

## Food and Beverages

## Trading desk insights on Cocoa Markets – transcript inside

Industry Overview

## Cocoa call takeaways with BofA Senior Ag Trader

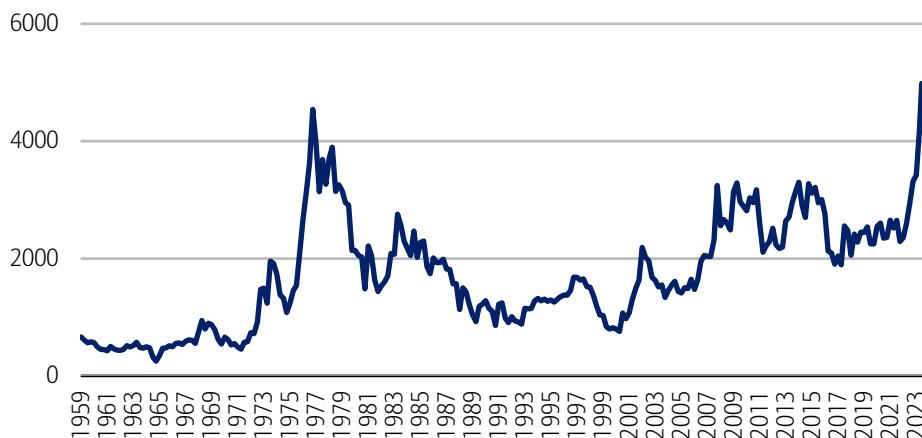
On Friday February 2<sup>nd</sup>, we hosted a call with BofA Senior Ag Trader Pierre-Antoine Papillon to discuss recent activity in Cocoa markets. See inside for a transcript of Q+A.

## Cocoa prices currently at 65-year highs

Cocoa prices are currently at historic highs, breaking \$5,000/MT-levels in intra-day trading on Friday, and up ~100% since the start of 2023. The last time cocoa prices peaked to this magnitude was in 1977 with prices reaching ~\$4,600/MT. In reaction to steep cocoa prices, HSY raised the wholesale price of its 1-pound cans of cocoa in Jan 1977 by 46% after it had already done a smaller price increase of ~18% in October 1976. Similar to what we are seeing today, the rise in cocoa prices was driven by production scarcities due to adverse weather conditions in key cocoa production countries including Ghana & Ivory Coast.

## Exhibit 1: Historical cocoa prices (1959-2024)

Cocoa prices at 65-year highs; previously peaked in mid-1977



Source: Bloomberg

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## Current crop conditions less than ideal in key markets

Weather conditions have been less than ideal in Africa particularly in the Ivory Coast and Ghana. Moisture levels have been sub-par and more and more trees are getting infected with Cacao Swollen Shoot Virus (CSSV). Africa makes up the largest portion of cocoa production (~80%)—Papillon estimates that there is currently a ~400,000 metric ton deficit in the crop, comparable to Ecuador's full year production. As it stands right now, it's very unlikely to completely make up the current deficit in this year's crop. The question is whether weather conditions continue to be sub-par and the spread of CSSV worsens, impacting the 2024/2025 crop and potentially pushing cocoa prices up further.

See Q+A inside...

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12654856

Timestamp: 05 February 2024 05:00AM EST

05 February 2024

Equity  
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**Opening Remarks:** The cocoa market has been astonishing—we are in unprecedented times with the futures market reaching new 45 yr highs every day. There's strong price action, futures are up close to 100% since the start of 2023 and it's been a very methodical rise with few dips and any weakness that we've seen has been met by a lot of coverage from industry and a lot of under-covered companies are buying every dip they see in futures. We saw some of that in the first couple weeks of Jan when the market dropped. Right now, there is a mix of problems with weather, moisture levels below averages, and the debate is whether structural problems are affecting the trees, and how much of the cocoa shoot virus is longer term? Are we just pricing in what's happening or is there still room for prices to move higher if things are worse than we currently have price in?

**Question:** How much of cocoa production is coming out of West Africa? What's going on with the weather? Trees contracting swollen shoot disease?

**Answer:** Africa combined is ~80% production worldwide for cocoa and then Asia and South America remainder. Ivory coast and Ghana are main two producing countries.

Weather wise, there is the effect of depleting moisture that has resulted in lower yields. Strong winds are due to the season we are in right now. Most of the crop is in November/December/Jan (main crop) which produces ~60-70% of the crop, while March onwards is called the mid-crop and produces the remaining ~30%. So the Harmattan winds has been affecting the prospect of the mid-crop. The question is: are we just facing a bad crop affecting supply and demand?

Swollen shoot is a virus affecting the trees right now. If a tree contracts it, by year 2 they produce 50% of their original yield, and the tree dies in year 3. Swollen shoot could make '24-25 crop worse more so than the 22-23/23-24 crop. The market is partially pricing probability of swollen shoot disease right now.

**Question:** Can you give us a read into how cocoa futures have traded historically when these situations arise?

**Answer:** Everyone had a 5,000 target, which is where we are right now. Cocoa has been topical on the desk, and positioning is very extended. If at some point, there is an underlying issue with the trees, there is a chance that they haven't made enough ground into pricing cocoa.

**Question:** Given that it's a tight market, if supply were to come on in other parts of the world how much that would affect the price? How much incremental supply do you need to offset the deficit we are currently seeing?

**Answer:** Projections for the '23-24 crop is that the deficit will reach somewhere near 400,000 metric tons, comparable to the production of Ecuador. So if you want a country like Ecuador to come to the rescue, they need Ecuador to double production overnight, which is not really possible. Nothing they can do short term. Don't really see a saving grace from other production countries.

**Question:** Do you have a sense the share of speculators relative to chocolate companies covering positions?

**Answer:** Right now it's probably 80% specs vs hedging. Speculators tend to track this in a couple ways, one is Commitments of Traders data, US government data, etc. At this stage the speculators category is about as long as can be on the New York contracts,

and a little less extreme when you look at London contracts. Early 2024 saw industry buying the dip and then only speculators bought the last 500/600.

**Question:** Which is the more relevant market for futures-- US vs London, which should we pay more attention to?

**Answer:** Market trades both actively, volumes are generally very similar, both have equal importance. Arbitrage between the two is also a function of imports into Europe and imports into US. The premium of London vs NY has been going up in this situation and expecting that to continue as long as the market shows some tightness. Back of the curve is at somewhat of a discount, lots of HF interest in trading that market as well.

**Question:** How do contracts work on spot vs futures?

**Answer:** To my knowledge definitely a mix, would have forward contracts with suppliers embedding some hedging mechanisms. A lot of the purchasing will be done forward and then a question if there is hedging embedded in it those forward contracts or not, and then the remainder would be spot.

Don't think what companies hedging patterns will determine the chart. So the question is when do you decide to destroy demand.

**Question:** On the spec piece, are we at peak speculative with prices at highs?

**Answer:** If you look at it in absolute futures contracts the answer is no, specs have been longer before in NY. But specs also look at how a contract at 2000 also look different 5000. I would say we are close to peak speculative engagement. At this point it takes new players to push higher, getting questions from the investors who don't typically look at cocoa.

**Question:** How about as contracts roll?

**Answer:** Spec people tend to get out before delivery anyway.

**Question:** If you're talking about 400,000-ton deficit, whose volume amongst the chocolate manufacturers is going to be shorted?

**Answer:** The smaller guys are going to suffer—they won't be able to pay up. The bigger guys can pay up and erode their margins/pass on price to customers.

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