

REPORT FROM CANADA BEEF

Executive Summary

Consumer spending stepped up 23% over two years between Q2 2020 and Q2 2022, but early warning signs of a descent are on the horizon. The upward momentum of Canadian consumer spending has been a key determinant of positive national economic growth over the last two years. Canadian food expenditure increased 11% from the fourth quarter of 2019 to peak in the first quarter of 2021 but has since declined 8% into the second quarter of 2022 (2012 constant terms). Food expenditures are diminishing as Canadians decide on consuming less at current price levels.

Canadian retail beef prices remained strong in July 2022 with value product prices moving higher. Ground beef and stew meat prices increased by double digits. Switching to more affordable products and discount retailers are proven strategies for consumers during inflationary periods. This is true now for wealthier segments of the population as it was for lower income families squeezed earlier this year. While still historically strong, total supermarket and grocery sales declined 0.7% from May to June and a further 0.9% from June to July 2022.

Rib prices at wholesale remained steady for the summer, but loin prices declined dramatically, pressuring the cutout value compared to recent years. The US composite cutout year to date 2022 (September 16) at CDN\$338/cwt (US\$264/cwt) was still resilient, but lower compared to CDN\$344/cwt (US\$276/cwt) at the same time last year.

Food service sales are positive and steady, with traffic nearly returning volumes from 2019 by the second quarter of 2022. The food service sector faces headwinds in staffing and margins. Casual dining is likely to surge ahead in 2022 whereas demand for high-end restaurants could ease. Beef import values increased substantially year to date (Jan-July) in 2022 with volumes steady with 2021, reflecting the tightening of global beef supplies. Year to date volumes declined from the US (-1%) and increased from Australia (+43%) showing a reverse trend in suppliers.

Economic Outlook

In the second quarter of 2022, robust consumer savings, a tight labour market, increasing wages, and larger disposable incomes continued to support consumer spending. Over the last two years (Q2 2020 to Q2 2022), consumer spending stepped up 23% (Statistics Canada 2012 constant prices). By July 2022, evidence of a descent sparked conversation around recession. Statistics Canada's core retail sales (excluding gasoline and motor vehicle parts) declined 0.9% in value from June to July 2022, the first decline this year. Their manufacturing ratio of inventory to sales at 1.65 in July 2022 was the highest since September 2021. The data show, potentially, that we have reached cruising altitude on the sky-high spending frenzy. While Gross Domestic Product (GDP) for 2022 was forecast in September to remain positive, estimates were revised down by the National Bank of Canada (to 3.2%).

Until the end of 2022, steady to strong performance is expected for beef at retail, wholesale and food service sectors. It was still blue skies for consumers this summer as the labour market tightened in the second quarter of 2022. Statistics Canada's new hire to job vacancy ratio showed less than half (44%) of available job vacancies were filled. The resulting competition for labour supported wage growth (+5.4% year over year in August 2022) and increased household disposable income, up 2.6% in the second quarter of 2022 from the first quarter and up 4.8% from the second quarter of 2021.

Wage gains in any sector, however, have been offset by inflation at 7.0% year over year in August 2022, down from 7.6% in July and 8.1% in June (Statistics Canada). Low-income Canadians were affected first, responding by cutting spending, looking for discounts, postponing purchases and buying more affordable items. Rising interest rates have begun to tamp the stock market and erode the wealth effects among higher income earners now too. According to the Bank of Canada, there was a 10% decline in household net worth in the first half of 2022 compared with the first half of 2021, and that is burning out consumer confidence. The Conference Board of Canada shows consumer confidence up 2.3 points from July to August 2022, but still down 38.4 points from August 2021 and lower still than August 2020. In a high interest rate environment, consumers are expected to cut spending, increase their savings, postpone major purchases, and pay down debt.



For Canadian beef, the potential for recession may be a less concerning phenomenon than the gathering headwinds against domestic consumption for 2023. Based on the National Bank of Canada's September 2022 forecast, any growth in domestic GDP next year will likely hang on by increasingly strong terms of trade. Canadian consumers will face inflation above target levels for the next year and a half with only a slight easing of interest rates forecast during that time. Unemployment is expected to increase slightly. The plan seems to be to land this three-year spending flight, preferably on solid and steady economic ground.

Retail Sector

Canadian retail beef prices remain historically strong and supported by price increases in value products. The Canadian retail beef price increased 0.4% from June to July 2022 to \$19.45/kg, up 1.5% from July 2021 and up 11.8% from the five-year average for July. Year to date (Jan-July), retail beef prices outperformed last year, up 13.7% from the same period in 2021 and up 24.1% from the five-year average. Despite overall strength, the retail beef price declined 8.6% counter-seasonally from March to July 2022, pressured by the unusual declining price of middle meats into grilling season.

Switching to discount retailers and switching down to more affordable products are proven strategies for consumers during inflationary periods. Ground beef prices increased 3.5% from June to July 2022 to \$10.64/kg, up 13.1% from July 2021 and up 10.5% compared with the five-year average for July. As supply remains robust, the higher prices signal continuing strong demand for ground beef. The table below shows how all cut prices fared at retail in Canada in July 2022.

Cuts	Retail Price July 2022 (CDN)	Change from June 2022	Change from July 2021	Change from the Five-year Average for July
Beef rib	\$25.99/kg	+0.2%	0%	+14.8%
Beef striploin	\$23.27/kg	-3.8%	-13.5%	+0.2%
Beef top sirloin	\$18.61/kg	-1.4%	-8.9%	+14.9%
Beef stewing cuts	\$18.73/kg	+0.2%	+14.1%	+22.6%
Ground beef	\$10.64/kg	+3.5%	+13.1%	+10.5%
Total retail Beef	\$19.45/kg	+0.4%	+1.5%	+11.8%

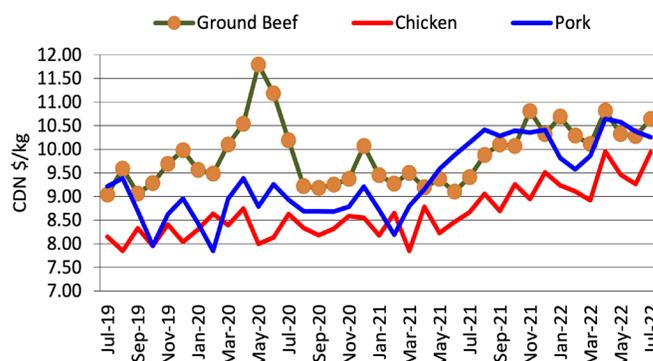
Source: Statistics Canada

Prices for competing proteins have been rising at faster rates than beef in recent months. The Canadian retail chicken price increased 7% from June to July 2022, to \$9.94/kg, up 14.7% from July 2021 and up 20.2% from the five-year average for July. Higher chicken prices have pressured the beef-to-chicken price ratio in July 2022 to 1.96, well below trend, in favour of beef.

Poultry products in the Consumer Price Index (CPI) increased 4% from July to August 2022 and were up 4.6% from August 2021. The data reflect the effects from outbreaks of Highly Pathogenic Avian Influenza (HPAI). The disease is distributed amongst dozens of commercial and non-commercial poultry operations concentrated in British Columbia, Alberta, and Saskatchewan has affected turkey, egg, and chicken production and pricing. The risk of higher poultry prices around the holidays could have consumers once again switching up their holiday recipes. Retail beef prices typically decline from September to October and spike in November. The uncertain availability of poultry may affect that seasonality this year.

The Canadian retail pork price was down 1.1% from June to July 2022, to \$10.26/kg, up 1% from July 2021 and up 13.6% from the five-year average for July. The beef-to-pork price ratio at 1.90 in July 2022 was within a normal range and has declined from the high this year at 2.20 in February 2022 to favour beef. The highest ratio on record over the last five years was back in June 2020 at 2.33. The lowest ratio on record was December 2018 at 1.48.

Retail Prices



Source: Statistics Canada

The dissipation of wealth effects may drive higher-income Canadians into discount retailers in the months to come. Expect the shift into discount retailers and the switching down between products to accelerate. Ground beef has a comparable price to the pork or chicken composite price. Consumers considering a trade down from the pricier items like breasts and bacon to drumsticks and loins may find these lower priced items less versatile than ground beef.

Total supermarket and grocery sales in June 2022 were higher year over year after 12 months in year over year decline. Sales in July 2022 were up 4.5% from July 2021. Halfway through 2022, sales are still large enough to reach approximately \$8.3 billion annually, for the third year in a row. Supermarket and grocery sales are roughly 12% greater than before the pan-



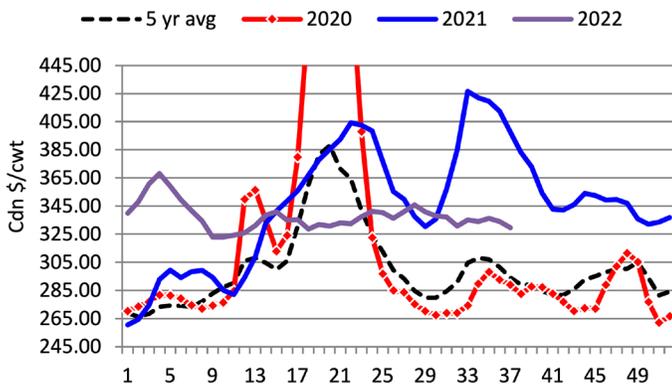
demic. Month to month, however, sales did decline by 0.9% from June to July 2022, the second month in a row of declining sales.

Wholesale Market

The American market provides insight into the Canadian wholesale sector.

After a strong start well above 2021 levels in the first quarter of 2022, the US composite cutout stabilized through the second quarter of 2022 and was moving toward the five-year average trend line in September. As a result, the year to date (September 16) US composite cutout at CDN\$338/cwt (US\$264/cwt) was down 2.8% from 2021 and down 0.9% from 2020; but still up 10.1% compared to the five-year average (2017-2021). There was no typical late summer support for the US cutout this year which leaves questions about whether any seasonal lift is possible going into November or if prices will remain flat.

US Composite Cutout



Source: USDA, Canfax

While Choice ribs values were relatively steady through the summer, loin values really diminished. Chuck and round primals were supportive of the US cutout with 85% and 50% trim values remaining steady and strong. The Choice Select/Spread in August 2022 was the highest in at least three years at US\$25.96/cwt, reflecting a continued demand for higher-grade beef. Among the primals, the spread was most pronounced for loin.

In Canada, more Prime and AAA was available as production increased earlier than usual this summer. By mid-September 2022, year-to-date Prime and AAA production was at 74% of all grades, compared with 71% year-to-date September 2021,

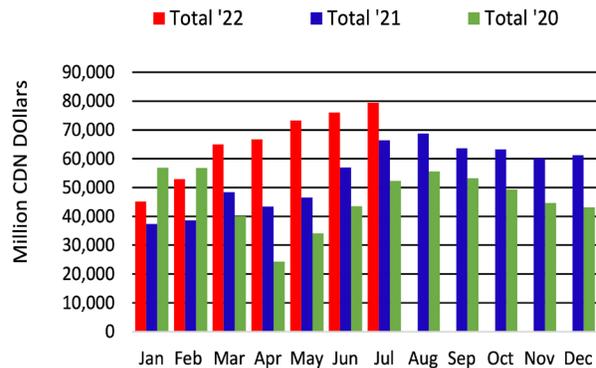
and 82% this year for Prime and Choice production in the US.

In Canada, year over year sales growth for food and beverage processors is expected to slow in the second half of 2022. According to the Farm Credit Canada's mid-year update on the Food and Beverage Report, there are, however, "positive trends in red meat and expect sales to rise in 2023."

Foodservice Sector

In the first half of 2022, food service sales were large and growing and pointed to a typical summer surge. Food service sales grew each month from January to July 2022 and were up 36% year-to-date. Special food service sales were back in black for June 2022, up 93% from June 2021 and up 6.8% from June 2019. Unable to maintain momentum, special service sales declined 8.9% from June to July 2022, but were 77% higher than July 2021 in July 2022. Limited-service sales were up 12% from July 2021 to July 2022, increasing 3.8% from June to July 2022. Full-service sales were up 22% from July 2021 to July 2022, increasing 7% from June to July 2022.

Canadian Food Service Sales



Source: Statistics Canada

Restaurants Canada (with CGA by NielsenIQ) reported the positive progress of on-premise dining by mid-September 2022. National growth was up and check values were positive. Customers increased their visits to on-premise establishments over the Labour Day holiday. Most were out for occasions with beer and wine pairings most popular. In their survey, approximately four in five Canadians had reportedly been out to eat in the past month with about the same number going out more than or as often as usual. More than four in five Canadians planned to eat out next month too, with approximately one in three Canadians



planning to increase visits to hospitality for the rest of 2022. For those who visited restaurants less often, cost of living increases and price increases in eating and drinking out were reported as the predominant deterrents; those respondents numbered around 20%.

Restaurant Canada’s 2022 Food Service Facts report pointed out that food service traffic remained barely below pre-pandemic levels by the second quarter of 2022. The market share of traffic, 76% at quick service and 24% at full service was typical market share. The burger remains a top food trend in 2022, polled as even more popular today than in 2019.

The 2022 Food Service Facts report also shows that Canadians value restaurants and have a positive view of food service workers. Yet persistent job vacancies are hamstringing the accommodation and food service industry. Statistics Canada’s reported job vacancies for the sector increased 12.7% from the first quarter of 2022 to the second quarter, to 149,600 unfilled positions for front and back of house staff. The increase in job vacancies in the second quarter is a reversal of the declining trend of the three previous quarters. The job vacancy rate (vacancies as a percent of labour demand) at 11.9% for the accommodation and food service was comparatively high across all sectors, the highest across all sectors since summer 2021.

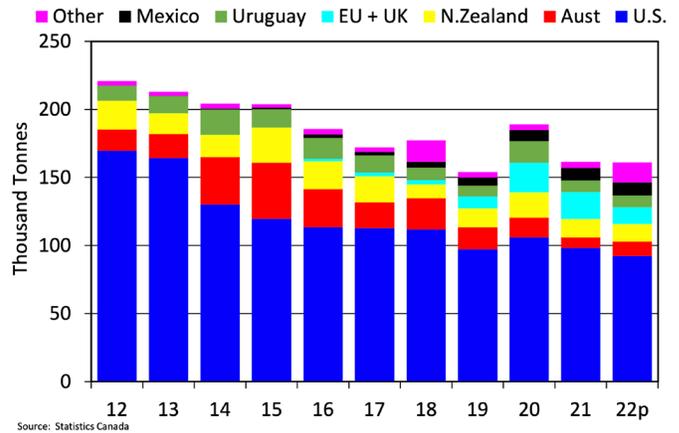
Food service operators are not immune to the high-altitude headwinds from inflation and interest. Many operators have debt from the pandemic and rising interest rates and inflation are eating into profit margins. From July to August 2022, the restaurant food CPI increased 0.5% (compared to 1% at supermarkets and grocery) and increased similarly across all food service channels. The restaurant food CPI in August 2022 was up 7.4% compared to retail CPI’s 10.8% growth year over year. Food service menu price increases are occurring at a slower rate than grocery which may be a testament to the ability of food service to control costs in innovative and agile ways.

Imports and Distribution

In July 2022, beef import volumes were steady with July 2021 but down 11% from the five-year average for July. Imports volumes for 2022 are projected to be steady (-0.2%) with 2021. Beef imports may be under pressure from a

tightening of global supply. From January to July 2022, beef import volumes were steady with last year, but up 20% in value. Larger volumes from non-traditional suppliers signal that importers expanded their search for product in 2022.

Canadian Beef Imports



Year to date (Jan-July) import volumes declined from the US (-1%), New Zealand (-20%), Argentina (-81%), Uruguay (-37%) and Brazil (-28%), but increased from Australia (+43%), the EU 27 (+26%), UK (+66%) and Mexico (+5%). End of year projections are for lower imports from the US (-6%) but higher imports from Australia (+37%) reflecting a trend reversal. To support increasing production at home, the Saskatchewan Stock Growers Association completed a feasibility study proving the viability of a 500-1,000 head per day harvesting facility for Saskatchewan.