

Poultry producers about to rebound

By Nick Hedley^{23 Apr 2014}

The poultry sector could start to emerge from an extended downturn in the second half of this year, making it on to watch for analysts and fund managers.



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The industry has been through a difficult few years, weighed down by cheap imports, soaring feed costs, weak consumer demand and impending regulations to cap the levels of brining allowed in frozen chicken products.

Nine smaller producers have either gone under, filed for business rescue or been absorbed by larger companies in recent months. Astral Foods has recently snapped up the assets of two producers at liquidation auctions.

The sector had something of a reprieve last year when tariffs were imposed on imports from most regions - though Europe was exempt due to free-trade agreements. However, the sector has since lobbied for duties on "below-cost" imports from Europe.

The International Trade Administration Commission of South Africa (Itac) sent an investigative team to Germany and the Netherlands between 26 March and 10 April as part of its verification process.

Itac spokesman Thembinkosi Gamlashe says that the investigation "is still in progress" and a preliminary determination - which could grant interim protection - is expected to be made within the next two months.

Market commentators have been divided over the justification for the sector's protection from imports. Some say consumers will bear the brunt in the form of higher prices, while others say chicken is clearly being "dumped" at below the cost of production.

Sector looking interesting



Analyst Anthony Clark says that the poultry market is showing strong signs of improvement. Image: Twitter

Vunani Securities Analyst Anthony Clark - who has voiced negative views on the sector for two years - says the sector "is now starting to look very interesting". Contributing to a turnaround would be a possible decline in maize prices and import protection.

"But the recovery will be very gradual," he says, "as there are too many variables out there which are beyond the control of anyone in the sector." The upturn will be held back by food price inflation and a rising interest-rate cycle, which will further stretch consumers.

Clark says, importantly, the bigger maize harvest this year could translate into lower input prices in the second half of the year. Feed costs, which are largely made up of maize, account for about half the costs of raising a chicken.

Clark says the harvest in the US - which influences world prices - is expected to be decent, though this is not certain.

He says that depending on the local and US harvests, the input price could be lower in the second half of 2014, which bodes well for the costs of the poultry sector.

While maize prices have come down in the past month, this will take time to feed into the system.

Clark says recent efforts by some producers to grow their African footprint is a highly positive move - partly because it mitigates weak conditions in SA, where the days of making super profits are over.

According to Clark, the rest of Africa offers exposure to rising populations and incomes, and to markets with a limited supply of quality chicken and more fast food companies and retailers are moving into these developing markets.

Greater demand, more efficiency



Chicken farming remains big business in South Africa. Image: [Images](#)

Chris Logan of Opportune Investments believes there's a good story here from a recovery play. His company has been buying shares in Astral and Country Bird, and has held Sovereign shares for some time. Logan believes local producers are probably where their American counterparts were in about 2009, when US companies experienced a downturn because of over-supply.

Logan says US producers emerged far stronger after improving efficiencies, reducing production and increasing exports, which helped boost pricing power.

"Here it looks as if the local producers are establishing pricing power through scaling back production and shutting out imports," he says. He says producers such as Astral have been cutting back on costs while increasing capital expenditure.

"It's a cyclical industry and generally the seeds of the upturn are laid in the downturn," he added.

Logan says that because of the strong pricing power and market dominance gained by American producers, the correlation between the chicken producers and the corn price has broken down.

While he believes the sector is on the up, producers need to double up on the good efforts they've got under way so they can emulate their American counterparts.

South African Poultry Association Chief Executive Kevin Lovell expects that by mid-year, the maize price should drop, which

the association is hoping for provisional protection against European dumping by the end of next month.

"It will take a little while for the effects of that to flow through. So there's a chance that quarter three could start to look better," Lovell says.

However, unpredictable factors remain intact, including weak consumer demand and the market's reaction to upcoming elections. "We are still in the bottom of the trough. I don't think it's going to get worse but I do think it's going to take a little while before it gets better."

Lovell says he does not expect brining regulations to be finalised before the end of this year. He says the government intends to give the industry six months from the date that brining regulations are gazetted until the laws become effective.

"There is still no certainty on what these regulations will entail," he says. "Further consolidation is possible as producers look to build scale and attempts are made to start changing the product mix wherever possible," he added.

Analysts have highlighted the need for producers to reduce their exposure to individually quick-frozen products, which will be subject to brining regulations. Producers such as Astral Foods have a large weighting towards frozen products.

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