



THE HOLM TEAM *Agriculture Economics Journalism Trade Cooperation*

292 Smuggler Cove Road, Bowen Island, B.C., Canada V0N 1G1
(604) 417-2434 www.wendyholm.com wendy@wendyholm.com

April 26, 2021

REPORT TO STAKEHOLDERS¹ (Producers, Hatcheries, Growers and Processors) BCFIRB LIAISON, LONG TERM CHICKEN SECTOR PRICING REVIEW

Following the Phase Two Round Tables, Phase Three kicked off with the Boards asking Stakeholders for additional information needed to come to an informed decision on long term pricing for the BC broiler chicken industry. During Phase Three, Round Tables were replaced by bilateral tables, each stakeholder meeting with their regulatory board to provide requested clarification.

BCBHEC, which has been working on a COP formula for 3 years, had few unanswered questions and used this time principally for digging into feedback from stakeholders to initial COP and hatchery margin Round Tables (including draft conditions and efficiencies proposals in response to concerns), assessing MNP's third party verification report received in late-April, and comparing proposed HEC's new COP to Ontario pricing developments to understand how they relate in practice. All in preparation for distribution to Stakeholders on May 6.

BCCMB asked Growers and Processors a number of questions, the most substantive of which was to further explain what they mean *by reasonable returns to growers and processor competitiveness*. Like the import/export issue, two different stories emerged.

REASONABLE RETURNS TO GROWERS

Two models of grower returns were tabled with BCCMB, both based on actual 2016/2017 production costs from twenty-eight farms prepared by Art Friesen and submitted by BCCGA during the course of the 2018 BCFIRB appeal. The CGA submission was based on a one-year model; PPPABC's was based on a 40-year model.

The CGA model predicted that a gross margin of 58¢ per kg was required after feed, chick, levies, catching and bedding costs to break even on a flock of 80,000 birds per cycle at 95 per cent. The PPPABC model, based on 2018 Friesen data with a slightly smaller flock size, measured rate of return on equity rather than gross margin. Expressing the PPPABC model in CGA model terms, a gross margin of 34¢ per kg was required to break even based on year one costs for an equivalent flock of roughly 70,000 birds per cycle quota at 95 per cent.

A comparison of both was undertaken to understand how two models based on the same data could have produced such different results. The purpose was not to suggest that the assumptions built into either of the models are correct (or incorrect), but rather to identify the differences in the calculations.

Due to the complexity of the 40-year PPPABC cash flow model, it was easier for comparison purposes to a) bring CGA model into alignment with PPPABC's rather than the other way around, b) restrict the comparison to year one and c) compare the two based on required gross profit per kg to break even.

¹ This is the ninth in a series of reports to Stakeholders to keep you informed/engaged as we move through the Review process.

Once calibrated² for the same flock (70,000 b/p/c at 95%) and barn size (50,000 sq feet), it took four iterations of the CGA model to bring it into alignment with the PPPABC model:

	Grower Model	Processor Model	Impact on Gross Margin
Iteration 1: Reduce cost barn/equip ³	\$60.00	\$38.35	-8.9¢
Iteration 2: Reduce overhead cost	0.16	0.11	-5.0¢
Iteration 3: Assume 25% equity	0%	25%	-3.5¢
Iteration 4: Exclude land cost	\$1.5 mil	0	-10.9¢
Gross Margin to break-even/kg ⁴	\$0.625	\$0.342	28.3¢

There are many arguments to be made regarding the appropriateness of different cost and financing assumptions. It is a fact of economic modeling that the assumptions upon which the “hypothetical” farm is constructed often differ widely from actual costs and returns experienced by individual growers. If true costs of production were known for all growers, there would be a bell curve along which farms would fall to the right (lower costs, higher returns) and left (higher costs, lower returns) of “average”.

For example, Friesen’s 2018 average overhead cost of .11¢ /kg, used in the Friesen-based PPPABC model, may arguably have increased in 2021. By how much? Hard to say – this will vary by farm... Friesen pegs it at 16¢/kg in his 2021 CGA model. Actual overhead costs today for an efficient grower are likely somewhere in between. Likewise, building and equipment costs – which were not included in 2018 Friesen data – will vary from farm to farm. Friesen notes that he based his \$60/sq ft assumption on costs that included excavation, driveway, services and standby generator costs. PPPABC costs align with costs expressed anecdotally by some growers in the Round Table discussions. Land costs always spark a lively debate, particularly in the Fraser Valley. Yes, land will appreciate over time, which is its own return, but many growers feel it should be included as a capital cost. The CGA model includes it, the PPPABC model does not.

The point of the comparison is merely to show how the assumptions embedded in these two different models impacted their conclusions regarding required gross margin to break even. It is left to the BCCMB and Stakeholders to decide, if a modeling approach is used, how the model should be built and what assumptions it should be based on.

One thing this comparison demonstrates is that models are vulnerable to assumption bias. Regularly surveying actual production costs of individual growers is the only accurate way to identify grower/sectoral costs.

The PPPABC model, if shared with BCCGA, could potentially become a useful tool for growers. Tailored to fit the profile of an individual farm, it could be used to inform decision-making, support efficiency gains and density optimization, facilitate expansion and succession planning and provide the information financial institutions and advisors need to support the sector. (PPPABC tabled 5 additional scenarios at the request of BCCMB.)

PROCESSOR COMPETITIVENESS

Again, BCCGA and PPPABC presented two very different positions with respect to processor competitiveness. Growers asserted BC processors enjoy the highest margins in Canada, margins substantively above those in Central Canada. PPPABC asserted they compete directly with their eastern counterparts in a national market while experiencing significantly higher production and labour costs.

² Labour was kept constant at CGA’s 80,000 b/p/c assumption of \$76,000 per year

³ Building and equipment costs per square foot.

⁴ Required Gross Margin over feed, chick, levy, catching and bedding once models calibrated to same flock and barn size.

At the request of PPPABC, Agri-Stats, a North American consulting and bench-marking firm with specific expertise in poultry processing facilities, collected confidential production, sales and financial data from PPPABC members for October 2019 and October 2020⁵. The data was then aggregated and consolidated based on the respective market shares of the PPPABC members and compared with National and Central Canada data from 16 processors over the same time period. Plant costs were categorized as below to allow for comparison between plants. According to Agri-Stats, these cost categories represent more than 97% of total processing costs.

- Live Birds costs per eviscerated Kg
- Labour costs per eviscerated Kg
- Packaging Costs per eviscerated Kg
- Plant Supplies per Eviscerated Kg
- Maintenance costs per eviscerated KG
- Ice/CO2/ Utilities/ Water per eviscerated KG
- Department Overheads per eviscerated Kg
- Lease and Depreciation costs per eviscerated KG

In their confidential report, explicit BC cost data compared with plants across Canada and in Central Canada based on total processing costs, eviscerated yields, labour, and packaging costs. Product mix and industry structure and scale were also compared. The results indicated that primary poultry processors in Central Canada have a significant cost advantage over BC processors.

BCCGA's submission to BCCMB on processor competitiveness, based on analysis by Kevin Grier, did not unfortunately provide sufficient basis for a direct comparison with PPPABC's analysis.

CORRESPONDENCE

Add in the complexities of A-169, and Phase 3 was characterized by a lot of spirited discussion. Attached is a list of correspondence over the past month. Hopefully much can be posted to the Review Website.

WHAT'S NEXT?

BCBHEC and BCCMB will meet in a joint board session April 27th and will present their draft pricing formulas for discussion at the May 10th Stakeholder Round Table. Stakeholders will receive background packages on May 6th for their review prior to the meeting to facilitate an informed discussion.

Following this, there will be a three-week period for Stakeholders to provide the Boards with feedback to the draft pricing formula. There will be a Round Table in the first week of June for Stakeholders to review feedback received and provide any final comments.

It is expected now that BCBHEC and BCCMB will provide their suggested pricing formula to BCFIRB in mid-June for approval. A final Issues and Opportunities Stakeholder Round Table will be held following this, date to be announced.

Please find attached an updated Review Schematic reflecting the above.

Please call me with any questions, and even if you have not been engaged so far, please plan to attend the next three Round Tables! You have a stake in this discussion, and your voice and perspectives are both welcome and needed at these Tables.

Kind regards and keep safe and well...



Wendy Holm, P.Ag.(Ret'd), M.M.C.C.U.
BCFIRB Liaison - Long Term Chicken Sector Pricing Review

Attached: Updated Review Schematic
List of Phase Three Correspondence

⁵ October 2020 was chosen because Covid "hero" pay had been removed and allocations were relatively "normal."

Stakeholder Feedback + FIRB Approval of Terms of Reference: Long-Term Chicken Sector Pricing Review (Oct 6 – 28th 2020)

Call for Stakeholder feedback CMB Oct 30-Nov 2

Call for Stakeholder feedback HEC Dec 10- Jan 4

STAKEHOLDER ROUND TABLES

Nov 5th Introduction

Dec 14th Pricing Policy Objectives
Reasonable Returns + Proc Competitiveness

Jan 5th Pricing Policy Objectives II + Ontario Price

Jan 12th Some Liveweight Pricing Options (Table)

Jan 28th Hatching Egg Cost of Production (Serecon Report) (2 links)

Feb 3rd Hatchery Margins, Breeder chick and Vaccine formula

BCCGA
Feb 1 – High Level Questions Regarding BC Processor Submission

PPPABC
Jan 6 – Comments on CGA Submission Costs/Returns BC Chicken Market
Feb 12 – Comments on CGA Submission *Live Chicken Pricing in BC*

BCCGA
Feb 22 meeting with CMB
Mar 10 presentation to CMB + Mar 12 letter and follow up documents
Mar 23 Meeting with CMB

CMB Request for Questions and Concerns re Submissions

CMB Request for Metrics on Reasonable Return + Competitiveness

BCCMB
Feb 10 letter to PPPABC re Jan 6 Submission
Feb 12 [letter fm PPPABC](#) requesting further on: Processor Competitiveness, Reasonable Returns to Growers, Pricing Formula, Markets, Processing Structure, Health of Chicken Industry in BC
Feb 12 [letter to BCCGA](#) requesting further on: Reasonable Returns to Growers, Processor Competitiveness, Pricing Formula, Health of Chicken Industry in BC and Markets

BCCGA
Feb 2 – Return on Investment (attaching Serecon ROE fm HECOP)

PPPABC
Jan 28th **CONFIDENTIAL** Submission to CMB on advantages/ disadvantages for Ontario based on second-tier processor structure

PPPABC
Feb 18 and Mar 9th **CONFIDENTIAL** Presentations to CMB on Processor Competitiveness
Mar 25 Meeting with CMB

SAFETI Analysis

Third Party Review

BCBHEC
Final Hatching Egg Pricing formula sent to Stakeholders for feedback on draft SAFETI, pricing options and linkage considerations

BCBHEPA
Mar 29 meeting with BCBHEC

MARCH/APRIL HEC + CMB DEVELOP PRICING MODEL 

MAY 10 STAKEHOLDER ROUNDTABLE - PRESENT HEC+CMB Pricing models,

TBA STAKEHOLDER ROUNDTABLE - FEEDBACK+ SWOT/SAFETI analysis

BCCMB and BCBHEC RECOMMENDATIONS TO BCFIRB

TBA STAKEHOLDER ROUNDTABLE ON STRATEGIC ISSUES

 WE ARE HERE

LONG TERM CHICKEN SECTOR PRICING REVIEW
PHASE THREE CORRESPONDENCE

1. February 12th letter from BCCMB to PPPABC re Pricing Review Material
2. February 12th letter from BCCMB to BCCGA re Pricing Review Material
3. February 12th PPPABC DOCUMENT Chicken Sector Pricing Review – Live Chicken Pricing in BC: An Evaluation Lisst of Outstanding Questions and Concerns
4. February 17th PPPABC Presentation to BCCMB: Processor Competitiveness
5. March 4th letter from PPPABC to BCCMB re A-169 Live Bird Pricing
6. March 5th letter from BCCMB and BCBHEC to BCFIRB re Pricing Review: Projected Timeline and Process to Completion
7. March 8th letter from PPPABC to BCCMB re Responses to Competitiveness and Fair Return Questions
8. March 9th Memo from BCCGA to BCCMB re Responses to Questions by the BC Chicken Marketing Board
9. March 12th letter from BCCGA to BCCMB CONFIDENTIAL appending 2017 and 2019 Grier reports on comparative costs in BC processor and hatchery sectors.
10. March 12th letter from BCCGA to BCCMB CONFIDENTIAL re Cash Flow Requirement to Maintain a Farm by Art Friesen, CGA, March 2021
11. March 17th letter from BCCGA to W. Holm Response to Questions on Processors' Margins
12. March 17th letter from BCFIRB to BCCMB and BCHEC re Long Term Chicken Sector Pricing Timeline Update
13. March 19th letter from PPPABC to BCCMB: Reasonable Returns to Growers.
14. March 26th BCCGA Document: Sound Marketing Policy for BC Chicken Growers.
15. March 29th letter from PPPABC to BCCMB: CONFIDENTIAL Processor Recommendation on Live Bird Pricing – Fixed Differential.
16. March 29th letter from PPPABC to BCCMB: CONFIDENTIAL Assurance of Supply.
17. March 29th letter from PPPABC to BCCMB: CONFIDENTIAL Grower Return Model – Reasonable Returns for Growers. .
18. March 29th letter from PPPABC to BCCMB: CONFIDENTIAL Chicken Live Pricing Supervisory Review - Process Concerns
19. March 29th letter from BCCGA to W. Holm re Kevin Grier Sources and Methods
20. March 30th and April 1 letters from BCCGA to W Holm: Sensitive and Confidential Information.
21. March 31st letter from BCCMB to BCFIRB re Long Term Chicken Sector Pricing Timeline Update
22. April 7th letter from Serecon to BCCMC A-169 Pricing Linkage
23. April 9th letter from PPPABC to BCCMB re Live Bird Pricing for A-169
24. April 12th letter from PPPABC to Jim Byrne, Chair of PPAC re A-169 Live Bird Pricing in BC – Variation for Exceptional Circumstances.
25. April 13th letter from BCCMB to FIRB re A-169 Pricing Update.
26. April 13th letter from BCCMB to PPPABC re March 4 and April 9th correspondence regarding A-169 Live Pricing in BC
27. April 15th Letter from BCCMB to Jim Byrne, Chair of PPAC re Exceptional Circumstances request respecting A-169 Mainstream Pricing decision of BCCMB
28. April 18th letter from PPPABC to BCCMB raising pricing irregularities in past cycles.
29. April 20th letter from PPPABC to BCCMB Follow Up to BCCMB Live Price Application
30. April 23rd letter from PPPABC to BCFIRB Long Term Chicken Pricing Sector Review – Further Procedural Concerns