

Gíra

Consultancy & Research
Prospective et Stratégie

Securing a better future for the Canadian
pigmeat chain
A preliminary diagnostic analysis

by

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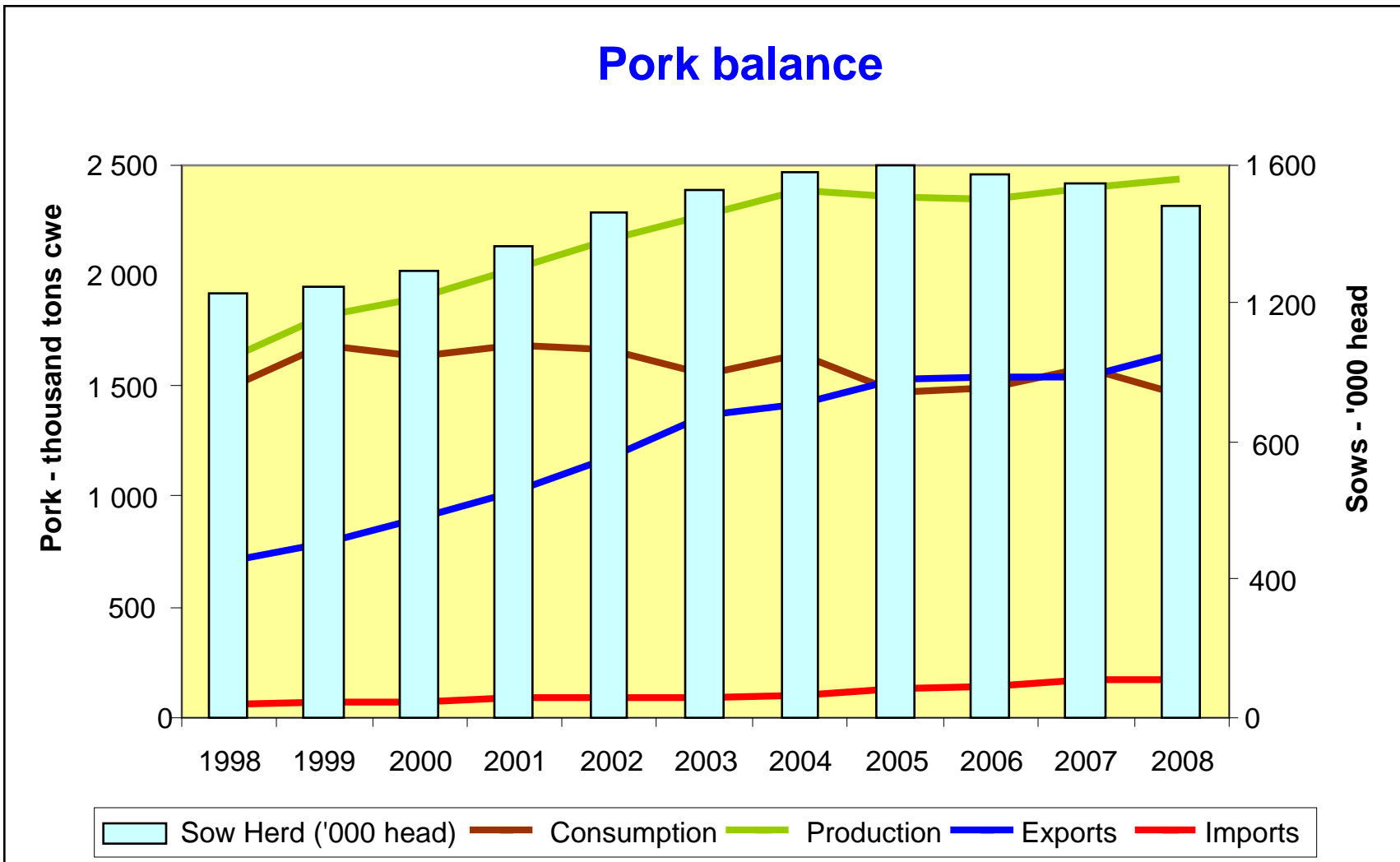
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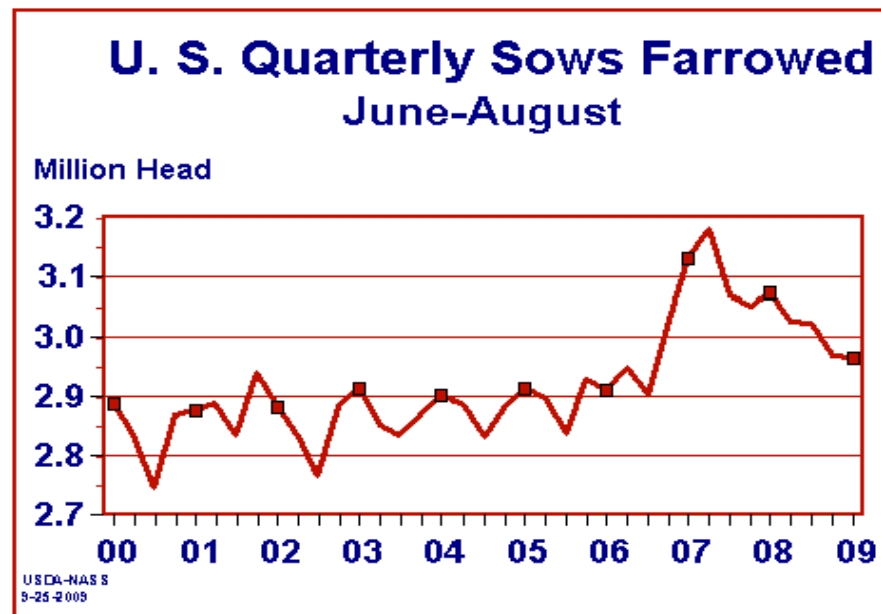
- Too many pigs in North America
- The Dollar
- Pig prices
- Competitiveness
- Supply chain blockages
- The changing trade balance
- A domestic market under attack
- Conclusions & some preliminary suggestions

Pork balance



DUE TO:

- **Over-farrowing** in the US after the strong demand of 2007-8 (Chinese once-off demand)
- **Decline in US consumer demand** due to the economic crisis
 - In the context of a long-term decline in US and Canadian pork consumption
- **Decline in world demand** as some countries in crisis eat less meat
- H1N1



There has been very little “marketing” or added-value for pork and pork products in North America (including in Canada) to soften the blow of the inevitable “commodity” price swings due unwanted pigs and pigmeat on the market.

COOL and last year’s lysteria emergency have made the Canadian situation even worse.

There will certainly be a cyclical upswing in prices – due to a recovery of demand after the recent crises and to reductions in production – but probably not for another 12 months.

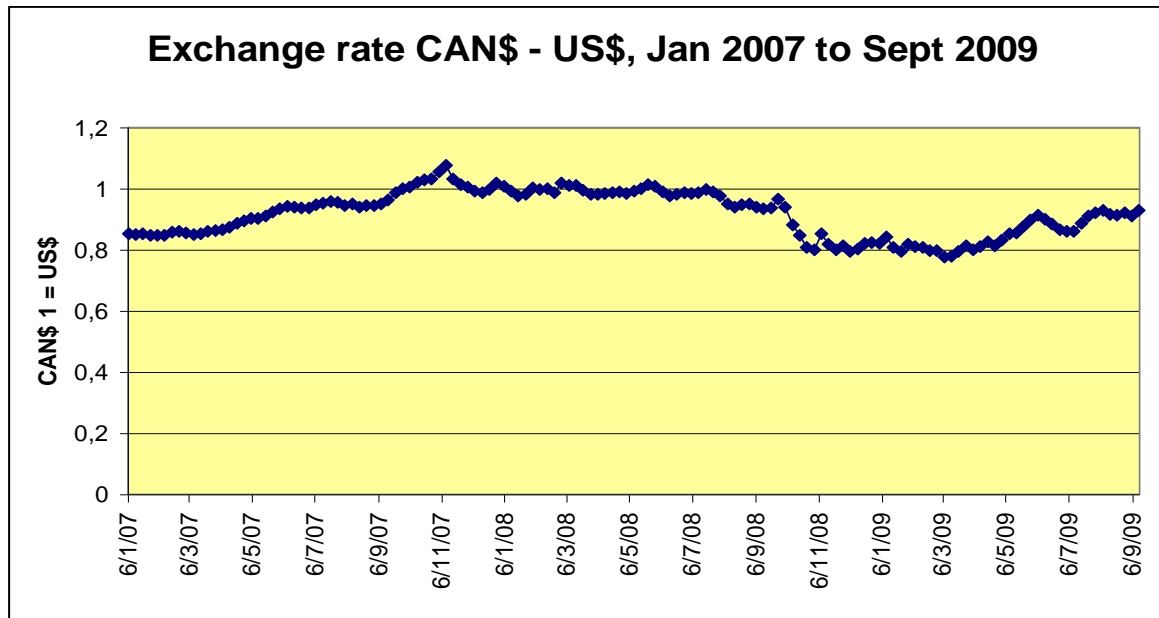
- And it will all start over again in another few years – if we do nothing in the intervening period.

Canada also has played a role in the current overproduction, having led the world in commodity export growth for several years.

It must now find a way of reducing its vulnerability to the high price elasticity that affects all purely commodity markets – the US-driven American market in particular.

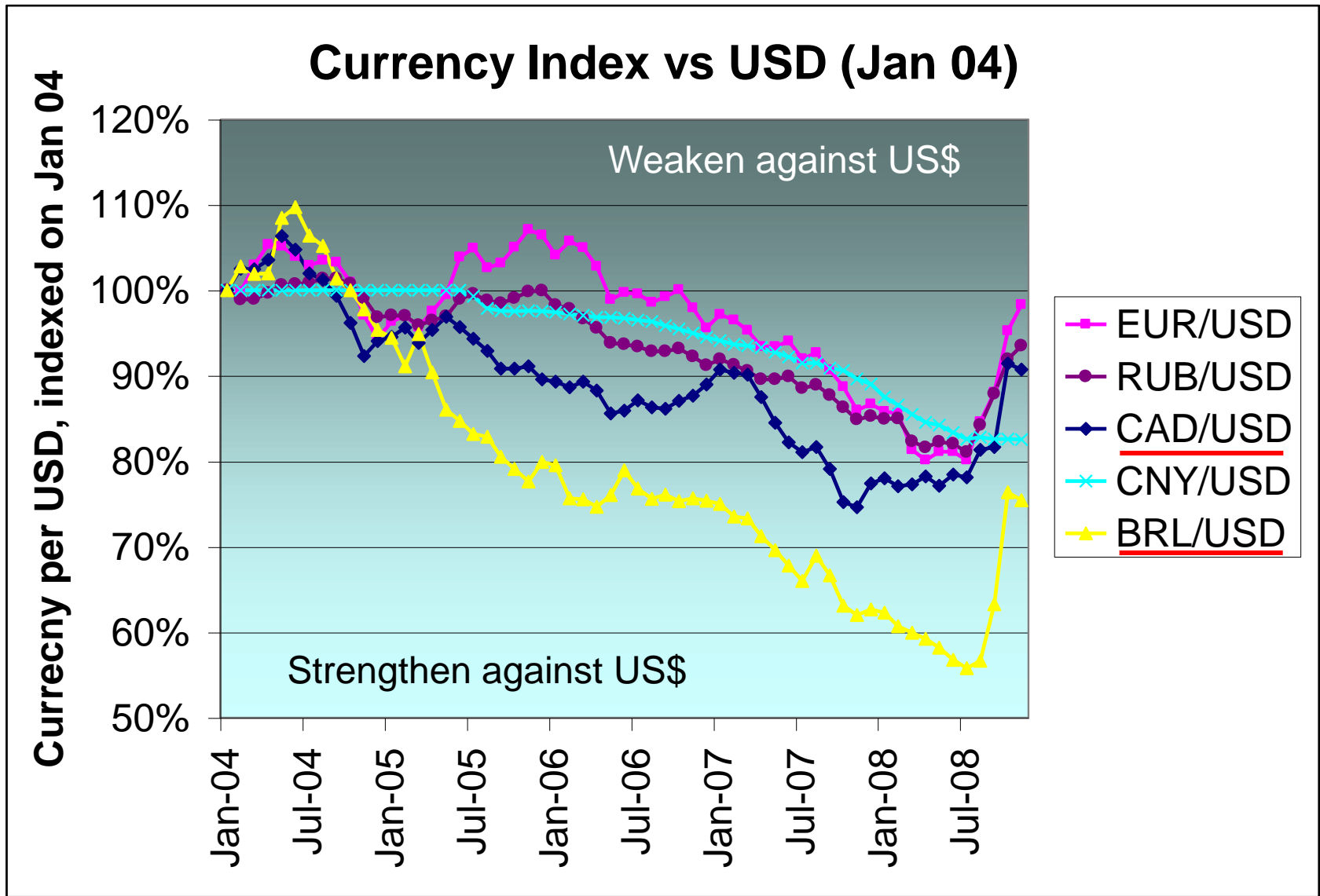
2. A dollar that is oblivious to the realities of the hog sector

- If, as many say, the Canadian pork industry was built primarily on the back of a weak currency, then those days are indeed over
 - The CAN\$ has recently become a petro-currency, at US 90c rather than US 70c
 - A prudent medium term business plan would today assume parity
- "It is estimated that 100% of hog revenues are US\$ related, but only 50% of costs"
- But it is as much **the speed and amplitude of change** that does the damage as the actual exchange rate itself.



Hog producers must “liberate” themselves as much as possible from the US\$:

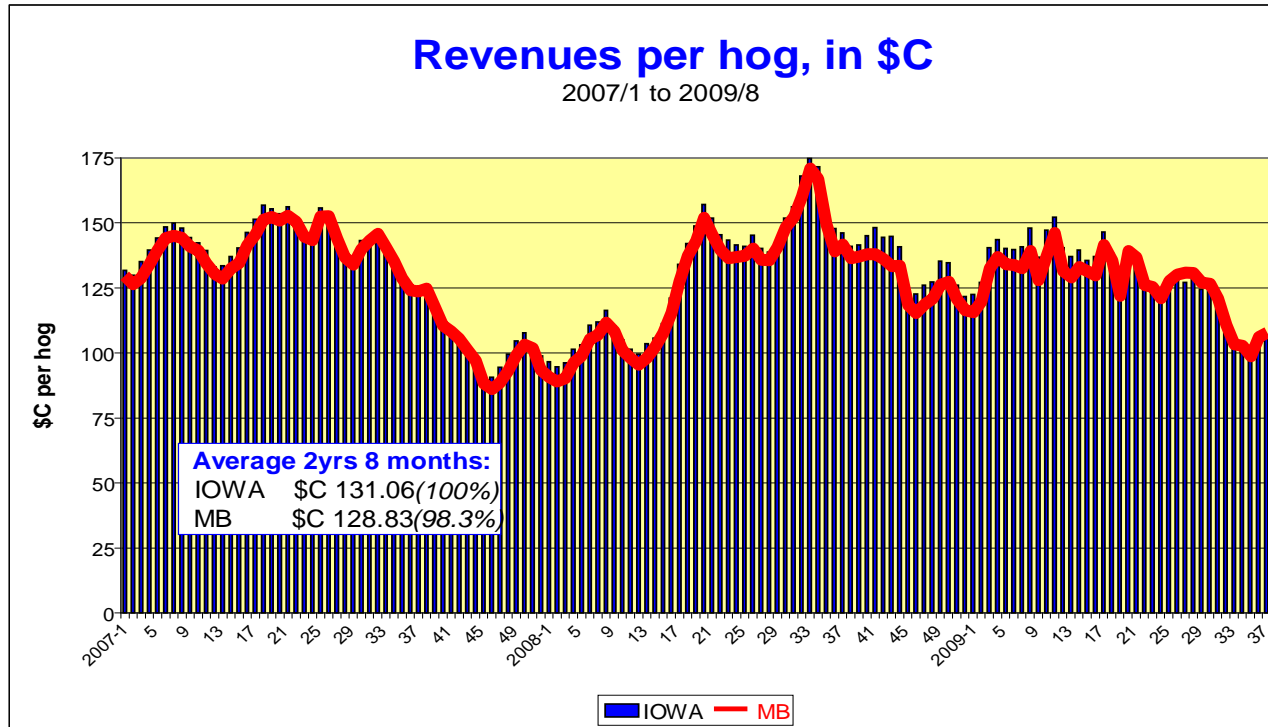
- Covering and smoothing the currency element in sales and feed
- Re-thinking the US element in hog pricing



3. Bad prices in Canada are not *only* due to overproduction in North America

Canadian hog prices have always been BASED ON the US published price

- Even though this price is the result of just a fraction of all US transactions



And until the last few years, this has generally suited everyone:

- An objective, trustworthy price (in the context of a “low” CAD)
- That reflected US plants’ competition for pigs, when there is often just *one* plant buying in Canada
- And the fact that the US was the major buyer of Canadian hogs and meat

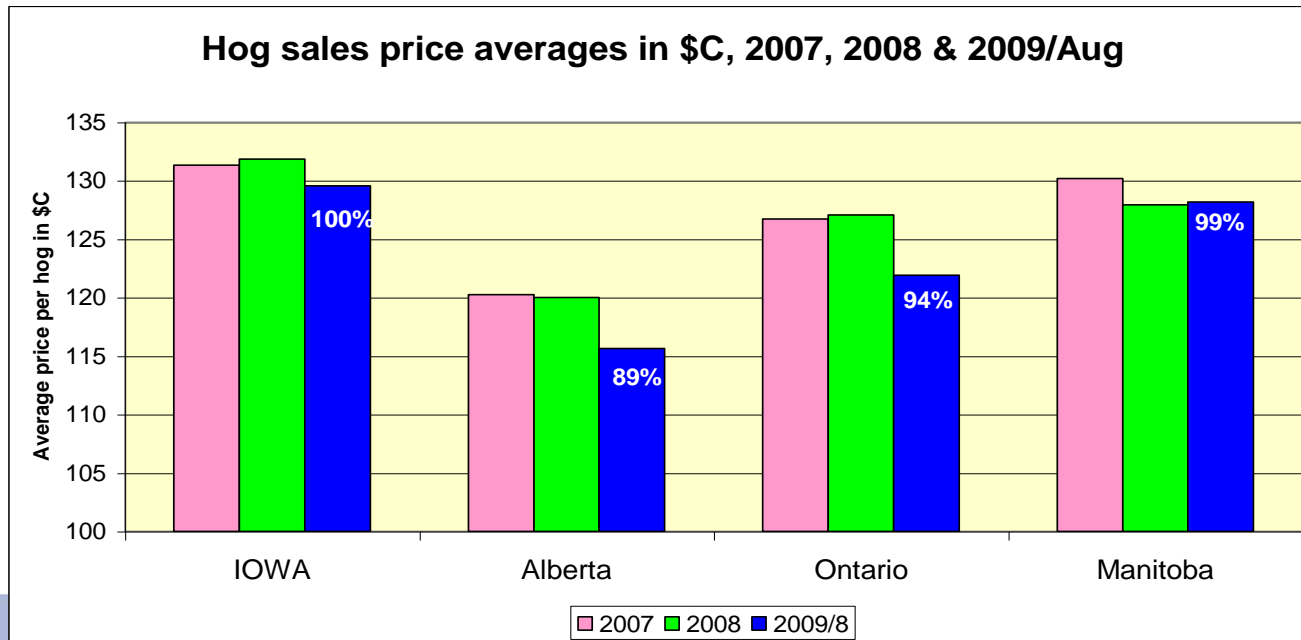
But religiously following the US price today makes Canadian meat one of the least well remunerated pork producers among the trading nations.

To the extent that [we must at least look at whether it still really makes sense today](#).

The Canadian situation is moving away from that of the USA, with :

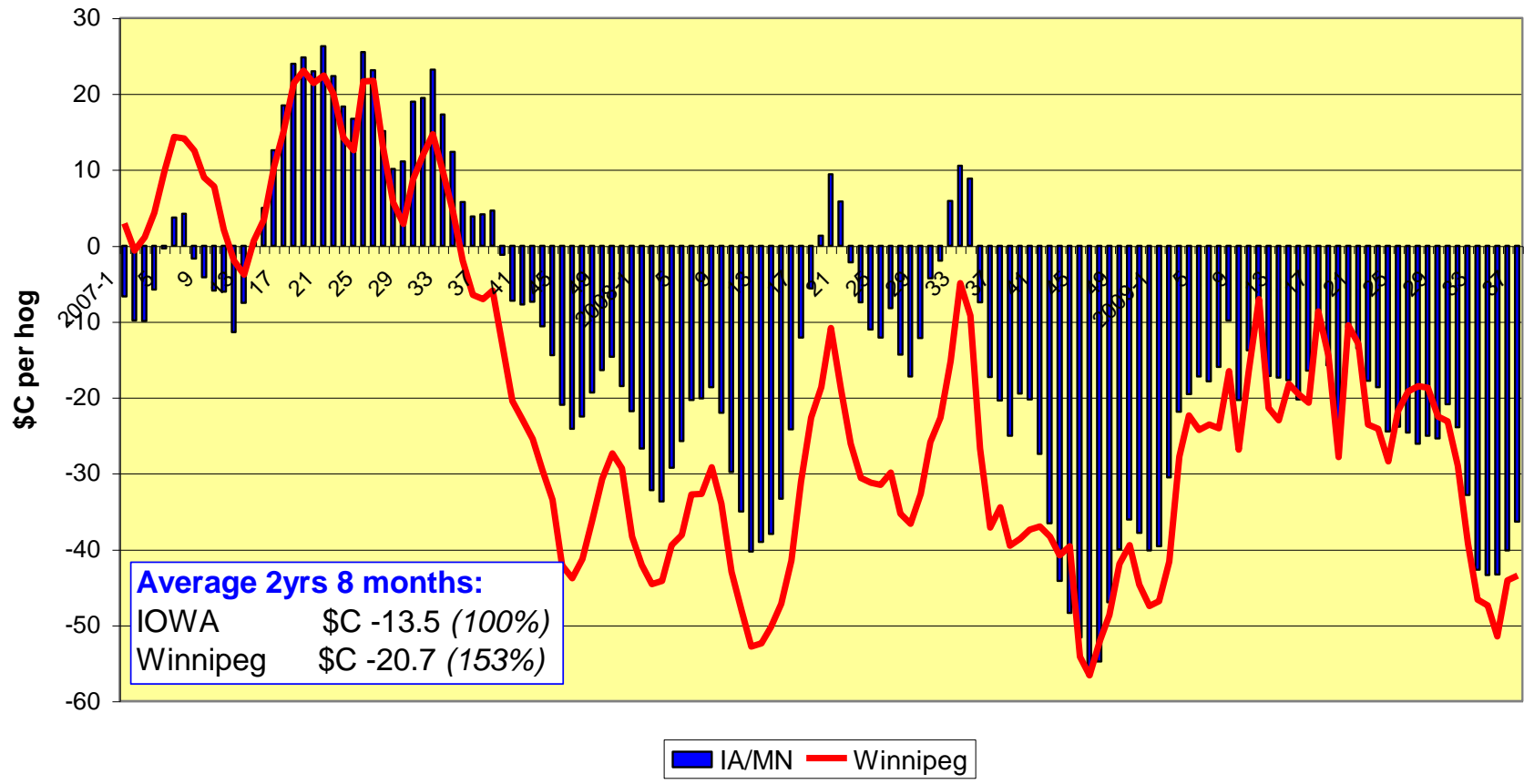
- The decline in the live pig trade (from 9 to 4 million hogs?) and the US share of total Canadian meat exports already at under 30% and probably declining further
- The introduction of COOL - meaning Canadian products are paid less than equivalent US meat
- Growing US *imports*.

And anyway, provincial hog revenues already vary considerably from US prices – always lower...

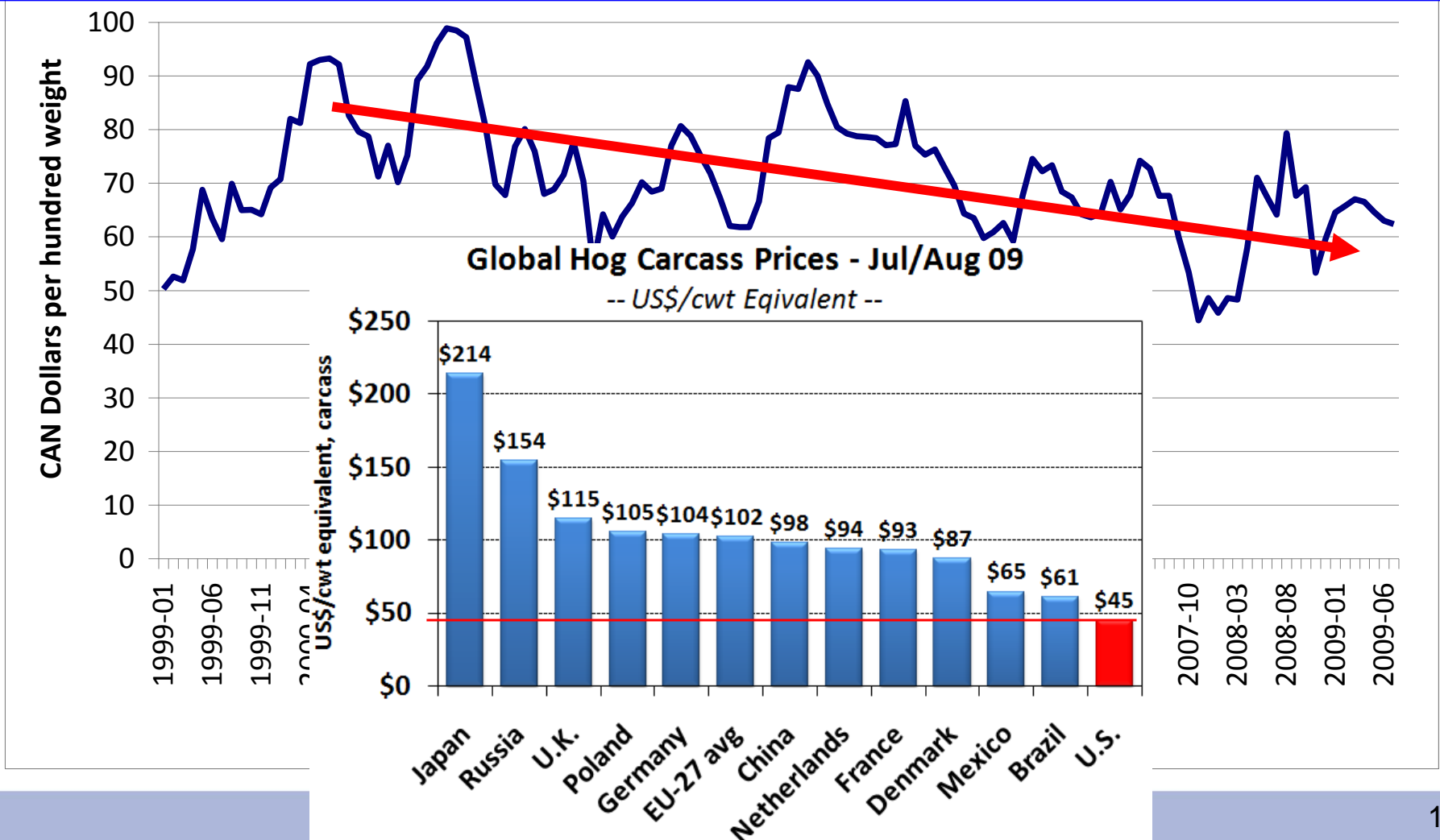


Returns per hog, in \$C

2007/1 to 2009/8



Canadian producers and packers should at least be looking whether their current pricing system **really reflects the reality** of their producer base and of a domestic (and even foreign market) that is in many ways significantly different from the US's.



4. Just how competitive – or uncompetitive – are Canadian production and slaughtering

There is general defeatism today about the competitiveness of Canadian pork production, particularly in comparison with the US (already one of the world's lowest cost producers...).

Gira has been shocked by the lack of reliable, comparable information – both at farm and plant level – available on this subject.

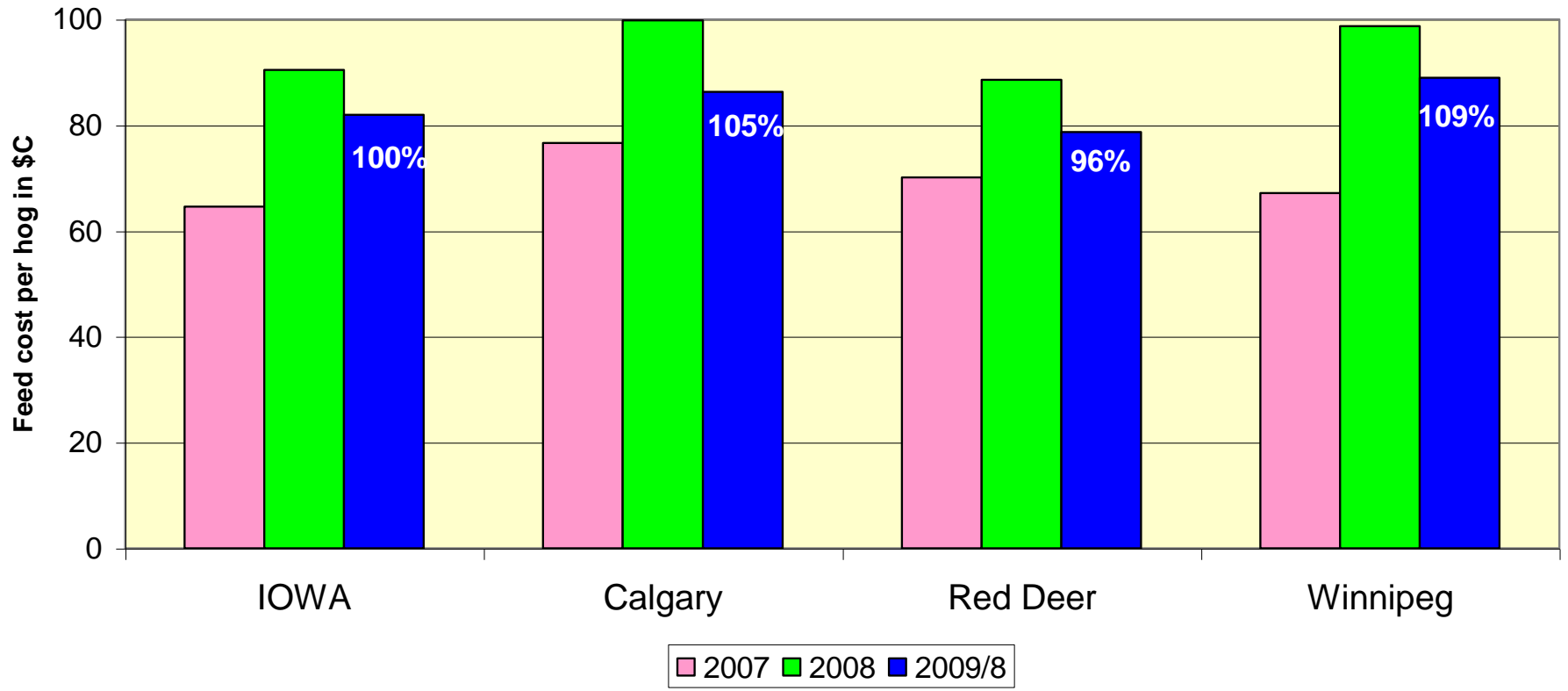
This lack of transparency encourages unnecessary pessimism and makes any “best-in-class” emulation impossible.

Transparency is a prerequisite for trust, and hence for any form of partnership.

In fact, it would appear that most Canadian hog production is comparable in cost – even with a “high” Canadian dollar – to that in the US.

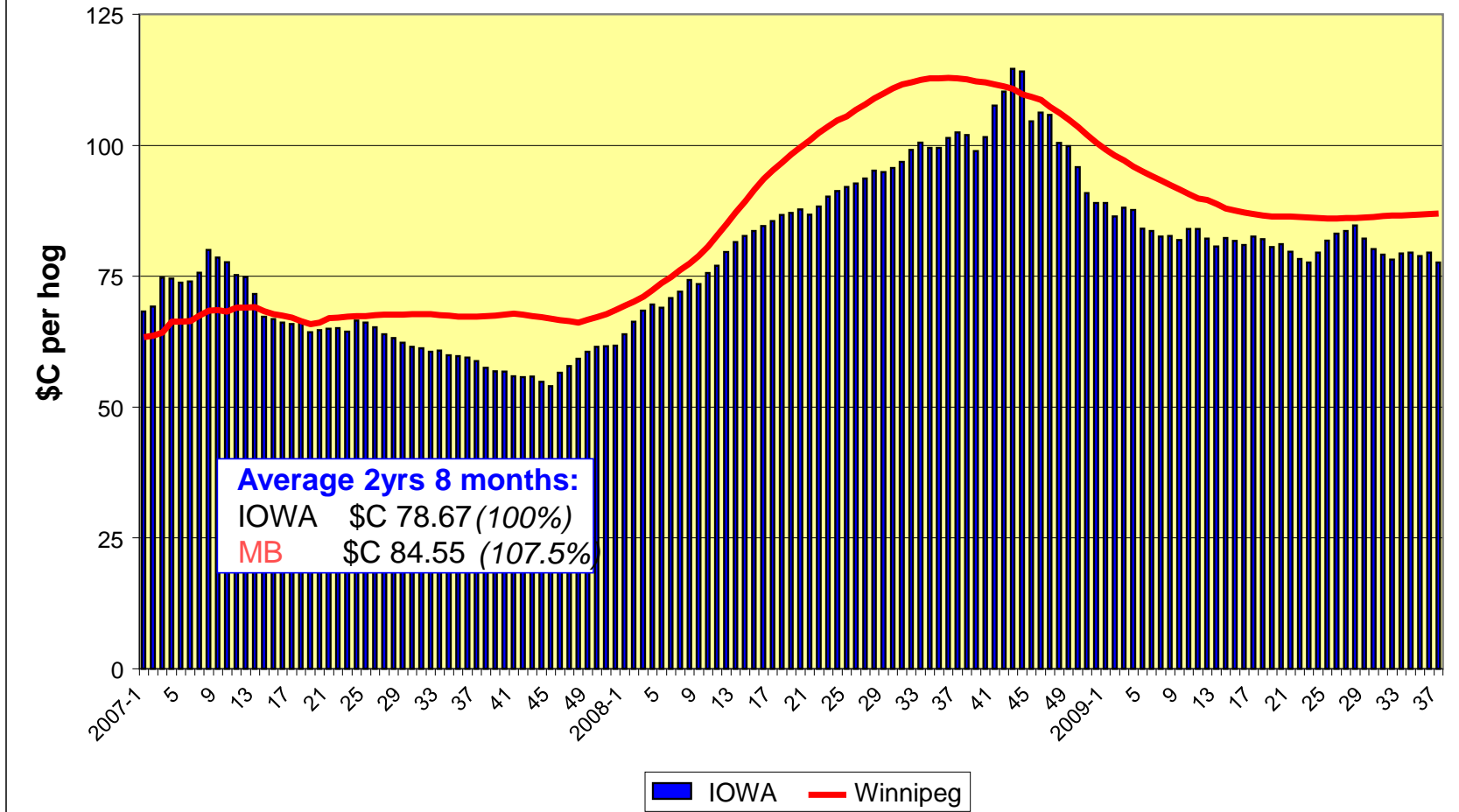
- Feed is probably more expensive
- But Canada has maintained at least some of its superiority in the technical aspects of breeding and fattening, thus reducing cost.

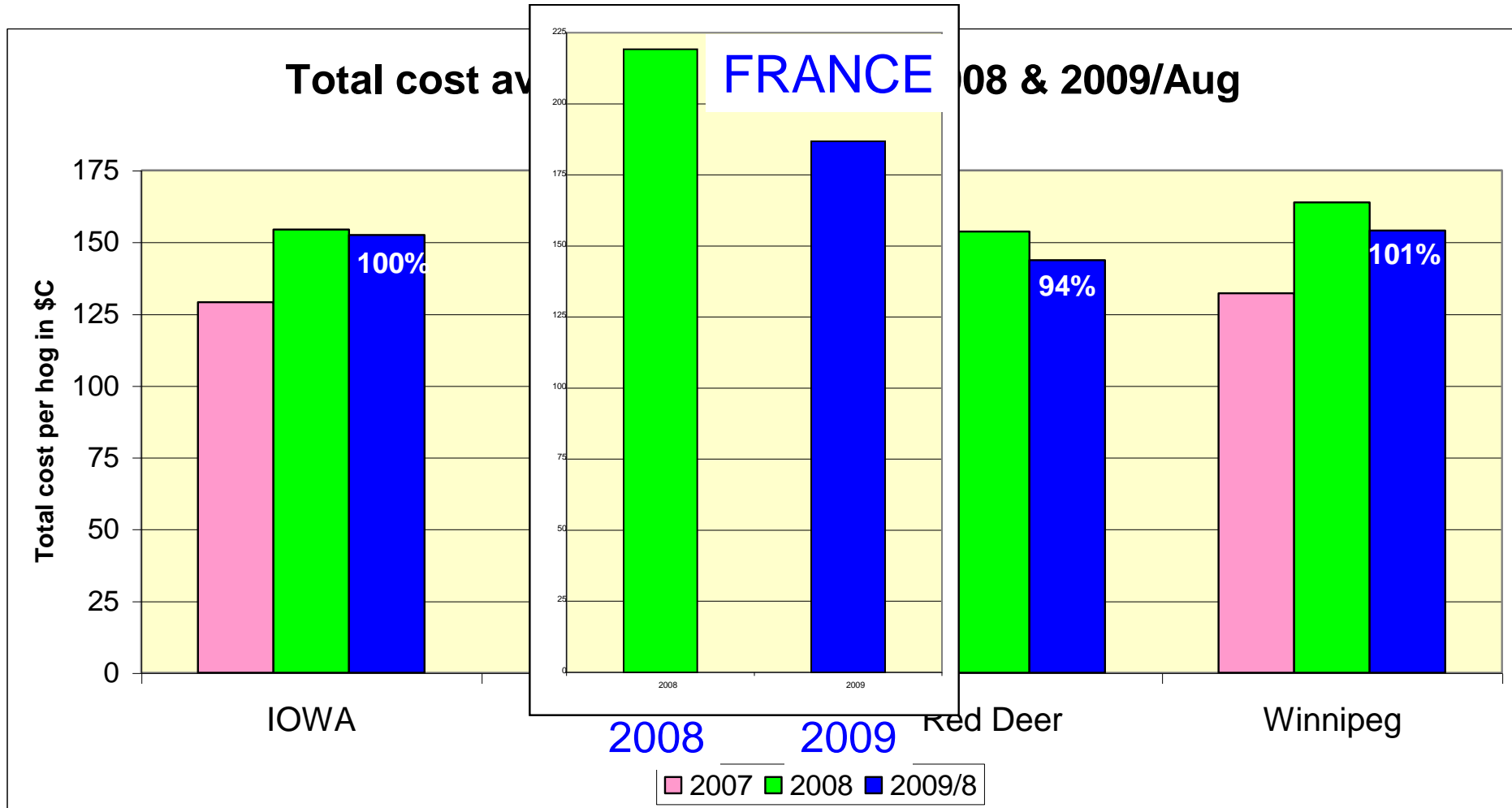
Feed cost averages in \$C, 2007, 2008 & 2009/Aug



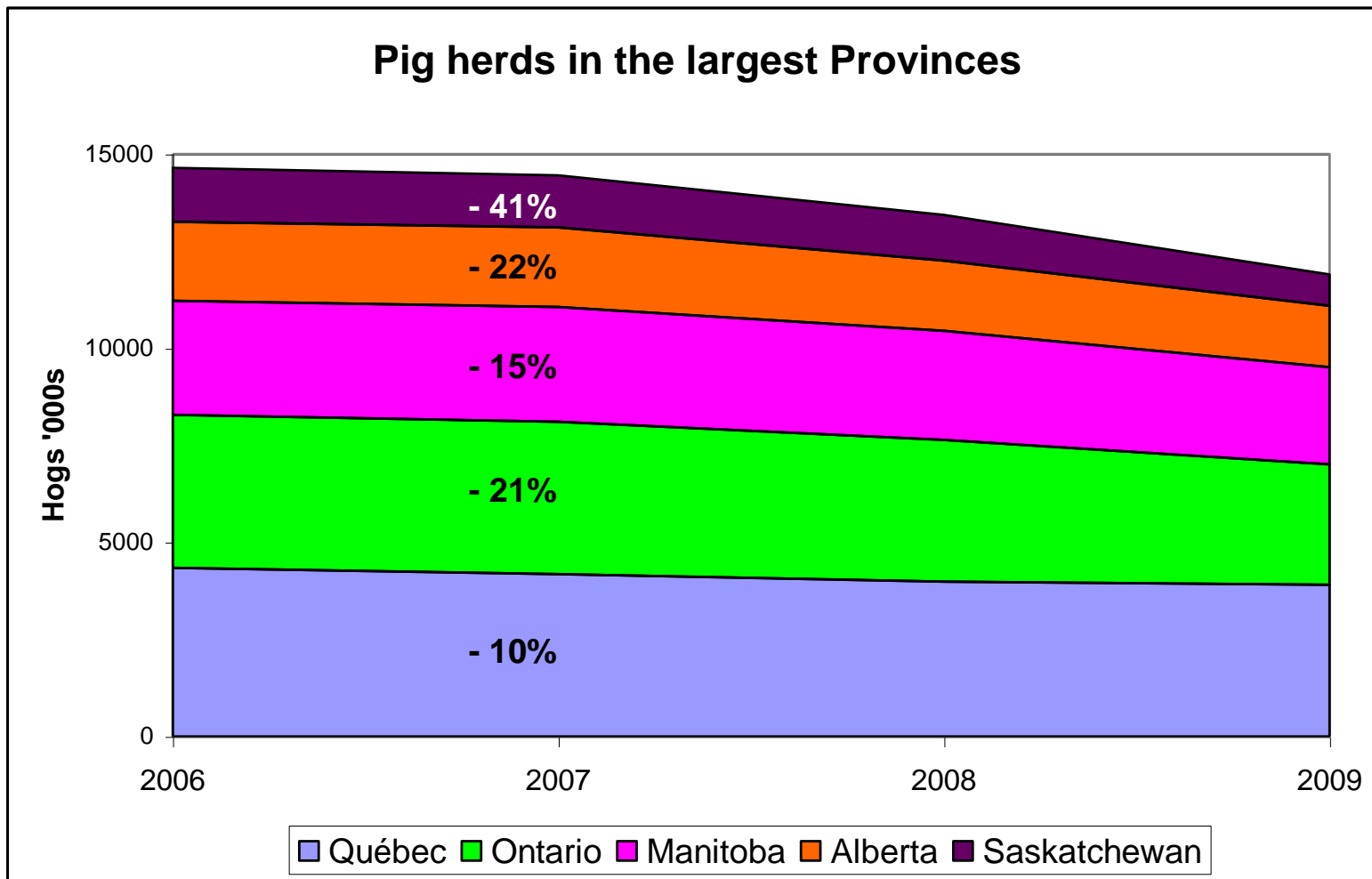
Feed cost per hog, in \$C

2007/1 to 2009/8





Canada appears to win on management and technology, Iowa on feed cost.



There is a general belief (mainly among farmers...) that Canadian slaughtering costs are higher than those in the US, and there is a belief that this significantly disadvantages Canadian meat exports

- and that this is responsible for the current strong growth of US meat imports on the Canadian market.

There is no comparative information freely available on this subject

- and Gira even doubts, given the wide diversity of plants, whether benchmarking would be realistic and meaningful for most Canadian plants.

On the permanently-recurring question of the advantages of **double-shifting**, Gira has been quoted figures of between \$1 and \$7 per hog ...

Gira believes that, providing plants are being run optimally in their given circumstances, the **impact of any competitive inefficiencies in slaughtering is probably not a major element in the meat price** compared to the costs of transportation and to marketing and pricing imbalances.

In general, there is no reason to believe that Canadian production is uncompetitive. It is simply *less* competitive than it was five years ago.

It is in the area of hog production that benchmarking and diffusion of information relating to best practice would have the greatest pay-off.

And ways of obtaining cheaper feed must be envisaged.

“The only thing that flows along the Canadian pig supply chain is pigs!”

In a declining domestic market that is under threat from imports, and in a world where the attributes of the pig production process itself will be an increasingly important product valorisation tool ...

- The “brick walls” that separate production from slaughtering, and slaughtering from retail are strangling development of the sector
- And stopping concerted actions to attack the root causes of the current situation.

With very few exceptions, there are no joint producer-packer initiatives to add value to pigmeat. Retailers don't know their pigmeat producers, and producers don't know or understand the needs of retailers

- And thus, by definition, farmers and their representatives don't know what shoppers and consumers really need and want.

But that's not all – the producers hardly talk even among themselves, *between* Provinces.

- Yet each province has such widely different circumstances and objectives, that an absence of coordination means that there is a real risk of a free-for-all on the domestic (and export) market as the product, pork, gets ever more de-valued in consumers' and retailers' eyes.

All of this made more urgent by the existence of just two packers controlling nearly two-thirds of the pig kill, and with very large shares of the further processed pork markets.

What will happen when the supply chain is *forced* to coordinate its efforts and to cooperate:

- About shelf-to-farm traceability
- On animal welfare
- On CO2etc. ?

Not to mention: “Buy Canadian ... Québec ... Alberta” ?

And when it happens – especially if it’s US-driven – you won’t have the time or the mutual trust necessary to do it.

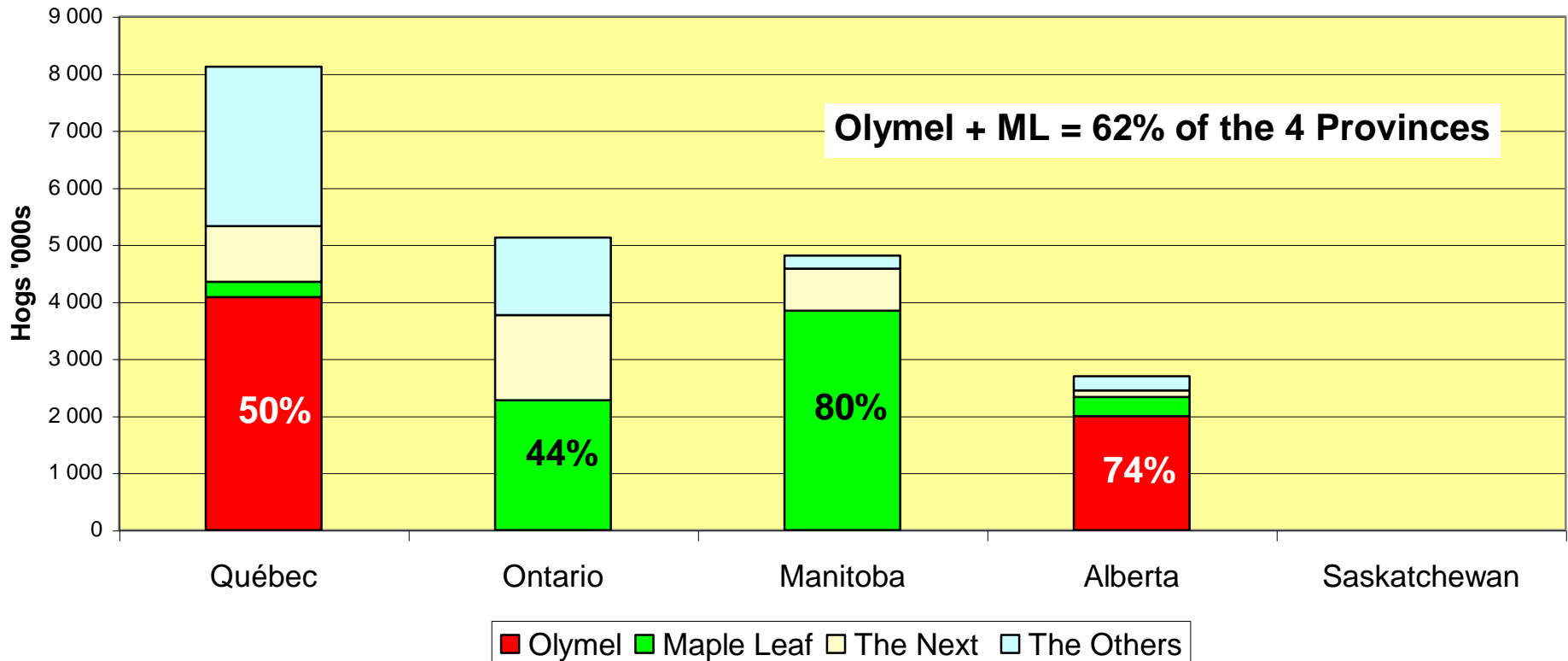
- It takes years of personal contact and mutual respect to build an efficient supply chain.

And right now – how do you intend to respond to the conviction of one of the top Canadian retailer’s meat buyer that:

“It’s up to the producers to create the demand for their product – and I will then satisfy that demand”!

You can’t do this without the help of the packers – will they play ball?
Do they even know it’s in their interest?

In Province slaughtering, 2008



There is an urgent need for education of both producers and retailers in how each one functions and what their needs and potential are.

This contact obligatorily also involves the guys in the middle, the packer and the further processor.

In a declining, commodity market, the only alternative to trust and understanding is mistrust and war!

But all of this requires credible, trusted and funded structures.

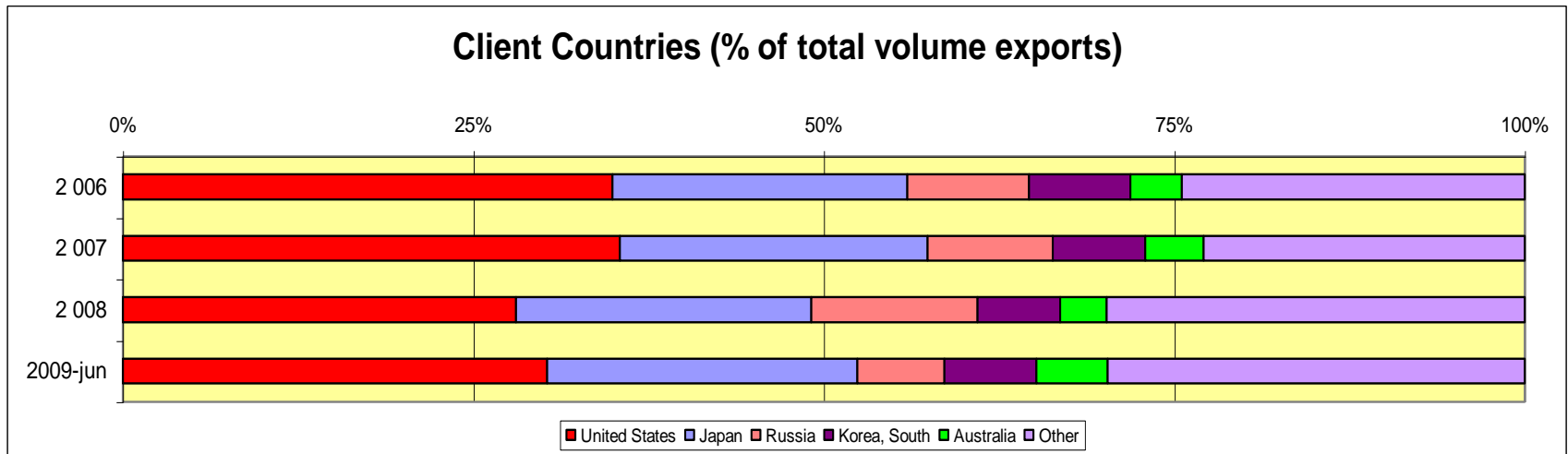
Canada was among those who “invented” today’s worldwide pigmeat trade. It has an enviable list of often highly solvent clients ... who respect Canadian quality and prices.

Having built up a farming base where exports are over 50% of pig and pork production, you cannot simply “let it go”.

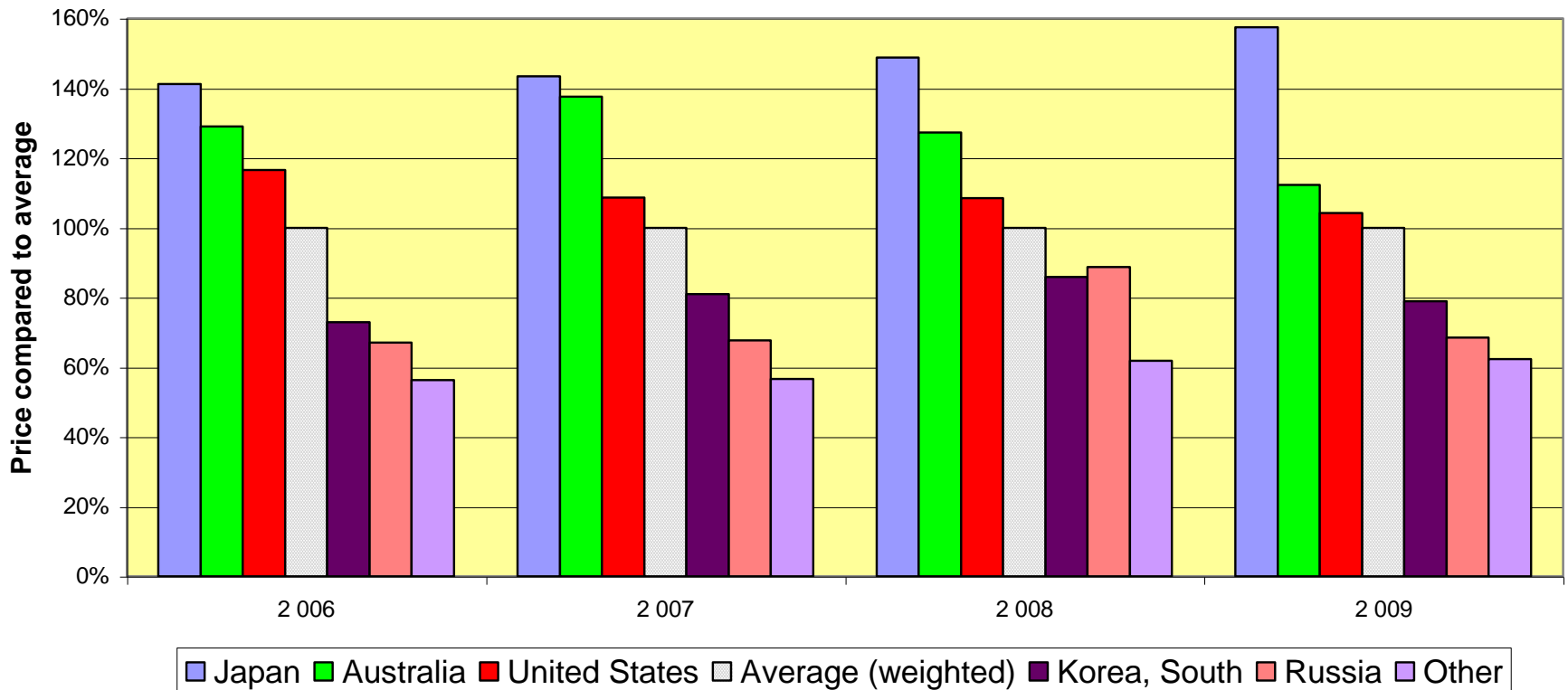
- Even if some downsizing may indeed be necessary, if growth has outstripped the structures necessary to support it.

Too rapid or too unprepared a withdrawal will destroy the very basis of Canadian agriculture

- Making what remains uncompetitive
- And opening even the domestic market to even more cheap US (Chilean etc.) imports.

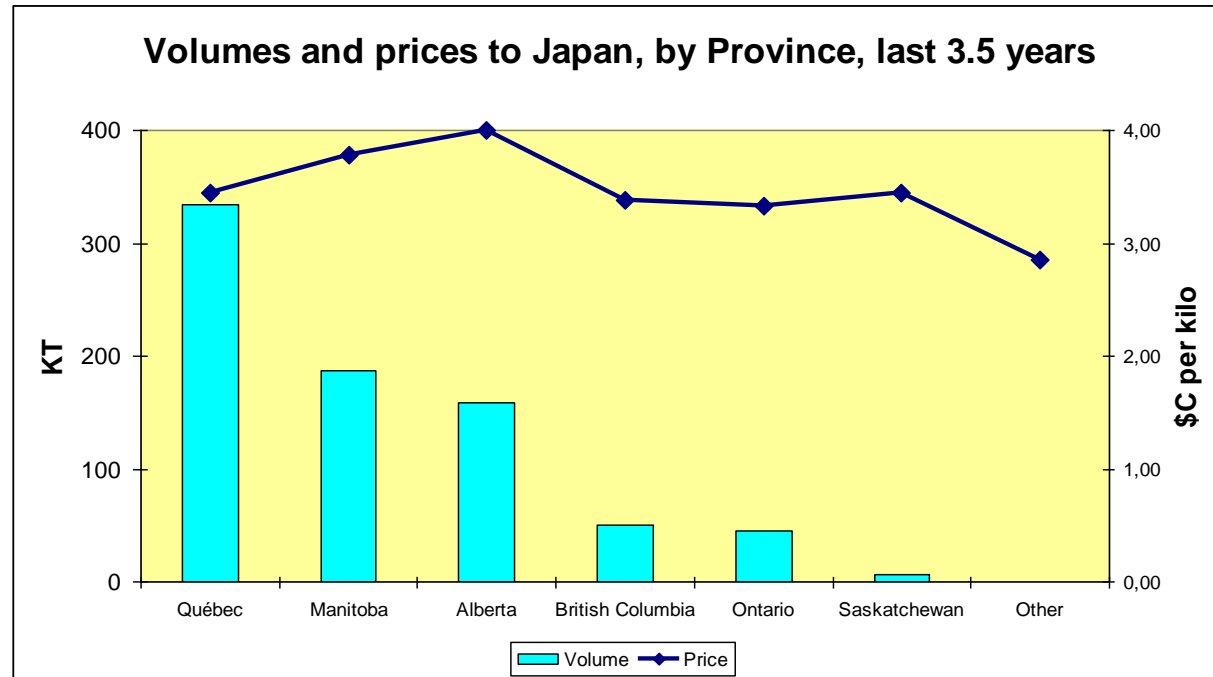
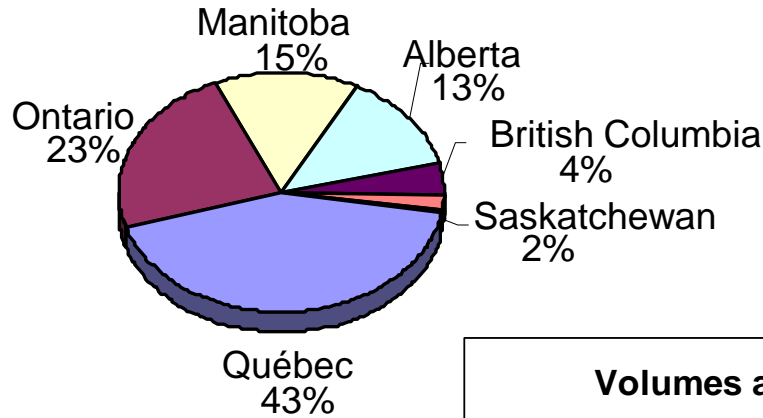


Client country prices compared to year's average, 2006-2009/6

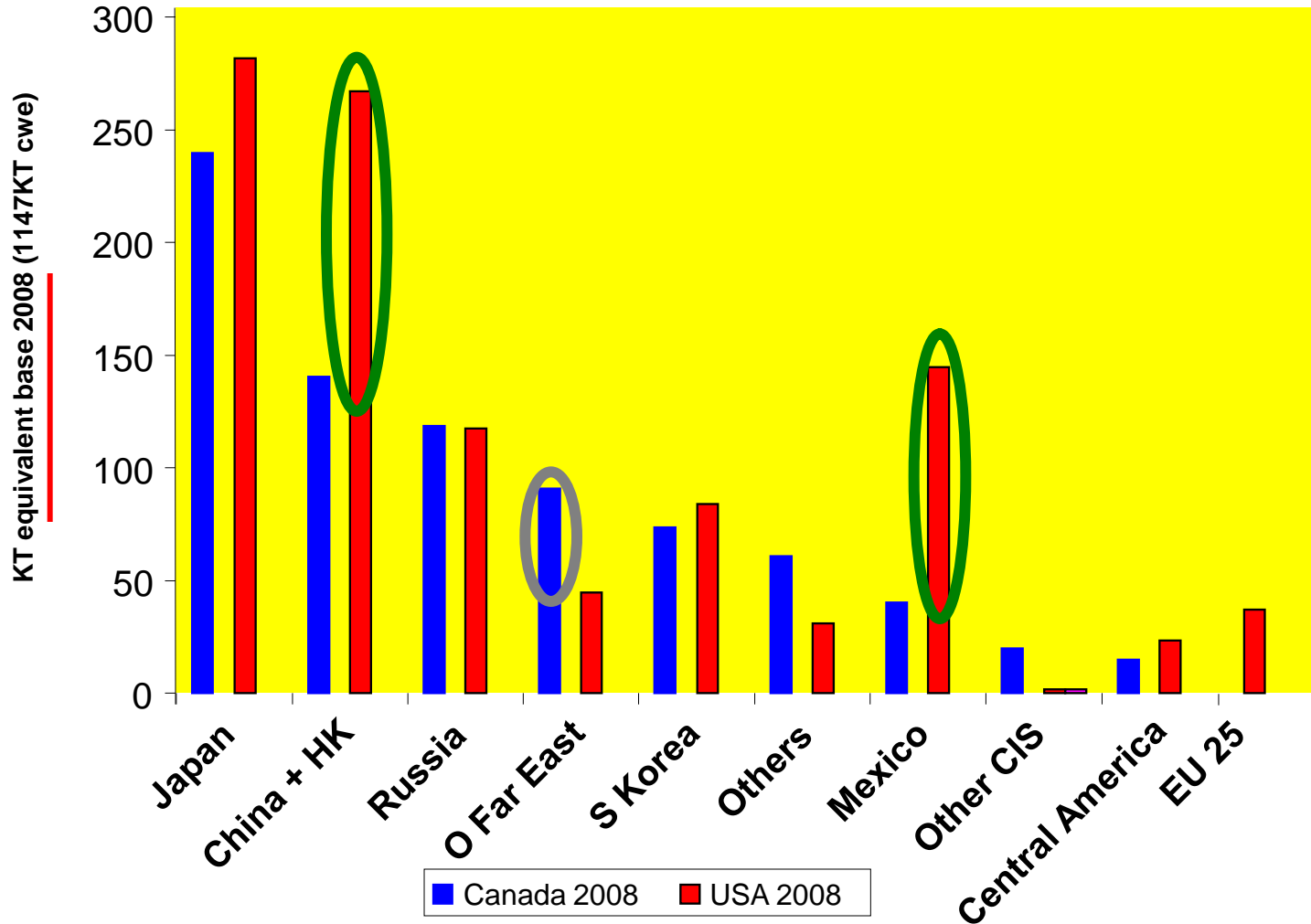


Meat exports by Province

As a % of total exported volumes in the last 3.5 Years



CA & US export destinations compared: 2008



Canada has the know-how, the experience and the infrastructure to export large volumes to the world markets.

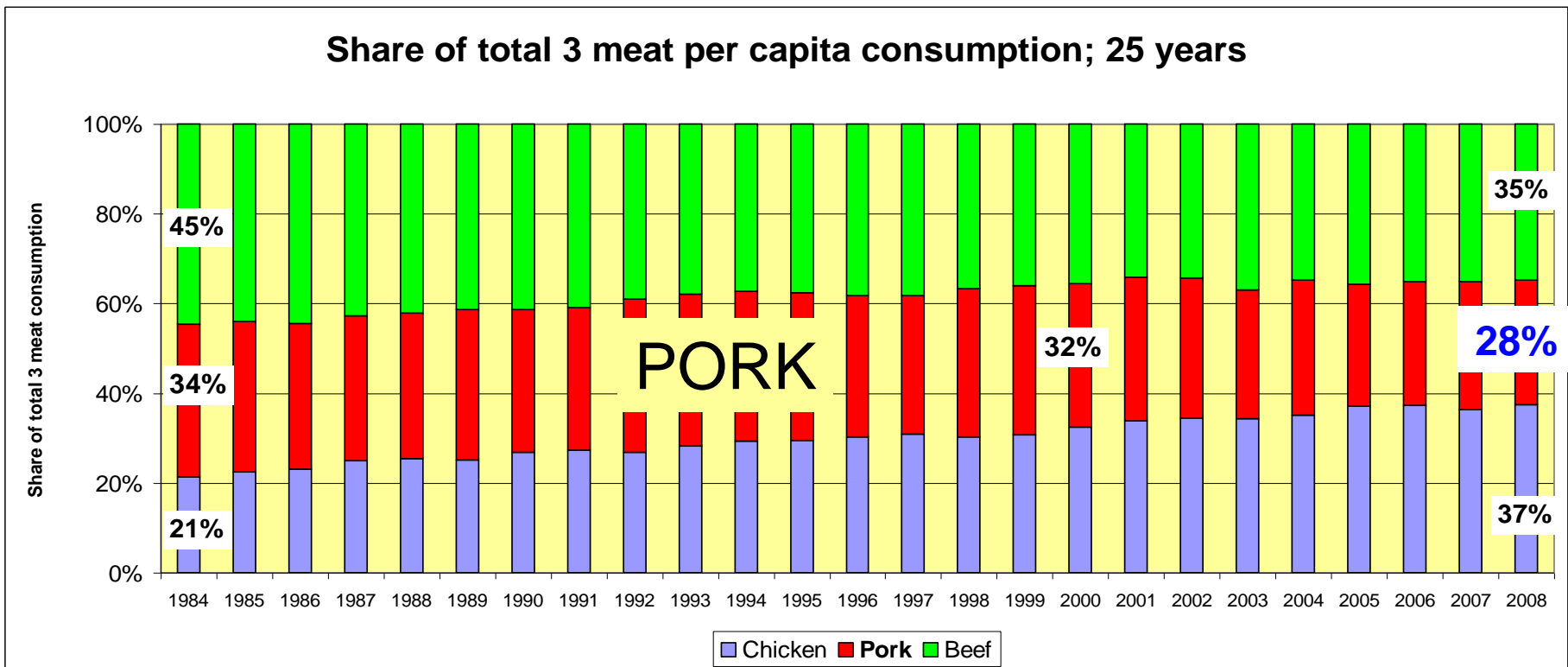
- Canadian products could be better valorised on some markets.
- Differentiate Canadian from the US product

But in the future, the lack of communication along the pork supply chain will be an increasing handicap for Canada against its main competitors.

Imports of mainly fresh meat, mainly for retail, have been growing strongly in recent years, as overall pork consumption has been stagnant or slightly declining, and as per capita consumption falls inexorably.

This means that domestic production is being squeezed out of its own market. Unless something is done to re-start consumption growth and substitute imports, then the very basis of Canadian pork production will be increasingly unstable and price-oriented.

Share of total 3 meat per capita consumption; 25 years



Canadian pork is as good, or better, than any anywhere in the world.

On its domestic market it has less competition from other proteins than in most other countries:

- Beef is more expensive anyway
- Poultry (and cheese) is Supply Managed, and thus “artificially” more expensive than it need be.

So why isn't it selling?

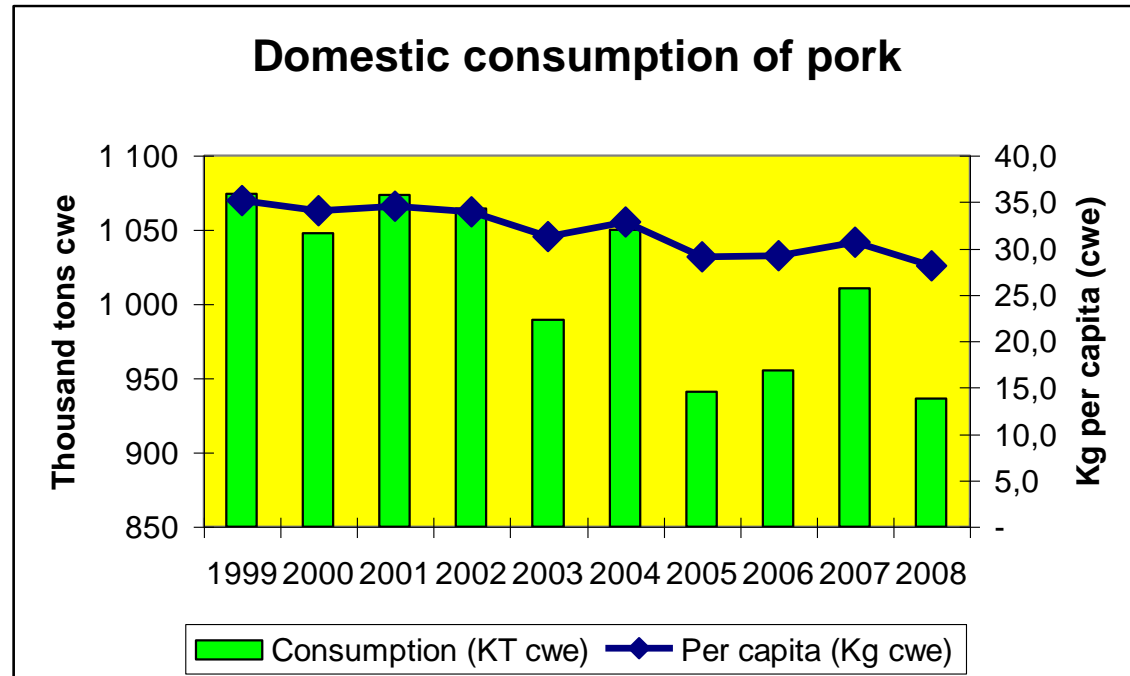
Because it's being “supplied” and not “sold” – it's being “pushed” onto the market, not “marketed”.
It doesn't target consumers' needs - it's just there if they care to pick it up.

The only way retailers can sell more of it is to put it on price promotion

- Around 40% of fresh pork sold is on price-promotion
- And promotions are now almost all of US meat!

Yet retailers would love to sell more pork

- Their gross margins can be up to 35%!



Imports of US pork have grown at 13% per annum since 2000.

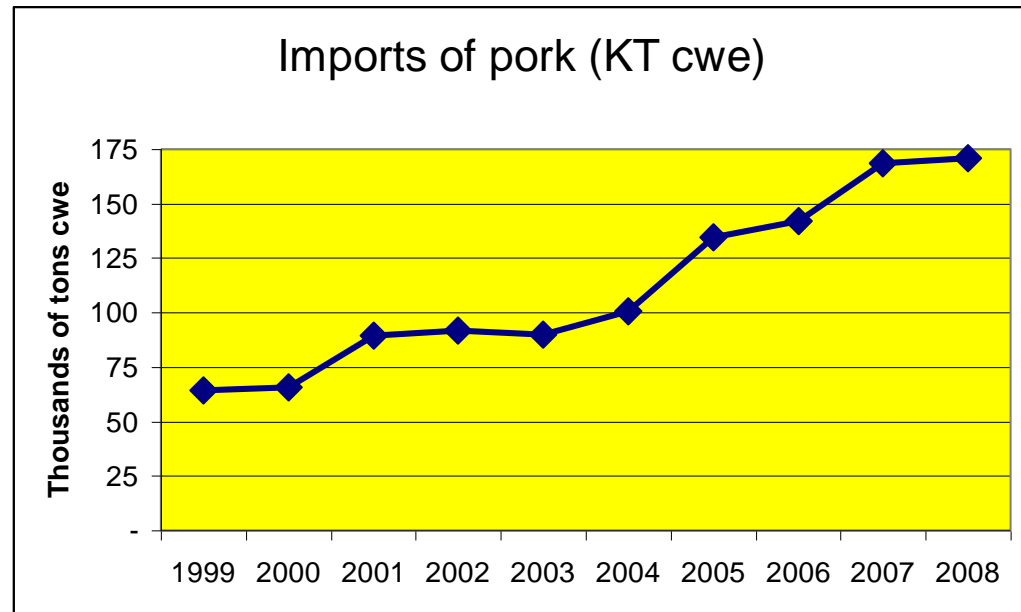
They are said generally to be between 10% to 25% cheaper than the equivalent Canadian product.

They have been mainly limited to fresh pork until now, but the threat of further processed products being imported is real.

And Wal-Mart's still to come...

There is coherence in what we see and what Canadian retailers and contract caterers tell us:

- There is no obvious economic explanation of why US imports are so cheap compared to domestic packers
- Imports are primarily of certain (very popular cuts) which Canadian packers can't or won't supply on a *regular* basis
 - This is contested by the Canadian packers we interviewed



There is a very ambiguous reaction to the problems of the domestic market among the producers and their representatives interviewed by Gira. This is due to:

- A complete lack of knowledge of what happens to their product after the abattoir, but an awareness that little is being done in the way of promotion by the packers
 - Reticence to “shake the boat”, especially when the large neighbour is in it. This means that little or no action has been taken against US imports,
 - In spite of the non-tariff barrier, COOL that has cut live pig exports to the US in half and devalued Canadian pigs by 10%
 - And of the fact that Canadian meat pays the producer levy when entering the US, but that US meat is levy-free in Canada
- “We are boy scouts”**
- A belief that nothing can be done about it anyway.

There is a profound difference between being aggressive (what French farmers are...) and simply defending one's rights fairly.

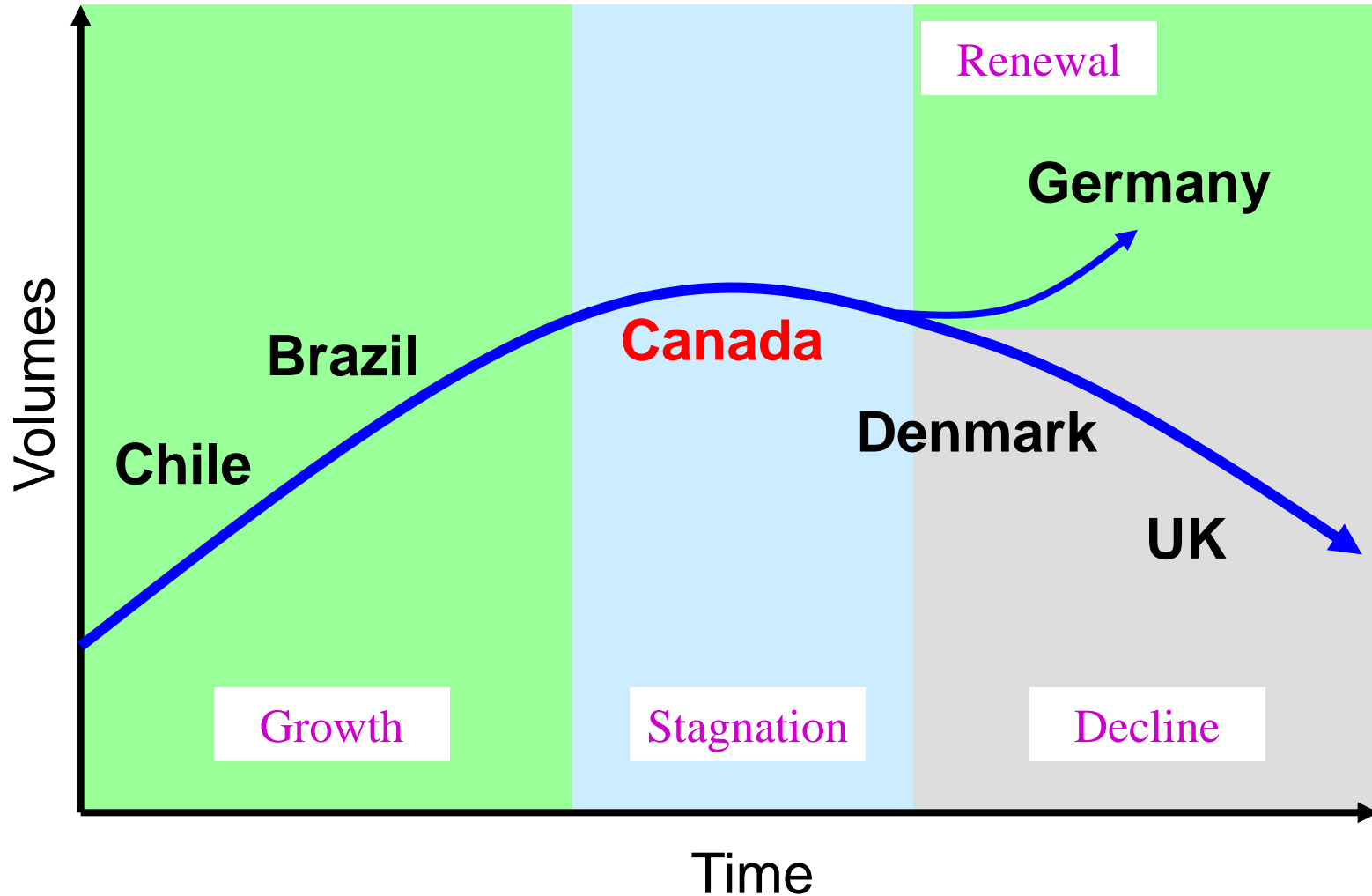
Gira believes that Canadian hog producers owe it to themselves to defend themselves at least by ensuring that the rules are the same for everyone

- **“Canadians believe there is just one N. American pork market, the Americans don't”**

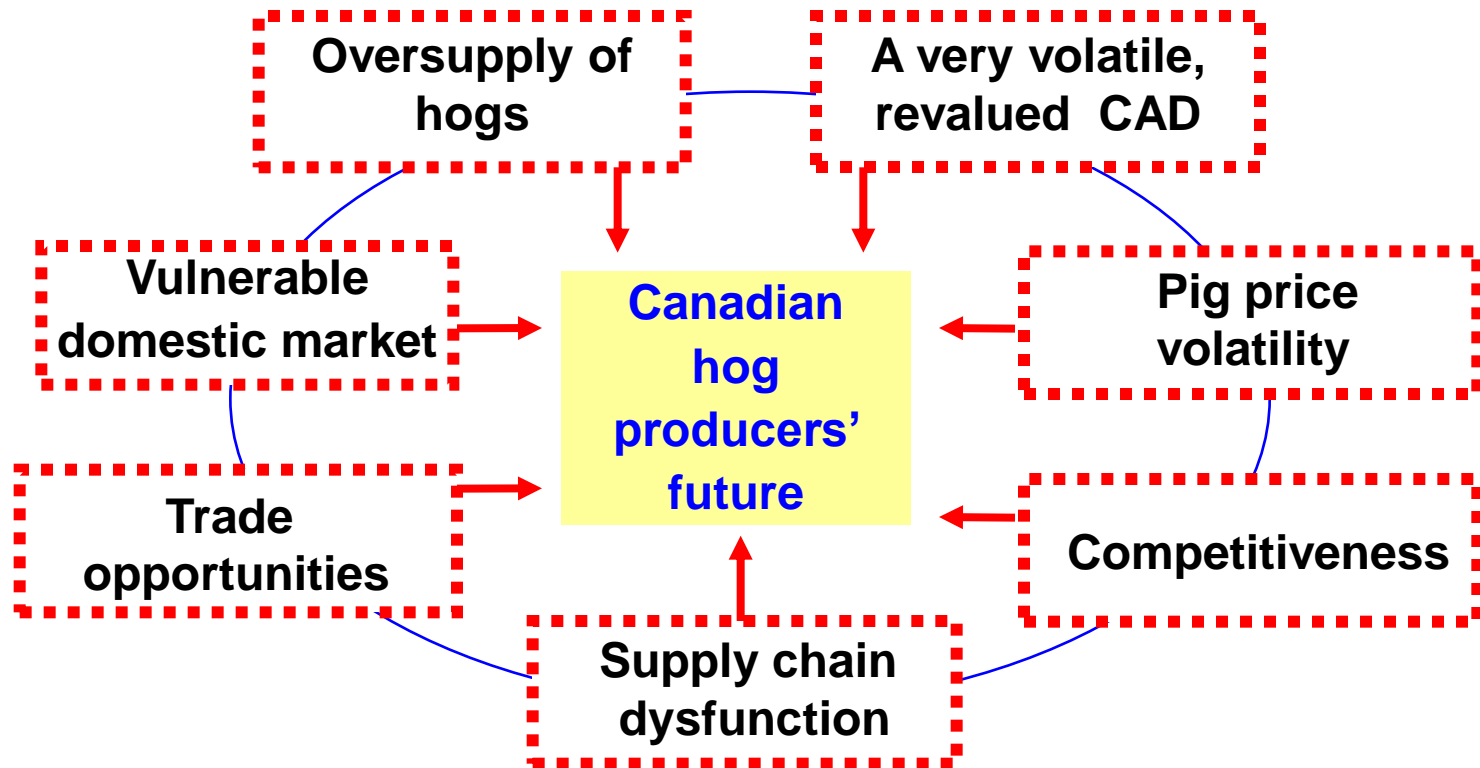
Hog producers have an urgent need of market education and information.

Consumers, at home & abroad, should be told about the many USPs of pork & of Canadian pork

And a serious look should be taken at stemming the flood of imports of pork into Canada.



Summing up: the pressures that are compromising the prospects of hog production into the next decade



Conclusions & some preliminary suggestions

1. Too many pigs in North America

Canadian producers must now find a way of reducing their industry's vulnerability to the high price elasticity that affects all purely commodity markets – the US-driven American market in particular.

- Adding more value on the domestic market (“second tier” meats)
- Targeting high value export markets

The surplus will disappear anyway with the next pig cycle

- But where will the live pigs come from then?

2. The Dollar

Hog producers must “liberate” themselves as much as possible from the US\$:

- Hedging

Organised at provincial or federal level, as part of price hedging:

- To reduce the cost to farmers
- Accompanied by a concerted programme of farmer education

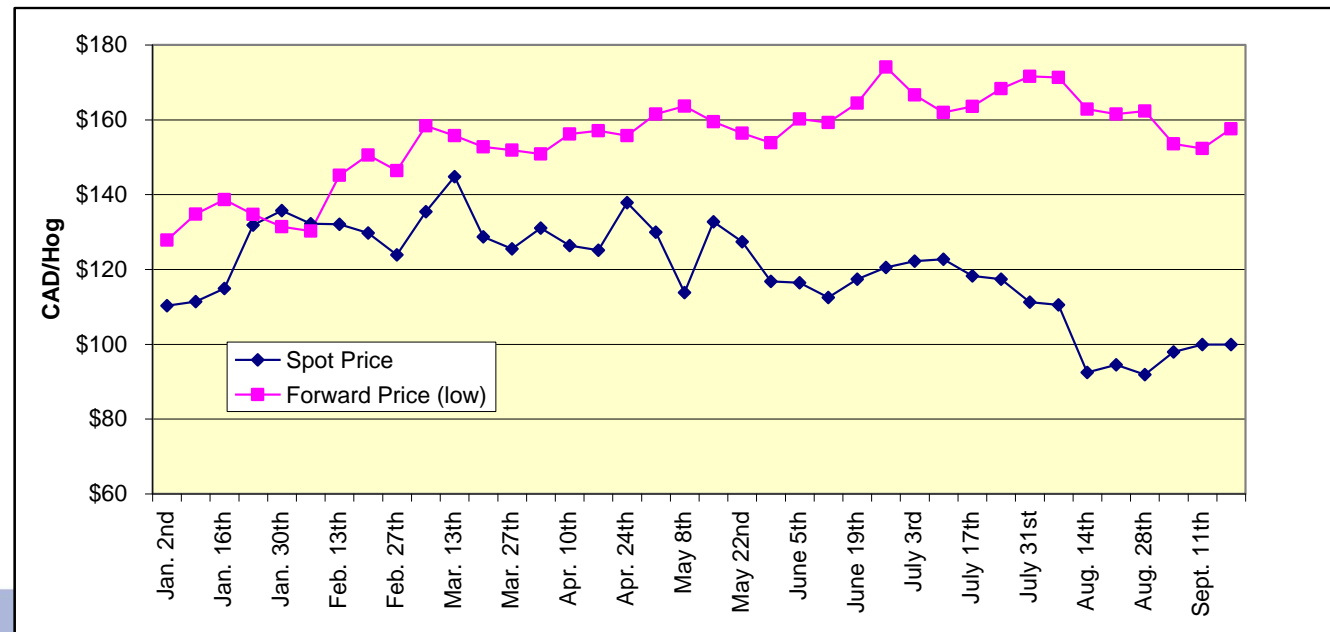
3. Pig prices

Canadian producers and packers should at least be looking whether their current pricing system really reflects the reality of their producer base and of a domestic and even foreign market that is in many ways significantly different from the US's.

- Analyse major markets to determine the degree of US presence
 - Does the US make the price in these markets?
- To what extent does the meat price represent the hog price?
- Forward hedging to smooth the prices and protect profits
 - Need to reduce cash-flow impact of margin calls

The effect of hedging the selling price of a hog 8 months earlier – against the spot price on the day of sale:

- price smoothing
- a guaranteed price



4. Competitiveness: lack of transparency

It is in the area of hog production that benchmarking and communication of information relating to best practice would have the greatest pay-off.

- Don't reinvent the wheel - look at what's being done in other countries

And ways of obtaining cheaper feed must be envisaged.

- Joint purchasing – forward buying

5. Supply chain blockages

There is an urgent need for education of both producers and retailers in how each functions and what their needs and potential are.

This contact obligatorily also involves the guys in the middle, the packer and the further processor.

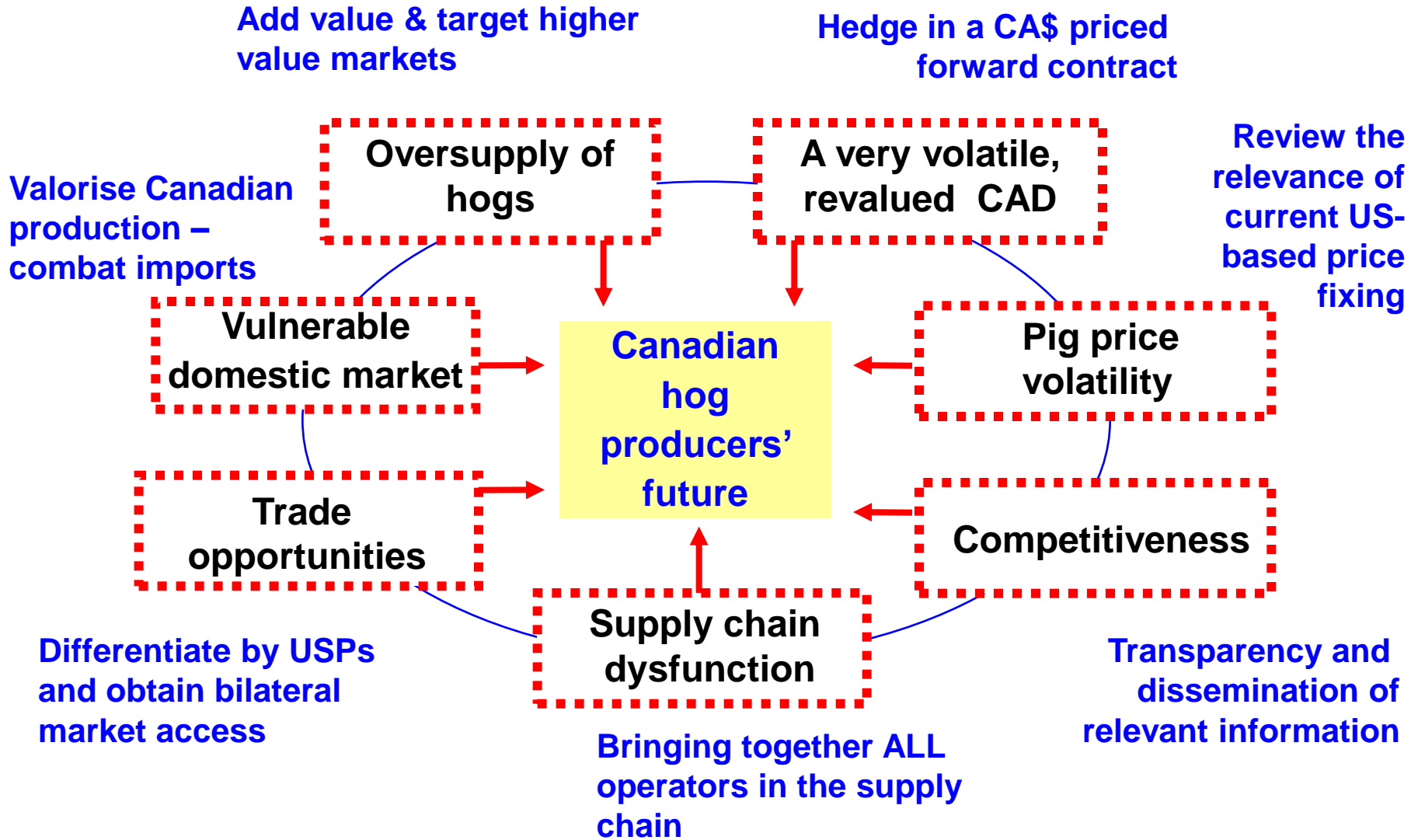
- There is a need for a truly "interprofessional" organisation, bringing together high-level representatives of producers, packers and distributors
- To resolve disputes, share information and create synergies

6. The changing trade balance

Canada has the know-how, the experience and the infrastructure to export large volumes to the world markets.

- Canadian products could be better valorised on some foreign markets
 - Market analysis and targeted product promotions
- Differentiate the Canadian from the US product
 - Valorising what the American don't have: traceability, environment, no antibiotics
 - Use COOL as a vehicle to *promote* the superiority of Canadian pork in the US
 - Combat US imports into Canada by setting up new standards for the Canadian pork industry
 - ✓ Full traceability from farm to shelf. Get the support of the federal government. Canada is already 2 years ahead the US industry.
 - ✓ Look at Europe to see what's coming:
 - Animal welfare
 - Ecological
 - Carbon footprint....
- Get the government to do its job of ensuring equitable access for Canadian pork to foreign markets
 - ... and more bilateral agreements.

7. A domestic market under attack from inside and outside: it's high time to do something about it:
- There is a need to educate the Canadian consumer about pork in order to valorise it better – convenience, the best way to cook it... and why it's better than imports (healthier ...)
 - Create a Pork Marketing Board, with proper funding at federal level and with staff in each province working with the Boards
 - Promote Canadian Pork within Canada
 - *“There is more branding of Canadian pork in Tokyo than in Canada”*
 - Acquire regular market information and disseminate it efficiently.
 - This will also increase the transparency within the supply chain
 - Combat US imports.
- But the question remains: who will lead all these changes.... ?





ONTARIO PORK

QUESTIONS FOR POLICY DAY DISCUSSION AND PRESENTATION:

1. Based on GIRA's findings do you think its conclusions and recommendations are valid? Why or Why not?
2. Which ones are unrealistic or too difficult to achieve?
3. Who should take the lead in finding a solution?
4. Are there any areas that have been missed entirely in the findings and what are they?