

REPORT FROM CANADA BEEF

Executive Summary

Beef remains competitive in the Canadian retail sector even as prices remain historically high. Retail products like top sirloin and ground beef provide budget-balancing options for Canadian consumers. The wholesale beef market is seeking a new equilibrium as North American production tightens and demand shifts into lower value primals like short plate and flank.

Canadian food service may receive a boon as travel increases during the summer months and labour shortages ease, but consumers will be forced to be more cautious with their spending. Canada remains a high value market for beef supported predominantly by domestic production. Importers may increasingly look to low-cost suppliers to supplement unwavering Canadian demand for beef.

Economic Outlook

A strong economy in the first quarter of 2023 convinced the Bank of Canada to add more pressure through raising its policy rate on June 7, 2023. Both lagging and leading indicators suggest that the searing economy may continue to cook low and slow in the medium term. Despite a pessimistic economic outlook that puts the proverbial 'peak' of growth in the rearview mirror, significant tailwinds are keeping the coals burning in the beef markets.

Canadian consumers continued to use household savings to support consumer spending in the first quarter of 2023. At 2.9% in the first quarter of 2023, the household savings rate was within historically normal ranges, but down considerably from the 5.8% reported in the fourth quarter of 2022. Very few savings remain compared to the pandemic-related excess over the last three years.

Government transfers to consumers eased and household disposable income declined 1% from the fourth quarter of 2022 to the first quarter of 2023. The decline in disposable income was the first in four consecutive quarters and means less cash left over for Canadians to spend after tax. Shel-

ter, debt, and food all compete to be paid with disposable income. Rising shelter and debt servicing costs have implications on available expenditure for food.

In May 2023, unemployment contracted to 5.2%, after five consecutive months at 5.0%, and the participation rate and employment rate declined. The upward momentum may be temporary, as a surge of immigrants in the first quarter of 2023 enter the workforce; but may also signal a softer labour market. Population growth and the upward momentum on wages paid in the first quarter of 2023 supported the all-item Consumer Price Index (CPI), up 0.1% from March to April 2023, and up 4.4% in April 2023 from April 2022.

The money supply in Canada is a leading indicator of the future direction of the economy. As a measure of cash and liquid balances, the M2++ money supply is 'near money' and a harbinger of inflation and nominal spending, closely linked with demand in the medium term. The pace of M2++ growth in the first quarter was historically slow, potentially signalling downward pressure on the economy in the years to come. This view is shared by the Bank of Canada who point to lower overall consumption, lower profits and higher unemployment over the next two years.

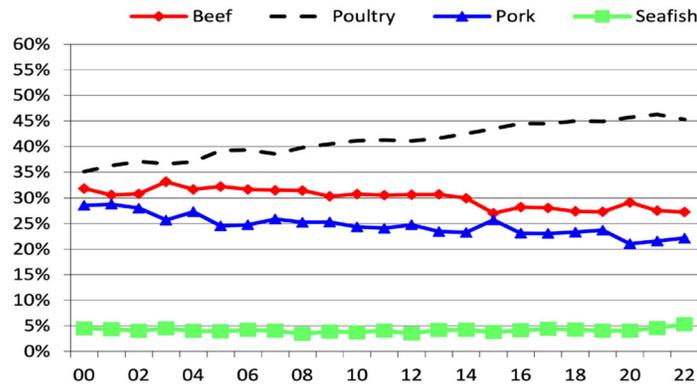
Continued downward pressure on the overall economy does not bode badly for beef markets, especially in the context of a larger population. These factors may actually promote medium term price equilibrium at today's high levels, given the current levels of relatively smaller production.

Retail Sector

Statistics Canada released consumption data on May 31st that showed consumers paid more in real terms for beef in 2022, and ate more of it. Beef demand grew in 2022 as the result of a 1% increase in deflated retail beef prices and a 3% increase in per capita consumption to 17.5 kg per person (retail weight). The retail beef demand index at 124.68 in 2022 (2000=100) was slightly above the 2020 surge to 124.43. Canadian beef consumption from domestic beef production increased to 80.6% in 2022 compared with 79.85% in 2021 and up from the ten-year average at 76.50%. The increasing proportion of domestic consumption speaks to trends in local capacity to meet domestic beef demand.



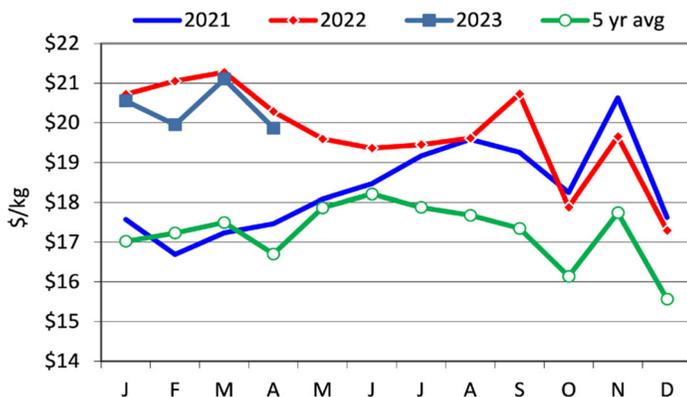
Meat Market Share



Source: Statistics Canada

Overall protein consumption was higher in 2022, up 3.8% year over year, and is evidence of the strong Canadian economy. While beef demand increased in 2022, market share (on a volume basis) shifted very slightly away from beef and poultry and toward pork and seafish. Beef market share declined 0.2 percentage points to 27.3% in 2022. Poultry market share declined 1 percentage point to 45.3% in 2022. Pork's share increased 0.5 percentage points to 22.1% in 2022, and market share of seafish was up 0.7 percentage points to 5.3% in 2022.

Canadian Retail Beef Prices



Source: Statistics Canada

In 2023, retail beef price inflation remains muted relative to other foods, including bakery, dairy, proteins, fresh fruits and vegetables. The CPI for retail beef, up 5.5% year over year in April 2023, has been growing at a slower rate each month in 2023 (Jan-April) compared to other categories. The exception is pork that is experiencing slower year over year CPI growth than beef. This competitiveness could support retail beef demand in the near term. Furthermore, while the CPI for food was up 8.3% year over year in April 2023, it has been easing since January 2023. Food price inflation could be expected to ease further with the recent policy rate hike that is once again biting into Canadian consumers disposable income.

The average retail beef price from January through April 2023 was down 2% from the same period in 2022, but remains historically strong. In April 2023 the average retail beef price was up 19% from the five-year average for April. Beef options remain for the cost-conscious consumer. While top sirloin prices were up 0.7% year over year in April 2023, striploin was down 6.0%, ribs were down 1.3%, stewing beef was down 2.6%, and ground beef was up 2.8%.

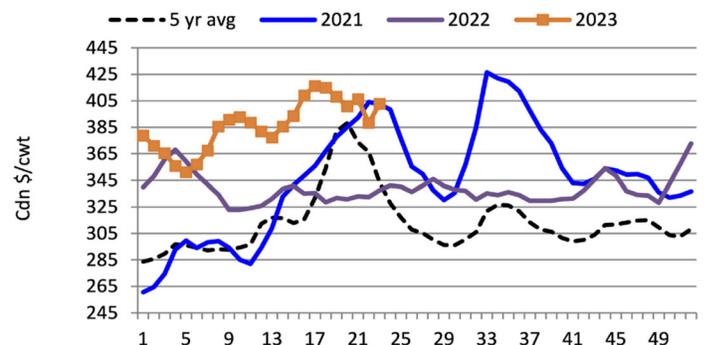
Canadian retail beef prices declined 6% seasonally from March 2023 to April 2023 to \$19.87/kg. From March to April 2023, the beef-to-pork price ratio declined from 2.33 to 2.05. The beef-to-chicken ratio also declined from 2.18 to 2.05. This has realigned beef's price ratios with historical ranges, supporting beef consumption, after being uncompetitively high in the first quarter.

Recent research suggests it now takes a larger price hike of beef over pork and poultry to entice consumers to switch. That is, beef is becoming more cross-price inelastic. The willingness of consumers to keep buying increasingly priced beef suggests beef is becoming more price inelastic to changes in its own price as well. Both measures toward becoming more inelastic reflect rock solid consumer demand for beef.

Wholesale Market

The US wholesale composite cutout price in the first quarter of 2023 was up 10% from the same period in 2022 and up 27% from the five-year average for the first quarter. Unlike previous years, the composite value declined from January to February 2023, but the market found strength through the spring. The second quarter price reached a high of CDN\$415/cwt the last week of April 2023. In May, at CDN\$404/cwt it was up 22% from May 2022 (with an extra week included in May 2023) and has stayed near this range at CDN\$403/cwt as of June 10, 2023.

US Composite Cutout



Source: USDA, Canfax



Primal values for rib, loin, and brisket in May 2023 were all higher than May 2022 levels, but not quite as high as 2021. For example, the table below shows the Choice rib primal in May 2023 at US\$449/cwt (CAD\$607/cwt) was up 12% from May 2022 but down 15% from May 2021, a time when rib primal values were historically high. While round prices remain steady, short plate and flank primal values surged to record highs in May 2023. Overall higher prices were being paid for all primals in May 2023 versus May 2022, except for brisket and for 85% trim.

Primal	May '23 US\$/cwt	May '23 CAD\$/cwt (Converted at 0.7391)	% Change May '23/'22 (US\$)	% Change May '23/'21 (US\$)	Ytd (Jan-May) % change '23/'22
<i>Choice</i>					
Rib	448.92	607.39	12%	-15%	15%
Loin	437.01	591.27	20%	-9%	12%
Round	230.71	312.16	10%	0%	0%
Brisket	233.16	315.47	11%	-21%	-10%
Chuck	242.29	327.82	19%	3%	5%
Short Plate	265.01	358.55	35%	23%	13%
Flank	211.83	286.60	36%	34%	15%
<i>Select</i>					
Rib	388.98	526.28	10%	-13%	6%
Loin	388.70	525.91	19%	-10%	9%
Round	230.66	312.09	11%	0%	0%
Brisket	225.76	305.45	10%	-23%	-10%
Chuck	238.06	322.10	18%	4%	5%
Short Plate	265.01	358.55	35%	23%	13%
Flank	202.59	274.10	34%	30%	14%
<i>Trim</i>					
50%	190.21	257.35	81%	140%	28%
85%	256.73	347.35	5%	13%	-3%

Fifty percent trim values at US\$190.21/cwt in May 2023 surged toward their previous record high of US\$197.53/cwt in May 2020. May 2023 values for 85% trim did not break any records but were also in line with May 2020 levels, a time when wholesale pricing found significant support from supply disruptions.

Canadian beef production has responded to price signals for high-quality beef. Prime and AAA production as a percentage of all A grades was 75.8% January through May 2023, up from the five-year average of 71.8% but down from 78.6% from the same period in 2022. The availability of Prime and AAA in Canada has been pressured by lower production of youthful cattle (-7.5% year to date Jan-May 2023) that typically grade better. Overall production has been supported by larger production of mature cattle (+6.5%).

Youthful cattle production is projected to be down 4.6% in 2023. Lower production would lead to higher prices for Canadian Prime and AAA, if demand remains constant. Mother

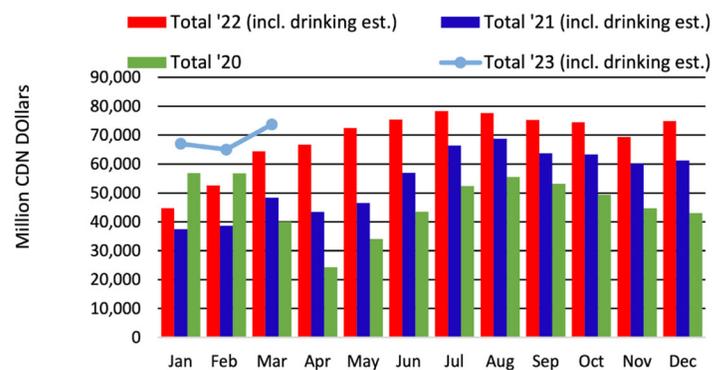
nature will play a significant role in production decisions this year. If rain supports pasture conditions, cattle supplies may tighten this year as cows and heifers are retained to produce more calves and ease the back half supply for 2024. However, if dry conditions spread and pasture quality deteriorates, production may be supported in the short-term with liquidation; but leave supplies tighter in the coming years.

Foodservice Sector

Wholesale beef demand was down 6% in 2022 compared with 2021 (based on Canadian consumption and US wholesale prices). With retail demand up but wholesale demand down, foodservice appears to be the market where wholesale beef demand may have lost ground in 2022.

Gross domestic product data from the first quarter suggests that consumer spending has shifted increasingly into accommodation, food service and travel in 2023. Overall food service sales (not adjusted for inflation) in the first quarter of 2023 were up 27% from the first quarter of 2022. Full-service sales were up 34% from the first quarter of 2022, limited service (counter-service) sales were up 17% and special service (on-location catering and food truck) sales were up 54% (Statistics Canada). RBC Economics data show that nominal spending at restaurants has been positive in February, March and April 2023. US travel into Canada in March 2023 was still roughly just 75% of pre-pandemic levels, but the overall trend has been toward increasing travel, commuting and flights, which bodes well for food service.

Canadian Food Service Sales



Source: Statistics Canada

Even as travel returns, consumers still have lower levels of disposable income, savings, and purchasing power to rely on. Food service trends suggest consumers are finding ways



to eat out, but spend less doing so. Food-away-from home dollars are shifting into off-premise dining with the continued popularity of burgers and sandwiches joined by Asian and Mexican inspirations. These products are supporting the surge in trim, short plate and flank primal values. At 6.4% in April 2023, restaurant food inflation (6.2% for table service, 6.9% for fast food and take-out, and 6.6% for special service) was lower than retail food inflation, but declined less overall since January 2023. Food service inflation declined 1.7 percentage points from January to April 2023, compared to a 2.3 percentage point decline in the retail food CPI.

Despite higher sales, traffic is hanging back and restaurant profitability is under pressure. Seventy-eight per cent of Restaurant Canada’s React survey respondents reported lower profitability in Q1 2023 compared with Q1 2019. Profitability will drive the purchasing decisions of owners at wholesale. Rising food and labour costs will support streamlined menus, but menu prices are forecast to increase a further 6% in 2023 due to inflation. Restaurants Canada estimates a capacity issue around 15-25% from a labour shortage and a lower number of commuters is impacting traffic. The good news is that in April 2023, the strongest growth in jobs by industry year over year was for accommodation and food service (+6.2%), but the vacancy rate remained stubbornly high at 7.8 in March 2023.

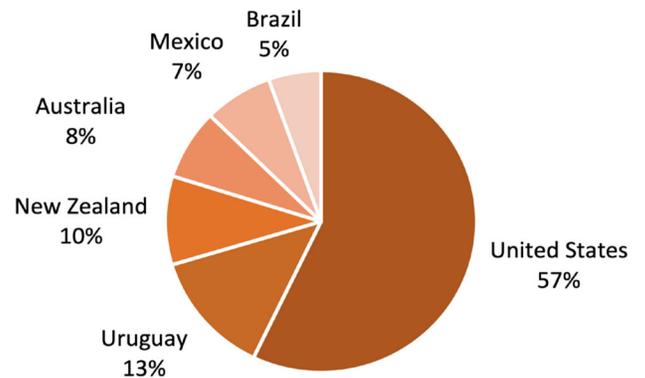
Imports

First quarter 2023 beef imports were up 1% in volume at 40,986 tonnes imported, but down 2% in value. Volumes declined from the U.S. (-10%), EU 27 (-30%), the UK (-67%), and Argentina (-15%), but increased from New Zealand (+26%), Uruguay (+73%), Australia (+14%), Mexico (+13%) and Brazil (+387%).

In April 2023, imports seasonally declined 1% from March 2023 but were up 11% from April 2022. Imports from the US were steady in April 2023 compared with April 2022. Imports declined from New Zealand (-18%), but increased from Australia (+44%), Uruguay (+785%), and Brazil (+253%). Higher May imports would be a good sign of domestic beef demand before imports seasonally ease through the summer.

Changing transaction costs and tighter North American production have the potential to affect market share from beef suppliers to Canada in 2023. While supply chain backlog costs have subsided, higher transaction costs in the form of exchange rates, carbon taxes on fuel and wage increases will play a role in shifting trade flows. The graphs show that imports from January through April 2023 have increased from the Southern hemisphere.

Year to Date (Jan-April 2023) Beef Suppliers to Canada



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