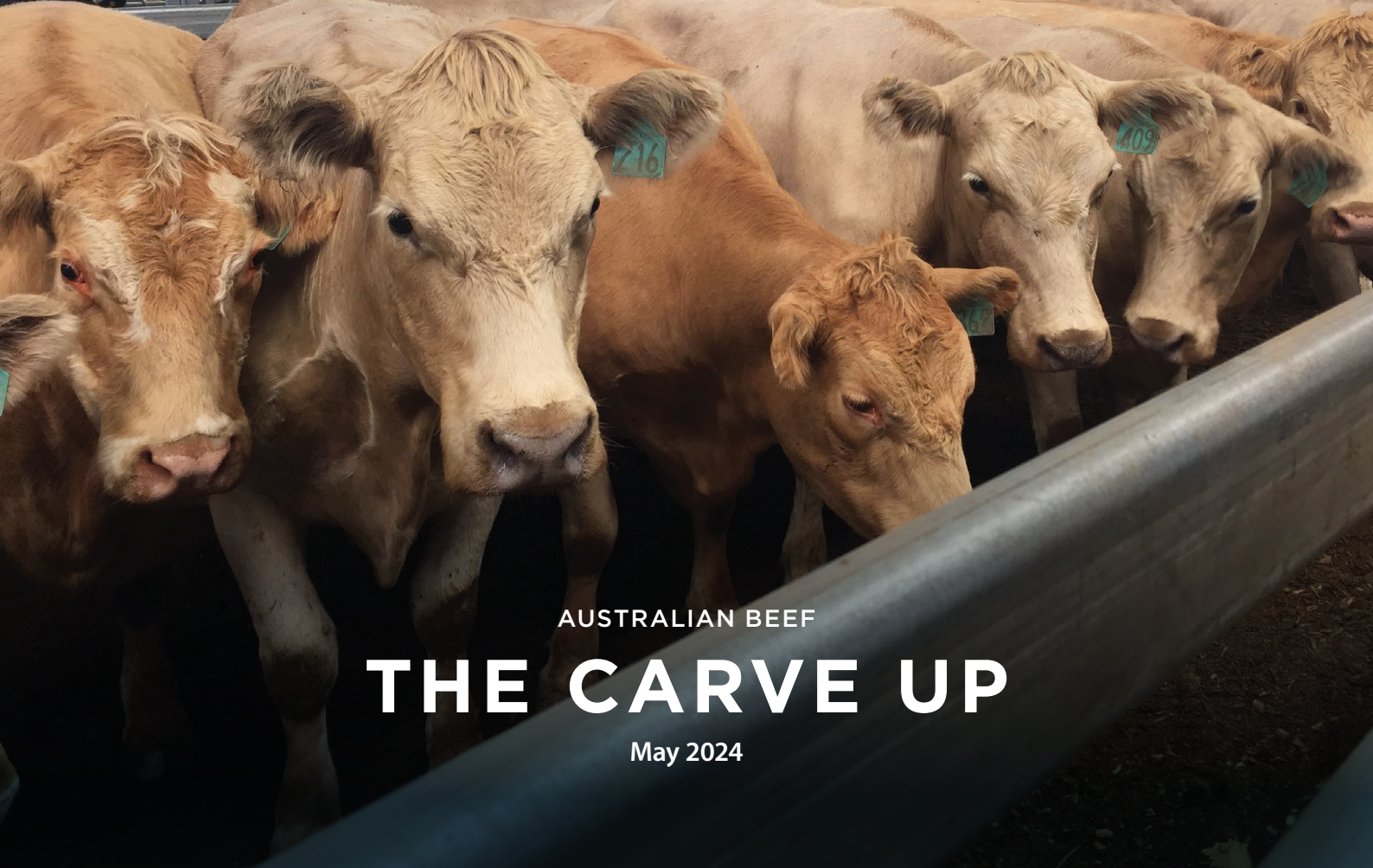




AUSTRALIAN BEEF

THE CARVE UP

May 2024

FOREWORD

As the Australian beef industry returns to some sort of 'normal' following the post-drought years and the marked price drop which followed, industry news is dominated by high slaughter rates, a large number of cattle in saleyards and feedlots, and prices which sit far off the highs of a few years ago. Given the widely held view that a return to an Eastern Young Cattle Indicator (EYCI) of 1,200c/kg is unlikely in the short-term, farm business profits are increasingly focused on margins – what age and weight to sell from farm to achieve the greatest return, what channels to sell through, and what portion of the final retail price is being delivered back to the producer?

While currently a topic of much discussion, the debate around how many cents in the retail dollar are flowing back to the beef producer is a complex one. While the retail price of beef has remained relatively stable for many years, the more pronounced shift has been the increase in volatility in prices, most particularly for the producer, and to a lesser extent, the processor.

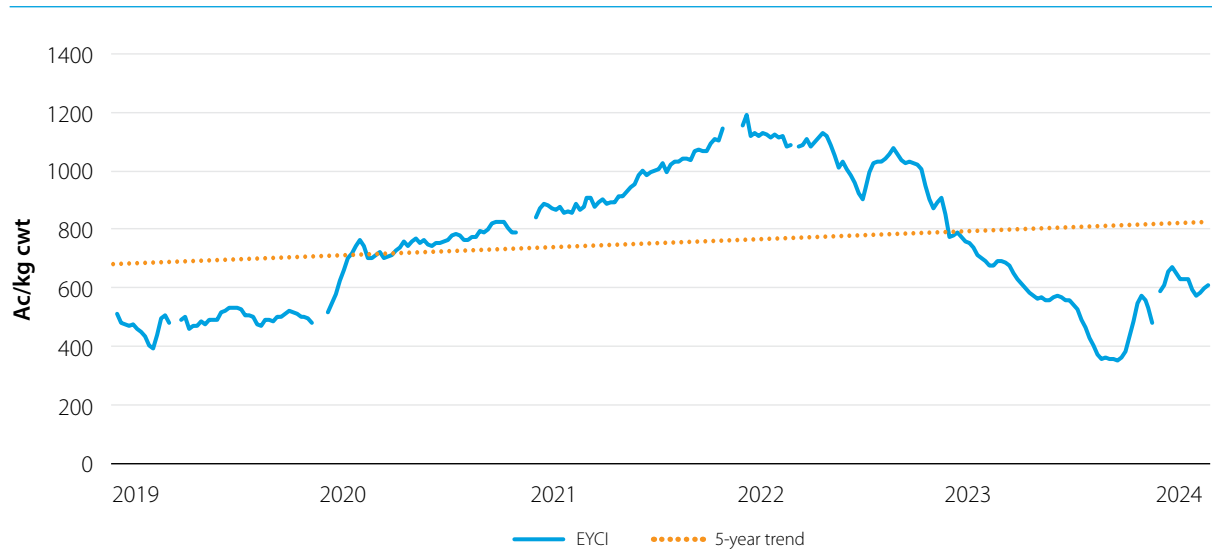
ALTHOUGH THERE IS CLEARLY BOTH UPSIDE AND DOWNSIDE FOR THE PRODUCER - THERE ARE REAL RAMIFICATIONS WHICH STEM FROM BOTH THE RELIABILITY OF INCOME AND PROFITS FOR CATTLE PRODUCERS.

Another topical issue is the increasing reach of Environmental, Social and Governance (ESG) requirements both on farm and throughout the beef supply chain. There is particular apprehension around the potential cost for any possible future mandated changes in farm and livestock management that may be worn by producers, particularly in light of an increasingly volatile income stream.

STATE OF THE INDUSTRY

The Australian beef industry has been through an eventful few years with the ups and downs of emerging from drought, followed by the price declines coming into drier seasons. The Eastern Young Cattle Indicator (EYCI) has declined from the highs of 2021 and 2022, primarily as producers reacted to seasonal conditions and adjusted their expectations for the season ahead. As rain fall events assuaged concerns over an El Nino event, saleyard prices have however started to recover, albeit reasonably slowly.

EYCI - 5-YEAR TREND



Source: MLA, ANZ

Given that the EYCI is currently trading over 25 per cent lower than the 5-year trend, it is reasonable to assume that there is a strong upside to prices, assuming a good season. Indeed, if the EYCI were still solely tracking on trend, it would be trading at just over 800 c/kg cwt – and while not heralding a return to over 1,000c, a return to trend would represent welcome assistance for many producers' back pockets.

It is no real surprise that the primary factor driving cattle prices coming out of the drought was demand from restockers, which may have slightly skewed the perception of the beef market underlying the industry. As a result, many producers keep an eye on anticipated herd growth and restocker demand, with the knowledge that these categories of cattle can return the strongest price growth in the right conditions.

Looking forward at the Australian herd which is currently sitting at highs not seen since 2014, the industry sentiment is that the herd will stay around the same level, if not slightly lower, for the coming year. A current female slaughter rate of 48 per cent supports this view, with producers now in a position to turn off female stock surplus to replacement requirements. As a result, the demographics of the Australian herd are not particularly supportive of a surge in prices for light, young stock such as that which pushed the EYCI over 1,000 Ac/kg just a few years ago. The only exception to this may be an extremely favourable season combined with a considerable jump in heavy/finished cattle prices.

That said, strong demand for processor-ready cattle has, since late 2023, contributed to a reduction in the significant margin between heavy processor steers and restockers, which has provided some support for saleyard prices in general. A sugar-hit was also given to both the feeder and restocker market earlier in the year, as rain events hit cattle producing regions and producers realised that the predictions of El Nino were not coming to fruition.

National slaughter rates have jumped to multi-year highs around the first part of 2024 as processors take advantage of plentiful supply, combined with lower saleyard and over-the-hook prices, to fill growing export orders, and utilise their increased slaughter line capacity.

Given all of the factors impacting the market at present, what is the x-factor for Australian cattle prices? Most likely, it will be the international market which provides a welcome demand boost for domestic producers. Whilst the herd rebuild has commenced in many parts of the US, the herd liquidation continued longer than anticipated as drought conditions persisted in many areas, with data from earlier this year forecasting that the national cattle herd would finish 2024 at 87.4 million head. The result is now flowing on to lower US beef production and exports. The United States Department of Agriculture (USDA) is forecasting a 7.6 per cent decline in US beef exports – primarily offset in global markets by a 143,000 tonne increase in Australian exports from 2023 to 2024. Given that the other primary sources of growth for beef exports – Brazil and India – do not compete with Australia in terms of quality of exports, the US herd decline creates increased demand for Australian beef.

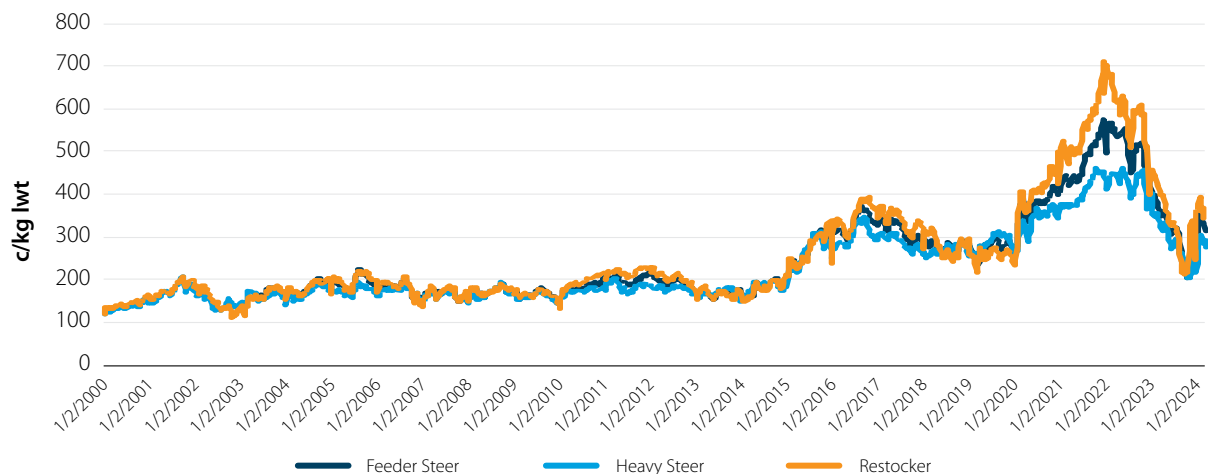
BEFORE THE FARM-GATE: MARGIN ON FARM

One of the outstanding features of saleyard pricing in Australia in recent years has been the emergence of significant and growing margins between the various saleyard categories of cattle. First emerging around 2010/2011, the diverging prices per kilogram between processor, feeder and restocker steers has been a marked trait of the market – particularly in good seasons. A clear example has been restocker demand overtaking demand for feeder steers and most particularly, heavy steers, coming out of drought.

It is not unusual in good seasons for restocker and feeder steer prices to jump away from heavy/processor steers – but the noticeable change in the market is the increasing margin between the categories, providing an opportunity for producers to take advantage of selling younger, lighter stock in a good season. Also adding to the shifting demand for lighter stock, is the continued growth in feedlots, with almost 1.3 million head currently on feed, the highest feedlot inventory in Australia on record.

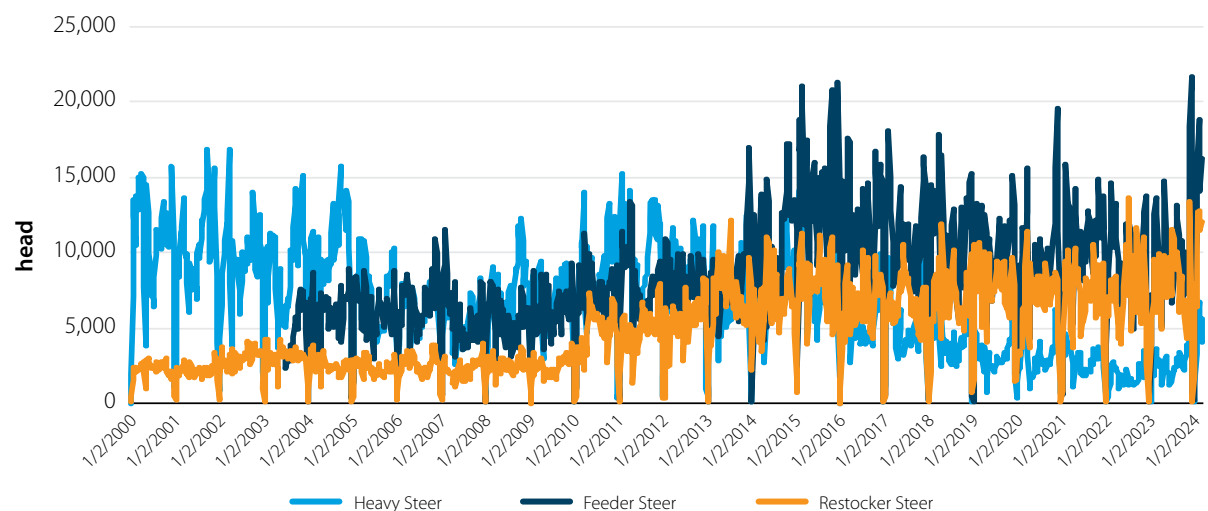
So what does this mean for the producer? In short, the ability to sell lighter cattle for a higher price per kilogram has seen producers revisit their production system, such that they focus on producing a higher number of stock which grow rapidly to a saleable light or feeder animal category, with some building long-term relationships with backgrounders or supplying cattle direct to feedlot. It also provides an excellent opportunity for producers to diversify their sales and mitigate the risk of a season or market shift during the fattening process. More broadly for the industry, the opportunity for 'out of the paddock' sale before moving cattle off farm, generates greater opportunity for profit in good seasons – however on the flip side, also heightens the possibility of excess stock and overly depressed prices in poorer seasons, if stock do not meet desired weights and are offloaded into saleyards.

SALEYARD PRICES BY CATEGORY



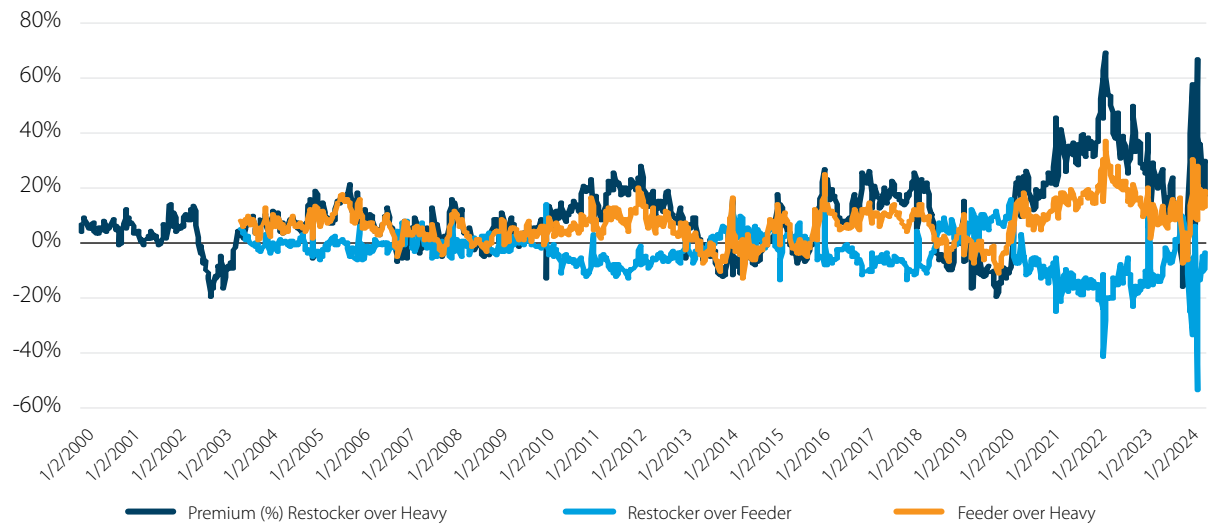
Source: MLA, ANZ

HEAD COUNT - YARDINGS BY CATEGORY



Source: MLA, ANZ

SALEYARD PREMIUM BY CATEGORY

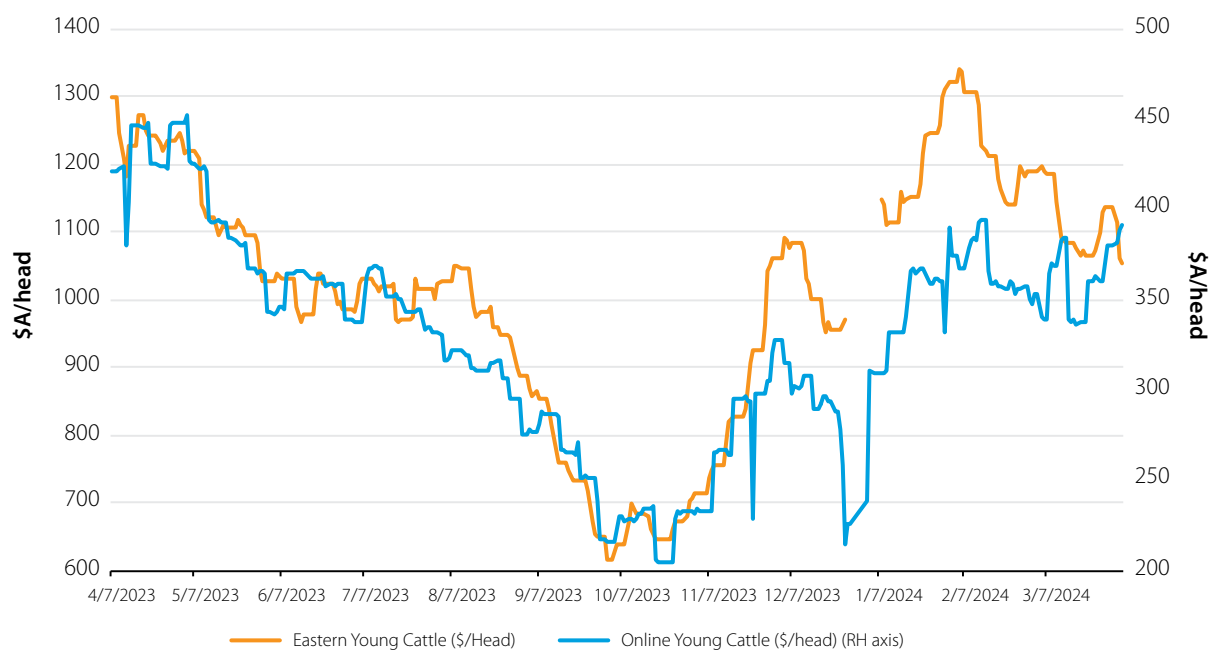


Source: MLA, ANZ

The decision on which channel to sell stock is an increasingly important on-farm decision to make. In recent years, sale via over-the-hook (OTH) has become increasingly popular and now constitutes an estimated 80 – 90 per cent of all stock sales. Increasingly, heavy or processor steers are being sold direct from the paddock, and lighter stock increasingly through the online auctions channels. The question of whether there is a clear leader in terms of benefit to the producer, is ultimately a question of specifics – those with long-term contracted relationships with the next step purchaser will often benefit not only from surety in the number of head being sold, but will

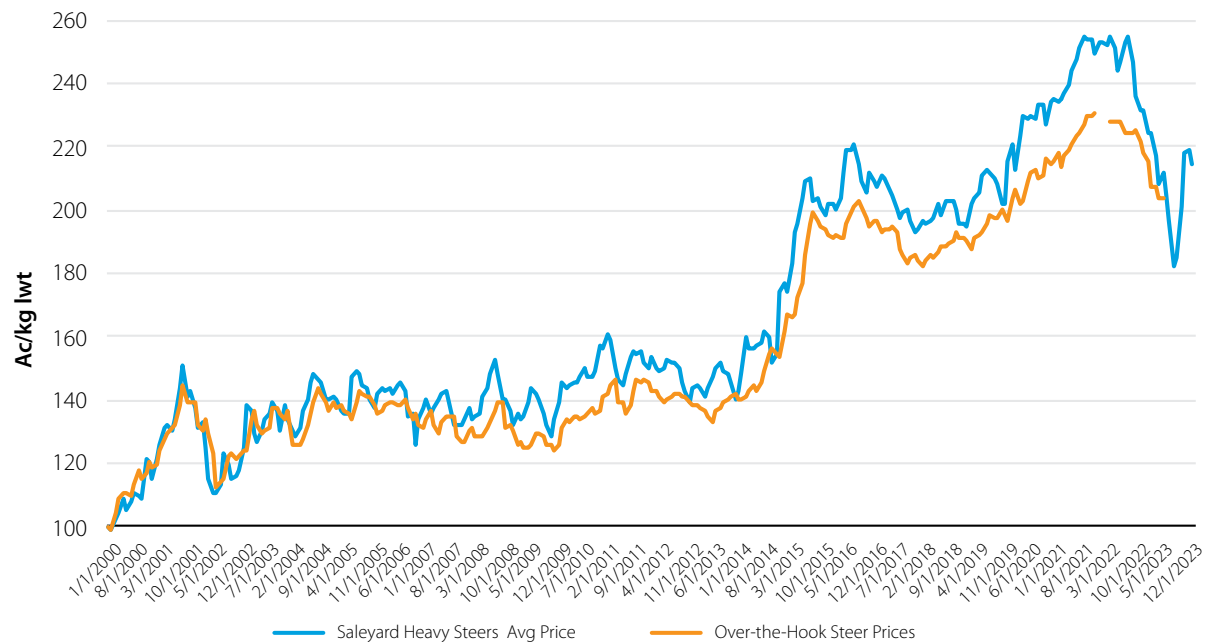
also be insulated against sudden shifts in the market, making forward business planning easier. That trade-off is becoming clear when comparing saleyard and OTH prices, as the margin achieved by saleyard prices over OTH prices is tending to grow, such that producers are paying a price for surety and long-term contracts provided by OTH sales. Anecdotally, however, the higher margin being gained through the saleyard is limited to larger saleyards with sufficient competition between processors – in saleyards with a smaller number of processors competing for heavy or processor stock, the saleyard price tends to be under the OTH price.

ONLINE V SALEYARD SALES



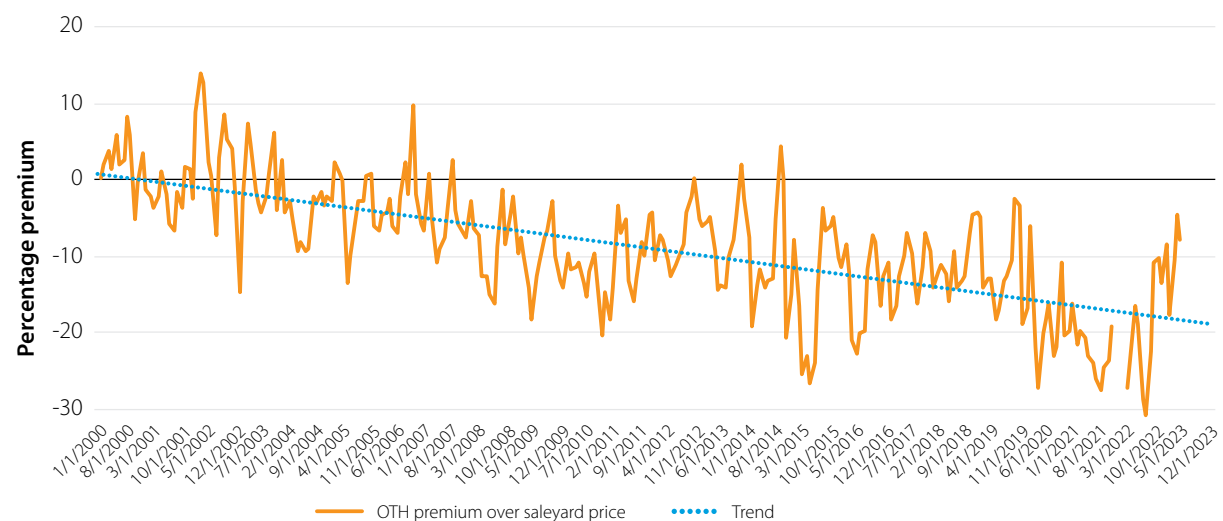
Source: MLA, ANZ

OVER-THE-HOOK V SALEYARD HEAVY STEER PRICES



Source: MLA, ANZ

OVER THE HOOK PREMIUM V SALEYARDS (%)

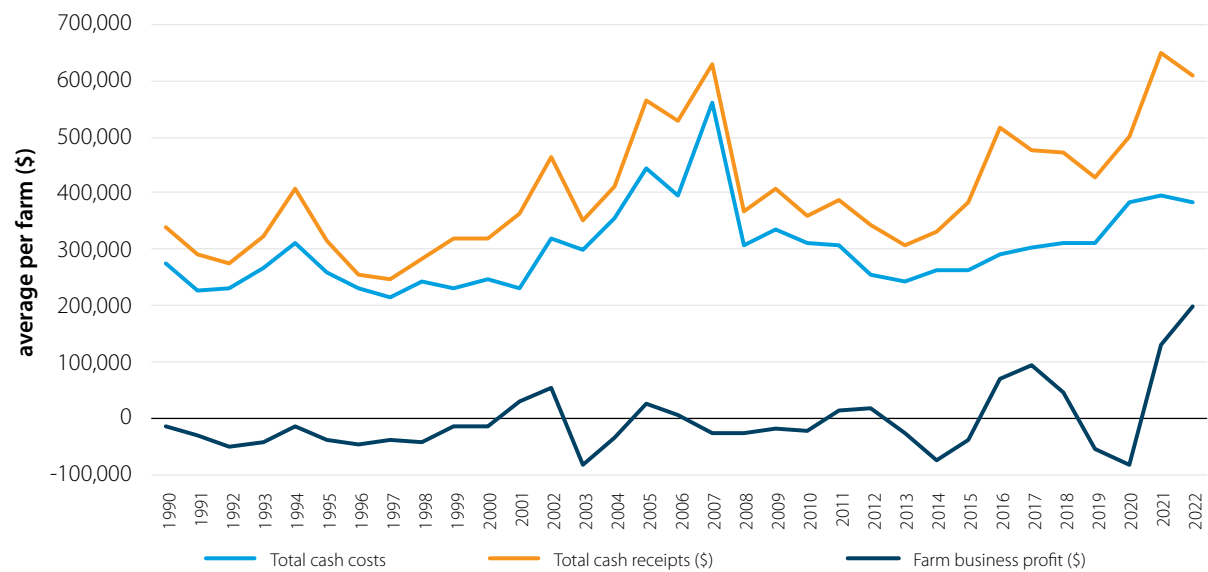


Source: MLA, ANZ

For most producers, while they keep a weather-eye on the saleyards, they also keep an eye on costs. Increasingly, rises in saleyard prices are being followed by increases in the cost base for producers. As costs tend to be far stickier than livestock prices, an growing trend toward systems with lower costs of production per kilogram of output, such as feeder and restocker production, may prove to be the industry response. Of course, buyers for these cattle, such as backgrounding or feedlot operators, need to be in a position to purchase these cattle and return a

profitable trading margin themselves, for this model to be sustainable. Indeed, regarding costs, in following the latest surge in prices starting in 2020, costs rose over 30 per cent in just two years, while prices received rose just 18 per cent. What's notable for cattle producers, however, is that despite total costs for the agriculture industry rising so strongly, cattle production and livestock production remains one of the lower cost agricultural enterprises, providing some insulation from changes in the cost base.

BEEF INDUSTRY - COSTS, RECEIPTS AND PROFITS



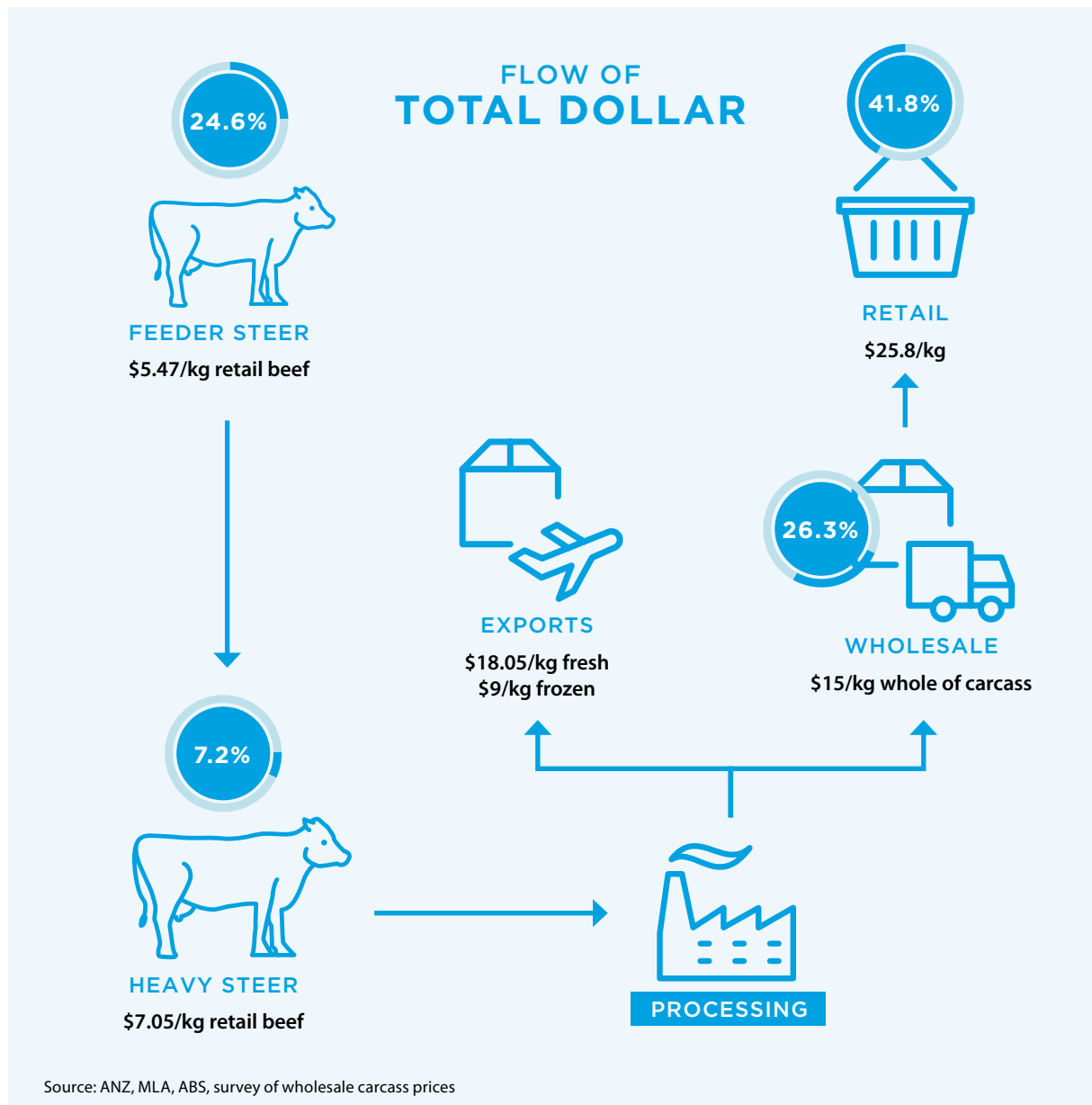
Source: ABARES, ANZ

There is little doubt that the nature of producing and selling cattle in the Australian market has changed in the past decade or so. While costs have continued to increase year on year – and rarely decline by any significant margin – income is now more volatile with many decisions to be made to take advantage of season, saleyard prices, contractual arrangements, the outlook for future costs and the risk of a shift in any one of those factors. While this

sounds like a downside for the industry, it is also clear that once a business is well positioned to take advantage of mid-season opportunities, there is a far greater ability to mitigate risk and diversify income – all of which bode well for the industry in the long-run. In short, while cattle prices are showing more volatility and risk, the changing supply chain is also offering greater opportunity to diversify and mitigate that risk before the farm-gate.



AFTER THE FARM-GATE: SHARE OF BEEF DOLLAR BY INDUSTRY



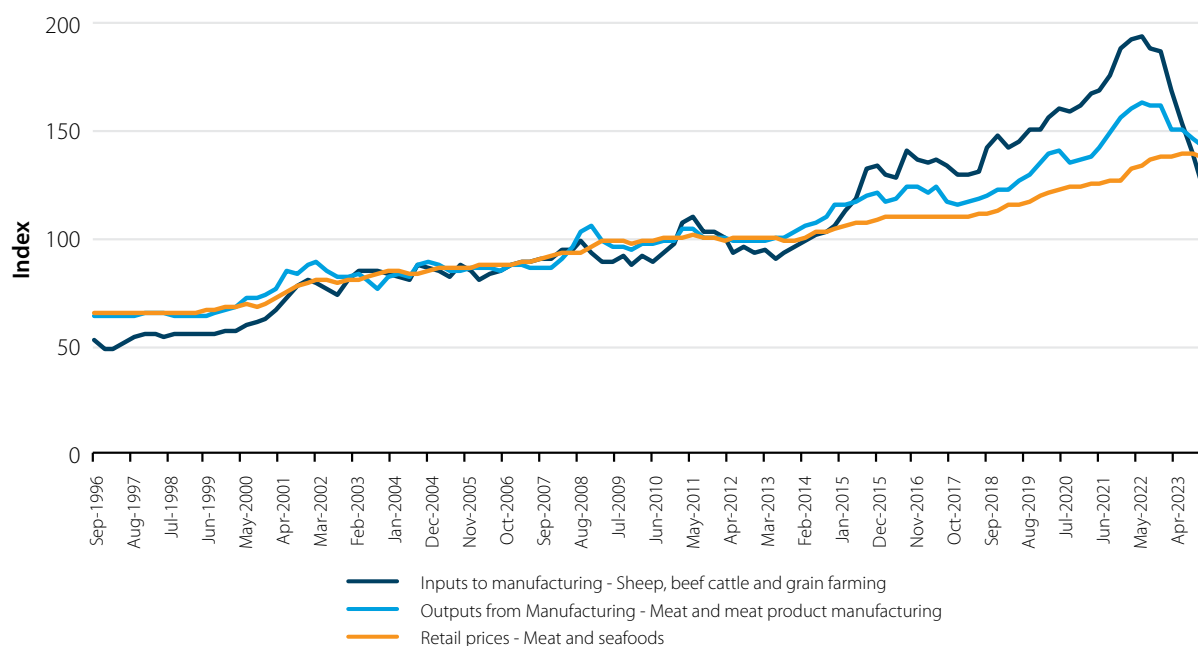
Across the Australian agriculture industry, there is considerable discussion around a number of inquiries into the Australian supply chain and supermarkets. In part, these inquiries are partly based around the question of how much of the final retail dollar do producers actually receive? While the question appears clear cut, the answer is far from simple. Retail prices for beef have certainly increased in recent years, but when we look long term, they've remained relatively stable despite increasing volatility at the farm-gate. This is not to say that the industry hasn't changed however. It is clear that coming into the drought years in 2013, the nature of the supply

chain has changed with farmers – and to a lesser extent processors and retailers – bearing an increased burden of volatility in the industry, for both good and ill. Prior to 2014, farm-gate prices, processor prices and retail prices all moved relatively closely with each other. As the farm-gate prices became more volatile between saleyards categories in the early 2010s, so did the prices received by the processor. The prices paid by the consumers however, broke away from the farm-gate price. The question of why retail prices have perhaps not dropped as heavily, can in part be explained by the longer-term trend towards keeping a lid on retail prices to maintain consumer demand.

So who is taking the largest slice of the retail dollar when it comes to beef? The issue is further complicated when we look at the prices being received for Australian beef exports. As Australia exports over 70 per cent of total beef and veal production each year, simply looking at how the retail price is distributed will miss the largest part of the picture. Indeed, it would appear that at the time that the farm-gate and processor price growth began

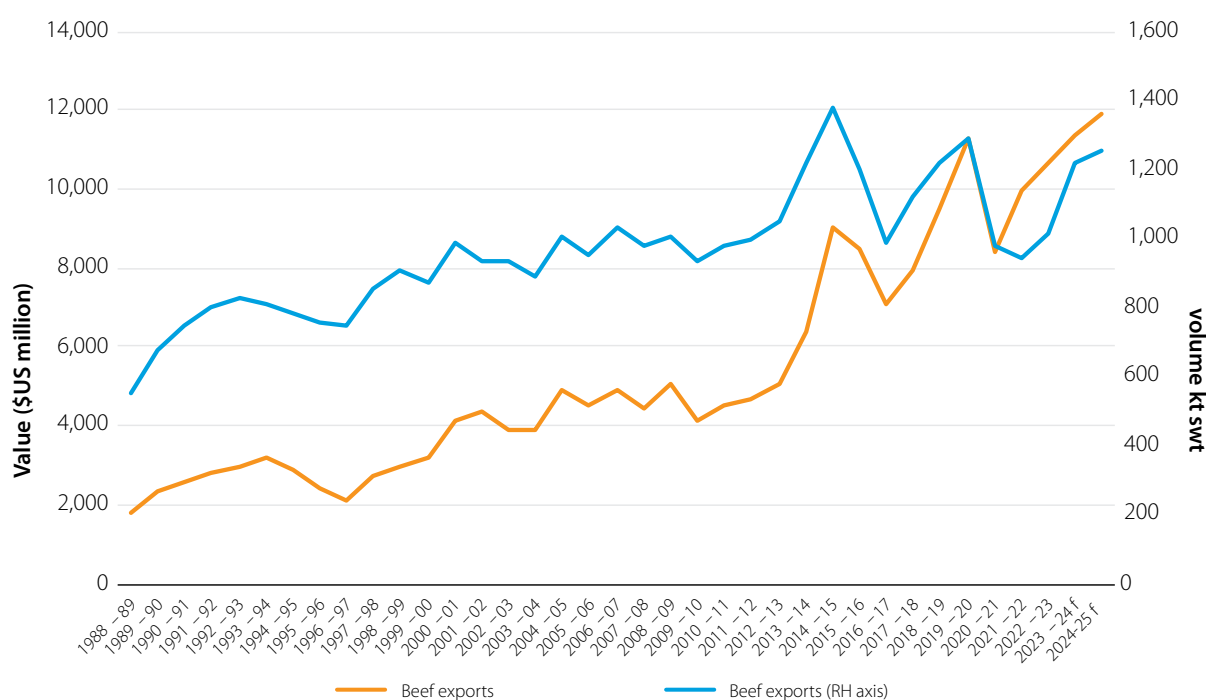
to outstrip retail price growth, was also the time that export prices and total export value jumped strongly. This strongly points to Australia's export markets being the major contributor to both farm-gate and processor prices jumping away from retail – in short, it could be said that Australia's export markets were subsidising relatively low and stable retail prices.

PRICES BY STAGE OF PRODUCTION



Source: ABS, ANZ

BEEF EXPORTS BY VALUE AND VOLUME



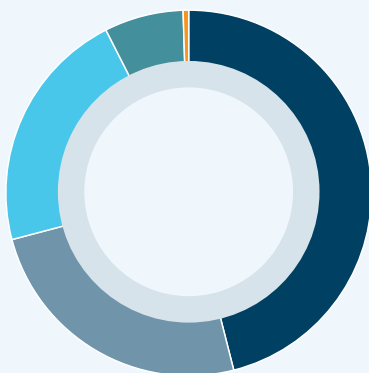
Source: TradeMap, ANZ

INTERNATIONAL FOOD DOLLAR

The current debate around who takes what out of the retail price of beef is an issue that has been explored in many other nations for a number of years. While not drilling down to a commodity level, analysis completed by the United Nations Food and Agriculture Organisation, based on the USDA long-running Food Dollar Series, shows that while Australian farmers appear to take a smaller cut of the final food dollar than the international average, Australian producers also appear to retain a larger proportion of their farm-gate dollar in profits. The most recent FAO data shows that across the food supply chain, Australian wholesale and retailer sector takes just over 50c in each dollar spent on food, while the agriculture sector takes 19c and manufacturers take 18c. This aligns relatively closely with the global average, while itself only reporting on a limited number of countries, of wholesale and retail accounting for 46c in the food dollar and agriculture accounting for 22c.

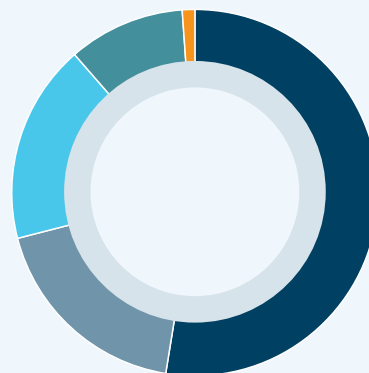
AGRICULTURE'S SHARE OF FINAL FOOD DOLLAR

Share of Final Food Dollar - World



- Wholesale and retail trade
- Manufacture of food, beverages and tobacco products
- Agriculture, Forestry and Fishing
- Transportation and storage
- Accommodation and food service activities

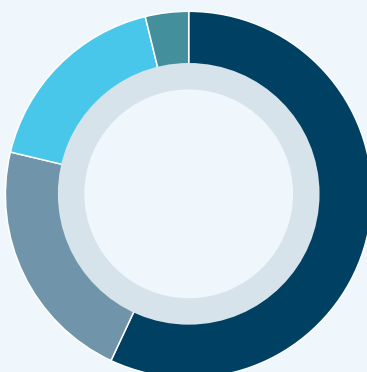
Share of Final Food Dollar - Australia



- Wholesale and retail trade
- Manufacture of food, beverages and tobacco products
- Agriculture, Forestry and Fishing
- Transportation and storage
- Accommodation and food service activities

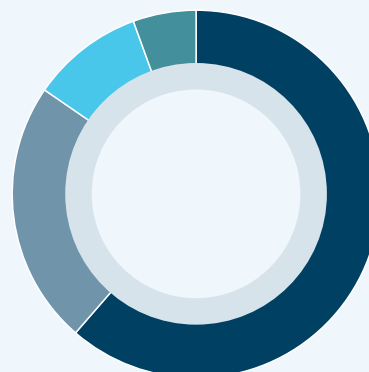
AGRICULTURE'S SHARE OF COSTS

Primary Factor Share of Agriculture - World



- Operating surplus
- Labour
- Import
- Taxes

Primary Factor Share of Agriculture - Australia



- Operating surplus
- Labour
- Import
- Taxes

Source: FAO, ANZ

ESG IN THE SUPPLY CHAIN - CAN THE OPPORTUNITY OR COST BE QUANTIFIED?

Increased volatility in Australian beef industry pricing experienced over recent years has largely been absorbed by the producer on both the upside and the downside. The potential introduction of new environmental standards for beef producers, to meet either a supplier or market requirement, or any future regulatory requirement, is therefore a major discussion point for industry. Understandably, there is apprehension from producers that the process of both proving and improving their environmental credentials is likely to see new costs introduced on farm. The flip side is of course, that there may also be an opportunity for producers to generate income from the same process.

Pleasingly, recent industry research in on-farm greenhouse gas (GHG) emissions from livestock operations suggests that the greatest contributions to lowering GHG intensity from livestock businesses will come from a combination of strategies such as productivity increases, breeding and genetics, feed and nutrition improvements and improved animal health. These strategies, both individually and combined, make up a familiar toolkit for any current beef producer as they go about their daily operations. For those strategies that are more technical in nature, the industry is proactively working on commercially viable solutions, and collaboration along the beef supply chain in regard to these advancements is strong.

The reality however, is that while the cattle industry undergoes a very significant process of exploring best-practice in accounting for, and reducing greenhouse gas emissions, it is possible that a significant emissions base may still exist for years to come on a collective, all of industry basis. While it is unknown what form a scheme to reduce or offset emissions may take or how it may

be accounted for, some possibilities may include on-farm abatement activities or even the purchase of Australian Carbon Credit Units (ACCUs).

While there is no indication of an emissions price being levied against the livestock industry, to explore a hypothetical cost impost for GHGs from cattle operations in their current state, the industry can take a point in time look at its estimated emissions, and apply a current 'offset' price to that figure. Whilst this is a very simplistic measure, it gives some yardstick to what the cost of GHG emissions may look like against current farm-gate prices.

The latest GHG emission accounting undertaken by MLA estimates that of those GHG emissions attributed to overall Australian agriculture in 2020, around 60%, or 40.7Mt, were attributable to beef cattle production.*

At 2020 ACCU prices, this would have cost the industry \$682 million to offset in full via the purchase of carbon credits – or a total of 5.4 per cent of the value of total production. As noted, this is a simplistic calculation that does not consider factors such as on-farm abatement, which may be considerable for some producers.

Depending on how this cost was levied, based on the above figures, it equates to \$78 for every head of cattle slaughtered that year, or around 29c/kg cwt. Since 2020, ACCU prices have increased significantly to currently sit over \$33/tonne, up from \$16.4/tonne. A similar GHG emission profile offset through the purchase of ACCUs in a 2024 market would represent a cost of around 10 per cent of current production value. Current higher ACCU prices also however represent increased opportunity for producers who may be in a position to sell surplus credits in the open market.

* Meat and Livestock Australia, Greenhouse Gas Footprint of the Australian Red Meat Production and Processing Sectors 2020.

While the red meat industry continues to make inroads into meeting the representative body's goal of being carbon neutral by 2030 many have questioned the reality of such an achievement. What we know, is that individual producers will adapt and manage change differently, and what may present as a cost impost to one, could represent an opportunity for others. As the Australian carbon pricing market develops, it is clear that the cost of off-setting GHG emissions from the beef industry could represent a significant cost to producers, should the producer be responsible for 100 per cent of the cost.

In these matters, the question of where such a cost might be levied would also significantly impact how much of the impost is placed on the producer. If for instance, GHG emissions were paid for at the point of sale for slaughter, it is arguable that the producer would not be able to pass on a small amount of that cost to processors and retailers. If, however, the cost was to be collected at the consumer end of the supply chain, it is arguable that the cost would be dissipated along the supply chain with the producer likely to pay a lighter load. Should a cost be imposed on-farm, and prior to any sale into the supply chain, it is unlikely that the producer would be able to pass much of that cost into the supply chain at all.

GHG emissions are not the only environmental cost with the potential to be levied against the cattle industry, however it is the most clear cut and quantifiable given the operating ACCU market. Other ESG standards, such as changes in on-farm practices regarding fertiliser use and nitrogen run-off, biodiversity and vegetation removal restrictions, animal welfare standards and others, all represent a variety of possible cost impositions at varying points in the supply chain. Some, such as animal welfare standards, arguably represent a simple, acceptable base-line for on farm operations, with the cost wholly born by the producer. Others can be argued to represent a cost demanded by either consumers or government, which should logically be shared along the supply chain.

Which cost falls where and on whom, is clearly a vexed issue which will remain an issue for many years to come as markets, governments and individual consumer expectations of production standards change. What is also clear, is that given the changing nature of volatility and income within beef production, it cannot be assumed that beef producers or the Australian agriculture industry in general, has the underlying profit margin available to viably sustain any ongoing costs associated with new ESG standards. A whole of supply chain approach to sharing the ESG load, whatever that may become for beef production, would appear to be the best approach.



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