

**Summary of “Competitiveness of the Alberta Cattle Industry” Study
Completed by Informa Economics
For Alberta Beef Producers and Alberta Cattle Feeders Association. August, 2006**

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Overall, Canada has the resource base to be competitive in the basic production of calves. As product moves through the up stream production phases (feedlot and packer/processing) concerns exist as to whether this competitiveness is sustained.

Competitiveness Issues

Information and Technology

- Core cattle sector research is easily transferable between research/analytic institutions in the US and Canada. Canadian research should be focused on highly regional issues and let the US engage in the basic research.
- More effort should be extended towards speeding up technology transfer between researchers (public and private) and industry participants.

Labour

- Higher labour cost and lower labour availability has an adverse effect on the competitiveness of the Alberta beef processing sector compared to the US.

Exchange Rate

- A higher Canadian dollar will result in higher feed costs relative to the US, as well as other costs rising in the medium to long term.
- In the long run, the feedlot sector will attempt to gain acceptable margins by bidding lower on feeder cattle with the risk being that more and more feeders and calves may move to the US for feeding. The cow-calf sector will also be impacted by lower fixed asset values, particularly land.
- Currency change does introduce additional volatility in prices and margins. Volatility creates higher risks, which typically translates into higher costs.
- The appreciation of the Canadian dollar has negatively impacted Canadian packers, particularly in the area of gross margins.
- Unlike cattle and beef costs, most operating costs (including the largest component, labour) are not immediately affected by changes in the exchange rate. However, an appreciating dollar makes static Canadian dollar-denominated operating costs appear to increase in US dollar terms, thus reducing competitiveness in North American and international markets that do beef trade in US dollars.

Government Regulations: Pharmaceuticals

- The feedlot sector in Canada is at a distinct disadvantage to US feedlots as it relates to the approval time for various pharmaceuticals. Extended delays in getting approval create an economic hardship for Canadian-based operations as the flow of benefits can have as much as a 2-5 year head start in the US. This difference can often aggregate to several dollars per animal.

Government Regulations: Environment

- Regulatory requirements as it relates to the environment are deemed to be effectively equal in both countries.

Government Regulations: Slaughter & Processing

- Investigation showed that regulatory requirements at the packing/processing level in each country really are pretty well harmonized between the two countries, with the exception of possibly more stringent SRM (specified risk materials) removal and disposal requirements for Canada. The US is still considering changes. Differences here could put Canada in a favourable merchandising position.

Traceability Technology

- The development of a national animal ID system with related traceability capabilities is more advanced in Canada than it is in the United States. Traceability of cattle and beef, as a key differentiation point, is an attribute that could help the Canadian beef industry gain marketing leverage in the key Asian markets, the EU and even in the United States, but it will require additional investment in process without a clear indication of what the potential economic payoff will be. Alberta should continue to adopt/mandate enhancements and be a leader in traceability initiatives.

Price Discovery, Price Transparency and Existence of a Viable Futures Market

- There exists a high correlation between pricing at all levels of the beef supply chain with Canadian fed cattle & feeder cattle prices trading at a discount to the US market due to the export dependence of the Canadian industry. By and large, price spreads are reflective of arbitrage costs and changes in localized supply/demand conditions.
- The US cattle futures market can and is used as an effective hedging tool by the Alberta cattle feeding sector. Since cash cattle prices in Canada are denominated in Canadian dollars and the futures are priced in US dollars, there is added complexity, transactional costs and risk for Alberta cattle feeders using the futures as a hedge tool due to changes in exchange rates.
- The Alberta/Canadian industry is lagging in the area of price gathering and reporting that puts the Alberta industry (at least segments of the industry) at an information disadvantage to business counterparts in the US. Efforts to further develop the voluntary beef price reporting system in Canada should be made.

Market Power

- The existence of two major players in the Canadian slaughter sector creates potential for oligopoly/oligopsony behavior both on the transactions between the packer and cattle sellers (feedlots) and the packer and retail/food service buyers, most particularly if the US border is closed.

- The existence of a small number of relatively large packing plants in Alberta is a strong point for the Alberta industry, as the plants are highly cost competitive with US plants, but also a potential competitive bottleneck.
- Both primary slaughter facilities in Alberta are owned by the two largest packers in the US, Tyson and Cargill. Operational decisions at the two Alberta plants can be impacted by the American headquarters. The study authors suspect there are times when these decisions are not in Alberta's best interest, although no analytically based determinations in this regard could be made.

Farm Policy

- It is not analytically clear that US farm policy by itself has created a distortion in pricing of grains and oilseeds to the detriment of the Canadian livestock sector although it has a bottom line effect of creating an environment of relatively low cost grains and oilseeds.

Grain Production and Costs

- In the US, corn yields have trended higher over time and additional significant yield gains appear possible. In Canada, barley yields have been steady at best with the end result being declining per bushel production costs over time for US corn and steady to higher per bushel production costs for barley.
- This is creating, over time, a relative competitive feed cost advantage for the livestock sector in the US. Yield variability in Canada on barley is higher than yield variability for corn in the US, creating an added level of uncertainty and risk for the livestock value added industries in Canada.
- Efforts in Canada should be focused on barley yield growth research and in encouraging more private sector investment in Canadian barley seed technology.

Rapidly Expanding US Ethanol Industry

- Expectations are that ethanol production will continue to expand rapidly over the foreseeable future and this expansion will create a major boost in corn demand.
- As ethanol production in the U.S. expands rapidly some of the current advantage afforded to the U.S. livestock sector from a corn pricing perspective may disappear for a period of time although expansion of the production of the by-product distillers dried grains (DDG) may be partially or totally offsetting in the cattle sector. If US corn yields double in the next 5-10 years as seed companies claim is possible, then U.S. corn producers will be able to satisfy both feed and fuel demand with little long term upward impact on corn prices.
- With the increased availability of DDG close to ethanol plants, cattle feeding (or at least, new growth in cattle feeding) may migrate back towards the Corn Belt at the expense of cattle feeding in traditional feed deficit areas. This potentially creates a competitive element that will impact not only Southern Alberta but the US Southern Plains as well.
- It is not expected nor deemed economically justified for Canada to attempt a likewise expansion of its renewable fuels industry, given Canada's rich fossil fuel resources and competitive disadvantage in corn production or other alternative feed stocks.
- Caution needs to guide investment in ethanol production as yield enhancements may not occur to satisfy an expanded demand for barley and/or feed wheat.

- Therefore, there will be an anticipated evolving feed advantage to the US feeding industry from the use of ethanol by-products unless the US corn industry is unable to meet the expanding demand for US corn through acreage adjustments and yield enhancements. Failure to meet this challenge could result in a sharp appreciation in US corn prices and hence, feed costs.

Gross Margin Issues

- As up to half of Alberta's total fed beef production equivalent is sold into the US, Canadian fed cattle and fed beef are sold at a discount reflecting transportation and other associated costs needed to penetrate the end market for the product in the US.
- Relatively efficient arbitrage of both cattle and beef between the two countries (when borders are open) assures that the discounts being reflected in Canada for fed cattle and/or beef are truly a reflection of economic factors (including transportation costs) related to regional supply and demand conditions.
- Arbitrage in feeder cattle and calves should reflect costs associated with relocating such animals to the US for feeding and ultimate slaughter, but IF the feed cost structure in the US is lower than in Canada, US cattle feeders can afford to pay more than feedlots in Canada which creates a feeding margin squeeze for the Canadian cattle feeder. Unless the feed cost disadvantage can be offset by advantages on other cost factors (relative feed costs, cattle performance, approval of various pharmaceuticals, currency values, etc.), a lower long-term return on equity or assets would occur in Canada relative to the US.
- The cattle feeding sector in Alberta is or already has lost its economic advantage upon which the industry was built back in the 1980s and 1990s.

Additional Packer/Processor Competitiveness Issues

Slaughter Sector Structure

- The beef packing/processing sector is relatively concentrated on both sides of the US/Canadian border. Alberta plants are at least as efficient as the US plants.

Plant Location relative to key beef demand centers

- Transportation costs from feedlot to packing facilities in southern Alberta is equal to or less than similar costs in most major slaughter regions within the US.
- Regarding end markets, Alberta is at a distinct disadvantage both relative to major population centers in Canada as well as the US.

Grading Differential

- Canadian beef cannot be given a USDA grading designation. This is a critical issue as it relates to choice grade beef. Product values (as measured by currency adjusted cutout values) are discounted in Canada due to a perception that USDA choice beef is a premium product to the AAA grade in Canada even though the two grading systems are virtually identical. For select/AA product, there is more equivalent pricing as Canadian product is deemed to be mostly on a par with the US select product.

- As a consequence, the price that packers can afford to pay for cattle in Alberta is less than what they can afford to pay in the US.

Other Factors

Public Grazing & Land Use Policies

- Public grazing fees tend to be similar in the U.S. and in Alberta.
- In both the U.S. and Alberta, public grazing is so small that Informa views it as a non-factor in competitiveness.

Industry Structure

- The cow calf sector in Alberta has no major identifiable structural and/or economic cost disadvantages to those that exist in the US, although as is common, there are production pockets in both countries that have advantages to others because of specific resource issues, weather anomalies, geography, etc.
- There are a multitude of “other” cost factors in the cattle feeding sector including the costs of capital, energy, veterinary services etc. It was determined that there are relative advantages and disadvantages across these cost factors but that nothing can be identified as being consistently advantageous to either country over time.

Recommendations: Strategic Development

- In its closing recommendations, Informa notes that the Alberta cattle sector, individually or collectively, needs to pick one (or possibly two) strategic approach(es) and devote resources to implement that strategy. The three choices they note are:
 - a low cost leadership position,
 - a product differentiation strategy (producing something that is perceived as unique) or
 - a focus strategy which is built around serving a particular market very well.
- The Alberta industry has in past decades relied primarily on a low-cost strategy relative to the US; however, the findings of this study suggest that the Alberta cattle sector is not the overall cost leader in the North American industry - hence, the need to re-evaluate the sector’s strategic position and formulate new alternatives.

Strategic Alternatives for the Alberta Cattle Sector

- Diversify customer base and differentiate product set
- A focus on creating demand expanding programs, whether they be natural, organic or more conventional quality-focused brands would seem to be a requirement for the industry.
- We need to remove the negative impacts associated with the beef grading differential between Canada and the U.S.

- Alberta should continue to adopt/mandate enhancements and be a leader in traceability initiatives.

Address the packer ownership/concentration issues

- A highly concentrated and US owned packing sector is a competitive bottleneck for the Canadian industry and without change, could potentially be a deterrent to long term industry profitability.
- Instituting a mandatory price reporting system on live fed cattle transactions as well as beef product sales would create pricing efficiency and price transparency in the market and thwart attempts on the part of the packers to collude on prices.
- Industry wide support should be given to programs that encourage development of export markets other than the US.

Focus on returning Alberta industry to low cost status

- The North American beef industry will continue to exhibit traits of a commodity based industry so continuous efforts should be focused on cost reduction opportunities, technology utilization, etc. in Alberta/Canada.
- Cost reductions should be focused on both commercial factors as well as regulatory burdens. The role of government regulations should be one of building harmonized programs with the US, to the extent possible, and to be minimally intrusive on private sector decisions and self-governance while preserving the public good.
- Canadian Universities and other publicly funded research organizations should focus efforts on developing higher yielding varieties of barley as yield enhancements continue to lag those being experienced in the US for corn. Without this, relative feed costs in Canada will continue to increase.
- Caution needs to guide investment in ethanol production as yield enhancements may not occur to satisfy an expanded demand for barley and/or feed wheat.

Establish joint venture feeding operations in US corn belt

- As more small US feedlots may develop in response to the growth of the ethanol industry, Alberta cattle producers could create sourcing alliances with US feedlots and/or invest directly in such lots in the US.

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