M&A's in Animal Fat market: how much is too much?

Vertical and horizontal integration trends in Europe will significantly limit trading and brokerage activities on the animal fat market. TME producers acquire the entire supply chain to prevent supply problems and price volatility but, at the same time, they contribute to a bearish trend in the sector and a decrease in market liquidity.

In Europe only, the rendering industry currently employs over 15,000 people. Previously considered as waste, animal fat is nowadays a valued product, a sought-after feedstock, used for biodiesel production. Once highly problematic, greatly demanded today, animal fat is what fuels our cars now.

Animal fats of categories 1 and 2 (animal by-products not intended for consumption) both belong to the double counting system of the EU, favoring the collection and recycling of waste by counting double the blending of a unit of waste-based biofuel into ordinary fuel. Indeed, waste-based, and especially animal fat-based biofuel contributes directly to the EU objectives of GHG reduction (twice as strong compared to other feedstock-based fuels) and the incorporation of at least 10% renewable energies into transportation until 2020.

M&A's dominate the French market

Recently Intermarché, a French supermarket chain and biodiesel producer, and Saria, one of the leaders of the rendering industry and a subsidiary of the German group Rethmann, jointly opened up a new factory Estener in Le Havre, France. It created a great buzz in the animal fat sector, confirming the current tendency of vertical integration.

Estener is supposed to provide 75.000 tons of biodiesel a year, absorbing a great part of France's cat 1 and 2 animal fat supply (110.000 tons): a 40 million euros worth investment, proving the current expansive tendency of animal fat-based biofuel production. Other recent projects, such as the expansion of Biodiesel Amsterdam announced for 2015/2016 or new plants in Italy, Croatia and France in 2014, only confirm the trend. All the investments are mainly focused on technology improvement in order to produce more efficiently.

This vertical integration also leads to a perfection of the circular economy and a nearly complete control of the supply chain. Intermarché thus guarantees itself a secure supply of animal fat from Saria, the feedstock being smoothly transformed into biodiesel by the new plant and integrated into the fuels of the company's own gas stations (up to 7%, according to the new EU directives).

Meanwhile, there is also a tendency of horizontal integration between producers, leading to more M&A's and a higher concentration in the sector. The three big leaders of animal fat-based biodiesel: Saria (EU) and Darling (International), followed distantly by Akiolis (FR), put an effort into acquiring small independent firms, leading to a sort of oligopoly in Europe. However, both types of integration fail to resolve the animal fat supply difficulties that the EU faces.

Situation outside France

M&A's in the animal fat sector are not a typically French phenomenon. We observe the vertical and horizontal integration trend in numerous markets across different continents, one of the most noted examples being the acquisition of both Rothsay (a Canadian rendering company, subsidiary of The Maple Leaf Foods) and Vion Ingredients (a member of Vion Food Group) by Darling International, a leading US provider of rendering, recycling and recovery solutions in the food industry.

These transactions enriched Darling International's portfolio of brands, allowing the company to better control its supply chain. Vion Ingredients, with its 58 rendering facilities across five European countries under the name of six different brands, among which there are Sonac and Rendac, will ensure a smooth feedstock supply. The acquisition of Rothsay, however, will facilitate the biodiesel manufacturing, as the company owns 5 plants across Canada, which produce both, for domestic and international markets.

At the same time, Sonac also keeps acquiring new smaller businesses, among which there are Innovative Proteins (USA) and BAIC Blood Products (Australia), consequently leading to a market with a few very big players.

In Spain, meanwhile, one can observe a horizontal integration of Saria Bio-Industries with its former competitor Garnova Group.

Factors determining supply difficulties

Coming back to the supply difficulties, one might think of the average European diet, which contains less and less meat, substituted by fish or meat containing less fat, such as poultry. In Western countries, it is mainly caused by rising health-awareness. At the same time, the economic downturn, accompanied by the rise in meat prices, also contributed to a 1.5% decrease of meat consumption in 2012-13 (compared to 2011). Animal fat supply has been consequently falling due to less national slaughtering and increased tallow export. Yet, currently, a slight recovery in the global demand for meat can be observed, which should stabilize the animal fat supply in the longer run.

Another reason contributing to limited availability of animal fat might be the low profitability of farming, especially in the livestock-farming sector. The higher feed costs and the difficult conditions weigh on the attractiveness of this domain, making it even harder to narrow the gap between the falling supply and the consistently growing demand for animal fat. Even though the limited availability remains quite stable, there is some growth potential, animal fat being no longer required for heating, boilers turning to gas as we speak.

Among limited animal fat supply in Europe, a battle between biofuel producers and oleochemical companies continues. Both sides are concerned about their supply security and therefore try to influence the decision of the EU Parliament about whether to include animal fat in the double counting scheme or not. The final voting will take place this year. One can only hope that the Members of Parliament will not allow huge oleochemical companies to win over waste-based biofuels and thus dominate the market.

Price scenario

The animal fat market is an OTC market, dominated by 10 top buyers, which makes the market very illiquid. So far, the amounts supplied have been sufficient to meet the needs of major purchasers, causing animal fat prices to remain relatively stable. Historically, sellers used to observe the price trends of fuel to choose whether to use their fats for cogeneration or sell them on the market. This fuel vs. animal fat price relationship has no sense today, as the price of biodiesel, the main market for animal fat CAT 1, has no correlation with the fuel market. The majority of the quarterly contracts is therefore concluded on a fixed base.

Demand for animal fat is predicted to be relatively stable until 2016 and the strong integration of market players should not have a significant influence on the pricing. However, with the evolution of the meat market and new players arriving, one could expect different mechanisms to reach the market, such as the creation of price indexes or quotas.

Recent developments on the meat market

Global meat demand rose by 65% in the last 20 years and is expected to reach 400 million tons by 2030. By 2020, 56% of the growth will be contributed to Asia and Pacific and 19% to Latin America and Caribbean. The growth of demand on other continents will be much less significant. Moreover, big companies outside the EU, such as the American Tyson or the Brazilian JBS, dominate the global ranking and lead to a consolidation of the meat industry, leaving Europe with a significant, but nevertheless small share of the market.

Zooming into Europe, German, Dutch and English companies, such as Vion, take over the leadership, leaving French companies, such as Bigard and Doux (at the verge of bankruptcy in 2012) at a two-times lower production capacity, struggling to compete with such strong players.

For a couple of years already, the farming sector is considered to be in a state of crisis in France, preventing the country from taking position among the European leaders. New standards and the increase in feed prices raise the production costs above the sales prices (pork being sold at 1,65 euros a kilo to a slaughterhouse instead of the needed 1,80 euros, for example, in 2013), making it increasingly hard for farmers to remain competitive.

Future outlook

The recent developments on the rendering market such as the increase in feedstock prices, growing costs of the farming sector or the BSE crisis ("mad cow disease") largely contributed to a decrease in animal fat supply. While the volume of animal by-products processed in Europe is still declining, there is some hope for a slight recovery in the next few years. However, the demand is not expected to reach the levels from the past.

The global meat industry landscape is changing significantly and companies from emerging markets, such as China and Brazil, will start playing an increasingly important role. Europe, to counter its supply shortcomings, should therefore be prepared to reconsider the ban on imports from outside of the EU. Imports of feedstock could allow the industry to run at full capacity as well as to maintain reasonable prices.

There is no doubt as well concerning the fact that the animal fat market will experience an increasing number of M&A's, big players acquiring smaller companies to further integrate their supply chains. At the same time, trading activities will largely disappear within the sector. A question remains, though, how far the consolidation trend can go without leading to an uncontrolled oligopoly on the market.

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