– Intelligent Solutions –

The Manitoba Pillar

in a Canadian Federally-Inspected

Beef Packing Industry

Matching current agricultural policy with future forecasts

MCEC

Manitoba Cattle Enhancement Council

Executive Summary

With global demand for quality, nutritious food growing exponentially, and transportation costs forecast to rise even faster over the next 10 to 20 years, Canada's beef industry has an opportunity today to adapt its infrastructure to take advantage of these long-term trends.

Canada's agricultural policy needs to encourage additional players to enter the beef packing industry in areas of the country where there currently are few options. This may seem counter-intuitive given the current reported over-capacity of packing plants in Alberta. However, the alternative is to officially give up on regional beef production entirely, hand the fate of our national industry over to the two remaining multi-national players, and forsake our country's chance to foster the growth of a multi-billion dollar export-driven beef industry. That would make Canada's beef industry nothing more than a feeder for the giant U.S. industry. And it's worth noting that with recent U.S. Country of Origin Labelling legislation, we are not expecting trade barriers to become simpler in the future with respect to shipping live animals.

- **As it is currently constituted, our industry is at odds with current and forecasted industry trends. It is now focused on producing the lowest cost commodity beef products for the slow-growing North American market, while almost all of the expected increase in world demand for beef will be in Asia and developing countries around the world.**
- **Our major packing facilities are located in labour-starved Alberta, which skews their reports as to cost and capacity and which suppresses cattle prices in other parts of the country where producers are forced to absorb higher transportation costs.**
- **Important growth markets in the developed world, such as for kosher and specialty health-based and "functional food" beef products, are underserved by current industry infrastructure, because large plants are not suited to fill the demand for these niche markets.**
- **Long range shipping of live cattle is environmentally unsound and creates unnecessary risks of biohazards.**
- **Local ownership and management of regional plants encourages knowledge of disease and other risk factors, builds industry infrastructure, and improves both producers' and packers' financial feasibility. At the same time, it helps our industry avoid potential trade barriers or outright border closures.**

As it stands, Canada's beef industry poised to continue move sideways and shrink instead of grow and exploit major demographic changes foreseen by most industry experts.

The funds recently allocated by the federal government to support agriculture in general and the beef industry in particular need to be dispersed intelligently into initiatives that will have the most benefit over the long-term. The danger is for money to flow only to the already over-developed infrastructure in Alberta and Ontario. This will only exacerbate the industry's current malaise rather than start the process of pulling it toward a brighter, more dynamic and prosperous future.

Canada's agricultural policies need to position our beef industry for a future of sky high transportation costs, rising global food demand, increasing environmental sensitivity and enhanced demand for a wider variety of beef products. One of the smartest ways to address those pressures is to embrace a smart, nimble regional infrastructure consisting of smaller plants.

The Industry is Changing

The launch of Keystone Processors Ltd. can start a tide of change for our beef industry. Located in Winnipeg Manitoba, the transportation hub of Canada, Keystone's business model aims to produce a wide variety of beef products for premium niche markets around the world. It is one of several plants currently in the process of developing additional federally-inspected slaughtering capacity in Manitoba.

Opponents to adding beef packing capacity in regions such as Manitoba point to an over-capacity of production facilities, principally in Alberta. However, the overcapacity in Alberta has been fuelled by the province's chronic labour shortage, and relentless competition from U.S. feedlots (*source: Reuters article, Canada left with two beef packers as Tyson flees, June 26, 2008*).

This, in turn, has led to a decline in competition and a steady erosion of our domestic capacity to both raise and market beef. Should the U.S. border be closed again to Canadian beef, as it was in 2003 at the onset of the BSE crisis, then the Canadian industry will be certainly decimated.

Good Investment Opportunities, Sound Agricultural Policy

It isn't easy to change a firmly set industry paradigm, especially during an economic downturn. But we cannot escape all the signs telling us that the future holds high transportation costs that will demand more nimble regional production capacity.

The Manitoba Cattle Enhancement Council[1] has already invested in Keystone Processors Ltd. (MCEC was created by the Manitoba Government in 2006 to administer an investment fund for the provincial beef industry that is made up of equal contributions from producers and the government.) Keystone Processors is a mid-sized Winnipeg plant that is currently being upgraded to become the province's first new federally-inspected beef and slaughtering and processing facility in a generation. That company has developed a solid business plan to serve well-identified, growing niche markets internationally.

Additionally, MCEC is reviewing applications for funding two other Manitoba plants that are each planning to convert to federally-inspected plants.

The need for developing new federally-inspected plants in Manitoba is being driven by both supply and demand:

Supply: Manitoba producers have seen their transportation costs rise as much as fourfold since 2003 (source: Plains Processors, Carman, MB). At the same time, producers have been hit with rising feed costs and increased regulatory costs while the commodity markets for beef have kept selling prices low. As a result producers are seeking markets closer to home that can mitigate those rising costs.

Demand: The Canadian beef industry needs to respond to rising demand both at home and abroad. At home, transportation costs also affect supermarkets' bottom lines, providing pricing advantages for local packing plants. Additionally, consumer demand for premium, locally-raised produce is growing. Globally, the demand for higher protein diets in developing nations such as China has been surging in recent years and forecasts call for that trend to continue for decades. At the same time, demand for niche, premium-priced products such as kosher and halal products has been growing. Those kinds of niche markets are best served by small to mid-sized plants.

The Project Pipeline

1) Keystone Processors Ltd.

The company has the direct support of 50 Manitoba beef producers as well as from the Manitoba Cattle Enhancement Council, an investment fund that acts on behalf of all Manitoba cattle producers. Though Keystone has attracted nearly $5 million in equity to start up, current economic conditions have made it more difficult to attract the additional private investment required to bring the plant on stream for export.

The plant is focused on targeting niche markets including kosher and halal markets in North America, Europe and the Middle East, premium domestic markets as well as premium Asian markets. The plant is expected to have a capacity to handle between 250 and 500 head of cattle per day. At that size, it can be easily fed by the existing Manitoba herd.

Keystone requires additional support from both provincial and federal governments to help it get its premium, value-added products to market. The company is seeking $7.5 million in debt from both levels of government to bring new, much needed infrastructure to support the long-term health of Manitoba's cattle industry.

2) Plains Processors

Plains Processors is a provincially-inspected plant near Carman, Manitoba that is planning to expand into a federally-inspected plant to serve Manitoba's independent and national grocers and supermarkets.

It is planning a three phase plant upgrade to take it from approximately 80 head per week in 2009 to up to 1,000 head per week in 2011. Plans for the plant call for innovative environmental engineering upgrades that will attempt to create a self-contained system that will minimize or eliminate effluent.

MCEC is working with Plains Processors to finalize its feasibility study and business plan. It is owned by a well-respected local cattle producer who has also developed a retail arm in Winnipeg, which will further expand the company's vertical integration and control of its products from farm to consumer.

3) Oak Ridge Meats Ltd.

MCEC is also working with Oak Ridge Meats of McCreary, Manitoba, to develop a small federally-inspected plant to serve niche markets such as the growing organic beef market in Manitoba and Saskatchewan. The current plant has a long history of marketing beef to Manitoba retailers. Plans call for plant capacity to expand from 3,000 to 6,000 head per year.

The bottom line is there is pent-up demand from producers and consumers for new federally-inspected beef slaughtering capacity in Manitoba.

Beef Industry Capacity in Canada

Most of Canada's beef industry is centred in Alberta and dominated by two privately held American companies: Cargill and XL Foods. According to Canada's George Morris Centre, a leading agricultural think tank, **Alberta's packing plants have been running at less than 70 percent capacity principally because they are facing a lack of cattle and labour.**

There is a lack of cattle for two main reasons. First, the Canadian herd has been going through a 'right-sizing' process ever since the 2003 U.S. border closure after the BSE crisis led to a glut of cattle on the Canadian market. There were 14.3 million head of Canadian cattle (including dairy) as of January 2007. That is up from 10.7 million in 1987, but down from 15.1 million in 2005 and sharply down from the glut of 16.8 million cattle we had on the market a year after the border closed (*sources: Canadian Beef Export Federation, CBC report August 19, 2004*). Second, now that the border is open again, cattle are moving south to the United States in greater numbers. Cattle exports surged by 35 per cent in 2007 because of cheaper U.S. feed costs, lower U.S. regulatory burden (i.e.: SRM disposal), and higher bids from U.S. feedlots and packers, leaving fewer cattle in Canada to slaughter.

The greater challenge is the labour crisis in Alberta where packers have had to compete for workers with the province's red hot oil and gas industry, construction industry and tourism industry. Inflated wages have squeezed margins, which has led to pressure on commodity beef prices due to the large market influence of the major packers.

Further compounding the problems for the Alberta cattle industry were a severe drought earlier this decade that raised the cost of feed to finish cattle, as well as rising transportation costs.

Had the industry not been so concentrated in Alberta, it is possible that we never would have developed an over capacity.

The facts remain: we needlessly and inefficiently export millions of head of live cattle a year to the United States; our producers are forced to sell to a small number of large players and they must swallow high and growing transportation costs; and Manitoba cattle prices are further discounted due to the wear and tear on the animals due to those long hauls.

Regional Plants Make Good Business Sense

There are compelling business reasons for developing regional federally-inspected slaughtering and processing plants in Canada. There is a clear cost benefit for industry stakeholders including government to adding a certain amount of slaughtering capacity in Manitoba both for the plant itself and for the producers who would feed the plant.

The Manitoba industry is recognizing the changing supply and demand scenarios, and is ready to seize the opportunity with innovative, smart business plans that employ the latest in food safety and environmental processes.

The proposed plant expansions can be easily fed by the Manitoba herd. Having plants close to home will reduce transportation costs for both producers and processors. And by having direct contact with and more control of the food chain, local processors will be able to deliver higher quality husbandry and processing standards, thereby further increasing the premium the company can earn on its products.

Businesses need stable and affordable supply AND strong, growing demand for long-term success. Manitoba's beef processors have both, but **the current economic downturn has dried up credit and private investment. Government support is needed** to kick start a resurgence of the provincial federally-inspected beef industry. To do so will promote sound business risk management for the industry now and for the future.

We envision a resurgent Manitoba cattle industry will also spur additional private investment into superior breeding programs and enhancements at every level of the value chain. Having a handful of small to mid-sized plants around the province will benefit producers, give new markets for industry suppliers in multiple towns, increase employment, and will lead to a general enhancement of our provincial tax base.

Regional Plants Make Good Government Policy

Offering support to increased federally-inspected slaughtering capacity in Manitoba makes good government policy as the plants will mitigate environmental concerns (smaller carbon footprint from reduced transportation costs for example), while increasing our provincial tax base and further diversifying our provincial economy. It is also good, proactive economic policy given the virtual certainty of a future border closure or some other trade crisis, as it will help ensure our agricultural economy will remain stable and less sensitive to externally caused disruptions.

This is about the Manitoba industry taking control of its own future. Government support now means less dependence on income stabilization later. Long range forecasts for fuel, feed and transportation costs are certain to make individual producers even less competitive. But they can become more profitable if the industry starts producing more wealth here in Manitoba through value-added slaughtering and processing for growing markets in North America and abroad.

Additionally, bulk live cargo transportation over long distances is simply not an environmentally friendly practice. Shipping processed, boxed beef creates less pollution (carbon), uses lower fuel and transportation costs and produces less stress on the animals.

Shipping live animals across borders also leaves Canada open to higher risk of disease and cross-contamination of herds – the ramifications of which are significant as we saw in 2003. And it isn't just a north-south trade issue: the history of imposing interprovincial border controls on elk transport may also apply to beef in a crisis, further isolating Manitoba producers from much needed infrastructure. Disease can be better controlled, understood and contained by keeping the distance from field to finished product shorter; local vets know local problems. Animals can be treated more humanely in that they suffer less from the rigours of transportation (particularly young calves) resulting in less dehydration, less bruising, less stress to the animals, fewer deaths, reduced disease and higher quality beef.

And more competition in the Canadian cattle industry as a whole is good for producers, consumers, for government and for our industries to compete on a world stage. It will lead to more competition for cattle, which should have a positive impact commodity beef prices; it will encourage further industry innovation; and it will create a better, healthier selection of beef products for consumers. Ultimately, a more competitive industry focused on winning intelligently selected market share around the world will help Canada's beef industry thrive and prosper in the future.

In Sync with Growing Forward

An investment in Manitoba's federally-inspected beef slaughtering capacity is in sync with the federal-provincial-territorial Growing Forward initiative (formerly Agricultural Policy Framework), which puts emphasis on building a profitable sector through:

- More investment in innovation;
- Action on key regulatory priorities;
- Environment and food safety programs;
- Programs that better meet local needs;
- Measures that enable farmers to be proactive in managing risk when faced with disasters.

The plants' proponents are each committed to a number of innovative initiatives that are designed to help add value to their products and to drive more value for both their companies and the producers that supply them. For example, Keystone expects to offer complete gate-to-plate traceability. In our age of increasing concern over food safety, traceability mitigates risk, ensures a higher standard of food safety protocols, and can add a premium to pricing. Keystone is also planning to offer producers full carcass yield data. This will let producers know exactly which of their animals offered the most yield to the plant, which will encourage a better breeding and feeding program on individual producers' farms.

Keystone's business plan calls for it to target niche markets that deliver premium revenue over the bulk commodity cattle markets. And unlike the massive plants that dominate the industry today, the Keystone plant will be build to the right scale to serve these niche markets.

Environmental Innovation

For its part, Plains Processors is planning to develop a plant that will produce low or no effluent into the environment. It is committed to using the latest environmental engineering to ensure the plant leaves next to no environmental footprint.

Oak Ridge has a business plan that focuses on developing organic processing and top quality local products.

Plains Processors and Oak Ridge are right sizing for smaller numbers to serve Manitoba producers and consumers. Like Keystone, they have demonstrated there are sufficiently large local markets to accommodate the new federally-inspected capacity without putting them into direct competition with the larger plants in other regions. Developing these plants will reduce environmental, biohazard, business, and trade risks for the entire Manitoba industry.

Economic Development

The proposed federally-inspected plants will also feed tremendous benefits into the Manitoba economy through employment, an increased tax base and a more stable and vibrant agricultural sector. By producing value-added products for sale to domestic and export markets, more money will stay here in Manitoba than if we export raw materials (cattle) for finishing and marketing elsewhere.

Manitoba producers have been hurt in recent years more than most of their Canadian peers. They were effectively shut out of the Alberta and Ontario markets after the U.S. border closure, which led to a glut of cattle and plummeting prices. And because they are forced to ship their cattle long distances, they were disproportionately affected by the 2007-08 run-up in both feed and transportation costs. Long range economic forecasts predict feed and transportation costs will resume their recent rise once the world economy returns to health. Once that happens, Manitoba producers will again face ever diminishing returns on their herds and higher (possibly prohibitive) business risks.

Manitoba Cattle Enhancement Council
545 Hervo Street, Winnipeg MB R3T 3L6 (204) 452-6353 kbutler.mcec@mts.net

Appendix A

Where the Growth Is

Asia
According to the International Food Policy Research Institute in Washington, D.C. approximately 40 per cent of the expected growth in demand for meat products by 2020 will come from China.

> *A demand-driven "livestock revolution" is under way in the developing world, with profound implications for global agriculture, health, livelihoods, and the environment. Between the early 1970s and the mid-1990s, the volume of meat consumed in the developing countries grew almost three times as much as it did in the developed countries. With continued population growth, urbanization, income growth, and changes in lifestyles and food preferences, we project that meat demand in the developing world will double between 1995 and 2020 to 190 million tons and increase by 25 percent in developed countries to 122 million tons.(source: IFPRI Food Policy Report, 1999).*

Kosher and Halal
Where in demand, kosher packaged foods tend to carry at 10 to 25 per cent premium over non-certified products. Kosher meats come from the front end of the animal, which creates the potential for increased revenue from the sale of the less desirable front cuts.

To give you a sense of the size and growth of the market: a USDA study indicated growth in Canadian kosher food sales from $480 million in 2000 to $575 million in 2001, a 19.7 per cent increase. This has been attributed to a return to traditional religious roots among Jewish people as well as concern about food safety and food quality by other Canadians.

Halal is a comprehensive Islamic term that means "lawful". The Canadian Islamic community is growing quickly, doubling between 1991 and 2001 (*source: www.muslim-canada.org*) and, predictably, so is the demand for halal meats. The Canadian halal industry is fragmented and presents a current opportunity for new processors to come to market.

Organic, Natural and Functional Foods
Recent years have seen tremendous increases in demand from North American consumers for healthier, more nutritious foods. A growing number of consumers, wishing to avoid meat products raised with antibiotics and hormones, are attracted to organic and naturally raised beef.

At the same time, there has been a proliferation of food products that offer specific health benefits, such as the inclusion of Omega 3s in eggs, poultry and pork today.

Premium Beef

Sales of premium beef have also been on the rise as consumers seek better quality food choices in restaurants and at home. Partly driven by the rise of the "foodie" culture in North America, this trend has influenced the growth of breed-specific brands such as Angus Beef and private label aged beef from a number of processors. For example, the Certified Angus Beef program announced record sales of 634 million pounds in December, 2008, an 8.8 per cent increase over 2007 (*source: www.certifiedangusbeef.com*)

---

[1] ***About MCEC***

MCEC was created in 2006 with a mandate to support made-in-Manitoba solutions for a long-term, viable beef industry in Manitoba. The first goal of the Council is to provide seed capital and support for business plans to increase slaughter and processing capacity here at home. The Council administers an investment pool that is funded by a $2 per head levy on all cattle sold by Manitoba producers. The Province is matching the levy for the first three years so every $2 becomes $4.

For more information on the Council, please visit www.mancec.com.

Manitoba Cattle Enhancement Council
545 Hervo Street, Winnipeg MB R3T 3L6 (204) 452-6353 kbutler.mcec@mts.net