

SECTOR UPDATE:

Between drought and COVID-19 – multiple economic strains on agricultural, food and timber industries



The drought years of 2018 and 2019 were followed by an excessively dry spring 2020. With around 108 litres per square metre, precipitation in March, April and May fell short of the required 186 litres per square metre for the seventh year in succession. Spring 2020 was thus one of the six driest springs in Germany since 1881. Precipitation in June and July was not able to significantly improve the dryness of the ground as a whole. The effects of another year of drought combined with additional effects from the COVID-19 pandemic are devastating for the agricultural, food and timber industries:

ECONOMIC BURDENS TO DATE

In 2019, 137 companies in the agricultural sector had to file for bankruptcy (+25.7% vs. 2017). Lower revenues and higher costs caused by the drought in 2018 were the main reasons behind the increase in insolvencies. However, in addition to a below-average harvest for farmers, the drought also affected the availability of basic fodder for livestock farms as well as tree mortality in forestry. This development is expected to continue due to the ongoing drought and price pressure in the food retail industry and will be intensified by the impact of the COVID-19 pandemic.

SHORT-TERM POLITICAL MEASURES

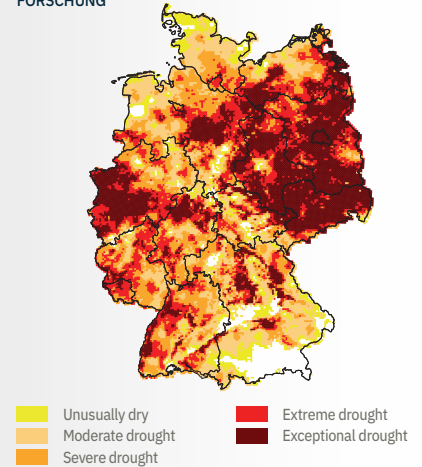
In cooperation with the German Rentenbank, the German Federal Government introduced a guarantee scheme on 16 April 2020 to secure liquidity for farmers, which agricultural enterprises can call on at short notice. However, in the meat-processing industry, for example, the ban on most works contracts and temporary employment effective from January 2021 will intensify the crisis. Together with increased political pressure, this will have a significant impact on factor costs, will weaken Germany's position as the "slaughterhouse of Europe" and lead to overcapacities caused by companies relocating abroad. Especially medium-sized companies along the value chain will get into financial difficulties and the oligopolisation of the market is likely to continue (current market share of the three largest pig slaughterhouses: 58%).

In forestry, the current lack of sales is leading to a further drop in timber prices, which are already lower due to drought and increasing pest infestations. While the sawmill and timber industry is currently benefitting from low purchase prices, it fears that there will be a significant shortage of supply and a sharp increase in prices in the medium and long term. From the perspective of forest owners, the low price level means that active forest management is currently commercially unattractive, which further increases forest dieback.

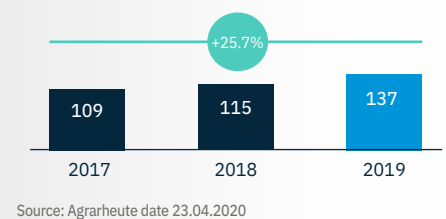
LONG-TERM POLITICAL MEASURES

The COVID-19 pandemic led to significant short-term fluctuations in both the supply and demand of agricultural products. In the long term, extreme weather events will have an equally significant impact on agricultural production. The 2018 drought year has shown that, despite millions in aid from the German federal government, exceptional weather events and a lack of financial buffer can quickly lead farming operations into a financial crisis. To reduce financial risks, agricultural enterprises can offset their losses or profits against tax over a period of three years from 2020. Fluctuations in profits can be corrected by an individual tax reduction. In addition, the value-added tax for drought insurance will be reduced from 19% to 0.03% from summer 2020. This makes insurance, which was expensive in the past, more affordable for farming businesses. It is uncertain whether these measures will suffice in view of the current situation and this year's harvest forecasts.

DROUGHT MONITOR TOTAL GROUND (1.8 M DEPTH) BY THE GERMAN ENVIRONMENTAL RESEARCH CENTRE HELMHOLTZZENTRUM FÜR UMWELTFORSCHUNG



NUMBER OF INSOLVENCIES IN AGRICULTURE AND FORESTRY IN GERMANY



"A third consecutive drought year would hit many of our farming operations harder than the previous ones. In many cases, cash reserves have been used up. There is a lot of uncertainty."

Joachim Rukwied, President of the German Farmers' Association, in an interview with Redaktionsnetzwerk Deutschland on 22 April 2020

CURRENT STATUS OF SELECTED MARKET SEGMENTS



Fruit and vegetables

Consumer demand for fruit and vegetables more difficult to predict. "Undulating" retail demand. Increased fruit and vegetable prices compared with previous year. Continued limited availability of seasonal workers for harvesting and planting.



Grain

Demand for wheat at normal level again after decline in panic buying. Yield expectations for wheat are strongly driven by the predicted weather conditions in the growing regions. The European forecasting authority MARS recently reduced its yield expectations for EU wheat.



Meat industry

Persistently low demand from the catering sector and consumer reticence caused by recent events in German slaughterhouses are leading to a significant decline in demand and prices. China continues to have a great demand for cheap pork, which will further increase the price pressure among exporters.



Forestry

Oversupply caused by dead wood from previous droughts and other calamities (pests, storms, etc.) leads to a significant decline in the price of timber. Urgently needed reforestation for revitalisation is only carried out sporadically due to the lack of manpower and economic unprofitability.

SHORT-TERM IMPACT OF A DROUGHT IN 2020

- Aid already announced by the German federal and state governments will probably not be sufficient to compensate for damage caused by yet another drought.
- The liquidity requirements of companies along the entire value chain will increase significantly and, in view of the low reserves typical to the industry, lead to a strained financial situation. The probability of covenant breaches and defaults of existing financing structures will rise.
- The structural change to ever larger production units will continue to accelerate.

LONG-TERM IMPACT ON THE MARKET SEGMENTS



Fruit and vegetables

- Volume-related low yields and various extreme weather events put a strain on fruit and vegetable producers.
- Due to market structures (low number of food retailers; high number of fruit and vegetable producers) the pressure to consolidate will increase further. In addition, continuous capital-intensive measures are required to enhance efficiency.



Grain

- Cultivation of resistant varieties such as soybeans, millet or sorghum millet, which are resistant to the spread of fungi, viruses and harmful insects caused by the mild winter.
- Unforeseeable crop failures have a negative effect on farmers when planning to expand crop rotations and investments in technical equipment to monitor ground water retention.



Meat industry

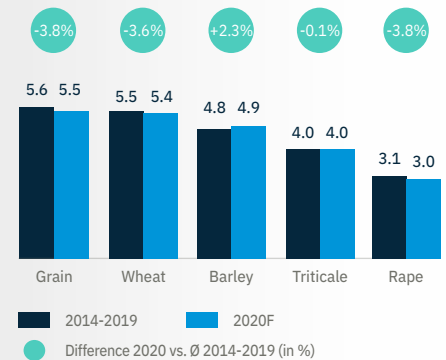
- More frequent phases of drought and heat lead to a shortage of fodder. Additional conditions imposed by the ban on works contracts and temporary employment as of 2021 will increase the pressure for consolidation.
- Extended range of meat substitutes to reach new customer groups difficult due to cost pressure in the industry.



Forestry

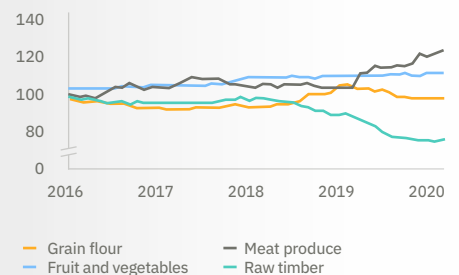
- Required change in forest composition towards more heat-resistant types is insufficient due to profitability issues.
- Comprehensive investment programmes for the further development of mixed forests fail due to foresters' lack of financial reserves.

HARVEST YIELD 2014-2019 AND FORECAST 2020 IN THE EU-27 STATES FOR SELECTED GRAIN VARIETIES (IN MILLION TONS)



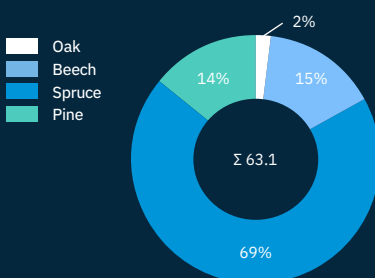
Source: Crop Monitoring agency of EU Commission (date: July 2020)

PRODUCER PRICE OF SELECTED COMMERCIAL PRODUCTS (2015 = 100)

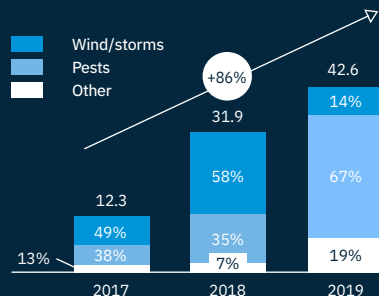


FORESTRY SNAP SHOT

TIMBER FELLING 2019 IN GERMANY BY TIMBER SPECIES GROUP (IN 1.000 M³)

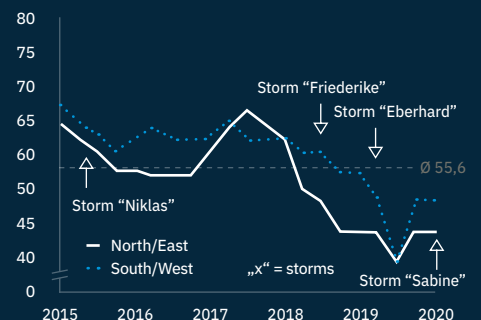


TIMBER FELLING IN GERMANY CAUSED BY DAMAGE (IN 1.000 M³)



- In 2019, coniferous wood accounted for about 85% of all felling, of which spruce was by far the largest proportion at 69%. The high proportion of felling is mainly the result of increasing pest infestation (including bark beetle), which has perfect conditions due to the drought and mild summers with little snow.

PRICE DEVELOPMENT OF ROUND TIMBER (PINE 2A QUALITY, AVERAGE PRICE/SQM)



- The average price of round timber has been volatile over the last five years, but reached a five-year low in the first quarter of 2020. The projected price of round timber will remain at a low level in both 2020 and 2021 due to oversupply of deadwood from previous droughts.

Are you interested in the market trends of the agricultural, food and timber industry? Please get in touch and arrange a meeting for an informal chat without any obligation. We look forward to hearing from you.

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