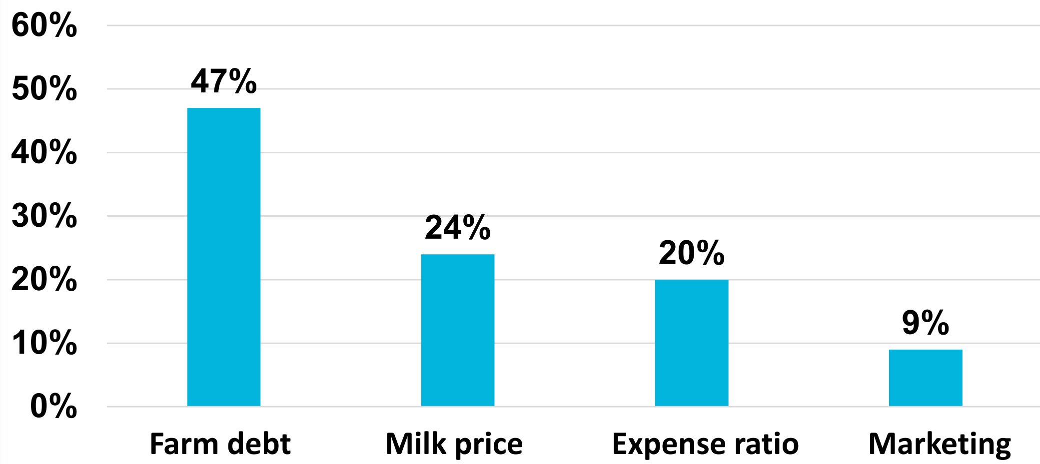
Dairy Business Environment:
Impact on the Business Management

Gilbert Lavoie, Agr. and Nicolas Jobin, Agr.

What are the issues of the dairy sector?

Answers of 58 participants in 2018

2018 Annual Meeting: Trends and issues in agriculture

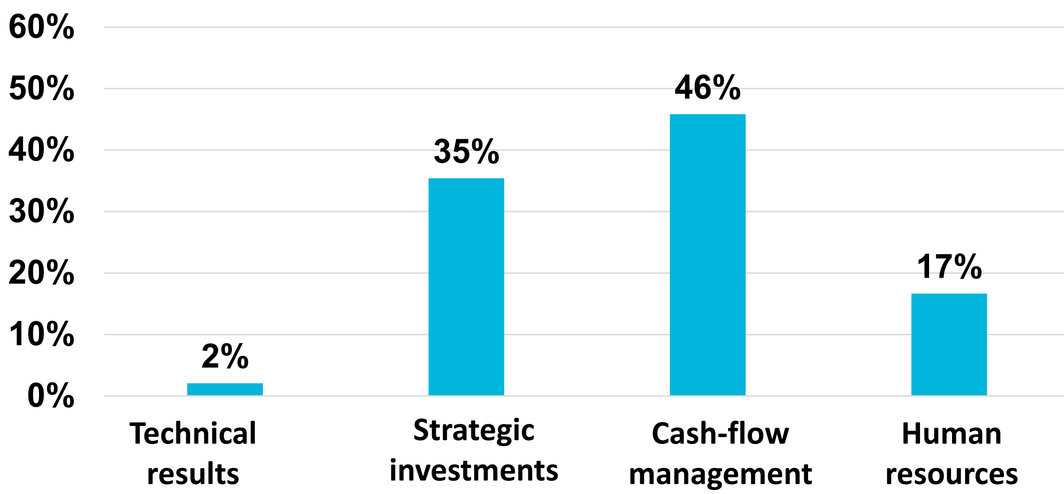


Source: 2018 Annual Meeting Conference: Trends and issues in agriculture

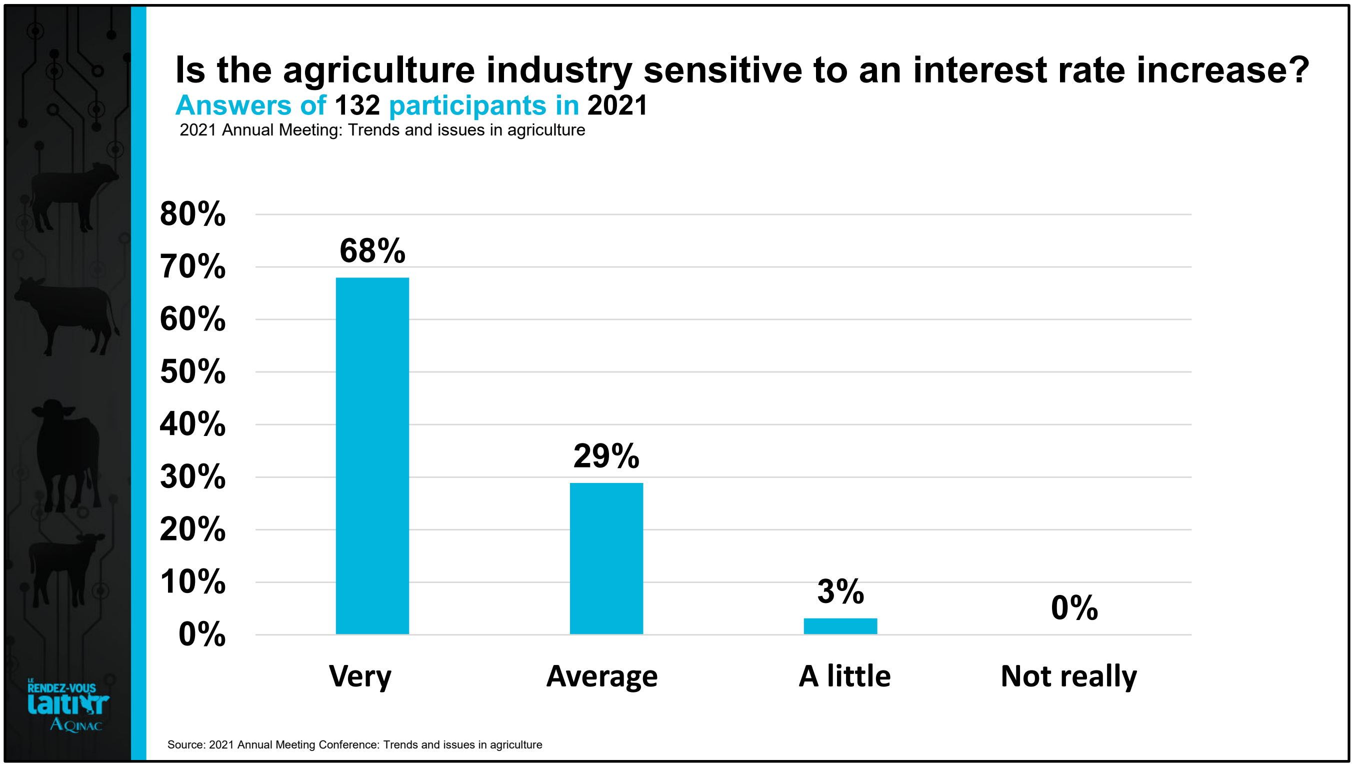
What are the issues of the dairy sector?

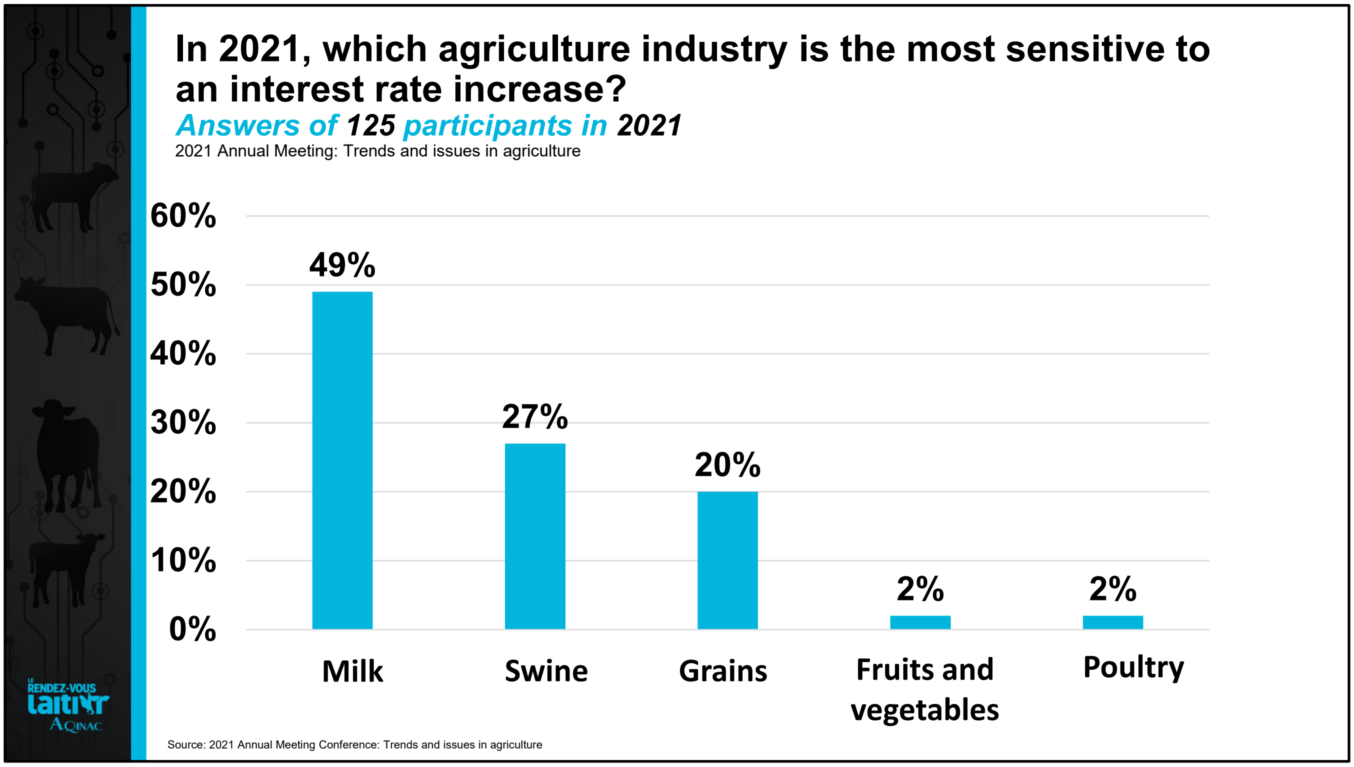
Answers of 48 participants in 2019

2019 Annual Meeting: Trends and issues in agriculture



Source: 2019 Annual Meeting Conference: Trends and issues in agriculture


Is the agriculture industry sensitive to an interest rate increase?
Answers of 132 participants in 2021
2021 Annual Meeting: Trends and issues in agriculture
80%
70%
60%
50%
40%
30%
20%
10%
0%
68%
29%
3%
0%
Very
Average
A little
Not really
Source: 2021 Annual Meeting Conference: Trends and issues in agriculture


In 2021, which agriculture industry is the most sensitive to an interest rate increase?
Answers of 125 participants in 2021
2021 Annual Meeting: Trends and issues in agriculture
60%
50%
40%
30%
20%
10%
0%
49%
27%
20%
2%
2%
Milk
Swine
Grains
Fruits and vegetables
Poultry
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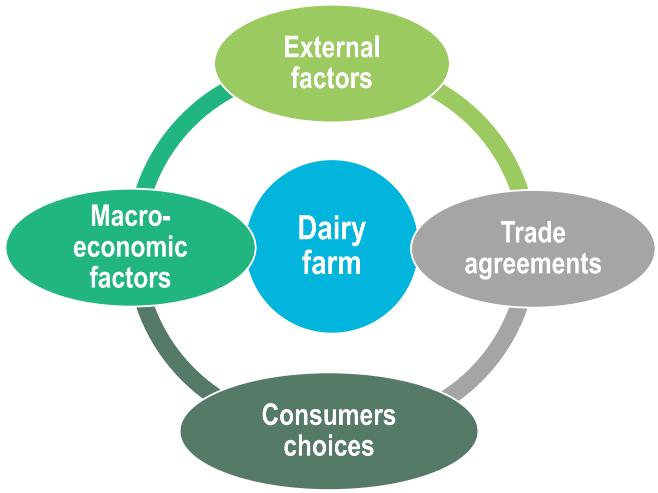
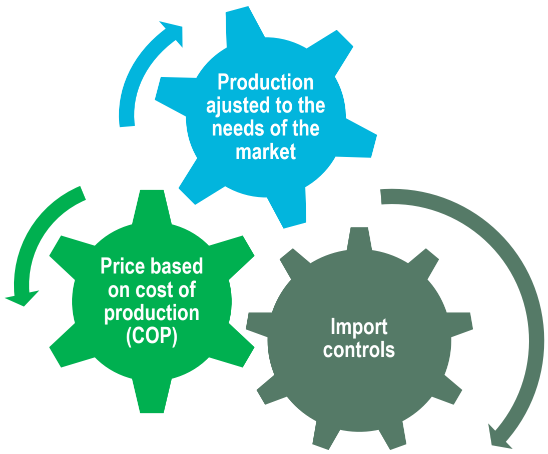
Source: 2021 Annual Meeting Conference: Trends and issues in agriculture

Business Environment
Dairy sector

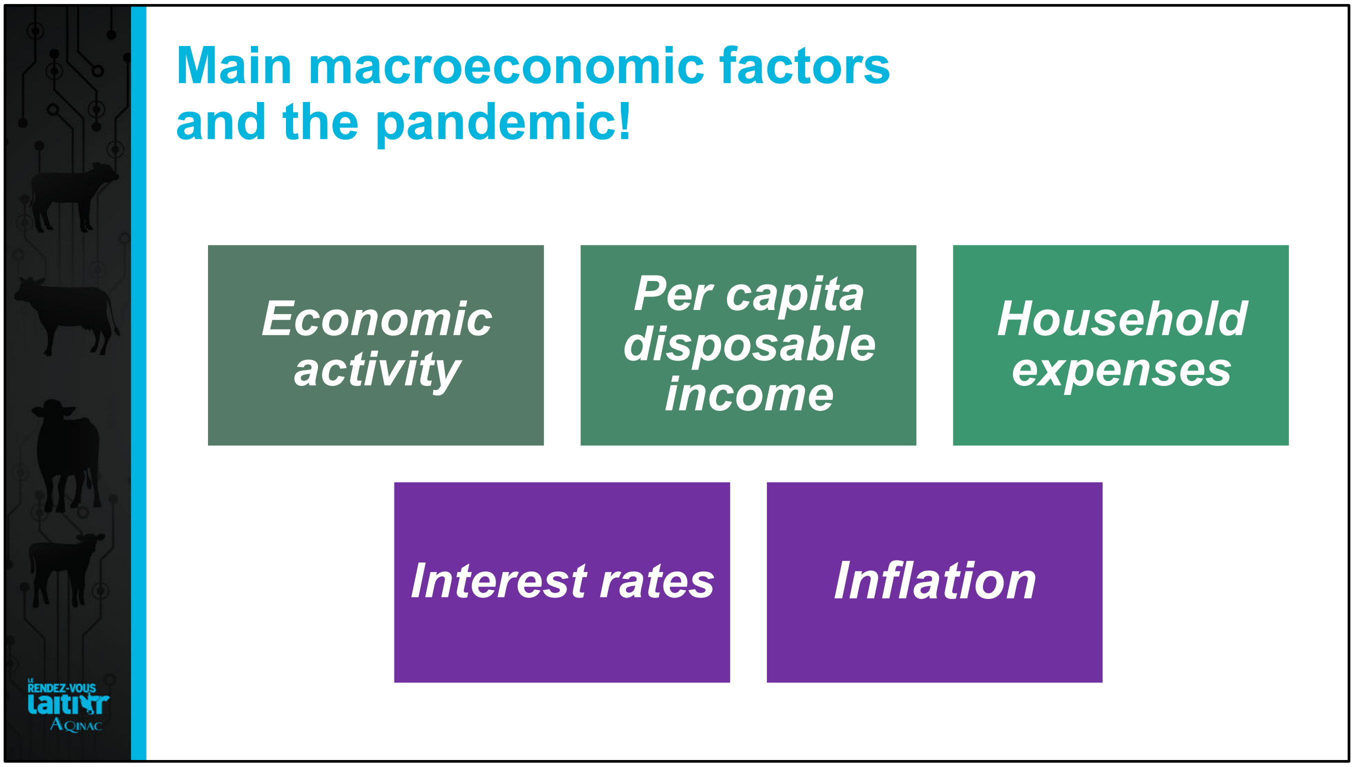


More sensitive to the business environment

Opening up of the markets and the pillars of supply management



Importance of business strategic choices


Main macroeconomic factors and the pandemic!
Economic activity
Per capita disposable income
Household expenses
Interest rates
Inflation
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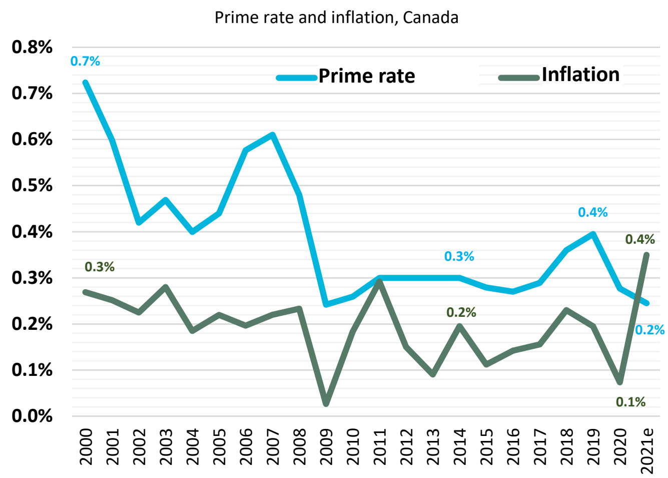
Interest rates and inflation during the pandemic



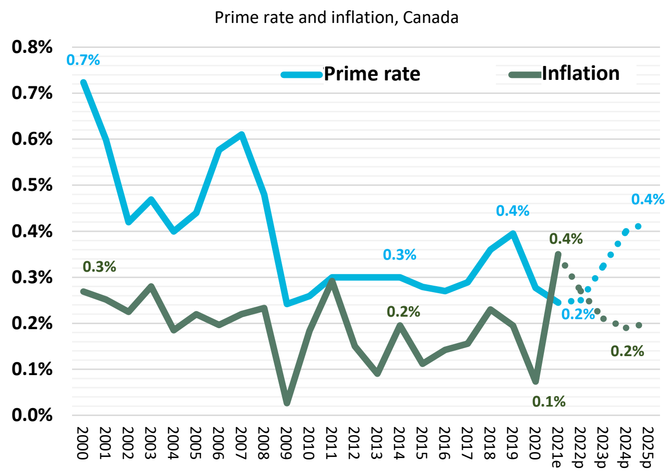
Source: Statistics Canada, Bank of Canada, Desjardins and National Bank, FLC compilation

The Bank of Canada has lowered its prime rate to support an economic recovery

The financial institutions then lowered their policy interest rate

In 2021, the interest rates were below inflation! and it carries over in 2022…

Post-pandemic interest rates and inflation!

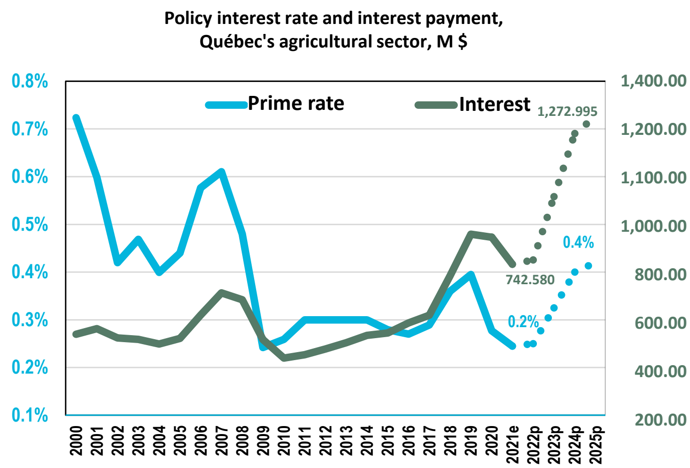


According to the economists in the financial institutions, the prime rate should increase by 1.7%, going from 2.5% in 2021 to 4.2% in 2025

Inflation should decrease to stabilize around the 2% target of the Bank of Canada

Source: Statistics Canada, Bank of Canada, Desjardins and National Bank, FLC compilation

Interest rates and the agricultural industry!



A growth potential for interest costs of over $500M at maturity for Québec's agricultural industry

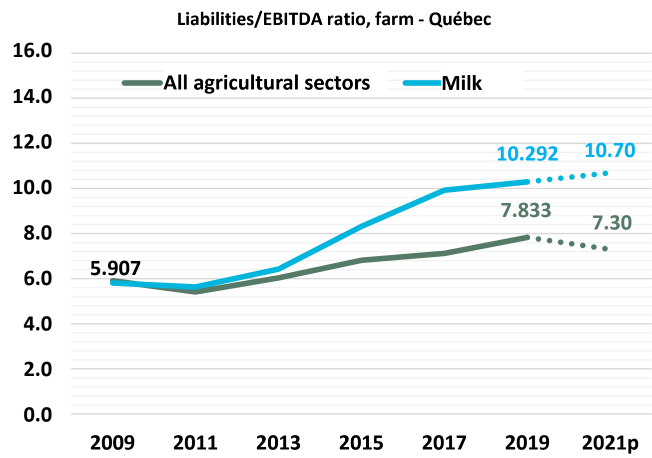
Source: Statistics Canada, FLC compilation

Debt/EBITDA Ratio Analysis
What is it?

- Measures the weight of the debt vs. what the business is generating
- Debt: all the interest-bearing liabilities
- EBITDA: Earnings before interest, taxes, depreciation, and amortization

- **The higher the ratio, the more sensitive the business is to an interest rate increase**

Debt/EBITDA Ratio
and the supply management sectors



The dairy sector is almost certainly the most sensitive to an interest rate increase

Source: Statistics Canada, 2021 forecast and FLC compilation

EBITDA vs. Revenues:

	2017	2021
• Dairy	40 to 45%	35 to 40%
• Poultry/Grains	25 to 30%	20 to 25%
• Swine	15%	10%
• Beef, cattle	10%	5 to 10%
• Fruit and vegetables	10% to 30%	10 to 30%

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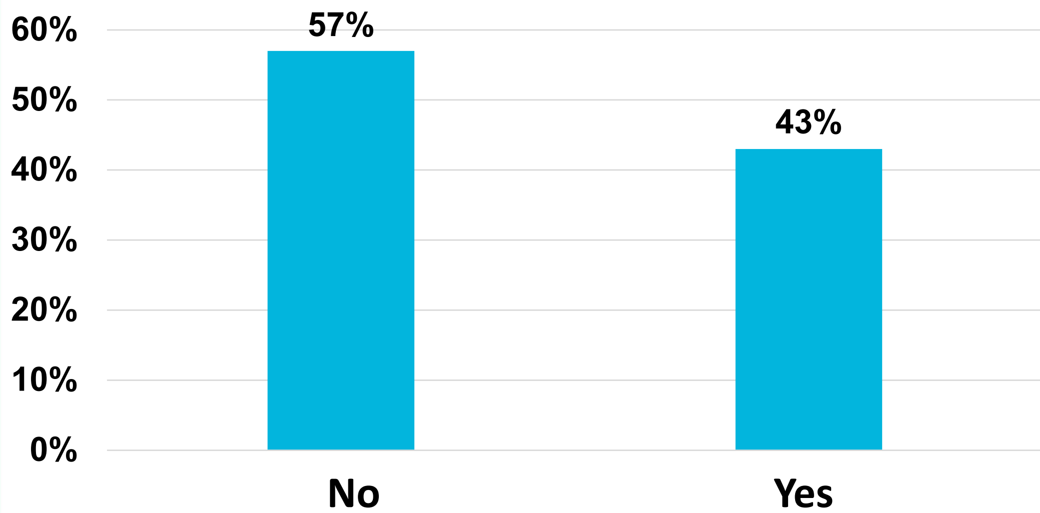
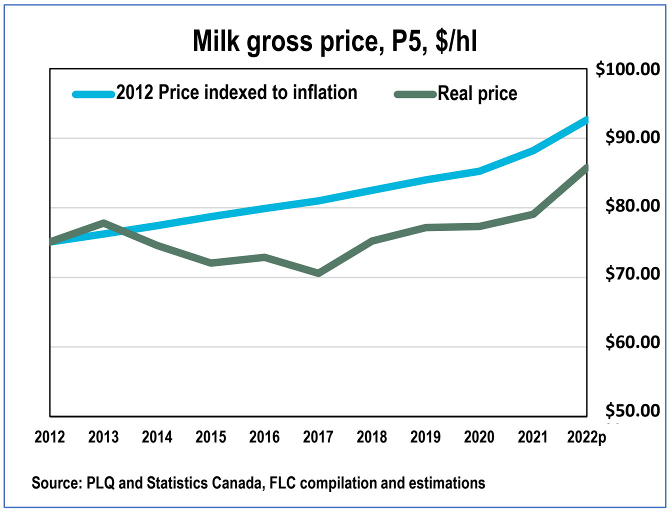
In your opinion, will an increase of the price paid for milk to farmers help reduce the Debt/EBITDA Ratio?

Answers of 123 participants in 2021



Source: 2021 Annual Meeting Conference: Trends and issues in agriculture

Milk Price and Inflation
Dairy sector



It should not be assumed that the price will automatically adjust, even if there is inflation and/or higher interest rates!

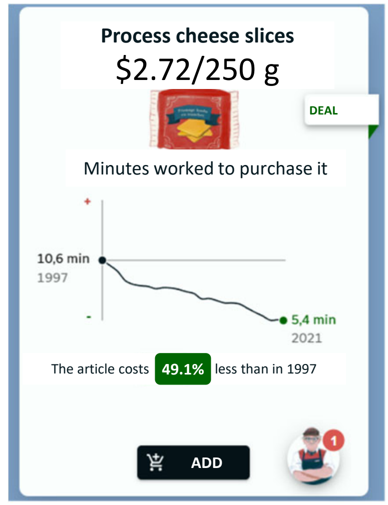
Source: PLQ and Statistics Canada, GVG compilation

Milk Price and Inflation
Dairy sector

Milk Products and Eggs

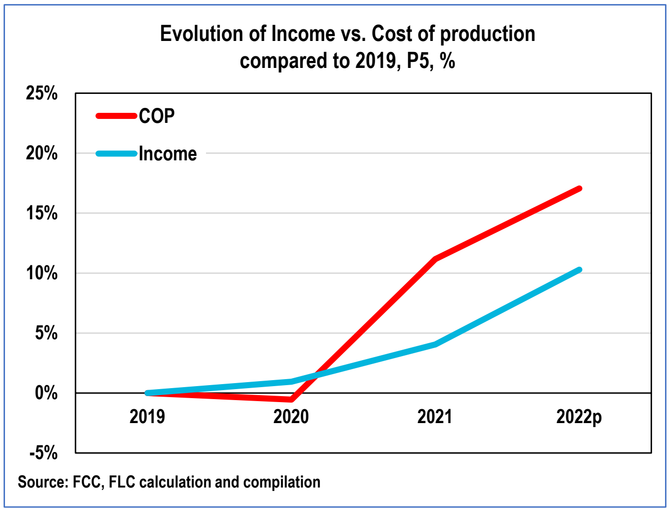
As they are subject to supply management, milk products and eggs have seen a progressive price increase, but at a generally slower rate than wages. They are thus now more affordable.

SCROLL →



Source : Daniel Blanchette Pelletier, Radio-Canada https://ici.radio-canada.ca/info/2022/panier-epicerie/hausse-prix-aliments-inflation-pouvoir-achat

Milk Price and Cost of Production
Dairy Sector



Difficult to increase the price according to the cost of production

Source: FCC, 2021 forecast and 2022 FLC

A Few Figures

Since 2010

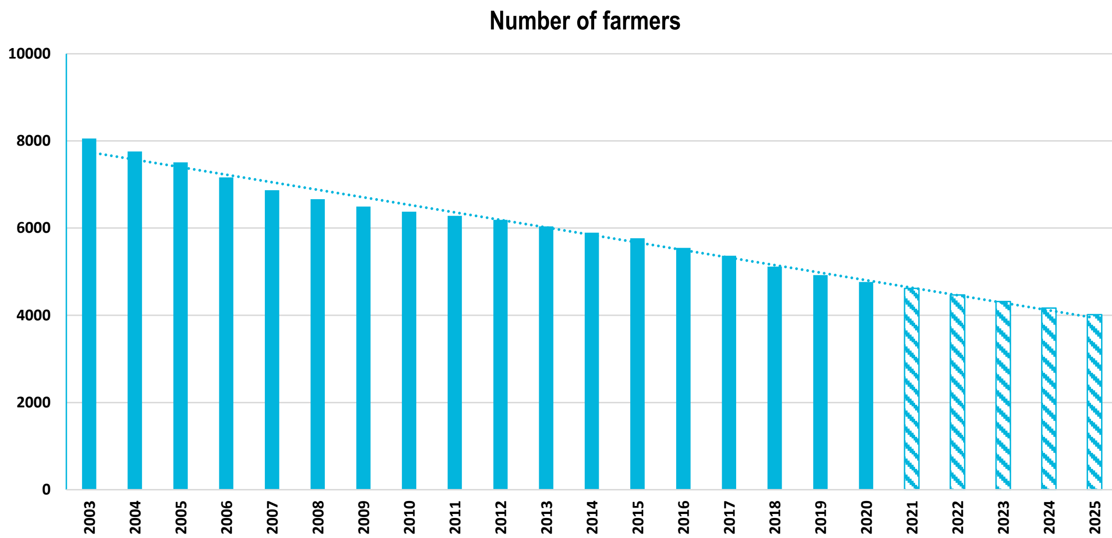
Number of dairy farmers

2010	2021	2025
6,375	**4,681**	**4,016**

-26.6%
1,694 producers

Source: Canadian Dairy Commission

A sustained decrease!



Source: Canadian Dairy Commission

In summary, my understanding is that…

The dairy sector will remain more stable than many other agricultural sectors, but compared with previous years, the business environment of dairy farms will be characterized by:

- More unpredictable variations
- Larger variations
- Faster variations
- Larger threats
- Greater opportunities

In summary, my understanding is that…

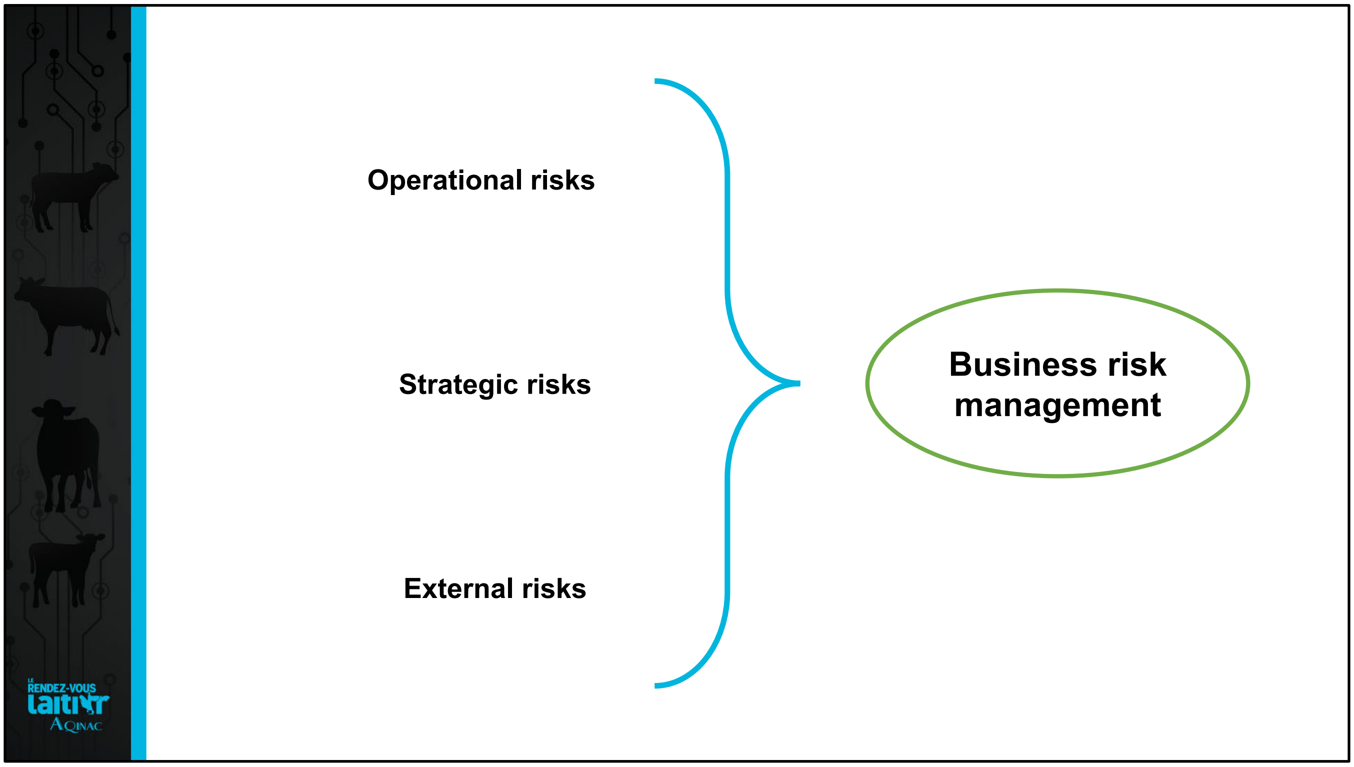
There will be

- *A sustained trend in decreasing number of farmers*
- *Larger fluctuations of prices and volumes*
- *Sustained upward pressures on the cost of production*
- *Increased variability of net margins*
- *Increased interest expense over the next few years*

This implies that the farmers who seize opportunities and protect themselves against threats will be those with improved financial management and they will get support to do so

Business strategic management:

What should be considered?


Operational risks
Strategic risks
External risks
Business risk management
Le Rendez-vous laitier
Aqinac

Risk management

- **Operational** risks – what the owners must control

  - **Skills of the managers**

  - Operation efficiency
    - Technical aspects
    - **Administrative management**
    - **Financial understanding**
    - **Support**

Today

Operational risks related to the management capabilities

- Manager
  - Defined roles and responsibilities
- Administration
  - Accounting
  - Cash Flow
  - Project analysis
  - Supplier relationship
- Level of financial understanding
  - Capacity to determine if the business is profitable and able to refund the debt
- Support
  - Be willing to get support
  - HR, management, accounting, taxes, legal, etc.

How can I do it?

- It's important to know your financial capacities
  - > Revenues/cost of production
  - > EBITDA
  - > Investment/debt
    - Repayment capacity
  - > **Administrative strengths**

With:
- Working capital analysis
- Cash-flow monitoring
- Understanding financial results

Implementing strategies

- Monthly accounting
  - Result validation
  - Including adjustment entries
  - Stock variation
- Monthly cash-flow
  - Planning for the coming months
- Support
  - Technical aspects
  - Accounting
  - Finances
  - HR

Implementing strategies

In a nutshell, what does it mean for farmers and their advisors?

- Be more attentive and sharp about the financial strategy of the business
- Have business discussions that provide facts and insights
- Increase the quality of the financial information

Thank you!