



# LEVINOFF-COLBEX S.E.C. REPORT

Number 4 - December 2009

## SUPPLY

In 2009 (excluding the month of December), the enterprise slaughtered 2,496 cows per week, a significant drop from previous years. The decline in the volume of culled cows received at the plant is primarily due to an increase in milk production entitlements over the past two years and the poor quality of hay crops.

This decline was observed throughout eastern Canada, particularly between January and September. During this period, the number of cull cows was down by 11% in Ontario and 20% in Quebec compared with last year.

However, since October, the volume of Quebec cull cows has risen, with an increase of more than 25% compared with the same period in 2007 and 2008.

Number of cows slaughtered (weekly average) <sup>1</sup>	January to November 2007	January to November 2008	January to November 2009
Quebec	1513	1449	1338
Outside Quebec	1317	1484	1158
Total	2831	2933	2496

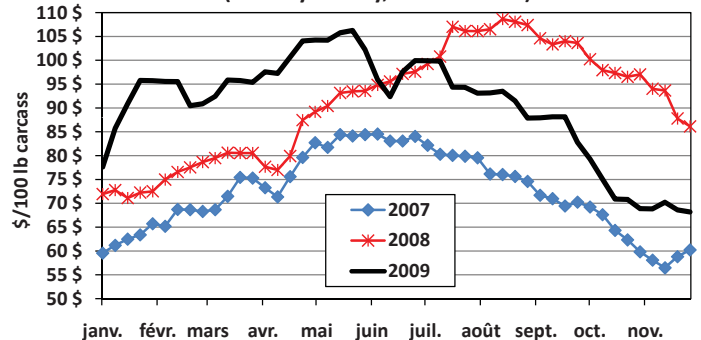
<sup>1</sup>Includes no calves or fed cattle

In 2009 (excluding the month of December), direct deliveries to the plant accounted for 22% of the volume of Quebec cows. Since the introduction of a premium this fall for deliveries of twelve or more cows, direct deliveries have risen significantly and now represent one-third of the volume of Quebec cows.

## PRICES

The average price of Quebec cull cows rose steadily in the first five months of 2009. However, since June, prices have dropped by 35%, falling from \$105/hundredweight (cwt) to lightly less than \$70/cwt. The average price for 2009 (excluding December) is equivalent to that recorded in 2008 (about \$90/cwt) and higher than in 2007 (\$72/cwt). You will recall that the U.S. opened its borders to cattle over 30 months in November 2007.

Average price of Quebec cull cows (January to May, 2007 to 2009)



## MEAT AND BY-PRODUCTS MARKET

The decline in cull cattle prices is chiefly due to the drop in boneless beef prices. Between May and November, the price of lean boneless beef fell by 38%, similar to cull cow prices.

The world economic recession continues to impact the price of some carcass by-products. The price of hides is now around \$35/hide, after reaching a low of under \$20 this summer. On average, hides sold for \$25/hide in 2009. This is significantly lower than the \$50-\$60/hide recorded in previous years. Market conditions have not readjusted to reflect this reality. As a result, Levinoff-Colbex is left with a shortfall of over \$4 million.

## TRADING RESULTS

After ten months of operations, we estimate that this year's operating loss will be around \$7.5 million, based on an estimated annual slaughter volume of approximately 133,000 head (average of 2,558 head/week). Since our break-even point is about 3,000 head/week (cows, calves and fed cattle), or 156,000 head/year, we have a shortfall of 20,000 head/year to cover costs.

In addition to a low slaughter volume, the 2009 fiscal year was marked by a dramatic drop in the price of hides, as previously mentioned. Furthermore, as was the case in 2008, Levinoff-Colbex had to cover recurring annual costs of more than \$4 million caused by Canadian regulation banning the use of specified risk materials (SRM) in livestock feed.

This regulation is one of the primary factors affecting Levinoff-Colbex' competitiveness. The United States does not have equivalent regulation. The difficulties caused by the SRM regulation is very serious. The Gencor plant in Ontario and XL Foods in Saskatchewan had to close down because of the high costs associated with the management of SRM.

Following the FPBQ's \$30 million investment at the end of the 2008 fiscal year, Levinoff-Colbex realized savings in interest and bank charges of \$2.4 million after ten months of operations in 2009.

Our operating losses reduced our working capital. As a result, the FPBQ posted a guarantee bond at the bank to support our activities. However, since October we have seen a substantial increase in slaughter volumes, regularly reaching more than 3,000 cows and fed cattle/week. This has given the bank a sense of security, at least for the time being.

Lastly, together with our external auditors, we will have to address the value of intangible assets on the balance sheet. You will recall that in 2008, Levinoff-Colbex had to write off the consolidated goodwill, thus reducing the balance sheet by the equivalent amount.

## **GOVERNANCE**

In September 2008, the Board of Directors was expanded to eight members including three outside members (directors who have no direct link with the Fédération des producteurs de bovins, the Fédération des producteurs de lait and the UPA). At that time, these three directors were Serge Michel (chairman of the Board of Directors), Marcel Ostiguy and Paul Dupont. They demanded that the problem of refinancing Levinoff-Colbex S.E.C. be resolved. This was completed in September 2008 based on the financing offers that were accepted.

In July 2009, the bank's refusal to provide the credit that it had already authorized led to the resignations of Marcel Ostiguy and Paul Dupont. The latter remains as Secretary of the company, but not as a director. Two independent director positions thus remain to be filled. This will only be possible when the company has obtained the financing needed to support its integrated plant project in Saint-Cyrille-de-Wendover, which we hope will be completed this winter.

## **THE COMPANY'S CHALLENGES AND PRIORITIES**

### **• Supply**

The company's greatest challenge is to obtain the maximum possible number of cull cows from Quebec so as to achieve break-even. This will help reduce our dependence on supply from outside Quebec to a reasonable level.

Specifically, in 2010, we will need to increase our local volume by 10,000 to 15,000 head annually. This is essential to ensure the enterprise's sustainability.

### **• Zensho contract**

Since October, Levinoff-Colbex has been slaughtering and processing 200 head of cattle per week (10,000 head/year) under contract to Zensho, a Japanese company. This large enterprise has more than 3,000 restaurants under various banners in Japan. Quebec's traceability system gave us an edge in winning this contract, since it enabled us to respond to Zensho's requirements that cattle be born and raised in Quebec and have a verified age of less than 21 months. Zensho has already indicated an interest in raising the volume to 400 cattle per week.

### **• SRM program**

We will have to continue our efforts to obtain financial support from the federal government to cover the costs associated with SRM requirements. Our concerns in this regard are shared by all representatives of the beef industry and Canadian dairy farmers. They have jointly asked for a financial assistance package of \$31.70 for each cull cow slaughtered. This program is essential for the survival of our enterprise.

### **• Business profitability improvement project**

The enterprise has submitted an infrastructure modernization project (integrated plant) under the federal government's Slaughter Improvement Program. The implementation of this project would reduce operating costs and enable us to develop new business. We have received a conditional offer of \$9.6 million from Agriculture and Agri-Food Canada. In conjunction with this offer, we are asking the Quebec government for assistance to complete the financing of the project.

### **• Collective Agreement at the Montreal plant**

We are currently negotiating the renewal of the Collective Agreement at our Montreal cutting plant, which expired a year ago. Given the difficult and uncertain context in which we operate, discussions with our partners have not yet been finalized.