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Beer Quarterly Q1 2021

The Rise of Hard Seltzers in the US and Beyond

RaboResearch

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Introduction

As the reporting season draws to a close, we conclude that the latest quarter has not been brilliant for brewers, but at least it was much better than during the first lockdown in Q2 2020. In a new section of the Beer Quarterly, 'The World of Beer in Graphs', we show how the beer sector performed in Q4 2020 and make the following observations:

- The recovery of volumes seen in Q3 2020 has stalled as the on-trade faces renewed restrictions in certain parts of the world.
- Volumes of niche players with US exposure to Mexican imports and hard seltzers did well in Q4, as did Latin America. Western Europe, however, underperformed due to its high on-trade share and the fact that people are less likely to drink outside in the winter.
- Volumes were affected most in highly on-premise markets, especially in Europe.
- Most global brewers saw a mid-single digit decline in revenue/hl, due to changes in their channel mix.
- Profit, especially in the US, is driven significantly by premiumization, in the fourth category and newer above-premium light lagers.
- Some Latin American markets suffered from currency weakness and hyperinflation.
- COGS were benign in Q4 but might rise as hedging has delayed the effect of higher barley and metal prices. Shortage of aluminium cans, which led to pressure in Q2, abated.
- MG&A costs were generally more muted as many brewers dropped or delayed marketing spend, often around large scale events (the spend will return in upcoming quarters).
- The pattern of profit pool development has been similar to that of revenues, as operational gearing was the main profit driver in Q4.

In this Beer Quarterly, we look at hard seltzers in detail. We ask if the product will be facing saturation in the US any time soon and whether the phenomenon can spread to other parts of the world.

North America: Hard seltzers are the success story of the US beer market, driving new consumers to the segment, with massive levels of innovation, significant marketing and capex investment, and even some M&A activity. It's not just the current size of the category, which is attention grabbing enough, but the fact that it can sustain significant growth for many years to come. For many brewers, seltzers provided a notable tailwind in a challenging 2020 – and virtually every player in the US beer space has major plans for new products in 2021. However, the category boundaries are rapidly blurring, and the marketplace is getting very crowded.

Europe: Hard seltzers in the UK are following the US and are seeing strong growth from a low basis. In continental Europe, the number of new product introductions is high. The presence of leading US hard seltzer players like A-B Inbev, Molson Coors and Heineken in the region is also helping the category, but there is more competition from established traditional products such as gin & tonic. On the demand side, there is a consumer focus on low calorie products, but SKUs with reduced alcohol content are also on the rise.

Asia: Australia is leading the hard seltzer push in Asia-Pacific and will remain the top destination for companies. Japan is another market with a considerable potential for hard seltzers. A large flavored alcohol consumer base is common to both markets and is the target segment for hard seltzer brands. Interestingly, the new genre beer in Japan, which eschews malt in favor of pea, soy, or even wheat spirits, has been booming in the past few years. As the tax advantages that drove the growth of new genre beer are reduced, Japanese brewers could benefit from positioning hard seltzers as a healthier alternative.

In the rest of Asia, brands will need to innovate the route-to-market and their positioning in order to build consumer traction and consumption occasion for hard seltzers. The young, health-seeking, conspicuous consumer is the target segment in the rest of Asia, limiting the reach of hard seltzers to highly-urbanized micro-markets in the region.

North America

It is exceedingly rare for a new alcohol type to capture almost 10% of a total market, but hard seltzer is fast approaching this within the beer segment.

In the US, we want to look at what the core drivers were for the large growth of the category within five short years. We use this as a framework to understand why the growth in the US has been so powerful. Hopefully, this may help us understand how seltzers may develop in other parts of the world, and in what ways hard seltzer may or may not be suited to expand into new markets.

Then we will discuss the rapid evolution of the hard seltzer space – how the industry is changing and will continue to develop, both in terms of products and channels. And we will talk a bit about industry consolidation – it can't stay this concentrated forever.

Consumer need states (hard seltzer satisfies basic consumer needs):

- Entry-level alcohol: Light flavors with a high level of flavor innovation for consumers without established category allegiance – part of the very long shift to super light American lagers.
- 'Healthy': Low cal and low carb.
- New brands that excite consumers and can span the gender divide: Established light entry-level beers are in long-term decline and are weighed down by declining brand equity and a history of sexist, juvenile marketing.

Consumer readiness (hard seltzer tying into to core consumer trends):

- Growth of flavored seltzer category: Hard seltzer builds on established consumer habits (including massive growth of flavored sparkling waters in the off-premise, as well as vodka soda in the on-premise)
- Blurred lines: old categories no longer defining consumer drinking experience: Across alcohol and non-alcohol, consumers are already drinking (and seeking out) brands that cross multiple category lines – like a coffee-flavored energy drink with protein. Hard seltzer is a perfectly natural product in this world.
- Generational change – not your parents' drink: Each generation tends to embrace something new. Hard seltzer is quite new but clearly builds off previous light lagers/Flavored Malt Beverages (FMB). Hard seltzer consumers skew younger than overall beer (and alcohol) consumers.

Corporate strategy (hard seltzer gives companies what they need):

- The race for white space: The largest beverage companies are striving to build a fuller brand portfolio across multiple alcohol categories – and increasingly across non-alcoholic. No "stick to beer" mentality. Even within 'seltzer', there's huge opportunity to build out a very diverse portfolio.
- Growth (not cost-cutting) mentality: Days of zero-based budgeting as a first priority are over – and corporate focus is on finding growth through innovation.

- Incrementality: ABI reported that 75% of Bud Light seltzer sales were incremental to the top-line. Constellation has said that 90% was incremental – this means beer is stealing consumers from other categories. Seltzer is not cannibalizing beer volume, but greatly adding to the strength of the beer category.

The nuts and bolts of it (it’s pretty easy to do – and profitable!):

- Switch-over costs are reasonable and make use of current brewing equipment: Despite the need for a bit of extra de-flavoring equipment, the production of hard seltzer is largely aligned with current beer production capacity.
- Sugar is cheaper than malt and hops.
- Pricing is at a premium to the beer category: Which can be really great for margins, especially with greater scale.

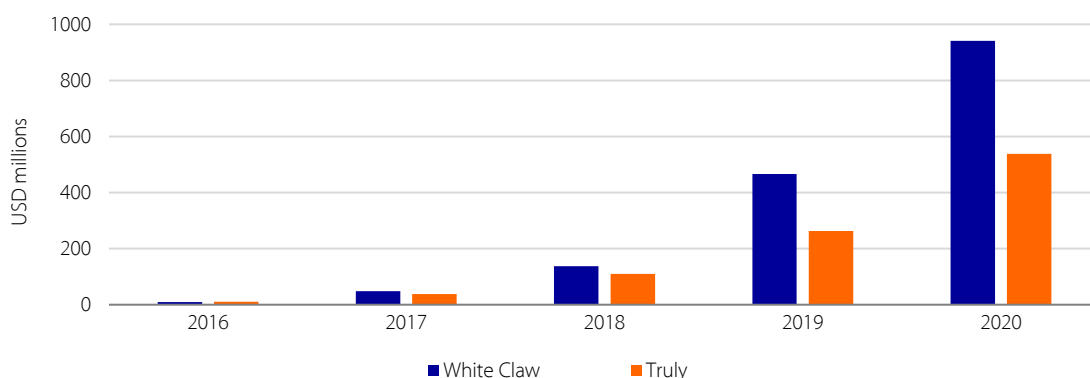
Much More Growth Ahead

We expect significant sales growth in the hard seltzer market, and could see the hard seltzer category reaching 20% of total beer over the next five years. This would still be far less than the peak of the macro-light lager share, decades back (the market is far more fragmented now), but easy-drinking, very accessible products will always naturally have a large place in the industry.

Predictions from the industry are equally bullish, and the industry (both leaders and challengers) is putting its money where its mouth is, investing not just in marketing, but putting large cap-ex into production capabilities to keep up with surging demand.

We don’t expect more years of >100% growth as seen in the chart below, but with the seltzer category already accounting for USD 4bn in sales, 50% growth next year (an achievable goal) would represent massive gains. In fact, household penetration for seltzer remains far below that of light lager.

Figure 1: Growth of top-two seltzer companies – measured channels



Source: IRI, Rabobank 2021

The category has so many new entrants, that it can be hard to keep up with. Every week brings new products from big and small brewers, wine and spirits companies, start-ups and even restaurant brands (Sonic announced a new hard seltzer to launch in May).

The category is also rapidly evolving. New entrants are pushing well-beyond a now standard variety pack of hard seltzer flavors. For now, iced tea and lemonade hard seltzers are taking center stage, along with tequila-based RTDs, but these examples only scratch the surface of new formulations coming to market. As an example, the lemonade category of seltzer is already such a big deal that Boston Beer said its Truly Lemonade was “the most incremental new product in the entire beer industry [off-premise measured channels]” last year.

Before addressing why we think the category will continue to grow, we have to think about what the category is becoming.

The Fourth Category

The hard seltzer category is changing already – and we like the definition we first heard from Michel Doukeris at ABI – calling it the fourth category of alcohol. It is an intersection of beer, wine, spirits and, at the same time, also a massive expansion of the FMB sector in the US.

We view hard seltzer, which has exploded in growth for the reasons listed above, as the genesis for what is quickly becoming a larger fourth category alcohol revolution. In thinking about how and why this category is different and what it brings to the table (or retail shelf in this case) we should first try to define it.

Fourth category alcohol falls outside of standard beer/wine/spirits – but has a broader remit than FMB/RTDs have had historically. We see the following as key trends behind the emerging category:

- Significant flavor innovation/variation
- Lower sugar/calories and great sessionability
- De-emphasis on the provenance of the alcohol source
- Non-traditional alcohol branding (often borrowing from non-alcoholic segment)
- Single-serve packaging/convenience

Defining the fourth category is an inexact science – best done in opposition to the traditional beer/wine/spirits categories. With so many new products coming to market they are often falling even outside some of these broad guidelines

But the most exciting part of the category is that it truly puts the consumer first. Innovation in this category can focus on the question of ‘where do we want to be?’ – knowing the flexibility of the fourth category allows a great deal of creativity in being able to formulate the actual drink. This is a big change from starting with a beer and simply imaging a line-extension to meet a different consumer need. Any move away from process-led innovation to consumer-led innovation is a win.

Why Will the Category Grow?

The fourth category is already the hub of innovation throughout the entire alcohol category in the US. ABI’s own portfolio in the space already shows that many different approaches are possible and shows the massive speed at which they can be introduced (Molson Coors and Constellations similarly have an array of entries into the category). New brands are using a wide array of flavors, normally only seen on a non-alcohol shelf, a wide range of alcohol bases, ABVs, and even leaning into health and wellness with organic labels and added vitamins.

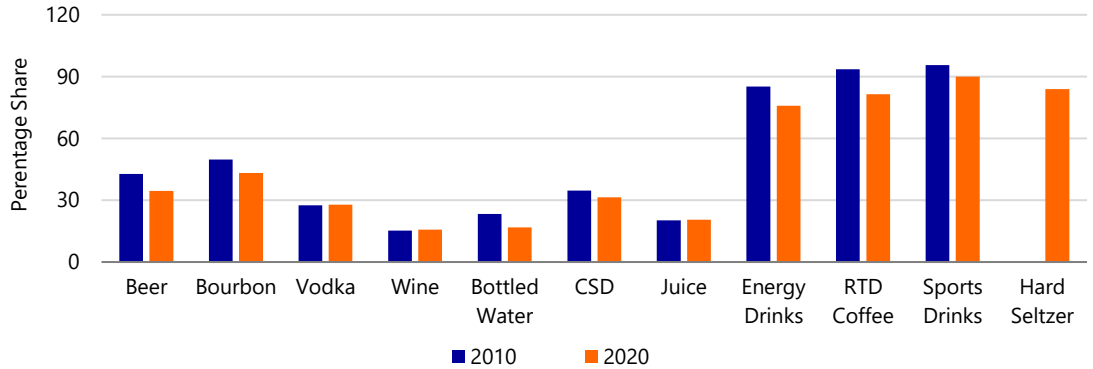
We expect more shelf space for the category – as nothing else is growing this fast. Not only will increased shelf space and prominence create a virtuous cycle, but the fourth category (depending on the base) can be located near any of the other alcohol categories or create its own space. And the hard seltzer/fourth category is just beginning to lean into c-store growth, with new packages targeted at this channel.

This category is still in its infancy - only about 5 years old, but still very highly concentrated behind the two leading players, Mark Anthony Brands and Boston Beer Co. While those two companies would love the category to stay highly concentrated, like energy drinks, over the long term we expect competitors to steadily take share.

Our belief that concentration will decrease from the energy/rtd coffee/sports drinks levels is not a reflection of the quality or innovation prowess of the market leaders, who score very well on both accounts. It is driven by the fact that the leaders are smaller companies – and every large global player in the US (including from outside the beer category) has made seltzer growth a top priority for 2021 and beyond. Equally, start-ups and craft brewers are creating a very long-tail – with over 400 or 500 SKUs already in the marketplace. Add on how quickly the category is evolving (fragmenting) into smaller sub-categories – the seltzer/fourth category space looks less and less like energy drinks with every passing month.

Still, we think market share changes will come relatively slowly – more likely with new consumers entering the space than those already consuming (perhaps the re-opening of the on-premise will drive some of this). The lead that Red Bull had – decades before the newer competitors – does not exist in the fourth category. The hard seltzer category already contains many dozens of well-funded brands all entering the market in relatively quick succession.

Figure 2: Market concentration: share of top-three brands in each category



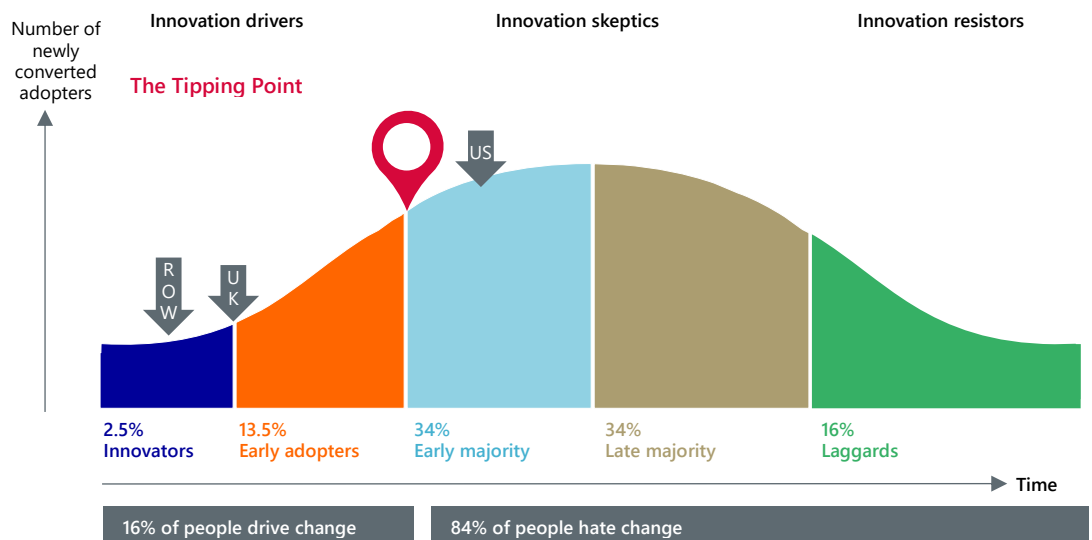
Source: Euromonitor, IRI, Rabobank 2021

The broader FMB/RTD segment in US has long existed in a series of booms and busts – and it is worth it to reiterate that this time it looks very different. Whereas previous entries in this segment were effectively one-off brands that never created a category of similar-ish competitors, now we have an entire blurry category where one type of drink begets more. More importantly, now these drinks, driven by greatly increased session-ability, are simply playing for the bigger piece of the pie (all light lager volume).

Europe: Strong Growth but Less Potential Than the US

The hard seltzer category in Europe is still in its infancy. In the most developed market, the UK, it reached sales of GBP 10.5m and a volume of 1.6m litres in 2020, 12 months after introduction. The product has achieved a 3.3% penetration and a repeat sales rate of 27%. Although this is significantly behind consumption in the US, where hard seltzer retail sales now top USD 4bn annually, it does make the UK the leading hard seltzer market in Europe and leaves the category with a lot of growth potential (see Figure 3).

Figure 3: Hard seltzer development curve



Source: Bodega Bay Company Presentation, 2020

The introduction of hard seltzers has started to rejuvenate the RTD category in Europe, but there are some doubts about its long-term potential when compared to the US:

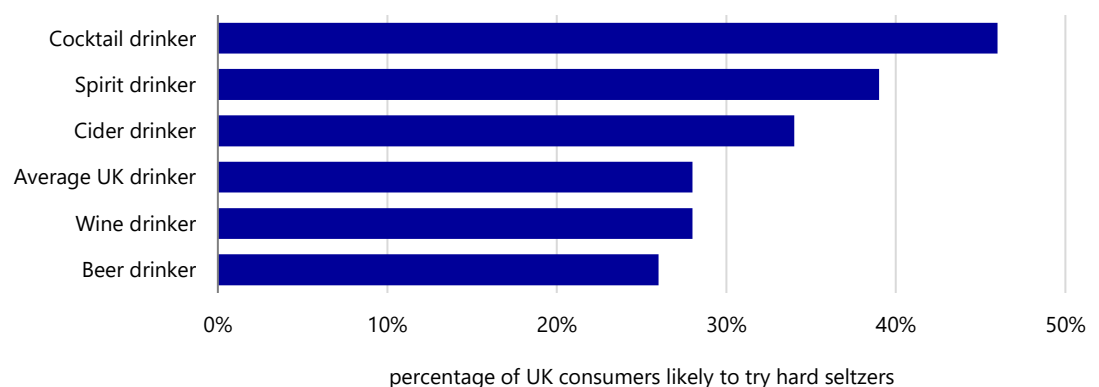
- Another RTD subcategory, alcopops, saw a 'boom-and-bust'-cycle in the early noughties when brands such as Two Dogs and Hooch were very popular with young drinkers. The positioning of hard seltzers, with low calorie and sugar content (and high sessionability), is however very different and its consumers are more evenly spread among different age groups.
- Americans are focussing on calories when drinking healthily, whereas Europeans reduce alcohol content. This is reflected in the popularity of alcohol-free beer, but European consumers also look at calories, as shown by the rising popularity of low-sugar CSDs.
- Alcohol consumption in Europe is more focussed on the on-trade, while hard seltzers are primarily an off-trade product at the moment. This could hold back growth, but European off-trade share is growing. Although this will temporarily reverse after Covid, part of the growth is structural. There are also opportunities for hard seltzers to develop a strong on-trade presence.
- Competition in Europe differs from the US, where hard seltzers are taking share from the struggling light beer segment. In Europe, competition is primarily from cider and spirit mixes like G&T.
- The economics of hard seltzer in Europe differ from those in the US. In Europe, hard seltzers are taxed on ABV, while in the US they benefit from a lower tariff on malt-based production.
- The European consumer is, however, susceptible to new US trends, especially if pushed by established companies, as the recent craft beer development has shown.

We expect that hard seltzers will grow in Europe and establish themselves as a new category, but we also believe that their market share will remain less prominent than in North America.

Category is a Threat- But Also a Massive Opportunity- for Brewers

As American brands and non-beer companies such as cider maker Kopparberg, and Coca-Cola are looking to enter the European hard seltzer market, leading local brewers should consider using their infrastructure to play a role in the category themselves. The product will cannibalize their beer sales, but it will also attract consumers from competing segments, as well as bring new drinkers on board. Around half the hard seltzer drinkers in the UK are new to alcoholic beverages. Brewers have a lot to lose to hard seltzers, but even more to gain in our opinion.

Figure 4: UK consumer response on likelihood of drinking hard seltzer



Source: The DRTY Hard Seltzer Handbook, 2021

Positioning is Key to Creating Value

When we look at hard seltzers in the US, the category is dominated by two smaller beverages companies, Mark Anthony and Boston Beer, who have a combined market share of ~75%. Although these companies had positions in alcoholic beverages before, they were trailing giants like A-B InBev, Molson Coors and Constellation Brands. Those market leaders are now either playing catch-up or developing niche products.

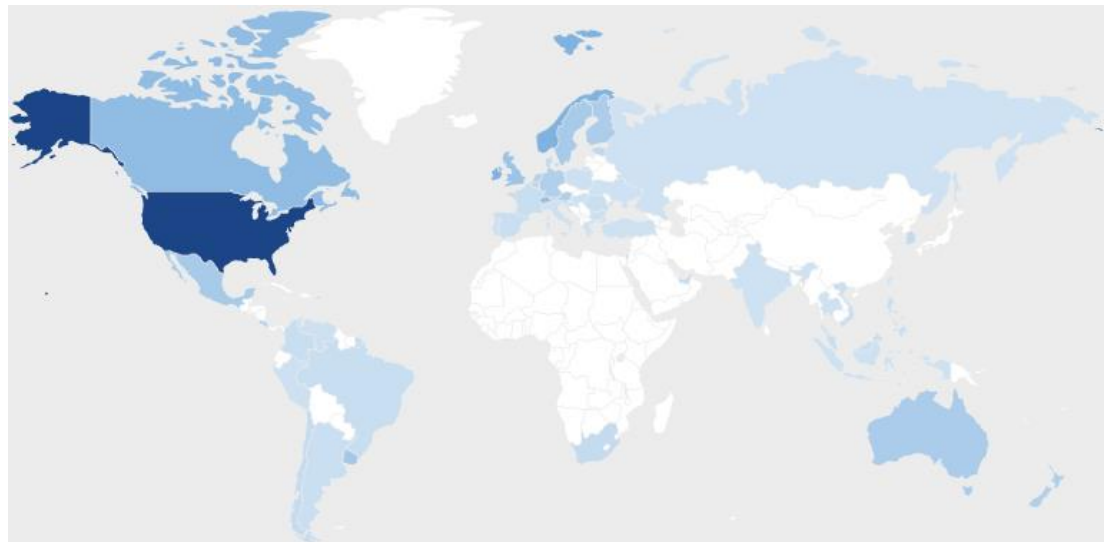
The European market is slightly different from the US. Europe does not have a three-tier system but it does have a well-developed private label and contract manufacturing industry. It is therefore likely that in European markets, there will be a market leader, a private label segment and premium niche products, such as hard seltzers made with super fruits or real juice.

As authenticity and provenance will be harder to establish in hard seltzer than in the craft beer category, scale and speed-to-market will be crucial to claim the top position in the mainstream arena. Leading brewers such as A-B Inbev and Heineken, as well as soft drink giant Coca-Cola already have hard seltzer brands in their portfolio, leaving independent brands at risk of being squeezed between multinationals and private label. An interesting strategy is being followed by Bodega Bay in the UK. The brand is positioning itself as premium niche (through ingredients and sustainability credentials) and has started a partnership with Molson Coors to help with production and distribution.

Asia: No Defined Hard Seltzer Market, yet

The hard seltzer market in Asia, as yet, remains undefined and under-explored. Google search statistics for "hard seltzer" offer an excellent proxy to understand the gap between the US and the rest of the world hard seltzer market. The map below benchmarks search volume for "hard seltzer" across the world relative to the US between February 2020 and January 2021 (see Figure 5). As is evident, consumer awareness in most markets outside of North America is relatively non-existent. Unsurprisingly therefore, the hard seltzer category in Asia is pretty much a blue ocean in 2020. It is worth noting that search volumes have gone up in the past 12 months, mostly driven by recent product launches in Asia Pacific.

Figure 5: Web search trend for "hard seltzer" by country, benchmarked to US



Source: Google Trends 2021

Say 'Hai' to Chūhai

While consumers in Asia are unfamiliar with 'hard seltzer,' there are several RTD alcoholic drinks with strong recall and customer traction. Across Japan, for example, shochu highballs, called chūhai, are popular and one of the fastest-growing alcoholic drinks categories. The typical chūhai is offered in a single-serve, colorful can packaging. Consumer interest is such that even Coca-Cola decided to enter the alcoholic drinks sector in this category! Interestingly, while packaged chūhai can have a high ABV (up to 9%), traditional, freshly-made chūhai is low in alcohol and allows customization of flavor and alcohol strength. Most packaged chūhai has vodka as the base alcohol instead of shochu, in order to manage cost. Overall, there are as many common product features between the chūhai and hard seltzer as there are differences.

Table 1: Comparing product features of hard seltzers and chūhai

<i>Product features</i>	<i>Hard seltzers</i>	<i>Chūhai</i>
ABV	1%-5%	3%-9%
Calorie	~20kcal/100 ml	40-50kcal/100 ml
Pricing	Premium	Mass
Packaging	Single-serve can	Single-serve can
Positioning	Health	Beer like
Target consumer	Gender free, young, health conscious consumer	Male, at home consumer

Source: Rabobank, 2021

The 'new genre' beer in Japan, such as Hon-Kirin, also offers an intriguing comparison with the hard seltzer. Both target the impulse channel and personal drinking occasion, unlike beer or spirits, which target social consumption. The new genre beer eschews malt entirely, in favor of an eclectic choice of base alcohol, from pea and soy protein to wheat spirits. Yet, neither chūhai nor new genre beer could be considered the precursor of the hard seltzer. Both are taking advantage of existing tax loopholes to offer consumer a competitively-priced product and are not positioned to address latent consumer need states.

The case is that while traditional RTD alcoholic drinks in Asia-Pacific might offer some similarities with hard seltzers, there are important distinctions. Each product offers a different functionality and has different target consumers than hard seltzers. This brings us to the question, is there is a case for hard seltzers in Asia?

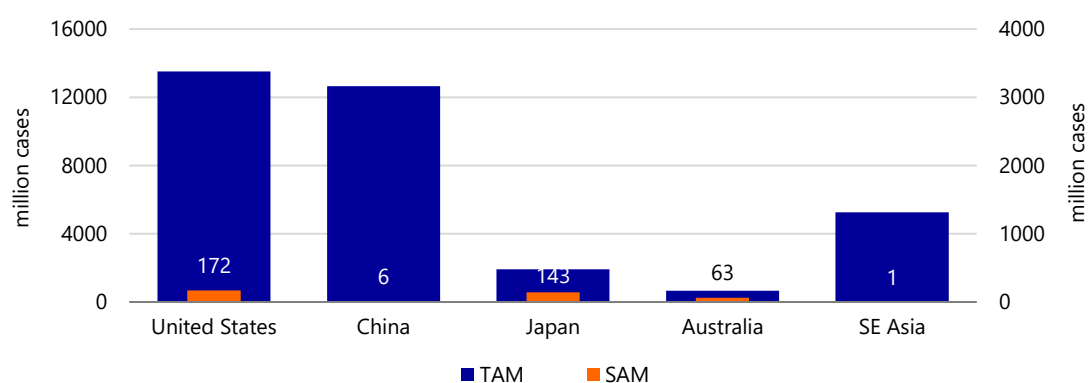
Is There a Case for Hard Seltzers in Asia?

To answer this question, we need to examine the underpinnings of the growth of hard seltzers in the US and compare that with the evolving consumer landscape in Asia. The three consumer readiness conditions and three consumer need states we identified above can serve as a useful template to understand consumer interest in hard seltzers. With that, we used the following factors to benchmark select markets in Asia-Pacific to the US.

- percentage share of millennial population
- percentage share of RTD alcoholic drinks segment to total alcoholic drinks consumption
- percentage share of low/no beer segment
- percentage share of diet cola segment relative to regular cola
- Number of new beverage product launches with blended flavors
- percentage share of alcoholic beverage product launches with healthy positioning to overall new beverage product launched between 2015-2019
- Benchmarking Asia-Pacific countries on the above criteria with the US will offer guidance on the region's hard seltzer category's potential size.

By serving consumer needs currently served by both hard and soft beverages, hard seltzers are blurring multiple category lines. Therefore, we define the total addressable market (TAM) as the sum of total beverage alcohol, carbonates, and bottled water category. The Serviceable Available Market (SAM) is the immediate size of the consumer pool that hard seltzers are targeting. In the US market, SAM is the sum of RTD alcohol and low/no alcohol beer segments. Asia-Pacific countries are benchmarked to the US to determine the SAM.

Figure 6: : Hard seltzer TAM (RHS) and SAM (LHS)



Source: Rabobank 2021

It would appear that Japan and Australia offer the most attractive potential for hard seltzer in Asia-Pacific. This is, of course, a static view based on 2019 actual market data and will evolve as brands drive changes across the consumption occasion and consumer need states, especially in the post-Covid-19 world. Other factors, such as taxation and competition from the existing RTD alcohol category will also impact the region's hard seltzer growth trajectory. Currently, Japan offers attractive tax rates for non-malt alcoholic beverages. Similarly, Australia taxes low-alcohol products at a favorable rate to beer and spirit-based products. While getting lager beer and RTD alcohol consumers to switch is critical initially, and in the mid-term, the long-term success will require brands to expand the hard seltzer category by bringing consumers from the diet soda and flavored/sparkling water categories. In other words, brand positioning becomes critical to the long-term success.

Where are we now in Asia-Pacific hard seltzer market?

It is early days for the hard seltzer category in Asia-Pacific. In the past six months, some global brands have introduced hard seltzer in select markets in Asia-Pacific. With over 30 brands introduced in 2020 alone, Australia is leading the Asia-Pacific hard seltzer market. Other markets in Asia-Pacific (China, India, and Singapore) have either seen hard seltzer introduced in local retail, or will soon see this.

Table 2: Hard seltzer brand positioning in Asia-Pacific

Brand	Zeya	Somersby	Vrai	Rainbird
Owner	Changzhou Madai Trading	Carlsberg	Natural Beverage Infusions	Pinnacle Drinks
Target market	China	Singapore	China, Singapore	Australia
ABV	4.5%	4.5%	5.5%	6.0%
Calorie per 100ml	21	29.2	47.9	40.9
Price	RMB 9.2	SGD 4.0	USD 3.49	AUD 5.5
Packaging	Slim can	Slim can	Slim can (355ml)	Slim can
Communication codes	Zero Fat, Zero sugar, Low Carb	Naturally flavored	Organic, Natural, Clean label	Natural, Low Carb, < 1% sugar

Source: Company website, Rabobank 2021

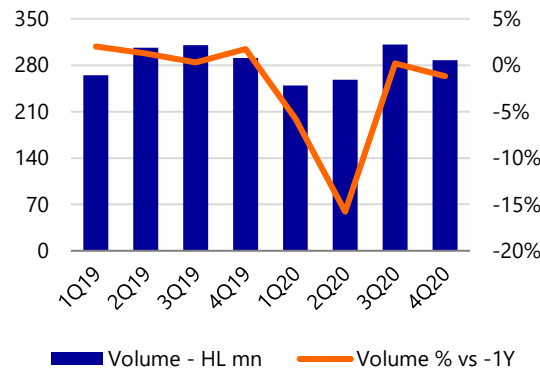
Hard seltzer brands in Asia-Pacific are targeting the 'health' and 'natural' positioning. With the standard slim can packaging, brands highlight low sugar, low carb, and natural or organic as the key attributes. In other words, the target consumer is between the age of 20 and 45 years, urban, educated, and health-conscious. The variety-pack strategy indicates that brands target the at-home consumption occasion instead of a sessionable alternative to beer and RTD alcohol. In 2020, this worked well with bars and the on-premise closed, and consumer traffic severely

restricted. The long-term strategy should include on-premise and out-of-home brand activation to drive conspicuous consumption and clearly define consumption occasions to build a captive consumer base.

Furthermore, there is an overlap in the craft beer and the hard seltzer consumer profile – young, educated, affluent, white-collar workers, health-conscious, aware of global trends. Craft beer consumption has grown rapidly in the past few years in India and Southeast Asia. Hard seltzers would also benefit from the craft beer trend-momentum.

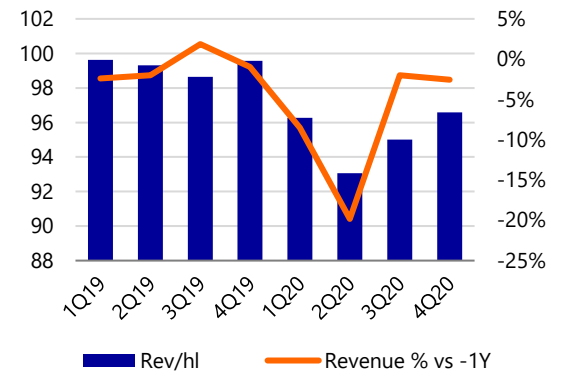
The World of Beer in Graphs

Figure 7: Global beer industry volume trend



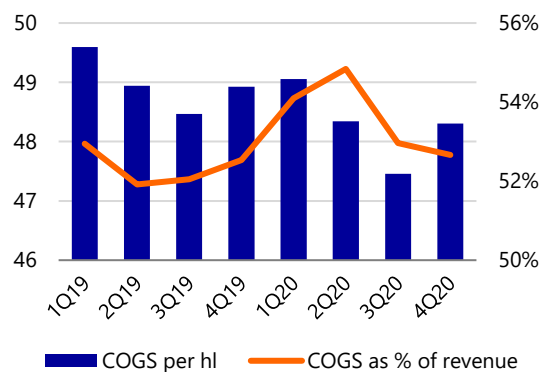
Source: Rabobank 2021

Figure 8: Global beer industry revenue trend



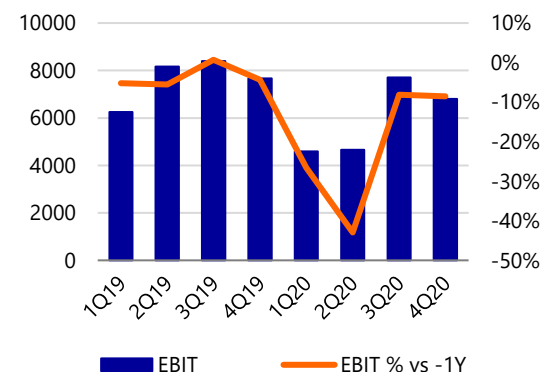
Source: Rabobank 2021

Figure 9: Global beer industry COGS trend



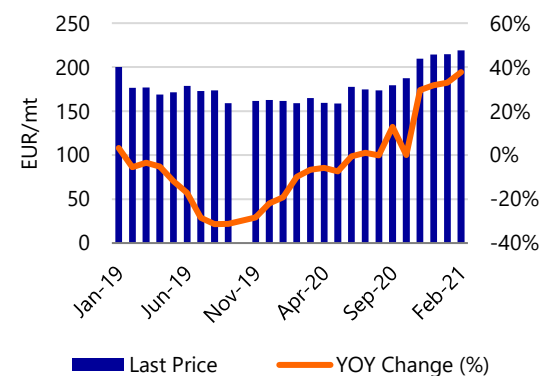
Source: Rabobank 2021

Figure 10: Global beer profit pool



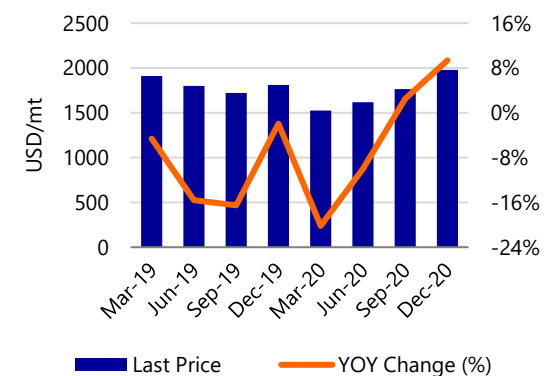
Source: Rabobank 2021

Figure 11: Malting barley price (LHS) trend



Source: Bloomberg, Rabobank 2021

Figure 12: Aluminium price (LHS) trend



Source: LME, Rabobank 2021

Note: Data in graphs 7-10 are based on the universe of listed beer companies, which together account for more than 50% of global volume. They are intended to highlight trends rather than show overall market size.

Imprint

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