

Long-Term Chicken Sector Pricing Review

Roundtable – BC Hatching Eggs – Hatchery Margin, Breeder Chick & Vaccine Costs

February 3, 2021

Attendees:

BCFIRB: Wendy Holm

BCBHEC: Jim Collins, Stephanie Nelson, Joshua Crossett, Joe Neels, Beata Kunze, Daniel Zylstra & Calvin Breukelman

BCBHEPA: Bryan Brandsma & Art deRuiter

BCCMB: Harvey Sasaki, Bill Vanderspek, Christine Rickson, Alistair Johnston & Ray Nickel

BCCGA: Dale Krahn, Fred Redekop, Jennifer Curtis & Ravi Bathe

BCEHA: Ernie Silveri, Ryan Whitmore & John Franck

PPPABC: Blair Shier, Craig Evans, Kerry Towle & Ken Huttema

Recording Secretary: Stephanie Nelson

Wendy: Welcome, the purpose of this meeting is to provide the Commission's proposed hatchery margin and breeder chick vaccine pricing formula.

Quickly going through the agenda – presentation from Joshua broken into three parts. At the end of each segment we will pause for questions and at the end we will have a round of questions and discuss the third-party verification process. The PowerPoint and draft notes will also be posted to the website.

Housekeeping, please remember to keep your mute on when you are not speaking and when you are speaking please turn your camera on, with that I will turn it over to the Commission. Jim.

Jim – Good morning and welcome to the fourth corner of the square, as described by Blair last meeting. Comments will be brief as Joshua has a comprehensive presentation. Last week's hatching egg COP Roundtable dealt with one of the two pricing issues of specific importance to the Commission, today's is the other.

As is the case with the COP, the Commission's objective is to establish a formulae-based approach to pricing that includes the hatchery margin, breeder chick and vaccine pricing and, by extension, the price of broiler chicks.

As also noted last week, these are all matters within the scope of the Commission's statutory pricing authority. However, the Commission fully recognizes the potential impact of these pricing decisions on all stakeholders.

To that end, the Commission has been examining, with the Chicken Board, possible ways to establish and manage a transparent, three-way pricing relationship between producers, hatcheries and growers.

Last week I stressed that there are still pieces of the COP puzzle that have to be put together. If, how and when to include or exclude costs in the COP, how to facilitate efficiencies, status of levies etc.

The same applies here today, we have pieces of a potential pricing solution. Josh's presentation will describe those in detail. How they will fit together is something that the Commission, in consultation with the Chicken Board and PPAC, will be looking at in preparation for the next phase of the roundtable process. The puzzle is not yet put together.

With that, over to Harvey.

Harvey – You have said it well. The complexity and intricacies in the puzzle make it very complex, at the end of the day we do need to address the 4 sides of the square.

Jim - Thanks Harvey, any questions we are happy to answer them during and at the end of the process. Over to Joshua please.

Joshua – What I have done here today is provide a brief background in starting to explore the formula of the breeder chick price and vaccine developed by a sub-committee that I supported in terms of administration and assisted with the calculations.

Sub-Committee

Joshua – To further discussion on pricing-related topics, a sub-committee was established between the BC Egg Hatchery Association (BCEHA) and the BC Broiler Hatching Egg Commission (BCBHEC). These topics fall into three main categories: 1. Hatchery Margin 2. Breeder Chick Cost/Price 3. Vaccine Cost/Price. Discussions were productive and reached a point where the provided document (“Hatchery Margin Calcs – for Sub-Committee”) laid the groundwork for what was tabled to the BCEHA to take back to its members in October 2019. Where to go now that we had formulated some ideas. A difficult document to understand without having this PowerPoint. This PowerPoint will look at each component separately and further examine.

The document summarized those three main categories. This presentation speaks to this summary by breaking out each of these three categories, exploring the background and the ideas generated by the sub-committee, the considerations remaining, and effects on pricing where applicable.

Hatchery Margin

Joshua – The hatchery margin is the amount earned by the hatchery, on a per chick basis, between what they pay to the Producer (saleable chick price) and the price charged to Growers (day-old chick price). The hatchery margin is fixed at \$0.1894 per chick. In the current Linkage-based pricing model, the prices received by Producers for their saleable chicks and paid by Growers for their day-old chicks are heavily influenced by the live kg price.

The price for kilograms of eviscerated chicken, as set by BC Chicken Marketing Board (per its pricing model) is inputted into the Linkage algorithm which is set to balance the returns between Producers and Growers: parity. The extent to which the saleable chick and day-old prices may move each period to achieve parity does not affect the hatchery margin – it remains at \$0.1894.

The net increase of \$0.020 to the hatchery margin (11.8%) was phased in over 3 pricing periods. Historically there has been no set review period regarding the hatchery margin. Consultations with affected stakeholders are required to facilitate any request to change (increase) the hatchery margin.

The “pure” margin increase request equates to 9.2% increase over its current rate approximately \$0.2069. The last increase was effective April 2012, approximately 9 years ago. The effective annual compound rate would be 1.0%, as illustrated.

As illustrated at the COP roundtable, as lay cycle increases, price per saleable chick and day-old chick price decrease, there are efficiencies there. It is important to note that as the hatchery margin is static, it does not participate in efficiencies that may be experienced by the system as more chicks are throughput (i.e., no hatchery COP). It has been stated by certain stakeholders that due to this efficiency mechanism, any profitability in the system for farmers has been due to volume increases recently experienced as recovery parity remains systematically below 100%. This presentation does not explore these points that is conjecture that I will leave to the affected parties in that aspect.

Difficulties arise in building scenarios given how inter-related many aspects of pricing are. However, based on the live kg pricing algorithm, it is generally understood (rule of thumb) that 75% of any increase in day-old price is, over time, recovered through the live kg price.

In reviewing the anticipated effect diagram, tacking on 1.75 cents to the day-old price, that has to be run through the algorithm as it would change the price to the growers. A moderation in price for day-old and saleable chick would occur to facilitate the hatchery margin. Anticipated price effects on a COP, essentially what happens is the first two remain the same, don't have a push down effect on that top price as it's no longer linked to Ontario through the live price, would see an increase to the day-old, that's it.

Considerations for going forward: Include a regular mechanism to review the margin, such as an MOU? - Provide indexing such as a cost-of-living adjustment, and using what index? - Require a third-party review of costs for indexing or future adjustments? - Hatchery efficiency inclusion? - COP-based inclusion, similar to the Ontario model?

Hydro and employee labour costs are the most relevant costs here. Did receive a similar report provided by hatcheries. Do we think about hatchery efficiency inclusion? COP-based tripartite Ontario model?

Pause there as that is the background, are there any questions or comments on this first part?

Bill – Joshua going back to the slide that talks about the proposed margin increase relates to linkage, 75% recovery on the chick price is based on a temporary formula used for the last few years that may or may not survive the next round of review. I do not think growers should assume you can recover any of the hatchery margin through the current pricing formula. The other point I want to make regarding the whole concept of a COLA clause: it doesn't make sense as no one else gets an automatic increase, that really needs to be discussed.

Ken – Since we are linked to the Ontario price and Ontario hatcheries receive increases overall why were those excluded in BC?

Joshua – I know in terms in running the numbers there are no mechanisms to distribute the margin throughout the parties.

Jim – Comparing the two are apples and oranges, not excusing the time it has taken to get here but its apples and oranges.

Ken – But there has been increases correct?

Jim – There are other differences involved and this increase will bring the hatcheries back within a certain differential but yes there have been increases.

Joe – Another point might be that the hatcheries in Ontario are a part of the COP agreement and the costs are included. BC hatcheries have been invited to be a part of the COP process, but the BC hatcheries decline participation. The Ontario hatcheries have a regular increase by that agreement.

Wendy – Further questions?

Blair – Building off Ken and Bill's questions. Bill you made the comment on the current formula with the tie in, the other piece is whatever formula we do come up with we need to understand the variables that impact the price in BC. Reinforces the points that the devil in the details will be how these two things tie together.

Bryan – Joshua, you keep mentioning pure hatchery margin what is an impure margin?

Joshua – The distinction is the inclusion of the breeder chick margin as expressed, potentially, on a per saleable chick versus a straight margin increase.

Bryan – Just to be blunt, the hatcheries are tied into the retail market, linked with prices to processors isn't it? Chicken growers and producers don't get a cost-of-living increase, but the processors do base on CPI.

Blair – I would reinforce there are no guarantees from the marketplace. Contract-by-contract basis. Recover the increases in live costs, no COLA in our formula.

Joe – I wanted to make a comment on why we came up with this idea, because it has been 8/9 years since the increase, for one reason or the other hasn't been done, but it's always adversarial when we discuss. The idea was that we could address this without a COP. We looked for different ways for how we could ease that pressure.

Ray – Joshua you stated that there has been a fixed hatchery margin and no other opportunities. Are you getting into other ways hatcheries have managed their margin, I understand the hatcheries have other ways to manage their margin.

Joshua – Yes in the document we mention the 20% margin in the breeder chick price.

Ray – When you mention Ontario, be cautious on that, unless we want to do exactly what they do in Ontario, I would suggest we be cautious on that topic.

Blair – Just thinking about that COLA comment, the reality is we will have to look at COLAs across the board as there are factors that have been flagged with built-in increases, something we may need to consider moving forward,

Jim – Modelling, in other words.

Blair – Yes, how do you model without a COLA?

Wendy – No more questions? We can move onto the next topic.

Breeder Chick Price

Joshua – BC Broiler Hatching Egg industry operates using a hen-based quota system. The Commission sends out placement dates and amounts to hatcheries who in turn place orders with the breeder companies for eggs (local hatch) or chicks (fly-in or truck-in). Producers are free to order the male percentage that suits their farm best, but 12-13% of the female order is recommended. Hatcheries set the price, and report that said price to the Commission every 8 weeks for its inclusion into Linkage. Producers currently pay their assigned hatchery directly for their day-old breeder chick within 30 days. Over the past 8 years the breeder chick price has moved significantly. A significant increase in the past 8 years. Increase of 125% female and 136% males. Annualized at 10.8% females and 11.3% males. A large part is attributable to the breeder company.

A significant increase in pricing has been experienced by the sector. A large amount of the increase is attributable to breeder company price increases, per hatcheries. The cost of breeder chicks is factored into the Linkage, but through the work at the sub-committee, a commitment to transparency and establishing formulae to achieve this began. No formal documentation is provided. Transparency is important on these increases.

Significant components of the breeder chick price include company cost, foreign exchange, other services, and margin. At this time, prices paid by Producers depend on the breed selected by their assigned hatchery. Therefore, although the Linkage will be updated for an average price, Producers do not experience the same costs at the placement of their flock. Hatching locally there on off lines that replace the need for the domestic chick and are taken out of the allocation. Not considered in this presentation are off lines, breeder company loyalty programs, payment discounts.

Cost (USD) - Consideration of applying an average price to Producer regardless of selected breed (formula) - Potential to include current breed mix and weighted by the market share of each hatchery - Potential to have one set price per bird regardless of sex - Potential to set the male order percentage – All in one price and delivery system. Establishing a mechanism for updating this component is at the sub-committee level

Services (USD) - Consideration of Services, including: - Beak trimming - Vaccines provided by breeder companies - Set figure was provided for services - Establishing a mechanism for updating this component is at the sub-committee level

Foreign Exchange - Consideration of what rate to use (Bank of Canada) - Spot rate (single date) or band of time (e.g., average past 8 weeks, 3 mos.) - Establishing a mechanism for updating this component is at the sub-committee level. The hatcheries take the ups and down for the 8 weeks in between pricing updates.

Other - Brokerage - Set figure was provided for brokerage - Blood work / lab - No figure was provided - Establishing a mechanism for updating this component is at the sub-committee level

Margin - It was stated that hatcheries apply a 20% margin to the costs of the breeder chick after foreign exchange conversion and any brokerage fees, and this covers the cost of providing the service of placing the breeder chicks on the Producers' farms. - At the then female price of \$9.90, a margin on that chick would have been \$1.9800. - The margin is applied to costs that are generally not in the control of either the Commission or the hatcheries.

Margin - The Commission's position is that the margin should not be applied in this manner and would prefer it be crystallized, recognizing that profit has been attained by providing this service and it needs to be locked down (\$1.98/hen). This can be reflected in the formula in one of two ways:

As part of the Breeder Chick Price Formula as a set \$1.98/hen. Or as part of the Hatchery Margin, where the hatchery receives such margin over the expected saleable chicks from those hens (\$1.98 / appx 115 chicks = 1.72¢ per chick). Close to pure hatchery margin increase.

Net effect - Producers would pay cost as determined through transparent pricing + a set margin. This figure would flow through the COP as is current practice (no change). Example: Should breeder company prices increase; producers will not be charged beyond the CAD equivalent of that increase.

As set by formulae and updated on agreed interval. Set at 1.72¢/saleable chick. Updated on agreed interval. Net effect Producers would pay cost as determined through transparent pricing + a set margin. This figure would flow through the COP as is current practice, reducing the COP and amount due by hatcheries on saleable chick. The amount would be recaptured in the hatchery margin. No net change to the day-old chick price, it will remain static. We are instead describing a cost and hatchery margin. The day-old chick price is anticipated to remain the same.

Overall Anticipated Effect under COP-Based Pricing Saleable chick price goes down 1.72¢/saleable chick; recovery % goes up. Hatchery margin goes up 1.72¢/saleable chick. No net change to the day-old chick price. In a sense we would be changing how we characterized costs and it would change the recovery percentage.

A lot of options here but I think we can all agree we need better transparent and whether to express the margin received on the breeder chick as a cost or a simple margin.

Questions:

Bryan – How did you come up with the idea of 20% as standard? Is that negotiable or just an example? The real world is more like 10-15% how did you land on 20%?

Joshua – That was the percentage presented to us by the EHA members, the original document had options.

Bryan – Needs to be negotiable 20% is ridiculous.

Ray – 1.72 cents per saleable chick, and then your original presentation you were talking about the hatchery margin, is this in addition to that?

Joshua – Correct, this is a separate issue.

Ray – Together, both of those would form the hatchery margin?

Joshua – Together would be 3.5 cents.

Ray – That would be passed on and hit the linkage formula?

Joshua – Yes it would?

Ray – We would have to figure it out within linkage

Craig – In a nutshell, in one scenario we are taking on the cost to the breeder chick and that's the hatchery margin, in the other it's about the productivity of the hen?

Joshua – Yes that is what we are looking at, we are looking at efficiencies, looking at hatchery efficiency.

Craig – What are the risk factors here? The hatchery can recover by hatching well but how does the decrease in productivity impact the costs? Kill age down etc. ... Do we put guardrails in?

Joshua – We would have to do a sensitivity analysis on those factors.

Joshua – Not at a point where we have direction so we can say move around the chicks by 10-15 per hen and see what that does, to begin looking at guardrails.

Joe – For clarity on Ray's question, if you add those two together you get 3.5, the 1.72 is in the COP, no impact downstream. The 1.75 is the only impact.

Joshua – Yes, it's all about how it is expressed within the system.

Calvin – Josh, is there any relevance in the calculation of 1.75 on imports?

Joshua – This is just a calculation on you getting the breeder chicks based on quota no bearing on TRQ and imports. Just based on average chicks per hen, the only overlap is the offline placements impacting the allocation on a one-to-one basis.

Harvey – Commend you on the presentation appreciate how you have laid this out for us and understanding on what is involved. Following up on the addition, seems to me we would benefit from this. Who pays for the increase or the change that's being proposed? Does it go into the price the grower pays of the hatching egg producer pays for the breeder chick and incorporated into the COP ultimately does surface into the saleable chick price; I am having some trouble wrapping my head around this. Can we get some follow up on this? On Craig's question, the upside risk and benefit in reducing the chick price. In the event the reduced productivity there would be a downside risk.

Joshua – Makes sense to me to that productivity would be a factor as it is a mix. The hatchery gets to choose the breeder, but the producer manages the flock throughout its life, how do you split that risk?

Wendy – Small Break for 5 minutes.

Further questions on the breeder chick cost please?

Art – I still do not understand how the 20% markup is justified for the service we are getting? It is just too high, it is not justified for me. On the average flock its \$15,000. Just wanted to make that comment.

Jim – Keep in mind, everybody should keep in mind, as you put the three elements together there is a quid pro quo and how they relate to each other and impact each other. Some hatcheries have higher vaccine costs but can offset on breeder chicken pricing and vice versa. I am not justifying the 20%; similar to the guardrail comments there needs to be some balancing of the books

Bill – Worth mentioning, whether its 5/15/20% its going through the linkage and by going through the linkage it is effecting our competitiveness in the province and the processor is paying it, you're getting that money back through your saleable chick price, Art.

Wendy – Further questions?

No? Joshua, you can move to vaccines.

Joshua – We all understand that the Vaccine Price Vaccinations have a significant impact on Producer flocks' progeny. Similar to the Breeder Chick Price, the amount paid by Producers varies depending on the vaccination schedule of their assigned hatchery. There are also differences in cost depending on whether the vaccine is commercial or autogenous (more expensive). Mandatory vaccination schedules are routinely updated by hatcheries in response to disease issues on broiler farms; the inclusion of a cost to the COP/Linkage requires attention to ensure timely incorporation. The cost of vaccines is included in the Pullet line of the COP. \$1.40 per hen. I do not have a lot to speak to on this; it is on the strategic plan and how do we update the COP to ensure the industry appropriately captures these types of costs.

Wendy – Questions?

Jim – Additional comment to expand on at what cost and what time does a vaccine become industry standard. Discussed with the EHA on how to accomplish this.

Wendy – Timely right now with all the vaccine chatter.

Joe – If average cost is \$1.40 some hatcheries are at \$2 and some are at a \$1 or less, not a level playing field for producers. One objective is to lateralize those costs.

Ray – Important piece, Josh, thanks, this has a big impact on chicken. The sooner we can get to the level playing field the better. This brings up the question for me of hatcheries having the option to do something differently if they want thoughts given to hatcheries wanting to use a different bird. Productivity etc. Has that impact been considered?

Joshua – With respect to the hatching egg side, because the determination of the breed is from the hatchery there's been brief discussion on a BEEP or an bird-egg equivalency program.

Joe – To Ray's question there, the Commission recognizes that the breed is driven by the processor, not looked at that closely. The processor has to sell the bird so it's their choice so far. It would be good if they looked at bird efficiency...

Bryan – As long as we do not move in that direction too fast as we both know it can go the other way and mechanisms need to be put in place to ensure we have it covered if the bird crashes.

Joe – Currently captured every time we do an update. It will be captured; we could capture it a little more frequently.

Ray – General on the hatchery margin as it pertains to the type of bird. Makes sense that certain breeds have a different pricing regime on them. One chick could be worth more to balance out the inefficiencies on both sides. Is that discussion happening?

Joe – We have not brought it to that degree yet. We have not had the discussion with the hatcheries yet. This is a way the industry could work together to get efficiencies and to get industry efficiency. This gives options for hatcheries and processors to make decisions. A good consideration for moving forward.

Harvey – Follow up on your point, Joe. Would be of interest if we knew what the factors were on the decision making on the choice of the bird? What are the factors? We could then be more creative in ensuring we are more competitive.

Blair – This is way outside my area of expertise but I have learned a few things. Don't we need to keep both breeds in play in BC? Having unique prices to each sound good but we need both breeds here in the province so we don't have all our eggs in one basket; processors make choices on the market. A lot of issues facing us on the horizon that do not make these decisions easy.

Joe – One more comment, we do not always know the difference in efficiency until the end of the flock. We are at best a year behind on performance.

Calvin – I think there is quite a degree of variability in the breeds but having two makes a lot of sense as they change quickly with genetics. Quite a range in expected chicks per hen.

Harvey – Thanks Blair for your comments, and yield of bird comments, some of the factors outside of our control too. Talking about efficiency throughout the system. Does the broiler grower receive a single breed or a mix in terms of chick placements?

Ray – My understanding is we receive a blend, difficult for hatcheries unless they are one breed exclusive – it's tough to manage. These are things we could consider further on.

Harvey – Interested to hear from Ryan and Ernie in terms of the challenges that the hatcheries have in trying to segregate the breeds and getting pure placements to the growers.

Ryan – Typically when running them mixed it is the challenge. It's not a perfect science you can't set for it but you can get above an 80% pure barn status.

Summary discussion

Joshua – The summary had brought together the breeder price and 'pure' hatchery margin increase but will require revision upon outcomes that remain at the sub-committee member level.

As the table was a mishmash of information provided in the first document, the PowerPoint unpacks the information and hopefully provides some clarity from a number's perspective.

Where it stands today, the hatchery margin is caught up within the pricing review. We do wish to have the input from the full EHA membership. Clarification of services from the BCBHPEA and the margin mark-up, cannot comment much further on that. The BCCGA questions reviewed and answered.

Wendy – General questions.

Jim – The EHA initial request for a hatchery margin increase was 3.0 cents, why it came down is the review of the input costs of the breeder chick and the vaccines.

Opened up for questions:

Bryan – For clarification, it's pretty common knowledge that hatcheries and processors are one in the same; one thing we thought of was, is it necessary [margin increase]? As they are the same companies, we do not see that need.

Blair – The hatcheries are a stand-alone business; we are integrated but it's an operating entity that has not received an increase. This is a four-legged stool with the hatcheries, it needs to make economic sense for all sides.

Dale – Enlightening presentation, one segment has margin controls with increases coming from the Commission, but we have the uncontrolled area of the breeder chick side and is uncontrolled by the marketing board. Why would we consider a margin increase if it can be recouped on the other side?

Jim – That's part of the package deal, we have the authority to price the breeder chick price, and the vaccine chick pricing and it's a package deal. Bring everything out into a transparent formula.

Blair – What we would also like to see is the impact to live price and impact to growers and processors. All of these things are linked, I am hoping that will be a next step. The information allows us to be more specific. To demonstrate the impact on the stakeholders.

Harvey – It is about addressing all four legs of the stool; we need to know the cumulative effect and individual impacts to stakeholders.

Calvin – Just a comment, we talked about efficiencies and that is important. On the hatchery side it is really important on how eggs are hatched, hatch of fertile is important. The numbers you see are the average, there is variability. We have not seen much technology improvements and innovation. There are some benefits to this technology, we should be discussing those pieces as well.

Wendy – Other questions? We will be post with the draft minutes and PowerPoint to the website. Turn it back to Jim now.

Jim – The Commission is reviewing all questions and submissions, BCCMB is doing the same thing. Will consider them in terms of next steps. As for third-party verification, MNP was used to review the formula, prepared to use them again as we get more information from stakeholders. Thanks Wendy and thanks everyone for constructive discussion.

Wendy – Will be looking to the six chairs and six liaisons for some meeting times to plan next Roundtables. We have COP information coming in, and linkage discussions to take place, metrics coming in from PPPABC.