



Canadian Pork Council
Conseil canadien du porc

Building a Durable Future

In the Canadian Hog Industry

November 2011

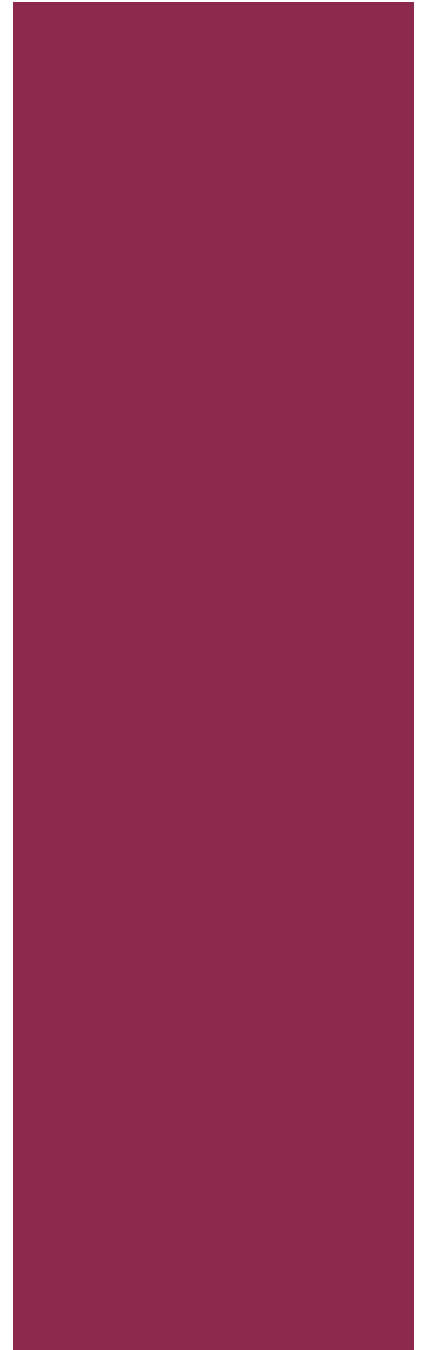




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Introduction

This report follows the hog industry's Strategic Transition Plan that was published in 2009. That plan was created in the depths of the industry's collapse, and set the context for the government of Canada's support to the industry in the form of the Hog Farm Transition Program. The elements of the program included:

1. A \$75 million HFTP fund administered by the Canadian Pork Council. It successfully allocated funds to assist producers across Canada to exit the hog business.
2. In addition, that plan laid the groundwork for the government's decision to guarantee lenders to provide loans that would: permit repayment of outstanding APP emergency advances under the 2008 stay of default; address liquidity issues; and make required investments.
3. As well the government of Canada provided up to \$17M to Canada Pork International to bolster critical market development initiatives.

Since 2009, the nature of the economy has changed. The hog industry has undergone a significant downsizing; both in terms of the number of producers and the size of the total national herd. It is therefore important to reflect the changed situation within the strategic focus of the hog industry's plans.

This document has been prepared in order to communicate with all of CPC's partners; including the provincial members, the Pork Value Chain Roundtable, federal policymakers and other stakeholders.

The purpose of this document is to set the broad parameters in which programs will be developed, strategic initiatives created and progress measured over the next 3 to 5 years.

Current Situation

Economic Circumstances

It would appear late in 2011 that the hog industry has moved from the worst economic circumstances of the last 60 years and is in the early stages of a slow recovery.

This is a resilient industry. While there has been a huge reduction (42%) in hog farms during the past five years, along with a major (20%) decline in the national herd size, there remain a substantial number of operators (7,000) who are confronting the risks, costs and operational challenges with amazing equanimity.

The steep rise in input prices has created havoc with producers' ability to manage their costs. Energy policies in particular are generating unacceptably grievous impacts on the cost of feed inputs.

A number of factors are contributing a serious challenge of achieving a sustainable level of revenue per pig. These include:

- Domestic market decline is a cause for considerable concern. We are still experiencing increasing imports of pork into Canada. In fact, they are more than seven times what they were 15 years earlier. In addition, total pork consumption has decreased in Canada relative to other red meats. Consequently, as a result of both factors, the total amount of Canadian pork that is consumed by Canadians is falling at a precipitous rate.
- The disruption in the swine trade between Canada and the US, due to the United States Mandatory Country of Origin Labeling (COOL) has been the major factor in the massive reduction in these exports. Year to year decrease in these exports has been in the order of 40%.
- Meat exports to the US have been in decline, but not at such harmful rates.
- The current strength of the Canadian dollar is resulting in a relatively reduced rate of return on sales.

Price levels in Canada during the last half of 2011 have offered hope for producers. However, it is not at all evident at the current time, whether or not, prices will allow an opportunity for producers to significantly reduce their debt loads and recapitalize their businesses. Another catastrophic event like those that have occurred several times in the last decade (swine flu, currency fluctuations, circo virus) would be brutal, given there is no foreseeable Agri-Stability coverage and the approaching APP repayments will start in 2012.

During this very difficult economic period producers have made great strides in addressing their competitiveness. In particular, producers have reduced their cost of production substantially through a focus on:

- Examining their costs (feed costs)
- Utilizing more risk management tools
- Adopting operational efficiencies
- Maintaining their commitment to food safety
- Introducing new elements of animal care
- Exploiting the powerful pork story to help expand international market penetration

There have also been technological and scientific advances that have led to increased efficiencies. Sow production is an excellent example. During this period the development of the circovirus vaccine was extremely important.

Producers have been developing niche products which have strengthened their relationships with specific processors and helped to differentiate Canadian products.

International markets have been very receptive to Canadian products. Total non-US exports have increased by more than eight times in the last 15 years. It is recognized that a differentiation strategy can further assist efforts to grow these markets.

Industry Structure

We have seen how economic factors have impacted the performance of the industry. It is also useful to recognize the structural forces that shape the industry; in particular, the bargaining power of Buyers (processors) and the bargaining power of Suppliers (feed & drug companies).

Bargaining Power of Buyers

Canadian hog producers are selling into a consolidated buyers market. A few processors (buyers) control at least 70% of the market. Moreover, producers generally sell within their regional marketplace in which there are only a few buyers. When consolidated buyers are purchasing from fragmented sellers, prices will generally favour the buyers. In any industry in this is the situation, commodity pricing tends to predominate over value-added pricing.

It is noteworthy that some Canadian producers have vertically integrated forward in order to alter this structural situation. In other cases, producers are developing special order products. Also there are special arrangements like in Quebec in which plants are governed by overall purchasing requirements. Each of these actions can alleviate the general situation described above. Also, there are periods in the hog cycle when the abundance of animals declines and prices go up. But on balance, the lack of ability to negotiate higher pricing formulae makes it relatively difficult to do business.



Bargaining Power of Suppliers

Feed and other inputs constitute at least 70% of the cost of hog production. Producers are faced with speculative markets of corn, barley and wheat, in which they have little price control and are based on US prices. In addition, pharmaceutical products are also sold by large industrial conglomerates, which have significant bargaining power. On the feed side, some producers mitigate these effects through local purchasing arrangements, and/or growing feed inputs themselves. However, on balance, the bargaining power of suppliers makes it relatively difficult to do business.

The impact of structural factors, (power of buyers and sellers) can be exacerbated or lessened during changing economic conditions. But over the long haul they play a significant role in determining the outcomes of producers.

Societal Pressures

The pork industry is facing the same types of societal pressures that many industries are experiencing. Some of the pressures stem directly from the requirements of their customers. Others originate further along the value chain. Frequently, the pressures are experienced through the regulatory agencies which are acting on behalf of society through their governments. In addition, disparate voices are affecting planning bodies, trade negotiations and editorial views, which in turn drive further regulatory scrutiny and market place actions.

These societal pressures represent vulnerabilities to either current or future business outcomes. In some cases, when the industry gets out in front of the issues they can become opportunities to exploit in both domestic and international markets.

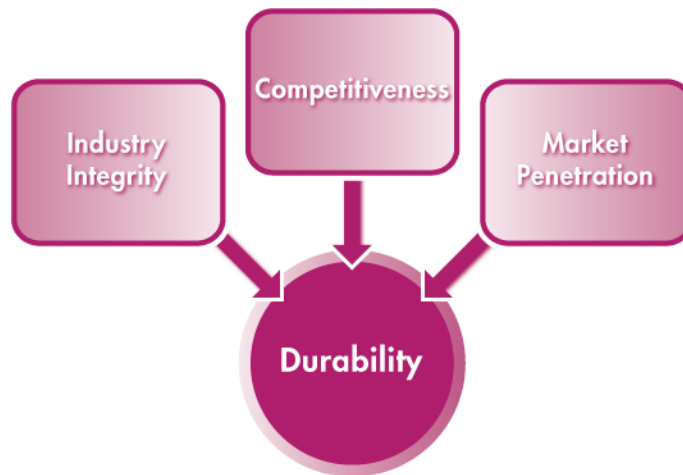
CPC has for more than a decade been addressing these issues as they have become necessary. The basic level of priority has been that of assuring food safety, which is addressed through CQA. There is an additional level of issues related to safety of the food system which traceability measures are designed to address. There are increased voices concerned about animal care, (ACA) which can translate into issues related to market place access. Finally, there are acceptance issues; whether it is related to the footprint the industry is leaving, or the acceptance of the industry as a community neighbour.

CPC's focus on these issues is addressed within the Value Chain Integrity Pillar in this plan.

Pillars of Durability

CPC will remain focused on three Pillars of Durability, which in combination can provide the industry with the resources and support necessary for long term success.

The Pillars of Durability respond to the Industry's situation in terms of the economic circumstances, industry performance, industry structure and societal pressures.



Industry Integrity Pillar has three elements which will help to defend the industry and provide mechanisms to gain and hold market access.

The Competitiveness Pillar will focus on four factors that will enable to industry to reduce the cost of doing business.

The Market Penetration Pillar has two components focusing on the domestic and the international opportunities and challenges.

Industry Integrity

The Industry Integrity Pillar focuses on those capabilities that will determine whether the public stakeholders and consumers will continue to embrace the industry. The Industry Integrity Pillar can turn vulnerabilities stemming from societal pressures into opportunities, by demonstrating to the world an industry that produces high quality and safe food; that is produced using humane practices; and that can coexist with its neighbours with benign impacts on the environment.



It is recognized that the Industry Integrity Pillar creates a tension between producers who believe that these programs are an unnecessary cost of doing business; or a necessary cost of doing business; and/or an opportunity to grow the business. The objectives of these programs need to be focused on each of these views. Therefore, each program should become:

1. Tools to defend the industry;
2. Mechanisms to gain market access and increase share; as well as
3. Methodologies to increase on-farm benefits.

In order to ensure a uniformity of approach and the efficient use of resources, these programs will be reviewed to determine if additional measures can be taken to ensure they meet each of the above criteria. Moreover, the goal will be to the extent possible to have these programs 'nationally bundled and branded'. The branding will lead to successful defense of the industry and to support proactive measures to gain market access and increase market share.

Food Safety

Canadian Quality Assurance (CQA)

CPC has concluded a review of its CQA program. CPC is implementing the recommendations to strengthen the current program.

The CQA program will take the necessary steps to achieve full recognition by the CFIA. This full recognition will further enhance external confidence and help drive Canadian competitiveness.

CPC will investigate additional modifications that are required to ensure that producers' use of CQA includes increased onfarm benefits.

Finally, CPC will increase its already stellar participation from 90% to 100% of farms that move animals to federally licensed plants.



Traceability

CPC and its members are in the process of developing an identification and traceability system for the hog sector that will allow the industry to provide information on Canadian swine premises and trace back and forward live hog movements. CPC views traceability as an ongoing program area of significant importance to the long-term stability and health of the Canadian industry. Traceability is anticipated to pay future dividends in terms of boosting our preparedness in the case of an animal disease outbreak, and ensuring continued market access for Canadian pork products. Moreover, traceability systems can provide the basis to enhance Canada's competitive advantages from the perspective of customers and consumers.

Traceability systems require a significant investment in technology (databases, software, reporting tools), animal identifiers, time commitment from industry stakeholders, and a significant investment in administration to ensure effective coordination of the system.

CPC has already invested significant time and resources in planning and implementing improvements to the Canadian swine traceability system. With continued support from federal and provincial governments, we look forward to demonstrating our ability to continue to administer this program on an ongoing basis.

Animal Care

Animal Care Assessment (ACA)

The industry has a long history of focus on animal care. Currently, the ACA program is being merged with CQA and will be completed by January 2012. There will be a focus on steps to enhance the participation in the program.

In addition, the code of practice is being revised and will be completed by 2013. This will ensure that Canada will be seen to be, as it is in fact, a country that stresses the importance of animal welfare as an important business principle.



Resource Accountability

The focus on food safety and animal care are likely to be insufficient in order to ensure that the industry is accepted by communities and by consumers over the long-term.

In parts of Canada, the industry is facing geographic restrictions in terms of where it can operate. Opinion leaders are commenting on the carbon footprint this industry is making.



Best practices will continue to be identified and communicated.

The Canadian Pork Council intends to become better equipped to demonstrate the environmental Resource Accountability of the industry. In the end, the hog industry will be seen as an industry that is going green and as a consequence gaining acceptance in critical markets by individual consumers. At the same time, the greening of the industry, including its ability to manage emissions, will result in a greater appreciation by municipal governments of the need to protect and generate jobs in the hog sector through more permissible zoning.

CPC Key Initiatives—Industry Integrity Pillar

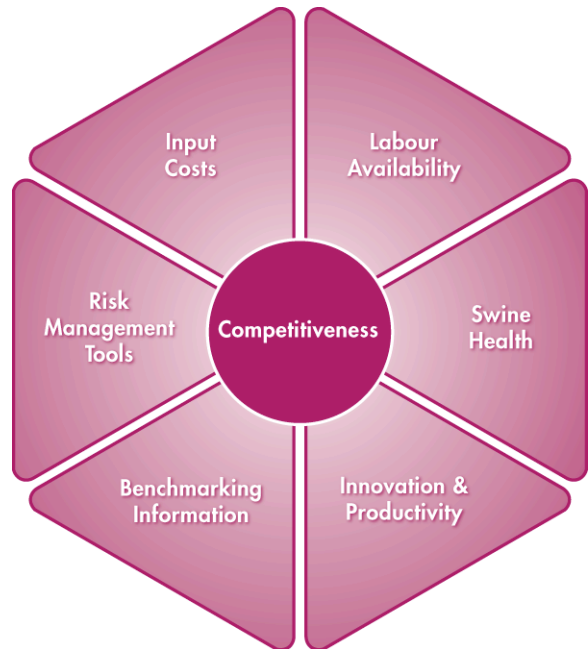
1. Secure terms for nationally consistent delivery of CQA, ACA, traceability, (bio security), increase CQA to 100% of federal plants, with national reporting & performance indicators.
2. Package and tell the story about pork quality—CQA, ACA standards—building tools to defend the industry on anti-microbial resistance, animal care, and environmental issues.
3. Define and improve on-farm benefits of CQA, ACA, and Traceability.
4. Understand emerging concerns of consumers about the hog industry.
5. Identify and track the global activities of groups that are responding to those audiences hostile to the pork industry.

Competitiveness

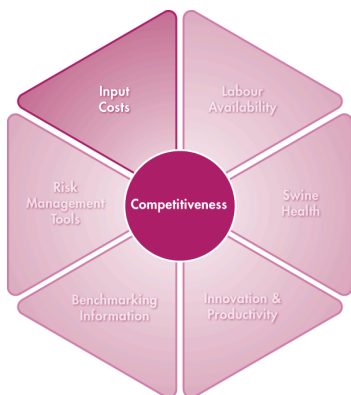
Competitiveness will be achieved when it is possible on a sustainable basis to bring products to market at prices that offer producers margins that provide a reasonable return on their capital and their labour, as well as the ability to retain sufficient earnings for recapitalization.

In order to achieve the required levels of competitiveness, a constant focus on costs will be necessary to achieve the required margins. CPC will be focused on six elements of competitiveness. They are:

- Input Costs
- Swine Health
- Innovation & Productivity
- Labour Availability
- Benchmarking Information
- Risk Management Tools



Input Costs



Feed Costs

Feed costs are greater than the sum of all other operating costs. Québec, Ontario and the West face different challenges in the structure of their feed markets. In some cases, the inability to inventory winter requirements during the harvest period results in higher costs. In Western Canada, the impacts of increased canola production and decreased barley production are changing the availability of lower-cost feeds.

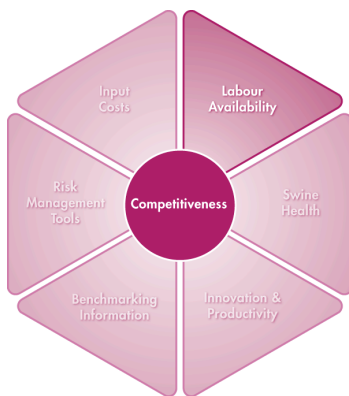
CPC will continue to support and monitor the development of initiatives that can lead to lower feed costs. At a minimum, the industry must achieve the goal of cost parity with its US counterparts. In particular the CPC will monitor and address the big picture policies that affect feed costs in Canada.

The Canadian Swine Research & Development Cluster is expected to continue a focus on research efforts that are aimed at reducing food input costs.

Veterinary Products

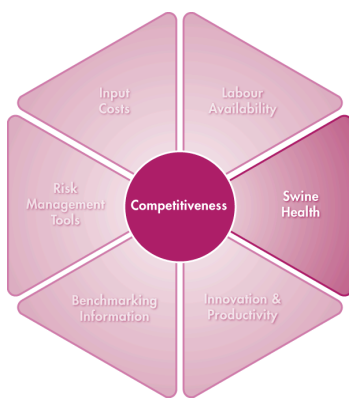
Drug costs are higher in Canada than in the United States due to both the regulatory regimes and the distribution systems of pharmaceutical companies. CPC will support investigations of these problems and identify solutions particularly as they relate to Health Canada's timely approval and the market availability of products.

Labour Availability



Getting and holding workers at an economically viable price and with the requisite skills is very difficult in some areas of the country. The hog industry would like to make greater and more effective use of the Temporary Foreign Worker Program.

Swine Health



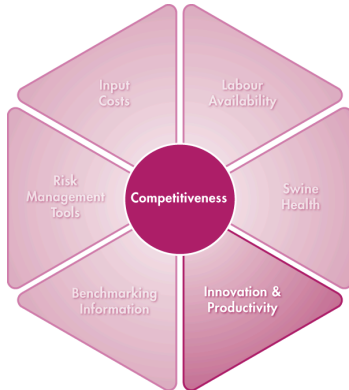
Swine health is the second most significant operating cost element in hog production. The ability to provide on-farm solutions that reduce health incidents and increase animal productivity is fundamental to long-term sustainability.

The Canadian Swine Health Board (CSHB) is the national organization mandated by CPC to provide leadership and coordination in support of the management of the health of the Canadian swine herd.

The areas of focus of the CSHB includes the development and implementation of initiatives to control diseases in the hog industry; biosecurity best management practices; research in circo-virus and emerging diseases; as well as building long term disease risk management strategies.

CPC supports the initiative of the CSHB in developing a plan for sustainability for the period following March 2013 when the current funding agreement with the government of Canada is set to expire.

Innovation & Productivity



There is a direct correlation between competitiveness and innovation and productivity. Throughout the past decade producers have found many ways to improve the efficiencies and effectiveness of their operations. To support their efforts a host of regional institutions including provincial associations, universities and companies have been directing their attention to finding solutions that will meet the needs of producers.

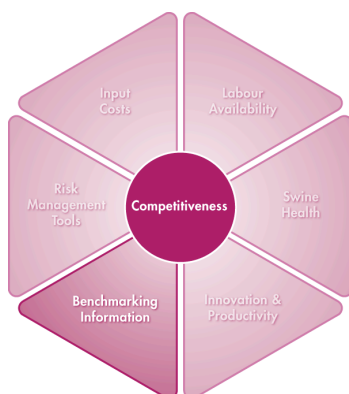
At the national level, the Canadian Swine Research and Development Corporation is implementing an \$11M program of research projects, which are designed to provide impacts at the farm level. CPC will be monitoring the output of these projects and ensuring that innovative ideas achieve the required level of commercialization, so they can be applied by producers, at the earliest opportunity.

It may well be that success will be derived from an accumulation of 1% solutions. The impacts of innovation are most often cumulative. However, given that the federal government is now holding discussions about a subsequent round of Growing Forward programming, CPC will be looking to the CSRDC to determine if their priority setting process and their joint planning process with their partners could result in more “game changers”. Specifically, the Board of Directors of the CSRDC with the full support of CPC is committed to using part of a new budget in 2012 that would result in:

- Significantly higher level of private-sector funding; that would
- Result in greater and quicker innovation breakthroughs, leading to cost reductions and/or increased product attributes and prices.

CPC will continue to provide input and direction regarding priority issues to be addressed within the research portfolio.

Benchmarking Information

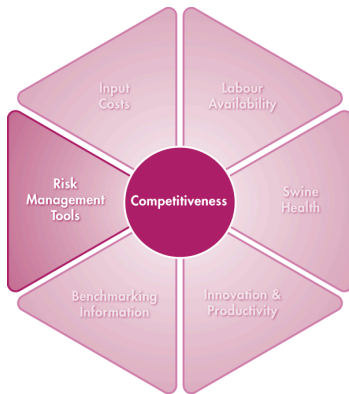


Achieving the required level of competitiveness is predicated in part, on the ability of producers to constantly test new approaches and to measure their success. An additional level of analytic activity is to compare ones performance against others—particularly an average of others.

‘Where we are today’ is more often a matter of opinion than fact. Perceptions are widely available, but verifiable data is not easily accessible. Important contributions are made by such groups as the George Morris Center, Meyers Norris Penney, Statistics Canada, CPC’s Regional Members and individual companies. These are useful but not sufficiently comprehensive.

In order to be able to provide data that can be used by producers, as well as at the regional and national levels to determine where we are on a host of issues related to competitiveness, CPC will assemble and submit a representative Canadian data set to InterPIG, an international swine cost of production network.

Risk Management



Hog producers face a combination of production, market and financial risks. Without a range of risk management tools and strategies these risks can undermine the success of the overall venture. To reduce production or yield risk both enterprise diversification and production insurance are options. In order to manage market or price risks the options would include futures hedging, forward contracting and spreading sales to manage market or price risks.

The CPC will determine its role in the development of and facilitating the use of effective risk management strategies and tools.

CPC Key Initiatives—Competitiveness Pillar

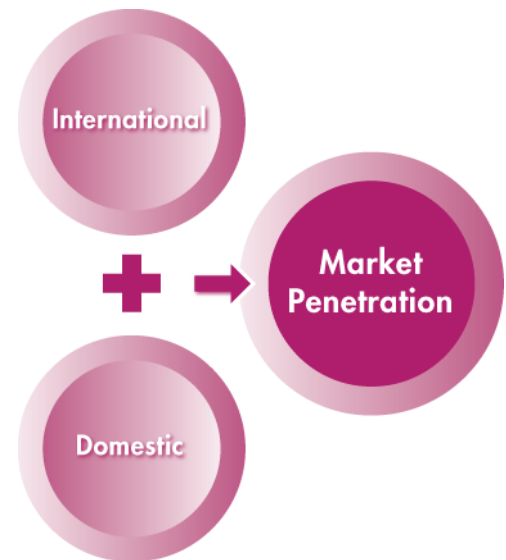
1. Identify and facilitate the implementation of an appropriate suite of risk management tools—(hedging, production insurance, price insurance).
2. Work with value chain partners to design an appropriate Canadian pork positioning (differentiation) strategy based on our strengths.
3. Create a database of key production information for policy development and communications.
4. Address regulatory changes related to the timeliness of Health Canada's drug approval process.
5. Identify the implications of Canada's bio-fuels policies.

Market Penetration

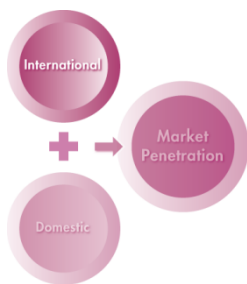
Market penetration of Canadian pork meat products is a fundamental determinant of success in the hog industry. To that end producer groups have actively engaged in understanding and responding to customer and consumer needs.

CPC has recognized the need for the development of differentiated Canadian pork products to be made available to consumers in both international and domestic markets. CPC and its member organizations are mounting a range of initiatives with processors and other value chain partners which can result in improved market penetration. CPC views the PVCRT as a critical organization to facilitate collaboration on a range of market penetration strategies.

Pushing innovation up the value chain, while respecting competitive and proprietary needs of individual companies, is challenging but necessary. In the coming years CPC will report on a range of collaborative approaches with a view to determining the most effective ways to meet the needs of the value chain partners.



International Markets



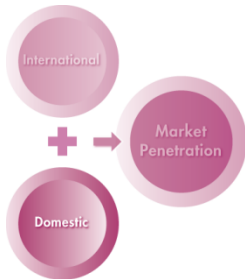
CPC has taken a proactive position in support of market penetration efforts, particularly at the international level. Canadian producers have provided contributions in the order of \$6M in the last five years to support the work of Canada Pork International.

Moreover, the leadership that Canadian producers have provided within this organization has been quite remarkable. CPI will continue to be the primary organization in which CPC rests responsibility for international success in pork marketing. CPC will continue to provide monetary and leadership support to this vital organization.

CPC will continue to play an active role in trade advocacy which includes:

- Representing Canadian hog industry interests in free trade negotiations
- Ensuring Canadian preparedness in the face of trade challenges
- Providing representation during trade disputes

Domestic Penetration



One of the most daunting challenges facing the Canadian pork industry is to reverse the declines in domestic pork consumption and the loss of market share to imports. Numerous observers have documented the decrease of market size, the decrease of market share and the rise of imports. Documented solutions are not so numerous.

Historically, CPC has provided a national service related to communicating the nutritional benefits of pork and responding to adverse claims about pork products.

Several member organizations have designed and implemented market penetration strategies and programs. More recently, initiatives are being more focused on a marketing based approach.

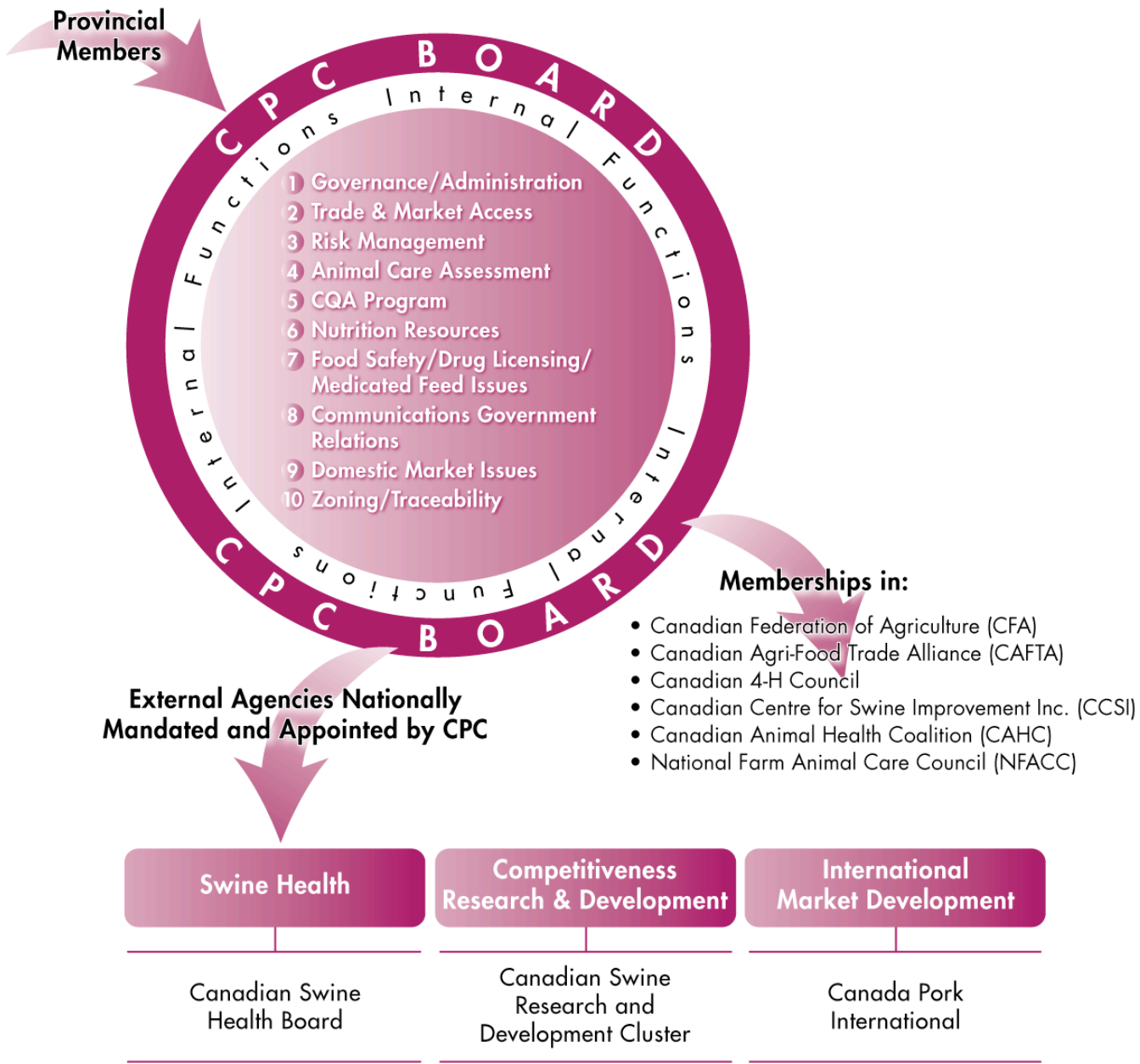
CPC is working towards a determination about the nature and scope of its additional involvement in national domestic market penetration programs and strategies. Decisions will be made in the following areas:

- Defining the role that needs to be played at the national level
- Establishing a national structure that is complementary to provincial approaches and organizations (This could mean adding an additional mandate to an existing organization)
- Determining the total investment that should be made for national pork promotion
- Establishing a plan of domestic market research
- Committing to a national check off for these purposes

CPC Key Initiatives—Market Penetration Pillar

1. Ensure favourable terms to the Canadian hog industry, by working with coalitions, to achieve Free Trade Agreements in key country markets.
2. Work to achieve total freedom of access to the United States markets for live hogs.
3. Develop a strategy to increase the Canadian share the Canadian market.
4. Understand why there's been a drastic reduction in consumer purchases of pork in Canada.
5. Understand the implications of a reduced domestic market to an exportbased industry and develop appropriate action plans.

CPC Hierarchy of Functions & Organizations



Building a Durable Future—A Summary

Since 2009, the nature of the economy has changed. The hog industry has undergone a significant downsizing; both in terms of the number of producers and the size of the total national herd. It is therefore important to reflect the changed situation within the strategic focus of the hog industry's plans.

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Industry Integrity Pillar has three elements which will help to defend the industry and provide mechanisms to gain and hold market access. These include a focus on:

- Food Safety
- Animal Care
- Resource Accountability

The Competitiveness Pillar will focus on four factors that will enable industry to reduce the cost of doing business. These include a focus on:

- Input Costs
- Swine Health
- Innovation & Productivity
- Benchmarking Information
- Risk Management Tools

The Market Penetration Pillar has two components focusing on the domestic and the international opportunities and challenges.

- International Markets
- Domestic Penetration

The CPC has identified an aggressive program of medium term key initiatives which, in combination with the strategic programs of its partner organizations (CSHB, CSRDC, and CPI) should enable the industry to move into a period of strengthened durability.



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