

December 18, 2020

Assessing the Protein Landscape as 2020 Comes to a Close

In an attempt to close out a despairing year for the foodservice industry, we once again take a look at the indicators we have analyzed in past reports. Back in March 2020, industry estimates suggested a foodservice sales contraction from 10 to 20 percent year-over-year. As of the second week of December, using data through November, it appears that 2020 will be closer to a 20 percent contraction. Furthermore, some recent states' mandates on restaurant closures (e.g. New York), are likely to make this contraction somewhat larger. Our estimates even for next year vary widely, depending on how the recovery develops.

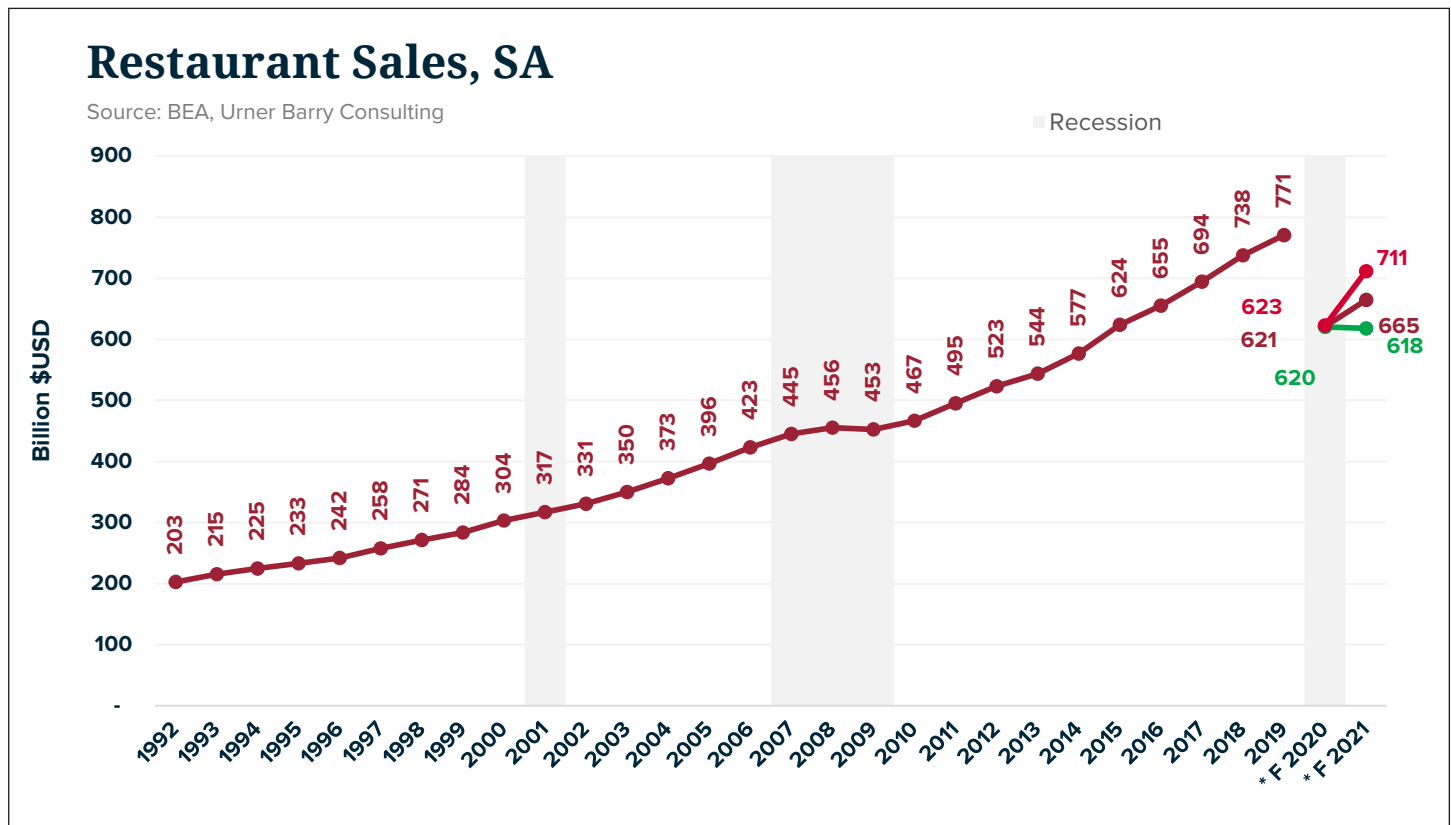


Figure 1. Advance Retail Sales, SA, for Food Service and Drinking Places. Source: U.S. Census Bureau.

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We continue to place a heavy emphasis on how foodservice sector sales hold up relative to retail (grocery stores). Seasonally adjusted data for October and November showed a decrease in sales from the previous month, halting a 5-month rally from April. We used seasonally adjusted data to show a plateau on the current trend rather than approach it on a seasonal year-over-year basis, which is usually the preferred measure for those in the industry.

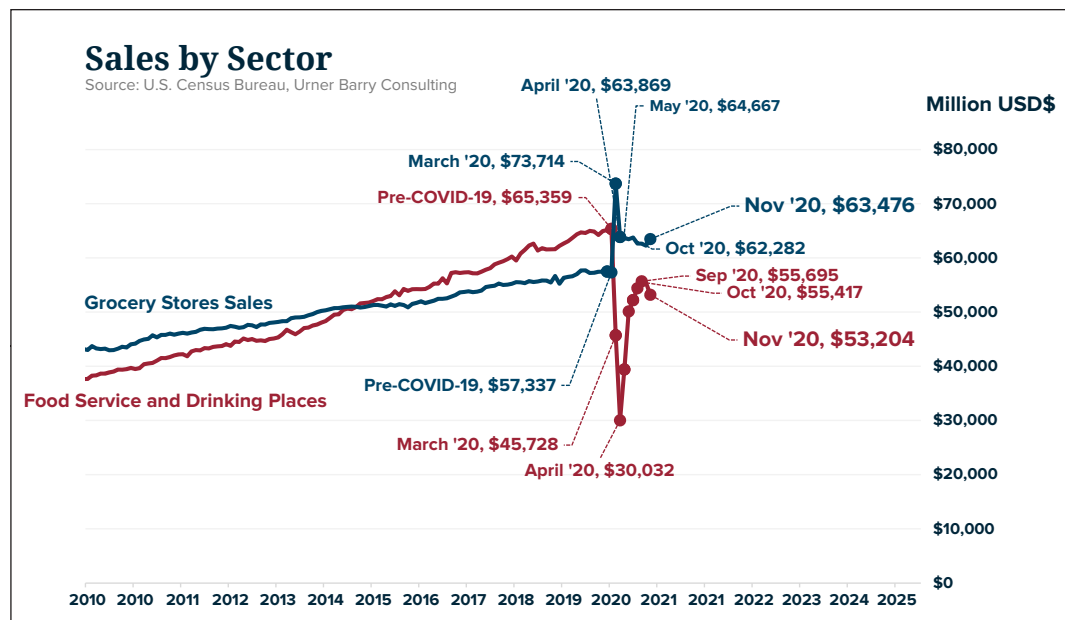


Figure 2. Advance Retail Sales, SA, for Grocery Stores and Food Service and Drinking Places. Source: U.S. Census Bureau.

So, as dining out contracts once again—mainly due to colder weather and many states shutting down indoor dining again because of back-to-back record figures of daily fatalities in December—it is likely there will be another not-so-abrupt increase in grocery sales shifting from foodservice.

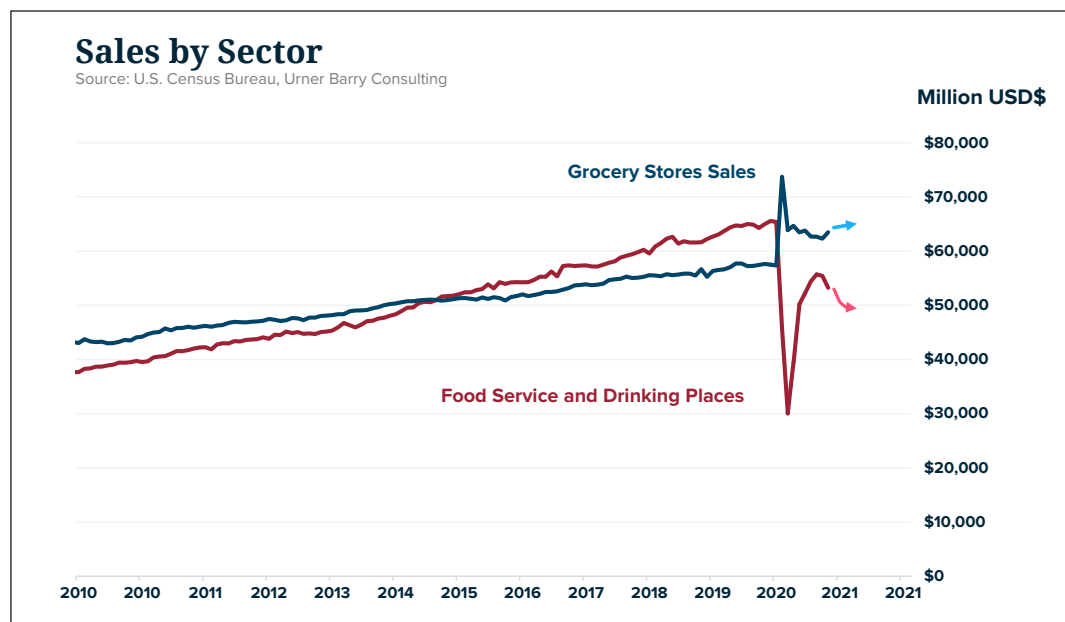


Figure 3. Advance Retail Sales, SA, for Grocery Stores and Food Service and Drinking Places; Forecast through December 2021 based on data through October 2020. Source: U.S. Census Bureau, Urner Barry Consulting.

This situation could once again shake the wholesale food industry, albeit, to a considerably lesser extent compared to March and April. What this means is, wholesale trade to the foodservice sector is also likely to suffer at the expense of gains in retail.

Yet, the fate of the economy remains uncertain and to a large degree dependent on more government spending as federal emergency unemployment programs from the CARES Act are set to expire on December 26th. This emergency legislation has provided quite a buffer from what otherwise could have been disastrous throughout the pandemic.

Disposable income remains stable while unemployment, particularly in the foodservice sector, remains high. Consumer spending at both grocery stores and restaurants during the summer and into the fall offset the potential spending contraction caused by high unemployment. After December 26th, millions of workers will see their benefits from the CARES Act cut off. It appears that providing another lifeline to consumer spending through another round of government relief on emergency unemployment benefits will prove crucial. We must remember that about two thirds of the economy run on consumer spending.

We believe that after the initial shock in March and April, protein consumption has been largely supported by a growth in disposable income despite high unemployment figures. As a result, this has also provided relative support to wholesale trade and thus prices. On the production side, domestically produced land-based proteins have cut back production where possible.

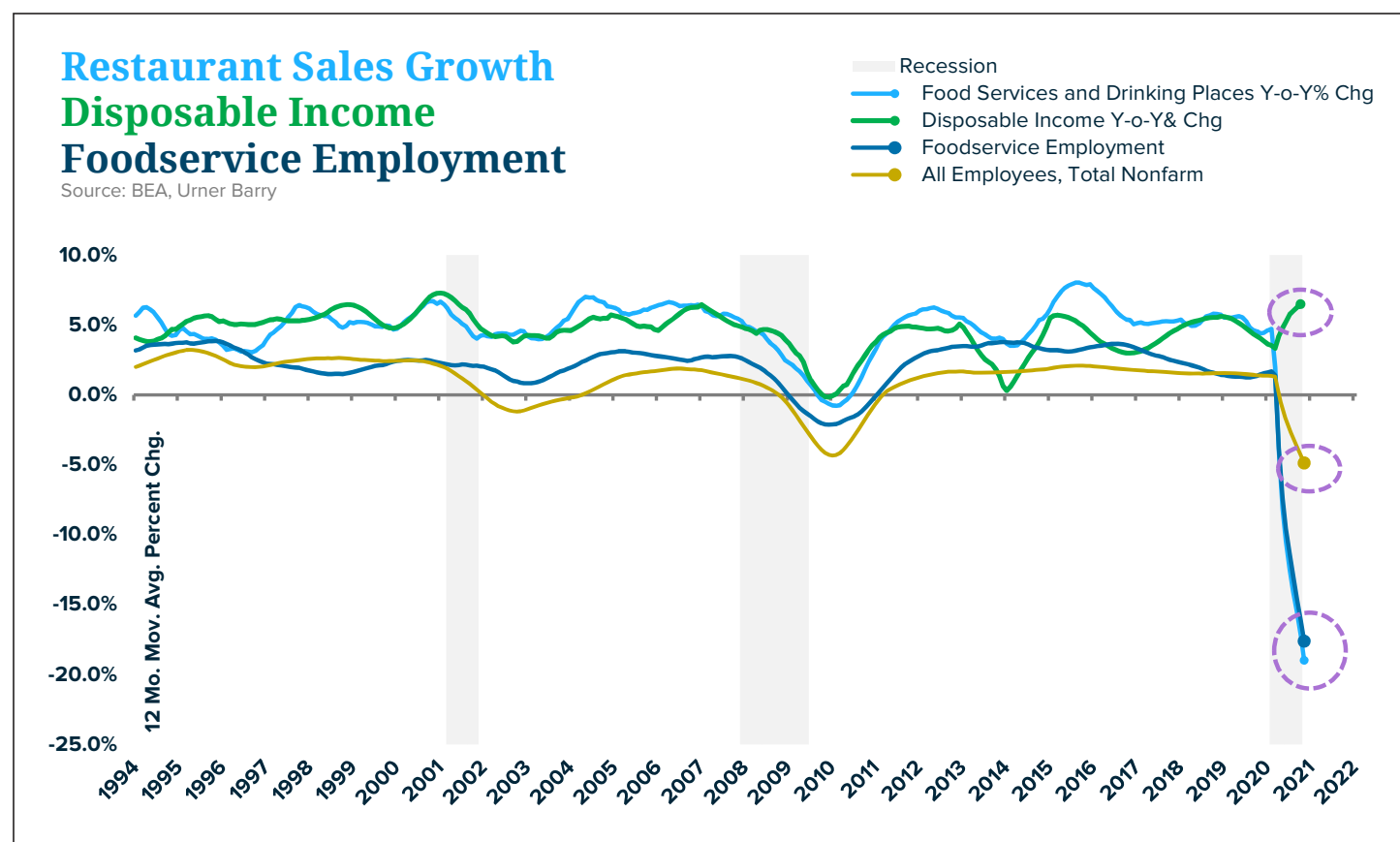


Figure 4. Restaurant Sales Growth and Disposable Income, Y-o-Y Chg, 12 Month Moving Average. Source BEA, Urner Barry Consulting.

Nevertheless, **we have not seen any dramatic drops in wholesale prices for mainstream animal proteins:** eggs, chicken, pork, and beef prices remain within their historical and seasonal averages and confidence intervals, with occasional non-seasonal jumps or drops. Pork prices have been a tad more volatile, which is partly caused by African Swine Fever (ASF) dynamics. On the seafood side—generally perceived as higher-priced by many consumers relative to other proteins—prices for salmon and shrimp appear to be barely holding and hovering around multi-year lows. Maine lobster prices fell counter-seasonally in March and, as expected, as the summer kicked in; however, seasonal prices resumed their behavior albeit with an estimated 15% reduction in landings.

In previous reports, we also predicted sporadic mild price volatility as supply chains shifted from foodservice to retail and vice versa. We still believe this will be true through the spring.

Finally, we must consider each protein’s dependence on foodservice relative to retail.

To summarize, our assessment indicates that cuts in production, renewal or expansion of government relief programs for the unemployed, and the potential recovery as vaccine rollouts begin across the country, will help mitigate potential price drops in the wholesale market during the winter and very likely into the spring.

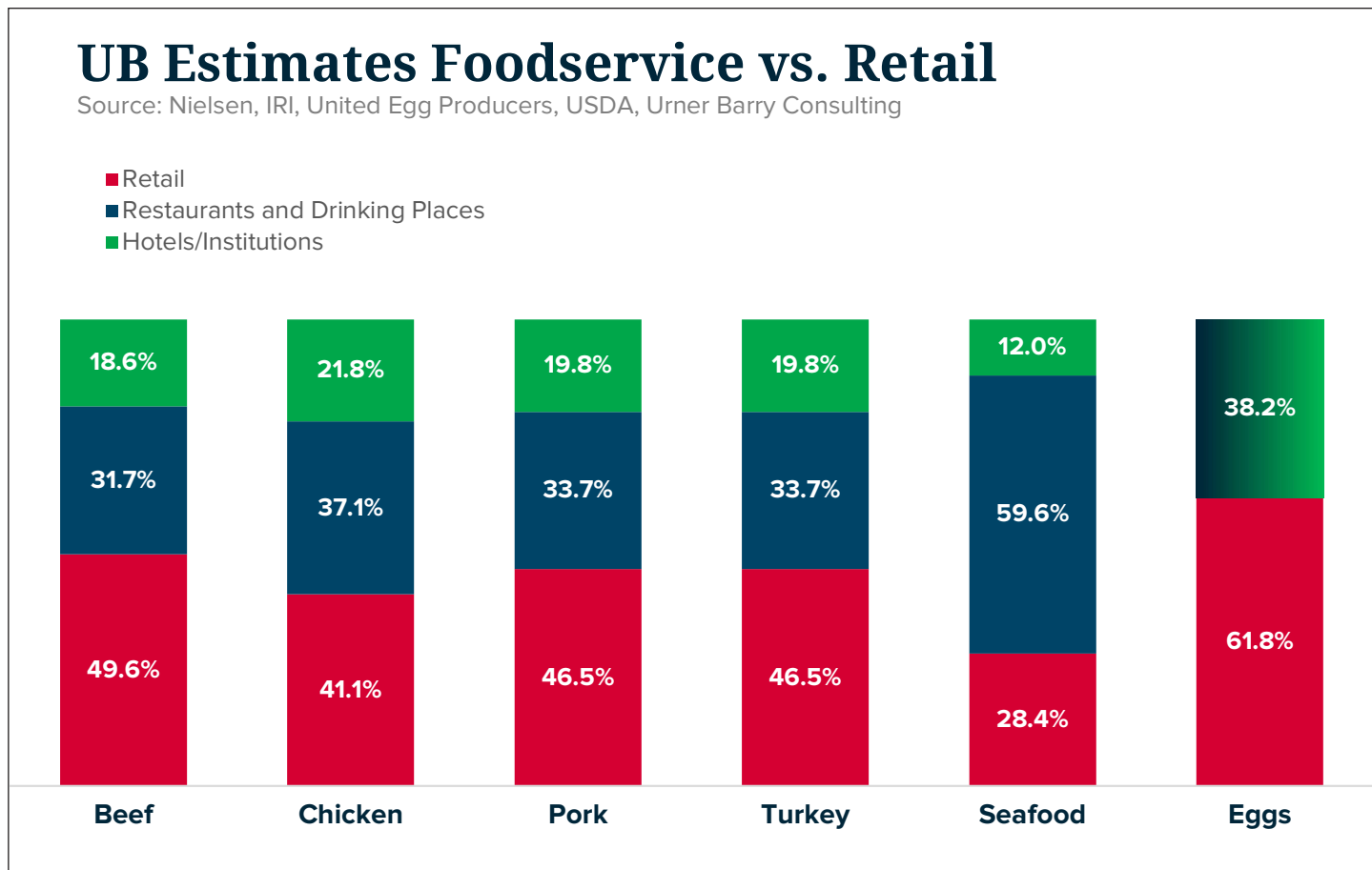


Figure 5. Urner Barry Consulting volume estimate of the Foodservice vs. Retail Share using data from Nielsen, IRI, USDA; data from United Egg Producers is taken as is from unitedegg.com.

EGG MARKET

Production in Q2 and Q3 decreased 5.3% and 2.9% from the previous year with overall volumes comparable to those seen during Q2 and Q3 of 2018. These production cutbacks appear to have provided price stability in the aftermath of the initial stages of the pandemic. Using our Midwest Large White Shell Egg quotation, we continue to see prices oscillate within support and resistance levels from 2016 until now. This means that at least for now, the wholesale market remains relatively stable.

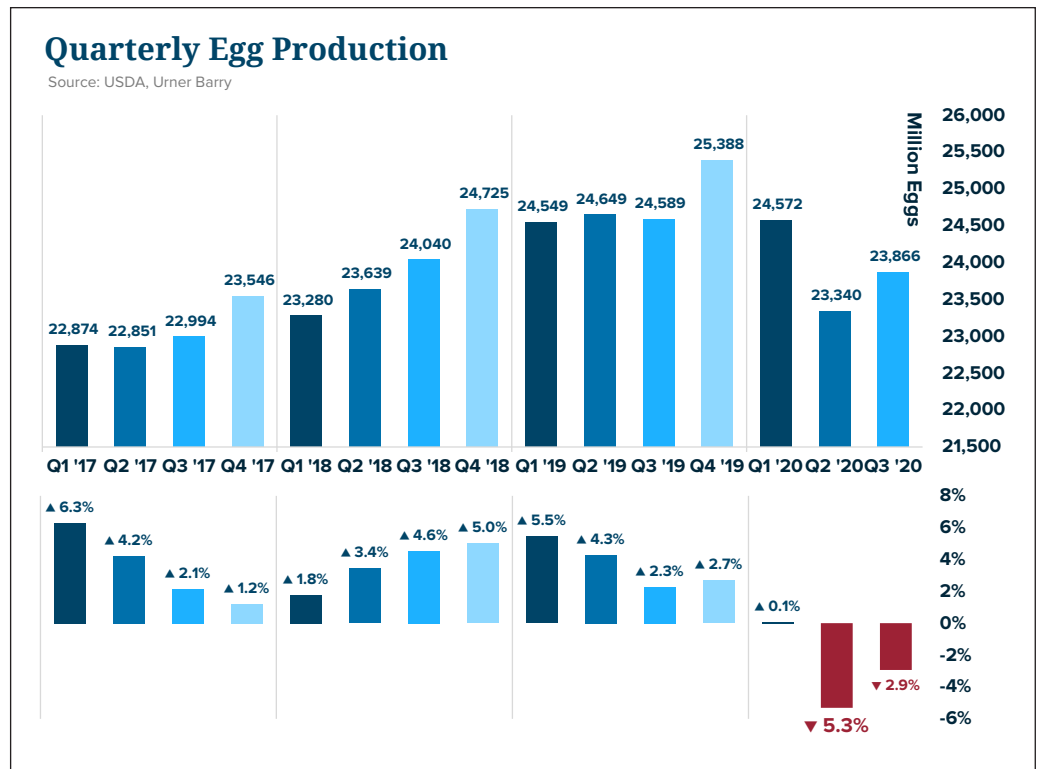


Figure 6. Table Egg Production. Source: USDA, Urner Barry.

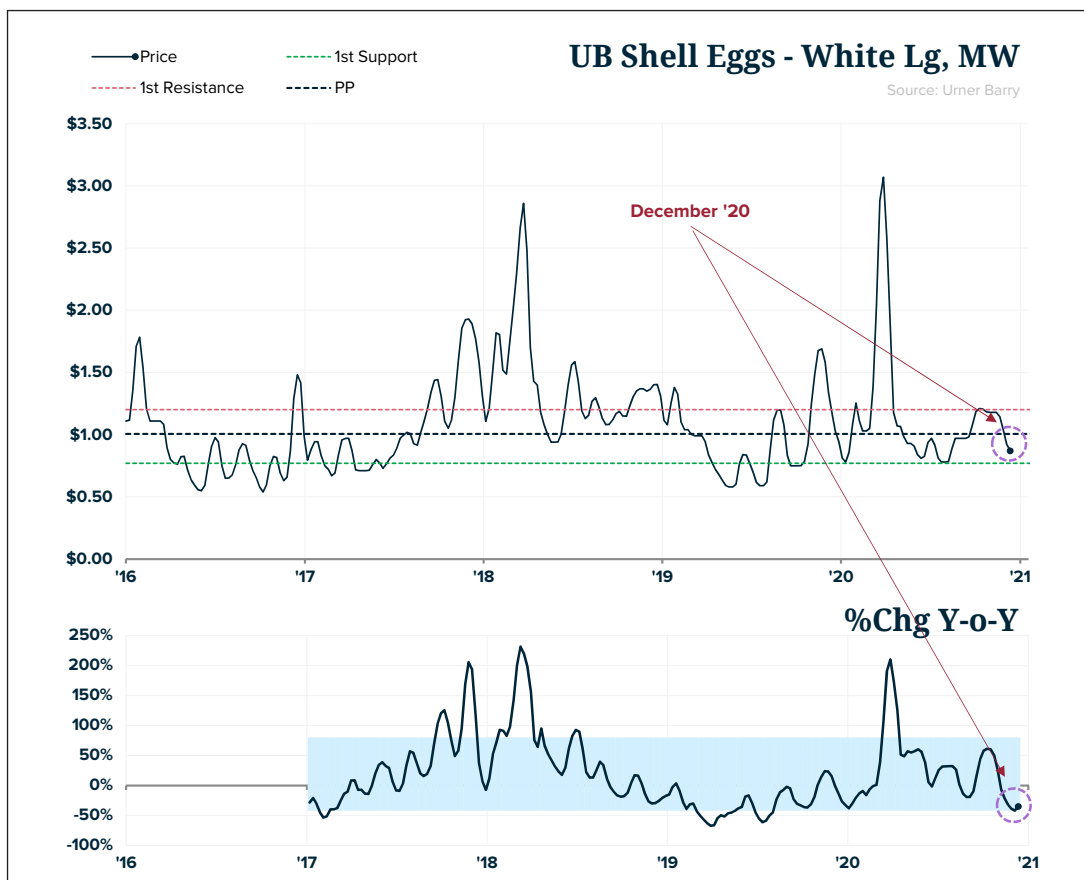


Figure 7. Average prices for Mid-West Large plotted linearly. Source: Urner Barry.

When looking at common variables to assess price, like inventory, we noticed how wholesale prices adjusted lower during the second half of November and into December at the same time when both shell egg inventory and breaking stock inventory surged. Unfortunately, both indicators are released two weeks behind.

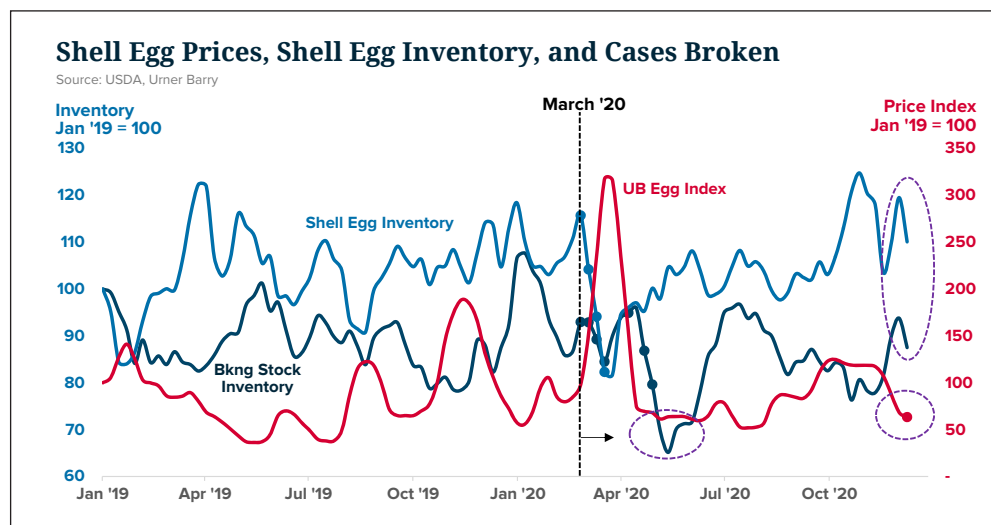


Figure 8. Shell Egg Inventory, number of Cases Broken, and UB Egg Price Index, indexed as a percent change. Source: USDA, Urner Barry.

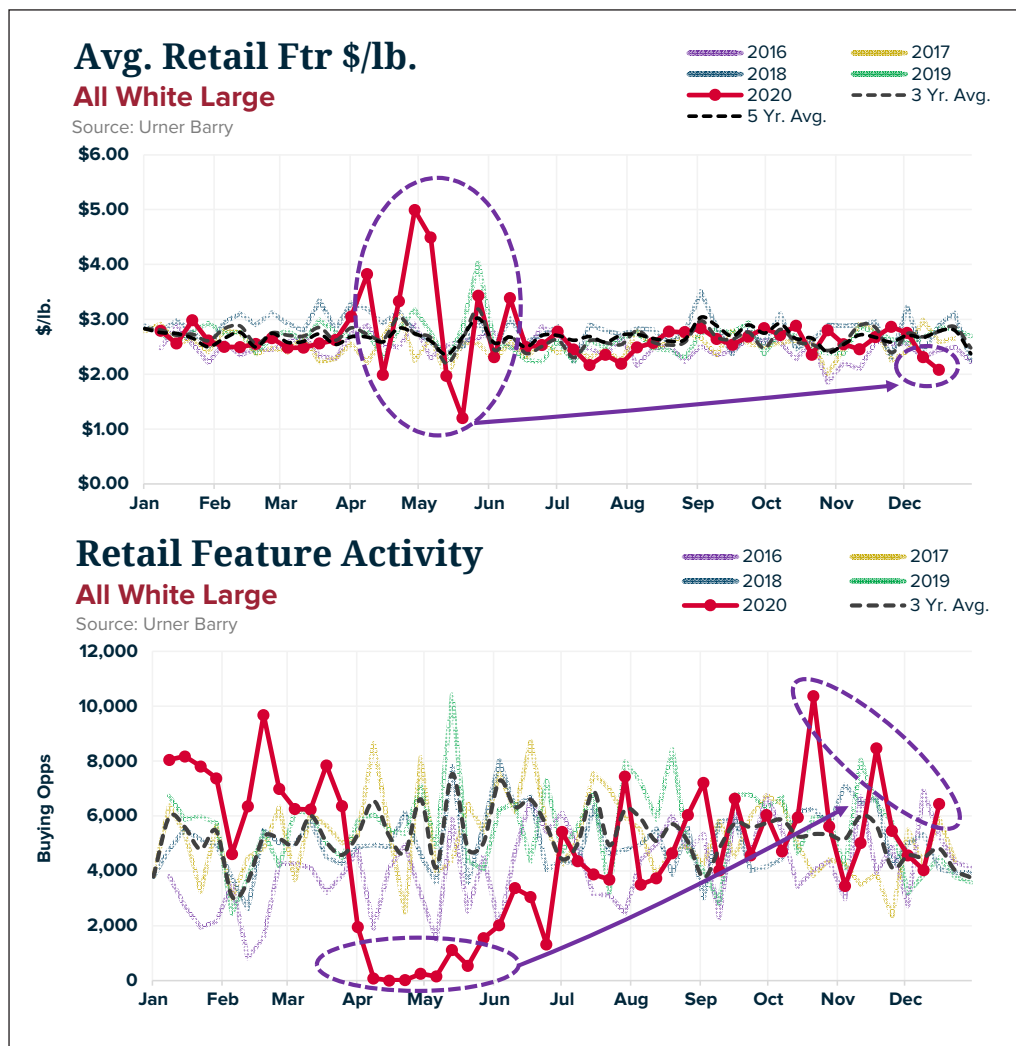


Figure 9. Shell Egg Retail Feature Ads (Buying Opportunities = Retail ad x (times) the number of stores) and Shell Egg Retail Feature Average Price. Source: Urner Barry Consulting.

As published two months ago, eggs will continue to hold an advantage over all other proteins due to their large reliance on retail (grocery) sales. As we go into the winter, the overall retail sector is likely to strengthen and hence provide support to egg prices at the wholesale level. Retail feature activity has recovered swiftly since July with activity increasing sporadically in Q4. Retail feature pricing, which is largely dependent on wholesale prices, has remained generally steady since July, with a slight drop in December.

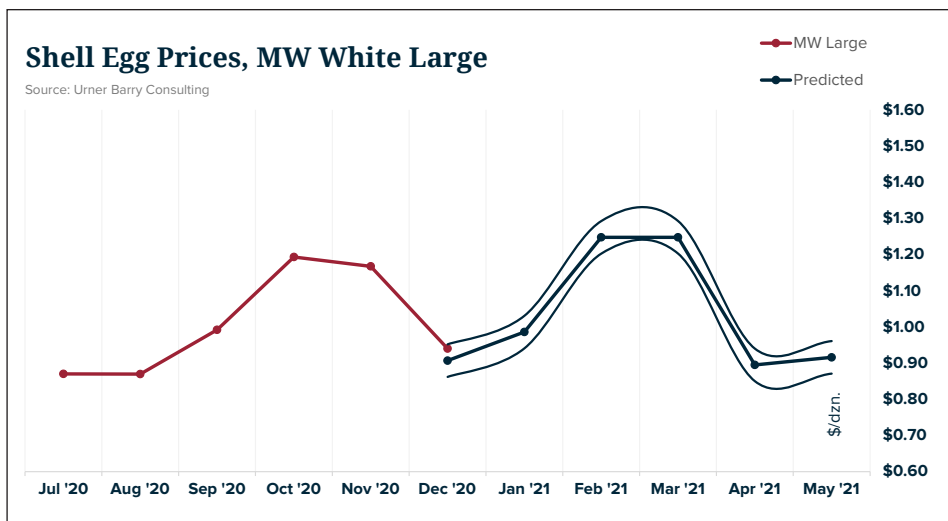


Figure 10. Shell Egg Midwest White Large UB quotation plus Urner Barry Consulting forecast.

Our revised forecast suggests prices are likely to remain mostly steady through the winter and experience a seasonal rise into the spring. Our models suggest that large price swings, either up or down, are not likely at least in the next six months.

CHICKEN MARKET

The chicken market started 2020 under downward pricing pressure as production continued its five-year expansion. Chicken weights also continued registering record highs throughout 2020 until the second week of October, when they managed to level off with last year's weights. While the pandemic managed to partly cause a reduction in slaughter numbers, ready-to-cook chicken (RTC) will end the year averaging record numbers. These slaughter cutbacks, as well as bird weight control in Q4, are providing overall chicken prices with support not seen since the beginning of the year.

Furthermore, the pipeline going forward now appears to be slightly more balanced than in our previous assessment, with both chicks placed and eggs set averaging figures below last year. And while the incentives to cut back production may be clear to many, such as low overall prices, or reduced demand from other countries, anecdotal evidence suggest that labor constraints are also a large reason for such cutbacks not only in the near term, but also in the long-term.

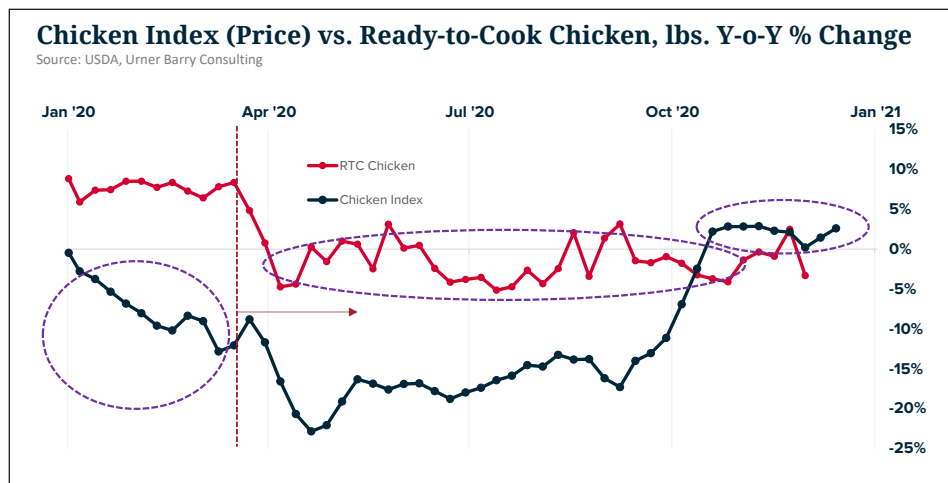


Figure 11. Chicken Wholesale prices using UB price Index vs. Ready-to-Cook Chicken. Source: Urner Barry, USDA.

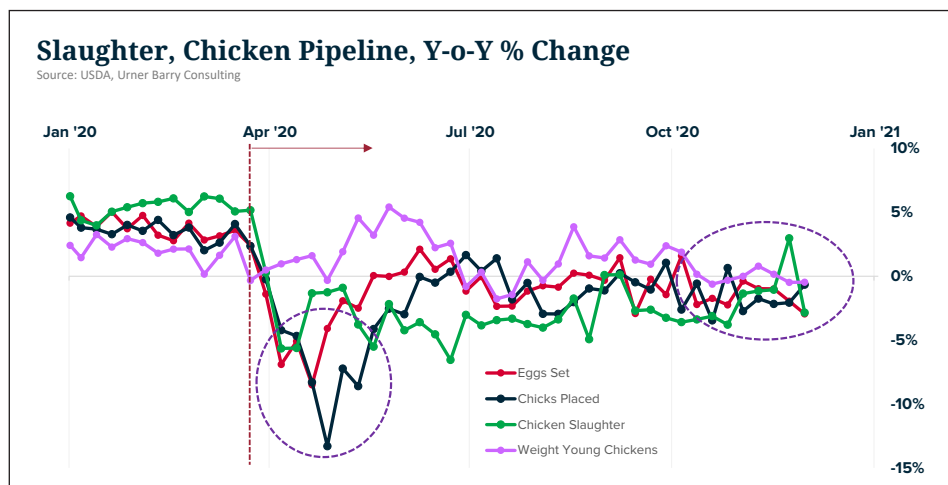


Figure 12. Y-o-Y Change in Slaughter, Eggs Set, Chicks Placed, Avg. Chicken weights. Source: USDA, Urner Barry Consulting.

Still, we must remember that chicken is the most consumed animal protein in the U.S. by a significant distance, and this year will also mark another record consumption year.

Retail items like WOGs are returning to previous year values, while boneless breasts remain within historical and seasonal averages. This is quite relevant since the wholesale trade will once again rely heavily on retail sales through the winter and possibly into the spring.

Items that are largely exported, like leg quarters, have recently recovered—generally helped by a favorable exchange rate. This item was showcased in the previous report as wholesale values had reached multi-year lows. These values have recovered since, and now appear to be steady.

We do not foresee any major changes in the chicken market unless outside factors affect the fundamental dynamics.

RED MEAT

On the beef side, while some items have experienced unusual and unseasonal bumps and slumps in wholesale values due to the changing foodservice environment, overall beef prices have returned to trading within historical and seasonal averages.

Taking two retail items, ground beef and ribs, we can see opposite moves. Beef ribs for instance, saw prices move significantly higher in late November and into December (+30%). Historically and seasonally, rib prices tend to increase during this period but this year the surge was unprecedented. Wholesale values for ground beef, on the other hand, have been underperforming compared to last year once the market corrected in June. When looking at the overall composite using Urner Barry's beef index, which is an overall measure of wholesale beef prices, values since June have been oscillating very close to last year's levels.

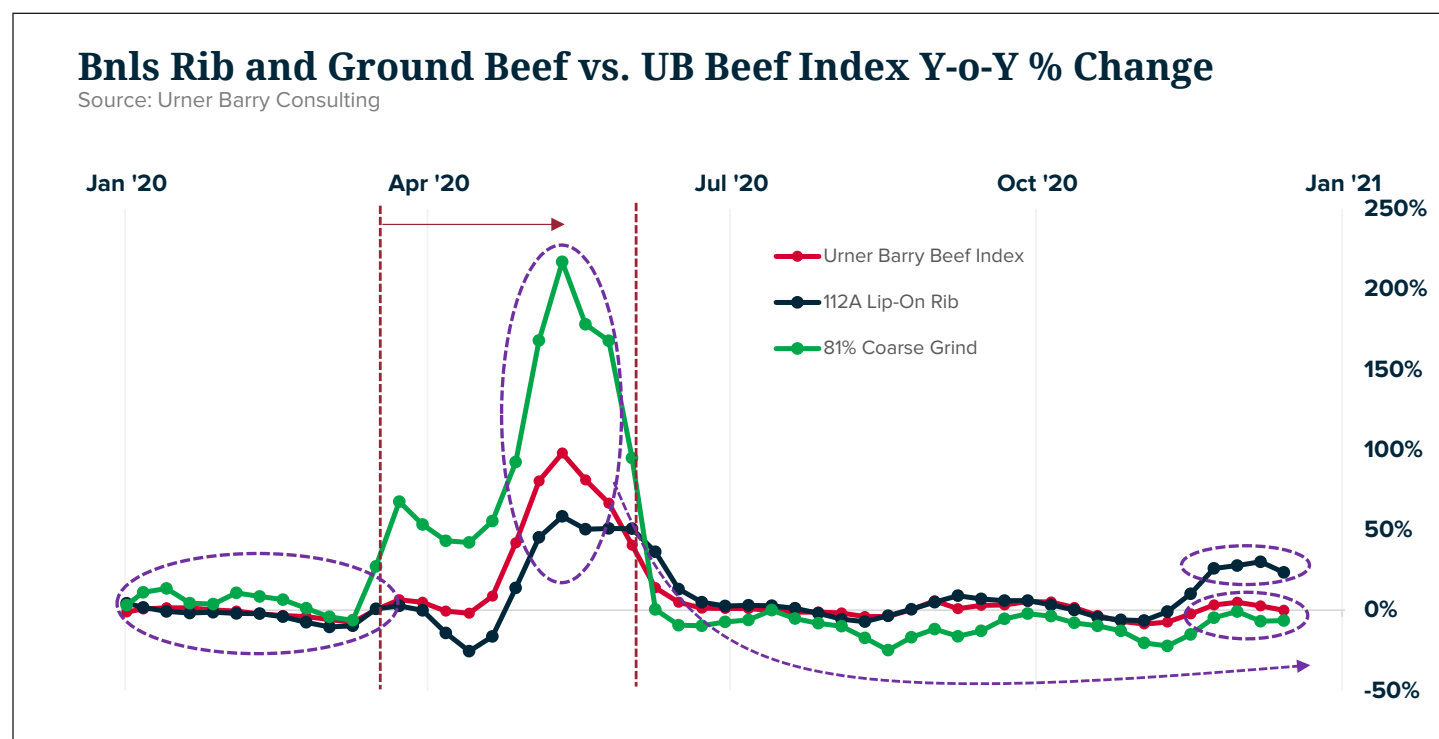


Figure 13. Y-o-Y Change in wholesale values for Beef Ribs, and Ground Beef, and Urner Barry Beef Index. Source: Urner Barry Consulting.

Heavy cattle weights will very likely cause total beef production figures in 2020 to match those from last year despite an estimated 3 percent slaughter reduction.

Although beef appears to be holding steady into the near future, wholesale values run a higher risk of declining relative to other proteins if disposable income falls. For now, however, we believe the beef market will likely hold steady.

For pork, after the rally seen in October mainly caused by the African Swine Fever (ASF) situation in Germany, wholesale values declined and remain under downward pressure.

The pork market situation appears to be relatively straightforward. Not only have hog weights increased, but hog slaughter numbers remain high. We estimate slaughter figures to end up around 1.1 percent above last year. As a result, production will also end up reaching record highs.

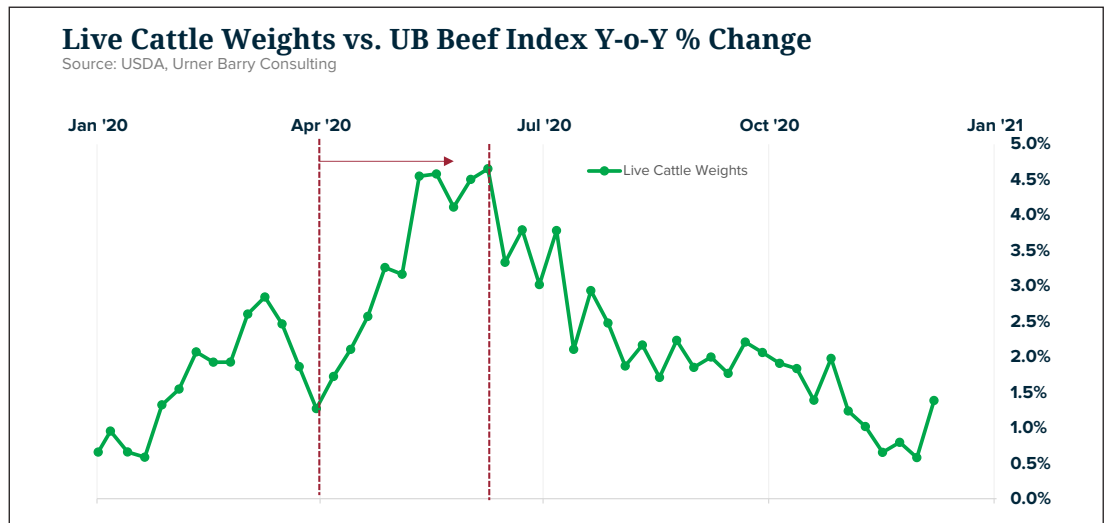


Figure 14. Y-o-Y Change in Live Cattle Weights. Source: USDA, Urner Barry Consulting.

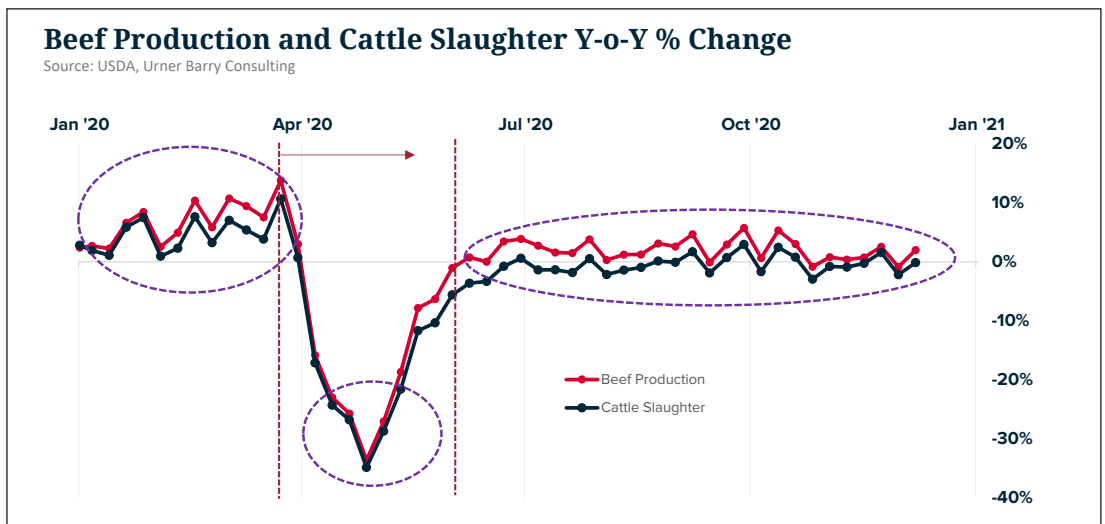


Figure 15. Y-o-Y Change in Cattle Slaughter and Beef Production. Source: USDA, Urner Barry Consulting.

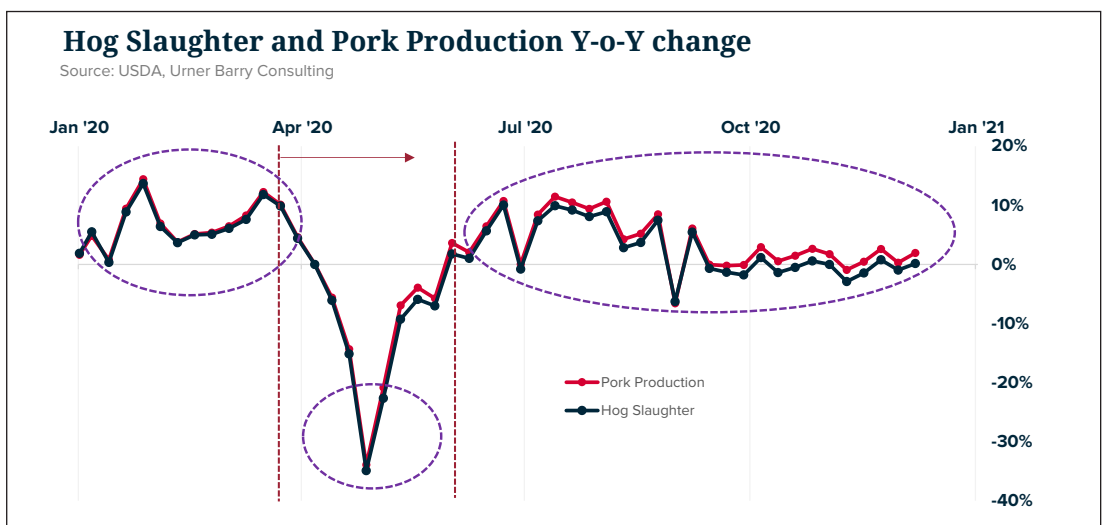


Figure 16. Y-o-Y change in hog slaughter and pork production. Source: USDA, Urner Barry Consulting.

In terms of wholesale prices, pork cutout values indicate the market is under downward pressure. Illustrating this, we see many main items are experiencing significant year-over-year declines. Pork butts, for instance, are at the lowest level year-over-year since 2003.

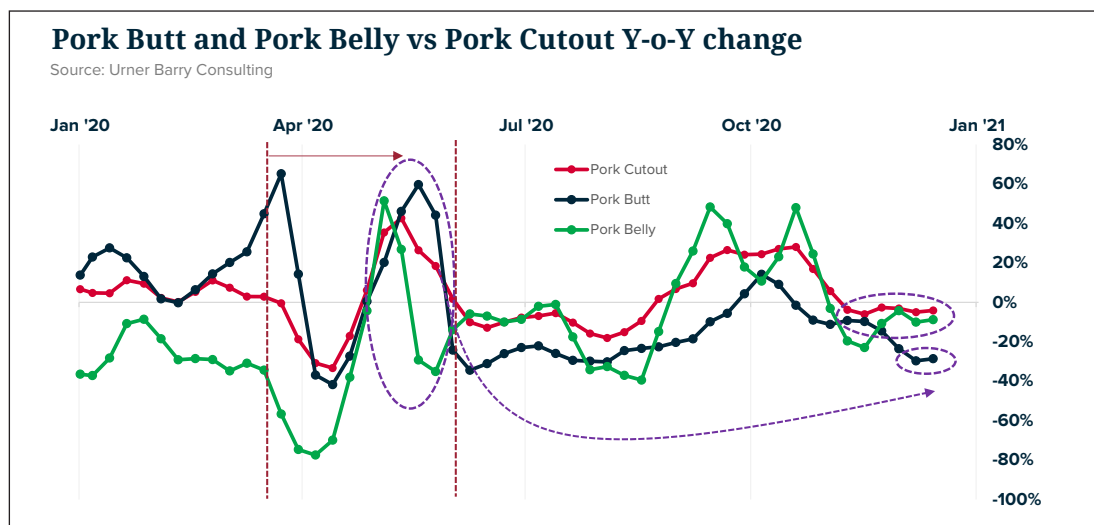


Figure 17. Y-o-Y change in wholesale pork values. Source: USDA, Urner Barry Consulting.

This appears to be showing how simple fundamentals can at times explain the big picture without looking at many other relevant variables, which are often required to properly analyze a market.

The conclusion going forward for pork is steady to weak. Labor shortages at processing plants continue to be an issue for deboning cuts—a highly labor-intensive process. Heavy hogs are still on the pipeline, with record pork volumes reaching a contracted market. And while export markets like Mexico, Japan, and other Asian markets can continue to provide some support, the U.S wholesale pork market will continue to face downward pricing pressure through the winter.

SEAFOOD MARKET

Again, seafood cannot be analyzed as a monolith, despite averaging overall higher prices both at wholesale and at the consumer level. Seafood, when compared to other land-based proteins, relies more heavily on foodservice sales. On one side, our assessment is that many seafood items will suffer during the winter, including the ones that are more well-established like shrimp and salmon. On the other side, many seafood items will likely benefit long-term from the expanded retail exposure during the pandemic; and once foodservice begins to recover, many of these seafood items will, too.

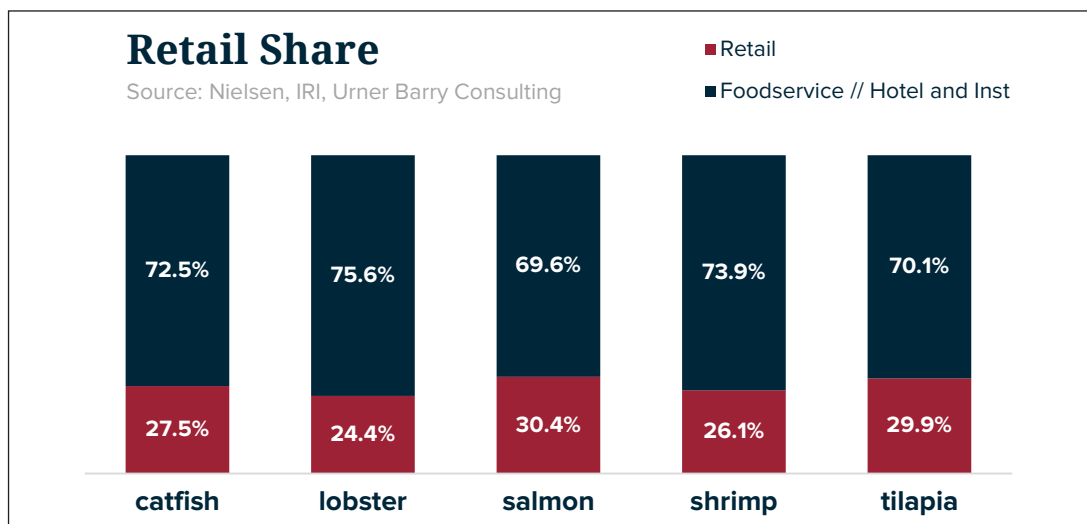


Figure 18. Urner Barry Consulting estimate of each seafood species' volume sales by sector. Source: IRI, U.S. Census Bureau, National Marine Fisheries Service, and Urner Barry Consulting.

Shrimp continues to weather the storm, but just barely. Taking the Urner Barry's White Farmed Headless Shell-on and Value-Added indices' average yearly values, shrimp prices are at their lowest level since 2009.

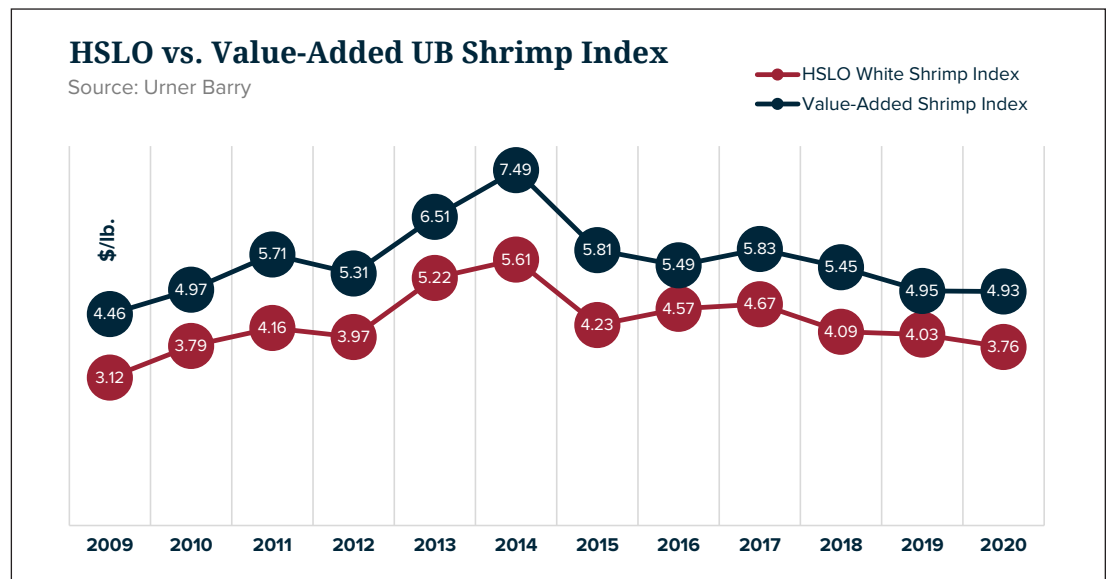


Figure 19. Avg. linear wholesale shrimp values using Urner Barry's shrimp indices. Source: Urner Barry Consulting.

When estimating shrimp imports for November 2020 using an in-house model that adjusts discrepancies between U.S. customs raw data and tariff codes, year-to-date imports are 6.2% above last year. This figure is the highest on record. Because cooked shrimp is largely sold to retailers, imports of this product form registered the largest gains compared to last year, growing nearly 36 percent, or about 52 million lbs. year-over-year through October. Shell-on and peeled shrimp imports, which are mixed in terms of foodservice or retail distribution, registered a significant increase of 14% or nearly 60 million lbs. and a decrease of 4.4% or 25 million lbs., respectively.

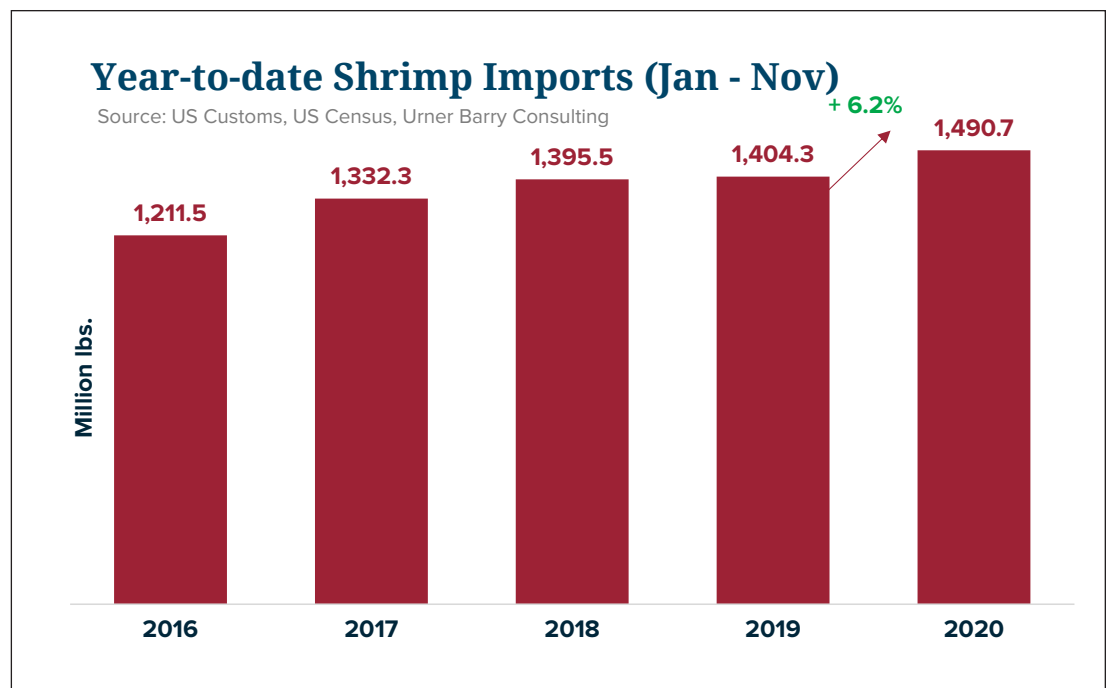


Figure 20. All shrimp imports. Estimates for November are included. Source: U.S. Customs, US Census, Urner Barry Consulting.

Taking cooked shrimp as an example, while retail feature activity contracted significantly, average feature price remained flat from last year.

Our assessment of the retail/foodservice split for shrimp is about 26/74. However, some in the industry have suggested the retail share prior to the pandemic was probably somewhere around 30 to 35 percent. Even if this is true, a 20 or more percent contraction in foodservice, in addition to a similar contraction in the accommodation sector, would be hard to offset by an increase of a similar magnitude in retail sales. In other words, our estimates suggest it could be a tough winter for shrimp.

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. Shipments from the largest supplier, Chile, continue to grow amidst a severely contracted foodservice sector, and are about 11 percent above last year's levels on a year-to-date basis through October. Although prices have not collapsed, they have been highly volatile bouncing off several times on the lower end of their 14-year historical support levels. Recently, however, pricing has rallied across the board, largely led by an immediate shortage of Chilean fresh fillets. Seasonally, salmon fillets compete for cargo space availability on both passenger and cargo flights. This year, travel routes have been significantly reduced, thus causing shortages.

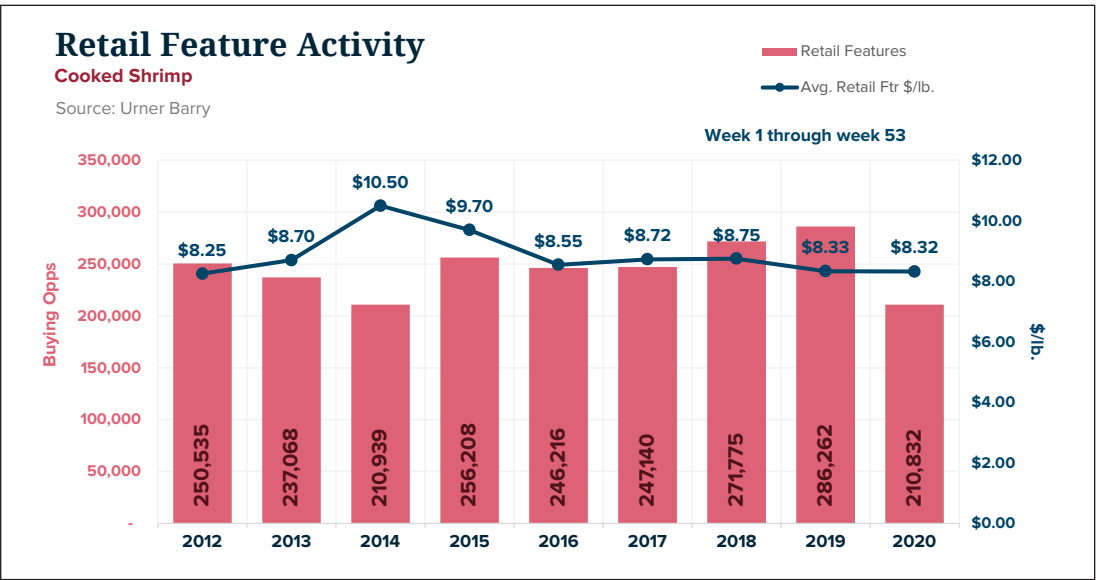


Figure 21. Avg. linear wholesale shrimp values using Urner Barry's shrimp indices. Source: Urner Barry Consulting.

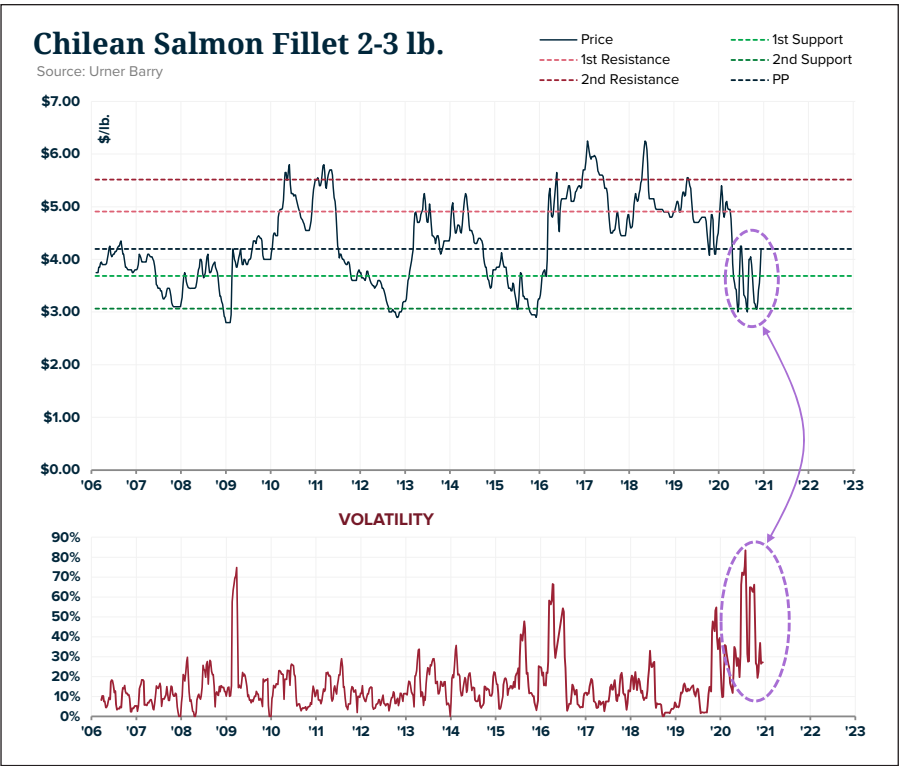


Figure 22. Linear Urner Barry Quotation of Chilean Salmon 2-3lb. trim-D Fillet. Source: Urner Barry Consulting.

One thing is certain: retailers are enjoying attractive buying prices for fresh salmon. While retail feature prices have also adjusted lower, meaning that some of the wholesale savings have been passed on to the consumer, the difference between these two has been hovering at record highs. An in-house margin estimate (green line, figure 23) illustrates this trend. We believe that there is plenty of room for more savings to be passed on to the consumer because of relatively low wholesale salmon prices.

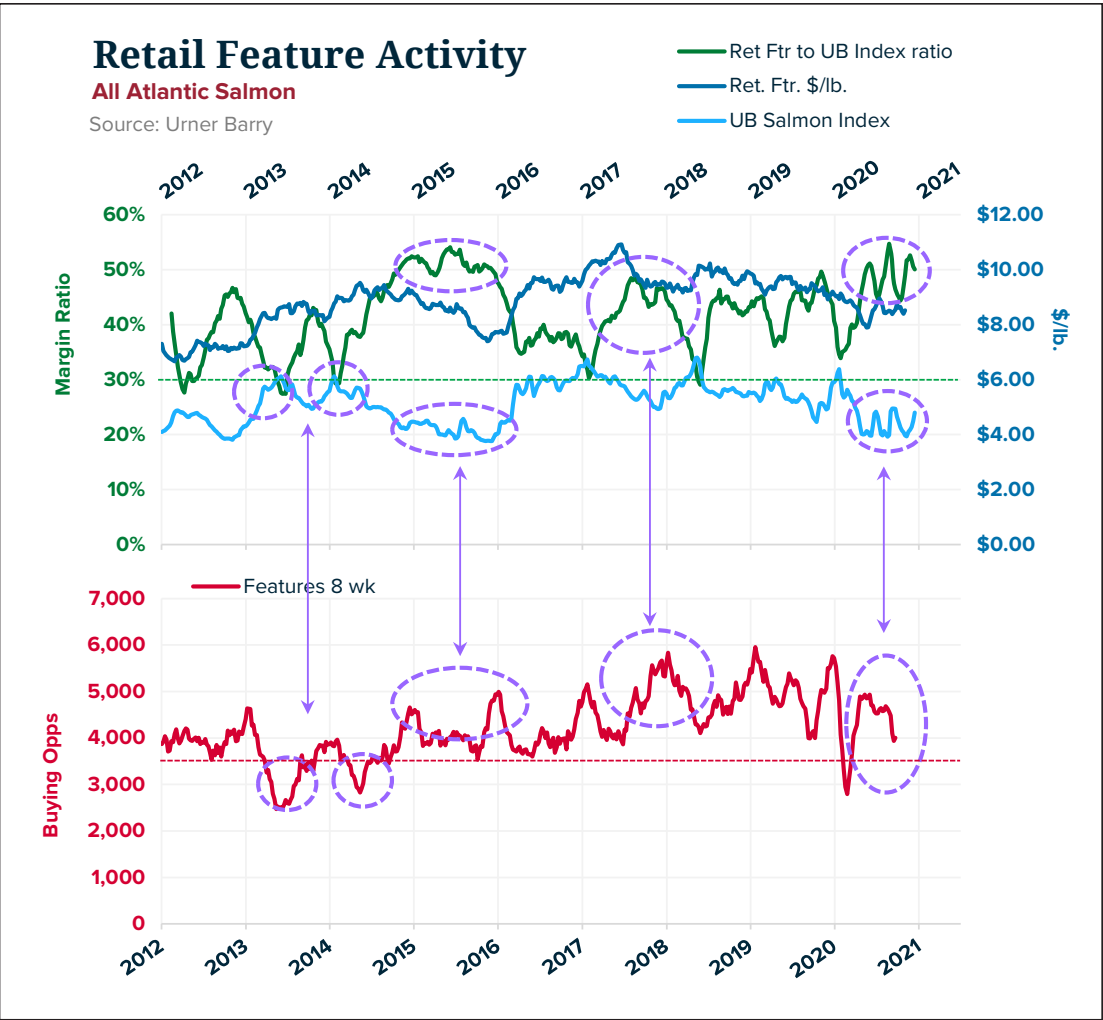
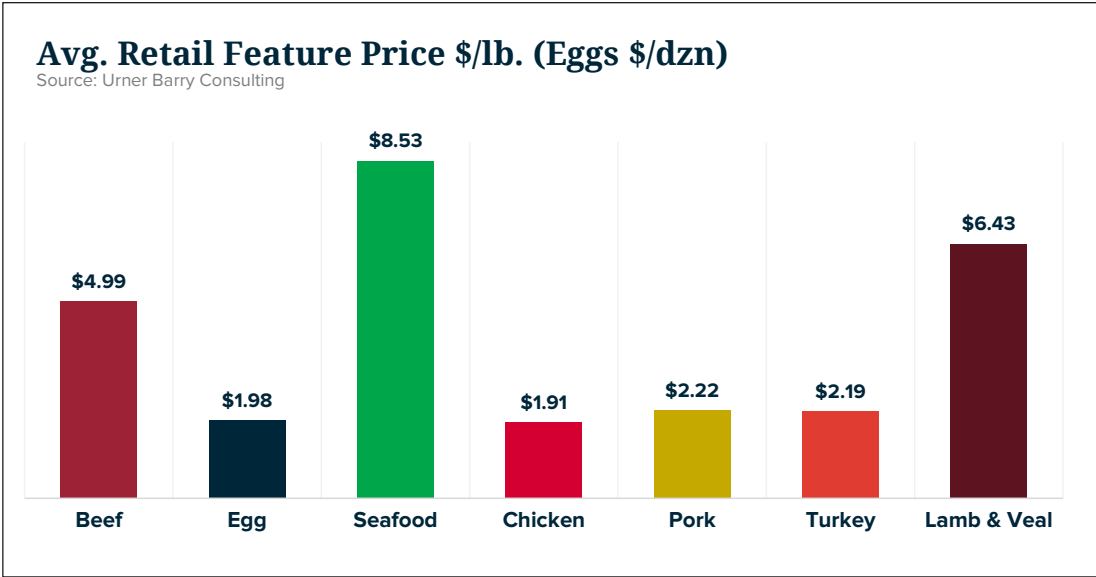


Figure 23. Atlantic Salmon Bnls Fillet retail feature activity and avg. retail feature price. Source: Urner Barry Consulting.



Retail feature activity has been oscillating above the 3-year average since June, with seasonal declines seen in late November and early December. This suggests that salmon sellers will very likely continue to rely heavily on retail ads to continue moving product.

Figure 24. Linear Urner Barry Quotation of Chilean Salmon 2-3lb. trim-D Fillet. Source: Urner Barry Consulting.

Winter will prove to be a tough test for many seafood items. As long as savings of already low wholesale prices are passed on to the consumer—whether it is through retail ads, attractive menu pricing at restaurants that can promote 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. Taking average retail feature price as a reference, the following charts illustrate where seafood stands relative to other proteins and among main seafood items. Price competitiveness might be crucial as (if) disposable income falls.



Figure 25. Average retail feature ad price in 2020 per main seafood species. Source: Urner Barry Consulting.

CONCLUSION

Our fundamental argument is that while consumers overall do not necessarily eat less during tough economic times, they certainly eat differently. In other words, people are likely to trade down to lower-priced proteins, dine out less, reduce vacations, and certainly eat more at home **when they see their disposable income fall**. We must also remember sporting events, concerts, cruise lines, movie theaters, and other similar establishments are all still significantly contracted.

Our previous deliberation of whether economic hardship is on the horizon for many Americans or not, appears to now be a question of “when” rather than “if.” As such, our premise made two months ago appears to have gained slightly more weight, which suggests that as unemployment rises and disposable income falls (pending, to a degree, any government relief extension or renewal), consumers are likely to trade down to lower-priced animal proteins.

Yet, 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 through the winter. However, this resilience will very likely come at the expense of an inevitable contraction caused by colder weather and increasing indoor dining restrictions. Therefore, we expect another shift in consumption from foodservice to retail.

Although there appears to be light at the end of the tunnel, the real test has already begun and so far, is looking as tough as initially suspected.