DOMESTIC MARKET REPORT | Q3 2023

REPORT FROM CANADA BEEF

Executive Summary

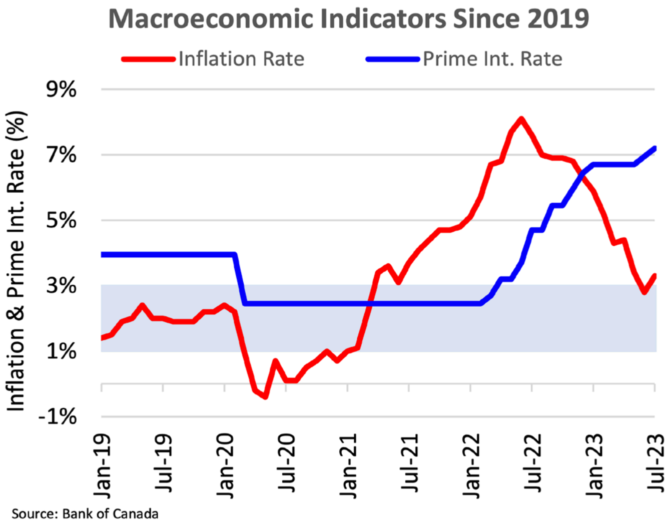
The Bank of Canada has taken their foot off the gas and left the prime interest rate alone in August and September. Inflation, though still elevated, is within range of its target. Unemployment remains relatively close to historically low levels, and GDP continues to trek ahead. Consumers have become accustomed to a certain lifestyle, including the desire to go out to eat, and to eat well at home. On the retail front, food prices continue to run higher - with some commodities up and others down in the first part of the year. Consumers continue to find ways to reduce grocery costs, including purchasing at discount retail chains and taking advantage of promotions. In addition, food service sales remain robust in 2023. Strong international demand for Canadian beef is pulling domestic supplies away from Canadian consumers. Canadian beef supplies are tight, carcass weights are light and quality grading has been reduced.

Economic Outlook

The Canadian economy has finally begun to trend in the right direction; and the Bank of Canada said as much when they met on September 6, 2023, to discuss their next policy decision. At their September meeting, the Bank of Canada policymakers opted to leave the overnight rate (the rate at which all Canadian lending institutions use to adjust their own interest rates) at 5%. The Bank of Canada policy makers indicated that the Canadian economy has reached a period of weaker growth; output contracted a very slight 0.2% in the second quarter. Higher interest rates have finally taken a bite, slowing household credit growth for a much larger range of borrowers. The inflation rate in July was 3.3%, only marginally higher than the 3% ceiling.

The GDP growth rate has been affected by several external factors, including widespread wildfires in Western Canada, flooding in the Maritimes, and the Port of Vancouver strike. There also remains some divergence between international economies. While global growth slowed in the second quarter, led by China, growth in the U.S. was stronger than expected. Europe saw strength in the service sector, offsetting declines in manufacturing. Canadian GDP in June 2023 was 1.1% higher than June 2022, and only 0.2% weaker than May 2023. This is only the third time since January 2022 that GDP has weakened month over month.

The Canadian unemployment rate in August was steady with July at 5.5%. However, divergence was seen between regions. Prince Edward Island, Nova Scotia, Quebec, Alberta, and British Columbia all saw a decrease in unemployment rates. Things aren't all rainbows and butterflies on the employment front though. Newfoundland & Labrador, New Brunswick, Ontario, Manitoba, and Saskatchewan saw unemployment rise between July and August. Saskatchewan has been the most severely impacted negatively, as they are the only province to see unemployment rates rise for three consecutive months.



The Canadian job vacancy rate stood at 4.4% in June, steady with May with around 784,000 jobs not filled. This is a considerable 23% improvement over June 2022, when over one million jobs were left unfilled. Year-over-year, the job vacancy rate largely improved, with the exception of the Maritimes.

In the second quarter of 2023, household disposable income increased 5% from the second quarter of 2022 and rose 2.5% from the first quarter of 2023. Consumers appeared to feel confident in the state of the economy, as the Canadian household saving rate in the second quarter of 2023 (household net saving divided by household disposable income) was identical to the second quarter of 2022 at 5.1%, and only rose 1.4%.

On an annual basis, wage gains averaging 4.9% were seen in all industries in August 2023 compared to August 2022; 6.6% in the goods producing sector and 4.5% in the services producing sector.

Retail Sector

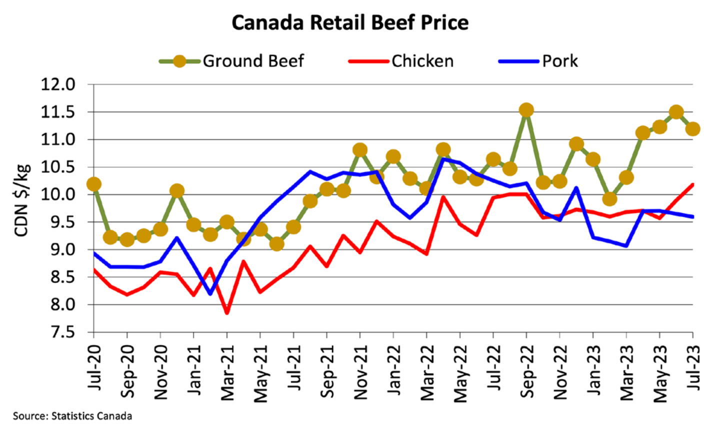
Data released by Statistics Canada shows that beef prices (the average price of stew meat, striploin cuts, top sirloin cuts, rib cuts, and ground beef) at retail averaged $22.29/kg ($10.11/lb) in July, a 4.6% increase from June 2023, a 14.6% increase from July 2022 and a significant 24.7% increase from the July five-year average. Retail beef prices in July are the highest on record; tight supplies are expected to keep retail prices elevated for the rest of the year and into 2024, barring a catastrophe.

Canadians continue to switch down the beef category, as well as toward discount retailers. Beef demand has historically remained robust during times of economic slowdowns, and it is expected that beef will continue to be on the centre of consumers' plates during this slowdown. The Canadian Retail Beef Demand Index is projected to decline in 2023. The drop in per capita consumption is expected to be driven by reduced available supplies, more so than by higher prices.

Cuts	Retail Price July 2023 (CDN)	Change from June 2023	Change from July 2022	Change from the Five-year Average for July
Beef rib	$26.96/kg	-0.8%	+4.0%	+20.8%
Beef striploin	$32.11/kg	+23.3%	+38.0%	+39.0%
Beef top sirloin	$21.71/kg	+1.3%	+16.7%	+29.4%
Beef stewing cuts	$19.48/kg	-3.5%	+3.7%	+14.2%
Ground beef	$11.19/kg	-2.7%	+5.2%	+14.7%
Total Retail Beef	$22.29/kg	+4.6%	+14.6%	+24.7%
Source: Statistics Canada				

Ground beef is considered the most economical of the beef cuts, and the last stop before consumers switch to either pork or poultry. Retail ground beef prices have climbed every month in the first half of 2023, before settling slightly to begin the second half. Ground beef at retail is 5% higher than a year ago, at $11.19/kg. On the other hand, prices for competing proteins have been considerably more stable than beef. Pork prices at retail have been unevenly stronger in the first half, with considerable softening seen in the first quarter, before a rebound in the second quarter. The larger trend shows a general softening in retail pork prices since July 2021. In July 2023, the average of the four-cut pork price at retail was 6.4% lower than July 2022, at $9.60/kg. The price of chicken at retail was mostly steady until June and July. The average of the four-cut chicken price at retail was a moderate 2.4% higher than July 2022, at $10.18/kg.

Consumers have seen how the price of food pinched their pocketbooks this spring. According to Statistics Canada, food price inflation has started to come down in July on a few fruit, vegetable, grain, protein, and dairy products. The price of lettuce declined by 12% and fresh fruit declined 7%. Relative stability was seen on most other Canadian food guide recommended products, ranging from a 3% decrease to a 3% increase. The exception is pasta products, up a significant 10%.



Sales of ground beef increased across most major markets, while sales of steak showed some weakness in the market. Consumers found relative value at discount retail chains, where they could see their grocery dollars at the meat counter stretch a little further. Stocks of beef in cold storage as of July 1, were 30% below last year, partially on reduced supplies, but also due to strong international demand.

Retail meat ratios have been widened significantly in 2023. Both the beef to chicken and the beef to pork retail price ratios have been running above 2:1 for the entire year. The beef to pork retail price ratio in the first half of the year averaged 2.20:1 with the beef to chicken retail price ratio at 2.13:1. In July, both retail price ratios exploded, with the beef to pork ratio at 2.32:1 and the beef to chicken ratio at 2.19:1. Significant misalignment over the long term could encourage switching at the meat counter.

Supermarket and grocery sales trended higher over the first five months of 2023, then moved sideways in June. Year-over-year, June supermarket sales are up a significant 7.2% to $9 billion, to be the third highest since 2019; behind only May 2023 and the pandemic-induced panic buying in March 2020. Second quarter supermarket and grocery sales are up almost 7% year-over-year, at $27 billion, with total year to date sales up 6% to $53 billion.

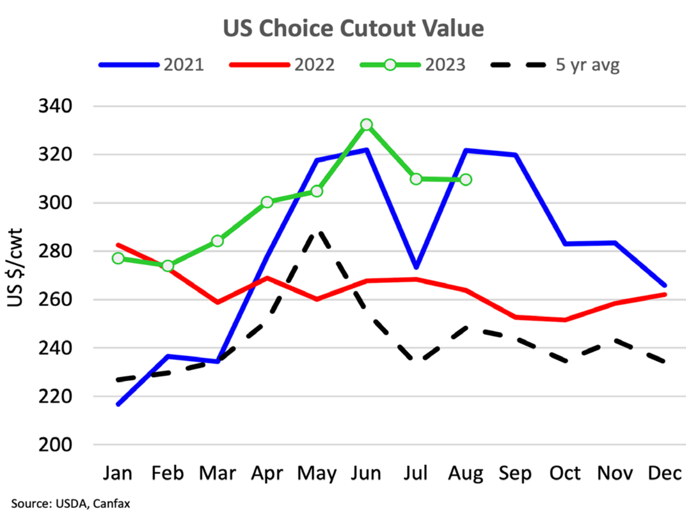
Research was recently conducted in the U.S. to measure consumer awareness of food inflation and determine how consumers respond. Data was gathered between 2018 and

2022 through several surveys, thus incorporating the Covid related factors of food inflation as well as the fundamental supply and demand factors. The first year of data gathering was stable, providing a perfect baseline. Of those surveyed, over 65% of consumers strongly agreed to having noticed an increase in grocery prices in 2022, compared to the year prior. Promotional purchasing and purchasing of store brands were the most popular cost saving strategies by shoppers; 11% chose to purchase less food in 2022, an increase of 5% from 2021.

Wholesale Sector

US cutout values are used as a proxy for the Canadian market due to the lack of available Canadian data. Though not perfect, the integrated nature of the two markets can provide some valuable insights into the current situation of the Canadian boxed beef situation.

US Choice cutouts had a strong first half climbing 20% to USD$332/cwt. Cutouts seasonally eased in July but have moved sideways in August. Summer cutouts are considerably stronger compared to the five-year average. Considering where cutout values are sitting compared to historical levels, sideways movement is not a bad thing.



Higher value middle meats, that is, Rib and Loin primal values have seen considerable volatility year-to-date; with higher prices, this is not entirely surprising. Rib primals ended 2022 on the up swing but couldn't maintain that momentum moving into 2023. A spring peak was established at USD$504/cwt. A significant summer rally has Rib primals 4% higher than in the spring and looking for more. Loin primals peaked at the same time as Rib primals, at USD$490/cwt but haven't been able to get their footing since. Loin primals are now within 5% of their annual low of USD$369/cwt with no indication of a rebound in sight. Choice end meats have been significantly more stable; both Round and Chuck trended inconsistently higher peaking in June and again in late summer.

In the first half of the year, cutout values were supported by flank steaks, which increased almost 80% between its January low and its July high, reaching a top near USD$960/cwt. However, since July, flank steaks have nose-dived, and are now within reach of their annual lows. Striploin and top butt values also strengthened in the first half of the year to USD$1,050/cwt and USD$534/cwt respectively, surpassing highs previously set in the summer of 2021. Both of these cuts have also eased since the beginning of July. Striploin values closely mirrored flank steaks and have dropped below their January lows. Top butt values eased, though they managed to find a mid-summer bottom, rebounding slightly through August.

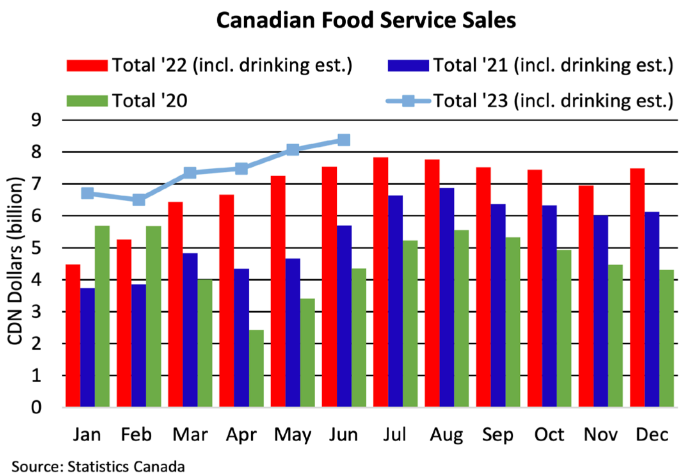
Perhaps the biggest surprise is the movement of 50% trim, which doubled in value between January and mid-May to USD$199/cwt. However, since mid-May, there has been a significant downward trend, as 50% trim shaved off 67% of its value. A noticeable bump occurred early in the summer, as consumers procured burgers for the July first holiday celebrations and summer grilling.

Tight Western Canadian feedlot supplies and a significant 31% premium for fed steers compared to last year have pulled fed cattle forward for slaughter. These cattle are producing carcasses that are on average, 9 lbs lighter than last year, again with significant regional disparities. In the West, steer carcass weights are 15 lbs lighter than last year but are 14 lbs heavier in the East.

Canadian cattle grading AAA or Prime as a percentage of all A grades took a hit this year, as these lighter steer carcasses weights had a direct impact on grading quality. Year-to-date AAA and Prime grading is down 2% from last year to 72% of all A grades. Regionally, carcass quality is higher in the East, at 77% of all A grade carcasses making AAA or Prime. In the West, only 71% of A grade carcasses are grading AAA or Prime.

Food Service Sector

Monthly total restaurant sales have increased nearly every month this year, with only a slight dip in February. Arguably, this can be attributed to the three fewer days in February, as average daily sales in February were $232 million 4% higher than January's 30 days (not including New Year's Day). By June, daily average daily sales were over $279 million. This really speaks to the confidence that Canadian consumers have in the state of the economy, that total restaurant spending can increase with so much chatter about rising costs and the potential for a recession to begin sometime this year.

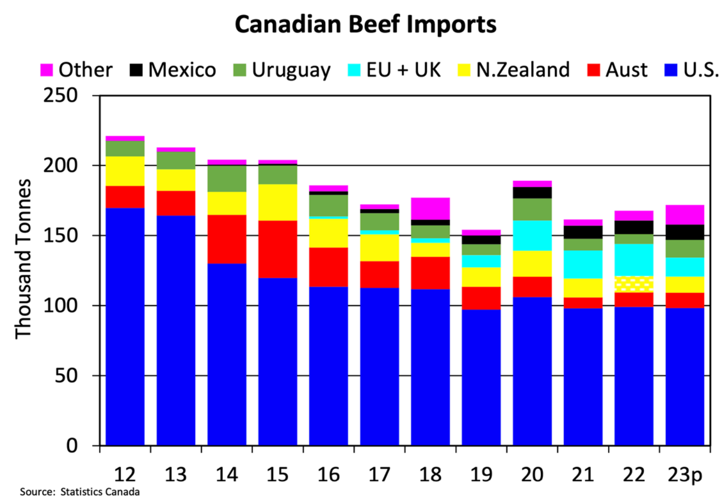


Total food service sales in 2023 remained robust in the face of continued higher overall inflation. For the first six months of 2023, food sales totaled $44.5 million, a solid 18% increase from 2022. Limited service eating places accounted for 46% of all first half sales, down a slight 1% from 2022, This was fully offset by full-service restaurants, which accounted for 44% of sales, a 3% bump from last year. Drinking places saw a substantial 5% bump in sales, due to a lackluster winter in 2022. Drinking placed accounted for 8% of all food service sales in the first half.

Statistics Canada's latest CPI report found that food purchased from all restaurants in July 2023 increased 6.1% from July 2022. Food purchased from fast food restaurants (+6.5%) out-paced sit-down restaurants (+5.8).

Imports and Distribution

In July 2023, beef and veal imports were up 33% in volume from last year and 20% higher than the five-year average for July. Year to-date, beef imports were up 6% in volume and 5% in value from last year. Annual import volumes are expected to be up a slight 2% from last year.



Until inflationary pressures re-align with Bank of Canada expectations, or Canadian's get used to paying higher beef prices, imports of more economically priced trims and grinds from international markets will make their way onto grocery store shelves.

Year-to-date import volumes declined from the EU (-24%), the UK (-73%), Australia (-1%), and Argentina (-79%), and increased from the U.S. (+4%), New Zealand (+4%), Uruguay (+62%), Mexico (+25%), and Brazil (+428% on small volumes). Imports from Uruguay, Mexico, and Australia are all projected to increase in 2023 with softer demand from China as their economic struggles and regional weather shifts impacting production. Imports from our other less frequent trading partners is expected to double on small volumes.