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Sugar Outlook: Sweeter Times Ahead for Sugarbeet Growers and Processors

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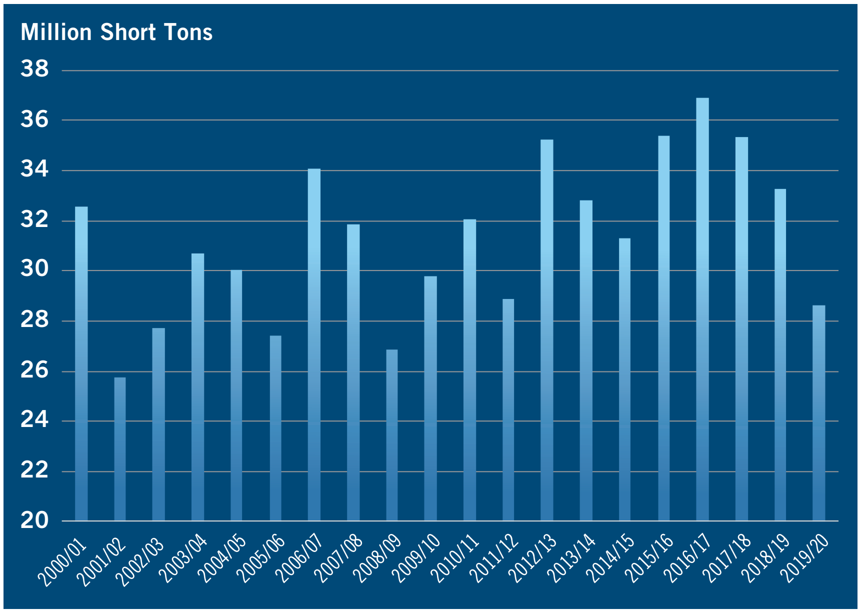
Key Points:

- The severe crop production losses for the 2019-20 marketing year inflicted significant financial stress on many U.S. sugarbeet growers and processors.
- Many U.S. sugarbeet growers financed their spring crop planting with crop insurance indemnity payments and financial aid from USDA while processors struggled with less throughput and lower extraction rates amid high fixed costs.
- The smaller Mexican cane sugar crop and capacity constraints to convert raw sugar to refined sugar in the U.S. will continue supporting U.S. sugar prices heading into this fall's sugarbeet harvest, which should allow U.S. processors to market their expected record crop at lofty prices.
- COVID-19 has had minimal impact on total U.S. sugar demand, but processors will be watching retail and food service sales closely in the months ahead as state and local economies reopen.
- Assuming normal harvest weather returns this fall, U.S. sugarbeet growers and cooperatives are expected to have a stronger year financially for the 2020-21 crop. Improved production and high prices offer a much needed recovery from the stressful 2019-20 growing season.

Introduction

The U.S. sugarbeet industry has experienced multiple financial stressors from production losses in some regions of the U.S. stemming from reduced sugarbeet harvested acreage, lower quality sugarbeets, and an abbreviated processing season that has hurt both growers and the cooperatives that process the sugarbeets into refined sugar. Some processors had to declare force majeure on contracted sugar in affected areas as a result of the significant loss in sugarbeet production. Although refined sugar prices have rallied, the 2019-20 sugarbeet harvest had been previously marketed at much lower prices. The steep loss in production hurt both processors and growers, with USDA stepping in to provide $285 million in financial aid to U.S. sugarbeet growers in April 2020 in time for planting of the 2020-21 sugarbeet crop. This financial support helped stressed growers cover planting costs.

EXHIBIT 1: U.S. Sugarbeet Crop



Source: USDA-NASS

Sugarbeet farmers are again experiencing less-than-ideal planting conditions this spring but have an improved planting pace compared to last year's complicated spring planting season. Assuming a return to normal harvest weather this fall, expectations are for a much bigger 2020-21 crop to be harvested. With processors also contracting refined sugar at much higher prices, fortunes are expected to turn favorable for growers and processors next marketing year.

Lower Production

The U.S. sugarbeet harvest last fall made the record books with production notching the fifth biggest YoY decline on record, falling 14% YoY to 28.6 million short tons for the 2019-20 crop year *(Exhibit 1)*. Crop production in three major sugarbeet-producing states in particular – Minnesota, North Dakota, and Nebraska – fell more than 20% YoY. Abandonment rates nationwide skyrocketed to the highest level since the Great Depression with 13.5% of U.S. planted acres not harvested due to ongoing wet weather issues stalling field operations through the fall and winter. Yields, meanwhile, also fell to the lowest level in five years due to late planting and poor harvest conditions.

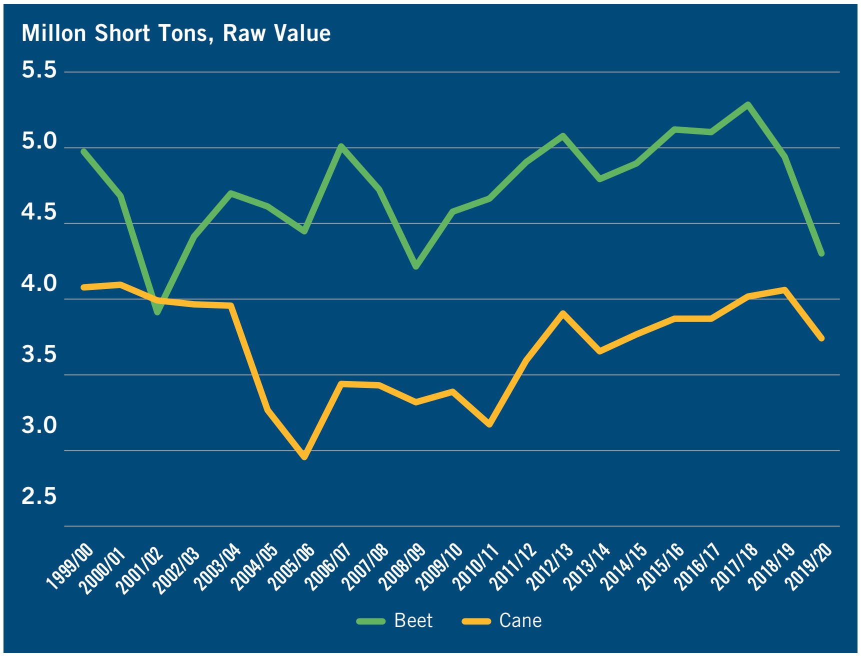
Farmers who sustained crop losses recouped some losses through crop insurance indemnity payments, while farmers who did manage to harvest the crop still suffered from losses on yield and quality. To the extent permitted in the marketing agreements between growers and cooperatives, farmers were also assessed liquidated damages for beets not delivered. While refined sugar prices rallied following the disastrous harvest season, sugarbeet growers have not yet benefited from the price rally since sugar from processing cooperatives was marketed the year prior at lower prices.

To support U.S. sugarbeet growers heading into the 2020-21 growing season, USDA delivered $285 million in relief payments to sugarbeet growers via sugarbeet cooperatives across the country through Wildfire and Hurricane Indemnity Program-Plus (WHIP+) in March and April, playing an integral role in helping farmers finance the planting of the 2020-21 crop sugarbeet crop.

Processors were also negatively impacted by the steep drop in sugarbeet production. Some processors declared force majeure on contracts with buyers due to the crop losses. And because sugarbeet processing plants also have high fixed costs and can only process sugarbeets, processors in areas with big crop losses suffered significant financial losses.

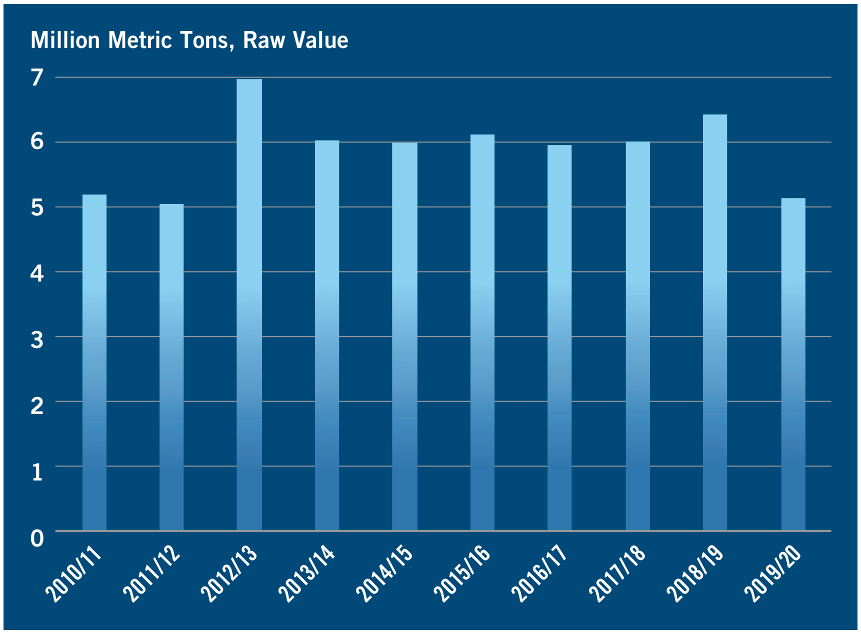
Lower sugarbeet quality also impacted processors' profitability. Hard freezes and early frosts last year hindered sugar accumulation in beets with the nationwide average sugar extraction rate from slice falling to 14.3% this year – the lowest since the 2016-17 crop. However, with fewer beets to process, processors were able to make up for lower beet quality by slowing the processing pace to push extraction rates higher.

EXHIBIT 2: U.S. Sugar Production



Source: USDA-NASS; USDA-FSA

EXHIBIT 3: Mexican Sugar Production



Source: USDA, Sugar and Sweeteners Outlook

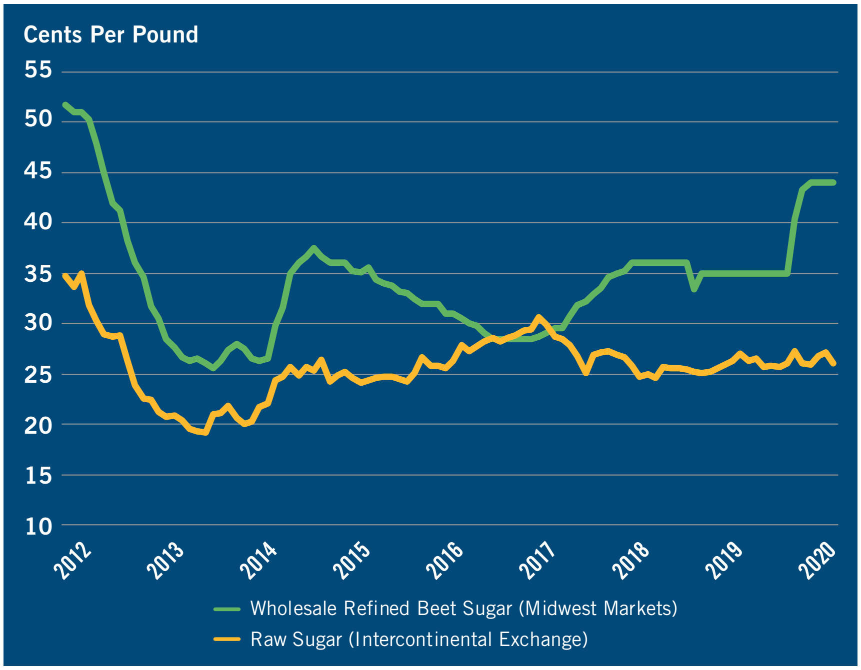
Total beet sugar production this marketing year is 4.3 million short tons raw value (STRV), down 13% YoY according to USDA's latest estimates. U.S. production of raw sugar from cane was also down because of a poor harvest in Louisiana. Total cane sugar production for 2019-20 is estimated at 3.7 million STRV, down 8% YoY *(Exhibit 2)*.

To replace the drop in U.S. domestic sugar supplies, USDA has raised the tariff rate quota (TRQ) for both raw and refined sugar to allow for imports, particularly from Mexico. Fifteen percent of U.S. sugar demand is allowed to be filled by imports, per the U.S. Farm Bill, which is managed by a quota system. Under the Suspension Agreements that govern sugar exports from Mexico to the U.S., Mexico is given the first right to fill U.S. import demand for sugar.

However, just as the U.S. suffered a significant drop in sugar production and raised the TRQ to allow for more sugar imports from Mexico, drought cut the Mexican cane sugar crop to the lowest level in seven years *(Exhibit 3)*. Mexico is not expected to not meet the higher allowance into the U.S., while imports from other countries outside Mexico are not expected to fully meet U.S. demand due to higher tariffs and costs.

Further limiting the supply of refined sugar in the U.S. are capacity constraints limiting the processing of raw sugar into refined sugar. While sugarcane refiners' melt has been running at record pace in 2020, the increase in processing of raw supplies into refined has yet to

EXHIBIT 4: U.S. Sugar Prices



Source: Milling & Baking News; Intercontinental Exchange; USDA-ERS

meet demand. According to the most recent USDA data, refiners' melt in March was up 18% YoY at 650,000 STRV. Even if the current break-neck pace continued through the remainder of the marketing year, the processing of raw sugar would still not meet total U.S. demand for refined sugar.

The threat of plant slowdowns or shut downs resulting from a COVID-19 outbreak is low. Since workers in processing plants are generally not in close contact and precautions are being take to maintain social distancing in closer-contact areas of the plant, processors do not expect production interruptions, mechanical repairs notwithstanding.

U.S. Demand Holding Strong

COVID-19 has had minimal impact on total demand for sugar in the U.S. While total sales to sugar buyers in the food service sector has suffered due to the loss of customers from social distancing and shelter-in-place laws, retail sales to consumers during the pandemic has skyrocketed.

With demand remaining stout in the U.S. and refined sugar supplies tightening, the price of Wholesale Refined Beet Sugar has surged to 44 cents/pound, up from 35 cents/pound last fall and the highest since 2012. Raw sugar prices, though, have held steady at around 25 to 27 cents/pound over the past two years *(Exhibit 4)*.

With demand for refined sugar holding strong and capacity constraints limiting the amount of raw sugar to be processed into refined sugar in the U.S., refined sugar is expected to maintain a significant premium over raw for the remainder of the marketing year which ends in August when the 2020-21 slicing campaign begins and new crop supplies enter the market.

The wild card, though, is food service demand and how the sector responds to the gradual opening up of the U.S. economy in the weeks and months ahead. With consumers having stockpiled sugar at the start of the COVID-19 pandemic, retail sales are widely expected to drop off as consumers use sugar supplies sitting on pantry shelves. However, sugar processors will be closely watching how food service demand recovers. If the recovery of food service demand is weaker than expected and retail sales slow, USDA could readjust TRQs for imported sugar.

Outlook

Growers and processors are expected to see better than normal conditions in 2020-21 following this year's stressful year wrought with extreme weather and market uncertainty.

While wet field conditions again disrupt spring planting efforts for sugarbeet growers, total acreage planted is expected to increase YoY and drive total production higher despite the expectations of lower yields caused by later

planting. USDA's Prospective Plantings report forecast U.S. sugarbeet acreage at 1,138,500 acres for 2020, up slightly YoY by 6,500 acres. Total acreage, though, will likely be revised upward with farmers expected to make up for lower yields to fulfill their shares of contracted beet production with processors. USDA currently is predicting the 2020-21 sugarbeet crop currently being planted to be 18% larger YoY at 33.7 million short tons – assuming a return to normal harvest weather this fall.

With processors contracting an expected large crop in today's strong price environment, cooperatives are expected to be in a much-improved financial position, enabling them to make debt payments, reinvest proceeds to make plant upgrades, and disburse more to co-op members.

Sources

Crop Progress Report: https://usda.library.cornell.edu/concern/publications/8336h188j

Prospective Plantings Report: https://usda.library.cornell.edu/concern/publications/x633f100h

USDA Sugar & Sweeteners Outlook: https://www.ers.usda.gov/publications/pub-details/?pubid=98274

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