

STRATEGIC TRANSITION PLAN

The Canadian Hog Industry's Plan for Success



Canadian Pork Council
Conseil canadien du porc

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■ Introduction

The hog industry in Canada is now facing its latest challenge; the impacts of a world pandemic caused by the H1N1 virus. This has delayed the prospects for price recovery in hog markets for at least the next 10-12 months. The cumulative impacts in recent years of health challenges (circo-virus), macro economic factors (fluctuating currency exchange rates), US public policies (affecting feed costs), economic cycles (a demand reducing recession); as well as trade inhibitors (US COOL) have created the conditions for an industry that is now unprofitable, highly leveraged with debt and facing the prospects of imminent catastrophic implosion.

Industry leaders recognize that changes are required in both scale and strategy to ensure that a transition results in a business model that is sustainable for farmers , while providing Canada with the future meat supplies that will be required by processors and their domestic and international customers.

The Canadian Pork Council (CPC) has undertaken an intensive review of the current situation and developed a Strategic Transition Plan; one that respects the prudent role and capacity of government, while underscoring the primary responsibility of agricultural entrepreneurs to succeed or fail based on the merits of their efforts.

When the Transition Plan is implemented, a leaner, greener, and more innovative industry will emerge – one that is prepared to capitalize on domestic and international opportunities. In the meantime, many owners and their employees will have been transitioned out of the industry in a way that mitigates some of the damages to their communities, which would occur if there were only unbridled decisions based on fear, without any transition mechanisms.

It is understood that it is not in Canada's interest to simply prop up the industry in an attempt to maintain the status quo. However, it would be damaging to Canada's interests in terms of its economic prospects and rural viability if the productive capacity of the Canadian hog industry was to implode. It could recede to a level that threatens too many direct production and processing jobs, export sales and the exploitation of new technology development opportunities.

For that reason the CPC is asking Minister Ritz and the federal cabinet to:

- **Approve a special H1N1 Recovery Plan Loan;**
- **Agree to adjustments to the Advance Payments Program emergency advances; and**
- **Establish a Hog Farm Transition Payment Program.**

This document provides a brief history and a description of the current situation; details the expected transition through 2014; defines the industry's financial support requirements; and enumerates the strategic initiatives the hog sector will be undertaking in order to establish a foundation of future success.

■ A Brief History

Hog production practices and productivity improvements, as well as the exports of live animals and pork meat has been a Canadian success story for the past two decades.

Before the 1990's, Canada produced primarily for its domestic and the American market. However, commencing in the mid 1990's a steady rise of exports to other world markets became so significant, that by 2008 they represented over 70% of the total exports; more than double those going to the US.

During the same period, producers have increased sow productivity such that pig production increased from 1995 to 2008 by 79% which only required a growth in the breeding herd of 23%. It is noteworthy that efficiency gains were achieved from innovation, increased scale of operations and modern capital investments. These same attributes have been applied to genetics, feed and plant processing.

During that period there were low price cycles but the industry adapted to market conditions and prospered accordingly.

During the past several years however, a combination of factors placed producers in a "perfect storm". The outbreak of the circo-virus disease (2005/06) resulted in significant mortality and morbidity which dramatically affected the implicated farms. The unexpected and wildly appreciating Canadian dollar eroded almost all operating cost competitiveness relative to the US competition. The dramatic increase in the demand for corn, due to US ethanol subsidies raised the price of corn so that it hugely increased the feed costs of producers.

As a consequence of these "severe economic hardships" the Canadian federal government responded to pork producers in 2008 with emergency advances within the Advance Payment Program. This helped farmers see a way through this difficult period. Throughout 2008 producers continued to grapple with these market factors. The cost of corn came down but still remained 50% above levels of a few years ago. Similarly, the Canadian dollar began a descent. However it still remains at levels far above historic averages.

During the same period, the federal government introduced the Cull Breeding Swine Program which facilitated the reduction of Canada's swine breeding herd (sows, boars and pregnant gilts) by approximately 8%.

Following these events the early impacts of the US COOL legislation began to exacerbate the situation. Exports of live hogs to the US began to falter at a critical time. Because of all these and of the preceding conditions, the federal government agreed to extend the payback date of the emergency advances to September 2010.

In spite of all the challenges that pork producers had confronted, they believed as evidenced by futures markets, that 2009 would be a year for a turnaround. This has not been realized. The crushing weight of the world recession has greatly dampened markets. The hysteria surrounding the H1N1 virus has become a cruel blow.

■ The Current Situation

Today the hog industry is in the worst circumstances of the last 60 years.

Domestic market decline is a cause for considerable concern. We are experiencing increased imports of pork into Canada. In fact, they have risen steadily such that by 2008 they were almost seven times what they were fifteen years earlier. In addition, total pork consumption has decreased in Canada relative to other red meats. Consequently, total Canadian produced pork that is consumed in Canada has declined significantly.

The United States remains the only export market for Canadian slaughter hogs and feeder pigs. The recent disruption in the swine trade between Canada and the U.S., due to the United States mandatory Country of Origin Labelling (COOL) has been the major factor for the massive reduction in these exports. The year to year decrease in these exports has been in the order of 40%.

Meat exports to the US have also been in decline in recent years.

Other international markets have been very receptive to Canadian products however. Total non US exports have increased by more than eight times in the last fifteen years. It is recognized that a differentiation strategy can assist our efforts to grow in these markets.

Hog farmers are currently losing approximately \$40 on every hog that is sold. Input costs are rising, prices are continuing to decline, and total farm debt ratios are escalating. Farmers today are likely in one of three categories:

- **Those that would exit if there was a way to avoid total personal catastrophe**
- **Those that are barely managing to operate on farms that were not already heavily capitalized during the past decade; and**
- **Those that will take advantage of the transition period by acquiring additional cheaper assets and increase their scale**

Without a managed transition, many of these farmers will not exit orderly, or stabilize their operations, or grow their businesses. Only turbulence and destruction will be the order of the day. This will be felt throughout the pork value chain and by businesses and communities that are reliant on the sector.

■ A Managed Transition

The Canadian Pork Council is looking out to 2014 in terms of managing an industry transition. We believe that the right combination of government policies and programs, industry initiatives and farmers' actions, will establish a foundation of success. During this period there will be a significant amount of pain for farmers, their employees, their customers and suppliers.

A description of the anticipated industry situation in 2014 has the following characteristics:

- **Domestic disappearance of Canadian produced pork at 730,000 tonnes, an improvement of 150,000 tonnes from 2008 (combination of import replacement and increased domestic consumption)**
- **Export of 4 million live hogs to the US – a reduction of 5.3 million from 2008**
- **Total pork exports of 1 million tonnes of which only 20% will be to the US**
- **Total domestic slaughter of 21.5 million – a reduction of 0.2 million from 2008**
- **A reduction in total production from 31 million in 2008 to 25.5 million pigs**
- **Domestic market share of 88% compared with 75% in 2008**

These elements in totality describe an industry that will have “right sized” itself. This will be necessary before launching into a period of new growth and higher margin revenues. It will only be successful if the right financial transition supports are provided by the federal government now. It is also dependant on the industry's strategic initiatives being successfully implemented in the short and medium term.

■ Transitional Financial Support Requirements

The following financial support requirements reflect the recognition that the hog industry is in transition. It recognizes that there will continue to be a hog sector in Canada, one that is competitive globally and has a strong export focus that will be able to share in the increased global demand for pork as conditions improve. But in order to capitalize on those opportunities it must first adjust. To facilitate that adjustment the CPC is asking Minister Ritz and the federal cabinet to:

- **Approve a special H1N1 Recovery Plan Loan;**
 - **Agree to adjustments to the Advance Payments Program emergency advances; and**
 - **Establish a Hog Farm Transition Payment Program.**
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■ H1N1 Recovery Plan Loan

This recovery loan program will correspond to the beginning of the H1N1 Crisis, and would be effective as of the 2nd quarter of calendar 2009. (April to June)

- 1) **Hog Producers will be advanced a first draw on the program of \$30 per market hog shipped in the 1st quarter of 2009 (January to March) All subsequent payments will be based on the previous quarters shipments**
- 2) **A formula would be established based on average of provincial cost of production**
- 3) **For the 3rd and subsequent quarters producers would receive a payment based on average provincial prices minus average provincial cost of production**
- 4) **This would continue until average provincial prices return to pre H1N1 Levels**

The loans will not be restricted by farm size and will be repayable over a 10-15 year period. The loans will be subordinate to other loans and a farm plan may be required.

■ Adjustments to the Advance Payments Program Emergency Advances

The current emergency advances are required to be re-paid in September 2010. These loans need to be termed out over a 10-15 year period, allowing producers to manage the repayment schedule. In addition, by moving these loans off the Advance Payments Program balance sheet, a second year of emergency advances could be provided, and be available to producers regardless of whether or not they had used the initial advances.

(The criteria of the Advanced Payments Program is sufficiently restrictive, particularly caps, to preclude only its use in providing Transitional Financial Support; hence the need for the H1N1 Recovery Loans).

■ Hog Farm Transition Payment Program

For farms that have managed to stay in business but no longer see a profitable future, assistance to move out of hog production is needed. Producers have used much of their equity and for many simply exiting would mean a loss of everything they have – farm, house, animals. Finding a way to assist these producers would help the entire sector adjust.

This program would need to be different from the original Cull Breeding Swine Program as producers that stayed in business are often significantly worse off than those that exited. The program would need to be composed of a per sow payment of \$500, plus the market value of the animals. The animals would go into the regular market. Producers would agree to keep the barns free of breeding animals for 3-5 years. While other details of the program remain to be developed, the initiative should be retroactive to the end of the original Cull Breeding Swine Program.

■ Hog Industry's Strategic Initiatives

The industry as a whole is committed to the need for a significant adjustment. It continues to work collaboratively on elements outlined in the Strategic Framework developed by the Pork Value Chain Roundtable (2008).

Producers individually will be making the tough decisions about their future. Producers will also be working together to consolidate the gains that have been made in the past and to create a stronger foundation for success in the future.

It is important to note that hog producers contribute in excess of \$20,000,000 annually, net of marketing, through provincial levies, for their collective actions. No other part of the pork value chain contributes these amounts to their industrial sector.

In addition to the initiatives that have been identified by the Value Chain Roundtable, the CPC will be championing additional measures that will contribute to the competitiveness of the industry, improve access to domestic and international markets, strengthen the integrity of the value chain, and introduce innovation throughout all aspects of the production cycle.

Below are descriptions of the key initiatives that will be designed and implemented by the CPC in collaboration with its partners during the period through to 2014.

■ Competitiveness

The long term success of the Canadian hog industry will be determined by its ability to establish a sustainable level of competitiveness compared to international competitors, particularly the US. Canada will work hard to reduce costs of production in order to access key markets in the world. However, it must be successful in creating and executing a differentiation strategy that will achieve higher margins in its chosen markets.

During the period 2009-2014 the Canadian Pork Council will focus on the following competitiveness priorities.

Canadian Swine Health Board

The health of the national swine herd is of paramount concern. The potentially calamitous results of a significant disease outbreak are obvious. The perception of the health of the animals can be a significant national differentiator.

The Swine Health Board will focus on biosecurity issues and measures as well as initiatives to reduce the risk of new disease outbreaks.

Benchmarking

For too long the considerations of our relative competitiveness has been based on anecdotal information. The CPC intends to address this by developing a dash board of key indicators that reflect the state of Canadian competitiveness. The indicators will be generated on a regional and national basis. The indicators will be compared against comparative data from key competitors e.g. Denmark, Brazil and the US. The project will include identifying the indicators, creating the infrastructure to capture and report the data as well as providing interpretation of the data.

Comparative Regulatory Review

Planning and implementing a review of the US and Canadian regulatory environments is an essential element of competitiveness. The project will include the identification of the relative financial costs of complying with the regulatory regime and the identification of other burdens of complying with the respective regulatory regimes.

Competitiveness Strategy

The results of the benchmarking and regulatory reviews will be used to create a new competitiveness strategy. Both macro and micro strategies can be identified.

The strategy will recognize the transitional nature of our market place. It will be based on tough assumptions about key operating variables. For example we will assume that the US- Canada exchange rates will be closer to parity than to their historic lows; feed grains will remain stubbornly high and live hog prices will be constantly under pressure. The strategy will therefore be focused on succeeding in a difficult business environment.

CPC Competiveness Forum

It is not enough to be in the research and strategy mode. It is essential that information be transferred to individual farmers to help shape their business plans and on farm practices. The CPC Competitiveness forum will be a virtual sharing of best practices to help operators drive down costs, increase productivity and increase value to their customers.

■ Market Penetration

A strong domestic industry can only be successful if it has access to the important markets of the world. That is the reason for the Canadian Pork Council's request that the remaining funds from the Cull Breeding Swine Program be re-profiled for domestic and international market initiatives. A pork positioning and merchandizing initiative is needed to differentiate the cuts, define quality attributes and position pork products.

These initiatives will benefit the industry over the long term but the need for the resources is now to allow the industry to adapt to a restructuring market. This will be seen as the 'legacy fund' for the pork sector which the Pork Value Chain Roundtable included in its recommendations for strengthen the competitiveness of the Canadian hog/pork industry.

During the period 2009-2014 the Canadian Pork Council in conjunction with its partners will focus on the following Market Penetration priorities.

HINI Virus

The greatest threat that needs to be managed for the foreseeable future is consumers' perceptions about the HINI virus flu pandemic. The summer of 2009 is only the commencement of an expected duration of many months. In Canada, human vaccinations are expected to be available in a two shot protocol beginning late in the fall. The second vaccination would be during the January –February period. Therefore the issue of the pandemic will be at the forefront of news for an extended timeframe.

Regaining consumer confidence, both domestically and globally, is vital. As well, we must have the readiness to influence international governments in the event of a swine farm incident.

International Strategy and Programs

The producers expect that there will be a decreased reliance on US markets. High value markets including Japan, Korea, Australia and, pending the EU/Canada trade discussions, European countries should be the primary focus. These countries offer the potential to execute differentiation strategies that will deliver higher margins.

CPC's partner organization, Canada Pork International will be revising its strategic plan during the fall of 2009 with a view to implementing a differentiation strategy that creates a competitive advantage for the Canadian products, delivery and service.

Export Enablers

The pork industry will be piloting a trichinae certification program in the 2009/10 period and then undertaking a full implementation. This will facilitate the export of high value fresh pork to key international markets. This is but one example of initiatives that will be taken to ensure Canadian access to potentially profitable markets.

Canada Brand Pork/Domestic Disappearance

Domestic disappearance is a critical issue. The foundation of a strong export industry that is based on differentiation must secure its own domestic markets as a foundation of innovation and experience.

The CPC will work with its value chain partners, including PMC and CMC, to create pork as a “destination product” – one that can increase market share of pork against other products as well as increase the Canadian share of pork products sold in Canada. A national promotion strategy will be developed and implemented. It could be funded if an import levy was instituted similar to the US system. As part of this initiative, the CPC will work with processors and key retailers to understand how they can meet the specifications of Canada’s largest purchasers of products which include COSTCO, Wal-Mart and others so that they resume purchases of Canadian Pork.

We will also investigate methods to ensure that Canadian consumers are aware of the origin of the pork they purchase.

Country of Origin Labelling

COOL is creating enormous problems with access to US markets and the CPC is unequivocal in its support for Canada’s related challenge that is before the WTO. In the longer run however, Canadian producers and their partners must learn how to capitalize on the likely introduction of similar measures throughout a range of other countries.

The CPC and its partners will develop plans to increase Canadian capabilities so that it can be said, “we are prepared to go anywhere in the world and meet the most stringent requirements”.

■ Value Chain Integrity

Canadian Quality Assurance (CQA)

The CPC is engaged in a review of its CQA program. The results of the review will include recommendations to strengthen the current system, thereby providing confidence about the capability of quality assurance. The CQA system will be the gold standard in the world.

In addition, 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.

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

Animal Care Assessment (ACA)

The ACA program will focus on steps to enhance the participation in the program.

In addition the code of practice is being revised and will be completed by 2012. 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.

Traceability

The Canadian Pork Council (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. The 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.

Effective 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, and ensure effective strategic planning, communications, and customer service for industry stakeholders.

The 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.

Environment

We are aware of the impact that liquid manure storage methane and nitrous oxide from soil application of liquid manure is having on global warming and we will be fully engaged in the issue and willing to act. The technology exists for the industry to harness GHGs and produce renewable electricity and heat energy. We will help facilitate the investment in these technologies.

National standards will need to be developed that recognize the state of the art in sustainable environmentally friendly operations. A code of practice will also be instituted.

The hog industry is eager to participate in climate change adjustment mechanisms particularly by readying the industry for a trading system for carbon credits.

■ Innovation

The National Swine (Pork) Science Cluster is being established. The governance will be provided by a Board of Directors, appointed by the Canadian Pork Council. Much of the work of the National Swine (Pork) Science Cluster will be driven by the advice and the actions of the science community. When the Cluster becomes operational it is expected to feature:

The National Swine (Pork) Science Cluster will be focused on two important objectives:

- 1. Generating impacts that will improve the competitiveness of producers (increase productivity and drive down costs); and**
- 2. Generating impacts that create Canadian differentiation that can be demonstrated through the value chain, (recognized by the domestic and/or international markets)**

The Science Cluster submission to the federal government expected in late 2009 will include a business plan that reflects the organizational dimensions of the Cluster, as well as work plans for science projects for the period until 2013. It will demonstrate considerable private sector investment in the research, technology transfer and commercialization projects.

■ Summary

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- **Approve a special H1N1 Recovery Plan Loan;**
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Only with the federal government's financial commitment now, combined with the Hog Producers' determination to build a strong foundation for success, can the focus move away from today's grim reality to that of a more prosperous future.
