



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

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

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

February 2005

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AGRICULTURE AND AGRI-FOOD**

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FROM THE PARLIAMENTARY INFORMATION AND RESEARCH SERVICE

Jean-Denis Fréchette, Principal

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

has the honour to present its

SECOND 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 2nd report, which concludes phase I of 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 is now conducting phase II of its 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.

Status Report
Financial Analysis Relative to Meat Packing Companies in the Context of the
BSE Crisis of 2003
Phase I

Introduction

Consulting and Audit Canada(CAC) has been engaged on behalf of the Committee to provide assistance and expert financial advice in the review and analysis of financial information provided by specific companies. CAC was also requested to assist in formulating the information requests and templates, based on the Committee motion of March 29, 2004.

This report provides the status to date on the information submitted and our analysis thereof.

Background

The Committee has conducted hearings and other research. In April 2004, the Committee submitted its report titled “Canadian Livestock and Beef Pricing in the Aftermath of the BSE Crisis”.

According to this report:

- the exports of beef products were down 36% in the first 11 months of 2003 as compared to the previous year;
- in the post BSE period, Alberta feedlots suffered a 33% decline in price of steer from 2002 and a 40% decline in price from the pre BSE period in 2003;
- fluctuations in wholesale prices (i.e. prices received by packer) were more moderate than fluctuations in cattle prices and retail price fluctuations were more moderate still;
- the wholesale to farm-gate (i.e price received by cattleman) price spread increased from \$70 cwt. in January 1999 to \$100 cwt. in December 2003 and retail to wholesale spread increased from \$220 cwt. to \$320 cwt. during the same period. The pattern has been transpiring for more than four years;
- average retail price of beef and beef products declined 13.8% between May and December 2003;
- packers have faced added processing costs; and
- there was an increase in gross margin to \$431 per head for the period September 2003 to February 2004 versus \$144 per head a year earlier for Canadian packers, as quoted in a report from an industry association.

In July 2004, the Auditor General of Alberta released his report on the BSE crisis. Among his key observations are the following:

- The Canada-Alberta BSE Recovery Program put further downward pressure on cattle prices

- as producers rushed to sell their cattle for slaughter;
- There has been a shift in value obtained from cattle between the producers and packers, in favour of the packers, since the discovery of BSE,;
- The three Alberta based packers benefited significantly from the impact of BSE on the price and slaughter volumes of cattle (281% increase in profit per head in terms of net margin and 174% in terms of gross margin, comparing 2002 yearly results with six month results from July 2003 to December 2003), as a result of supply and demand forces at work in a distorted market;
- Financial information shows that integrated meat packing operations of 3 major packers have performed substantially better post June 18, 2003 than preceding 3 years;
- The information received to substantiate additional operating costs to comply with new regulations is not complete nor uniform in scope. What is clear is that those costs have been much less significant than the increase in operating results; and
- The clear answer why beef prices are not lower at the retail level is that there is no surplus of beef at either the retail consumer or packer level for cuts that are popular in North America.

Scope

The scope of our analysis was the information submitted by five meat-packing companies based on various requests submitted on behalf of the Committee. The information provided by the companies has not been audited by their external auditors, although in some instances, the companies have indicated that they have reconciled the data submitted to their annual financial statements. The data we have used is for calendar years 2002 and 2003. The companies may report annual financial statements on a different year-end.

By December 3, 2004, all the companies had responded. The summary of our review is presented below.

Summary Analysis

Our analysis is presented under five main headings which correspond with the information that was requested from the companies, based on the Committee motion of March 29, 2004.

Added marginal costs attributable to BSE safety costs

Companies have reported information on such costs to a varying degree and in different formats. Most have indicated that they do not segregate such costs separately in their financial records. The financial information from the companies indicate that their overall expenses have decreased by approximately 2% for the period July to December 2003 as compared to the same period for 2002.

The data provided is not in a meaningful format to compile the dollar impact of added marginal costs. However, our analysis confirms that there was an increase in expenses, as a percentage of sales, during the last six months of 2003, reportedly attributable to increase in marginal costs due to BSE related regulations.

Explanation of why the prices the companies paid for steers and heifers dropped by 50% in the three weeks following the BSE recovery program announcement

The data provided by the companies is not consistent. Some report prices they paid for cattle (as opposed to steers and heifers) whereas others have quoted or referred to market prices per the George Morris Centre, and not provided any additional information. In one case, the company reported that they do not deal in steers and heifers.

Impact on Profit Margins on a monthly basis

Comparing the financial results year over year from January to December between 2003 and 2002 show the following

- i. Decrease in sales: 17.50%
- ii. Increase in gross margins : 12.90%
- iii. Increase in net margins : 84.55%
- iv. Decrease in expenses: 1.22%

A breakdown shows the following increase (decrease) in comparing the calendar year 2003 with the calendar year 2002.

	January to April	May - June (BSE detected May 21, 2003. BSE Recovery Program announced June 18, 2003)	July - December
Sales	5.21%	(40.74%)	(22.88%)
Gross Margin	7.57%	(67.60%)	44.91%
Net Margin before Income Tax	(389.83%)	(209.85%)	223.45%
Expenses	10.44%	(17.89%)	(2.32%)
Increase (Decrease) in Net Margins in dollars	(\$5.7M.)	(\$84.0M.)	\$196.7M

The above analysis indicates that gross margins for packers increased significantly and the net margins increased even more substantially post BSE. Overall, the packers had substantially better profitability year over year.

Additional Financial Information

The packers have provided information on inventories, inventory valuation practices and in some cases, a breakdown between domestic and export sales. Inventories are valued on a consistent basis among the various companies.

Explanation on the effect of fed steer and heifer market following the BSE program announcement as far as your company is concerned

Some companies indicated they had nothing additional to offer beyond comments made in previous testimony to the Committee. Others have offered anecdotal comments of general nature mainly relating to market forces.

Conclusion

The five companies, on an aggregate basis, had a much better financial performance in 2003 than in 2002. In the last 6 months of 2003, both their gross and net margins were substantially higher than the comparable period in 2002. As the producers suffered a significant decline in prices, comparing the last 6 months of 2003 to the similar six month period in 2002, it is fair to conclude that there was value transfer in favour of the meat-packers.

Our analysis confirms that there was an increase in expenses, as a percentage of sales, during the last six months of 2003, reportedly attributable to increase in marginal costs due to BSE related regulations. Despite those increases, the net margins of the packers improved substantially in the July to December 2003 period as compared to July to December 2002.

Sufficient information has not been provided to determine what prices the packers paid to producers or feedlot operators for steers and heifers post BSE recovery program announcement.

**APPENDIX A
LIST OF WITNESSES**

Associations and Individuals	Date	Meeting
Consulting and Audit Canada Fred Jaakson Director General and Chief Auditor Janak Shah Director	14/12/2004	18, 19

MINUTES OF PROCEEDINGS

A copy of the Minutes of Proceedings of the Standing Committee on Agriculture and Agri-Food (Meetings Nos. 18 and 19 which includes this report) is tabled.

Respectfully submitted,

Paul Steckle, M.P.
Huron-Bruce

Chair

MINUTES OF PROCEEDINGS

Meeting No. 19

Tuesday, February 1, 2005

The Standing Committee on Agriculture and Agri-Food met *in camera* at 3:35 p.m. this day, in Room 371 West Block, the Chair, Paul Steckle, presiding.

Members of the Committee present: David L. Anderson, Charlie Angus, James Bezan, Claude Drouin, Wayne Easter, Roger Gaudet, David Kilgour, Larry Miller, Denise Poirier-Rivard, Gerry Ritz, Paul Steckle and Rose-Marie Ur.

Witnesses: Consulting and Audit Canada: Fred Jaakson, Director General and Chief Auditor; Janak Shah, Director.

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

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

It was agreed, — 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 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.

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

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

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.

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

It was agreed, — That the Pest Management Regulatory Agency (PMRA) make available a progress report on its activities, prior to its appearance before the Standing Committee every six months;

That the progress report highlight various indicators such as the number of new pesticides approved, the number of old pesticides re-evaluated, the number of minor use pesticides approved, the number of temporary and emergency registrations, and other information pertaining to Agency's operations, including cost recovery initiatives and staffing requirements; and

That the report be reviewed in consultation with the Commissioner of the Environment and Sustainable Development.

It was agreed, — That officials from the Canadian Food Inspection Agency appear before the Committee as a follow-up to the Abbotsford, British Columbia meetings on the avian flu crisis.

It was agreed, — That the Canadian Bankers Association appear before the Committee to discuss the farm income crisis.

It was agreed, — That the Committee conduct a study of plant breeders' rights.

At 5:27 p.m., the Committee adjourned to the call of the Chair.

Bibiane Ouellette
Clerk of the Committee