

Middle Market

Food and Agribusiness



Food & Ag: What's happening

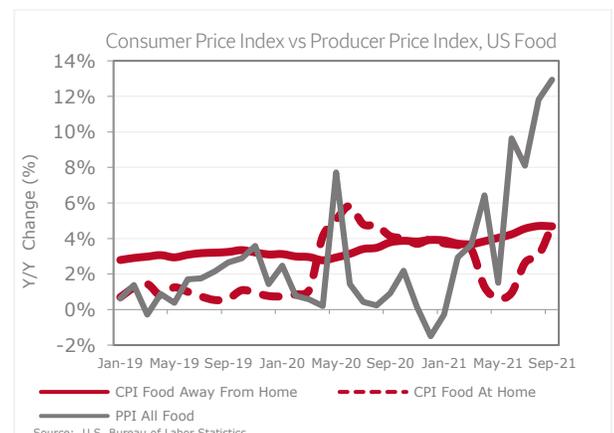
- Supply chain disruptions continue to create bottleneck in both input and trade for all sectors. Port congestion and transportation cost spikes, exacerbated by worker shortages, challenge agribusinesses at all points of supply chain.
- Consumers are faced with accelerating food prices, however meaningful substitution and/or demand destruction has yet to be seen. Longer term trends driving purchase decisions remain. Health and wellness, exacerbated by the pandemic led interest in immune-support and so-called superfoods, convenience, and value remain.

Key Demand Developments:

- Wells Fargo economists are now forecasting real GDP growth of 5.6% in 2021, the strongest full year for U.S. economic growth since 1984, but a

meaningful downgrade from the 7.3% rate Wells Fargo forecasted in June. Forecasts are 4.0% for 2022, down from 4.5% last month. Adjustments are heavily influenced by supply chain issues linked at both global and domestic front. Headline inflation, as measured by the personal consumption expenditures (PCE), rose to 4.3% on a year-over-year basis, reflecting the highest headline and core inflation in more than 30 years.¹

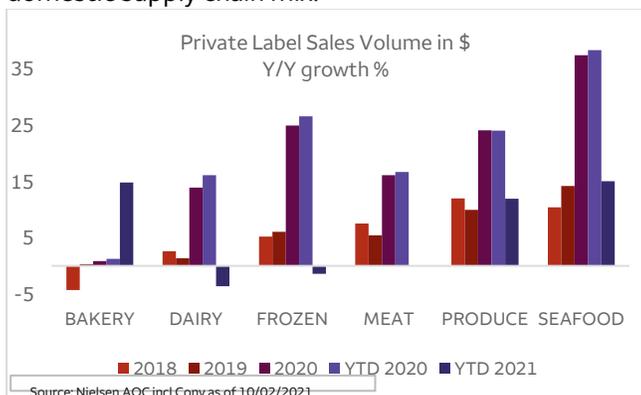
- While an upward creep in long-term interest rates is possible, rate hikes are not expected until the labor market improves. 'Maximum' employment is not a condition that Wells Fargo economists are anticipating until the second half of 2023, and thus a target rate increase of 75 bps for the fed funds rate is linked to this time frame.
- While medium-term growth outlook for global GDP remains favorable, Wells Fargo has made modest downward revisions to 5.9% growth for this year (compared to 6.0% a month ago).
- See [Monthly Economic Outlook – Wells Fargo Commercial](#) for additional details.



¹ U.S. Department of Commerce and Wells Fargo Securities

Food Highlights:

Food price inflation and packaging cost increases, and the resulting potential for demand destruction is an acute challenge for ag processors and food manufacturers. In addition, significant wage increase pressure, along with transportation price spikes and truck driver shortages continue to pressure margins and drive players to focus on market positioning, including SKU rationalization. Food manufacturers also being forced to find new and/or alternative suppliers for their ingredients given the strong uptick in consumer demand the past 18 months amidst the global supply chain challenges. This is not an easy or quick task, as companies must carefully vet new suppliers for food safety practices, quality, and delivery capabilities, including complications of vetting overseas providers. This presents opportunities for North American based ingredients manufactures/suppliers, as US based food manufacturers begin to more strongly value a larger domestic supply chain mix.



- Retail Overview:** Food retail is recalibrating as food-away-from-home channels re-open. While total annual growth remains positive (Aug'21 saw the largest consumer spend on food & beverage stores since Mar'20 during the pandemic²), food inflation is driving concerns about product substitution. Departments showed negative Y/Y growth in volume for Q1-Q3, with the exception of deli, bakery, and produce. Deli department sales by \$ volume increased 7.4%, and bakery sales increased 11.6% for Q3 2021. Produce sales posted 3.0% increase in Q3, after a -1.7% Y/Y dip in Q2. This is the first negative growth rate in produce department since 2011.³

- Sustainability and ESG:** Labeling with environmental and social impact continues to grow, reflecting consumer interest in traceability, transparency, and a socially responsible supply chain.
- Private Label vs Branded:** While private label and contracted production has played a big role in growth of value-oriented merchandising, premium or branded products may have margin cushion to withstand input cost inflation. See graph, for relative Y/Y across retail departments of private label.

Beverage Highlights:

While soft drinks still reign by dollar volume, other beverages continue impressive Y/Y gains at retail. Energy drinks continue to gain Y/Y% segment share. 2020 share is estimated at 5.5% vs. 10.5% Y/Y gains in 2019. See chart below. In the channels that Nielsen measures, total sales of energy drinks are nearly 50% of soft drink sales volume by \$.

Sports drinks, water (including value-add, sparkling, seltzer, tonic), ready-to-drink coffee, kombucha demand increasing. Fruit juice drinks / blends and apple cider posted reversal of sugar-avoidance reversal in 2020. A slowdown in growth of these segments has slowed down as the pandemic buying has transitioned to additional re-openings of foodservice establishments.

Top 10 Non-Alcohol Beverages at Retail, by Sales \$

	Marketshare		Y/Y % growth by Sales \$	
	2017	2020	YTD 2020	YTD 2021
Total category			9.27%	9.05%
SOFT DRINKS	31.86%	31.19%	10.74%	6.27%
ENERGY BEVERAGES	13.78%	15.13%	6.14%	14.76%
WATER	11.91%	11.00%	2.92%	7.56%
FRUIT DRINK	8.02%	7.65%	9.26%	5.78%
SPORT DRINKS	7.07%	7.60%	12.84%	16.34%
FRUIT JUICE	7.96%	7.31%	14.40%	1.15%
LIQUID TEA	5.46%	4.92%	5.69%	5.02%
VALUE ADD WATER	3.17%	3.68%	6.89%	21.24%
SPARKLING WATER	2.63%	3.54%	21.54%	10.10%
RTD COFFEE	2.76%	2.96%	12.82%	21.57%

Source: Nielsen AOC incl Conv as of 10/09/2021

² US Bureau of Economic Analysis

³ Nielsen AOC incl Conv as of 10/02/2021

For alcoholic beverages, frequency of on-premise visits to bars and restaurants has steadily increased over the past 3 months. According to Nielsen's consumer research, 78% surveyed have gone out three or more times, vs. 64% in June. For those deciding to spend less time on-premise, both covid-19 and less disposable income are given reasons. Global 2021 consumer and retail M&A volume had its strongest start in recent years, with YTD March 2021 volume approx. 119% higher compared to YTD March 2020 and approx. 153% higher compared to YTD March 2019. The wine category continues to experience robust activity across equity capital markets and M&A, along with heightened focus from financial sponsors who seek to make strategic investments while opportunities are available.⁴

Commodity Highlights

- **Grains and oilseeds**

- As of Q3 2021, pricing in the U.S. grains and oilseeds complex has stabilized, albeit at prices well above pre-pandemic levels.
- The higher prices are in response to low carryout levels. Demand from China drove prices to current levels although 2021 corn production is roughly 15 billion bushels and soybean production is 4.4 billion bushels, both strong production numbers.⁵
- Soybean usage in 2021-22 will be impacted by elevated soy crush for biofuel usage. Wheat pricing will likely be volatile until mid-2022 as the 2021 crop was hindered by drought.

- **Protein:**

- The Bering Sea Snow Crab fishery total allowable catch (TAC) for the 2021-22 season was announced 88% lower than the previous fishing season⁶. Russian supply expected to partially offset lower U.S. supply, but prices likely to stay elevated into 2022. In addition to the decrease in TAC for Snow Crab, the Bristol Bay Red King Crab is closed for this season, and likely for several years until stocks rebuild.
- U.S. meat and poultry prices rose for the sixth straight month in September, up 12.6% for meat and 6.1% for poultry from year ago levels⁷. Supply

constraints, labor shortages and robust demand expected to support prices in upcoming months.

- Chicken processor margins are currently at a multi-year high due to a combination of higher product prices and receding feed costs⁸.

- **Dairy:**

- Class I and Class III milk prices have moved higher as milk production is lower due to a reduction of cows and yield per cow. This is a response to higher feed costs.
- Milk demand is stronger due to reopening of schools and institutions.
- Exports continue to be high as China has been a strong buyer of dry skim milk products, whey products, cheese, and butterfat products.

- **Sugar:**

- 2021/22 harvest season is in full swing and current USDA estimates indicate higher YoY sugar beet production offset by lower sugarcane production (down 6.4%) due to impact of Hurricane Ida in Louisiana. October 2022 stocks/use declined to 13.2
- Mexico's sugar production is projected up 3.9% YoY. Due to plentiful rain this growing season which has alleviated much of the lingering drought issues, but exports are expected to be down YoY as more sugar will be delivered domestically to boost ending stocks.⁹
- Bulk refined sugar prices remain firm and deliveries active resulting in domestic raw sugar futures increasing 0.06¢ to 0.50¢ a pound spot through November 2022 and January 2022 futures up to 37.00 ¢/lb¹⁰, up 9.25 ¢/lb. Y/Y.

- **Cotton:**

- Cotton prices surpassed \$1.00/lb. in October, reaching levels not seen since 2011¹¹. Strong demand, global supply tightness and speculative buying are supporting prices.

- **Permanent crops:**

- Tree nut harvest in California is wrapping up with strong volumes and continuous shipments of product. Almonds and Walnuts both have appreciated pricing with Pistachios holding firm. Demand from China is drawing down pecan inventory.
- California wine grape harvest is at its peak with most grapes expected to be processed by middle November. Crop looks good with good quality.

⁴ Wells Fargo Securities

⁵ USDA

⁶ Alaska Dept of Fish and Game

⁷ U.S. Bureau of Labor Statistics, Consumer Price Index

⁸ USDA, CME, and calculations by Wells Fargo

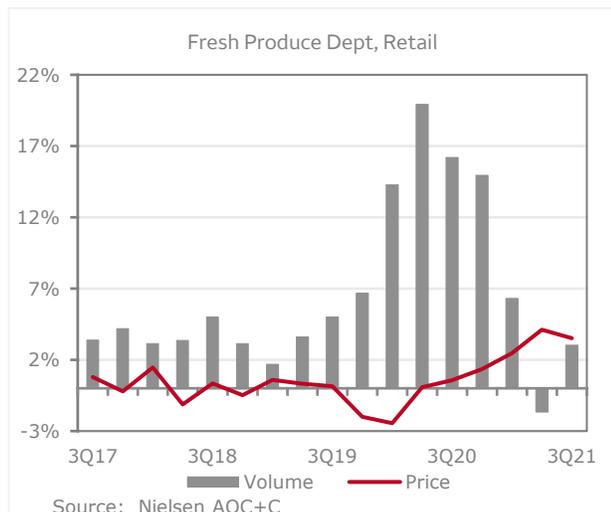
⁹ USDA ERS

¹⁰ Intercontinental Exchange

¹¹ Intercontinental Exchange

- **Fresh produce:**

- Fresh produce sales volume, as measured by Nielsen retail data, declined for the first time in recent history in Q2 2021. It's important to consider that it's a very small decline based on comparison to the gain in 2020. Compared to 2019, fresh produce is still gaining volume, and the positive uptick in Q3-2021 shows that the consumer is still focused on fresh and nutritious.
- Pricing improvement is function of the market return to a more "normal" environment. A reduction in acres for 2021 resulted from uncertainty caused by economic closures, and with food service improving – stronger demand across the channels, with a bit lower supply, producers are looking to push through price increases to cover higher labor, packaging and shipping costs.



- **Forest products:**

- Lumber prices are on a roller coaster ride, the composite price roaring back up 40% to \$545/MBF¹² in the last seven weeks from the nadir of the late August dip. As of end of Q3, lumber futures markets are also up.
- Over the same period, structural panel prices have improved 12% with the composite increasing to \$656/MBF¹³, but the dip in the composite wasn't as big a drop as in lumber.
- North American market pulp prices retracted slightly at the end of Q3, but remain near record highs with NBSK recently trading at over \$1,500/ton¹⁴.

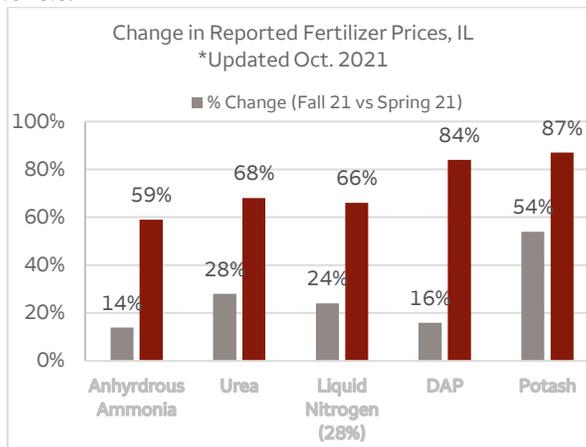
¹² Random Lengths

¹³ Random Lengths

¹⁴ Random Lengths

- **Crop inputs:**

- Fertilizer prices reached all time highs due to numerous supply and demand issues. These included higher grain prices and countervailing suits limiting imports. Hurricane Ida shut plants and shipping channels, high natural gas prices in Europe impacted regional nitrogen plants and China blocked exports of fertilizer (especially urea exports in the north)¹⁵.
- Ethanol production has returned to pre-Covid 19 levels.



Source: USDA AMS and aei.ag

- **Imports/Emerging Industries**

- Coffee prices are being pressured by adverse weather in Brazil. Production has declined by approximately 10MM bags of coffee, the equivalent production of Costa Rica, Guatemala, and Honduras combined.
- Import costs for coffee and other commodities are rising due to the supply chain challenges. Coffee prices for next year may stay elevated as input costs have also increased in prices. Farming costs are going up all over the globe.
- The first two years of legal hemp farming in the U.S. has been marked by oversupply, confusion in code enforcement.¹⁶ These constraints are beginning to lift as the industry professionalizes and federal policy takes shape.
- The global industrial hemp market is expected to continue to grow at CAGR of 16%+ from 2021 to 2028, from 3.6b in 2020.¹⁷

¹⁵ Green Markets

¹⁶ Hempbenchmarks 2021

¹⁷ Grandview Research 2021

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