Sugar Price Survey

August 2014

AMERICA’S SUGAR PRODUCERS… Meeting America’s Needs
Introduction

On July 14, Hershey Co. announced that it was raising prices of its products by 8 percent to “help offset part of the significant increases in Hershey's input costs, including raw materials, packaging, fuel, utilities and transportation, which the company expects to incur in the future.”

In other words, Hershey – which also announced a 5.4 percent quarterly profit increase just days later – is immediately increasing prices for grocery shoppers to further boost revenues because it might see higher input costs in the future.

Hershey’s entrée into future telling appears to be fueling other big moves within Big Candy circles, too. Mars Chocolate North America told an industry trade publication on July 25 that it would increase prices by 7 percent.

Price increases by large candy companies are nothing new. History has shown that the cost of sweetened products rise consistently regardless of what’s occurring in commodity markets.

For example, a Hershey bar cost about 35 cents in 1983, and the biggest ingredient in that bar, sugar, made up about two cents worth of its cost. By 2013, the cost of that same Hershey bar had risen to $1.39, and sugar still just constituted about 2 cents worth of its cost.

That is because, unlike candy prices, sugar prices have remained remarkably flat over the long haul. The average price that candy companies paid for sugar in the 1980s was 27.06 cents per pound. In the 1990s, it averaged 26.63 cents; in the 2000s, 27.79 cents; and in 2013, 27.22 cents.

With a setup like this – steady price increases for its products and low, stagnant prices for its biggest ingredient – it is not surprising that confectioners are outpacing other food makers in the profit department. In fact, the candy industry’s net profit margin at the end of 2013 averaged 12.3 percent, according to Yahoo!Finance statistics. That number is even more impressive when you compare it to the 7.3 percent profit margin for aerospace and defense contractors or the 6.2 percent profit margin for major oil companies.

So with all the good news, why have large candy companies engaged in a multi-million-dollar lobbying effort to imperil U.S. sugar producers and leave the country dependent on foreign suppliers? Because they believe inefficient foreign industries can undercut U.S. prices by using subsidies and low labor and environmental standards.

But Congress has rebuffed Big Candy’s lobbying efforts on every occasion because U.S. sugar policy works. Confectioners are very profitable and efficient U.S. farmers have a fighting chance to survive amid a sea of foreign sugar subsidies.
The U.S. Sugar Market

When discussing sugar prices in the United States, there are three prices to consider: the raw price that sugarcane processors receive from refiners who extract molasses from the sugar; the wholesale refined price that food manufacturers and grocers pay to refined cane and beet sugar processors; and the retail refined price that grocery stores charge consumers for the wholesale sugar they procure from processors.

In the case of raw and wholesale refined sugar – the prices that farmers, mills, and processors receive for their production – the price picture has changed very little since the 1980s. In fact, the prices in 2013 were almost identical to 30 years earlier and were 55 percent cheaper when adjusted for inflation.

<table>
<thead>
<tr>
<th>Producer Prices</th>
<th>’80s Average</th>
<th>‘90s Average</th>
<th>‘00s Average</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Raw Sugar</td>
<td>22.16 cents/lb.</td>
<td>22.03 cents/lb.</td>
<td>21.36 cents/lb.</td>
<td>20.46 cents/lb.</td>
</tr>
<tr>
<td>U.S. Wholesale Refined Sugar</td>
<td>27.06 cents/lb.</td>
<td>26.63 cents/lb.</td>
<td>27.79 cents/lb.</td>
<td>27.22 cents/lb.</td>
</tr>
</tbody>
</table>

The static nature of pricing over the long haul has meant that sugar producers cannot offset increases in fuel, machinery, labor, transportation, and other input costs through sugar price hikes like manufacturers of most other products.

Since 1980's:
Producer Price for Sugar Has Fallen 8%
While Farmers’ Costs Have Soared

Key farm inputs costs have increased even more than the rate of inflation

Sugar price data source: USDA, Table 4: Raw cane sugar prices, #16 contract.
The resulting tightened returns have created tremendous pressure on the entire U.S. industry, from sugar farmers to beet processors, cane millers, and refiners. And with 142,000 associated jobs and $20 billion in annual economic activity, such revenue anxiety in the sugar sector reverberates throughout the rural landscape.

U.S. sugar producers have instead relied on vertical integration and technological advancement to boost yields and increase efficiency to survive stagnant prices.

For example, 55 sugar facilities have closed since 1985, leaving just 48 highly efficient plants in operation today. Those left continue to produce approximately the same volume of sugar thanks to plant modernization, farmer cooperative arrangements, unique business ventures, investments in workforce training, and new yield-maximizing seed and equipment.

An industry that has long been in the top half when compared to its global competitors on a cost-of-production basis is today in the top fifth of all sugar producing countries, according to a 2011 study by commodity market experts at LMC International. In fact, LMC noted that America ranks first in global beet sugar efficiency.

But not everyone in North America favored the same business model of improving efficiency to cope with shrinking margins.

Mexican sugar producers also faced stagnant prices and climbing costs. However, even their most inefficient producers stayed in business and aren’t making needed improvements because the Mexican government bailed them out, taking control of half the country’s sugar mills to avoid bankruptcies.

Even today, the Mexican government remains the biggest single sugar producer and sugar exporter in the country, accounting for one-fifth of the country’s sugar production. Support hasn’t stopped at direct ownership either. The Mexican government further coddles its producers with preferential loans, debt forgiveness, cash infusions to cover operating shortfalls, export subsidies, and numerous other grants.

Due in part to these handouts and an unwillingness to let poor-preforming producers go out of business, Mexico remains woefully inefficient by global standards. A 2007 examination by the World Bank pegged Mexico among the world’s least efficient producers because of small un-mechanized farms, a failure to invest in the innovation of new sugarcane plant varieties, and antiquated transportation systems.

Despite its ineptitudes, Mexico continues to expand its sugar production, with acreage increases of 66 percent since the North American Free Trade Agreement went into effect in 1994. For comparison, acreage devoted to sugar production in the United States has fallen by 15 percent over the same period.

And the U.S. market is the preferred destination for Mexico’s subsidized sugar surplus.
In the 2012 crop year, subsidized sugar from Mexico represented approximately 9 percent of the U.S. market. By 2013, that market share had risen to 18 percent.

Mexico has already exported 1.7 million metric tons through the first six months of FY 2014, and based on U.S. Department of Agriculture data is expected to export another 1.7 million tons of sugar to the U.S. during FY 2015.

As one would expect, the glut of subsidized Mexican sugar has taken a toll on U.S. sugar producers’ prices and industry returns. However, low producer prices haven’t necessarily been passed along to consumers.

Retail prices reflect what a grocery shopper pays for a pound of sugar at the store. And because sugar producers package, store, and ship the sugar on a grocer’s behalf, nearly every penny of difference between the wholesale and retail price represents profit for grocery stores.

Unlike raw and wholesale refined sugar prices, retail prices, and the spread representing profit for grocers, have steadily climbed through the years. In 2013, grocery chains charged consumers more than double what they paid sugar producers for the product.

<table>
<thead>
<tr>
<th>Grocery Profits</th>
<th>‘80s Average</th>
<th>‘90s Average</th>
<th>‘00s Average</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Sugar Price (Wholesale Price)</td>
<td>37.19 cents/lb. (27.06 cents/lb.)</td>
<td>41.88 cents/lb. (26.63 cents/lb.)</td>
<td>46.88 cents/lb. (27.79 cents/lb.)</td>
<td>64.32 cents/lb. (27.22 cents/lb.)</td>
</tr>
<tr>
<td>Grocer Profit</td>
<td>10.13 cents/lb.</td>
<td>15.25 cents/lb.</td>
<td>19.09 cents/lb.</td>
<td>37.10 cents/lb.</td>
</tr>
</tbody>
</table>
Big Candy Gets Bigger

The same phenomenon is occurring on other aisles of the grocery store too – especially the candy aisle – where product prices historically increase even though producer sugar prices don’t. And consumers feel these price hikes at the grocery store during a down economy.

Harris Interactive released a national public opinion poll in July 2012 that showed 8 in 10 Americans noticed a price increase for candy and sweetened products since the summer of 2010. They were correct, as USDA data pointed to a 7 percent increase in candy, a nearly 6 percent increase in cookies and cakes, and a 12 percent increase in ice cream over that 24-month period.

Unfortunately for consumers, price increases weren’t an isolated, a one-time thing, as the chart below clearly demonstrates. Over the last 30 years, sugar-producer prices are essentially flat, whereas the price of candy, cakes and other sweet treats has more than doubled.

To see how this trend is currently playing out in local stores, ASA took a shopping trip to the store nearest its offices and purchased confectionery products – the same grocery store visited every couple of years to gauge consumer prices. While most prices were similar to 2012 levels, and up from 2010 levels, it should be noted that the shopping trip occurred before two of the biggest candy companies in the world announced increases to their prices.

Hershey Company announced an 8 percent price hike on July 14 and Mars a 7 percent price hike on July 25. These announcements inevitably will lead to higher consumer costs, which will be captured in the next Sugar Price Survey conducted by the American Sugar Alliance (ASA).
Looking back at past Sugar Price Surveys, the run-up in candy prices becomes even more pronounced. For example, candy bars that today cost $1.39 averaged 90 cents in 2008, meaning consumers have shouldered a 54 percent increase in just six years. Candies like Starburst and Skittles didn’t make the shopping list in 2008 but were purchased in 2009 for 99 cents. That’s 40 cents cheaper than the current price.

Even before ASA’s shopping trips began, the steady march upwards was underway. According to the Hershey Bar Index, which is calculated by FoodTimeline.org using mostly data supplied by Hershey Co., the price of a Hershey Bar from 1983 to 2003 increased as follows:

- 35 cents per bar in 1983;
- 40 cents per bar in 1986;
- 45 cents per bar in 1991;
- 50 cents per bar in 1995;
- 70 cents per bar in 2000; and
- 80 cents per bar in 2003.

And because sugar prices have remained largely stagnant over that time – with about two cents worth of sugar in the candy bar – sugar’s percentage of the product’s total cost has dropped from about 4 percent in 1983 to just 1 percent today.
With ingredient costs falling and grocery store prices rising, it’s easy to see why profits are high for confectioners.

Dr. Alexander J. Triantis, dean of the University of Maryland’s business school, examined this profitability in a May 2013 paper on the Sugar Containing Product, or SCP, manufacturing sector.

“SCP companies have experienced strong revenue growth over time. These companies have high profitability and high returns on equity, even when sugar prices increase,” Triantis wrote. “Coupled together with low risk and therefore a low cost of capital, SCP companies have generated impressive total shareholder return since 2000, and their stocks are priced to reflect strong expectations for the future.”

Employment figures are likewise impressive, according to Triantis, who noted SCP job growth since 2006 compared to job loss of 3 percent for other food manufacturers.

Also, as part of his work, Triantis examined the financial performance of 10 large U.S. publicly held companies that produce highly sweetened products and found:

- Share prices have shot up more than 300 percent since 2000, compared to an almost flat S&P index during that period.

- Revenues grew by 45 percent between 2004 and 2012, 50 percent higher than the growth rate for the rest of the U.S. economy.
• Return on equity was 47 percent higher than the overall food-processing industry and 115 percent higher than the U.S. economy from 2004 to 2012.

• Net profit margins from 2004 to 2012 were 17 percent higher than the average for all U.S. public companies and 60 percent higher than all the food processing industry.

And apparently the good times have continued for manufacturers of sweetened goods like candy makers. Yahoo!Finance tracks net profit margins for many sectors in the U.S. economy using data made available by publicly traded companies.

Confectioners check in at an amazing 12.3 percent profit margin through Dec. 31, 2013, up from an already healthy 10.7 percent in 2012 and compared to 6.9 percent for other major food manufacturers. To put this profitability into perspective, below is a sampling of other industries from Yahoo!Finance’s list.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Net Profit Margin ’13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Confectioners</td>
<td>12.3%</td>
</tr>
<tr>
<td>Property and Casualty Insurance</td>
<td>9.3%</td>
</tr>
<tr>
<td>Wireless Communications</td>
<td>8.6%</td>
</tr>
<tr>
<td>Aerospace and Defense</td>
<td>7.3%</td>
</tr>
<tr>
<td>Major Oil Companies</td>
<td>6.2%</td>
</tr>
<tr>
<td>Major Auto Makers</td>
<td>3.9%</td>
</tr>
<tr>
<td>Hospitals</td>
<td>3.9%</td>
</tr>
<tr>
<td>Health Care Plans</td>
<td>3.6%</td>
</tr>
<tr>
<td>Resorts and Casinos</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

Seems the former head of the National Confectioners Association wasn’t kidding when he told one press outlet: “A lot of people think that it’s oil and energy that drives this economy, but it’s candy, it’s chocolate that’s doing well in this economy.”

This successful outlook has continued in 2014 as well, and ASA is chronicling the good news on its revamped website in a section titled “Big Candy’s Big News.” That section – which has posted more than 60 stories since January, ranging from major expansions to record profits and sales – can be found at www.sugaralliance.org/big-candy.

Articles posted to the site certainly lead one to question the motives of candy company lobbyists on Capitol Hill crying poverty in hopes of gutting sugar farmers’ only safety net.
Big Candy Crying Wolf

Seeking legislative handouts to further boost profit margins is nothing new for big candy makers. Fights over sugar policy are decades old and candy lobbyists have cried wolf about financial hardship for years. What has changed though, is the legislative wish list for confectioners.

Throughout the ‘90s, and until about 2006, sugar policy opponents lobbyed for a complete repeal of sugar policy – an action that would leave the United States entirely dependent on subsidized foreign sugar. During that time, sugar producers and their bipartisan supporters on Capitol Hill successfully turned back nearly annual attempts to eliminate the policy.

Calls for elimination temporarily subsided during the 2008 Farm Bill. Shortly before that bill was debated, Hurricanes Katrina, Wilma, and Rita harmed domestic supplies, temporarily reduced U.S. sugar refining capacity, and gave food manufacturers what they had been clamoring for – a substantial supply of refined sugar from foreign sources.

Those foreign sugar shipments were often late, and when they arrived the refined sugar wasn’t fit for human consumption. Much of it had to be re-refined by U.S. companies to remove metal shavings, hunks of burlap, and even rat feces. Delays and refining issues added to the sugar’s cost and ultimately created problems for confectioners.

Realizing it needed a strong, vibrant domestic sugar industry, candy companies turned their attention in 2008 to transforming sugar policy into a subsidy-check system modeled after other commodities.

This proposed overhaul was meant to use taxpayer money to buy down ingredient costs, but its $1.3 billion-a-year price tag found few supporters and was quickly dismissed. Congress instead continued the existing sugar policy that has worked so well for decades.

2012 brought yet another policy change by confectioners, who were bankrolling the Coalition for Sugar Reform. They began by lobbying for complete repeal of sugar policy, but such extreme actions were unpopular on Capitol Hill – especially amid growing deficits and sugar policy’s small price tag.

Opponents then presented a proposal to slowly chip away at the very foundation of sugar policy. This “reform” proposal would mandate oversupplies on the sugar market, artificially lower market prices, and impair the USDA’s ability to maintain the policy’s low-cost attributes.
These “reform” proposals have been likewise unpopular on Capitol Hill and have been rejected in eight separate votes since 2012, including three votes on the Senate floor, two votes on the House floor, and three House committee level votes.

The likelihood of future votes on the issue is unknown, but the voice of Congress has clearly been heard on sugar policy, which arguably faced more scrutiny during the Farm Bill debate than any other issue besides the multi-billion-dollar Supplemental Nutrition Assistance Program.

And big candy companies haven’t stopped their attacks on U.S. sugar producers. In addition to pushing appropriations amendments attempting to reopen the Farm Bill, these companies are supporting Mexico’s efforts to erode the U.S. market using unfair trade practices.

“The USDA is trying its best to deal with the flood of subsidized Mexican sugar and give U.S. farmers a chance to survive while the DOC and ITC conduct their impartial investigations,” an ASA spokesperson said in a June 4 press release. “If lawmakers are interested in protecting taxpayers and promoting a market where the most efficient producers thrive instead of the most subsidized, then they will reject attacks on sugar policy and let the government investigations into Mexico run their course.”