



March 8, 2021

Mr. Harvey Sasaki
Chair
BC Chicken Marketing Board

VIA EMAIL

Dear Harvey:

Re: Responses to Competitiveness and Fair Return Questions

Further to our presentation on February 18th and our discussion on processor metrics, we want to provide you with comments and responses to the other questions posed in your February 12th, 2021 correspondence summarized below.

Processor Competitiveness

- The Chicken Board is awaiting your submission on measures of BC processor competitiveness in Canadian markets.
- When comparing the cost differences and based on your description of the different processor structures in Ontario and BC, the Chicken Board would like to ensure that any cost comparisons provided represent a consistent and comparable processor activity base. Elaboration is provided on the second page of this document in the “Processing Sector Structure” section, but in general refers to the costs from catching through to chilling the eviscerated carcass, including the cost of transporting the birds from the farm to the processing plant.
- In addition to considering the cost disadvantages that BC processors have, identify the cost advantages for BC processors and the impact and effect on BC processor competitiveness, i.e. transportation costs within the province and comparison of transportation costs to move product east versus west.

We believe this section was covered in our last presentation where Agri-Stats compared production cost data of our four BC companies against that of seven plants in Central Canada. As the Board is aware, we do not have unfettered access to cost details of our competitors in Central Canada so there is a limit to the detail we can review. We are comfortable that the comparative cost data we presented provides sufficient detail to conclude:

- BC Processor overall costs are approximately 30% higher than processing plants in Central Canada.
- Central Canadian Processors outsource the complex, labour intensive aspects of their business to lower cost co-packers and focus on selling primary cuts.
- Live Bird and labour costs represent approximately 85% of total processors costs and make up 75% of the cost gap relative to Central Canada.

Reasonable Return to Growers

- Provide what you feel would be appropriate measures of reasonable return to growers that the Chicken Board consider.
 - Provide any evidence or examples that demonstrate that the current pricing formula is or is not providing a reasonable return to growers.

Returns to Growers should be measured as “return after operating costs” rather than the traditional methods of “return after feed and chick”. Return after operating costs is the cash flow of the business available to invest in capital purchases and to pay a return to shareholders. As a result, it can be measured to determine whether Growers are receiving an appropriate financial return. In addition, there is a need to discontinue reliance on “models” and move towards the use of actual costs.

We continue to believe that quota values are a reasonable proxy to measure grower returns. The generally accepted value of a business has been defined as “what someone is willing to pay for the business” based on “the anticipated future cash flows.”

We will provide a more detailed analysis regarding reasonable returns to growers under separate cover.

Pricing Formula

- If important to the pricing formula, suggest the methodology and metrics to establish guardrails that the Chicken Board should consider.

While not our preference, if a live price formula is implemented that floats in some manner relative to the ON Live Price, then it is imperative that it includes the use of guardrails. It is particularly important when new live price formulas are being implemented to use guardrails to protect stakeholders against unintended consequences that may surface in any new formula.

The upper guardrail needs to be tied to some maximum Live Price differential relative to the ON live price to ensure Processors’ competitive disadvantage is capped at some level.

Similarly, the lower guardrail should be tied to some level of grower return that ensures growers receive a minimum level of grower return.

It is critical to find measures that are consistent, transparent, relatively easy to establish / understand, and measures that cannot be manipulated by stakeholders.

- If a differential over Ontario is to be considered in the BC live price formula, what factors would you recommend the Chicken Board consider and account for in the differential?

A differential should recognize a portion of the operating costs for BC Broiler Growers that are higher than those costs in Central Canada.

- What rationale can you provide for a fixed differential versus a floating differential (with an example of floating differential being the current formula)?

A fixed differential with ON provides more pricing certainty than a floating differential and ensures we maintain our competitive position with our largest competitor. A fixed differential also brings stability to the operating environment that can stimulate the investments required to improve overall industry efficiency.

- Claims have been made that other components of the chicken value chain are taking advantage of the current pricing formula, in particular hatching eggs and the feed industry. Please provide evidence to support the claim for the Chicken Board's consideration.

In terms of Hatching eggs, we believe their recent actions to change the long-standing pricing arrangements to their sole benefit are indications they are taking advantage of the pricing formula. In addition, the on-going increases in hatchery margins that have been implemented in ON over the last 7-8 years has flowed through to the ON live price which has in turn increased the Live Price in BC. This has benefited both the Broiler and Breeder growers through the linkage model. Regarding the feed companies, we do not have specific evidence to substantiate this. Processors themselves do not even directly deal with feed companies. We brought this risk up at the initiation of the formula by the Board. We believe it was incumbent then, just as it is now, on the BCCMB as the regulator to set up monitoring systems to ensure that the pricing formula cannot be manipulated to the disadvantage a stakeholder or the industry. We believe the Board should review this situation and determine what, if any advantage that feed companies have taken because of this formula

- What adjustments would you recommend the Chicken Board consider, if any to the BC formula to account for the changes recently announced to the Ontario Farm Gate Minimum Live Price formula.

These recommendations have been provided under separate cover.

Markets

- One of your submissions has indicated that the Growers submission has incorrectly described the live price-based pricing model used by processors.
 - Provide a comprehensive explanation of the live price-based contract model as well how much of BC production is based on live price-based contracts.

It is estimated that approximately 40% of BC Processor Volume is tied to live price contracts.

A live price contract works as follows:

At a point in time a retailer will circulate a Request for Proposal (RFP) to a number of potential suppliers. The RFP will indicate sales volumes and it will be tied to a specific time frame (1-3 years). It will also indicate a "start date" for the contract, where the product will be delivered, and other logistical details (pack sizes, fill rate penalties, etc.).

Suppliers will submit pricing to the retailer for each of the products in the RFP based upon the current live price in place at the time. The supplier will also provide a pricing table summary showing how prices will move up and down as live prices change. An example of that chart is provided in the Appendix.

A retailer will award the contact to a supplier generally based on the lowest product pricing submitted by the processor.

Prices for each individual product will then move on a cycle-by-cycle basis (up and down) over the course of the term of the contract.

It is important to understand that: competition for these contracts crosses Provinces, customers look at the cost of product – not live price, and the initial bid price forms the base from which live price changes occur.

- The proportion of fresh versus further processed chicken products for BC and whether this is similar or differs from other provinces.

We assume you are referring to proportion of sales of FP chicken products in BC relative to other provinces. Our hypothesis is that we assume consumer purchase patterns are very similar across provinces [there might be some regional nuances] but we do not have data to support this assumption.

Processing Sector Structure

- The Chicken Board understands that processor structure in Central Canada differs from BC and would like to ensure that any comparisons represent a consistent and comparable base for comparison of cost advantages and disadvantages.
 - An example of this is the secondary processing tier prevalent in Central Canada where much of the boning and tray pack operations that prepare and sell fresh chicken products directly to retailers are done by companies not owned or operated by the primary processors.
 - The Chicken Board is of the view that a more accurate comparison of processing costs between BC and Central Canada would be comprised of the following segments of the operation of a poultry processing plant:
 - Catching, Loading and Live Haul
 - Kill
 - Evisceration
 - Chill (water or air)
 - These components would provide a consistent measure of costs in poultry processing plants in Canada. Individual plant operations will vary greatly at the point of transfer from chill to the next steps in the process depending on the product mix (SKU's) of a given processor.

We have provided actual data which compared live costs (including premiums) plus live haul costs delivered to plants in Central Canada and have compared that to the same cost in BC. On an eviscerated basis BC costs are \$0.30 / kg higher than in Central Canada.

We do not have specific data for the areas listed under the following 3 bullets. It is not publicly available and the secondary processors are not part of Agri-Stats data.

It is our position that looking at production costs to the end of the chiller is not a relevant comparison for processing costs. Any comparison of costs needs to include all costs incurred to convert a live bird to a saleable product. Typically, cutting, processing, and packaging are the most labour intensive and highest cost aspects of processing.

Heath of the Chicken Industry in BC

- Provide specific measures you would consider to reflect the health of the BC chicken industry.

We believe that quota values and other industry investments provide a good measure of overall industry health as returns would need to adequately support these investments. It must, however, be recognized that there are many reasons for investments, and some are required or forced as a cost of doing business (i.e. regulatory type investments).

We believe this covers the questions you have posed to us to gain further understanding of processor competitiveness and fair returns for producers. If you have further questions, do not hesitate to contact us.

Sincerely,



Blair Shier
President
Primary Poultry Processors of BC

c. Bill Vanderspek – BCCMB
Wendy Holm – BCFIRB Liasion
PPPABC Members
Craig Evans - PPPABC

APPENDIX

FOR ILLUSTRATIVE PURPOSES ONLY

SELLING PRICES								
Live	Boneless Skinless Breasts	Wings	Back on Legs	Thighs	Drums			
	4.5x	2.5x	2.0x	2.5x	2.5x			
\$ 1.48	\$ 7.21	\$ 5.20	\$ 2.76	\$ 3.45	\$ 2.95			
\$ 1.49	\$ 7.26	\$ 5.23	\$ 2.78	\$ 3.48	\$ 2.98			
\$ 1.50	\$ 7.30	\$ 5.25	\$ 2.80	\$ 3.50	\$ 3.00			
\$ 1.51	\$ 7.35	\$ 5.28	\$ 2.82	\$ 3.53	\$ 3.03			
\$ 1.52	\$ 7.39	\$ 5.30	\$ 2.84	\$ 3.55	\$ 3.05			
\$ 1.53	\$ 7.44	\$ 5.33	\$ 2.86	\$ 3.58	\$ 3.08			
\$ 1.54	\$ 7.48	\$ 5.35	\$ 2.88	\$ 3.60	\$ 3.10			
\$ 1.55	\$ 7.53	\$ 5.38	\$ 2.90	\$ 3.63	\$ 3.13			
\$ 1.56	\$ 7.57	\$ 5.40	\$ 2.92	\$ 3.65	\$ 3.15			
\$ 1.57	\$ 7.62	\$ 5.43	\$ 2.94	\$ 3.68	\$ 3.18			
\$ 1.58	\$ 7.66	\$ 5.45	\$ 2.96	\$ 3.70	\$ 3.20			
\$ 1.59	\$ 7.71	\$ 5.48	\$ 2.98	\$ 3.73	\$ 3.23			
\$ 1.60	\$ 7.75	\$ 5.50	\$ 3.00	\$ 3.75	\$ 3.25			
\$ 1.61	\$ 7.80	\$ 5.53	\$ 3.02	\$ 3.78	\$ 3.28			
\$ 1.62	\$ 7.84	\$ 5.55	\$ 3.04	\$ 3.80	\$ 3.30			
\$ 1.63	\$ 7.89	\$ 5.58	\$ 3.06	\$ 3.83	\$ 3.33			
\$ 1.64	\$ 7.93	\$ 5.60	\$ 3.08	\$ 3.85	\$ 3.35			
\$ 1.65	\$ 7.98	\$ 5.63	\$ 3.10	\$ 3.88	\$ 3.38			
\$ 1.66	\$ 8.02	\$ 5.65	\$ 3.12	\$ 3.90	\$ 3.40			
\$ 1.67	\$ 8.07	\$ 5.68	\$ 3.14	\$ 3.93	\$ 3.43			
\$ 1.68	\$ 8.11	\$ 5.70	\$ 3.16	\$ 3.95	\$ 3.45			
\$ 1.69	\$ 8.16	\$ 5.73	\$ 3.18	\$ 3.98	\$ 3.48			
\$ 1.70	\$ 8.20	\$ 5.75	\$ 3.20	\$ 4.00	\$ 3.50			
\$ 1.71	\$ 8.25	\$ 5.78	\$ 3.22	\$ 4.03	\$ 3.53			
\$ 1.72	\$ 8.29	\$ 5.80	\$ 3.24	\$ 4.05	\$ 3.55			

The above chart is representative of a typical formula pricing schedule on fresh product that exists with many retailers in Canada.

The yellow line that is highlighted would be the price a retailer pays for each of the various commodity products that they purchase from a processor when the Live Price is \$1.60 / kg.

The orange line represents the amounts a retailer would pay for those same commodities if the Live Price was to be reduced by 4 cents / kg.