Rabobank

Sugar Quarterly Q1 2015

Overwhelming Stocks

Stock levels are high at both origin and destination. Lack of import demand from destination countries, despite falling sugar prices, reflects that these locations are well stocked, which in turn is causing a build-up of stocks at origin.

Main exporting countries' currencies depreciating against the US dollar. Producers from main-producing countries like Brazil and Australia are willing to sell at lower future prices that are denominated in a strengthening US dollar.

Tighter import regulations by governments in main destinations like China and Indonesia have led to the reining in of raw sugar imports from refiners in these countries.

Regional outlook

India

There is significant upward revision in India sugar production estimates for 2015, from 25.5 million tonnes to 26.5 million tonnes, driven by higher cane acreages in states like Maharashtra and Karnataka, which have better cane varieties in larger areas.

Brazil

Rabobank's preliminary projection of Centre/South (CS) cane production for 2015/16 stands at 575 million tonnes. Due to lower investments, this is only a modest increase over the 571 million tonnes in 2014/15, despite better expected weather conditions.

EU

Rabobank estimates EU sugar production of 19.3 million tonnes raw value in 2014/15, which is an increase of 14% compared to the previous season.

US

A slight increase in US planted beet acreage, particularly in the Red River Valley areas of Minnesota and North Dakota is expected in 2015, with slightly higher sugar prices and lower corn and soybean prices. However, the increase is unlikely to lower prices significantly.

Mexico

Rabobank's production estimate for Mexico remains at 6.2 million tonnes for 2014/15, up from the 6 million tonnes in 2013/14. Cane harvest and sugar production have been up 6.9% and 7.1%, respectively, over the same period a year ago.

Australia

A positive start to the year, with higher expected cane yields and a small increase in area planted, culminated in an Australian production forecast of 5 million tonnes for 2015.

Rabobank

Food & Agribusiness Research and Advisory

Published by the Global Sugar Sector Team

For a full list of authors, see back page

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Global summary

The upward movement of the New York No. 11 March contract at the beginning of the year got the bulls excited, as the front month contract managed to break USc 16/lb in late January (see Figure 1). But it has been all downhill since then, with the March contract expiring below USc 13/lb. The delivery against the March contract was also larger than what the market expected, further compounding the bearish outlook of the industry. Things are not looking any better for the May contract, as prices have fallen below USc 13/lb for the first time since April 2009.

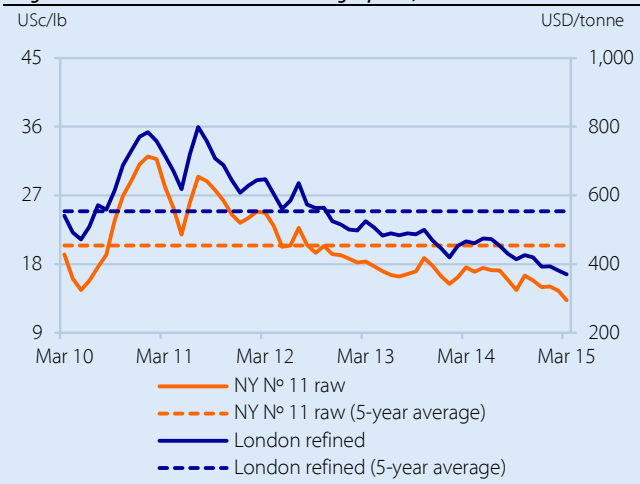
The decline in prices has been blamed on abundant sugar supplies that have been steadily accumulating after four years of production surplus (see Figure 2). Main import destinations like China and Indonesia have abundant stocks and are wary about importing more sugar in 2015, after seeing domestic prices collapse.

Despite the falling world market price, many would have expected Brazilian producers to switch from producing sugar to ethanol. A single percentage point switch of cane to ethanol would be equivalent to around a 0.75 million tonne reduction in global sugar production. However, the weakness of the Brazilian real against the US dollar means that in terms of the real, Brazilian producers are still receiving relatively attractive sugar prices.

Rabobank is forecasting a sugar deficit of 0.7 million tonnes raw value for the season (see Figure 3). The biggest change to our numbers from the previous quarter forecast has been an upward revision of India's sugar production.

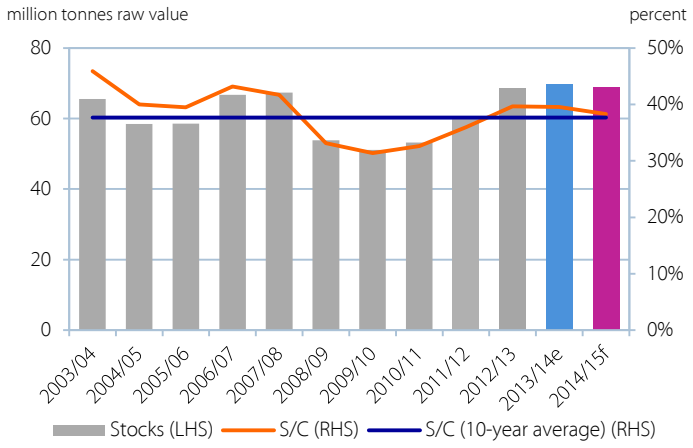
Despite the deficit forecast, we acknowledge that the market is stuck with the weight of stocks and the strong US dollar for the next few months; only by the third quarter of this year will we have some preliminary vision for 2015/16, which will better indicate whether the global sugar industry is headed for a cyclical downturn in production following low prices, or whether producers will choose to continue enduring low sugar prices.

Figure 1: International raw and refined sugar prices, 2010-2015



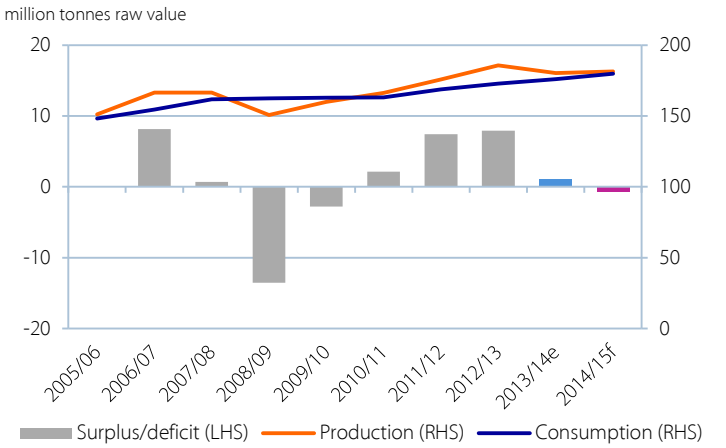
Source: Bloomberg, 2014

Figure 2: Global stocks and stocks/consumption ratio, 2005/06-2014/15f



Source: F.O. Licht, Rabobank, 2014

Figure 3: Global supply/demand balance, 2005/06-2014/15f



Source: F.O. Licht, Rabobank, 2014

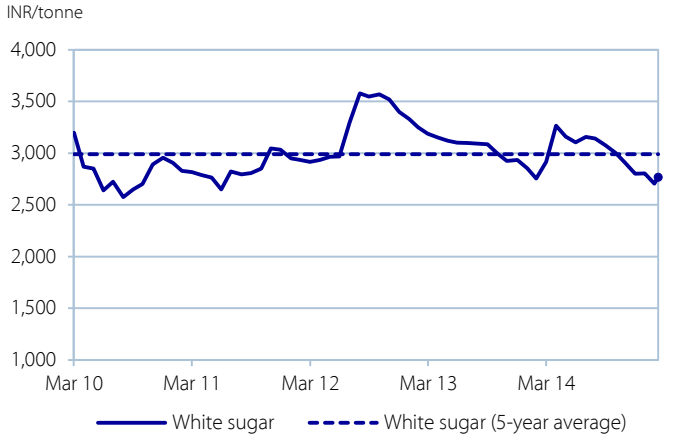
Regional outlooks

India

The latest data from the Indian Sugar Mills Association (ISMA) confirms that sugar output stood at 19.4 million tonnes at the end of February. This was an increase of 2.3 million tonnes (14%) over a similar period in 2013/14. Confirming the prognosis of significantly higher output, the Indian Food Minister announced that full-year production for 2014/15 would reach 26.5 million tonnes white value, which is a significant increase over previous estimate of 25.5 million tonnes white value. Despite the overall cane acreage being largely similar to that of the previous year, higher cane acreages in key production states of Maharashtra and Karnataka, with better cane varieties planted in larger areas, resulted in higher cane availability. Furthermore, mills in Uttar Pradesh began crushing about 25 days ahead of 2013/14. Although the peak crushing period is nearly over for the sugar mills in Uttar Pradesh, a tough state government stance on rising cane arrears could create headwinds affecting crushing in the rest of the season.

The Cabinet Committee on Economic Affairs (CCEA), approved an export subsidy of INR 4,000/tonne for 2014/15. This subsidy is limited to the quantity of 1.4 million tonnes of raw sugar. Unfortunately, for the sugar mills this is a case of too little, too late. Domestic sugar output expectation has been consistently revised upwards since the start of the season, while international prices have maintained a bearish outlook. Under the circumstances, exports (aided by the subsidy) are unlikely to reach 2013/14 levels and may be restricted to between 0.8 million and 1.0 million tonnes in the current season.

Figure 4: Indian white sugar (S30) wholesale prices (Mumbai), 2010-2015



Source: Bloomberg, 2014

Indian domestic sugar prices have been falling constantly over the past year (see Figure 4). Any expectation of the sugar export subsidy pushing domestic price was dented as decline in global sugar prices limited the attractiveness of exports. With sugar output ahead of projected annual domestic demand of 24.8 million tonnes and limited export opportunity, inventories continue to pile up and exert pressure on prices. Therefore, the expectation for domestic prices in March 2015 is bearish. With the bulk of the crushing period completed, sugar mills are sitting on large inventories at the start of the peak summer demand. Thus domestic sugar price expectation remains bearish over the next quarter.

Indonesia

Indonesia's 2014/15 sugar production is expected to be only marginally higher than last year, while consumption is expected to surge ahead at a growth rate of 4% to 5%. In order to meet domestic demand, Indonesian refineries will need to rely on imports, and the country will likely remain the world's second largest importer of sugar.

Despite government announcements of a new self-sufficiency sugar roadmap, which includes plans to build at least ten new sugar plants and integrate the sugar industry as a whole, Indonesia is still a long way from achieving this target. Although the price floor set by the government serves to protect the livelihood of the farmers in the country, it does not provide a strong incentive for them to adopt better farming practices and modern methods.

However, this year's greatest development has been the Indonesian government's decision to keep refiners and industry players in the dark as to the total volume of import quotas it will release. The decision to release import licenses on a quarterly basis rather than an annual basis definitely makes life tougher for

refiners. However, it does allow the government to have more control of the domestic sugar market. Domestic prices have barely budged above the price floor this year, ample stocks have built up over the past few years and end users are in no hurry to purchase additional stocks.

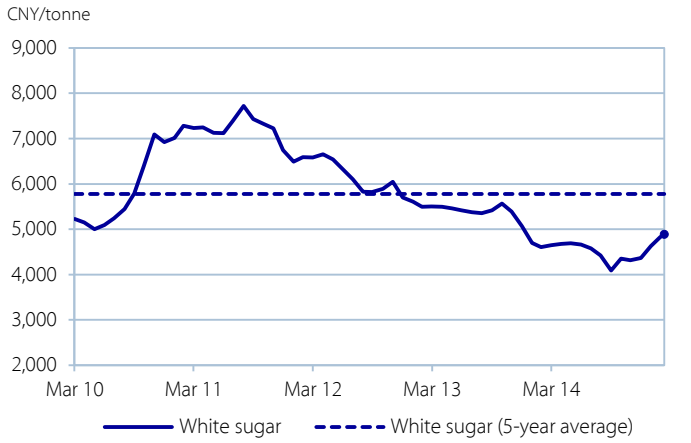
Thus far, only 600 thousand tonnes of licenses have been released for the first quarter, with expectations for the second quarter being around 900 thousand tonnes in order to meet the seasonal demand of Ramadan. Last year, sugar refiners ran at only slightly above 50% of their total max capacity, and it is widely expected that the sum of this year's import licenses will not exceed that of last year.

Thailand

Thailand's sugar production for 2014/15 is slightly behind compared to this time last year. So far, yields have been lower, largely attributed to the dismal weather conditions during the growth phase. Rabobank is expecting around 10.25 million tonnes raw value of sugar to be produced for the year.

Despite having a small sliver of profitability from the fixed domestic sugar price, Thai millers are definitely still feeling the heat from low export prices. Unlike the rapid depreciation of the Brazilian real, the Thai baht has depreciated at a much lower level against the US dollar, providing less cushioning from the fall in international sugar prices.

Figure 5: Chinese white sugar prices (Guangxi), 2010-2015



Source: Bloomberg, 2015

However, a growing trend has emerged, with millers searching for means to supplement their diminished income from sugar. Of course, the obvious choice would be to maximise the revenue they receive for the by-products of producing sugar, in this case molasses and bagasse. Increasingly more mills are exploring the option of having ethanol distilleries that utilise molasses as a feedstock, while other mills have cogeneration capabilities that utilise bagasse as a fuel source. Some mills have also tried differentiating themselves by producing organic sugar.

So far, the Thai government is very supportive of the sugar industry, as after the disastrous results of the rice buyback scheme, the military government has repeatedly encouraged farmers to shift from growing rice to planting sugarcane. In fact, the government has set a target of producing over 180 million tonnes of cane in 2025, roughly 80% higher than today's cane number. Although this roadmap might seem a tad over ambitious, it is important to bear in mind that only five years ago the country's total cane production was only around 68 million tonnes.

In order to assist the sugar industry, the Thai government is expected to continue subsidising sugarcane production and implementing measures to promote both ethanol production and cogeneration efforts. However, some of these measures have brought about discontent from other producing nations and have been brought to the attention of the WTO.

China

At the end of February, China's total sugar production was down by more than 12%. Sugar mills in Guangxi are already reportedly running out of cane to crush, with some shutting down operations. Production figures for the year 2014/15 are expected to be substantially lower than last year, mainly due to a 10% reduction in cane acreage from the previous season.

Domestic sugar prices have risen 25% since the lows of October last year (see Figure 5). Much of the rise can be attributed to lower expected sugar production and higher seasonal demand due to the recently concluded Lunar New Year. Although China

still has an estimated 6 million tonnes of state reserves, it is widely acknowledged that these will not be released back into the domestic market anytime soon.

This season's mandated cane price has been set at CNY 400/tonne, down 9% from last year's prices. The discounted cane price coupled with the increasing sugar prices would mean that the market is once again profitable for sugar millers, and it is unlikely that we will see the situation of cane arrears occurring like we did last year.

Looking ahead to 2015/16, we should expect to see further reduction in sugarcane planting. Current cane prices are simply not attractive for farmers, as rising labour costs and better paying competing crops like fruits, vegetables and peanuts mean that Chinese farmers will be looking at other more lucrative options for the next season.

On the import front, the out-of-quota import parity for raw sugar is once again open, and we have indeed seen shipments from Central America and Brazil trickle into the country. However, the decision by China Sugar Association (CSA) to cap the out-of-quota sugar imports at 1.9 million tonnes means that there is no rush to import sugar into China, even though the arbitrage window is currently open. Nevertheless, current healthy price levels coupled with weak international prices have definitely made smuggling sugar into the country more lucrative, and we may see an increase in such activities in the short run.

Brazil

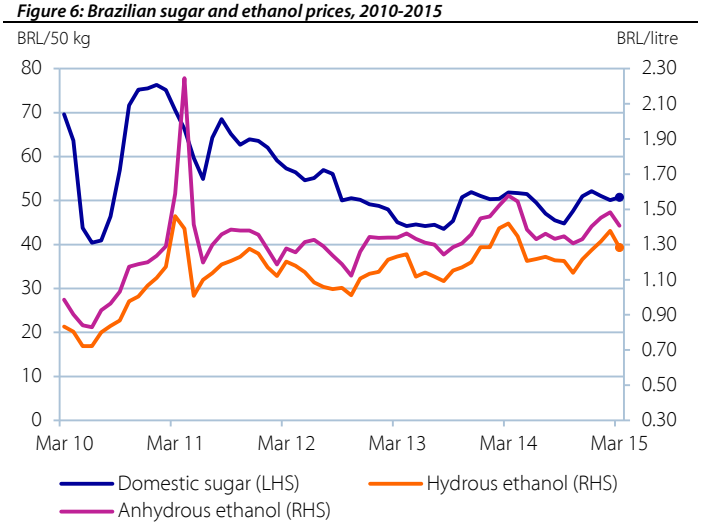
In 2015 to date, cumulative rainfall in a number of the Centre/South´s main cane regions, such as Ribeirão Preto, Araçatuba and Piracicaba, has been significantly better than in the corresponding period of 2014. Although, in some cases, it remains below the long-term average level. However, the variation between regions has been substantial, and a few regions have actually experienced less rainfall to date in 2015 than in 2014.

The full onset of the 2015/16 harvest is likely to be delayed by a week or two in order to maximise the time the cane has to recover from last season´s prolonged drought. While many of the mills that are in good financial shape expect that weather conditions will permit a modest rebound in yields compared to last season, it is also likely that mills and growers that are under financial pressure will tighten their belts via lowering investment in replanting (resulting in an increase in the average age of the cane in the field) and by reducing input use on ratoon crops.

With this in mind, Rabobank´s preliminary projection of cane production for the 2015/16 Centre/South harvest is 575 million tonnes, only slightly higher than the 571 million tonnes produced in 2014/15. Assuming normal weather conditions in 2015/16, cane quality (in terms of total recoverable sugar content, or ATR) is expected to be slightly below the 136.6 kilogramme ATR/tonne achieved in 2014/15.

The ceiling price for hydrous ethanol in 2015 is expected to be as much as 14% higher than in 2014 due to the reinstatement of CIDE[1] as of February 2015 (see Figure 6). The CIDE tax is levied on the ex-refinery price of gasoline at a level of BRL 0.22/litre. Rabobank believes that the reinstatement of the CIDE tax on gasoline should boost the average ex-mill sales price of hydrous ethanol to BRL 1.40/litre in 2015/16, versus an average price (to date) for the 2014/15 season of BRL 1.25/litre.

Figure 6: Brazilian sugar and ethanol prices, 2010-2015



Source: CEPEA, 2015

[1] Contribuição de Intervenção no Domínio Econômico, a tax on fuels originally introduced in 2001 to fund infrastructure and environmental projects, and to subsidise cleaner fuels such as ethanol and natural gas. Starting at BRL 0.28/litre gasoline, the CIDE tax on gasoline was lowered a number of times between 2009 and 2012, when it was eventually reduced to zero for an indefinite period.

On 4 March, the government announced that the blend of anhydrous ethanol with gasoline will be raised from the current 25% to 27%. The change takes effect as of 16 March. The move took place against a backdrop of rising costs of importing gasoline—the precipitous (-18%) decline in the BRL/USD exchange rate since the beginning of February means that the profitability of importing world market gasoline into Brazil and selling it on the local market, which was strongly positive in January, has been wiped out. With the increase in the blend, consumption of anhydrous ethanol could rise by close to 1.0 billion litres, and there will be a corresponding reduction in the country´s import requirement for gasoline.

Although the outlook for ethanol has improved, the extent to which there may be an increase in the use of cane for ethanol rather than sugar across the sector in 2015/16 is unclear. This is because, in spite of the decline in the futures curve for world sugar prices, the weakening Brazilian real has meant that sugar has continued to offer reasonable returns in terms of local currency, especially for those players able to hedge sales for 2H 2015, taking advantage of the steep forward curve for the BRL/USD.

Assuming a 43.0% allocation of cane to sugar, our preliminary projections of cane production and cane quality in 2015/16 imply sugar production at 31.7 million tonnes, slightly below the 32.0 million tonnes produced in 2014/15. Given the possibility that the allocation of cane to sugar may be less than 43%, owing to the uncertainty regarding sugar´s continued attractiveness relative to ethanol, it is worth noting that for every change of +/- 1% in the projected allocation of cane to sugar, the sugar production forecast varies by +/- 0.75 million tonnes.

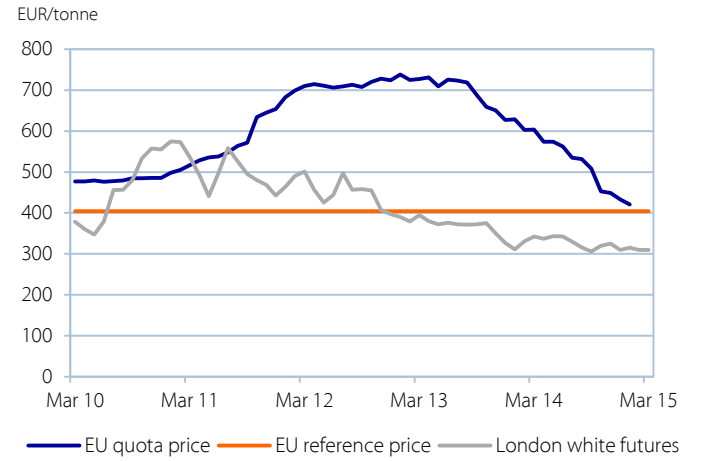
EU

The 2014/15 EU sugar campaign will be remembered as one with strong beet and sugar production, although revenues and margins for both growers and processors were under pressure. While in a liberal market these two go hand-in-hand and the current situation could make perfect sense, in the quota-regulated EU market, prices are not directly influenced by year-over-year crop variations. This can be illustrated by the 2011/12 season, when a record harvest was combined with a steady increase in EU white sugar prices.

Regarding sugar production in 2014/15, Rabobank estimates production of 19.3 million tonnes raw value, which is an increase of 14% compared to the previous season. The biggest increases will be seen in France and Germany, which will jointly produce over 1 million tonnes of sugar more than last year. A portion of the high volumes of out-of-quota sugar, which cannot be sold for food purposes, will be transferred to next year's quotas, thus already fulfilling some of next year's quotas without having to process any beets. This carry-forward will have an effect on the beet area in 2015/16. According to figures from the International Confederation of European Beet Growers (CIBE), the beet areas in all Member States except Finland will decrease. It is estimated the total EU beet area will account for less than 1.4 million hectares, which would mean a historically low beet area that is significantly below the 2014/15 season.

The price of EU white sugar peaked in January 2013 at a historical EUR 738/tonne and has dropped ever since. The latest reported price was EUR 421/tonne of white sugar in January 2015 (see Figure 7). The drop represents a 43% decrease in a timeframe of merely two years. The EU reference price, which sets the point when EU authorities are able to take measures such as private storage aid, stands at EUR 404/tonne. Since spot prices seem to have stabilised in various regions across the EU, we could expect the price drop to level off in the coming period.

Figure 7: EU refined sugar prices, 2010-2015



Source: Bloomberg; F.O. Licht, 2015

Average prices for industrial sugar have been fairly stable and were reported at EUR 337/tonne.

The key indicator for EU market supply is not the annual crop, but more so the imports of sugar from other countries. Generally, the volume of imported (mainly raw) sugar is between 3.4 million and 4 million tonnes per year. Imports from Economic Partnership Agreement – Everything But Arms (EPA-EBA) countries as well as through CXL quotas are significantly lower this season compared to last year, which is generally an indication of sufficient supply level. The latter is confirmed by the figures regarding sugar stocks, as the European Commission reported stocks above last year's levels.

Most expected the battle for new market shares would only commence in the post-2017 quota-free environment. However, since 2014, it seems that companies are already looking beyond their traditional customers and markets in an attempt to retain and capture market share. The well-supplied market, in combination with the increased competition, clearly had an effect on prices over the past two years. As producers have no possibility to sell additional quota sugar in the food market, and excess sugar can only be sold for industrial purposes, exported to the world market (up to 1.5 million tonnes per year) or carried-forward to the following marketing year, the key question is how the market and prices will develop in the next two-and-a-half years. We could see prices recover due to the regulated market, but surplus out-of-quota sugar could become a challenge for EU producers until the current regime ends in 2017.

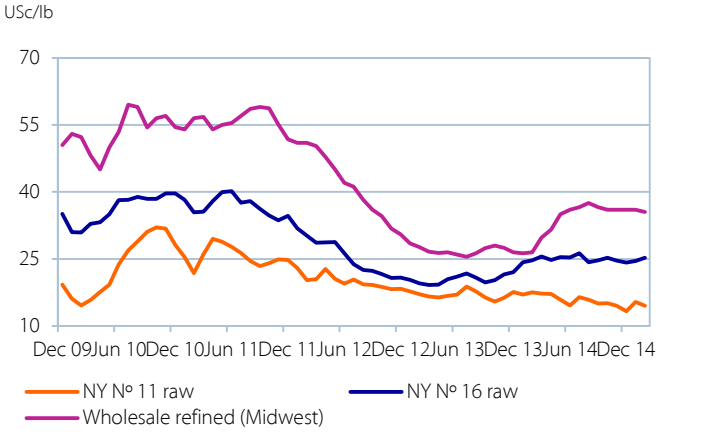
US

The trade dispute between the US and Mexico continues to cast a cloud over both markets. In December, the parties to the dispute signed an agreement suspending duties imposed on Mexican sugar entering the US. In place of the duties, new guidelines were drawn up to regulate the importation of Mexican sugar into the US. The guidelines outline price minimums, volume maximums, specific timing and licensing of Mexican exporters. However, two US cane refiners objected to the suspension of the agreement, which must now be reviewed by the US International Trade Commission (ITC). A ruling is expected by 24 March, but many in the industry expect a decision will not be forthcoming until summer. Meanwhile, market uncertainty remains the status quo.

As a result, US sugar prices have remained well supported since the filing of the suit in March 2014 and are just off the September 2014 highs (see Figure 8). Many in the industry believe prices will weaken once the trade dispute is resolved. While we believe we could see some softening of prices once an agreement is reached between the US and Mexico, potentially a much as USD 0.01/lb, we do not expect any significant price decline. There is one other factor which may keep US prices firm. The warmer temperatures of the past couple of weeks are raising concerns about deteriorating conditions of the remaining beet piles. While this is always an issue this time of year, our sources indicate there is concern that there may be more significant loss of sugar this spring than in past years. This issue and the loss of sugar will help firm prices as the crop year progresses.

The USDA is walking a tight rope by trying to maintain a stocks-to-use ratio in the 13.5% to 15.0% range. The 2014/15 US sugar balance sheet is currently at a relatively tight 13.5%. With declining imports from Mexico, the USDA will have to carefully manage entering Tariff Rate Quota (TRQ) sugar to meet demand—too much at once and the market crashes, or too little and market prices spike.

Figure 8: US sugar prices, 2009-2015



Source: Bloomberg, USDA, 2015

On 31 March, the USDA will release the 2015 Prospective Plantings report. Planted sugar beet acres have been trending lower over a number of years, with high corn and soybean prices, increasing sugar content of beets and static beet processing capacity contributing to the decline (see Figure 9). As sugar content increases, less beet acres are required. With sugar prices slightly higher this year and lower corn and soybean prices, we would expect to see a slight increase in planted beet acreage in 2015, particularly in the Red River Valley areas of Minnesota and North Dakota. However, we do not believe the increase will be significant enough to pressure price considerably lower.

Mexico

Mexican sugar exports to the US remain on hold as uncertainties regarding the future of the suspension agreement continue. In addition, the reference prices set in the agreement, particularly the estándard sugar set at USc 22.25/lb, deter exports to the US. From October 2014 to January 2015, exports to the US accounted for 10 thousand tonnes below the 69 thousand tonnes exported over the same period in 2013/14.

However, if the suspension agreement is back in place at the end of this month, we believe that Mexican exports can fulfil its entire allocation to the US of 1.4 million tonnes for the 2014/15 cycle. However, according to the USDA, if exports do not resume until May or later, a logistical bottleneck will constrain that volume. That will be a clear downside for Mexican domestic prices.

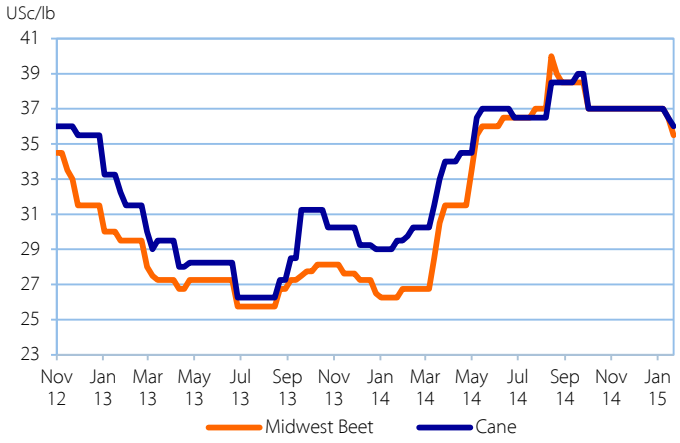
Our production expectation for the 2014/15 cycle remains on hold at 6.2 million tonnes, up from the 6 million tonnes produced in 2013/14. After 22 weeks of the Mexican sugar campaign, cane harvest and sugar production are up 6.9% and 7.1%, respectively, over the same period a year ago.

Domestic sugar consumption is expected to rise to 4.4 million tonnes, up 4.8% from 2013/14. Sugar users accelerated their purchases in previous months, as they expect sugar prices will increase as soon as sugar exports to the US resume.

Despite a low level of exports, domestic sugar prices, particularly for refined sugar, found some support on domestic consumption. However, we expect prices to gain momentum as soon as exports begin to resume. We expect prices to start moving above the MX 400/50 kilogramme bag (see Figure 10).

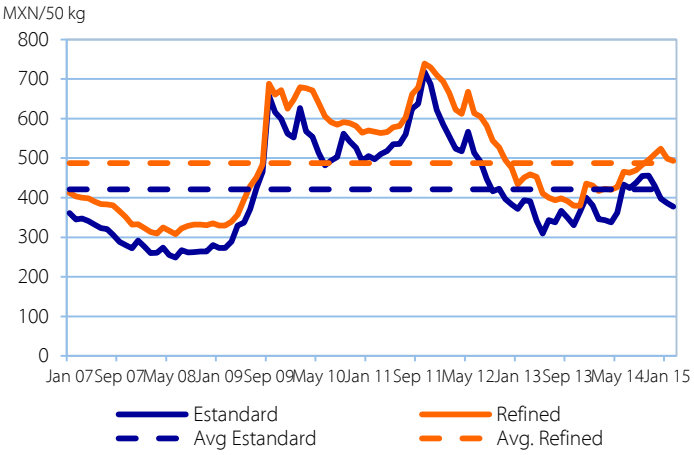
The Mexican government announced it will sell the nine sugar mills it owns and operates. The auction process will start at the end of this month and should be completed by July. The mills will be sold in different sets and the auction is open to all participants.

Figure 9: US cash cane & beet sugar prices, 2012-2015



Source: USDA, 2015

Figure 10: Mexican refined and standard sugar prices, 2007-2015



Source: USDA, 2015

Australia

Weather conditions across Central and North Queensland are supporting a strong start to the growing season in 2015. So far, rainfall has been slightly below average in the Northern and Burdekin regions. However, there was much needed improvement in rainfall recorded in Central Queensland. Furthermore, warm temperatures have been recorded and will no doubt assist cane growth. The Australian Bureau of Meteorology upgraded the potential of an El Niño to 'watch' status in March, with the likelihood of an event forming in 2015 increasing to 50%. Temperature patterns have been forecast to stay neutral until May, which will be an interesting factor to watch out for as Australia moves into winter and spring crush months.

The positive start to 2015 has prompted the Australian Bureau of Agricultural and Resource Economics (ABARES) to forecast production of 5 million tonnes for the year, attributing the production growth to expected higher cane yields and a small increase in area planted.

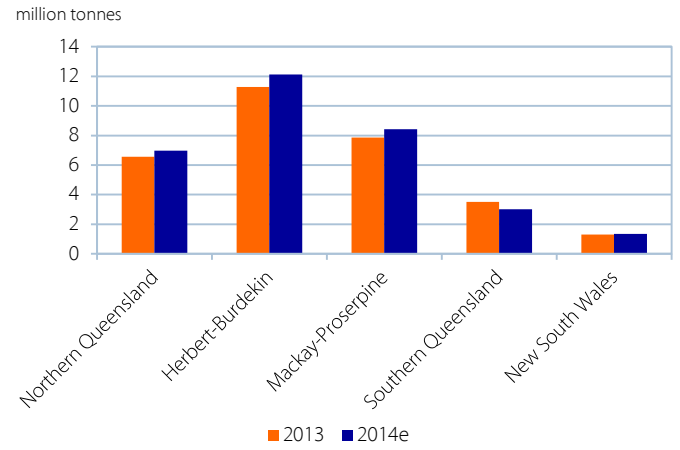
Prices for Australian growers are also currently being supported by improved yields as well as the substantial falls in the Australian dollar. In mid-2014, at the commencement of the crush, the Australian dollar was trading at about USc 94, but has subsequently fallen to trade around USc 78 in the first week of March. Rabobank maintains a forecast of further falls, with the 12-month outlook at USc 70. ABARES has subsequently reported that average returns to growers are forecast down just 1% YOY in 2014/15, despite the backdrop of low international sugar prices.

Australian exports for the year 2013/14 (July to June) are estimated at 3.1 million tonnes, their highest volume since 2009/10. Indonesia is the largest market, taking almost a third of all Australian sugar exports (see Figure 12). Forecast higher production, assuming favourable weather conditions, has lifted forecast export volumes and values in 2014/15 and 2015/16.

The proposed sugar marketing changes in the Australian industry have continued to attract government and industry attention. A senate inquiry will hold hearings in Queensland during March 2015, addressing the proposed industry marketing, supply chain and competition issues. The inquiry is due to report findings on 30 April 2015.

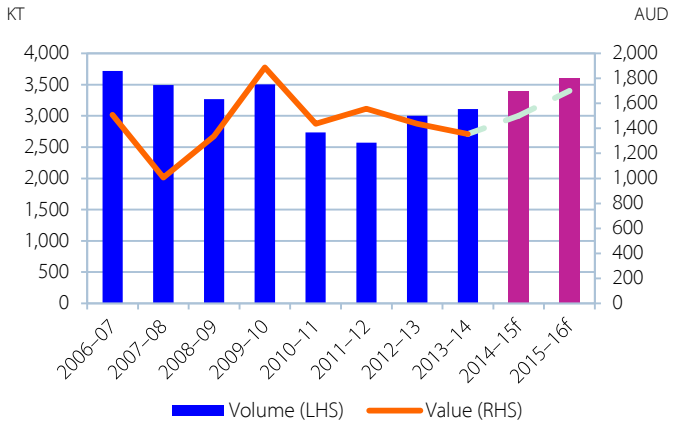
Meanwhile, energy costs remain a key concern for Australian growers as production costs come under even greater scrutiny, with downward pressure on farmgate returns. It is estimated that electricity prices for irrigators have more than doubled since 2011.

Figure 11: Australian cane crush, 2013-2014e



Source: ASMC, Rabobank, 2014

Figure 12: Australian sugar export volumes, 2006/07-2015/16f



Source: ABARES, Rabobank, 2015

Global outlook

Rabobank expectations

Not much has changed since our last quarterly update, as we continue to see weak fundamentals and macroeconomic developments keeping sugar future prices low. The market is no longer concerned if 2014/15 will be a surplus or deficit year, but rather all eyes are focused on the import policies of destination countries.

As we enter the second quarter of 2015, we also reach the halfway point of the 2014/15 international crop year. Increasingly, the market focus will begin to shift towards the preliminary outlook for the 2015/16 international crop year.

Upside influences

The outlook for the sugar market is not all that rosy at the moment, as initial production fears have simply not been realised. As sugar prices trend lower, we are finally seeing price signals starting to get through to the farmers. Sugar crop growers in countries like China and the EU have seen their crop returns falling consistently over the past few years. As such, we can expect even more farmers switching away from planting cane in favour of other, better paying, competing crops.

With global sugar consumption expected to continue growing at around 2% to 3%, and total global cane and beet acreage expected to trend even lower due to diminished returns, initial signs point to a much larger sugar deficit for the 2015/16 season. Hopefully, sugar supplies would have cleared up by then, and there would once again be room for imports. There could be light at the end of the tunnel after all.

Downside influences

At levels below USc 13/lb, it almost seems like the market could be very near rock bottom, but that may not be the case. The US dollar is expected to continue to strengthen or remain strong for the rest of the year, and this might result in international sugar prices moving even lower.

Rabobank

Rabobank Food & Agribusiness Research and Advisory Sugar Global Sector Team Analysts

Australia – Georgia Twomey
georgia.twomey@rabobank.com

Brazil – Andy Duff, Strategist
andy.duff@rabobank.com

Mexico – Pablo Sherwell
pablo.sherwell@rabobank.com

India – Sudip Sinha
sudip.sinha@rabobank.com

EU – Ruud Schers
ruud.schers@rabobank.com

Singapore – Chang Jian Yong
ChangJian.Yong@rabobank.com

USA – Stephen Nicholson
stephen.nicholson@raboag.com

far.rabobank.com

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