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There is no such thing as the "new normal," or at least not yet.

Two major topics are floating around concerning not only the protein industry but the economy as a whole. The first is logistical complications including container shortages for ocean freight and limited trucks for transportation within the U.S. And second is the compounding issue of overall inflation.

Luckily, with the data boom seen over the years, there are plenty of benchmarks available to corroborate anecdotal reports. From a global perspective, the pandemic proved many of us wrong.

"At the start of the pandemic, many in the ocean freight business thought that world commerce would decline, possibly even steeply," Judah Levine, Research Lead at Freightos from the fbx.com index, told Urner Barry Consulting (UBC). And if we think about it, this makes perfect sense, similarly to UBC's initial assumption about consumers switching to lower-priced proteins as unemployment surged and disposable income shrank. However, as soon as unemployment stimulus checks started flowing into the economy—in addition to shrinking consumer spending in heavily impacted sectors like tourism or entertainment—disposable income rose rapidly.

While we at UBC have been reporting on this main indicator regularly, others have been following this index behavior as well.

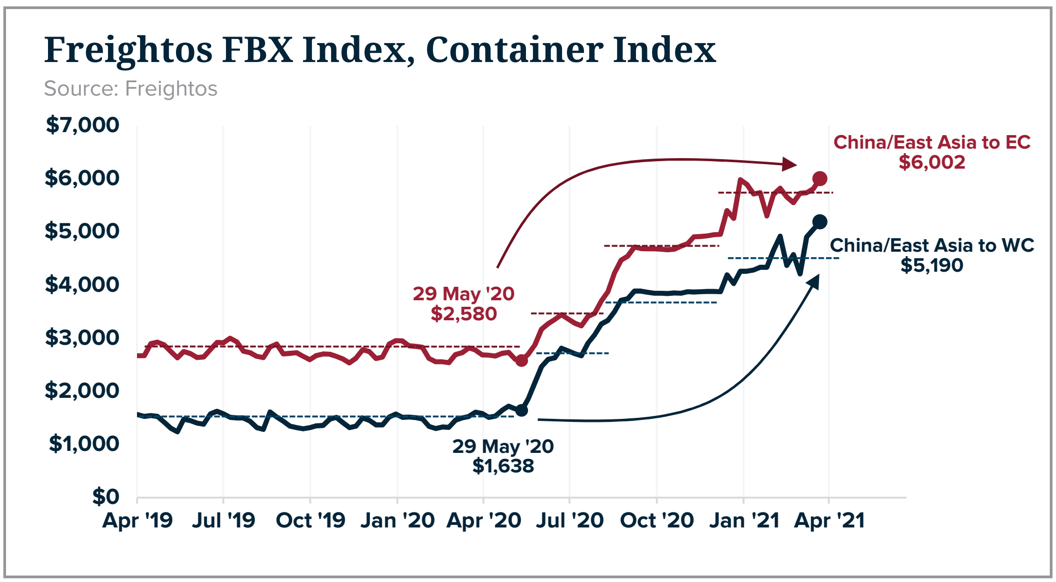

Figure 1. Freightos Baltic Index (FBX) Spot Rate Index, Container Index, from east Asia, China to the U.S. west and east coast.

"With consumers shifting their spending from heavily impacted sectors like tourism and entertainment, to buying material goods to be delivered to your home, ocean freight prices began to increase. Why? Because many of these goods are manufactured in Asia, particularly in China, and then shipped to the U.S.," Levine added.

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While U.S. ports are relatively equipped to handle seasonal increases in traffic, albeit with seasonal delays and backlogs, the surge in demand in June 2020 persists until today with no off-season respite at many of these ports. As many outlets have reported, there could be numerous shipping vessels holding hundreds of containers waiting to be offloaded at major U.S. ports for longer than a week.

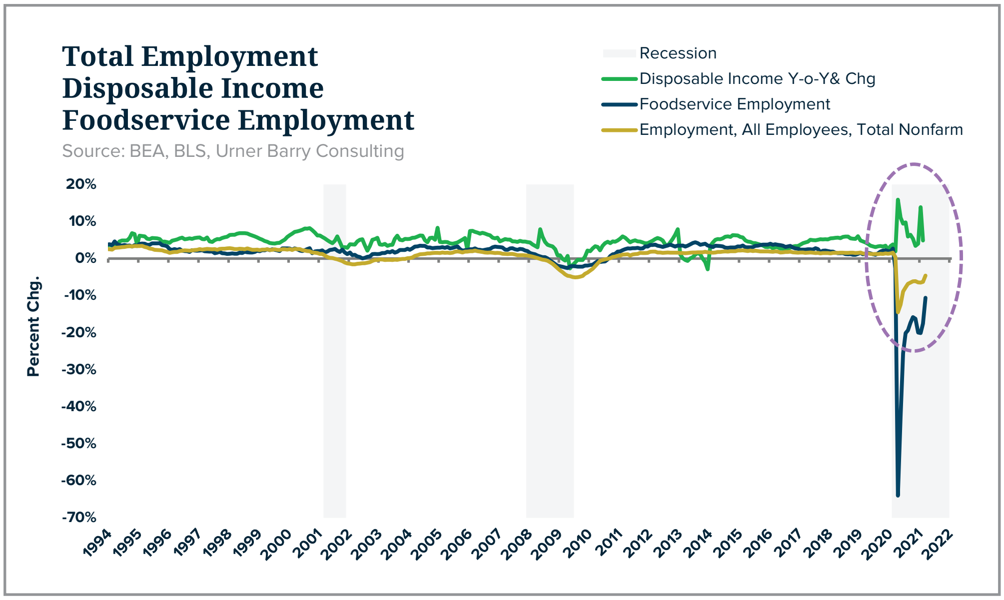

Figure 2. Freightos Baltic Index (FBX) Spot Rate Index, Container Index, from east Asia, China to the U.S. west and east coast. Source: Bureau of Economic.

"As a result, these vessels sitting at major U.S. ports are not heading back to Asia—or for that matter, anywhere else in the world—picking up more goods for existing orders caused by this pent-up demand."

What cascaded after that makes logical sense. Container shortage naturally developed at several ports worldwide, particularly at ports of origin. It then spilled further into trucks scheduled to pick up goods at U.S. ports that would move these goods across the country. All this behavior applies to dry goods, as well as temperature-controlled containers and trucks, known as "reefers." The latter is relevant as reefers would transport meat, eggs or seafood, whether imported, exported, or trucked within the U.S.

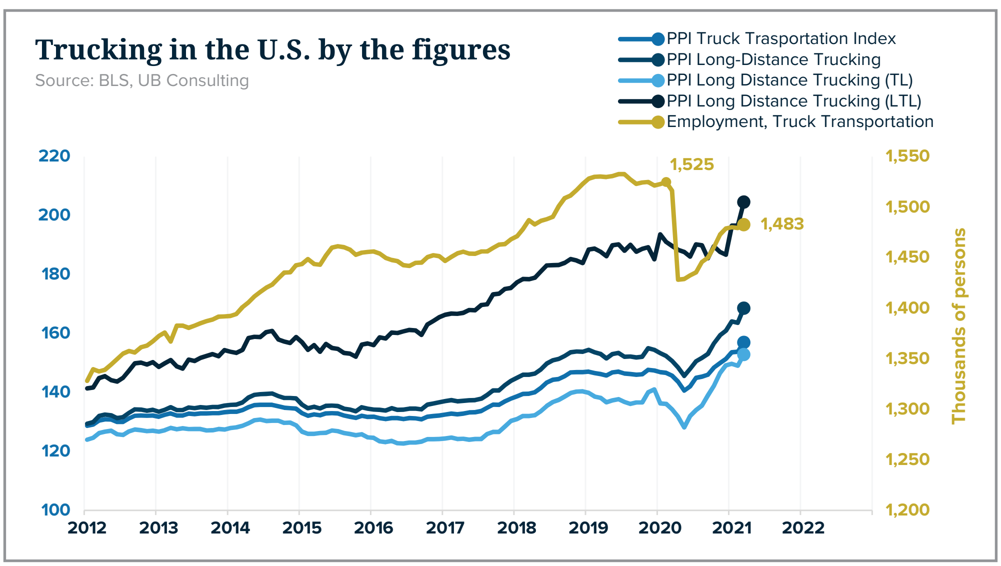

Figure 3. Producer Price Index (PPI) for long-distance trucking and employment. Source: Bureau of Labor Statistics (BLS).

Regular trucking and reefer spot market prices have skyrocketed since June 2020, with current prices sitting at record-high levels. Data provided by DAT Freight & Analytics, which operates the industry's largest truckload data analytics service and load board network, clearly show how both contract and spot rates are currently sitting at record-high levels. Further, DAT's load-to-truck ratio,

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which is the measurement of load posts relative to truck posts, suggests a shortage of reefer trucks available within the U.S. Further, employment in the truck transportation sector has not recovered to pre-pandemic levels.

For now, we don't suspect freight and logistics costs will ease in the near to medium term. As we have mentioned in previous reports, we expected foodservice recovery to impact the industry in a shock-like fashion. In other words, we expected rapid increases in overall price levels, or temporary price inflation, whether these were due to increased transportation costs or to pent-up demand.

On the topic of inflation, and as shown in previous reports, protein prices to the consumer rose in 2020. Some proteins also saw price increases at the wholesale level despite dealing with significantly contracted sectors such as foodservice, accommodations, entertainment, etc. Early in Q1, however, we saw modest protein price increases in industries that did not see wholesale prices rise in 2020, like chicken, salmon, and shrimp. Then, from early March through mid to late April, price

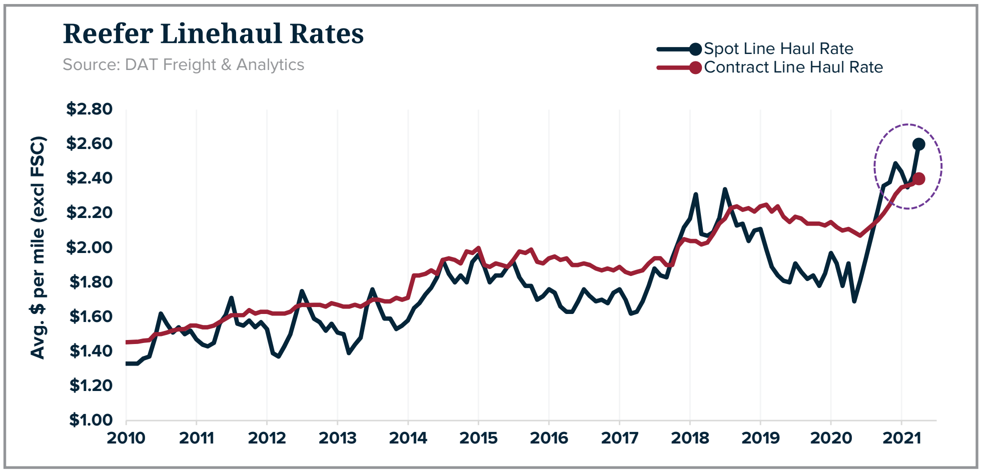

Figure 4. Spot and contract rates for reefer trucks in the U.S. Source: DAT Freight and Analytics.

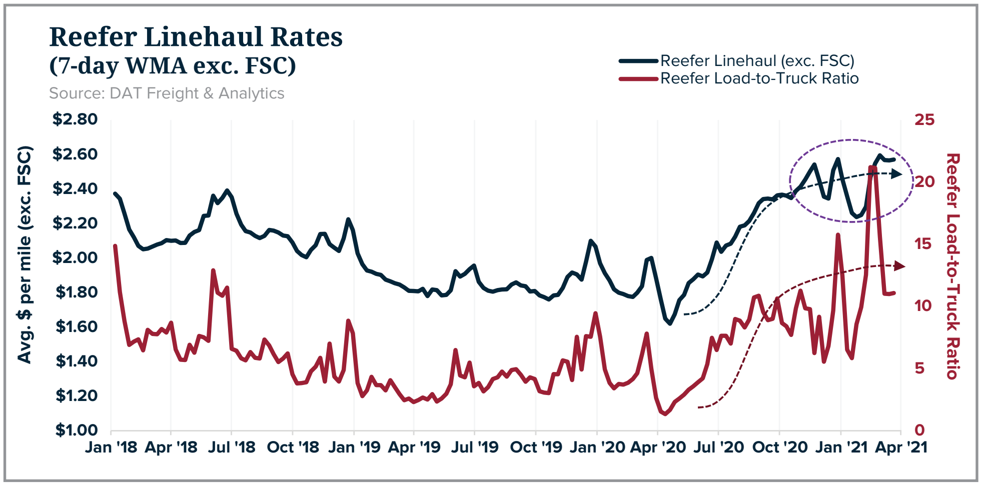

Figure 5. Reefer linehaul rates, 7-day w moving average, excluding fuel surcharge. Reefer load-to-truck ratio, a measurement of load posts relative to truck posts. Source: DAT Freight and Analytics.

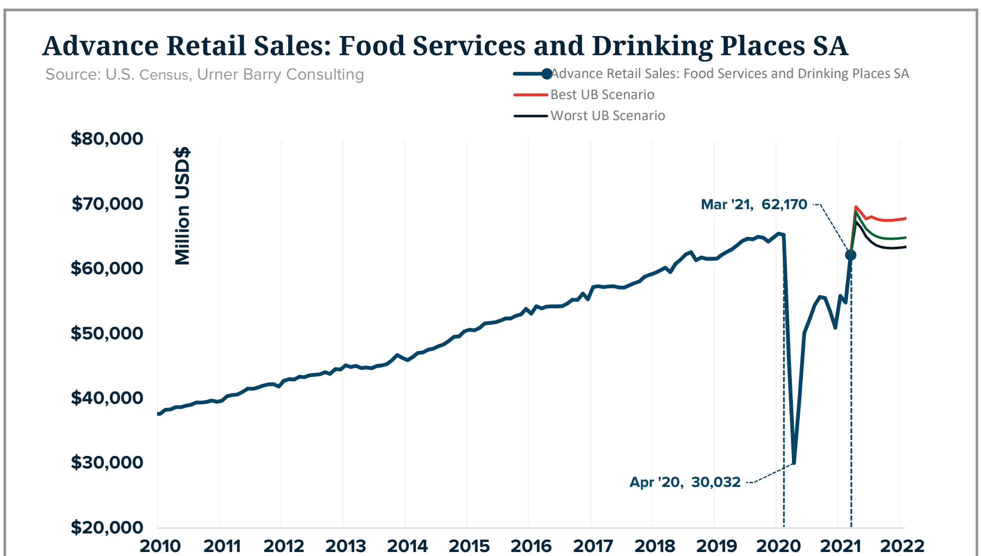

Figure 6. Restaurant sales growth and disposable income, y-o-y chg., 12 month moving average. Source: U.S. Census, BEA, BLS, UB Consulting.

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increases accelerated at an unprecedented rate. These price increases suggest that foodservice demand strengthened earlier and more robustly than anticipated. Restaurant sales in March surpassed our previous best-case scenarios, which was reflected in wholesale prices rising more than expected and out of seasonal patterns. It could also suggest that, at least for the quoted items on a delivered basis, increased transportation and logistics costs started to be passed along the distribution chain.

We believe both assumptions to be valid; stronger foodservice sales in March could be attributed to rapid rates of vaccinations and warmer weather across the country, and transportation costs have remained persistently high—relative to the past—for over six months.

Still, we must always look at the fundamentals. Chicken slaughter through March, for example, was the lowest since 2015, and whether or not foodservice demand had peaked then, fundamentals would have suggested an increase in prices, all else equal. But given the fast rate at which prices have moved up since March, it is safe to assume that foodservice demand continues to strengthen.

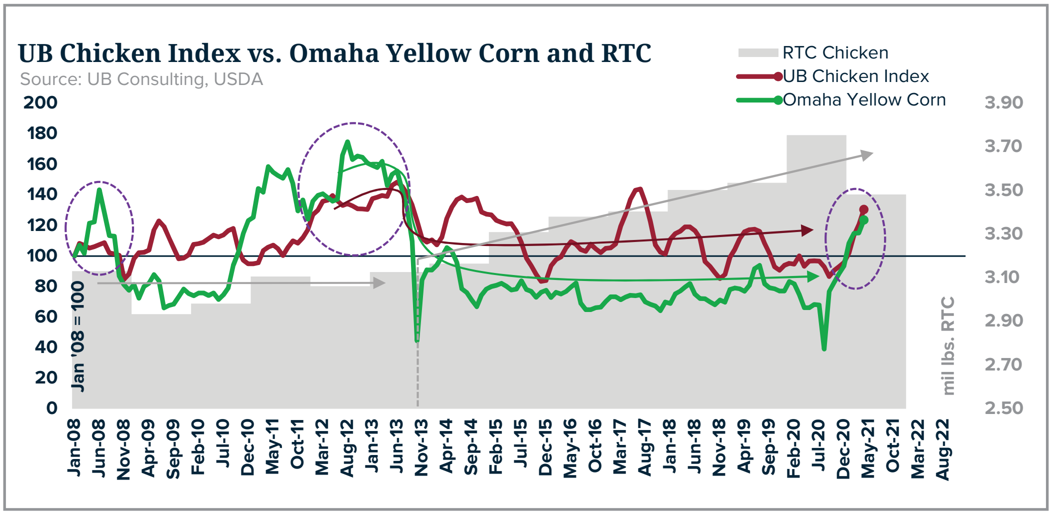

Figure 7. Urner Barry chicken index, yellow corn spot market prices, and Q1 monthly average ready-to-cook chicken (RTC) (young slaughter times chicken weights) by year. Annualized figures' trend for RTC does not differ significantly from Q1 data shown. Source: Urner Barry Consulting, USDA.

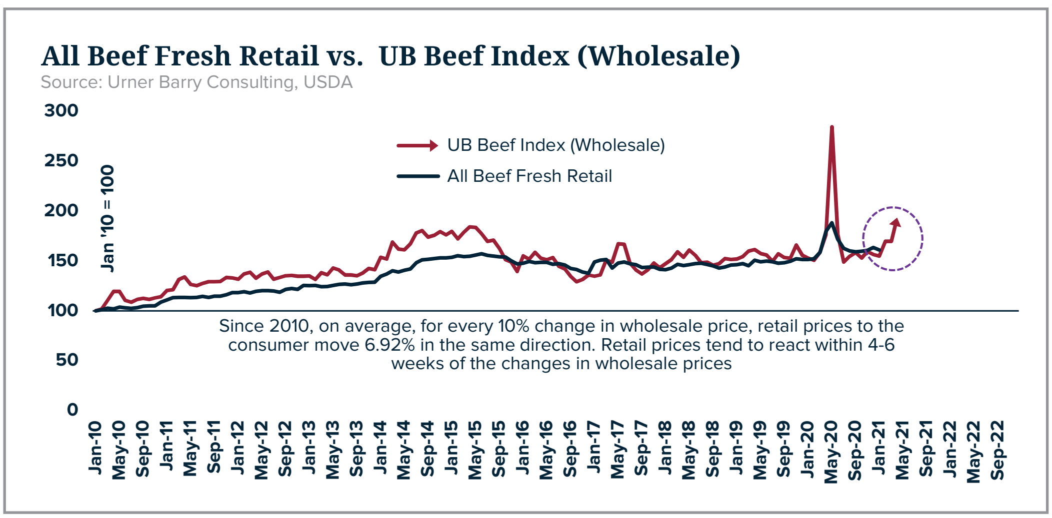

Figure 8. All beef fresh retail values vs. Urner Barry's beef index (wholesale), indexed at 100 on January 2010 using monthly statistics. Source: Urner Barry Consulting, USDA.

Another example is seen in beef. Prices advanced faster than their elasticity relative to what production would have suggested; again, all else equal. Finally, it is also imperative to mention that corn prices have been on the rise since October 2020, and while growers might be able to absorb higher feed costs in the short term, a different story develops in the long run. Similar to any increase in input costs, persistently higher feed costs will inevitably be transferred on to the next sales stage ending with higher prices to the consumer.

There exists the possibility of structural changes in nominal prices throughout 2021, where previously observed support and resistance levels no longer hold. We have seen these changes in cycles in the past. Some of them are strongly linked to changes in animal growth cycles and production fundamentals, while others to changes in consumer behavior.

Food inflation is very likely here to stay throughout 2021. Whether through higher transportation and feed costs passed along the supply chain or persistently strong animal protein demand driven by current and expected higher disposable and discretionary incomes. Maybe even due to the urgency to return to some sort of "normal."

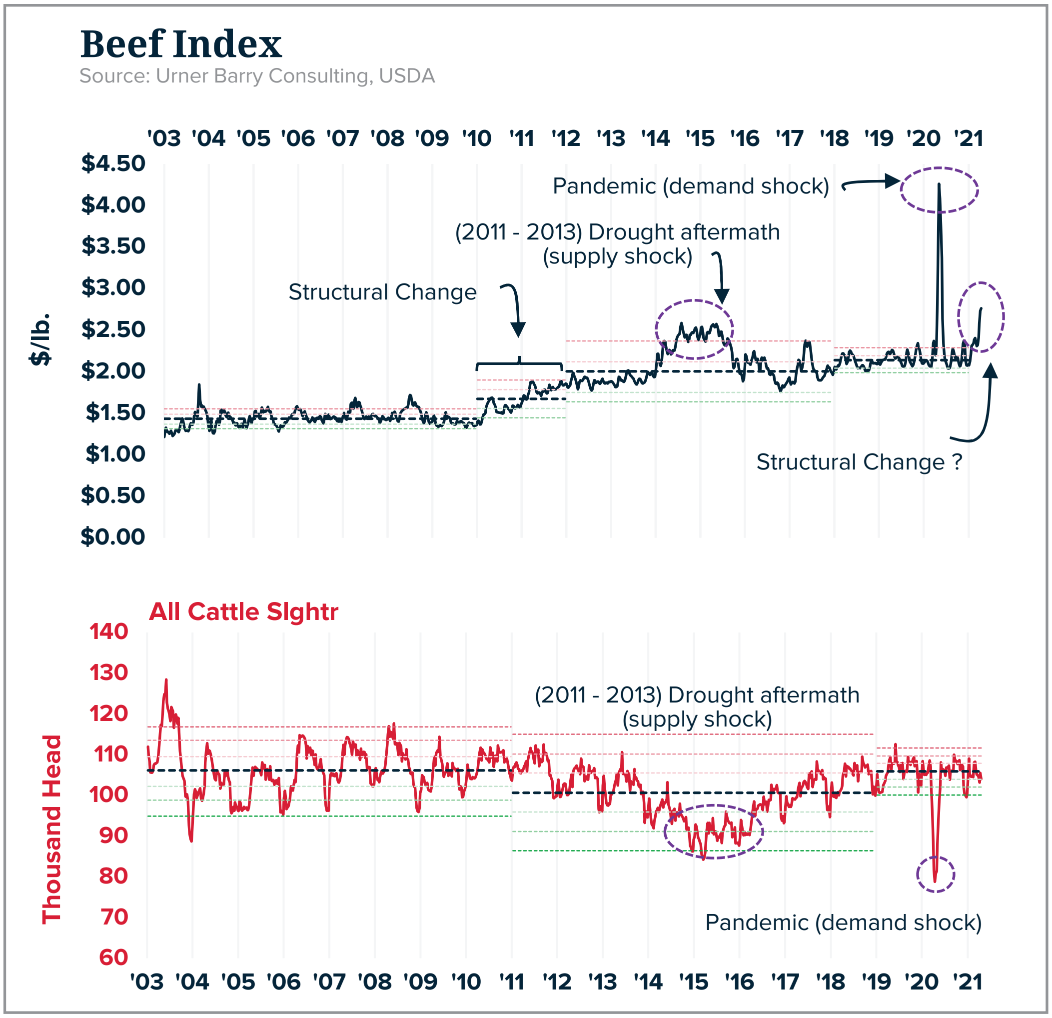

Figure 9. Urner Barry's beef index and cattle slaughter. Source: Urner Barry Consulting, USDA.

We suspect that as long as the operating margins remain profitable, all industries will continue to have incentives to increase production. Suppose consumers continue to absorb higher prices at the grocery store, restaurants, new openings at limited-seating sporting events, hotels, and so on. If that is the case, we may very well see sellers and producers continue to pass along higher costs and thus increase production. Let us hope it doesn't overheat.

