Monthly Report

JANUARY 2009

In this edition…

Written by Natalie Arnieri

Edited by Sharon Jensen

2009 Canadian cattle and beef supply outlook

Over the last five years the Canadian beef industry has faced a significant number of challenges, turmoil, and financial losses. Contributing factors include continuing border closures due to BSE, ongoing market access limitations, volatile currency, energy and feed prices, labour shortages and unpredictable commodity markets.

In 2008, profitability continued to be a challenge for the primary production sectors, with an appreciated Canadian dollar limiting gains in cattle and beef prices. Escalating feed grain prices, arising from the growing ethanol industry, strong global demand for grain, and tight feed grain supplies, further reduced profits. Volatile commodity markets swung dramatically due to the entry and exit of large numbers of speculators, who sought investment alternatives to the stock market's uncertainties. U.S. implementation of mandatory Country-of-Origin Labelling (COOL) also added to the challenges facing the industry (see details under COOL in this report).

On the positive side in late 2008, the industry finally experienced some relief from severe labour shortages and rising labour costs, through expanded foreign worker programs and the softening economy. By year-end, production costs were lower due to the economic slowdown and decline of oil prices, plus a lower Canadian dollar and reduced feed grain prices. Canadian packers are managing the costs associated with the implementation of the enhanced feed ban regulations, as initial enforcement requirements were adjusted somewhat. Although competing U.S. packers don't face the same costs, the enforcement changes reduced Canadian packers' expenses, bringing them more in line with initial industry expectations.

Moving into 2009, cattle and beef prices will continue to be challenged by lower cutout values, due to economic downturn and COOL. On the positive side, reduced North American cattle suppliers, improved exports, a depreciated dollar and reduced feed costs will provide some support to prices over the near term. Significant volatility is expected as the dollar and feed grain prices could rapidly increase, depending on how quickly economic recovery takes place and the supply situation for oil and feed grains change. In order to minimize this impact, and continue the Canadian industry's recovery, export development will be critical for increasing cutout values and reducing the industry's dependency on exports to the U.S.

Keeping up-to-date on COOL

A lot happened with Country-of-Origin Labelling (COOL) throughout January. Mid-month, the United States Department of Agriculture (USDA) issued the final rule for mandatory COOL. This final rule permits some flexibility that the CCA believes would enable U.S. packers to resume purchases of Canadian cattle for immediate slaughter.

However news of this positive development was short-lived as the Obama Administration temporarily suspended its implementation on their first day in office - January 20. The White House notified all U.S. Government departments that any regulations not yet in effect at that time were to be reviewed. It may still turn out that the COOL final rule proceeds as is, but at the time of writing this report, the door was open for delaying the effective date. If this occurs, a public comment period could ensue and potential changes to the rule may be made. However, it's premature at this point to speculate that the flexibility gained in the final rule, for B and C cattle, will be revised.

Under the final rule the regulations on segregation of animals changed, allowing greater flexibility for U.S. buyers in managing their inventories of Canadian cattle (and hogs) – eliminating the extra processing costs associated with producing two different labels. It stated that when animals imported from Canada for immediate slaughter, are co-mingled during a production day with animals born in Canada and raised in the U.S., then the resulting product from either category may be designated as a "Product of the U.S. and Canada". Previously the interim final rule required segregation of these two categories of cattle, so that two different labels could be applied. That regulation caused an immediate negative impact on Canadian animals, as most U.S. companies stopped utilizing cattle, imported for immediate slaughter, rather than incur the cost of segregation.

...continued on page two

Canadian Cattlemen's Association

310, 6715 8th Street N.E. - Calgary, Alberta - T2E 7H7

Tel: 403.275.8558 Fax: 403.274.5686

www.cattle.ca

...continued from page one,

Keeping up-to-date on COOL

The CCA agreed with the Government of Canada's decision to suspend World Trade Organization (WTO) proceedings until the market response of these policy revisions can be evaluated. However, we retained the right to pursue the case further at the WTO, once we document any ongoing trade disruption.

The Government of Mexico initiated its own WTO consultation process on COOL. We understand that the final rule's policy changes did not interest Mexico. They still plan to proceed with consultations in the final week of February. Canada is permitted to participate in Mexico's WTO process on COOL.

Naturally we have many questions about COOL's latest development. We continue to seek clarity, while working with the Canadian government and our industry partners to minimize the negative impact this creates for the Canadian livestock and meat industries. Keenly aware of the confusion this creates for the industry on both sides of the border, the Government of Canada remains committed to quickly resolving the issue and laying to rest the disruption it creates.

Hong Kong breakthrough trade agreement

In early January, Minister of Agriculture and Agri-Food, Gerry Ritz, secured an important agreement, in principle, for the restoration of commercially meaningful market access for Canadian beef exports to Hong Kong. Through a staged process, by year-end Hong Kong will permit all beef from under-30-month (UTM) cattle, plus boneless beef and offal from over-30-month (OTM) cattle.

CCA President Brad Wildeman accompanied Minister Ritz on the Hong Kong mission and believes the agreement is a win for both countries. It significantly contributes to the bottom line for Canadian producers, and provides Hong Kong families with access to high-quality, safe Canadian beef.

The first stage of the Hong Kong agreement allows UTM bone-in rib cuts to be added to the existing UTM boneless beef access. After complying with Hong Kong's requirements during an initial four-month, phase-in period, the second stage adds OTM boneless beef and offal. By calendar year-end, if Canada meets the full requirements, Hong Kong borders will open to all remaining UTM beef products, including T-bone and porterhouse steaks.

Prior to BSE, the Hong Kong market consumed 600 tonnes per year of Canadian beef. Our third largest export market since 2005, Hong Kong imports an average of 18,000 tonnes per year. Wildeman says the new agreement could further double our beef exports to Hong Kong.

The agreement sends a strong signal to other foreign markets of Canada's serious intent to re-establish commercially meaningful access for Canadian beef worldwide. We congratulate Minister Ritz for this achievement and encourage him, or a Cabinet-level beef envoy, to build on this success by reaching further agreements with other countries.

Canadian government adopts export market access recommendations

In early January, the Government of Canada announced plans to implement several key industry recommendations presented at the Beef Value Chain Round Table (BVCRT) meeting in November. The federal government announced the creation of a new export technical market access secretariat to work full-time on aggressively and strategically securing access to international markets. With the co-ordinating efforts of the secretariat's trade experts, industry and government trade initiatives will work cohesively to promote agricultural exports worldwide, and effectively eliminate any technical barriers to Canadian exports.

If the federal government implements the remainder of the BVCRT's market access recommendations, it will yield huge benefits for the Canadian economy. The comprehensive roadmap focuses on a number of key areas and was developed, in consultation, with major meat-exporting nations, Canadian market-access professionals, plus exporters responsible for more than 90 per cent of Canada's red meat exports. Reaching out to other national organizations across all agricultural sectors, CCA is encouraging each to participate as details develop on the formation of the secretariat.

We believe the initial impact of restoring all Canadian export markets would almost immediately add $100 of value to every head of cattle produced; creating optimism and encouraging growth throughout the cattle and other agriculture sectors. By 2015, industry exports could increase by $6.3 billion per year, creating over 93,000 jobs on farms, and in transportation, processing, sales and service sectors.

Korean inspection report waits on BSE results

From November 17 - 27, 2008, eight Korean authorities from the Ministry of Food, Agriculture, Forestry and Fisheries, paid an inspection visit to Canadian meat plants placing particular emphasis on Bovine Spongiform Encephalopathy (BSE)-related controls.

During their visit, Canada announced another case of BSE. As a result, the Korean authorities requested receipt of the BSE report before they complete their inspection report. Once completed, we hope that Canada moves quickly through the final stages of the eight-step process to regain Korean market access.

Historically, Korea has been Canada's second largest export market in Asia - second only to Japan. Koreans purchased approximately $60 million of Canadian beef in 2002 prior to BSE. Canada is working to regain the access lost to BSE and achieve access similar to that granted to the U.S.

Canadian Cattlemen's Association
310, 6715 8th Street N.E. - Calgary, Alberta - T2E 7H7
Tel: 403.275.8558 Fax: 403.274.5686
www.cattle.ca

U.S. foodservice buyer building business on Canadian Beef Advantage

The Beef Information Centre (BIC) recently hosted a Canadian beef trade mission for U.S. foodservice distributor, Dole & Bailey, a New England foodservice distribution company based in Massachusetts. The mission aimed at exploring options that promote increased profits and differentiation in the company's beef category.

Jeff Trafford, BIC's director of U.S. marketing services Trafford said, "Dole & Bailey are eager to explore paths that offer restaurant operators expanded signature opportunities on their menus and consistently excellent beef products".

With this in mind, Dole and Bailey quickly exercised the opportunity to visit the Canadian industry first-hand and explore supply arrangements. They left with an even stronger positive impression of the care, dedication, quality and safety standards that benchmark Canada's important beef sector.

Dole & Bailey's director of fresh meat and sustainable programs, John Stowell, and their sales manager Ed Brylczyk, spent three days visiting farms, feedlots and Canadian packers in Ontario. "The chance to visit and interact with Ontario cattle feeders was a real highlight that continued to receive praise throughout their stay and upon return to Boston," added Trafford.

BIC's trade mission helped develop a relationship linking Dole & Bailey to Canadian packers where the geographic proximity to Massachusetts makes the most sense - in this case Ontario.

The excellent brand equity of the Dole & Bailey name is firmly established on a history of quality dating back to 1886. Their motto is, 'Where Great Chefs Go For Great Food'. As suppliers to the New England foodservice distribution market, the company services a wide area from Connecticut to Vermont and north to Maine.

According to Jeff Trafford, enthused by discussions about the Canadian Beef Advantage (CBA), the Dole & Bailey team immediately envisioned a Canadian branded beef program under the Dole & Bailey 'Chef's Signature' name. "We are moving forward on training and education focused on the CBA. This would be of particular importance in launching and sustaining Canadian beef sales and generally assisting in building the entire beef category at Dole & Bailey."

Responding to NFU's Report "Farm Crisis ... New Analysis and New Solutions"

On November 19, 2008, the National Farmers Union (NFU) of Canada released a report, "The Farm Crisis and the Cattle Sector: Toward a New Analysis and New Solutions".

The NFU argues that retail and packer concentration, captive supplies, continental integration and export dependence resulted in a declining cattle price trend. This raised a number of questions within the industry regarding historical price trends, export dependence, profit margins and marketing practices

Historical Price Trends

The Alberta fed steer prices fell in real dollars from $250/cwt, in 1980, to range between $100 and $150/cwt, from 1989 to 2003. This price decline was expected, as the Canadian beef demand index fell from 100, in 1980, to 55.5 in 1998. This implies that if production remained constant, then in 1998, beef prices needed to fall to 55 per cent of 1980 levels for consumers to be willing to consume the same amount of product.

However, beef production did not stay constant over this time period and instead actually increased 51 per cent from 2.25 billion pounds (carcass weight, including offal) to 3.4 billion pounds. While retail beef prices remained virtually unchanged since 1975; with weaker beef demand and steady retail prices, consumption would be expected to decline. Per capita consumption declined from a high of 38 kgs/person, in 1976, to 22 kgs/person in 1993.

Changing consumer preferences and reduced prices for competing proteins led to the decline of beef consumption - not that consumers paid too little. The substantial reduction in Canadian and U.S. beef demand has a direct link to the reduction in fed cattle prices that occurred between 1980 and 2003.

Exports and the Cutout

Increasing Canadian exports, since 1989, allowed domestic packers to maximize the cutout value. This increased the overall return to packers, and in turn increased the price they were willing to pay domestic producers for fed cattle. For every $1 increase in the AAA cutout value, live Alberta fed cattle prices increased by $0.67, from 1999 to 2008. In light of reduced domestic consumption, expansion of exports was critical to supporting cutout values and consequently the demand for fed cattle.

Returns vs. Margins

Profits move through the supply chain. When borders are open and free trade occurs, domestic and U.S. packers compete for fed cattle. Price signals move more clearly throughout the supply chain. In contrast, when borders are closed or only partially open for trade, domestic packers have an advantage with more domestic supplies available. However increasing domestic supplies, when faced with fixed demand (limited by total slaughter capacity in Canada), depresses live cattle prices.

The higher cattle prices (in real dollars) seen in the 1970s do not imply larger profits for producers. In fact, given the

...continued on page four

Canadian Cattlemen's Association
310, 6715 8th Street N.E. - Calgary, Alberta - T2E 7H7
Tel: 403.275.8558 Fax: 403.274.5686
www.cattle.ca

...continued from page three,

higher feed grain prices shown for that time period, and the trend of fewer farms, implies that tight margins and periods of negative returns in the industry discouraged young people from entering the business. It is these small margins that lead to larger operations and consolidation within the packing and retail sectors.

Market Trends and Marketing Options

The NFU report points to captive supplies as a way packers control live cattle prices. The development and use of these marketing tools to reduce feedlot risk, provides producers the stability needed to survive in a volatile market. Captive supply arrangements arise out of economic incentives for cattle producers and beef packers to engage in such business arrangements. If these options were removed, it would expose producers to the increasingly volatile market place. A feedlot's ability to custom feed packer-owned cattle at a profit is critical to overall resilience in a small-margin industry.

Conclusion

NFU's proposed solutions aimed at increasing prices by limiting supply ultimately results in fewer producers and creates further consolidation as benefits of economies of scale and lower average costs would still be present.

A succession of competitive challenges has resulted in large losses and significant declines in profitability throughout the Canadian beef industry over the last several years. But the major contributing factor in declining prices is reduced beef demand across North America. Increased exports since 1989 have increased packer returns; which passed onto the producer as increased cattle prices reflect the move of profits or losses through the supply chain. However, decreased domestic demand and limited market access to international demand resulted in lower cutout values - depressing live cattle prices.

A feedlot's ability to use various marketing options, including contracts with packers, is an important part of an operation's risk management. Taking away mechanisms such as packer ownership, developed to reduce producer risk and lock in profits, is not the answer. To increase the overall cutout value and ultimately deliver the most impact on feedlot and cow/calf returns, demand for beef, domestically and internationally needs to grow.

Canadian Beef Advantage (CBA) update

As 2009 got started, so did the CBA. The CCA's new comprehensive branding program moved several steps closer to achieving its goals for differentiating Canadian beef and attracting worldwide consumer loyalty - critical to sustaining our industry long-term.

First on the list was unveiling the industry's new tangible brand mark. A highly-visible tool for differentiating Canadian beef from worldwide competition, the new CBA logo symbolizes the superior attributes of Canadian high-quality, grain-fed beef and cattle. It promotes the benefits of choosing Canadian beef from farm to fork. This includes production practices, environmental stewardship, beef quality and yield advantages - 'maximizing' the value of every cut and product from each animal, plus emphasizing our global animal health status (recognized by the World Animal Health Organization - OIE) and food safety practices.

Domestic

CANADIAN BEEF

The CBA logo helps create distinct recognition of Canadian beef as we regain full access to existing export markets and expand new market opportunities. It provides a tangible recognition point that delivers the good news about Canada's beef cattle industry. It also highlights the proximity of the just-in-time supply of fresh Canadian beef to U.S. importers - further mitigating some negative impact of COOL .

International

CANADA BEEF

CBA-information exchange pilot project underway

A significant tool developed to support the CBA initiative is a production information exchange database and system. To demonstrate the effectiveness of the CBA's information exchange database, a pilot project commenced with participants across the value chain to determine to what standards, technical requirements and information elements can, and will be captured.

Uploading to the database requires commitment from all sectors in the beef-production value chain. The exchange will incorporate data on attributes such as age and source verification, plus input from the Verified Beef Production Program. Participating feedlots and packers are collecting specific production data linked to RFID numbers and uploading this into the CBA's database. During the pilot, all participants can access this information.

Due to time constraints, the pilot project initiates at the feedlot; capturing data on cattle destined for slaughter by March 31, 2009. To finish the pilot within the timeframe of January - April 1, 2009, some age-verified feeder cattle have been identified in Alberta, Saskatchewan and Ontario feedlots.

The pilot is intended to prove that the CBA's system of data upload, capture and transfer works. When rolled out to the entire industry, the potential for voluntary data and information exchange will only be limited by the imagination.

Canadian Cattlemen's Association
310, 6715 8th Street N.E. - Calgary, Alberta - T2E 7H7
Tel: 403.275.8558 Fax: 403.274.5686
www.cattle.ca