

Wheat Processing in Canada



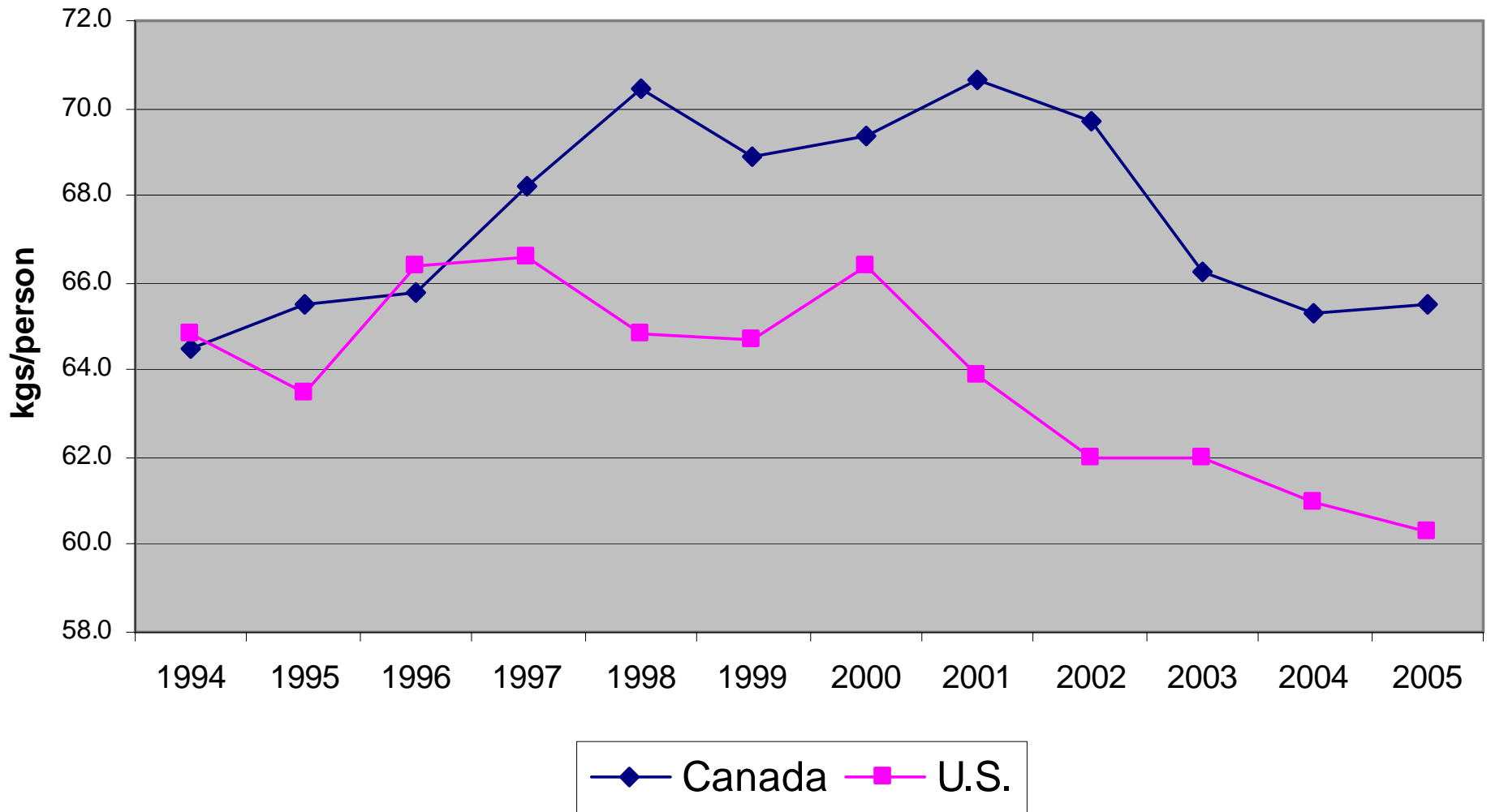
Introduction

- Competition
- Demand Trends – Processing Driver
- Investment
- Location
- Freight
- Industry and Pricing
- Summary

Competition

- Since Free Trade in 1991 value-added processing of wheat and durum in Canada has changed dramatically:
 - two price wheat system is gone
 - U.S./Canada border is completely open
 - changed freight environment
- No restrictions or duties/tariffs exist to importation of:
 - U.S. wheat, U.S. durum
 - U.S. wheat products including flour, mixes, doughs, baked goods & pasta

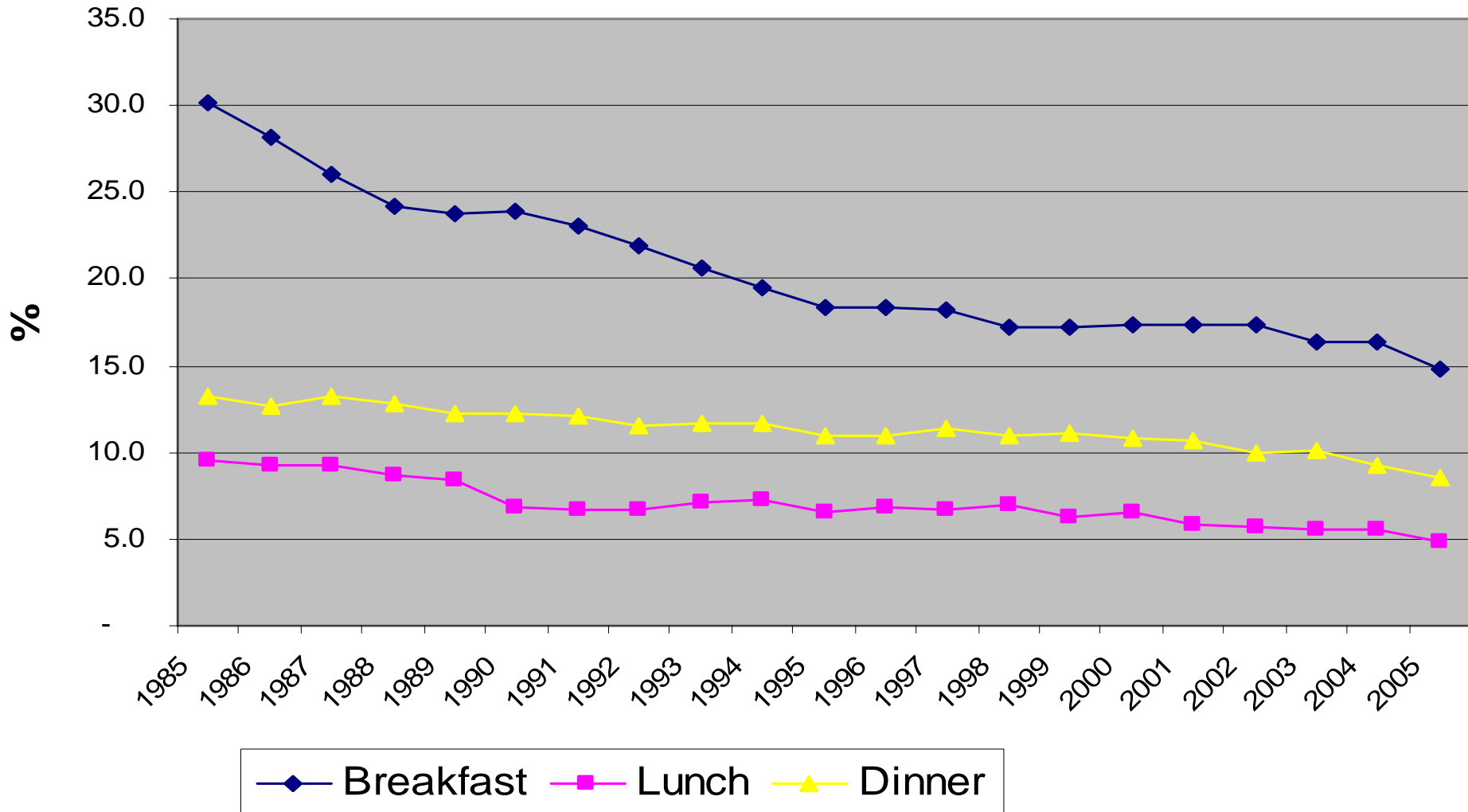
Per Capita Flour Consumption



Flour Consumption Alarm

- Low carb diets have shouldered the blame, BUT
- U.S. consumption of principle product - bread - is declining down 1.2% last year.
- This is a long term trend....

% of In Home Meals that include bread in the U.S.



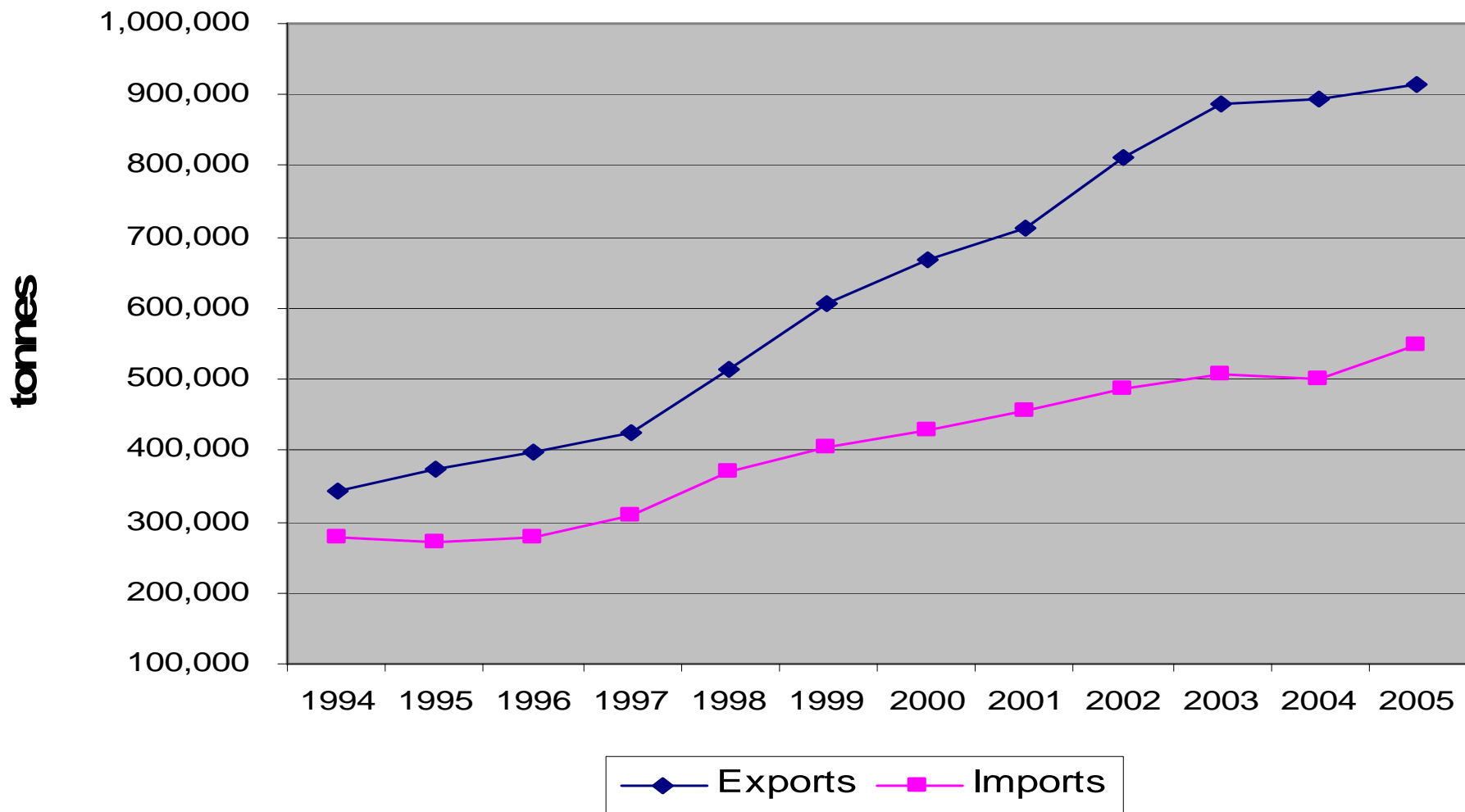
Industry Response

- U.S. has formed “The Foundation for Advancement of Grain-Based Foods” to promote wheat-based products. Budget at US\$4 million annually.
- Canada is working on a Generic Promotion initiative, involving the CWB, the BAC, millers, and pasta manufacturers. Budget at Cdn\$150,000 annually.

Canadian Effort

- Grains - They're Essential - www.grainsessential.ca
- Provide information about health benefits of grain based foods to
 - dietitians
 - nutritionists
- Encourage them to pass this message to consumers
- Back to School Campaign Sept. 2006
 - Information provided to school programs about grain-based foods

Canada & U.S. Trade in Wheat-based Products



Processing Driver

- Market demand - Domestic consumption and Export sales are the only drivers of increased value added processing
- Investors must identify market for product and meet the consumer demand
- Wheat marketing system does not change market demand dynamic

Investment in Value-Added

- Producers are completely free and able to participate as investors or shareholders in value-added processing
- No legal or regulatory barriers to additional investment in flour milling
- Technology is readily available to anyone willing and able to invest the capital cost.
- All participants must be subject to the same economic principles and obligations
- Absolute value is not an issue, the competitive price is

Value-Added Fundamentals

- Level of investment required is high
 - Requires significant level of start-up investment
- Processing is highly capital intensive
 - Technology is standard, little uniqueness
- Dominated by large international players
- Relatively low margin business
 - Extremely transparent to downstream customers
- Heavy cash flow requirements

Location, Location, Location

- **Origin Mill**
 - Located in proximity to where raw material is produced
 - Transports its finished product over long distance to its customers
 - Limited quality origination
- **Destination Mill**
 - Located in close proximity to its customer base
 - Transports its raw material over long distances
 - Flexible quality origination

Value-Added Incentive Program

Origin Mill Program

- Farmers who deliver their wheat, durum and malting barley directly to mills and malting plants in Western Canada will receive a \$3 per tonne premium under the VIP.
- The VIP was designed to promote farmer-direct delivery to value added processors in Western Canada.
 - **2003/04 (1st Year of program)** **207,000 tonnes**
 - **2005/06** **241,000 tonnes**

Who Pays the Freight? The Value of Grain

- Why are freight costs to port position deducted from cash tickets when you deliver to a mill or malt house?
- The value of grain at port (Vancouver/PNW) or gateway (T. Bay/Duluth/Mpls.) is always higher than the value of grain inland.
- This is true of all grains and oilseeds and special crops.
- This is true of Canada and the U.S.

Difference in Value

- The difference in the value between the port or gateway and inland is easily determined.
- The difference in value is result of the spatial/geographic price difference in the locations.
- That location or geographic difference in value is the freight cost to move grain over that spatial divide.

Price Difference

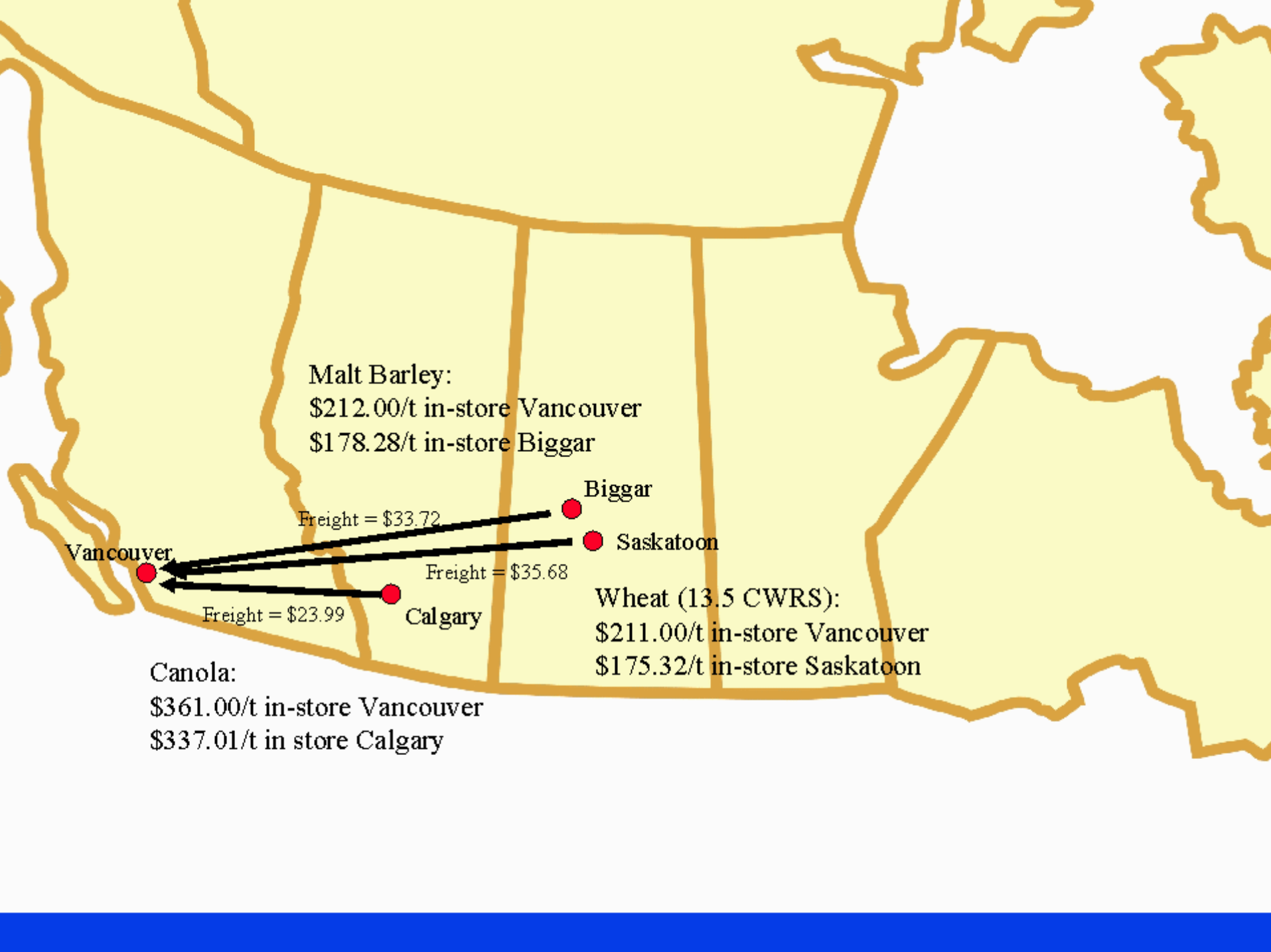
- Freight costs increase with distance.
- So price decreases the further a producer or processor is located from the port.
- The further the producer/processor is from port the lower the value of his grain.
- This applies to all grain - board or non-board.

Terminology

- In Canada for wheat, durum and barley the freight appears visibly on the cash ticket.
- For other grains, such as canola freight is captured in the “basis”.
- In the U.S. freight is not shown on the cash ticket.

Processor Effect

- The processor can thus buy raw material at lower prices in Western Canada than elsewhere.
- This is what attracts processors to locate in Western Canada. Lower cost raw material.
- If there was no geographical relationship why would processor locate in Western Canada if they had to pay port price anyway?



Malt Barley:
\$212.00/t in-store Vancouver
\$178.28/t in-store Biggar

Freight = \$33.72
Freight = \$35.68
Freight = \$23.99

Vancouver

Biggar

Saskatoon

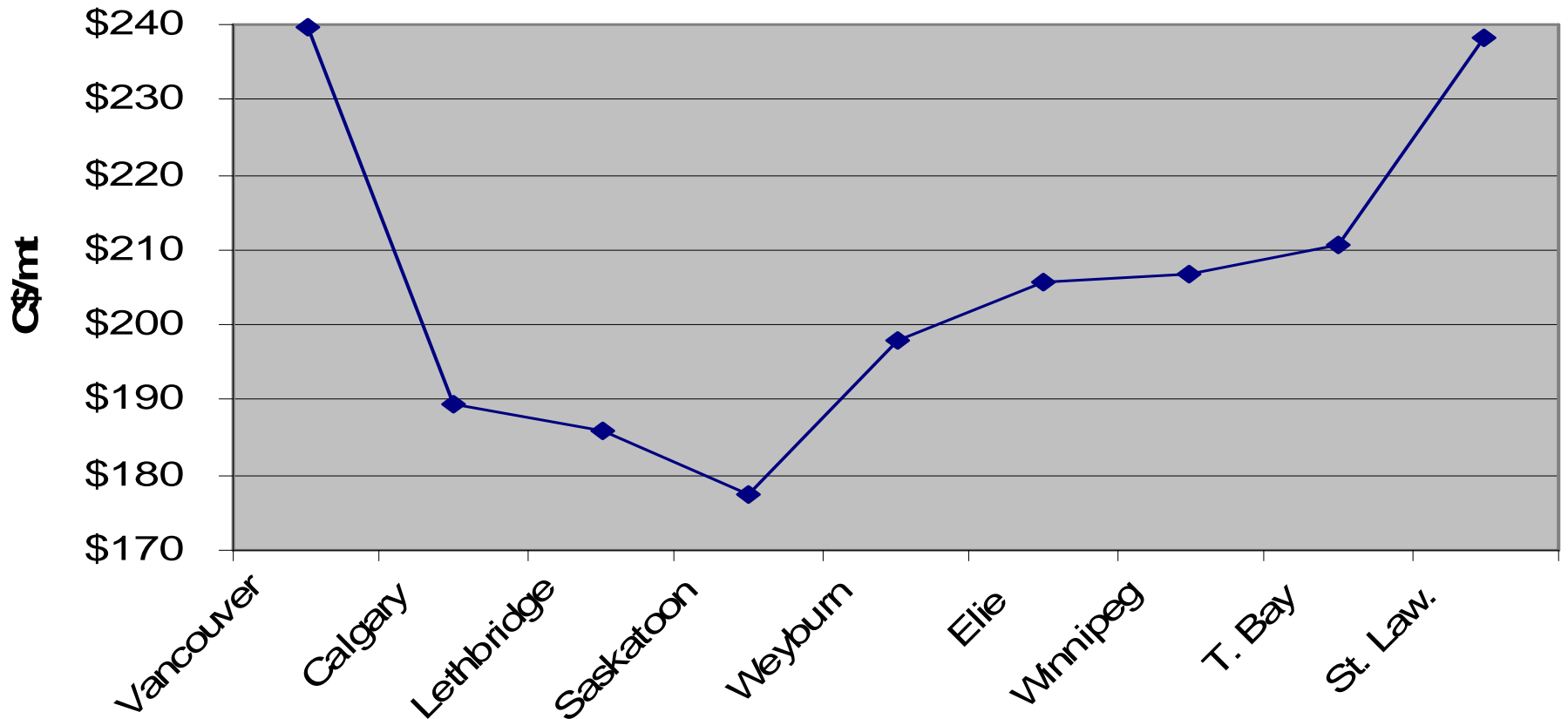
Calgary

Wheat (13.5 CWRS):
\$211.00/t in-store Vancouver
\$175.32/t in-store Saskatoon

Canola:
\$361.00/t in-store Vancouver
\$337.01/t in store Calgary

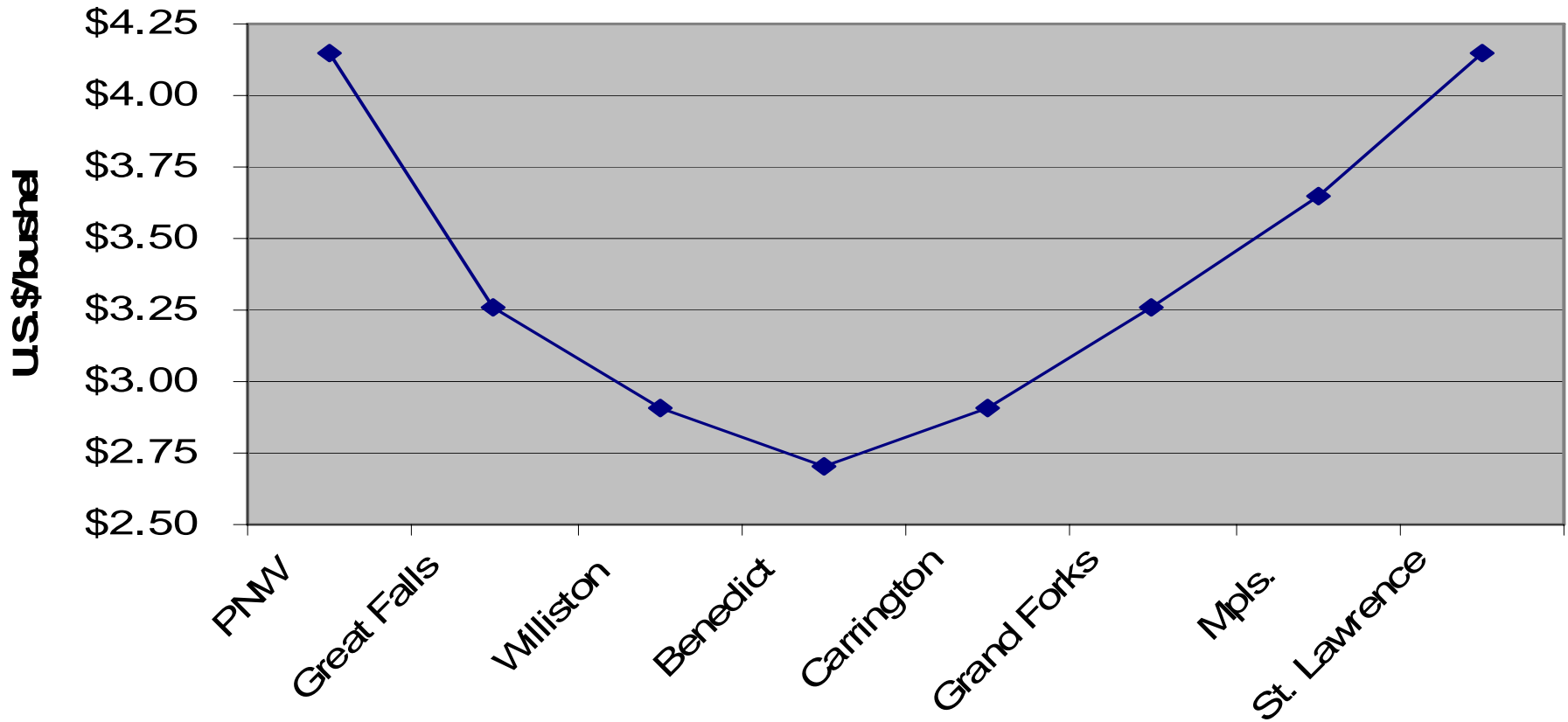
Difference in Value

Price Levels - 1 cwr 13.5%



Difference in Value

Price Levels DNS 14%



Canadian Mill Volumes

- Domestic and North American market is generally a premium market
- 2.7 million tonnes of Western Canadian wheat and durum is processed annually.
- 400,000 to 450,000 tonnes of Ontario wheat

Canadian Milling Industry

- Milling Capacity - 2006
 - Wheat - 44 mills - 10,931 flour tonnes per day (14,425)
 - Durum - 11 mills - 1,300 semolina tonnes per day (1,750)
 - % of Canadian Capacity
- ADM Milling 39.2%
- Horizon Milling 18.1%
- Dover Industries 9.0%
- P&H 7.8%

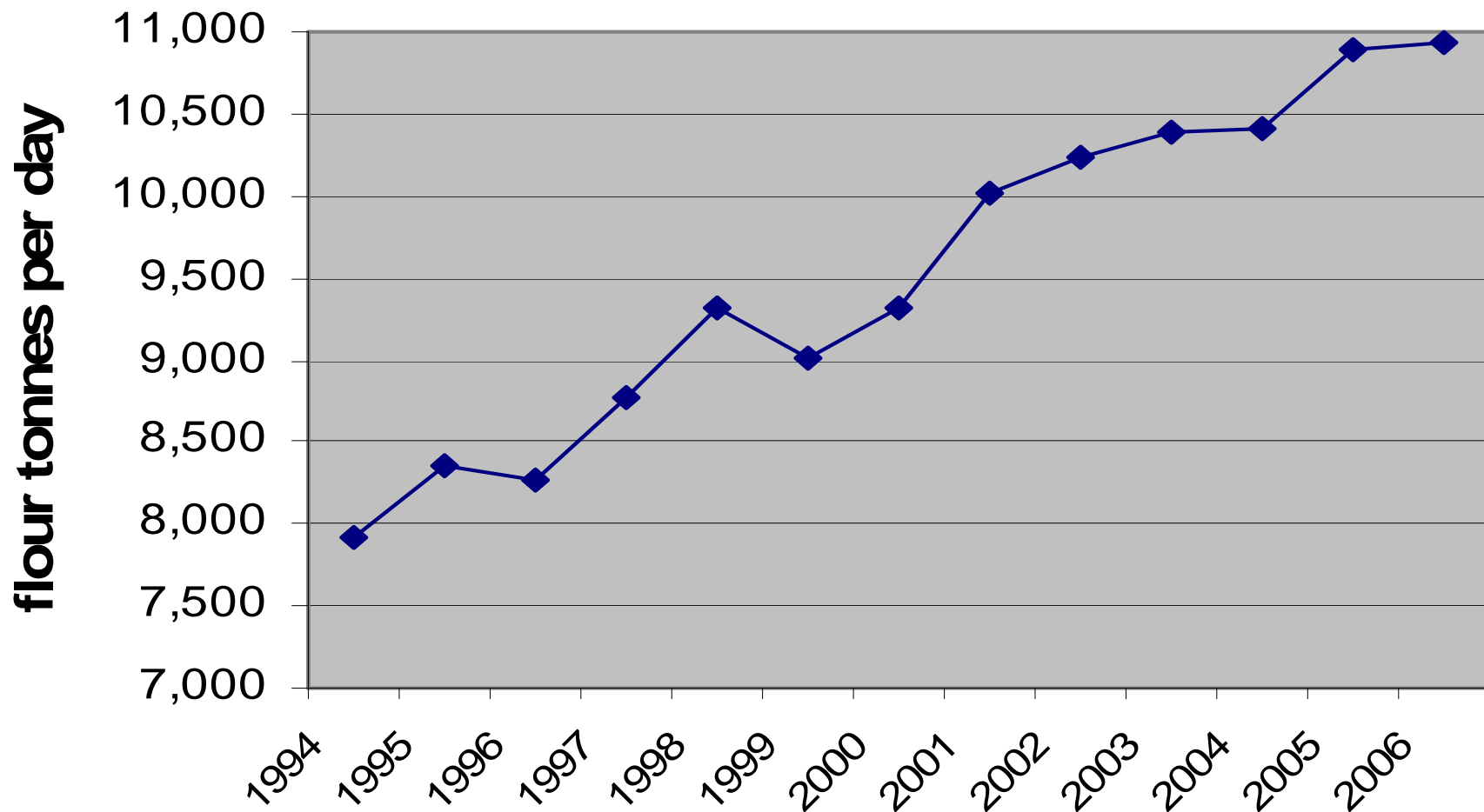
Canadian Wheat Mills - Regional

2006 % of Canadian Capacity

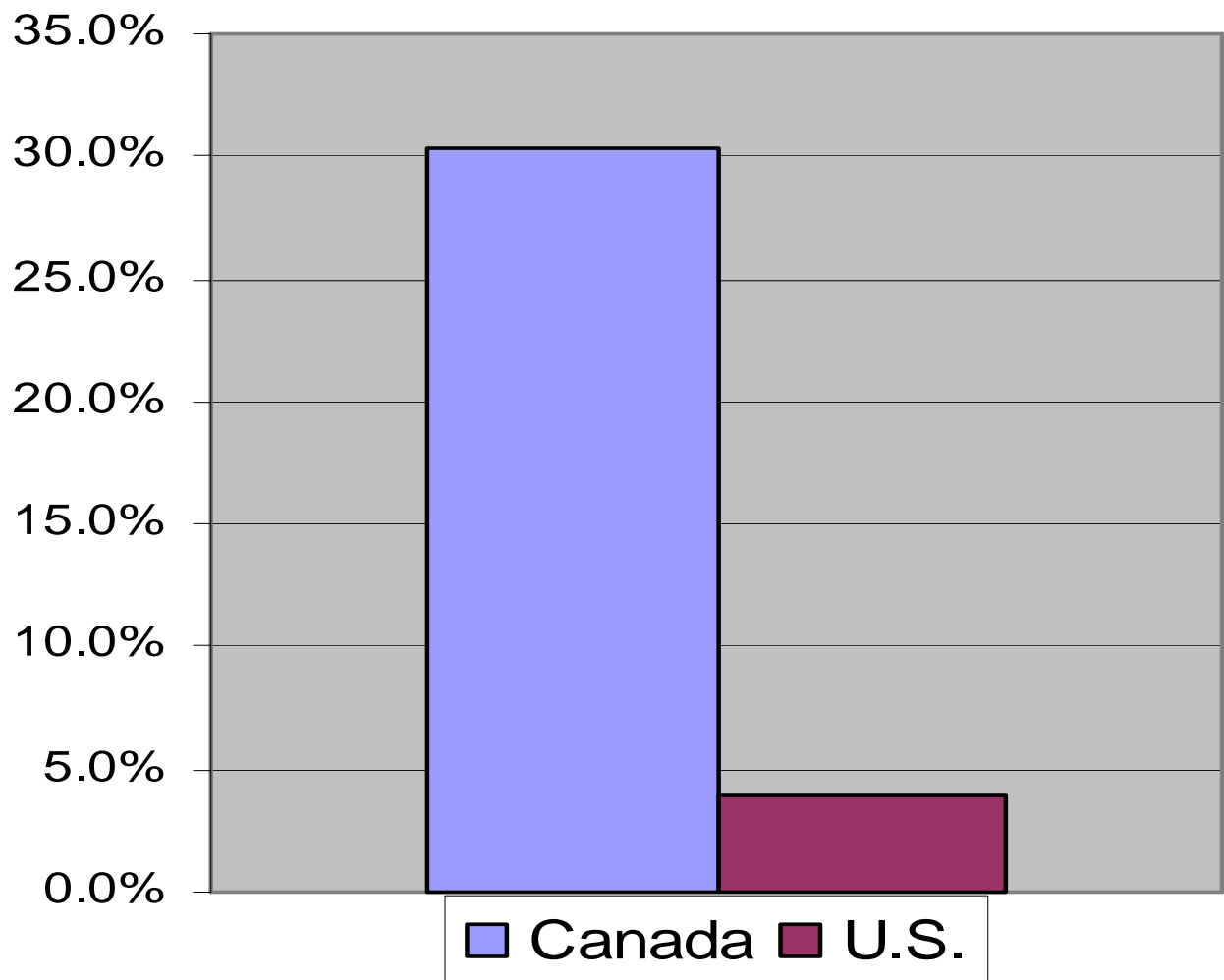
● West Total	19	34.0%
– Alberta	6	17.3%
– Saskatchewan	5	9.2%
– Manitoba	4	3.1%
– B.C.	4	4.4%
● East Total	25	66.0%
– Ontario	19	40.1%
– Quebec	5	22.9%
– Nova Scotia	1	3.0%



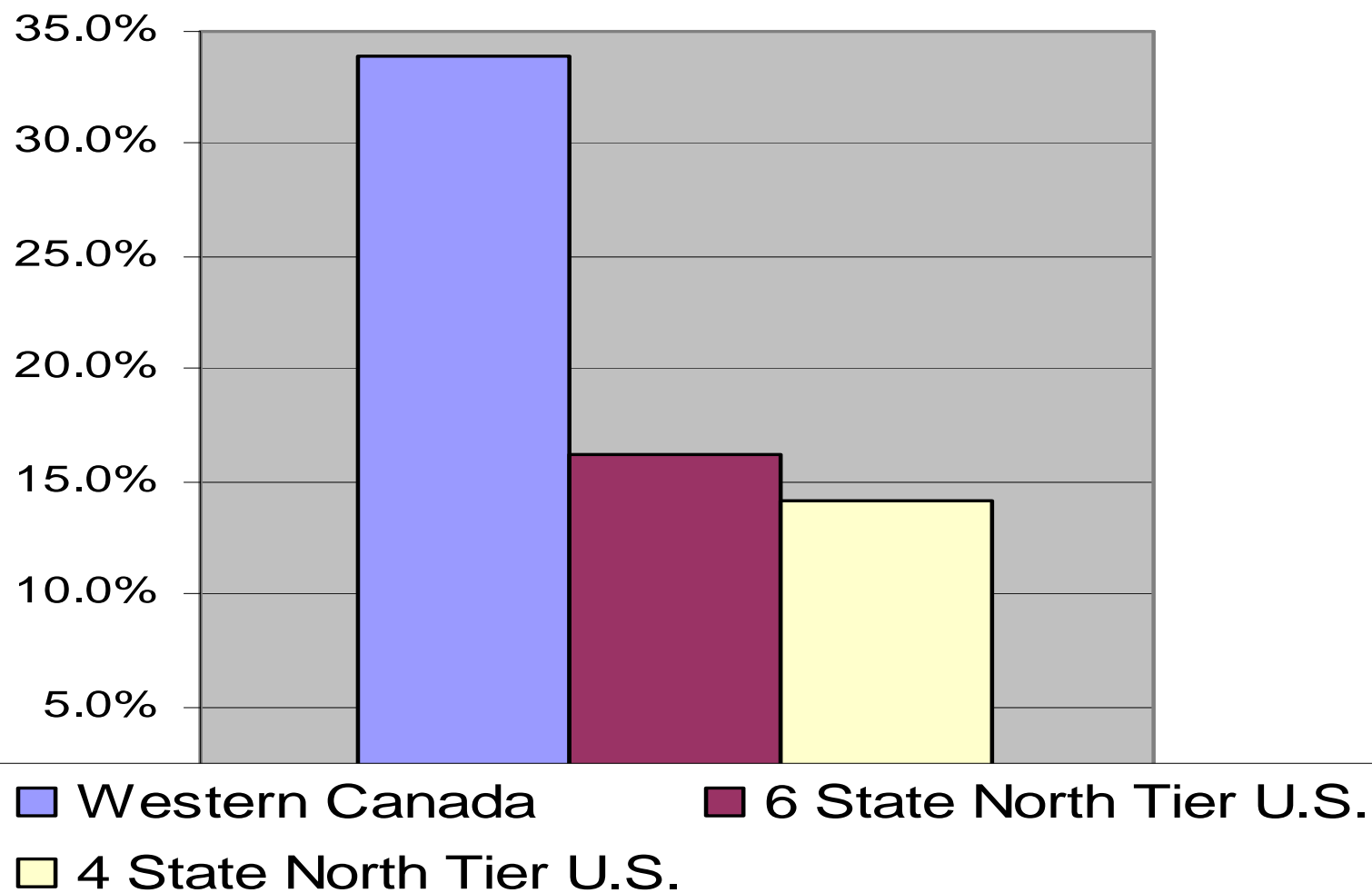
Mill Capacity in Canada



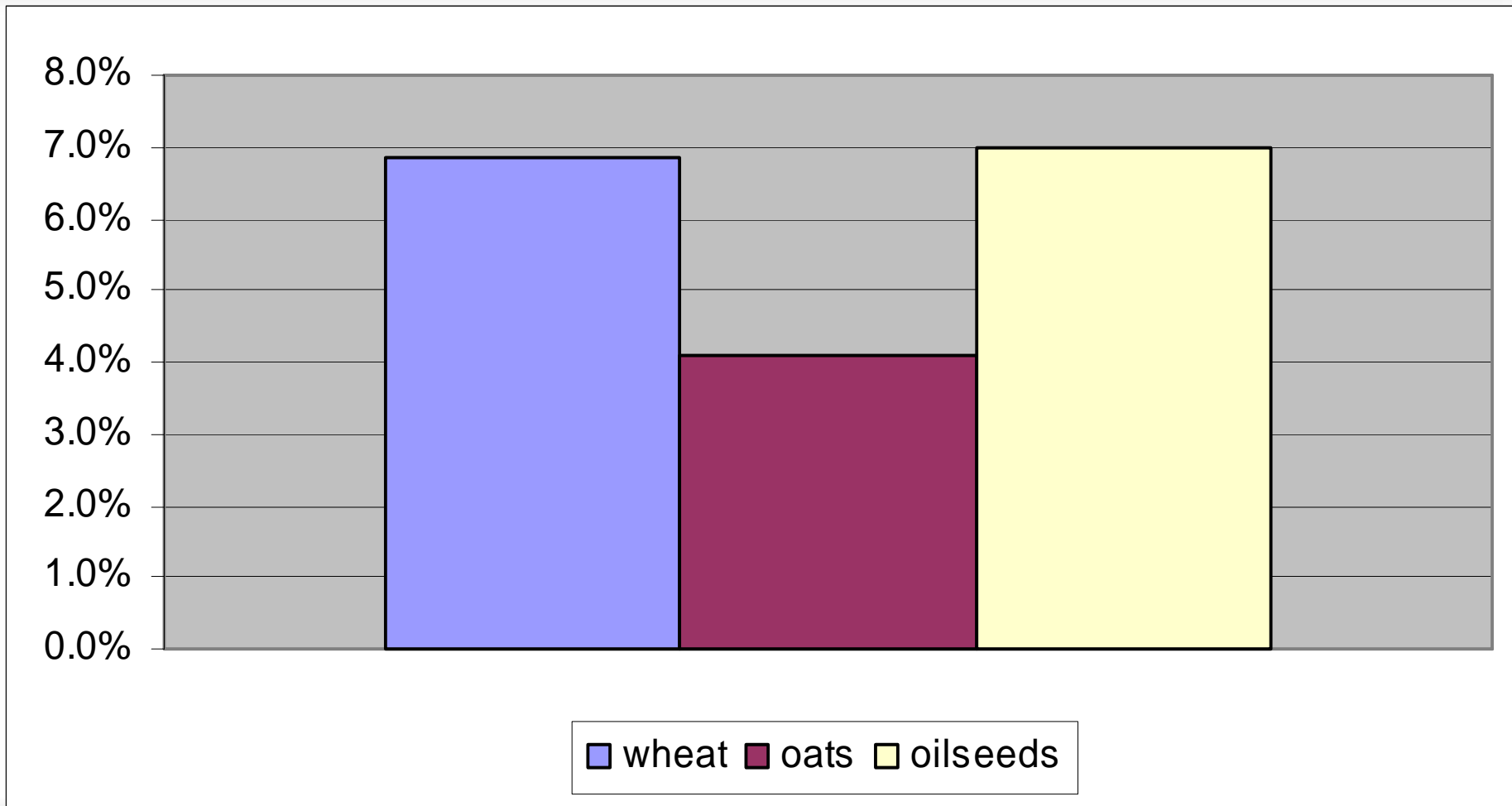
Milling Capacity Change 1995-2005



Mill Capacity Comparison 2006



Capacity Changes 2001/02 - 2006/07



CWB Pricing Objective

- Strike balance conducive to value-added processing and optimizes producer returns
- Pricing is at the highest possible value to the Pool accounts while respecting the Canadian processor's need to have pricing that is market based and North American competitive at all locations in Canada
- Price too high - market is lost to U.S. imports
- Price too low - reduces producer returns

Pricing Principles

- Provide price mechanism which is North American competitive at all locations in Canada on a North/South and East/West basis
- Fully take into account North American price discovery principles - guided by visible Minneapolis and West Coast values and prevailing commercial freight rates in U.S. and rates in Canada
 - Mills E of TB pay full commercial frt fwd to mill location
 - Mills in WC have full U.S. equivalent commercial frt cost deducted

CWB Services to Value-Added

- Supply assurance for premium market
 - One-stop purchasing
 - Risk management
 - Forward pricing
 - Sourcing flexibility
 - Transportation flexibility
 - Professional assistance
- 
- Technological assistance - CIGI, GRL, CMBTC, etc

Small Processor Program

- To encourage development of small niche-market processing ventures on the Prairies.
- Must be processed product.
- Evaluation will review type of product, target market, production facilities, capacity, product packaging and package size.
- Guideline for program is 500 tonnes maximum.

NGC Initiative

- NGC must be located in the Prairies and process grain into finished product.
- Farmers can deliver up to limit of share delivery obligation when called for by the NGC.
- Farmers must deliver directly to the NGC processor.
- Farmer owners may choose pricing option which would allow them to capture the North American sales value.
- Price may be higher or lower than pooled returns.

Value-Added Facts

- Market demand – consumption & exports drives value added processing.
- Customer location & economics determine processor location.
- U.S. is the single most important commercial customer for Canadian value added processing.
- Canadian exports of wheat value added products are strong and growing.
- Wheat processing has seen healthy growth over the past years.

CWB Position on Value-Added

- Support positive change that will work to grow value-added processing of wheat, durum and barley in Canada.
- Will not support changes that are detrimental to farmers' returns
- Wheat and durum is priced to return the highest possible value to the Pool accounts while respecting the processor's need to have pricing that is market based and North American competitive at all locations in Canada



QUESTIONS???