

PORK PRODUCTION IN CANADA - CHALLENGES AND OPPORTUNITIES

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I have access to capital, a comprehensive knowledge of the hog and pork business. Where should my company or I invest, anywhere around the world? Interesting question. This presentation will look at Canada as a possibility and do some analysis from a macro perspective. More detail and the actual presentation will be available at the conference.

In any good business planning process, one needs to not only look at the micro or day-to-day environment, but also the larger context, sometimes called an environmental scan. So, we will go through the challenges and opportunities as I see it for Canada.

The production in Canada is approximately 31 million hogs marketed; 22 million processed in Canada, 3 million exported as market hogs and 6 million exported as weaners/early weaners to the United States. Canadian's consumption of pork has remained stable over many years, resulting in over 50% of the pork produced being exported around the world. Although it is sold to around 100 countries, the largest 5 markets account for over 90%. (Graphs will be shown to demonstrate Canada's positioning)

The pork business has truly become global. Experts predict that the growth in the world trade of pork will continue to increase in the 2 per cent per year range for the foreseeable future as income levels rise in parts of the world and other regions become more dependent on imports (such as Japan and Korea). Part of the global opportunity is to market each cut of pork to the market around the world that has a particular preference for it (ribs to Canada, hams to Mexico, offal to China, etc.)

GEOGRAPHY

Canada is a very large country, spread out on an east/west plane with much of the economic activity within 200 miles of the United States border, particularly processing and further processing. The hog business is spread out across the 3,000 miles coast to coast, concentrating in approximately 3 regions, the Prairies, Quebec and Ontario. Although the farms are more concentrated in Ontario and Quebec, there are huge land bases in the Prairies. Even so, southwestern Ontario is almost as large as Denmark, yet all of Canada produces only a few more pigs than our competitor.

From an environmental perspective, there are limitless opportunities to use the nutrients produced by the livestock for fertilizer. There is generally an abundance of feed grains, and the requirements for value-adding (livestock, processing, etc.) as many communities are

dependent on agriculture. Yet at the same time, particularly in Quebec and Ontario, the industry is geographically close to the huge concentrated North Eastern market in North America.

Canada is closer to many of the major markets than many of its competitors, both to the United States and Asia. Both South America and Europe have significantly farther to travel, thus giving opportunities in the “chilled” markets of Asia, rather than just the “frozen” market. The chilled market is the fresh market in retail.

POPULATION

Although Canada is large, it only has a population of approximately 31 million people. On a pigs per people basis, Canada is one of lowest in the competitive pork world. As well, on a pig per square mile basis, Canada is also one of lowest.

This is both a challenge and an opportunity. In the event of a calamity, there is an inadequate consumer basis to support by consumption the local red meat industry. Also securing adequate skilled labour in certain regions is a huge challenge. On the other hand, theoretically society should have less interference with the agricultural business and there are huge opportunities for expansion.

CLIMATE

Canada is a country with four seasons, a temperate climate and geographically diverse. This has a positive impact on breaking disease cycles. The Prairies have a dry climate that is good for livestock production and for disease management. On the other hand, the colder climate requires both more expensive and complex buildings as well as increased expenses for heating. With the extremes of both hot and cold, buildings also have to keep the animals comfortable during the hotter, although generally shorter, periods of the year.

EXPORT DEPENDENCY

Suppliers need to focus on both the domestic and international needs of their customers. They are not always the same and that is both an opportunity and a challenge. The supplier has an opportunity to market each cut around the world where the highest price is found while customers can search the world for the best buy opportunity. Marketing programs, promotion and branding can be difficult because the markets are so different. Greater than 50% of pork is used in the international markets for further processing so there is no opportunity for value-added branding. Rather consistency, continuity of supply and price are critical for these processing markets.

Canada arguably is the most export dependant supplier in the world from the perspective of alternative in the event of significant border issues. Our competitor to the south exports only

approximately 14% of their production, and while Europe is the world's largest exporter; they have also have a population base of well over 200 million people.

Being a major exporter also makes Canada more vulnerable to demand changes around the world. For instance, Canada benefited in the Japanese market both during the BSE crisis and in 1997 when Taiwan, Japan's main importer at the time was eliminated from the market due to FMD. Currently, it could be argued that the Avian Flu problems are causing consumption of chicken to drop, particularly in countries experiencing the disease, thus causing reduced demand in particular for dark meat, making it more difficult for the United States to export, thus increased competition on the protein shelf and reducing prices to the entire protein complex.

CURRENCY

You could argue that currency is only relevant because we are a large exporter. With the strengthening of the Canadian dollar and the weakening of the US dollar, our competitive position is changing. Generally, only approximately 60% (feed) of our variable costs follow the North American currency change while 100% of our income, both pork and hogs vary.

Currency valuation is an indicator though of confidence and health of the Canadian economy. It to a degree indicates health. As we compare ourselves to other emerging competitors, such as Brazil, with relatively poor infrastructure and access to credit, confidence in the economy is an opportunity for Canada.

It could be argued in the long run currency is not the determining factor. However, it is the short-term variability and quick change that creates an enormous challenge for capital-intensive businesses such as hogs and pork.

DISEASE STATUS

Simply put, it is because Canada has been able to stay free of FMD and Hog Cholera that we compete in the elite markets around the world. At this point, Brazil is not in the same markets. Yet the pork business is a tough business.

This highlights the importance of prevention at our borders and a quick response and recovery system, should a foreign animal disease hit. Canada is in the process of developing and implementing a comprehensive system that will be state of the art. However, it takes a long time and significant commitment by both industry and government.

A study done recently for the Canadian Animal Health coalition indicates damage to the Canadian economy of between \$13-\$45 billion dollars by an FMD outbreak in Canada.

INDUSTRY ORGANIZATION & RELATIONSHIP TO GOVERNMENT AND SOCIETY

While this might surprise all of us as one of the macro factors, it is significant. Although agriculture is not always seen as the important driver of the economy in Canada, it is significant as the country is generally resource rich. Agriculture is a base for other value-added activity.

The Canadian pork industry works well together, in an interdependent approach. Governments, both provincial and federal support the industry through activities such as the National Pork Chain Value Roundtable. While the industry believes there is need for significant improvement in focus and priority setting, resulting in quicker responses to opportunities and challenges, this dispersed approach creates greater community support for the industry.

The Canadian industry works particularly well together through jointly owned initiatives such as Canada Pork International. This platform allows for the focused energy in international marketing and the creating of the Canadian platform and brand.

It is through the confidence in systems (for both domestic and international consumers) such as meat inspection (Canadian Food Inspection Agency) and the work of International Trade Canada that allows Canada access to so many international markets. Marketing pork around the world could not happen without this basic infrastructure and support by the government of Canada. It is one of the best in the world.

ACCESS TO CAPITAL/INDUSTRY PARTNERS

One of the most stable economies in the world gives the industry player access to capital, either individually (many farmers) or through the money markets (public companies like some processors). Canada has the skilled and interested businesses and business people to compete. It has a positive climate for long-term investment when the outlook and opportunities are positive. Some of our competitors are struggling in this area. Investment is dependent on stability.

At this point, investment is diverse in the Canadian hog industry. Concentration in certain parts of the supply chain assure world scale operations and targeted professional marketing initiatives worldwide, while opportunities exist for all size of participants.

Concentration within Canada at grocery retail is a reality. For the supply chain to return all interdependent players reasonable returns based on supply and demand over time, the marketplace needs to work efficiently. Some would argue structurally there are problems so I leave it to you to decide.