

Ottawa, October 22, 2004

Hon. Paul Steckle  
Chair Committee on Agriculture & Agri-  
Food Suite 486, Confederation Building  
House of Commons

Yesterday's committee meeting raised the very important issues of the regulatory difficulties provincial packers are facing and the absolute necessity for an increase in domestic slaughter capacity to handle the growing herd of cull cows. Unfortunately I was unable to be present for all of the meeting as I had to attend an executive meeting of the Canada-U.S. Parliamentary group at noon.

There was evidently discussion at the meeting about the loan loss program and how it will assist proposed slaughter plants in obtaining financing. Permit me here to bring to the committee's attention an issue that has been impeding the creation of new slaughter capacity.

Lenders continue to express concerns that the risk in backing loans for the creation of slaughter plants is still far too great despite the governmental guarantee on 40% of the value of aU loans issued. The key lender's concern revolves around the uncertainty created by the border situation and the potential for an oversupply of slaughter capacity. If the border were to suddenly open, some slaughter plants that are profitable under current conditions would immediately become unprofitable due to the increased cattle acquisition costs created by the sudden appearance of American demand for cattle. This problem would be exacerbated by the fact that slaughter plants would not only be competing with American plants but would also face increased competition domestically for cattle.

Lenders also worry that even if the situation were such that the border does not reopen the current government program does not feature any mechanism to limit the number slaughter plants that can be built. As a result, they fear that domestic slaughter capacity could easily eclipse demand and result in the failure of many slaughter plants.

Government intervention to stabilize the beef industry has created uncertainty for potential lenders as well. To put this into perspective we could take the announcement of the government's set-aside program as an example. The announcement of this program increased the price of cattle on a per head basis by \$200. For a slaughter plant this would have increased cattle acquisition costs by about a \$1 million dollars per week. The potential for this kind of volatility makes lenders reluctant to finance slaughter plants. Furthermore lenders face the risk that a government program may be announced, changed or terminated at any time, which increases their reluctance.

Basically, from the point of view of the lenders, the 40% guarantee being offered by the government still does not turn a bad loan into a good one. It merely prevents lenders from losing more than they would have if they had full exposure to the loan. In other words, it does not mitigate the risk of making the loan in the first place. Given the current uncertainties, from the perspective of a lender, there is too a high degree of risk that the particular slaughter plant they finance will fail rather than succeed.

If the program were to be restructured such that there is a limitation on the number of slaughter plants that will be financed and the \$37.5 million being made available is used to directly finance slaughter plants, these measures would lower the risk profile for potential lenders to slaughter plants. The restructuring of the program could be accomplished by implementing the following directives suggested by Art Price, chairman of Ranchers Beef.

- . The government should decide the amount of capital it is willing to provide in relation to the amount of processing capacity that it will support in accordance with government industry-wide policy objectives.
- Capital should be provided as "mezzanine capital" (ranks in preference to equity but is subordinated to all other capital)
- . The capital should have a low service cost, a five-year bullet term and no financial debt covenants that would trigger defaults in any senior debt.
- . The capital has an "earn out" provision whereby the principal amount of the instrument is reduced by 85% of any animal acquisition cost in excess of a basis no more than 14 cents.
- . The capital should be administered through the Farm Credit Corporation and must be linked to equity, not lenders debt. Furthermore the following restrictions would apply to any loans made.
  1. Loans will not exceed investor equity under any arrangement.
  2. Owners of initiatives may opt to receive government financing on a matched basis to equity (equity being no yield and subordinated to government capital) or as an amount that constitutes no more than 40% of the total capital invested. These funds would be drawn as capital is spent.
  3. The maximum amount of government financing available to any single initiative would be \$15 million.
  4. The funds provided by the government would be provided through Farm Credit Corporation, which would then make loans as opposed to the normal procedure whereby the funds are placed in an "arms length" pool of funds that Farm Credit attempts to profit from and leverage.

It is imperative that the changes to the loan loss program to make it workable be initiated as quickly as possible. Delay at this point will be costly; as it will prevent the commencement of construction before winter frost penetrates the ground. Once this happens construction will have to be pushed back until spring thereby costing the government more money in order to sustain cattle producers while slaughter capacity is being built.

I also would like to respond to the two objections made with regard to my remarks in my absence this morning. In regard to both objections about the state of the beef industry in Selldrk.Interlake and the suicide rates in that area I would like to clarify that I was quoting the words of Dr. Ralph Ashmead at the Serecon Consulting Group who conducted a study on the costs of BSE.

Hopefully the committee can put the issue of lender reluctance to finance slaughter plants on next week's agenda so we may work to quickly resolve the problem.

Many Thanks,

Warmest Regards,