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PROCESSING

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The European poultry industry is facing a future with little or no expansion in production and a marginal increase in consumption. Long-term forecasts predict declining production and rapidly increasing imports. What strategies did processing companies follow to stay in business?

By Wiebe van der Sluis

The European poultry industry is suffering from low cost poultry meat imports from Brazil and Thailand. Once an important exporter itself, EU exporters find it increasingly difficult to keep their traditional customers happy. For some (by)products it is not that difficult but the bulk has to be sold in the arena of price fighters. Due to the relatively high cost of production, European companies can no longer compete (*see Table 1*). Today the EU is exporting legs to Russia (>200,000mt), whole birds to the Middle East and offal and paws to Asia.

Changing markets

Forecasts for the next five years show that the current 15 EU countries will show a small growth in population and therefore a small increase in consumption. More important for the processing industry is that the consumer market will continue to move to convenience and value added products. This trend does not automatically require more chicken to be produced. It surely will require higher investments in processing technology and/or labour. For the time being this development is in favour of low labour cost countries like Thailand and Brazil.

With the enlargement of the EU by several Eastern European countries on January 1, 2004, the market volume will change in production as well as consumption. It is to be expected that consumption levels in the new countries may go up, in line with the improvements in their gross national income. Whether this extra demand will be covered entirely by domestic production is doubtful. It is certain that in the years to come some of the production will shift from Western Europe to the eastern candidate EU member states. Several processing companies already anticipate this development and bought or took stakes in processing companies in Poland or Hungary. Companies in the candidate EU member states will need investments during the coming years to bring their operations in line with EU legislations and market demands. A large part of the industry in these countries would currently be unable to survive in the highly competitive EU market. Furthermore, relatively modern EU-style retailers are urging companies in Central Europe to invest in high quality supply structures.

Table 1. Chicken meat production costs

Country	*USD/Kg*	*Labour/Month (US$)*
European Union	0.70	1700
Hungary	0.66	242
Argentina	0.60	900
Thailand	0.53	120
USA	0.46	1500
Brazil	0.40	400

(Source: Grolli,Coopavel,Brazil)

Choice of approach

Companies that want to be active on the international market have a choice of approach: international trade of products (export and import) or internationalisation. According to market analyst Nan Dirk Mulder of Rabobank International many companies, in particular in the food business, start out by exporting and importing products, internationalisation is then often the second phase.

Companies in the meat business have often been national players. It is only over the last five years that companies have started looking at internationalisation, especially in the poultry industry, says Mulder. The main driver for this is getting access to lucrative new markets, cheap sourcing opportunities, either for fresh products or products for further processing and the consolidation of the company's position in international trade. Consolidation and internationalisation gives retailers and food service companies increasing power.

Some ten years ago the Dutch companies Plukon Royalle and Astenhof acquired companies in East Germany to expand their business in Europe's largest import market, rather than investing in and expanding their domestic operations. Both have their own processing facilities in this part of Germany, which proves to be useful too when their home market is confronted with transport restrictions due to the Avian Influenza outbreak. Both companies announced earlier this year to have merger plans, making them the largest poultry processor in the Netherlands, but the combination will still not be big enough to play a major role in the international arena. Plukon processes 1.5 million broilers a week with a turnover of 285 million Euro and Astenhof 1.2 million per week and has a turnover of 190 million Euro (*see Figure 1*).

In recent years several foreign companies have already acquired a strong position in the lucrative Polish market (*see Figure 2*). This country offers a huge potential for the production as well as consumption of poultry meat. Foreign companies own the two largest poultry processors in Poland. The French poultry processor LDC owns Droset, with a market share of 22% since 2000 while US based Smithfield Foods gained a majority share in Poland's second largest poultry and pig meat company Animex. The German PHW-Gruppe owns the fifth largest Polish company, Drobimex-Heintz, and intends to gain further market share.

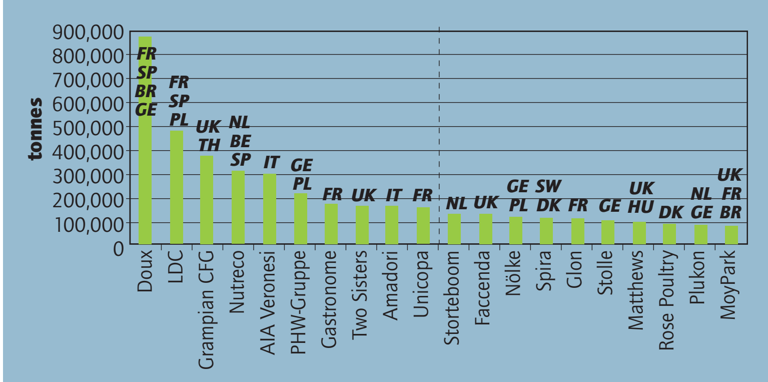
What strategy to follow?

Low growth in domestic markets and increasing competition from international companies increasingly urge European companies to choose between cost and market-driven strategies. The consistent adherence to one of these two basic strategies is essential to making a good investment decision. Companies have to ask themselves, according to the Rabobank analyst, the following questions:

panies search for expansion

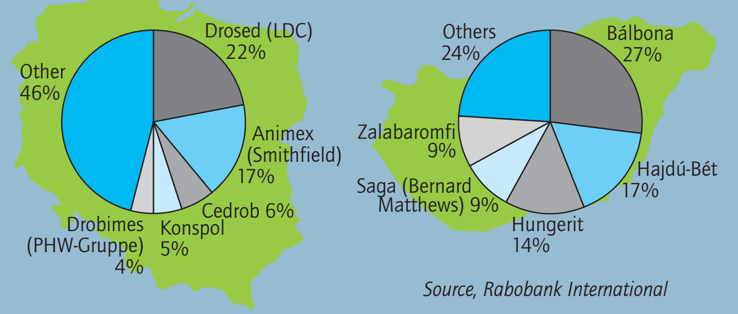
An increasing number of European processing companies are moving away from producing whole chicken by concentrating on producing breast meat products and developing strategies to optimise the profit on other chicken parts.

Figure 1. Ranking of the largest European poultry producers (base: worldwide production)



Note: The country codes at the top of the bars represent the countries where the companies have processing facilities *Source, Rabobank International*

Figure 2. The leading processing companies in Poland and Hungary



Source, Rabobank International

- Do we want to source more cheaply or to maintain our position in the international market?
- Do we want to develop new markets?

The reason behind the first question is that relatively low feed costs and relatively cheap labour could lead to cheap sourcing for sales markets. This could provide a way to maintain the company's position in international trade. Companies like Doux and Bernard Matthews have used this argument to invest in Brazil (Doux-Frangosul) and Hungary (Bernard Matthews-Sàga) respectively. In the late 1990's Doux was the market leader in the export markets of whole chicken to the Middle East but was feeling increasing pressure on its export markets from cheaper producers in Brazil. To prevent the loss of market share, the company believed that investments were necessary in a country with low production costs. The same argument led Bernard Matthews to invest in Sàga in 1998. However, whereas Bernard Matthews also uses Sàga to export to the domestic market in the EU, Frangosuil exports its products primarily to non-EU export markets.

Price advantages

Another argument for investing on the basis of the cost-price argument is, according to Mulder, to provide sourcing for a processing industry in home markets or direct sales to customers in important sales markets. These were arguments that led Ireland's Moy Park (part of OSI) to buy Brazil's Pena Branca. On the basis of the same argument some companies are investing in companies in Thailand. These investments allow the companies an opportunity to export cooked products at low cost. This idea lay behind Grampian's purchase of Golden Foods International and Cargill's Sun Valley's investment in Thailand. Cargill has also a joint venture with Sadia, Brazil's largest exporter of poultry meat, with the aim to increase sales of Brazilian meat in the EU.

Low production costs are not the only factor determining a company's competitive position. N optimal valuation of the sum of cuts is also very important in achieving optimal profits, states Mr. Mulder. A chicken can be divided into four economic parts. In general 19-24% of a chicken is breast/filet meat, 26-28% is bone-in-leg, 8% is wings and 50-50% is by-products like bones, feathers, intestines and trimmings. Marketing these products is also important since customers in regions like the EU and USA have moved away from consuming whole chicken to consuming breast meat. The optimisation of other parts has become a major activity in the drive to optimal profit. Solutions can be found, according to Rabobank analyst Mulder, in the domestic market with effective marketing strategies, development of new products and markets or by developing new export markets where this kind of meat is preferred. Companies that manage the valuation issue most effectively will have a strong competitive position and should be able to compensate for slightly higher input prices. □