



**FINAL REPORT: FINANCIAL ANALYSIS RELATIVE
TO MEAT PACKING COMPANIES IN THE CONTEXT
OF THE BSE CRISIS OF 2003**

**Report of the Standing Committee on
Agriculture and Agri-Food**

**Paul Steckle, M.P.
Chair**

November 2005

**STANDING COMMITTEE ON
AGRICULTURE AND AGRI-FOOD**

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Pontiac, Quebec

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OTHER MEMBERS WHO PARTICIPATED

Guy André, M.P.

Berthier—Maskinongé, Quebec

Wajid Khan, M.P.

Mississauga—Streetsville, Ontario

Inky Mark, M.P.

Dauphin—Swan River—Marquette, Manitoba

Kevin Sorenson, M.P.

Crowfoot, Alberta

CLERK OF THE COMMITTEE

Bibiane Ouellette

FROM THE PARLIAMENTARY INFORMATION AND RESEARCH SERVICE

Jean-Denis Fréchette, Principal

Marc Leblanc, Analyst

**THE STANDING COMMITTEE ON
AGRICULTURE AND AGRI-FOOD**

has the honour to present its

TENTH REPORT

Pursuant to Standing Order 108(2), the Committee has undertaken a study of the pricing of beef at the slaughter, wholesale and retail levels, in the context of the BSE crisis in Canada. After hearing evidence, the Committee agreed to report to the House as follows:

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CHAIR'S FOREWORD

The Committee is pleased to table its 10th report, prepared by Consulting and Audit Canada, which concludes its study of the pricing of beef at the slaughter, wholesale and retail levels, in the context of the BSE crisis in Canada.

The Committee conducted this study as per the motion of February 1st, 2005:

That, due to the need for additional analysis and follow up relative to financial and pricing information provided by meatpackers to meet requirements of the Standing Committee on Agriculture and Agri-Food regarding its study on BSE government programs, the Committee requests the extension of the professional services contract between Consulting and Audit Canada and the Library of Parliament in order to pursue, on-site, the second phase of its in-depth analysis of financial and pricing information as well as the government assistance received by packers and the latter's relation with beef pricing.

**Financial Analysis Relative to Meat Packing Companies in the context of
BSE Crisis of 2003 BSE Crisis
Final Report – In-depth analysis of financial and pricing information**

1.0 Introduction

This report follows the results of Phase 1 analysis which were presented to the House of Commons in February 2005. The Phase 2 on-site review was conducted pursuant to the Committee resolution of February 1, 2005. This review was conducted during the period June to September 2005 and was concluded by a final report to the Standing Committee.

2.0 Background

The Standing Committee on Agriculture and Agri-Food has been conducting hearings and research into beef pricing in the aftermath of the Bovine Spongiform Encephalopathy (BSE) crisis that started in May 2003. As part of this study, the Committee requested specific financial and pricing data from five meat packers in March 2004. In December 2004, Consulting and Audit Canada (CAC) presented a status report to the Committee, in camera, on the information provided by the five companies. In February 2005, the Committee asked CAC to conduct an in-depth analysis, including an on-site review, of the information presented by the companies.

3.0 Objective

The purpose of Phase 2 was to obtain and analyze specific information in relation to comments and questions that were raised by Committee members when discussing the Phase 1 status report. This final report covers the period from January 2002 to June 2004 and focuses on the following key elements:

- Government assistance received by the companies;
- Profitability, one-time costs/savings due to BSE, incremental costs of new BSE safety regulations and significant variances in costs and revenues;
- Prices received for key products;
- Prices paid to producers; and
- Comparison of throughput between owned cattle and purchased cattle.

4.0 Scope limitation

This review is not an audit. Therefore, it is based on analysis of information, inquiry and discussion. The review did not involve a detailed audit of books and records. Our approach is explained in Section 5.0 below.

The manner of proceeding with reporting to the Committee was established by the following resolution of the Committee:

That a letter be sent to Cargill Foods, Lakeside Packers Ltd., XL Foods Inc., Levinoff Meat Products Ltd. and Better Beef Limited, stating that this Committee is aware that certain information provided by the aforementioned companies, may contain sensitive business information, therefore the Clerk of the Committee is directed to not provide copies of the information received to Members of the Committee. The Clerk is directed to provide the information to the Office of the Law Clerk and such individual(s) that may be engaged by the Library of Parliament for the purpose of reviewing the information received and preparing a report to this Committee, such report to be prepared in such a fashion as to protect specific sensitive business information that may disclose the identity of any person or corporation providing such information.

We proceeded accordingly.

5.0 Approach

On April 5, 2005, the Clerk of the Committee informed the five companies of the Phase 2 on-site review. To respond to the needs of the Committee, CAC followed up with each company and several times provided clarification of the type of information that was being sought. CAC prepared a review program to ensure that our work was performed in an organized and consistent manner.

Four of the five companies agreed to the on-site visit and provided the information requested. The fifth company has provided the financial and slaughter information as well as responses to written questions, but did not agree to the on-site visit. This impacts on the completeness of information in Section 6.1, 6.3 and 6.4.

Our work on-site involved analysis of information submitted and a discussion of how the information was compiled as well as the general business model. We requested and reviewed supporting schedules and relevant information on costs and pricing. Where it would have been onerous to obtain supporting documentation, we relied on sales and purchase summaries.

The financial information was reconciled to year-end financial reports for the years during the scope period for which the financial statements had been prepared for external audit. The monthly financial information submitted was not subject to audit by the companies' external auditors. The information submitted on slaughter has been agreed to the production summaries.

6.0 Results

6.1 Government assistance received by meat packers

The companies and their associated operations received government assistance totalling \$73.4 million since July 2003 in connection with various BSE assistance programs. Of this amount, \$15.2 million was received during the period July 2003 to June 2004 and is included in the net profit for the meat packing operations for that period.

The bulk of government assistance reported by the companies relates to the BSE Recovery Program.

6.2 Meat packer profitability and expenditure trends

The information on meat packer profitability and expenditure trends on an aggregate basis is summarized in Tables 1 to 3 below. The key elements are as follows:

- Packers lost money on a per head basis during the May to June 2003 period.
- Per head margins for the July to August 2003 period were six times higher than the 2002 calendar year.
- The margins declined during the September to December 2003 period when the United States (US) border and later the Mexican border opened to Canadian beef. The net margins remained four to five times higher than the pre-BSE period.

On a year-over-year basis, the net profit in 2003 was 95% higher than 2002, and for the six months ended June 30, 2004, was 620% higher than the same period in 2002.

**Table 1: Meat Packer Profitability – Pre-BSE, During BSE and Post-BSE Recovery Program
Calendar Years 2002, 2003 and six months to June 30, 2004**

	Slaughter Volume	Aggregate Net Profit (\$000)	Gross Margin per head	Net Margin (loss) per head
Calendar Year 2002	3,095,524	\$ 132,266	\$ 248.42	\$ 42.73
January to April 2003	956,978	\$ (652)	\$ 217.00	\$ (0.68)
May to June 2003 (BSE – May 20)	372,871	\$ (40,516)	\$ 135.00	\$ (108.66)
July to August 2003 (BSE Recovery Program)	494,742	\$ 125,959	\$ 460.00	\$ 254.60
September to December 2003 (US border opened in September)	912,246	\$ 172,521	\$ 423.00	\$ 189.12
January to June 2004	1,677,622	\$ 298,833	\$ 388.00	\$ 178.13

Table 2: Meat Packer Profitability – Comparison for specific periods Pre-BSE, During BSE crisis and Post-BSE Recovery Program

	Slaughter Volume	Aggregate Net Profit (\$000)	Gross Margin per head	Net Margin (loss) per head
January to April 2002	936,882	\$ 456	\$ 207.00	\$ 0.49
January to April 2003	956,978	\$ (652)	\$ 217.00	\$ (0.68)
January to April 2004	1,085,117	\$ 165,680	\$ 361.00	\$ 152.68
May and June 2002	606,402	\$ 41,160	\$ 255.00	\$ 67.88
May and June 2003	372,871	\$ (40,516)	\$ 135.00	\$ (108.66)
May and June 2004	592,505	\$ 133,151	\$ 437.61	\$ 224.73
July to September 2002	817,913	\$ 66,494	\$ 285.00	\$ 81.30
July to September 2003	692,750	\$ 166,110	\$ 458.00	\$ 239.78
October to December 2002	734,327	\$ 24,156	\$ 255.00	\$ 32.90
October to December 2003	714,238	\$ 132,370	\$ 415.00	\$ 185.33

Table 3: Expenditure Trends

	Pre-BSE January to April 2003	During BSE May to June 2003	During BSE July to August 2003	Post-BSE Recovery September to December 2003	Post-BSE Recovery January to June 2004
Revenue per head	\$1,710	\$1,501	\$1,067	\$1,522	\$1,471
Cost of Sales as %	87%	91%	57%	72%	74%
Labour and Direct Expenses	9%	11%	13%	10%	10%
Admin Expenses	4%	5%	6%	5%	5%
Net Profit (Loss) – as percentage	0%	(7%)	24%	13%	11%

To ensure comparability, we have adjusted the submitted numbers by unusual items such as management bonuses, etc.

The chart in Appendix 1 shows the monthly revenue and expenditure trends over the period January 2002 to June 2004.

While the companies acknowledged there was a period of considerable uncertainty around the time the BSE crisis was announced, several indicated they moved quickly to control discretionary costs, including shift changes, temporary layoffs and forced vacations. The companies were unable to provide us with sufficient data to enable us to report on the incremental costs as a result of BSE safety measures. In relation to the overall profitability, these costs would not appear to be significant. The one-time costs identified were primarily associated with inventory write-offs and were incurred in May/June 2003. Additional freezer space costs of \$618,000 were reported.

6.3 Prices received

The companies sell to a variety of clients, including retailers, warehouses, distributors and further processors, located primarily in Canada and the US. Certain by-products such as hides and offals have markets abroad. The US market was closed to Canadian cattle and beef on May 20, 2003, as a result of the discovery of BSE. The US border was reopened in September 2003 to boneless beef from Canadian cattle under 30 months old.

The companies generally do not have written contracts for sales to their customers. The business is relationship-based. Companies may also sell directly to commercial and institutional customers. Often, special prices may be negotiated. Business is primarily conducted via telephone. Some companies sell custom cuts, but generally they sell large cuts.

Prior to the discovery of BSE in Canada, both the purchase price of cattle and the selling price of meat products were based on an integrated North American market. While the prices received from US customers are determined in relation to the US beef prices, there is a discount as Canadian beef does not receive a US grading.

Companies sell hundreds of products and do not maintain standard price lists. The prices are negotiated on a customer-by-customer basis. As a result, it was not possible to obtain consistent pricing data by products from the various companies. We selected certain sales on random dates in order to observe trends on pricing pre-BSE, during BSE and the post-BSE Recovery Program. We looked at variations in prices by reviewing information on selected dates for certain products to indicate trends in prices of comparable products.

The analysis, which is based on individual transactions, suggests the following:

- The companies did lower prices in the summer of 2003 due to the impact of BSE on beef exports. For the high-end products, the prices dropped in the range of 30% in July/August 2003 for certain cuts, but for prime cuts the drop was around 10% to 15%. By December 2003, the price drop for the high-end products was around 10% to 13% below the pre-BSE period.
- For the low-end products, the price drop was as much as 50% in July but then the prices bounced back. In December 2003, the price was still 10% to 20% lower than the pre-BSE period.

The average revenue per head on an aggregate basis suggests that in 2003 the revenue drop was 20% during May to June, 38% during July to August and 10% during the October to December period, as compared to the pre-BSE period.

There was a sense from our discussions with the companies that retailers promoted Canadian beef, and there was consumer support in Canada that helped maintain prices at the retail level in Canada during the BSE crisis. It is also possible that there was some shift in trading patterns as meat products that would normally flow north to south and vice versa might have been flowing west to east, thus helping ease the oversupply situation.

6.4 Prices paid

Companies purchase cattle in a variety of ways. Some companies use their buyers to purchase directly from feedlots for the bulk of their requirements, while others use both direct buying as well as cattle auctions, including The Electronic Auction Marketplace (TEAM). The dairy cows appear to be purchased mainly at auctions. Some companies use commission agents. A significant amount of buying is done via telephone, but we also understand that several buyers visit producers to inspect cattle. The buyers within a company talk to each other on a regular basis, often several times daily. Prices paid are generally spot prices. Some companies enter into contracts to secure supply over a period while others may own feedlots. While these tactics ensure a degree of stability in supply, they may create a financial risk if prices are dropping rapidly. We were informed that, except for owned cattle and contract cattle, there are no “captive” suppliers but that the industry is relationship-based. Cattle prices are reported through CanFax weekly reports.

It would appear that there is transparency in the marketplace as the TEAM information, the CanFax data and the auction pricing data are available to anyone who is interested in obtaining that information.

It was reported that purchases of cattle are usually for the following week's production. The buyers may also prefer larger lots as it is more efficient to meet the plant capacity that way. This may impact negatively on price if a lot size is small or if the plant capacity for the following week has already been met. Prices paid also depend on the weight of the cattle. For example, overweight cattle may need to be discounted due to the quality of meat. The cost of freight is usually taken into account in establishing the price unless the seller assumes the expense.

The trends on the prices, based on examination a sample of actual transactions, are as follows:

- The prices paid for cattle decreased by 60% to 70% during July and August 2003 as compared to the early 2003 period.
- The prices paid picked up in the September to December 2003 period, and by December 2003 they were around 22% lower than the pre-BSE period in 2003 for steers and heifers.
- For cull cows (cattle over 30 months old), the prices paid remained low at around 35% to the end of 2003 and beyond. There is limited slaughter market for cattle over 30 months old, which usually includes dairy cows and breeding cattle.

6.5 Throughput of owned and purchased cattle

Depending on their business model, most companies secure a supply of cattle by establishing relationships with certain feedlots or large producers or by establishing their own herds. Based on the numbers reported, approximately 14% of total cattle processed by the companies were the cattle they owned or had under contract. The percentage of owned and contract cattle during July, August and September 2002 were 12.76%, 12.70% and 13.96% respectively. For the same months in 2003, the relevant percentages were 8.16%, 13.18% and 18.04%.

We were unable to obtain data on cattle supply that may have been obtained through established relationships.

6.6 Operational data

The companies have some flexibility in terms of the number of shifts as well as the number of days per week that they run their production. Most indicated that they run two shifts per day, five days per week when demand warrants it, such as in the post-BSE period. Some may run a Saturday shift in high-demand periods.

The plant operations are basically "just-in-time" operations, and companies do not carry significant inventories of finished products or cattle for processing.

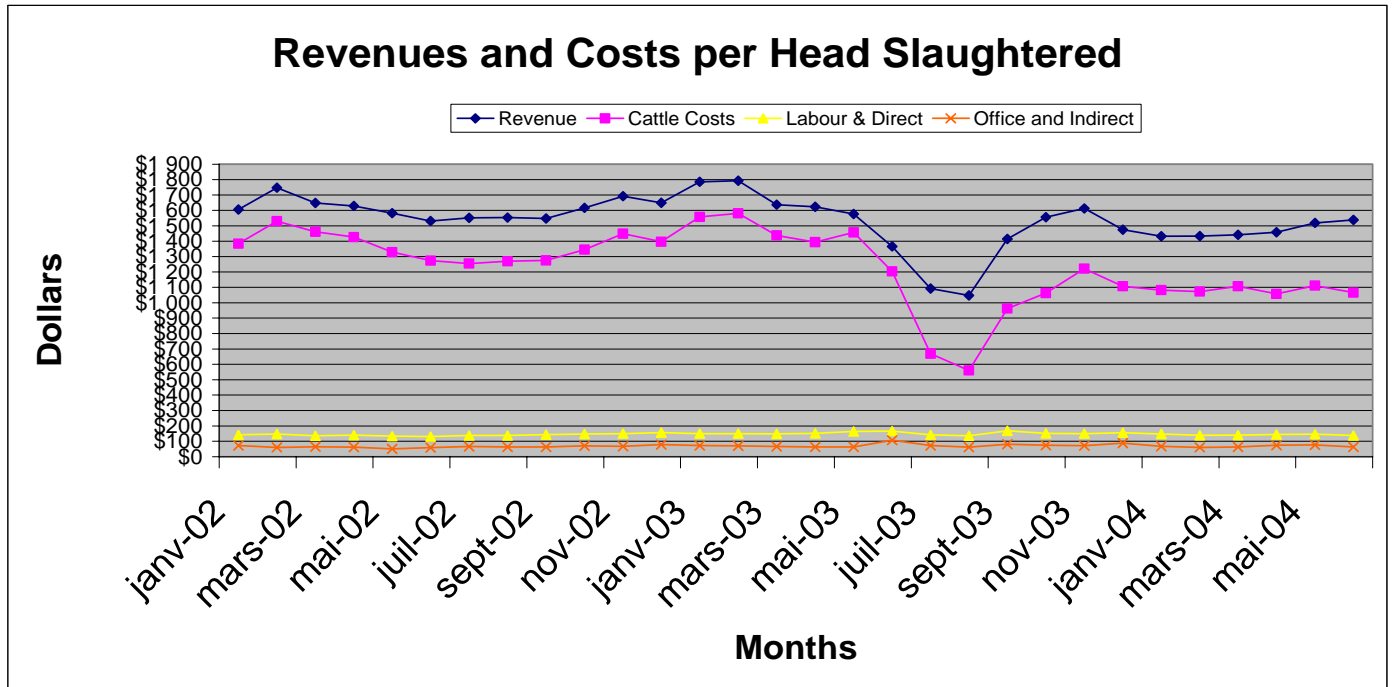
Some of the companies reported that they have made additional investments to increase their processing capacity.

7.0 Conclusion

Based on our review, nothing has come to our attention that would indicate that the financial and operational information submitted by the companies is not consistent with their books and records.

The information submitted confirms a substantial increase in profitability for the packers for the period from July 2003 to June 2004. There is variability in the rate of increase in profitability among the individual companies.

APPENDIX A



**APPENDIX B
LIST OF WITNESSES**

Associations and Individuals	Date	Meeting
Consulting and Audit Canada Margo Allore Audit Manager Janak Shah Director	22/06/2005	53
Consulting and Audit Canada Margo Allore Audit Manager Burns Giddings Chief Auditor Janak Shah Director	19/10/2005	57
Consulting and Audit Canada Burns Giddings Chief Auditor Janak Shah Director	21/11/2005	65

MINUTES OF PROCEEDINGS

A copy of the Minutes of Proceedings of the Standing Committee on Agriculture and Agri-Food (Meetings Nos. 53, 57 and 65 which includes this report) is tabled.

Respectfully submitted,

Paul Steckle, M.P.
Huron-Bruce

Chair

MINUTES OF PROCEEDINGS

Meeting No. 65

Monday, November 21, 2005

The Standing Committee on Agriculture and Agri-Food met at 3:30 p.m. this day, in Room 371, West Block, the Vice-Chair, Gerry Ritz, presiding.

Members of the Committee present: David L. Anderson, Charlie Angus, André Bellavance, James Bezan, Hon. Wayne Easter, Hon. Mark Eyking, Réal Lapierre, Larry Miller, Gerry Ritz, David Smith and Rose-Marie Ur.

Acting Members present: Wajid Khan for Paul Steckle and Kevin Sorenson for Larry Miller.

In attendance: Library of Parliament: Jean-Denis Fréchette, Principal; Marc LeBlanc, Analyst.

Witnesses: Competition Bureau: Gaston Jorré, Senior Deputy Commissioner of Competition; Richard Taylor, Deputy Commissioner, Civil Matters Branch; Morgan Currie, Senior Competition Law Officer, Mergers Branch. *Consulting and Audit Canada:* Janak Shah, Director; Burns Giddings, Chief Auditor. *Canadian Wheat Board:* Adrian Measner, President.

Pursuant to Standing Order 108(2), the Committee proceeded to a briefing on the marketing of canola in Ontario and the acquisition of Better Beef by Cargill Ltd.

Gaston Jorré made a statement and, with the other witnesses, answered questions.

At 4:33 p.m., the sitting was suspended.

At 4:36 p.m., the Committee proceeded to sit *in camera*.

Pursuant to Standing Order 108(2), the Committee resumed its study on the pricing of beef at the slaughter, wholesale and retail levels, in the context of the BSE crisis in Canada.

The Committee resumed consideration of a draft report.

Janak Shah made a statement and, with the other witness, answered questions.

It was agreed, — That the draft report be adopted.

It was agreed, — That the report be entitled: Final Report: Financial Analysis Relative to Meat Packing Companies in the context of BSE Crisis of 2003.

It was agreed, — That the Chair, Clerk and researchers be authorized to make such grammatical and editorial changes as may be necessary without changing the substance of the report.

It was agreed, — That the Chair present the report to the House.

It was agreed, — That, at the dissolution of the 38th Parliament, the Clerk of the Committee be instructed to destroy all confidential documents related to the study on pricing of beef at the slaughter, wholesale and retail levels, in the context of the BSE crisis in Canada, which commenced during the 3rd Session of the 37th Parliament.

At 5:17 p.m., the Committee resumed sitting in public.

The Committee proceeded to the consideration of matters related to Committee business.

André Bellavance moved, — That the Standing Committee on Agriculture and Agri-Food report to the House of Commons the following recommendations:

- (1) That the government of Canada reiterate its unalterable support for supply management, as an equitable agricultural model, and for the farmers who depend on it;
- (2) That the government of Canada make no concessions regarding supply-managed production during the current WTO negotiations;
- (3) That the government of Canada mandate its negotiators so that, at the conclusion of the current round of negotiations, the supply-managed sectors will not be subject to any over-quota tariff reductions or tariff quota increases, so that these sectors continue to provide farmers with fair and equitable market revenues; and
- (4) Given that a large majority of Canadian agricultural producers rely on exports and improved market access, the government of Canada should mandate our World Trade Organization negotiators to work toward: (a) the total elimination of export subsidies ;(b) the substantial reduction of domestic trade distorting subsidization; and, (c) the goal of increasing market access for Canadian agricultural products.

Debate arose thereon.

Wayne Easter moved, — That the motion be amended by adding in paragraph 3 after the word

“negotiations,” the following: “any over-quota tariff reductions or tariff quota increases are minimized to the greatest extent possible for supply managed products,”.

Debate arose thereon.

The question was put on the motion and it was agreed to on the following recorded division: YEAS: Wayne Easter, Mark Eyking, Wajid Khan, David Smith, Kevin Sorenson, Rose-Marie Ur — 6; NAYS: David L. Anderson, Charlie Angus, André Bellavance, James Bezan, Réal Lapierre — 5.

Charlie Angus moved, — That the motion be amended by adding in paragraph 1, after the word “management”, the following: “and single-desk selling”.

Debate arose thereon.

The question was put on the motion and it was agreed to on the following recorded division: YEAS: Charlie Angus, Wayne Easter, Mark Eyking, Wajid Khan, David Smith, Rose-Marie Ur — 6; NAYS: David L. Anderson, André Bellavance, James Bezan, Réal Lapierre, Kevin Sorenson — 5.

The question was put on the motion, as amended, and it was agreed to on the following recorded division: YEAS: Charlie Angus, Wayne Easter, Mark Eyking, Wajid Khan, David Smith, Rose-Marie Ur — 6; NAYS: David L. Anderson, André Bellavance, James Bezan, Réal Lapierre, Kevin Sorenson — 5.

At 5:46 p.m., the sitting was suspended.

At 5:47 p.m., the sitting resumed.

Pursuant to Standing Orders 110 and 111, the Committee resumed consideration of the certificate of nomination of Adrian Measner to the position of President of the Canadian Wheat Board which was referred to the Committee on Monday, October 24, 2005.

Adrian Measner made a statement and answered questions.

It was agreed on division, — That the Committee waive further consideration of the nomination of Adrian Measner for appointment to the position of President of the Canadian Wheat Board.

Pursuant to Standing Orders 110 and 111, the Committee commenced consideration of the certificate of nomination of John J. Ryan to the position of President of Farm Credit Canada

which was referred to the Committee on Thursday, November 17, 2005.

It was agreed, — That the Committee waive further consideration of the nomination of John J. Ryan for appointment to the position of President of Farm Credit Canada.

At 6:32 p.m., the Committee adjourned to the call of the Chair.

Bibiane Ouellette
Clerk of the Committee