

Food Inflation Report

Second Quarter 2014



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Food Inflation: A Full Frontal Punch To The Gut

America's Bureau of Labor Statistics reports inflation in the U.S. is running at 1.5%. This is dangerous nonsense! Rigging food prices by not including them in the official inflation index is a subtle form of delusion at best. Beyond the hocus-pocus, food prices, which were expected to remain flat this year, have already risen due to adverse weather conditions and supply concerns related to some major products—pork, beef and shrimp prices are all hitting all-time highs. Overall, the Commodity Food Price Index has increased 6% year-to-date (YTD), with the prices of pork increasing 42%, shrimp ballooning 61% and coffee beans up 70%, over the same period.

Considering the high price elasticity of food products, overall demand for certain products may suffer as a result of their recent price increases. More worrisome,

the rising price action will encourage more commodity futures speculators to jump in and continue the rapid price escalation. If the Fed does not get ahead of this coming tsunami of greed, they will be in a similar situation as when food prices took off in 2008.

Hard To Swallow

Food inflation is obviously back with a vengeance for a range of food staples, led by the core proteins at the center of the American plate. In short, meat processors quarterly results announcements give a clear picture that the pace of consumer product inflation is fueled by price appreciation rather than their own organic growth. It's the season to negotiate, fix prices, hedge input costs and generally be aggressive in price mitigation.



We've seen strong prices before, but nothing this extreme. This is really new territory. Changes in the prices of input commodities significantly impact the industry players,' manufacturing costs and margins.

Is Weather To Blame?

Did you know that the U.S. state that produces the most vegetables is also going through the worst drought it has ever experienced and that the size of the total U.S. cattle herd is now the smallest that it has been since 1951? Just the other day, a CBS News article boldly declared that “food prices soar as incomes stand still,” but the truth is that this is only just the beginning. If the drought that has been devastating farmers and ranchers out west continues, we are going to see prices for meat, fruits and vegetables soar into the stratosphere.

Speculations about the weather phenomenon, El Niño, have now added to concerns about the cost of goods. According to US government forecasters, there is a 65% chance that an El Niño will occur by the end of the year. This will cause commodity prices to increase even further and exacerbate problems for producers and end consumers alike.

Selfishly we hope that the sharp increase in food prices due to the rise in agricultural commodities prices will prove disappointing news for consumers in developing countries that import food products. This will help supply inventory, negatively impact the demand for domestic consumer goods and just maybe, impede manufacturers' ability to pass through price increases.



Protein Prices Are Booming!

In light of a slew of meat-related shortages (see: beef, shrimp, and pork) chicken still represents the least expensive protein option and the poultry industry is not wasting any opportunities to push its product on an amenable market. As beef and pork prices continue to rise, consumers increasingly switch to chicken. Prices have spiked and chicken is up 15% in April. Pork prices are up 42% over last year, despite the fact that corn, and therefore feed, is down. Cheap feed costs just haven't been enough to offset the negative impact the PED virus has had on supply, and Chinese pork consumption has had on demand. Until farmers can figure out how to stop the spread of the disease, prices will likely stay high.

Beef is experiencing similar cost hikes. The price of beef has hit record highs and this is in large part thanks to side effects caused by ongoing droughts and extreme weather across the U.S. The long, cold winter—and subsequent frozen grazing conditions—made it tough for some cows to put on weight. Ground beef costs jumped 12% in February from a year earlier with forecast prices by August being 27% above last year's.

Devastating Drought

If the drought that has been devastating farmers and ranchers out west continues, we are going to see prices for meat, fruits and vegetables soar exponentially.



Chicken still represents the least expensive protein option.



QUALITY & PRICE REALITY CHECK

So when can we expect the prices to drop again? See you in 18 months; that's how long it will take to replenish the herd.

Inflation has impacted dairy as well. With China importing record volumes of dairy products through fall and winter, and cold Midwestern temperatures limiting milk production in the US, prices are at record highs. This, of course, affects the prices of cheese and butter as well. In March, the cheese block market was 42% above last year's level. The butter market is 11% above 2013. The good news is that milk production is beginning to expand and we should begin to see some price relief in the dairy markets soon.

The U.S. isn't the only country suffering from crop-killing weather—a historic drought in Brazil recently laid waste to much of the nation's coffee-growing region and the consequent shortages caused price spikes. Case in point: Coffee prices reached \$3 per pound before retreating and we suspect continued strengthening.

Going forward, Mother Nature will push supplies up and down, but an ever-increasing demand from a rapidly-developing world is the driving influence on the global food market. Unfortunately, food inflation appears to be here for the foreseeable future.

Lettuce

Thank goodness for kale, because good, old-fashioned lettuce is about to get pretty pricy. As a consequence of ongoing droughts in California (the source of a lot of high produce prices this year), U.S. lettuce prices have jumped 34%, or a hefty \$2.18 a head.

With lettuce prices up 34%, it's Kale to the rescue!



Quality | Price

	HIGH	AVG	LOW	HIGH	AVG	LOW	
VEGETABLES							
Asparagus		•			•		
Beans		•				•	
Broccoli		•			•		
Cabbage		•			•		
Cauliflower		•			•		
Celery		•		•			
Cucumbers		•			•		
Lettuce-Iceberg		•			•		
Lettuce-Leaf		•			•		
Lettuce-Romaine		•			•		
Lettuce-Spring Mix		•			•		
Onions-Red		•			•		
Onions-Yellow		•			•		
Peppers-Green		•		•			
Peppers-Red		•		•			
Potatoes-Russet		•			•		
Squash-Yellow		•			•		
Squash-Zucchini		•			•		
Tomato-Cherry		•			•		
Tomato-Grape		•			•		
Tomato-Mature Green		•			•		
Tomato-Roma		•			•		
Tomato-V/Ripe		•			•		
FRUITS							
Avocado	•				•		
Berry-Blackberry		•			•		
Berry-Blueberry		•			•		
Berry-Raspberry		•			•		
Berry-Strawberry			•	•			
Grape-Red		•			•		
Grape-Green		•			•		
Kiwifruit		•		•			
Lemons		•			•		
Limes		•			•		
Melon-Cantaloupe		•			•		
Melon-Honeydew		•		•			
Melon-Watermelon		•			•	•	
Oranges		•			•		
Pineapple		•			•		

Food Inflation Update

	6 Weeks		26 Weeks		52 Weeks
Lean Hogs	30.50%	CME Block Cheese	31.43%	Lean Hogs	42.76%
Pork Cutout	19.80%	Lean Hogs	23.84%	Pork Cutout	37.10%
Minn Wheat	18.05%	Choice Beef	22.28%	CME Block Cheese	28.13%
Corn	12.83%	CME Butter	14.61%	Class III Milk	23.57%
Soybean Oil	12.00%	Cattle Futures	13.76%	Choice Beef	20.57%
Chicken Breast	9.91%	Pork Cutout	7.39%	Cattle Futures	13.89%
Crude Oil	4.29%	Corn	6.44%	CME Butter	11.68%
Chicken Cutout	2.36%	Class III Milk	4.29%	Crude Oil	9.85%
Choice Beef	2.28%	Soybean Oil	3.77%	Dollar Index	-4.00%
Cattle Futures	0.70%	Minn Wheat	-0.48%	Chicken Breast	-9.50%
CME Butter	0.27%	Dollar Index	-0.94%	Soybean Oil	-12.12%
Dollar Index	-1.80%	Crude Oil	-1.07%	Minn Wheat	-12.57%
CME Block Cheese	-2.54%	Chicken Cutout	-9.84%	Chicken Cutout	-19.34%
Chicken Wing	-5.47%	Chicken Breast	-14.51%	Chicken Wing	-29.43%
Class III Milk	-7.40%	Chicken Wing	-23.74%	Corn	-32.66%

Bullish markets are shaded in red. Bearish markets are shaded in blue.

Food Inflation Shows No Signs Of Abating

Market conditions during the first two months of the quarter were dominated by the impact of unusually severe winter weather conditions throughout much of the United States. As a result, operators experienced very modest sales growth in January and February. Conditions improved markedly in March as the adverse weather subsided, which likely contributed to consumers spending and eating more. This year's rise in agricultural commodity price risk is not a blip, but part of a longer-term trend. On a cyclical level, the change in weather patterns and a rise in extreme weather events have affected prices since the mid-2000s. Present inflation comes despite sharp decreases over the past year in the prices of grains, including corn, after a big U.S. harvest.

Are Cold Beverages Fizzling Out?

Even iconic brands like Coke and Pepsi have witnessed a sharp 3% decline in unit sales volumes over the past year, with biggest declines being witnessed in diet CSDs. Revenue growth has slowed sharply due

to intense competition and consumers switching their preferences to healthier functional beverages. To support dollar revenue growth expectations and offset case volume declines, both Coke and Pepsi have increased their weighted branded case prices by more than 3%.

Jumbo Price Hike For Shrimp

In August, as the price of shrimp soared to \$5.80 a pound, CNN called the new price on headless crustaceans an "all-time high." But do you know what consumers today would call that price? A bloody bargain. The sales success of Bubba Gump Shrimp Co. notwithstanding, the United States produces only about 10% of the shrimp we consume. The rest comes from Asia, and all across the continent, a disease known as early mortality syndrome is killing farm-raised shrimp. That's hurting shrimp supplies and raising the cost of the shrimp that the U.S. imports. Low supplies beget high prices, which in turn encourage shrimp producers to find ways to boost supply and capture those high prices as profit. For the interim get used to \$9 a pound shrimp, that's a whopping price increase of 61% over 2013.



Disease is killing farm-raised shrimp and raising the cost of shrimp imported to the U.S.

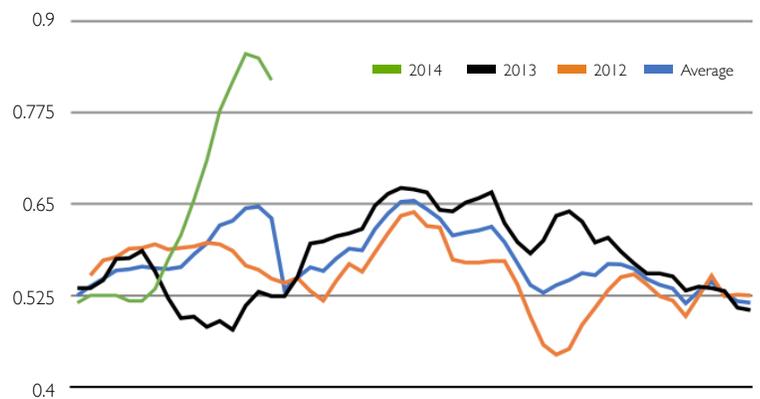


Foodservice establishments are at the mercy of record-high pork prices.

Taking the Sizzle Out of Bacon

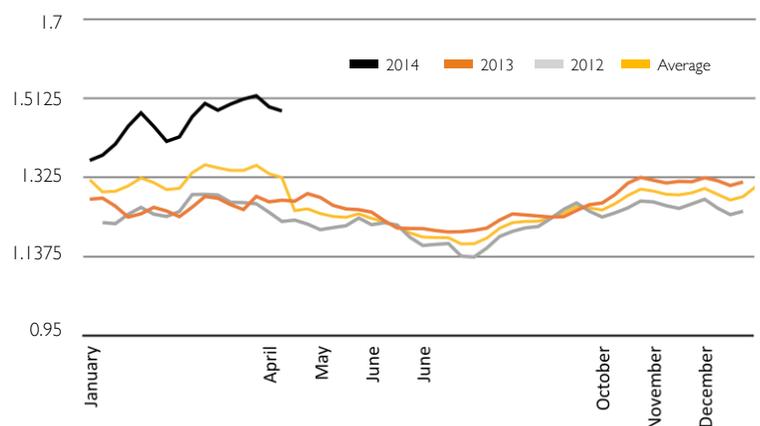
It's been a very challenging time for those on the purchasing side of the equation and demand will probably remain strong through the spring as supplies are expected to tighten. The killer stalking U.S. hog farms is known as PEDv, a malady that in less than a year has wiped out more than 10% of the nation's piglet population and helped propel pork prices to record highs. Frozen inventory is being depleted, over the short term this resulted in pricing relief for April.

LIVE HOGS - AVERAGE WEEKLY PRICE



Beef prices have reached their highest level in 27 years!

LIVE CATTLE - AVERAGE WEEKLY PRICE



Beefing Up Prices

Tomorrow's hamburger may cost you as much as today's steak. Shrinking supplies of cattle, lower production output, a 17% reduction in frozen meat stocks and rising export demand from Asia are driving price increases with little relief in sight. As a result, beef prices reached their highest level in 27 years. All of this means we will have to pay top dollar for beef for at least another year or two. USDA choice boxed beef cutout was running 14.6% above last year and 20.6% above the five-year average.

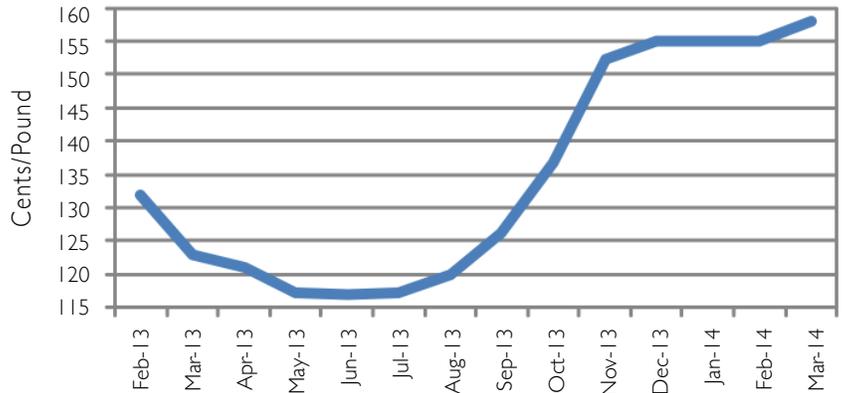
Going Cold Turkey

The availability of turkey meat in the US is at its lowest since 1988. Add that long-term trend to the present shortage of ground beef and the demand for boneless skinless turkey thigh meat is off the charts. Prices should ease a bit by summer, but will remain historically high for the rest of the year.



Turkey prices are expected to remain historically high.

UB THIGH MEAT, FRESH



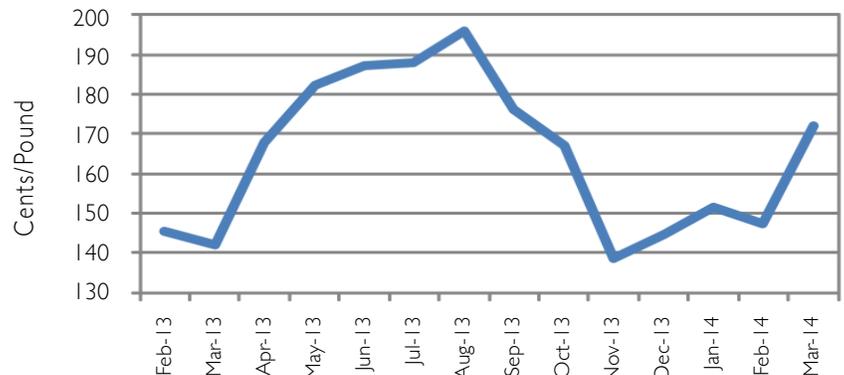
Winging It

Chicken supplies are up only slightly from last year and competing meat supplies are extremely tight. The result is exceptionally strong interest in white meat products, which will continue to grow as the weather warms. Chicken prices and value added item prices have soared, and are headed toward \$2 per pound. Prices should pull back some for summer but remain very high from a historical perspective. Despite this, chicken remains a better deal than other proteins.



Chicken remains a better deal than other proteins.

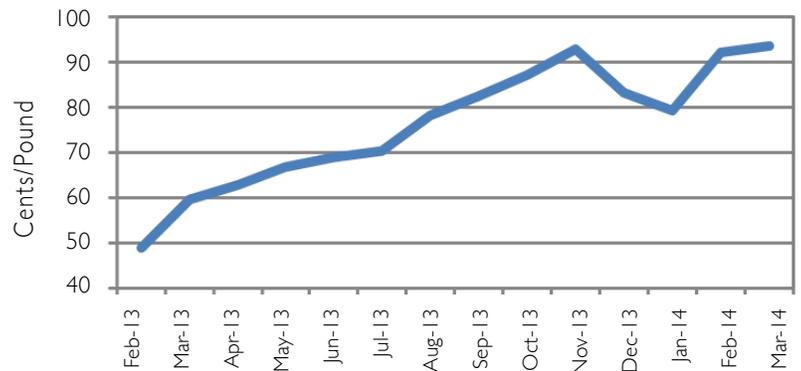
UB BROILER TENDERS, NORTHEAST



Health Trends Keep Egg Whites At Record Highs

Egg white prices took a seasonal break in early winter, but strong demand is back for spring and has sent prices to new record highs. Domestic supply gains have been minimal for a couple of years, thanks to a booming export market, and recent health trends have driven up demand. A key event was McDonald's adoption of the healthier egg, with the Egg White Delight. Raw liquid egg whites are in the mid-90 cent range and should remain there until the seasonal slump in May and June. This market segment is likely to remain very strong for the foreseeable future.

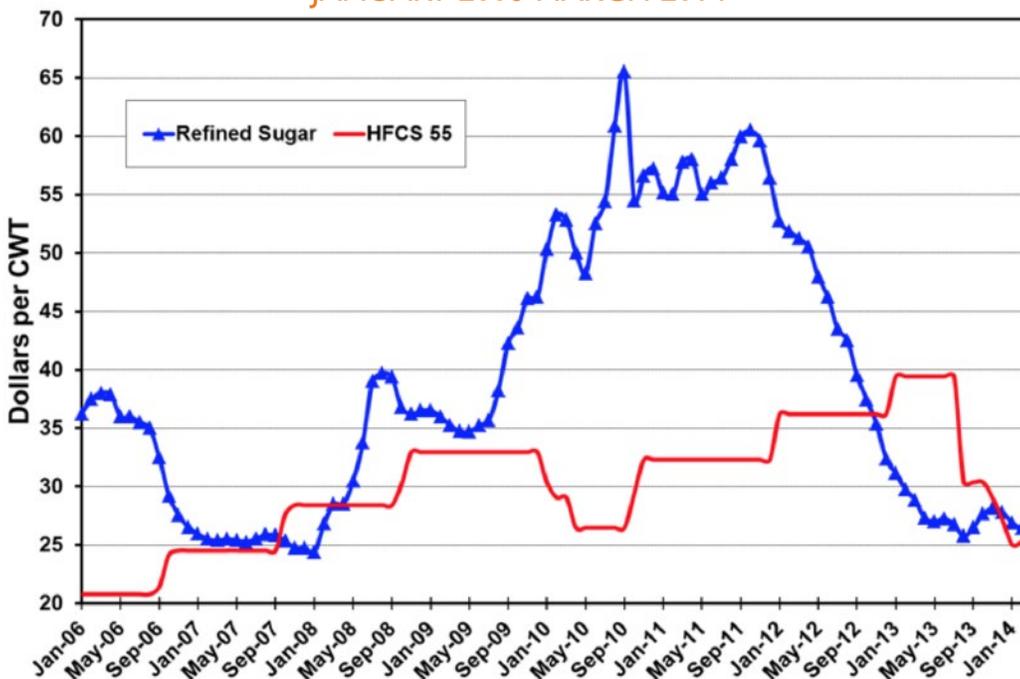
UB RAW LIQUID WHITES, NON-PASTEURIZED



Sweetener Prices Forecast To Remain Low

Sweetener prices remain low and should stay there late into 2014. Sugar prices are at a modest premium to corn sweetener prices and supplies should keep prices down through the fall. U.S. beet sugar production depends largely on growing conditions and with a plentiful crop season prices will head back down.

MIDWEST REFINED BEET SUGAR & 55 HFCS LIST PRICES JANUARY 2006-MARCH 2014



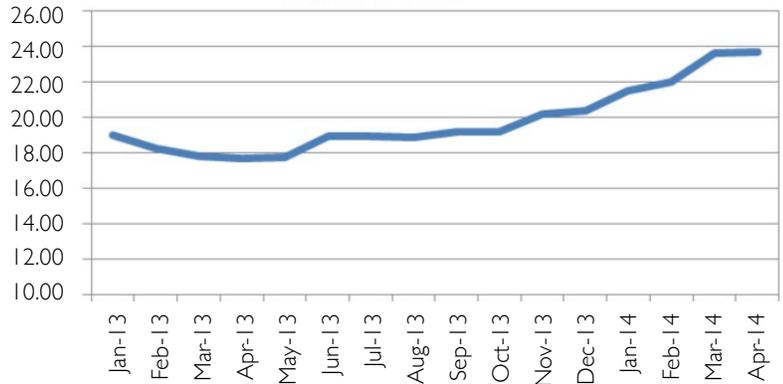
Sugar prices remain low and should stay there into late 2014.

More Moola For Your Milk

Fluid milk prices were up roughly 7% between February and March to reach record highs through April. The average price of a gallon of milk was \$3.56 last month, the main reason: a surge in exports to China and other Asian nations. Operators have been hit by a 36% price increase since December, and we anticipate that prices could rise another 25 cents to 50 cents this year. High cheese and butter prices are supporting the fluid milk price.



CLASS I MILK BASE PRICE

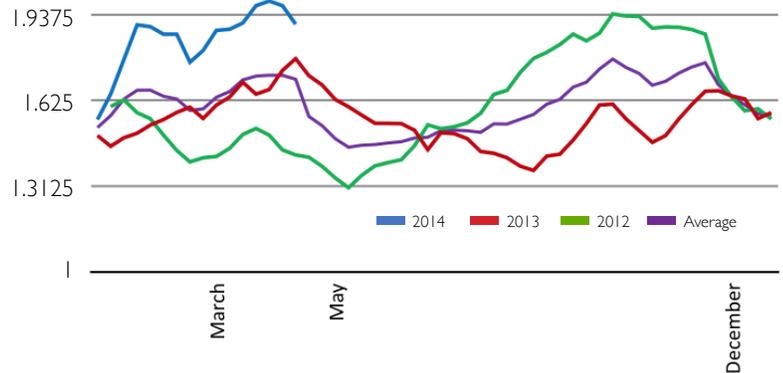


Milk Is Up, So Butter Follows

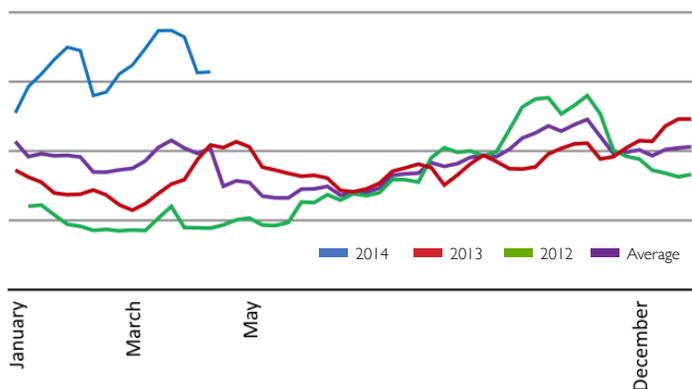
Butter was in the high \$1.80s during the first half of March. Strong domestic demand and exports are keeping inventories on the tight side and supporting the high price. Seasonally increasing production should push the market down later this spring, but prices will likely trend higher again over the summer. The market currently expects butter to remain above \$1.80 through November.



BUTTER AA - CME AVERAGE WEEKLY PRICE DOLLARS PER POUND



BLOCK CHEDDAR 40# - CME AVERAGE WEEKLY DOLLARS PER POUND



Say Cheese!

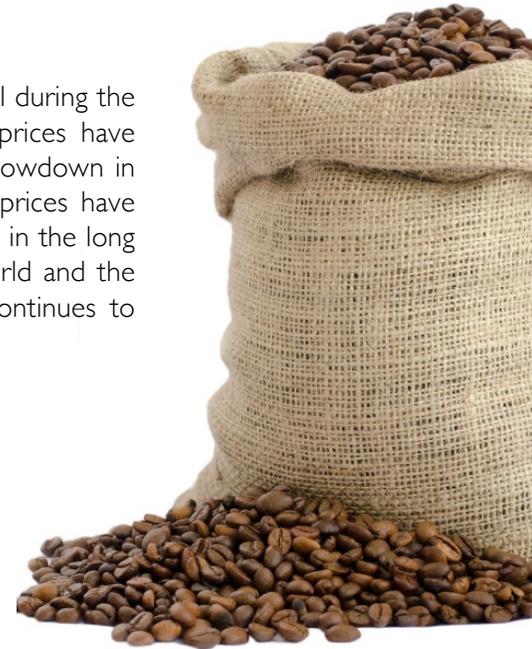
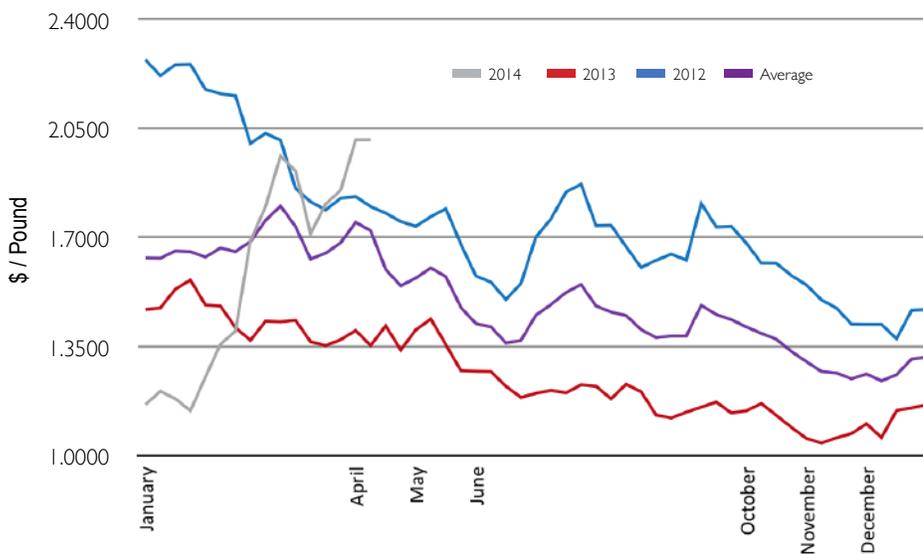
Cheese rallied to new record highs in March but has since relaxed to around the low \$2 per pound where it is expected to stay throughout the summer months.



Coffee's One Hot Commodity

Prior to harvest drought and possible El Niño this year could result in rains in Brazil during the second half of the year, which would slow the coffee harvest. Arabica coffee prices have already skyrocketed 70% this year (\$2.01/lb) because of supply concerns, and a slowdown in the harvest would only result in a further increase in prices. Historically, coffee prices have risen, on average, 10.2% during El Niño periods. Coffee prices are expected to rise in the long term primarily because of growing demand for the product in the developing world and the relatively inelastic supply of the commodity. In short, the increase in demand continues to outstrip the increase in supply.

COFFEE - (KC) NYBOT AVERAGE WEEKLY PRICE

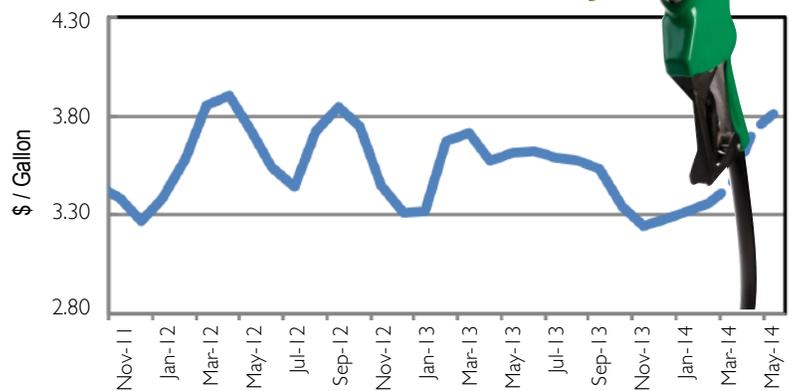


Arabica coffee prices have already skyrocketed 70% this year!

Gas Headed For The Normal Summer Increase

The retail price of all formulations for regular gasoline should average about \$3.45 before moving to the more expensive summer blend. Gas prices are significantly higher and likely to go higher still, which could make this the most expensive summer at the pump in five years. Batten down the hatches, for if there are any hurricanes or even hurricane threats to the oil platforms and refineries along the U.S. Gulf Coast, that could quickly cause price spikes across much of the nation.

U.S. RETAIL REGULAR GASOLINE PRICE



Sources

- Informa Economics
- Urner Barry
- U.S. Department of Agriculture (USDA)
- American Restaurant Association
- U.S. Bureau of Labor Statistics
- Chicago Mercantile Exchange (CME)