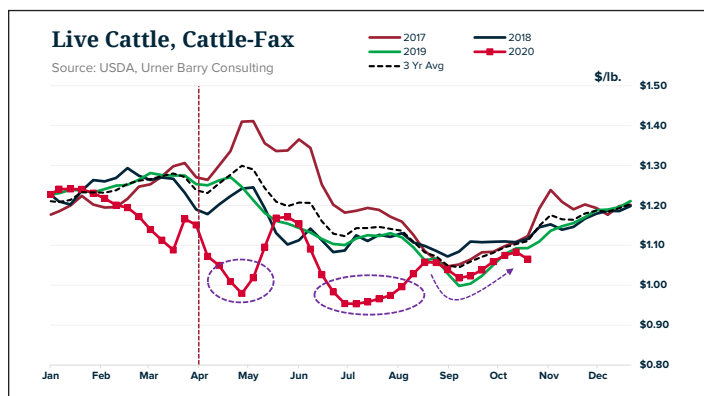


Figure 17. Cyclical view of Live Cattle Prices. Source: Cattle-Fax, Urner Barry Consulting.

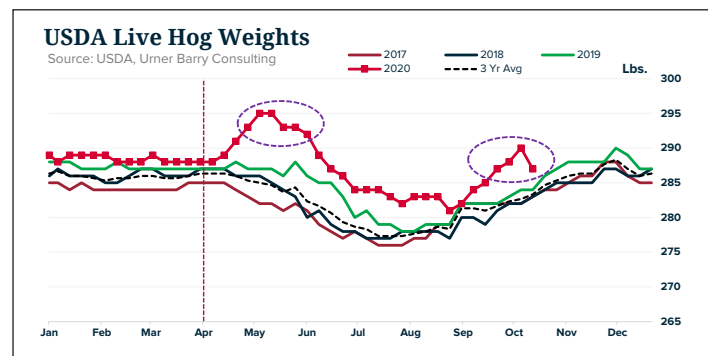


Figure 16. Cyclical view of Live Hog Weights. Source: USDA, Urner Barry Consulting.

Though both cattle and hog weights remain above last year, it appears that the production backlog caused by the slaughter reduction in April will take months to fully correct.

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In terms of retail, ground beef saw quite a strong demand during the summer, possibly as people grilled more than in years' past. Average retail feature prices for ground beef remained strong—at a record high since this series began in 2012. In a similar fashion to chicken breasts and eggs, retail promotions for 80% lean ground beef (which we will use as a bellwether item) have not returned to previous levels as retail sales remain strong, but are now near the 5-year average and comprise a historical high number of features relative to all fresh ground beef. Average retail ad prices have been below the 5-year average for the past eight weeks.

For pork, the retail story is not that different. Retail sales also remain strong, with some seasonal patterns for both price and feature activity returning to normal. Nevertheless, there are items that have not returned to normal seasonal patterns such as bacon, where demand remains strong.

On the beef side, demand remains strong, despite the pandemic and an ongoing recession. Therefore, we raise the question of whether we have already felt the negative effects of the pandemic as demand for high-priced items does not appear to have weakened much, if any.

The pork market overview is less clear due to the on-and-off effects of ASF in addition to other ongoing issues, such as trade tensions between the U.S. and China, lower exports to Mexico, labor shortages at packing plants—some deboning processes are highly manual—among others. Then again, prices for pork are comparatively competitive to beef and other higher-priced proteins like some seafood items, and despite the pandemic, demand for both lower and higher-priced pork remains strong.

Repeating the same premise, if the American consumer is likely going to be cash-strapped in the upcoming months—as a result from the potential negative effects of the pandemic on the economy—pork might not be as exposed as other higher-priced proteins, like beef or certain seafood items.

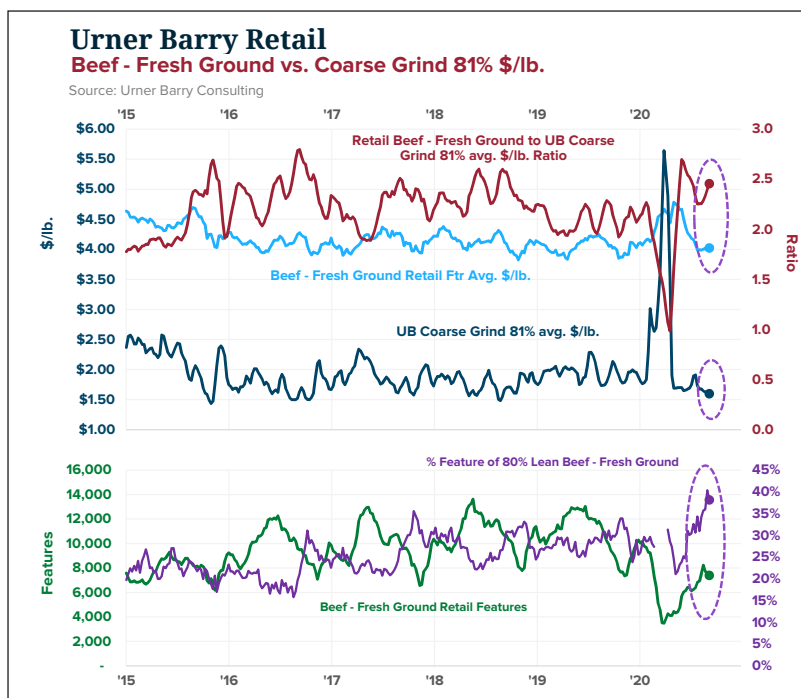


Figure 19. Cyclical view of Live Cattle Weights. Source: USDA, Urner Barry Consulting.

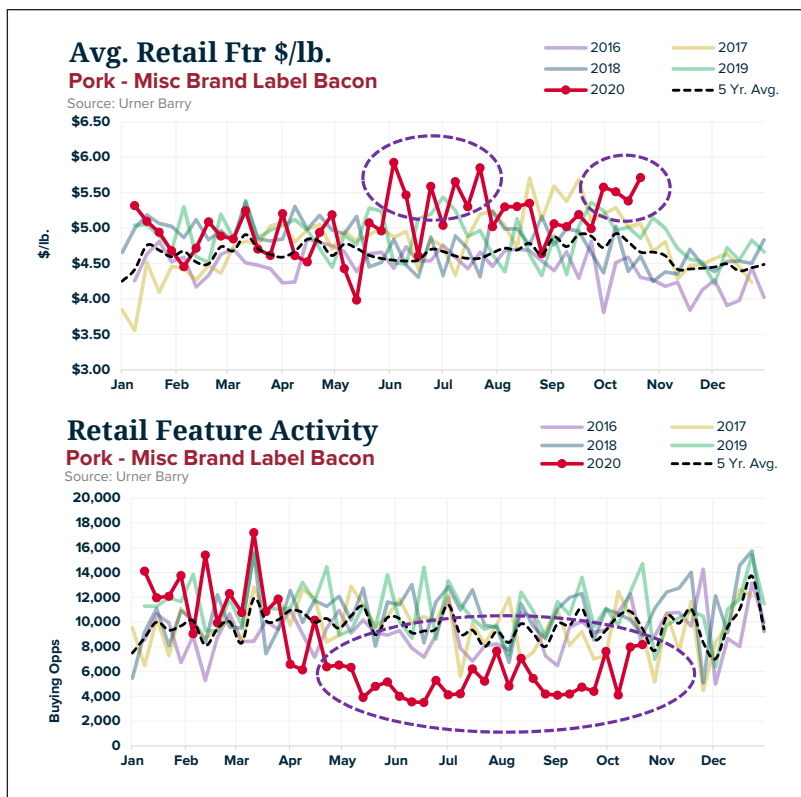


Figure 20. Cyclical view of Retail Ad Features and Average Retail Feature Price. Source: Urner Barry Consulting.

SEAFOOD MARKET

We are still holding to the previous thought that seafood cannot be fairly analyzed as a monolith. Each species' dependence on foodservice sales, as well as regional and seasonal consumption, varies notably—resulting in different positions for different seafood species.

Shrimp, for instance, appears to be weathering the storm despite its heavy dependence on foodservice thus far. Taking the Urner Barry's White Farmed Headless Shell-on Price Index as a proxy, shrimp has remained relatively steady, albeit oscillating at the lowest level since May 2010. Now, taking the value-added index, which covers cooked and peeled shrimp that are destined for both retail and foodservice, the market has remained flat from the second half of 2019 until now.

From a supply standpoint, shrimp imports, which comprise about 80% of the net supply, increased about 6.4% through August when compared to the same time a year ago. At first glance, this is quite puzzling as increasing volumes amid a pandemic in which foodservice demand has considerably contracted, does not make sense, unless that volume is targeted for retail.

But, when we break it down by type, we can see that imports of cooked shrimp through August rose by 27% from a year ago, which translates into 30 more million pounds; we suspect this trend will continue. Conversely, peeled shrimp imports, are down 5.5% through August, which translates into a 24 million pound reduction.

Shell-on imports, which include head-on shrimp as well as easy-peel, are up 15% through August, which translates into 48 more million pounds compared to a year ago. This is where the shrimp market is experiencing significant downward pressure on pricing. Yet, much of the trend in extra volumes coming in precedes the pandemic, largely caused by trade tensions between China and Ecuador; here we can assume that unsold or stranded product destined for the Chinese market, would end up in the U.S. market at a discount. During the pandemic,

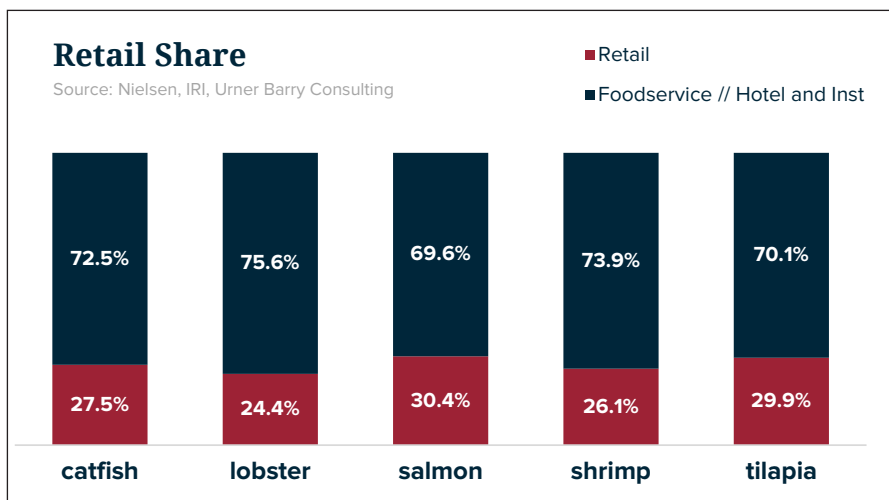


Figure 21. Urner Barry Consulting estimate of each seafood species' volume sales by sector. Source: IRI, U.S. Census Bureau, National Marine Fisheries Service, and Urner Barry Consulting.

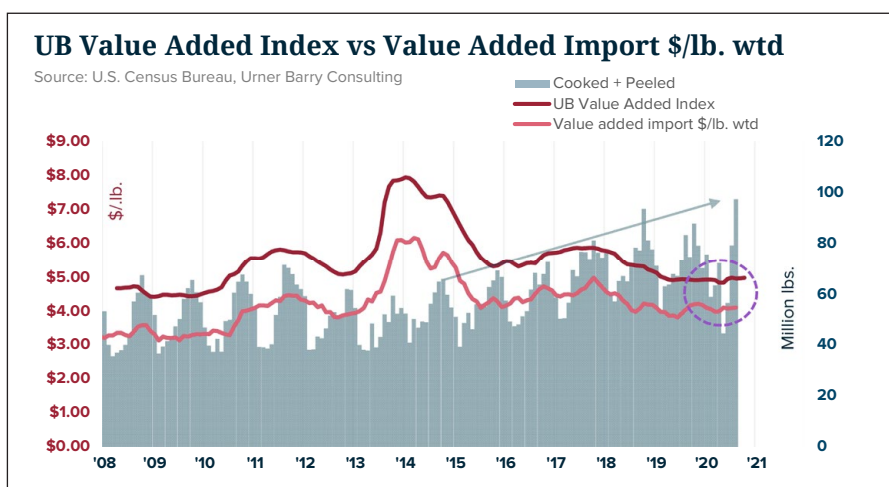


Figure 22. Linear imports of value-added shrimp (cooked and peeled); import price per pound vs. UB value-added index (cooked and peeled) price per pound. Source: U.S. Census Bureau, Urner Barry Consulting.

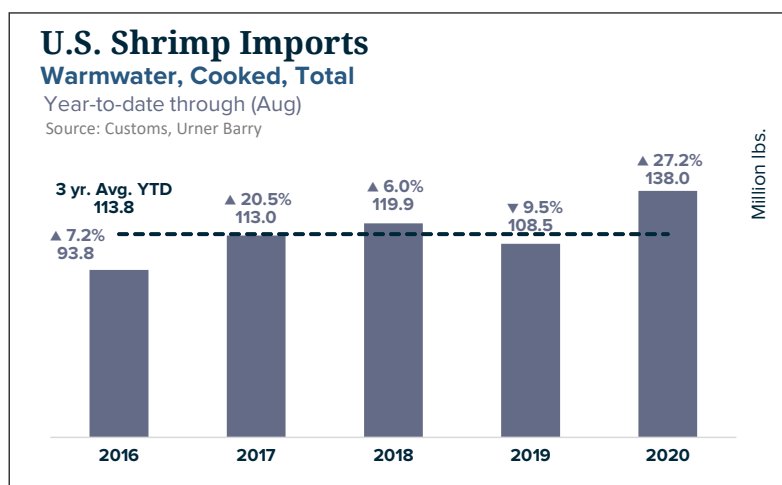


Figure 23. Year-to-date U.S. imports of cooked shrimp. Source: U.S. Census Bureau, Urner Barry Consulting.

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this situation just got exacerbated with even more volume from Ecuador entering the U.S. at the lowest price seen since April 2010. As a result, the shell-on market remains under downward pressure possibly through the winter.

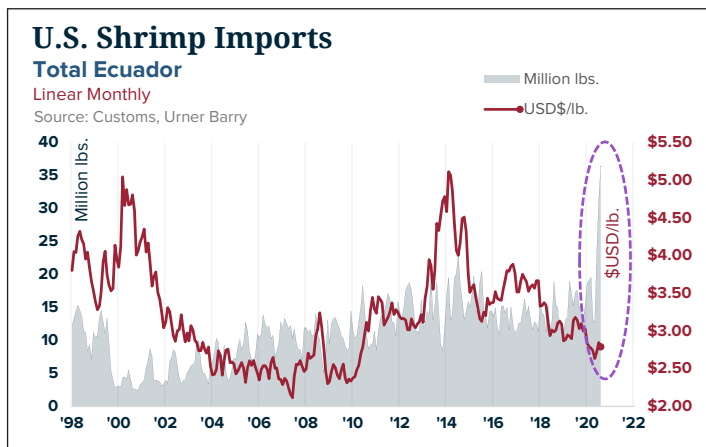


Figure 24. Linear shrimp imports from Ecuador in pounds and import price per pound. Source: U.S. Census Bureau, Urner Barry Consulting.

So, while there is more shrimp in the market, a large portion of this increase has been destined for the retail sector, which has been capable of absorbing such a surge. And while retail promotions declined during the initial stages of the pandemic, feature activity has returned to previous averages. Average retail ad price has remained steady just under the 5-year average.

Salmon, the second most consumed seafood species in the U.S., has been nothing but volatile. Different from shrimp, a much larger percentage of salmon is sold as fresh whole fish or fillets either trucked from Canada or the U.S. West Coast, or flown from Chile, Norway, the Faroe Islands, and Scotland. With a large portion of fresh salmon being shipped on passenger airline flights, sellers had to switch from regular passenger flights to cargo shipments as commercial air travel severely contracted during the pandemic. In addition, shipments from the largest supplier, Chile, continue to grow amidst a severely contracted foodservice sector. Like shrimp, prices have not collapsed either, but they have been highly volatile bouncing off several times on the lower end of their 14-year historical support levels.

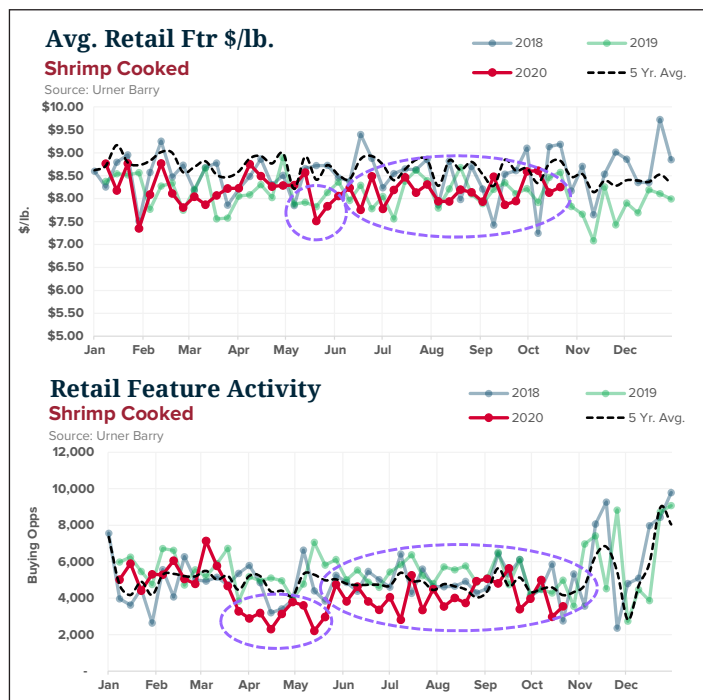


Figure 25. Cyclical view of cooked shrimp retail feature activity and average retail feature price. Source: Urner Barry Consulting.

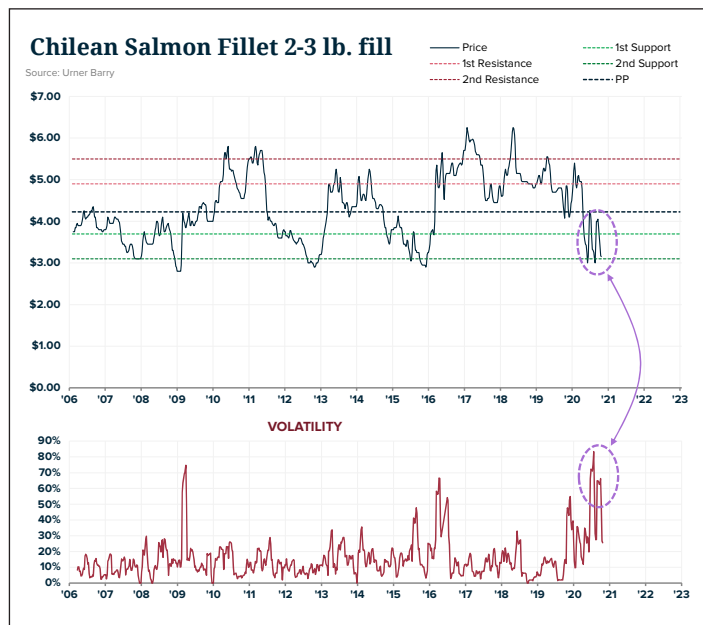


Figure 26. Linear Urner Barry Quotation of Chilean Salmon 2-3lb. trim-D Fillet. Source: Urner Barry Consulting.

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Retail feature activity for Atlantic Salmon was already sitting at an all-time high prior to the pandemic, possibly due to salmon being a good seller at grocery stores. Prior to the pandemic, salmon fillet wholesale prices had been sitting comfortably between \$4.25 and \$5.50, while average retail feature pricing had been sitting at about \$7.50 over the last three years. This year, however, average retail price is at its lowest level hovering around \$6.60 through the 3rd week of October.

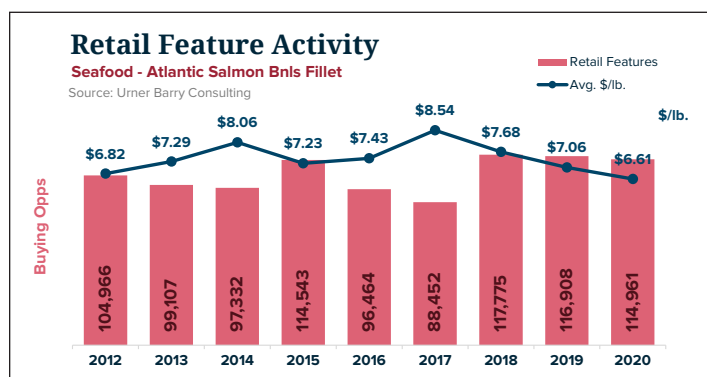


Figure 27. Atlantic Salmon Bnls Fillet retail feature activity and avg. retail feature price. Source: Urner Barry Consulting.

Retail feature activity has been oscillating above the 3-year average since June, suggesting that salmon sellers will continue to rely heavily on retail ads to continue moving product.

Such situations will persist for many seafood items, possibly intensifying somewhat going into the winter as many restaurants will likely see a contraction in demand, go into hibernation, or close out for good. While it appears that, to some degree, many main seafood items have been able to buffer the impacts throughout the summer, pricing to the consumer will play a more important role than in normal times in order to avoid drastic protein substitution effects.

As long as the savings of already low wholesale prices are passed on to the consumer—whether it is through retail ads, or attractive menu pricing at restaurants that can keep decent traffic during the winter, or even through delivery meal kits—many seafood items might be able offset some of the negative impacts of a constrained foodservice sector. On a price point level, as well as the amount of retail feature activity, this is where seafood sits relative to other proteins.

See Figure 5 on page 2.



Figure 28. Average retail feature ad price in 2020 per main seafood species. Source: Urner Barry Consulting.

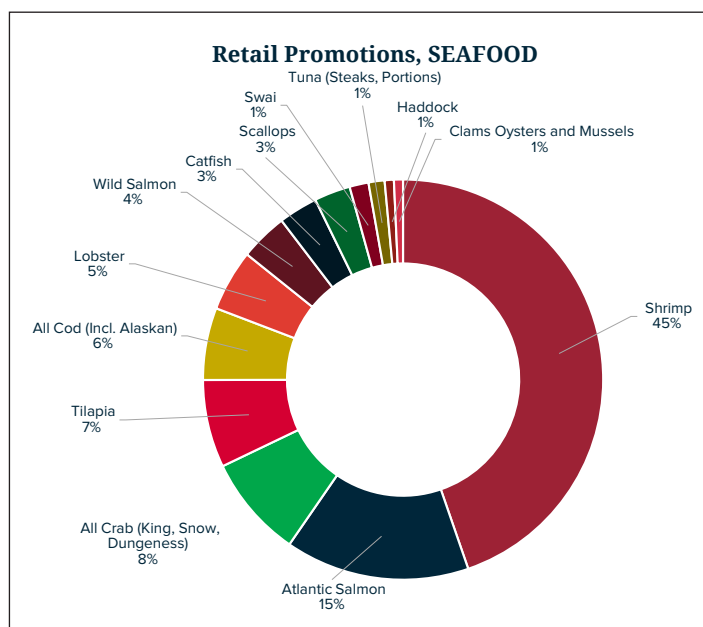


Figure 29. Share of retail feature activity in 2020 per main seafood species. Source: Urner Barry Consulting.



CONCLUSION

It is likely that the resilience seen by many operators during the summer through outdoor dining transitions as well as growth in food delivery and other innovations will continue during the winter. However, this resilience will very likely come at the expense of an inevitable, potentially subtle, contraction from current sales levels. Therefore, we expect that retail sales will likely see another minor increase during the winter in addition to the normal seasonal bump. Still, there are other factors that will play a crucial role in shaping the future of the foodservice and retail sectors other than a return to normal indoor dining capacity; these factors include unemployment, particularly in the foodservice sector, as well as disposable income, among others.

For the sake of everyone in the industry, it is hopeful that the foodservice and wholesale distribution sector can weather what's ahead of what could prove to be a bitter and long winter.

Advance Retail Sales: Food Services and Drinking Places SA

Source: U.S. Census, Urner Barry

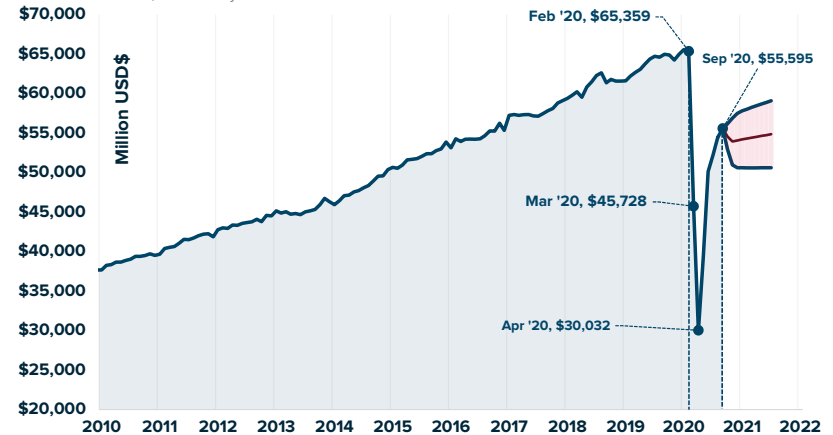


Figure 30. Advance Retail Sales: Food Services and Drinking Places, SA. It adds Urner Barry Consulting Forecast. Source: US Census, Urner Barry Consulting.

Advance Retail Sales: Grocery Stores SA

Source: U.S. Census, Urner Barry

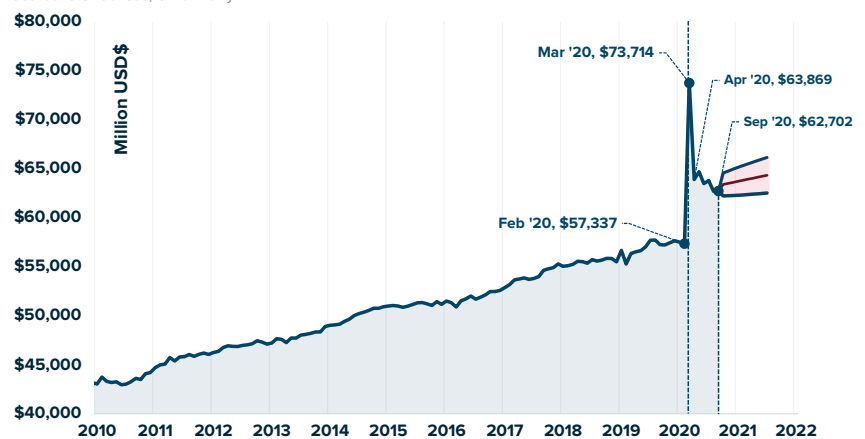


Figure 31. Advance Retail Sales: Grocery Store Sales, SA. It adds Urner Barry Consulting Forecast. Source: US Census, Urner Barry Consulting.

All Employees, Food Services and Drinking Places SA

Source: U.S. Census, Urner Barry

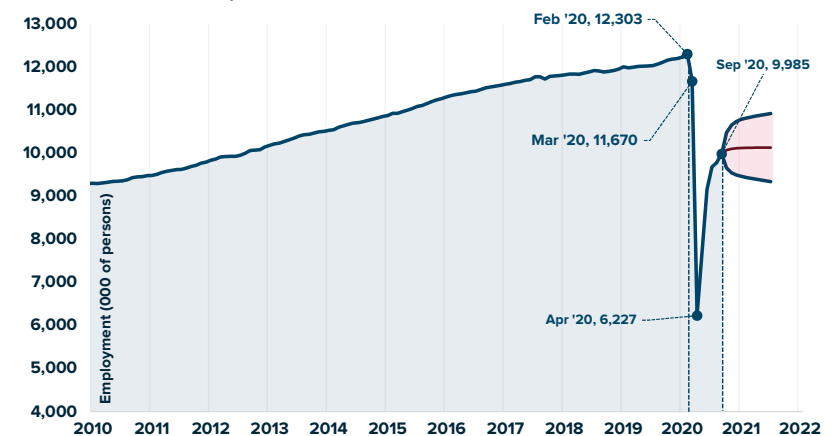


Figure 32. Employment, Sales: Grocery Store Sales, SA. It adds Urner Barry Consulting Forecast. Source: US Census, Urner Barry Consulting.

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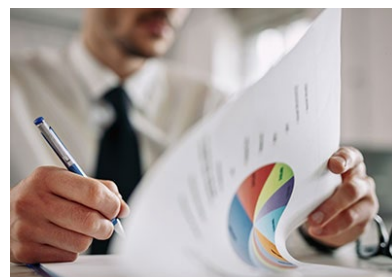
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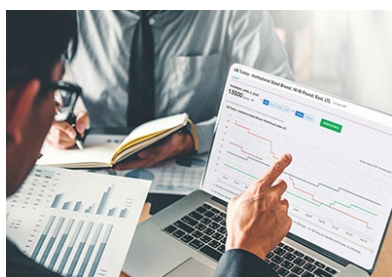
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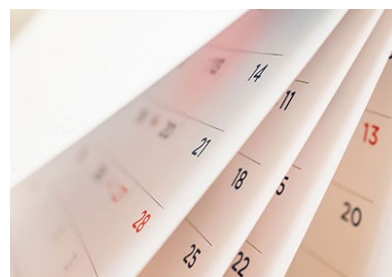
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