

British Columbia Egg Hatchery Association

March 18, 2023

BC Farm Industry Review Board
Chicken Live Price Supervisory Review Panel
Via Email:

Dear Supervisory Review Panel:

BC Chicken Marketing Board Long Term Chicken Pricing Recommendation

The BC Egg Hatchery Association (BCEHA) takes the position that the BC Farm Industry Review Board (BCFIRB) should not accept the British Columbia Chicken Marketing Board's (Chicken Board) recommendation on a new long-term pricing formula (the Recommendation) as the Chicken Board and the BC Broiler Hatching Egg Commission (the Commission) process has collectively failed to address key marketing policy objectives of the Supervisory Review outlined in the April 2020 Joint Terms of Reference.

The Chicken Board and the Commission agreed to the Terms of Reference to introduce a Long-Term Pricing Recommendation, the scope of which includes:

- A review of factors affecting the pricing of regulated products by the Chicken Board and the Commission, including defining:
 - “reasonable returns to chicken growers and hatching egg producers through verified costs of production or other mechanisms.”
 - “processor competitiveness in the Canadian market for chicken.”
 - “reasonable margin for hatcheries.”

BCEHA submits that to fully understand their collective impact on the industry, all objectives of the terms of reference must be calculated and assessed on an integrated basis given the inter-relationship of the priorities. The production cost increase effects for broiler growers cannot be fully evaluated and verified until reasonable hatchery margins are established.

It is therefore BCEHA's position that it would not be sound marketing policy to implement the Recommendation until the hatchery margin issue has been quantified and included in the live price formula. When this is completed, BCFIRB and downstream stakeholders will have the opportunity to assess the combined impact of the Recommendation on the industry and consumers. Developing and implementing the individual pricing elements from the individual sectors in isolation and without a clear view of the total impact prioritizes producers and growers over the interests of hatcheries and processors.

Hatcheries in nearly all other jurisdictions across Canada have been receiving margin increases on an annual basis over the last number of years. The Ontario hatchery margin has increased by 5.8 cents / chick over the last 2 years (A-175 and A-187) while the BC hatchery margin only increased by 2.9 cents over the same time frame. The hatchery margin increase provided to BC hatcheries in October 2022 was the first increase BC Hatcheries had received in approximately 12 years.

BC hatcheries have acted in good faith and withheld requests for additional increases given their concerns for the magnitude of the live price differential vs Central Canada. This has been a difficult and costly choice for BC hatcheries who have incurred significant incremental costs related to the Avian Influenza (AI) outbreaks, COVID restrictions, flooding and heat domes in the province.

The BCEHA is of the understanding that the Chicken Board and the Commission were to develop comprehensive pricing recommendations that balanced the needs and requirements of all stakeholders. The Recommendation combined with the implementation of Hatching Egg COP has only served hatching egg producers and broiler growers at the expense of downstream stakeholders.

1. What, if any, concerns should BCFIRB be aware of with regards to the process followed by the Chicken Board in developing the long-term pricing recommendation?

The Chicken Board's and the Commission's process to develop their long-term pricing recommendations has focused exclusively on grower and producers returns at the expense of others. As a result, The Board and Commission have not adequately considered the needs and impact on hatcheries, processors, and other downstream industry stakeholders.

From our perspective, the Board and the Commission have created cost of production (COP) based pricing formulas for the benefit of the producers and growers, without consideration for BC hatcheries and processors who bear 100% of the market risk from high prices and overproduction.

The Recommendation characterizes the Commission as having established a "verified/ reasonable returns-based mechanism" for hatching egg producers. However, the Chicken Board's process and analysis has failed to account for the fact that the Commission has not simultaneously fulfilled its obligation to "ensure hatcheries receive a reasonable margin for hatching egg services" and its impact on live price. It is important to understand that Ontario hatchery margins are currently 55% higher than BC and as such the impact of future hatchery margin adjustments should be considered material to the BC live price. Furthermore, Ontario hatcheries receive annual margin adjustments to offset inflationary cost increases and adjustments.

By not taking giving due consideration to the required increase in hatchery margin, the chick price and therefore the live prices that are calculated in the Chicken Board's analysis are understated. As such the Chicken Board is not able to fully determine the impact of the Recommendation on the competitive position of BC processors, and other downstream industry stakeholders and consumers.

Industry discussions have recognized BC as a high-cost production environment that requires stakeholders to share the cost burden of operating in the province to maintain a

viable industry. These discussions have also recognized that one sector cannot act to the detriment of others and there is a need to work together for the industry to be successful. The process undertaken by the Chicken Board and the Commission has failed to recognize the sector independencies to ensure the financial burden is shared equally across all stakeholders. Without a clear understanding and quantification of future hatchery margins, it is impossible to assess the impact of the Recommendation on other stakeholders, how the industry cost burden will be shared, or the demand/supply equation for BC chicken.

The BC hatcheries have been working with the Commission and Serecon on a process to develop a fact-based approach that supports future hatchery margins increases. The BCEHA embarked on process to establish metrics that might be used to establish future hatchery margins increases. Data has been collected and is now being updated to include 2023 cost increases, which will be shared with the Commission. The approach is fully transparent, with verifiable data that is compiled by a third party.

That being said, based on the BCEHA's analysis of the data combined with an increased understanding of what is included in the Ontario hatchery COP, it has become evident that simply updating major cost centre values for inflation will not be an adequate approach. It has become very clear that the current BC hatchery margin does not include a complete cost base, does not consider the capital employed, replacement costs, risk profile, and other elements that are included in the BC hatching egg COP, the BC broiler COP and the Ontario hatchery margin.

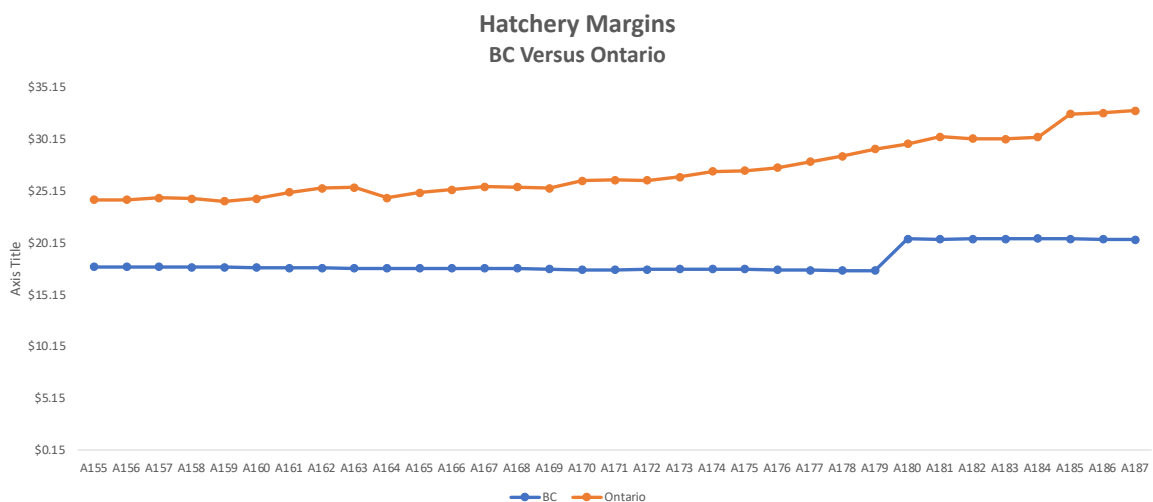
The interdependence of priorities among stakeholders is required to ensure that BC consumers do not pay the highest chicken costs in Canada requires that the Board approach their analysis and recommendations on a consolidated basis. By not doing so, the hatcheries will be at risk of being the last stakeholder to pursue their "fair return" and ultimately further increasing the live price differential between BC and Ontario.

2. Are there any outstanding sound marketing policy concerns with the Chicken Board’s long-term pricing recommendation BCFIRB should be aware of? If yes, provide a rationale for those concerns.

Given the current state of BC live pricing and the unprecedented live price differential with Central Canada, the BC hatcheries have not aggressively pursued increases in the hatchery margin as it was recognized that doing so would further exacerbate the live price differential vs Central Canada and thereby reduce demand and allocation requests for BC chicken by processors. A live price for BC Chicken that is 15% higher than Central Canada will result in less demand for BC chicken; less demand for BC chicken means fewer chicks through our hatcheries, which ultimately makes BC hatcheries less efficient and less competitive as chicks become more costly.

While it is recognized that coincident with the introduction of the Commission COP in A-179 there was a modest increase in the BC Hatchery Margin, Ontario hatchery margins are still 55% higher than BC hatchery margins, including the BC Margin increase. The graph below shows that the hatchery margin gap between Ontario and BC was \$0.065 / chick in 2019 and has now grown to \$0.12 / chick in 2023.

Exhibit 1



The historical BC hatchery margin differential with Ontario is summarized in Table 1 below and since A-155 has almost doubled.

Table 1

Hatchery Margin Differential (Cents per Chick)

Period	A-155	A-156	A-157	A-158	A-159	A-160	A-161	A-162	A-163	A-164	A-165	A-166	A-167
BC	17.82	17.83	17.80	17.79	17.77	17.73	17.72	17.69	17.69	17.68	17.68	17.67	17.67
Ontario	24.30	24.29	24.47	24.38	24.12	24.40	24.99	25.39	25.47	24.46	24.95	25.27	25.55
Difference	-6.48	-6.46	-6.66	-6.59	-6.35	-6.67	-7.27	-7.70	-7.78	-6.77	-7.27	-7.60	-7.88

Period	A-168	A-169	A-170	A-171	A-172	A-173	A-174	A-175	A-176	A-177	A-178	A-179	A-180
BC	17.65	17.61	17.51	17.52	17.56	17.60	17.60	17.58	17.54	17.49	17.47	17.47	20.51
Ontario	25.50	25.38	26.13	26.18	26.14	26.49	27.02	27.09	27.37	27.95	28.51	29.17	29.68
Difference	-7.85	-7.77	-8.61	-8.66	-8.58	-8.89	-9.42	-9.51	-9.84	-10.46	-11.03	-11.70	-9.17

Period	A-181	A-182	A-183	A-184	A-185	A-186	A-187
BC	20.49	20.52	20.52	20.56	20.53	20.49	20.45
Ontario	30.37	30.19	30.13	30.32	32.56	32.67	32.88
Difference	-9.88	-9.67	-9.61	-9.76	-12.03	-12.17	-12.43

While it is recognized that there are differences in services provided by the hatcheries in Ontario and BC, the magnitude of the margin gap cannot be ignored. Given BC has higher costs than Ontario in every other aspect of the value chain, it is not logical to expect BC Hatcheries to sustain this level of return for their services.

As well, the introduction of the Hatching Egg COP has increased the BC chick price gap with Ontario, with BC chick prices significantly below Ontario (Exhibit 2).

Exhibit 2

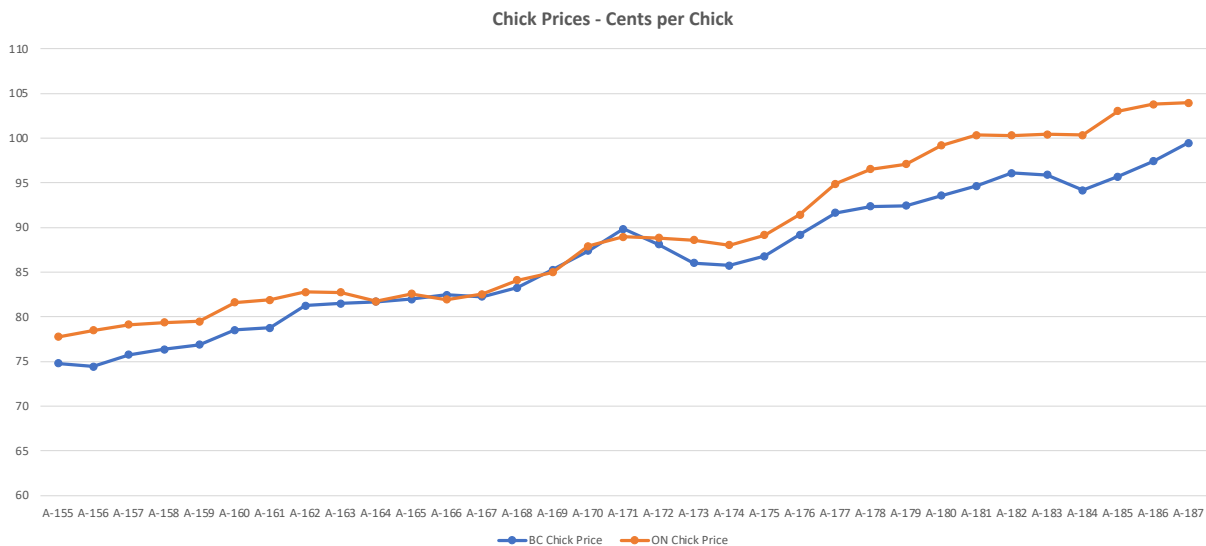


Table 2

Chick Price Differential (Cents per Chick)

Period	A-155	A-156	A-157	A-158	A-159	A-160	A-161	A-162	A-163	A-164	A-165	A-166	A-167
BC Chick Price	74.78	74.41	75.75	76.37	76.87	78.52	78.77	81.26	81.49	81.7	81.97	82.43	82.24
ON Chick Price	77.75	78.49	79.12	79.34	79.47	81.62	81.9	82.78	82.73	81.72	82.57	81.92	82.52
Difference	-2.97	-4.08	-3.37	-2.97	-2.60	-3.10	-3.13	-1.52	-1.24	-0.02	-0.60	0.51	-0.28

Period	A-168	A-169	A-170	A-171	A-172	A-173	A-174	A-175	A-176	A-177	A-178	A-179	A-180
BC Chick Price	83.25	85.27	87.39	89.84	88.09	86.03	85.75	86.76	89.17	91.63	92.35	92.43	93.56
ON Chick Price	84.08	84.97	87.88	88.95	88.84	88.58	88	89.16	91.44	94.86	96.53	97.09	99.17
Difference	-0.83	0.30	-0.49	0.89	-0.75	-2.55	-2.25	-2.40	-2.27	-3.23	-4.18	-4.66	-5.61

Period	A-181	A-182	A-183	A-184	A-185	A-186	A-187
BC Chick Price	94.64	96.07	95.88	94.16	95.68	97.42	99.45
ON Chick Price	100.33	100.3	100.4	100.32	103.01	103.78	103.94
Difference	-5.69	-4.23	-4.52	-6.16	-7.33	-6.36	-4.49

This is not due to BC having the lowest cost base, but rather because BC hatchery margins have not increased for many years – keeping chick costs artificially low and the BC live price competitive. The understatement of the BC hatchery margin flows directly into the BC live price and as a result, the estimates of BC live price in the Recommendation are understated. It is not sound policy to implement the Recommendation without understanding the level of increase that will be required on the hatchery margin and its potential impact on the live price differential and overall demand and allocation of BC chicken.

The BCEHA is also concerned that the COP formula proposed in the Recommendation now contains a number of calculations and assumptions that are different than what is being used in the Commission COP. Through the Broiler COP review process, changes were made to specific calculations (depreciation, maintenance, interest on working capital, indexes, etc.) and it is not clear how these changes will be handled within the Commission’s COP going forward.

In addition, the BCEHA has real concerns that the Chicken Board is positioning the Recommendation as a starting point with further changes to be made going forward (eg labour). It is not clear how these changes may or may not cascade into the Hatching Egg COP given they may have different starting points and assumptions in their respective models. It is our experience that this approach will result in gravitating to the higher cost “model” which is not in the best interests of the BC Industry.

The Recommendation has also identified certain items as “efficiency factors” in the submission. Those same items that are identified as “efficiency factors” in the Broiler COP are defined as cost indexes or used as updating mechanisms in the Commission COP. It is not sound marketing policy to allow for these principles to be defined and used differently in different sectors of the industry or to cherry pick and choose what works best.

We do not dispute that the Commission and the Chicken Board had numerous meetings discussing their respective pricing formulas, but the results show that there are many areas where they have been inconsistent and taken very different approaches (formulas, assumptions, indexing). This clearly suggests they have not been working to a common approach, but rather in silos, without consideration for the impact on hatcheries, processors downstream stakeholders and consumers.

The difference in methodologies creates further complications for the BCEHA as we now move forward on a Hatchery COP model. Without agreement of common methodologies, the Hatchery COP model has the potential to introduce additional inconsistencies and costs into the process.

The supervisory pricing review is intended to be comprehensive in its approach, addressing the inter-relationship of the priorities of all the stakeholders with an eye to grow and expand the industry. Introducing the Chicken Board’s COP, which is the most critical element of the review without having addressed hatchery margins is neither fair to the process nor consistent with the initial terms of reference.

Regardless of the ownership structure, the BC hatcheries, have acted in good faith by not pursuing margin increases because we understood that price increases would lead to decreased demand for BC chicken and increase the demand for less expensive chicken from other jurisdictions. We also recognized the need to balance the financial burden of operating in BC across industry stakeholders, a theme which seems to be lost on other industry participants. In hindsight the hatcheries should have been much more aggressive

in demanding the hatchery margin issue be resolved with the implementation of the Hatching Egg COP.

In closing and to summarize our position:

- The Board and Commission have worked in silos and do not recognize the need for consistent approaches between the sectors of the industry.
- The analysis within the Recommendation is not accurate as it fails to recognize or quantify the pending increase required in the BC Hatchery Margin.
- The process to develop the Recommendation failed to recognize the need to address the priorities and objectives of the Terms of Reference on an integrated basis given their inter-relationship and interdependence.
- The COP embedded in the Recommendation contains formulas and assumptions that are different than the Hatching Egg COP. These differences have not been assessed or quantified for their potential impact on the Hatching Egg COP or the industry in general.
- The analysis with the Recommendation pays no regard to the basic fundamental economic tennet that higher prices decrease demand and places 100% of the market risk of overproduction on hatcheries, processors and downstream stakeholders.

We therefore respectfully submit that BCFIRB not approve the implementation of the Recommendation without factoring in a Hatchery Margin review and increase. While some progress is being made, we believe there is still work to be done to get to an acceptable pricing structure for the entire industry. It is our recommendation that the interim formula be maintained until such time as the hatchery margin is resolved and the pricing formulas are considered, and their impact assessed on a consolidated basis.

Respectfully submitted on behalf of the BC Egg Hatchery Association,

Ryan Whitmore

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President

BC Egg Hatchery Association

c. BCEHA Members