Reflections from BMO's Farm to Market Conference

For a sector that's been around for centuries, there sure is a lot happening in the food, agriculture, consumer and retail industry today. From trade and technology to diseases and demand, the sector is undergoing significant changes – all of which could impact your business and the investments you make.

On May 15 and 16, BMO Capital Markets hosted its 14th annual Farm to Market Conference, where the company's leading FCR Equity Research team discussed the many issues impacting the industry. A few days later, BMO's analysts came together for a follow-up roundtable where they delved even further into the trends they're seeing across the food-related landscape.

The roundtable included **Ken Zaslow** (food and agribusiness), **Kelly Bania** (food retail), **Joel Jackson** (fertilizers and chemicals), **Amit Sharma** (food and beverage), **Andrew Strelzik** (restaurants) and **Tamy Chen** (cannabis). Here is what they think should be on people's radars.

Trade uncertainty continues

Trade was on everyone's mind at the conference. Earlier this year, China slapped 25% tariffs on American soybeans, among other products, and it's now adding further duties on U.S. pork, fruit and more. With the U.S. currently in a full-blown trade war with China, it's unlikely these tariffs will be removed anytime soon. That's a headwind for crop growers, food sellers and everyone in between.

"China's not buying as much corn or soybeans, and that's putting downward pressure on input prices on the feed side, but it's also slowed the agribusiness merchandising side," says Zaslow. "The ADMs and Bunges of the world are not moving as much from the U.S. to China."

Trade concerns are also causing farmers to plant fewer crops – if China's buying less, then farmers will adjust their supply – and that impacts fertilizer companies.

"We're hearing from our commercial ag lenders that a lot of growers are holding back on using fertilizer applications on their last acres because of the trade uncertainty," says Jackson.

Food, Consumer & Retail Analyst Team

Ken Zaslow Food & Agribusiness
Kelly Bania Food Retail
Joel Jackson Fertilizers & Chemicals
Amit Sharma Food & Beverage
Andrew Strelzik Restaurants
Tamy Chen Cannabis

If the U.S. and China resolve their differences, then expect food trade flows to pick up significantly, adds Zaslow. China, which put 70% tariffs on U.S. ethanol imports, would likely increase its ethanol purchases substantially, while more chicken, beef and pork would cross borders, too.

"A resolution would enhance ethanol margins in the U.S., while agribusiness margins would increase because there would be a greater flow of product," he says. "You'd see a change in trade flows across all business products, which would enhance margin structures."

African swine fever's big impact

As much of an effect as trade is having on food flows, there's an even larger issue food companies are facing: African swine fever. The disease has wiped out about 200 million pigs in China so far, which has been detrimental for global pork supply.

"The fever has the potential to be one of the most epic events in the protein industry in the last 50 years," says Zaslow.

While it's still unclear exactly how this will play out, if China does lose up to 30% of its hog supply, which is expected, it will need to buy protein from other countries. Pork prices will then spike, and consumers will have to pay more for their food.

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"There's a pretty high likelihood that you will see inflationary pressures starting in the summer and lasting for at least six to 12 months, if not longer," he says. "How quickly the U.S. and the rest of the world will be able to supply China will be the key determinant of the inflationary pressure over the long term."

African swine fever has the potential to impact nearly every part of the supply chain, including restaurants, says Strelzik. When it comes to this part of the sector, margins have a big impact on a company's share price. If margins are weak, as they were during the most recent earnings season, then stocks tend to sell off. Naturally, restaurant owners are worried about how the fever might impact their margins and earnings going forward.

"The most topical conversations I had at the conference were around the fever and how that might impact the restaurant industry," he says. "We talked about how it could affect their ability to price, the opportunities to mitigate this issue and the relative impact it could have on earnings."

Rapidly changing consumer demand

At some point, trade and fever issues will resolve themselves, but continually changing consumer habits could have a longer-term impact on the sector. Bania, who covers food retail, says the pace of change across consumer, retail and distribution is shifting rapidly and "companies have to adapt." She still sees a trend toward healthier eating, including fresher and more convenient food options, while there continues to be a strong consumer interest in ethnic foods.

Bania is also paying careful attention to how food delivery is changing – more people are ordering groceries online and having them delivered, for instance – and how changing labor force needs might impact employee retention rates and retail margins. Staff want more flexible hours and additional training, for instance, while the gig economy is affecting the nature of work overall.

"Companies are having to not only adapt to what the consumer wants, but also to what their employees are looking for," she says. "Companies have to manage through these different demands in a very tight labor market."

For Sharma, who covers food and beverage, one topic of interest that came up at the conference was the willingness of companies to pass tariff-related cost increases on to the consumer. Businesses think consumers can handle the price increase.

"If tariffs are going to be imposed and costs go up, then they'll pass them on to the consumer," he says. "There's no ambiguity about it. They're not thinking about what will happen with demand. That's a little different than how they've talked in the past."

Finding the right technology

When it comes to technology, companies across the industry are looking at ways to become more innovative. For restaurants, that means using tech to appeal to changing consumer demands. In such a competitive industry, though, that's easier said than done, says Strelzik.

"How do legacy brands appeal to changing tastes and preferences?" he asks. "We're talking about delivery, the importance of technology, drawing people into your app. How do you balance your own delivery app with third-party delivery? What's the best mechanism to reach your customers? There's a lot of debate about the right strategy."

Many companies haven't been as thoughtful with their tech investments as they should be, adds Strelzik. They've rushed into tech, adopting the easiest solution instead of a long-term one.

"It was almost like, let's get involved and then we can figure out what to do after that," he notes.

On the fertilizer and seed side, biotechnology is playing an increasingly important role. Over the next couple of years, new biotech-enhanced seeds will be rolled out by the big industry players, Jackson says. As well, many larger companies have started to partner with biotech startups to bring innovative products to market.

"We're going to see biological and microbials get ready for prime time in the coming years," Jackson says. "Farm to Market was a bit of a launch party for these new types of products."

Technology Investments Could Spur M&A

Technological innovation may also spark more M&A activity, says Bania. While many of the larger food distributors are incorporating new technologies into their businesses, some smaller, regional competitors, such as the private family-run operations, are finding it difficult to invest in tech. That could drive some of them to look for buyers willing to take their businesses to the next level.

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"A lot of small regional players just don't want to make those investments, and so that may cause businesses to move forward with selling the company," say Bania. "So that's a pretty clear outlook for food service distributors, which are in a consolidation phase."

In the food and beverage space, companies are taking more of a wait-and-see approach to M&A, says Sharma. Businesses are looking for complementary pieces to add to a portfolios. And while companies want to be opportunistic, they're also mindful about how much they're paying for these acquisitions. "You're going to see patience," he says.

Clearly, the food industry is facing some big issues that affect the entire food supply chain. Companies will need to figure out how to keep growing in the face of these challenges, while investors will need to determine which businesses can handle this change the best.

Supply issues remain for still-nascent cannabis industry

For the first time, the Farm to Market conference included a cannabis analyst and cannabis-sector attendees. The message they heard? While cannabis may be legal in Canada, it's still early days for the industry.

Tamy Chen, cannabis analyst with BMO Capital Markets, says the market has gotten off to a slow and costly start. Companies have been faced with growing challenges, which isn't surprising considering no one has ever tried to grow this much cannabis legally before, and that's impacted supply. Advertising restrictions have also made it difficult for retailers to properly brand themselves. Chen believes the sector will likely remain undersupplied for at least the next two years.

However, there is a bright spot: Companies will be allowed to sell vape pens, edibles and beverages, all of which come with better margins and better branding opportunities.

"That's the milestone we are waiting for this year," she says.

Due to some of the challenges Canadian producers have had, investors have focused on U.S. cannabis companies. While cannabis still isn't legal at the federal level, the state market is larger than Canada's, and companies don't have the same branding restrictions.

Chen is watching to see how Canadian companies take advantage of the U.S. market, which some are now trying to do. If they can expand their global reach and partner with a U.S. cannabis company, then their stock prices may continue to rise.

"That could potentially drive some of these Canadian stocks, irrespective of the slower fundamental aspects of the Canadian companies' businesses," she says.

In any case, this industry is very young, says Chen, so expect a lot of change in this market over the next few years.

"Most of the companies speak to a long-term strategy saying they will have brands that will get traction in the consumer markets," she says. "Investors are trying to better understand that, but it's still very early stage."

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