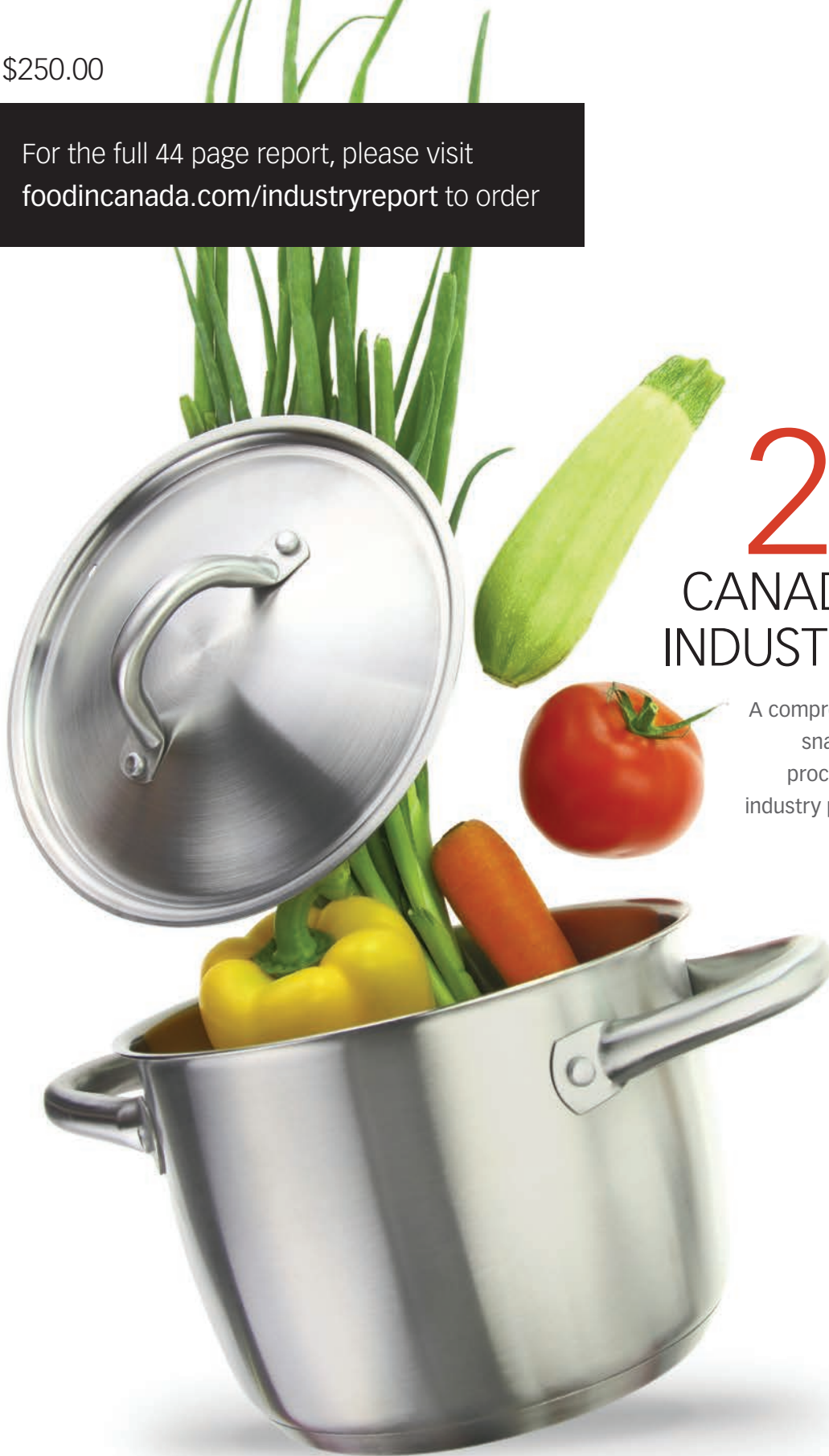


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2015

CANADIAN FOOD INDUSTRY REPORT

A comprehensive sector-by-sector
snapshot of food & beverage
processing and manufacturing
industry performance & innovation

Prepared by

FOOD in CANADA
Canada's food & beverage processing magazine

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2015

CANADIAN FOOD INDUSTRY REPORT

FOOD in CANADA

Canada's food & beverage processing magazine

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EXECUTIVE SUMMARY



In 2015 so far, the dollar dropped, gasoline prices plummeted, the CKFTA was ratified, CETA was being fine tuned, and TPP talks were ongoing. Target Canada reduced the oversupply of food retail supply by declaring bankruptcy. Grocers are shifting their investments from discount banners to conventional supermarkets and home meal replacement departments. The trend to natural, organic and nutrient dense foods continues but the free-from trend has stalled. The year ahead will be more profitable for Canadian exporters, owners of U.S. subsidiaries and, as it was in 2014, smaller firms in healthy niches such as artisan, organic, local and gluten-free.

THE DOLLAR & CRUDE OIL

The decline in the Canadian dollar by 11 per cent between the first quarter of 2014 and the same period this year has been good for exports overall but less so for meat packers, bakers and others who buy most of their inputs priced in U.S. dollars. It has benefited grocers to the extent it has reduced cross-border shopping.

The halving of crude oil prices between the first quarter of 2014 and the first quarter of 2015 has reduced forecasted growth in the Canadian economy but delivered as much as \$14 billion in gas pump savings to Canadian consumers. Food manufacturers have not benefited directly, but foodservice operators have reported increased traffic and convenience store owners an uptick in beverage sales.

TRADE DEALS

The first tariff reductions under the Canada-South Korea Trade Agreement took place on Jan. 1. This is important for pork producers and packers because pork tariffs are being phased out over just five years, and the U.S.-South Korea FTA of 2012 gave the Americans a head-start. The potential gains from the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) will be better known at the conclusion of the current technical negotiations. Movement on the Trans-Pacific Partnership (TPP) talks involving Canada, the U.S., Mexico, Japan, Australia, and seven other Pacific nations may move quickly if and when the U.S. Congress extends Fast Track negotiating authority to the president.

RETAIL COMPETITION

Perry Caicco, retail analyst with CIBC Institutional Research, expects Canadian grocers and mass merchandisers to have a more profitable year following the mid-January news that Target Canada will be exiting the Canadian market. The expansion of retail floor space, which averaged 2.5 per cent annually since 2012, should decline to one per cent this

year. Grocers are expected to reinvest in their conventional banners to justify their price premiums relative to their discount chains. The investment will focus on fresh departments and especially the home meal replacement (HMR) sections preparing entrées, side dishes, desserts and appetizers for shoppers to take home or, increasingly, to eat onsite. Robert Carter, executive director, Foodservice, for The NPD Group in Toronto, estimates that HMR now accounts for \$2.8 billion in foodservice receipts, or five per cent of the total, and is the fastest-growing segment after fast-casual restaurants.

MERGERS & ACQUISITIONS

The big news has been Warren Buffett and 3G Capital's acquisition of Kraft Foods via H.J. Heinz in March, although there were six other deals involving Canadian food manufacturers since June worth \$100 million or more. In July Lassonde Industries of Rougemont, Que. paid US\$150 million to acquire Port Washington, NY-based Apple & Eve. Also in July, Agropur Cooperative of Longueuil, Que. acquired the Lucerne dairy assets from Sobeys Inc. for \$365 million, and a week later acquired Davisco Foods International. In November, Cott Corporation of Mississauga, Ont. acquired DS Services, of Atlanta, Ga. for US\$ 1.25 billion. In November, Pinnacle Foods of Parsippany, N.J. acquired Richmond, B.C.-based Garden Protein International for \$175 million. And in December Grupo Bimbo, through its Toronto, Ont.-based Canada Bread subsidiary, acquired the bakery assets of Montreal, Que.-based Saputo Inc. for \$120 million.

DISCERNING CONSUMERS

Food manufacturers recognized the role of discerning consumers in setting food trends and cleaned up ingredient labels to remove artificial flavours, colours and preservatives, reformulated or repositioned products for a better nutrition panel, and promoted smaller portions to meet calorie targets. Discerning consumers, more concerned about value than price, are driving sales of artisan breads, craft beers, organic snacks and estate coffees and wines. ●

The Outlook

Exports will do well this year thanks to the exchange rate, but not as well as in 2014 due to slower economic growth in overseas markets. Grocers, thanks to the exit of Target, will be better able to restore their margins by raising prices, but due to the further consolidation of the industry will be more resistant to price increases from food manufacturers seeking relief from currency-driven increased costs of ingredients and packaging. This year, as in 2014, the small and independent makers of natural and organic snacks, beverages, baked goods and cereals will have more potential for sales and margin growth.

ECONOMIC OVERVIEW



The value of shipments of Canada's food and beverage manufacturers increased by \$6.5 billion (6.8 per cent) to \$102.1 billion in 2014, following a \$2.3-billion increase in 2013. Adjusted for price increases, the real value of shipments increased by four per cent in 2014, following a two-per-cent increase in 2013. Real value added increased by five per cent in 2014, following no increase in 2013.

Food and beverage shipments maintained the pace in the last half of the year and were beginning 2014 on a strong note. The value of shipments increased by seven per cent for the six months ended January 2015, compared to the year earlier period.

Over a third of the increased shipments were exported. Exports expanded by \$2.4 billion (10 per cent) to \$27.8 billion. Imports increased by \$2.6 billion (10 per cent) to \$28.9 billion. The increase in imports captured 38 per cent of the \$6.8-billion (seven-per-cent) growth in the domestic market to \$103.5 billion. The trade deficit rose to \$1.1 billion in 2014, from \$900 million in 2013.

INTERNATIONAL TRADE

In the last decade imports have grown their share of the domestic market to 27 per cent from 21 per cent in 2005. Over the same period the U.S. has increased its share of our imports to 60 per cent (from 56 per cent), as manufacturers have consolidated production on a North American basis. In 2014 our imports from the U.S., Italy and China grew by an average of nine per cent, while those from France, Thailand and Brazil grew by an average of one per cent. Our imports from Australia, Mexico and India grew by 28 to 36 per cent to \$1.5 billion. Combined, our imports from these nine countries accounted for 80 per cent of our total imports in 2014.

Canada's food and beverage exports today account for 27 per cent of our shipments, compared to 25 per cent in 2005. Over the decade China and Hong Kong have overtaken Japan as our second largest export market after the U.S, which accounts for 71 per cent our exports.

THE INDUSTRY

Food and beverage industry employment declined by 1,600 persons (0.6 per cent) to 246,400 in 2014, as the industry

continued to consolidate and rationalize. Yet at the same time the average number of hours worked by hourly paid workers increased by 0.7 hours (two per cent) to 36.2 hours per week including overtime. Value added per employee increased by \$6,000 (5.6 per cent) to \$111.7 million per year.

Capacity utilization increased by 3.3 points to 79.1 per cent in the food industry, fully offsetting the declines of the last two years. Capacity utilization in the beverage industry rose by 3.4 points to 77.8 per cent, its highest level since 2005. Capital investments rose by \$100 million (five per cent) in 2014 to \$1 billion, following increases of four per cent and six per cent in 2012 and 2013.

COSTS & PRICES

Manufacturers benefited from falling prices for grains and edible oils, with hard wheat prices down 14 per cent and canola prices down 27 per cent from 2013. Pork prices, however, rose 19 per cent due to the PED virus and beef prices by 20 per cent due to limited supplies. Cocoa prices rose 26 per cent and coffee bean prices by 44 per cent. Crude oil prices averaged US\$93 per barrel (a five-per-cent decrease) for the

SHIPMENTS, IMPORTS, EXPORTS & DOMESTIC MARKET FOR THE CANADIAN FOOD & BEVERAGE INDUSTRY, 2008 – 2014, PLUS LATEST DATA FOR 2015

		2008	2009	2010	2011	2012	2013	2014	LATEST '15
SHIPMENTS	\$ MILLION	\$84,600	\$86,000	\$87,000	\$91,200	\$93,300	\$98,800	\$102,100	\$103,500
IMPORTS	\$ MILLION	\$20,000	\$21,000	\$21,500	\$22,500	\$23,000	\$24,000	\$28,900	\$29,500
EXPORTS	\$ MILLION	\$18,000	\$18,500	\$19,000	\$19,500	\$20,000	\$21,000	\$27,800	\$28,500
DOMESTIC MARKET	\$ MILLION	\$66,600	\$65,000	\$65,500	\$68,700	\$73,300	\$74,800	\$74,700	\$74,000
EXPORT INTENSITY ⁽¹⁾	PERCENT	21%	24%	25%	25%	21%	21%	27%	28%
DOMESTIC MARKET SHARE ⁽²⁾	PERCENT	78%	76%	76%	75%	73%	74%	73%	73%

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1. Export Intensity = Exports/shipments. 2. Domestic Market Share = (Shipments – exports)/domestic market. Source: Industry Canada, Trade Data Online (North American Industry Classifications) supplemented with shipment data from Statistics Canada, CANSIM Table 304-0014 Manufacturers' sales, inventories, orders, by North American Industry Classification System (NAICS) Canada.

ECONOMIC OVERVIEW

ECONOMIC VARIABLES RELEVANT TO FOOD & BEVERAGE SHIPMENTS, TRADE & CONSUMPTION 2006 – 2012

	UNITS	2008	2009	2010	2011	2012	2013	2014
F&B EMPLOYMENT ⁽¹⁾	PERSONS	250,569	248,189	250,224	252,942	250,836	247,997	246,414
	CHANGE %	-1%	-1%					
F&B AVERAGE WEEKLY HOURS ⁽²⁾								
F&B GDP ⁽³⁾								
CAPACITY UTILIZATION FOOD ⁽⁴⁾								
CAPACITY UTILIZATION BEVERAGES ⁽⁴⁾								
F&B CAPITAL EXPENDITURES ⁽⁵⁾								
FOOD IPP I ⁽⁶⁾								
CPI FOOD ⁽⁷⁾								
F&B SPENDING IN STORES ⁽⁸⁾								
F&B SPENDING AWAY-FROM-HOME ⁽⁹⁾								
CANADIAN GDP ⁽¹⁰⁾								
UNEMPLOYMENT RATE ⁽¹¹⁾					7.5%	7.3%	7.1%	6.9%
HHL D NET SAVINGS RATE ⁽¹²⁾	PCT OF DISP INC	4%	5.4%	4.3%	4.4%	5.2%	5.2%	4%

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1. CANSIM Table 281-0023 Employment (SEPH), unadjusted for seasonal variation, by type of employees for selected industries. **2.** CANSIM Table 281-0030 Average weekly hours worked for employees paid by the hour (EPH) for selected industries. **3.** CANSIM Table 379-0027 Gross Domestic Product (GDP) at basic prices, North American Industry Classification System. **4.** CANSIM Table 028-0002 Industrial capacity utilization rates, by North American Industry Classification System. **5.** CANSIM Table 029-0009 Capital and repair expenditures, industry sectors 31-33, manufacturing, annual. **6.** CANSIM Table 329-0057 Industry price indexes, by North American Industry Classification System (NAICS). **7.** CANSIM Table 326-0020 Consumer Price Index (CPI), 2011 basket. **8.** CANSIM Table 080-0022 Retail commodity survey based on North American Industry Classification System (NAICS). **9.** CANSIM Table 355-0006 Monthly survey of food services and drinking places, by North American Industry Classification System (NAICS). **10.** CANSIM Table 379-0031 Gross Domestic Product at 2007 constant prices, by North American Industry Classification System (NAICS) All Industries (T001). **11.** CANSIM Table 282-0001 Labour force survey estimates (LFS) unadjusted for seasonality, monthly. **12.** CANSIM Table 380-0072 Current and capital accounts – Households, quarterly.

The Outlook

Last fall, Export Development Canada forecast five-per-cent growth in food and beverage exports in 2015 following 11-per-cent-growth in 2014. Although the OECD forecasts slow growth in many major markets this year, the U.S., Mexican, Indian and Chinese economies are expected to grow by three-, four-, six- and seven-per cent respectively. BMO Capital Markets Economics forecasts the Canadian dollar to average US\$0.79 for the remainder of this year, with a gradual rise through 2016 to US\$0.83 in the fourth quarter.

At home, BMO forecasts weak economic growth of 1.9 per cent this year, compared to 2.5 per cent in 2014. However, the unemployment rate in the first two months of the year was 6.7 per cent, compared to the 12-month average of 6.9 in 2014. The Conference Board of Canada reported at the end of March that consumer confidence was up 12.9 points to 108.5. The Board forecast 2.7-per-cent real (after inflation) growth for the industry in 2015.

year, but plunged 40 per cent between June and December to US\$60 a barrel before ending March down a further \$10 to US\$50, the lowest price in a decade. Natural gas prices increased by 53 per cent to US\$4.56 per million BTU.

Retail prices for food and beverages increased by 4.8 per cent in 2014 — compared to 2.5 per cent in 2013 — as the cost of imports rose with the decline in the Canadian dollar.

CONSUMER DEMAND

The foodservice sector led domestic demand growth for the third year in a row as consumer spending on away-from-home meals grew by \$2.8 billion (five per cent) in 2014 to \$57.6 billion. The foodservice industry spends about one third of its receipts on food purchases, or about \$20 billion annually. The retail value of food purchased from stores rose \$3.8 billion (3.4 per cent) to \$117 billion, following a 2.5-per-cent increase in 2013. ●