Dairy Farmers of Ontario
42nd Annual Meeting

Fairmont Royal York Hotel, Toronto
January 9, 2008

Remarks for Policy & Issues Panel Discussion
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1. I'll start with some general observations about the competitive environment that we all live and work in and that is a constant in business and that will only intensify over the next few years.

2. Then I'll turn to the food marketplace and the challenges and issues we all face – both as processors and producers in maintaining a dairy footprint in that marketplace – in supermarkets and in restaurants and the foodservice sector.

3. I then must address the issue of the new cheese regulations that were published and promulgated by the Federal Government on Boxing Day, December 26 and that pose an immediate and serious problem to dairy processors and our customers.

4. Finally, if I have time I'll have some concluding comments on specific issues we are facing in the food regulatory environment – health claims / probiotics.

5. We all marvel daily as we look around at the products and services that weren't available to us 10 years ago:

   - A pocket-sized personal computer and communications device – the Blackberry – invented and manufactured by Canadian entrepreneurs.
   - Email
   - Safer and more efficient cars
   - Google
   - MRI machines
   - Cheap air travel
   - Digital photo frames
   - Cleaner air and lakes
   - 25 different kinds of food at shopping malls in any city in most developed countries

6. Our society and economic system rewards those individuals and organizations who bring new products and services to consumers. And it abandons those that ignore the consumer. What happened to typewriters? What happened to VCRs? What happened to Polaroid's? The Canadian icons of a previous generation – Eaton's, Seagram's, Massey Ferguson, Hiram Walker, Inco, Stelco, and Dominion stores are gone. I can assure you that none of DPAC/ATLC's members like Saputo, Agropur, Parmalat, Kraft or Gay Lea want to see their businesses or products pushed to the side or disappear.

7. The major trend that shapes the way we do business already impacts our economy and most industries, including the food industry. That is consumer participation in the way products are conceived, manufactured, sold, purchased and monetized.

8. Consumer products whether they are cars, electronic games, personal care products, music or foods are being created, designed, made and marketed, and priced to suit an ever increasing complex set of consumer needs and demands. The successful businesses that serve those needs and demands first define what the modern consumer wants and needs, and how it can be made as efficiently as possible and then how best to market and deliver that product (or service) at a price that the consumer will pay.

9. And that process takes place in a world of technological development and rapidly changing consumer habits, interests and demands occurring.

10. Take the music industry. In the 1990's compact discs (CD's) produced, marketed and sold in retail outlets was the mainstream method for music artists, production companies and consumers to conceive, make, distribute and purchase music. In only a few years music consumers have radically altered this traditional business so that now (and especially over the past 24-36 months) most music is now obtained online and consumed via personal IPODs and other devices. Even mainstream artists no longer need to work through production/record companies but produce their product and make it available online. Some artists actually no longer charge for their music but accept voluntary payment and many report actually, that on an independent basis, they are making more money now than they did in the old system.

11. OK! How do these general observations relate to the food industry and particularly to Canada's dairy industry? The first relevant observation would be that other than copyright considerations, the rapid and profound change that came in the music industry example, came in an industry that had little if no regulatory /government oversight and regulation. On first blush the food industry may appear to be the exact opposite – an industry closely and tightly regulated and controlled by government policies, rules and regulations and therefore such a rapid evolution could not take place. That might be argued is still the situation in some parts of the dairy industry particularly at the producer level – BUT it certainly isn't at the level DPAC/ATLC's members do business in and in the rest of the food industry and with the food and beverage products that dairy processors must compete against – in terms of nutrient content, composition and value to the consumer. We may want to come back to this during the question period.

12. A second observation is that for dairy processors the consumer or customer is not necessarily the individual shopper in the grocery store or the patron of a restaurant or fast-food outlet. The direct customer is the grocer or retailer or foodservice distributor or restauranteur – and those significant businesses and economic powers play a major role in driving what modern dairy products need to be and how they are presented and priced to the consuming public. So let's examine those two markets for a few minutes. Those are the businesses that must relate directly to the consumer to survive and prosper and where increasingly the dairy footprint is threatened.

13. Let's start with the food retail industry. It makes up $88 billion in sales in 2006.

- A recent BMO Capital Markets survey of the Canadian grocery industry says Wal-Mart's aggressive expansion into food retailing this year is going to transform the industry.
- "The entrance of the Wal-Mart Supercentre is similar to implementing a process to deregulate a regulated industry," says the study, entitled The Canadian Grocery Industry: The Shadow of the Giant Comes to Life.
- Right now, the big three grocery retailers in Canada are Loblaws, with 32 per cent of the market; Sobeys, with 15 per cent, and Métro Inc., with 12 per cent. Wal-Mart has only four per cent.
- The study predicts Wal-Mart will give the big three – and, in particular, industry leader Loblaws – a real run for their money. And in Canada supermarket sales represent 88 per cent of the total retail food market.
- "We believe Wal-Mart could potentially double its food market share to eight or nine per cent in the next 10 years," it says.
- "The game-changing event in the industry is Wal-Mart's aggressive expansion into the food retail segment with its Supercentre banner," says the study, adding that Wal-Mart, which arrived in Canada only in 1994, will have 31 Supercenters in operation in Canada by the end of this month and 90 by the end of 2010.
- "With the Supercentre comes Wal-Mart's attempt to win market share by introducing price discipline to an industry that has yet to pass along to Canadian consumers the benefit of improved efficiency in the form of lower retail prices."
- In other words, Wal-Mart will be cutting prices in an attempt to win customers, forcing other retailers to follow. "(Loblaws) should remain the market leader in five years," says the study, "but with less market share and lower profitability. The other incumbent grocers, Métro and Sobeys, will also be under intense pressure from Wal-Mart and Loblaw as it continues to pound the market with lower prices."
- Does the consumer like lower prices? Canadian consumers certainly do: The BMO study quotes a survey that shows low prices are even more important to Canadian shoppers than they are to Americans and drives who are the winners and losers in the food industry.

14. The second market for dairy sales and consumer demand is the restaurant and food service sector. That industry has paid a lot of attention to our sector and again especially on pricing. In a public release last month, their trade association said:

- The Canadian Dairy Commission's decision to increase industrial milk prices by only 1% in 2008 is a step in the right direction to bring the exorbitant cost of Canadian dairy products down to earth for consumers and restauranteurs.
- The Canadian Restaurant and Foodservices Association (CRFA) met with the CDC in November to argue for a price freeze on industrial milk, the price of which has skyrocketed by 54% since 1994, or nearly double the rate of inflation. Over the same period, the cost of milk production has risen by just 1.5%, due to increased productivity, said the CRFA.
- "With unjustifiable price hikes over the last many years, dairy products have priced themselves off the menu. Restauranteurs want to grow the market for Canadian dairy products, but it can't be done when these products are among the most expensive in the world" said the CRFA.

- The CDC has made a responsible pricing decision for 2008, but we have a long way to go before we can turn the tide of declining dairy consumption in Canada" according to the CRFA.
- The release goes on to refer to the fact that per capita milk consumption has fallen by more than 16 per cent over the past 20 years, and is expected to drop another 12 per cent by 2020, according to a report prepared for Agriculture and Agri-Food Canada.
- "Focusing on a shrinking domestic market is not a long term strategy for success," concludes the CRFA. "As one of the dairy industry's largest customers, the restaurant and foodservice sector has an interest in ensuring the long-term viability of Canada's dairy industry."

So those are dairy processors' direct customers/consumers. DPAC/ATLC's members must compete daily with each other to sell their products to these customers. In my view Canada's dairy industry is not positioning itself strongly to maintain its current footprint in those markets – let alone prosper into the future. In the discussion period we may want to come back to this issue of a dairy footprint that I have mentioned.

15. Now let's move to the new cheese regulations and the lack of consumer/customer participation in creating these new regulations. Last fall a coalition of major Canadian stakeholders came together to bring to the attention of the Government serious concerns with the regulatory initiative to radically alter Canada's cheese regulations. That coalition was quarterbacked by the Canadian Chamber of Commerce and other national organizations including health advocacy groups like the Chronic Disease Prevention Alliance of Canada. Most importantly from our vantage point the food manufacturing and retail industries represented by the Retail Council of Canada, the Canadian Council of Grocery Distributors and the Canadian Restaurant and Food Service Association are part of that coalition.

16. These customers of ours are concerned with:

- The inadequate consultation process on this issue
- The negative impact on the health of Canadians as a result of implementation of the proposed regulations
- The negative impact on all Canadian consumers as a result of implementation of the proposed regulations
- The detrimental impact that the proposed regulations will have on Canadian competitiveness and innovation
- The proposed regulations are in direct violation of Canada's international trade obligations
- The proposed regulations are not enforceable and do not propose a realistic enforcement mechanism.

The coalition expressed these views to the Government and publicly through November and December. But apparently to no avail.

17. Just two weeks ago on Boxing Day the Government went ahead and promulgated a final set of radically new cheese regulations that all domestically made and imported cheeses must conform to by this December. DPAC/ATLC now is closely examining and assessing those regulations and their impact. The Government itself in their description of the new regulations and their impact concluded that:

    - The Agency (Canadian Food Inspection Agency) acknowledges that there will be impacts on some cheese processors regarding the cost of the amendment to infrastructure, reformulation, and the negative impact on innovation and investment.
    - The amendments have the potential to cause negative environmental effects.
    - The Agency acknowledges that additional costs could be incurred by both industry and government as registered domestic processors and licensed importers are responsible to develop good manufacturing and importing practices which include documented programs and maintenance of records.
    - Some processors may have products with compositions that will experience a higher degree of impact as a result of the amendments. Other additional costs to cheese processors as a result of the amendments include one-time costs to modify labels as well as costs related to infrastructure, adjustments, reformulation, innovation and competitiveness. Some processors may experience a reduction in cheese yields as a result of these amendments. Reduced yields will lead to increased costs.
    - It is anticipated that increased ingredient costs incurred by cheese processors will be passed along the food value chain, which includes retailers and food service. As prices in the retail market are not regulated, the incremental price increase from processors to retailers may be 100%.
    - Stakeholders in the food service sector may experience increased pressure to utilize substitute products in place of cheese in order to meet the evolving needs of Canadian consumers.
    - It is anticipated that increased ingredient costs incurred by cheese processors will be passed along the food value chain. As a result, consumers may experience an increase in the cost of cheese and food products containing cheese at the retail level.
    - Higher cheese prices may result in a reduced demand for varietal cheeses and food products containing cheeses.

18. And finally, in its final analysis and conclusions, it was publicly declared by the Government that: “There is no evidence to suggest there is any difference in (nutritional) quality between cheeses made with milk and some other milk products versus cheeses made wholly from milk.” And regarding enforcement, the Government confirms there is no analytic testing methodology. So the answer to the real question of why these regulations were proceeded with was not publicly declared by the Government.

19. Therefore would we not all agree the difficulty that exists and that we have in explaining to those customers /consumers I have described why these new regulations were put in place and why there are all these negative impacts? I’m sure our panel discussion afterwards will return to that issue.

20. I think I have already run over my allotted time and therefore will leave to another time comments on the other issues DPAC/ATLC is managing, like the use of health claims and the term probiotic, etc.

21. I look forward to the discussion on the comments I have made – especially the issues of whether the dairy industry's priorities are directed towards consumers or other priorities, how serious is the loss of the dairy footprint that is occurring in the marketplace and of course the problems that we face as an industry now that the new cheese regulations have been promulgated.

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