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CHERRY - MARKET INSIGHT

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INSIDE THIS REPORT

Con Williams
Head of Investment Research, Economist
Tel: 021 241 6321
Email: conw@myfarm.co.nz

An analysis of the trends influencing the Cherry market prepared by Head of Investment Research, Con Williams.

SUMMARY:

New Zealand cherries continue to hold a premium market position in Asia. The 2018/19 season was a tougher production one with export volumes falling significantly, but prices responding with gusto climbing to an all-time high. This is despite increased Chilean competition and the general economic headwinds in China and other key markets.

Looking forward New Zealand production will continue to increase, driven by an expansion in the growing area along with new production systems and management practices driving increased yields. The lucrative Chinese New Year market window will remain critical, but growth in sales through e-commerce and high end retail are broadening the appeal of cherries outside the festive season.

With an increase in the number of NZ cherry exporters it is also becoming important to have a reputable brand. Paying higher prices means buyers are more discerning about New Zealand cherries – they know there are differences between brands. Quality can therefore not be compromised.

Buyers are also becoming more discerning about varieties – they have definite preferences for some varieties over others. This means as New Zealand supply expands it will be important to have the right variety mix on an orchard to ensure workload is realistically spread at the orchard end, and product demand is optimised at the market end.

Major cherry competitor, Chile continues to focus on improving fruit quality and its production forecasts are eye watering. While New Zealand will very much remain a niche producer the expansion of Chilean exports, with increasing volumes being produced in the lucrative Chinese New Year window and incremental improvements in quality, needs to be watched closely for its impact on New Zealand's market position.

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NEW ZEALAND PRODUCTION:

The 2018/19 season:

It was a tough production season for cherries in 2018/19. The export volumes out of New Zealand dropped to 2,900 tonnes (down 32% y/y) with weather events at critical times reducing production and export packout rates. In Central Otago there was a good fruit set, but a severe frost in late October caused damage to fruit development. Coupled with the Central Otago region receiving an unusually high amount of rainfall through December and January this impacted on fruit quality and export packout rates. While there were lower export packout rates, the sector's absolute focus on only exporting quality product and reduced supply was reflected in a sharp rise in market pricing. This provided some relief for overall earnings despite lower production. In terms of logistics the export season appeared to run smoothly with a smaller crop allowing a focus on airfreight as opposed to seafreight.

The trends:

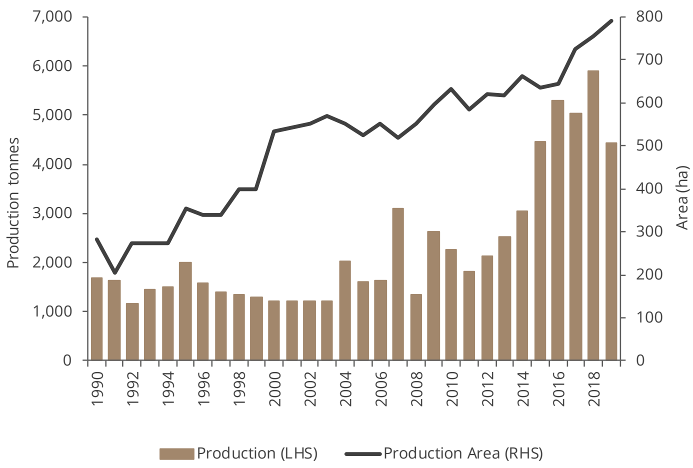
New Zealand currently produces around 4,500-5,000 tonnes of cherries each year from approximately 750-800 canopy hectares (cha). There are around 90 growers mostly at Central Otago (85%) due to the district's superior growing conditions. Expansion has been occurring at around 30 to 50 cha per year but is accelerating as capital from new sources emerges.

This expansion will see New Zealand production trend higher as the newly established orchards reach maturity. Average industry yields have been around 6-8 t/cha over the past four years. Industry yields have been volatile due to older style expansive orchard set ups, the lifestyle aspect of many orchards, the general nature of crop, and new greenfield developments over recent years having not yet reached mature production.

Newer cherry developments feature denser planting rates upward of 900-1,000 trees per cha, or even more in some cases. New tree training techniques (such as the Upright Fruiting Offshoots system - UFO) and pruning ensure plantings at higher tree numbers do not incur issues with light interception. Successful growing of any summerfruit is essentially all about harvesting sunlight. New varieties that possess a range of attributes - such as flavour, colour, size etc - are being grown on Colt rootstock. Secondary growing areas are being exited from and new management systems employed too.

These newer developments are expected to achieve gross yields at maturity around the 13-17 t/cha mark with fruit sized between 28-32 millimetres in width. Higher yields can be achieved, but fruit size and quality are likely to be reduced which in turn reduces the pack out rate and proportion of fruit that can be marketed to the higher value export markets.

Figure 1: New Zealand's cherry production and production area



Source: MyFarm, FAO, Fresh Facts, Statistics NZ

NEW ZEALAND MARKET PERFORMANCE:

New Zealand is fortunate to produce cherries at a time perfectly aligned to suppling the lucrative Chinese New-Year market. More specifically the Central Otago region's favourable growing conditions for cherries provides a competitive edge in its ability to consistently deliver fruit that is firmer, fresher, sweeter, and of the highest quality. Often given as a gift, consumers very much view Central Otago cherries as a luxury food item for this festive occasion.

Due to New Zealand's high-quality position there is minimal direct competition from other Southern Hemisphere producers, who have traditionally been more commodity focussed. Of course Northern Hemisphere producers can't produce or store cherries to market for the Chinese New Year period.

The consistent high quality, New Zealand brand and value-add formats employed by New Zealand exporters result in our cherries holding a significantly higher price point. Demand for this type of product during the festive season is virtually insatiable. The short window of supply (December through to early February) also provides a scarcity factor helping ensure New Zealand cherries are viewed as an exclusive novelty product.

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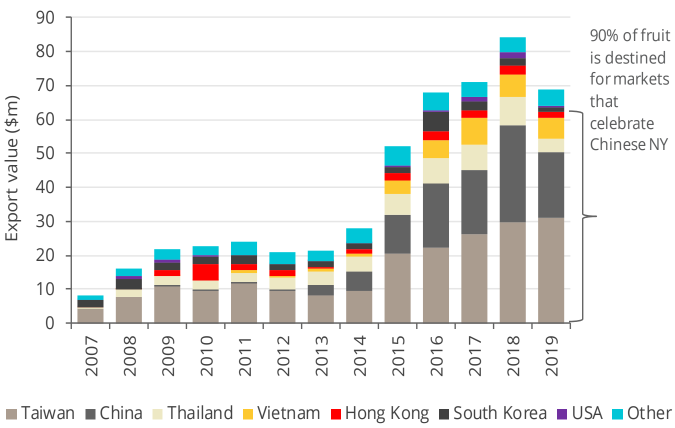
New Zealand's cherry sector is very small in the scheme of global production (0.1%) and international trade (0.5%). Its niche is an ability to supply high-quality and super fresh cherries for the main festive season in Asia – Chinese New Year. For this seasonal window there are only four Southern Hemisphere producers that can service this market, with only Chile and Australia offering any real competition. In New Zealand's case 80-85% of production is exported fresh with the majority (90%) destined for Asian countries that celebrate Chinese New Year.

Figure 2: New Zealand exports by major market

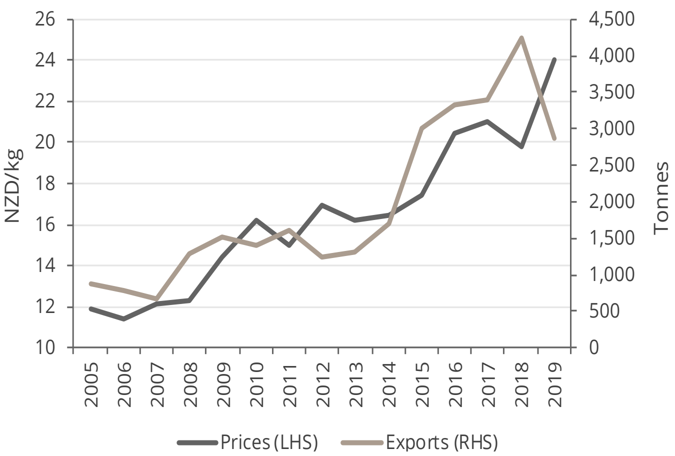


Source: MyFarm, Statistics New Zealand

The 2018/19 season:

In the season just finished while New Zealand production was down, average export prices rose an impressive 21% y/y to an all-time high of $24/kg. While the shortage of New Zealand product was the main driver the market price response given Chilean competition, shows very positive underlying demand fundamentals for high-quality New Zealand product.

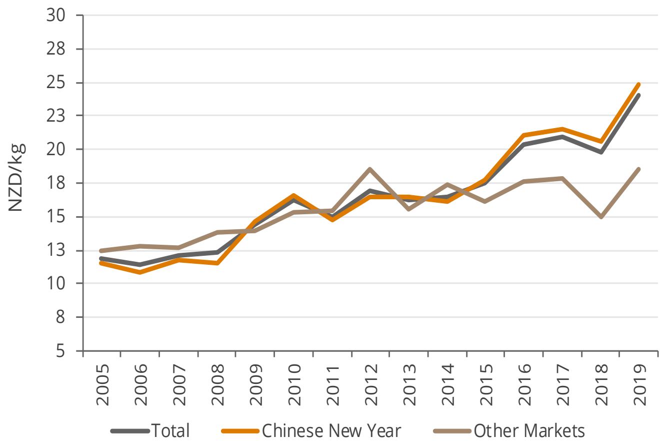
Figure 3: New Zealand export production and prices



Source: Myfarm, Statistics NZ

The Taiwanese market appears to have been prioritised in 2018/19 with its market share jumping to 43% of total export volumes, from the mid-30% mark previously. The mainland Chinese market share dropped to 28% of total export volumes, but was the highest paying market at $25.90/kg. Chinese New Year fell in early February this year, which meant New Zealand struggled to have maximum volumes available for the peak demand period in the fortnight immediately prior. Elsewhere most other smaller markets experienced a drop-in market share. Thailand experienced the largest drop (to 7% from 12%), while Vietnam was one of the few that saw a small increase (to 9% from 8%). The shortage of supply in the smaller markets saw a large increase in prices. However, prices achieved from the Chinese New Year markets remained at a greater than 30% premium to all other markets.

Figure 4: Long term New Zealand pricing trends



Source: MyFarm, Statistics New Zealand

Stepping back and looking at longer-term trends shows the return profile between the major Asian markets is similar, ranging from $18-22/kg (free-on-board level). The consistently highest paying markets are Hong Kong, China and Taiwan, which account for around 70% of total export earnings. Fruit in these markets is sold through a mix of modern and traditional platforms including high-end retail (i.e. gift, souvenir, and duty-free shops) and e-commerce channels.

The key growth channel is e-commerce where consumers can learn about the benefits of consuming cherries and how they are produced. In addition it is easier to manage and maintain high quality fruit through the e-commerce cool chain. This is particularly important with cherries as they are highly perishable. In an e-commerce channel fruit is delivered directly to consumers from a central warehouse within one or two days, and some cases, within hours. When extra links in the cool chain are included the

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risks to a highly perishable fruit such as cherries increases substantially.

The other key Asian markets include Thailand and Vietnam where new young consumers, with growing levels of disposable income, are increasingly drawn to luxury items like New Zealand cherries and SunGold kiwifruit. In both markets the rise of high-end modern retailers is attracting tourists and consumers through offers of quality fruit and produce in value-add formats.

In-store promotions, tastings, and point-of-sale displays have proven to be effective in increasing product awareness amongst many Asian markets and have increased sales during promotional events. Hosting training seminars for traders and retail managers for product handling, and tips to increase profitability has also helped build support for imported products. Packaging design remains important to stimulating sales, especially during holiday seasons. In particular Chinese consumers tend to buy visually attractive, well-packaged products as gifts for important contacts or relatives. For example, consumer-ready cherries in 1-2.5 kg packages have become especially popular.

New Zealand continues to have a very good name in its key markets. New Zealand average export prices have had a strong run since the early 2000's increasing 4% per annum over this period. Prior to this year's spike New Zealand returns had plateaued in the $20-21/kg range. But with an increase in the number of lines out of New Zealand it is also becoming important to have a reputable brand. Paying higher prices means buyers are more discerning about New Zealand cherries – they know there are differences between brands. Quality can therefore not be compromised.

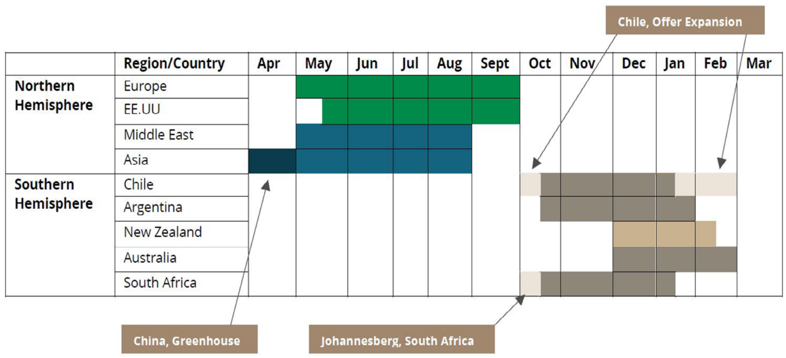
Buyers are also becoming more discerning about varieties – they have definite preferences for some varieties over others. This means as New Zealand supply expands it will be more important to have the right variety mix on an orchard to ensure workload is realistically spread at the orchard end, and product demand is optimised at the market end.

CHINESE & SOUTHERN HEMISPHERE COMPETITION:

The key competitive forces for New Zealand cherries come from other Southern Hemisphere producers targeting Asian markets during the December to early February period.

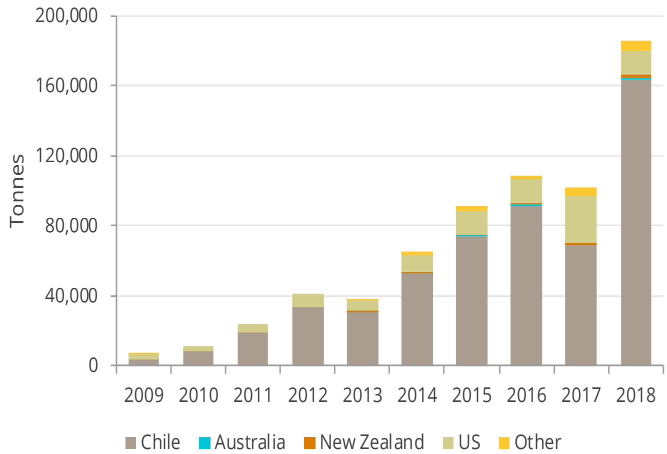
Within China, production of sweet cherries has been growing rapidly, but this is counter seasonal to Southern Hemisphere supply. In total China's sweet cherry bearing area and total production are both estimated to have more than doubled over the past seven years. Expansion into new growing areas and glasshouse production (estimated 10,000 hectares!) has seen the domestic production window spread from early-March through to late-July. Coupled with the growth in imports this has increased availability to more than half the year, supporting its consumption as an everyday fruit. In any other country, such rapid expansion would have led to dramatic falls in prices and a pullback in sector expansion. However, given the size of the overall Chinese market, the increased production has so far been easily absorbed by the local market.

Figure 5: Global ripening window for cherries



Another indicator of the potential size of the Chinese market is its ability to absorb an ever-increasing volume of imported sweet cherries, both during its main production period, and the off-season. Just under a decade after fresh sweet cherry imports were first permitted, imports have risen to 186,000 metric tonnes. The majority (70-85%) of this comes from Chile, which exports to China during the December to February period at a similar time to New Zealand fruit.

Figure 6: Chinese sweet cherry imports by country



Source: USDA

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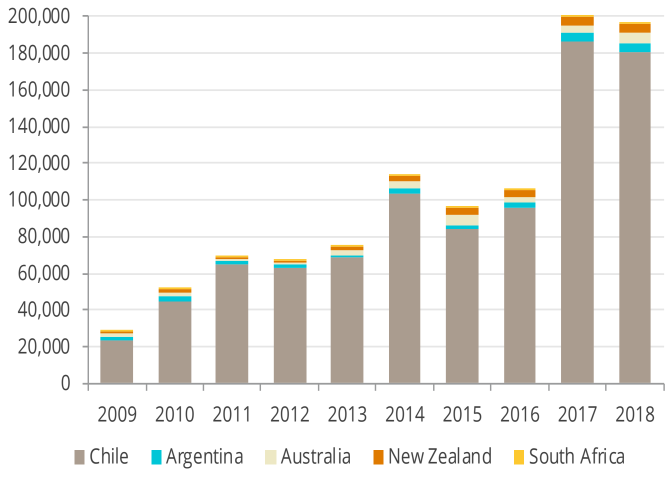
For much of its modern history, the Chilean sweet cherry industry expanded area and production in step with the steady expansion of off-season sales in the high-income markets of Western Europe and North America. While those markets remain important, they have become overshadowed by the boom in imports by mainland China in recent years. Indeed, their exports to China have leapt from less than 4,000 metric tonnes in 2009 to 163,500 metric tonnes in 2018. China now accounts for nearly 90% of Chilean exports, dwarfing those from all other countries.

The prospect of continuing meteoric growth in Chinese imports has fuelled a boom in plantings of sweet cherries in Chile, often in place of other tree fruits. The total growing area is now in excess of 30,000 cha and total production has risen substantially to well over 200,000 tonnes, the majority of which is exported (85-90%).

The forward-looking view is that production volumes could double in the next five years due to aggressive new plantings, particularly in the south of Chile. This will also increase their market offering of product in the January to February window. This could well increase competitive tension with increasing export volumes out of New Zealand at the same time. So far the experience has been a flat in-market pricing trend for Chilean fruit, but increasing one for New Zealand.

Figure 7: Southern Hemisphere sweet cherry exports



Source: USDA

While New Zealand will very much remain a niche producer with potentially only 10,000 tonnes of exports (up from 3,000-4,000 tonnes currently), the expansion of Chilean exports, with increasing volumes being produced in the lucrative Chinese New Year window and incremental improvements in quality, needs to be watched closely for its impact on New Zealand's market position.