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KINGSMAN SUGAR EDITORIAL

April 5, 2019

Notes from Geneva

As the 9th Annual Geneva Sugar Conference comes to an end, we recall the key takeaways from this year's discussions and presentations.

The tone was given by an impromptu audience poll showing a large majority of participants expecting the front-month London#5 contract to be somewhere between $300-$400/mt and the white premium between $50-$80/mt by the end of 2019. The consensus was trapped in a range.

A look at fundamentals

Consumption growth slowdown was an important point of discussion, with several speakers, including large producers, showing negative growth rates for the EU going forward. Alexandre Luneau from Tereos said iso-glucose has not been taking a large share in the short term. But he has also highlighted that the company is addressing customer tastes evolution with a diversified portfolio of sweetening solutions, including sucrose, stevia, glucoses and fructose blends.

On top of changing habits, there has also been a flurry of new sugar taxes in Europe. Eight EU countries have introduced a sugar tax: Belgium, Estonia, Finland, France, Hungary, Ireland, Portugal and the UK. Soft drinks producers tend to reduce the sugar content in their products in an effort to avoid or reduce these taxes.

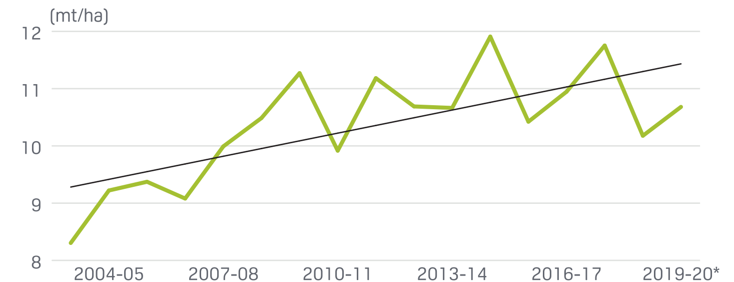
Discussions on production were heavily dominated by the neonicotinoid (neonics) potential impact on yields as well as on its potential disruptive impact on competition given that some countries allowed for exceptions. The ban affects about 70% of EU production but it was lifted in Poland and Belgium which are among the top producing countries. The range of estimates regarding the impact on yields varies widely though, with some institutes pointing to 15% reduction in beet yields while other studies mention a 50% reduction in areas under a maritime climate. What is undeniable is that the ban will increase production costs and decrease European competitiveness abroad.

S&P Global Platts Analytics' Daniel Rebelo reminded the audience that beet sowing has started relatively early this year thanks to favorable weather conditions in February. This contrasts with 2018's beet sowing, which was delayed due to a cold and wet spring. Early sowing turns beets more vulnerable and this is an important factor to take into account considering the ban on neonics.

Could the EU become a net importer in the foreseeable future?

The abolition of quotas in 2017 allowed for the freedom of production and exports. And if discussions ahead of the regulatory changes focused on how big of a net exporter the EU would be, this year there were no voices expecting the block to remain a net exporter in the near future. Actually the majority of speakers and panelist expect the 2019-20 production and consumption in balance.

EU: SUGAR YIELDS



*forecast
Source: S&P Global Platts Analytics

Historically the most important destination of EU sugar has the Mediterranean region but this trade flow, particularly towards North Africa, is partially at risk given the extra capacity that is due online in the near future. This will be an extra challenge for the EU in years of production and consumption surplus.

In one of the discussions, a question from the audience asked whether sub-Saharan Africa could be an increasing opportunity for EU producers. It is unquestionable the increasing opportunity that the continent presents, as showed by Alexander Stewart from Abercore.

However, processing and refining capacity in North Africa and around the Indian Ocean is increasing and so is competition. Other countries are looking at cane as a way to mitigate food dependency and the risk created by high currency volatility in many countries in the region. Finally, as highlighted in one of the panels, the EU may have a bigger interest in focusing on markets which are willing to pay a premium for their quality sugar instead of competing on price in highly price sensitive environments.

Even though some participants questioned about the impact of the low white premium on these projects in development, it is important to highlight that many of these are based on local feedstock (beet and cane) and target domestic markets, which mean they are much less impacted than tolling refineries.

What could shake the range?

Coming back to the initial paragraph, generally speaking there were little, if any, voices pointing to a clearly bearish or bullish view on world sugar prices. With the regulatory change, the EU and world prices have become more correlated and, as a consequence, the same applies to European prices. "Trapped in a range" was probably the most repeated

sentence. However, throughout the two days there were several hints about what could break the boundaries of this range.

One likelihood, according to Claudio Galimberti of Platts Analytics, is for higher oil and gasoline prices later this year due to the International Maritime Organization decision to lower the sulfur content on marine fuel oil to 0.5% from 3.5% globally. Basically overnight on January 1, 2020, this spec change will force the destruction of 3.5 million b/d of high sulfur fuel oil and a major increase of 2.3 million b/d in gasoil to compensate for that, which will be unprecedented and hugely disruptive for refiners. Balancing the new spec requirements in 2020 will require steps of increasing costs, which will result eventually in record gasoil to fuel oil differential.

Moreover, Galimberti added that global oil supply growth is slowing significantly this year and next, on deeper OPEC declines and slowing non-OPEC crude. As global oil demand growth remains robust, Platts Analytics' oil balances will be constructive going forward. Finally, Galimberti highlighted that diesel and gasoline prices in the US are expected to spike in Q4 and remain elevated in 2020, due to a combination of high crude prices and strong diesel and gasoline cracks. This will happen during a presidential election year in the US, and it's likely that fuel prices will be a topic in the campaign.

Interestingly enough, discussion with a refiner in the Indian Ocean about the IMO changes impact on sugar showed some in the market are well aware of its potential impact on freight rates and believe this will become a structurally relevant cost going forward. As IMO will impact the whole world, it will need to be factored in the white premium.

Another potentially disruptive factor is the weather. This week, Skymet predicted a below-normal monsoon due to a developing El Niño. In case this eventuates, Indian stocks could be locked in the country. In Center-South Brazil the weather in February and March has been excellent for cane development but the continuation of the rains would start disrupting the start of the harvest and could tight up both sugar and ethanol stocks in the region.

Back to Europe, Michael Sly from the National Farmers Union showed impressive data on how dry and warm this winter was across the UK. As the two days at the event in Geneva showed, there is no such thing as normal weather these days – on Tuesday the sun was shining and participants could enjoy the networking barbecue outside at spring temperatures, while on Wednesday it started to snow. Even though there is neither beet nor cane in the city of Calvin, this wide range of temperatures in two days reminds us that weather can be rather surprising.

Even though fundamentals and trade flows still show a surplus in coming quarters, all this is based on normal weather patterns as well as on current forward price curves for sugar, oil and currencies. And let's be candid, what are the chances that all these factors play out as initially planned?

In Thursday's editorial, we could not touch all topics and discussions that animated these two days, but we will continue to develop the key trends in upcoming reports.

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