



Canfax Research Services

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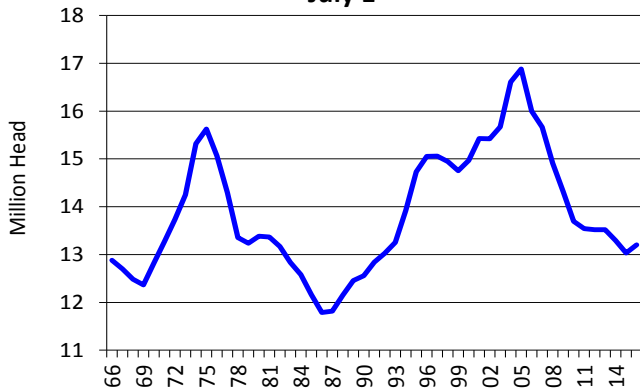
September 2016

Quarterly Report

INVENTORY

Canadian cattle inventories on July 1, 2016 were up 1.3% at 13.2 million head. All classes of cattle were up with the exception of steers (>1yr) which were down 2.6%. The largest increases came from beef heifers for breeding (+4.5%) and calves (<1yr) up 3.9%. The larger calf crop was due to a combination of larger beef cows and improved reproductive efficiency (going from 86% in 2015 to 90% in 2016). This will support production moving into 2017 as long as there is not a big jump in feeder cattle exports to the U.S. this fall.

**Canadian Total Cattle & Calves
July 1**



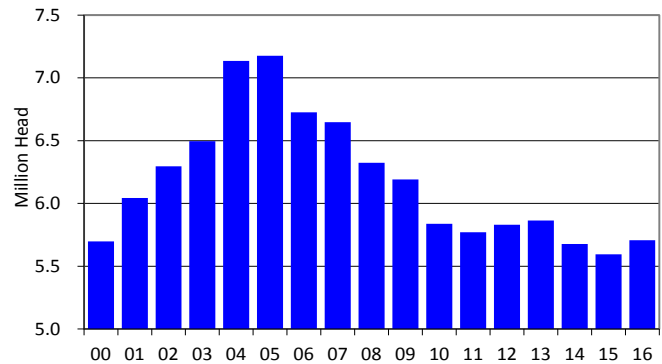
Source: Statistics Canada

Beef cow inventories were up 0.3% at 3.8 million head; this remains the lowest inventory since 1991. Beef cows inventories were up in BC (+3.8%), Manitoba (+2%), Saskatchewan (+1%), Quebec (+1%), and the Atlantic Provinces (+0.2%). Inventories declined in Alberta (-0.6%) and Ontario (-3%). Lower feeder prices in 2016 have dampened producer enthusiasm for expansion. The beef cow culling rate dropped to 10.5% in 2015 but it has rebounded to liquidation levels in 2016 at 14%. This is similar to 2013 and 2014 and may indicate beef cow inventories will be lower on January 1, 2017.

Beef heifer retention was up 4.5% at 641,800 head, the largest since 2008. While encouraging this remains 2%

below the 10 year average and 15% below the 20 year average. Beef heifer retention was up in all provinces: Atlantic Provinces (+13.7%), Manitoba (+9.3%), BC (+6%), Quebec (+5.5%), Alberta (+3.9%), Saskatchewan (+3.7%), and Ontario (+1.5%). Increased heifer retention is confirmed in a lower heifer slaughter ratio in 2016. At 57 heifers for every 100 steers this is down from 61 in 2015 and the 20 year average of 69. While it appears producers are focused on developing a younger herd it is not clear on if replacements will be large enough to offset culling rates.

**Canadian Feeder and Calf Supply Outside of
Feedlots - July 1 (Beef only)**



Source: Statistics Canada

The supply of feeder and calve outside of feedlots on July 1st was up 2% or 110,600 head. Smaller feeder exports since September 2015 combined with the larger calf crop this spring mean there are more feeders to place this fall. Ample feeder numbers in both Canada and the U.S. has dramatically shifted leverage from the cow/calf producers back to the feedlot as there won't have as much competition for supplies.

(Provincial data are available on page 7)

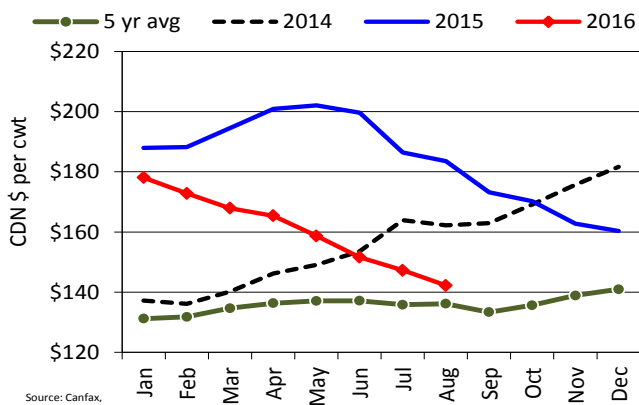
USDA has suspended the July 1st Cattle Inventories report. Therefore, U.S. numbers will not be available until January.

PRICES

FED CATTLE

Alberta fed cattle prices moved steadily lower in the third quarter falling from \$152/cwt in June to \$142/cwt in August, which is the 7th consecutive month of lower prices since January 2016. While the drop from January through April was a reflection of the stronger Canadian dollar, the exchange rate has been relatively stable since May. Lower prices have been driven by larger protein supplies weighing on the North American market. In August, Alberta fed steer prices were down 23% or \$41/cwt from \$184/cwt a year ago, and 30% or \$60/cwt from the peak of \$202/cwt in May 2015. This is almost back to the first year average.

Alberta Fed Steer Price



Source: Canfax.

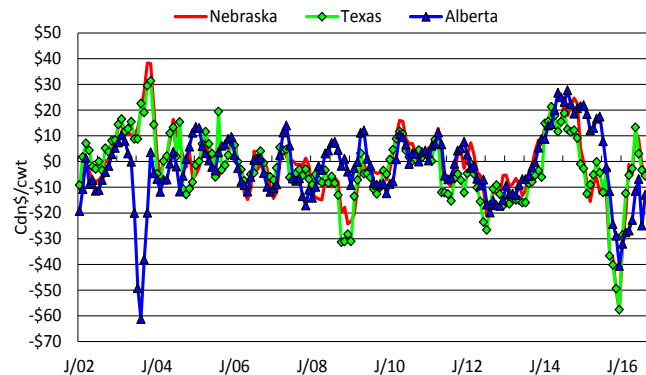
Ontario fed steer prices were down 8% from \$153/cwt in June to \$141/cwt in August. This is down 25% or \$47/cwt from last year, and down 29% or \$58/cwt from the peak of \$200/cwt in April 2015. Ontario prices were at a \$1-2/cwt premium over Alberta in June and July, but moved back to a \$0.94 discount in August.

U.S. fed cattle prices have also been disappointing with prices moving from US\$124/cwt (Cdn\$159/cwt) in June to US\$116/cwt (Cdn\$150/cwt) in August, down 22% or US\$33/cwt from a year ago and 32% or US\$56/cwt from the peak of US\$170 in November 2014.

The Alberta fed steer cash to future basis seasonally weakened from +\$1.58/cwt in July to -\$5.21/cwt in August, but remained stronger than last year's -\$8.94/cwt and the 5-year average at -\$7.59/cwt. The drop in the nearby live cattle futures from \$160/cwt in early June to \$131/cwt in early September have been weighing on fed cattle prices and will continue to affect cash prices moving forward.

The drop in fed prices over the last 18 months has pushed feedlot margins into the red. Canfax TRENDS reports feedlots selling on the cash market have been losing money since September 2015. Monthly losses have been the largest since 2003. Breakevens for fed cattle marketed in September ranged between \$140-\$163/cwt implying a \$52-359/head loss on cash sales. Despite lower feed grain prices, projected breakevens for shortkeep and yearling cattle placed in September at \$140-145/cwt still have negative margins around \$130-213/head, while breakevens for calf placements are projected at \$131/cwt with a positive margin at \$50-82/head. The significant equity losses in the feedlot sector are expected to dampen feedlot's willingness to pay for feeder cattle this fall and pressure feeder prices moving forward.

Cattle Feeding Margins - Yearling Steer



Source: Cattle-Fax, Cattle Hedging, Canfax

Fed cattle exports continued to run above year-ago levels in the third quarter, but the gap has narrowed. The year-over-year increase in weekly export volumes averaged 19% during July and August, down from 83% in the second quarter. YTD fed cattle exports at 191,000 head are 39% larger than year-ago. U.S. cattle supplies are expected to increase in the fourth quarter with August 1st cattle on feed numbers up 1.6% from 2015.

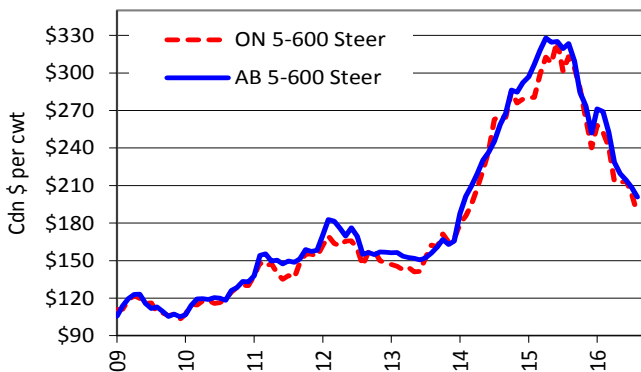
Seasonally, the fed market tends to hit the lows in the summer/early fall and rally in the fourth quarter. However, in the recent non-seasonal years (2008, 2009 and 2015), annual lows occurred in December. As feedlot placements increased in the first half of 2016, larger cattle supplies are expected to come to the market in the second half of the year, adding pressure to fed prices this fall. On the other hand, improved beef demand for the holiday season, a more current feedlot sector, and lighter carcass weights compared to year-ago should help support prices.

FEEDER CATTLE

Yearling prices experienced a weak seasonal rally in the west in July and August, but dropped in the east due to dry conditions. Alberta 850 lb steers prices were up 4% from \$173/cwt in July to \$181/cwt in August, but remained 30% lower than last year and 31% lower than the peak of \$262/cwt in September 2015. With good grass conditions in western Canada, producers look to maximize cattle weight on pasture. Alberta auction volumes in July were down 58% from last year at 27,272 head before ramping up to 95,239 head in August with one more trading week to be 23% larger than last year.

In contrast, eastern Canada has been suffering from drought this summer and some producers may have sold cattle early. Ontario auction volumes were down only 7% in July at 10,558 head, and jumped to be up 44% at 16,955 head in August. Prices of 850 lb steers were stalled at \$175/cwt in July and August, down 31% from a year ago and 32% or \$83/cwt from the peak of \$258 in September 2015. The Ontario prices moved from a \$2.10/cwt premium of Alberta in July, to a \$5.34/cwt discount in August.

**Ontario vs. Alberta
5-600 lb Steer Prices**



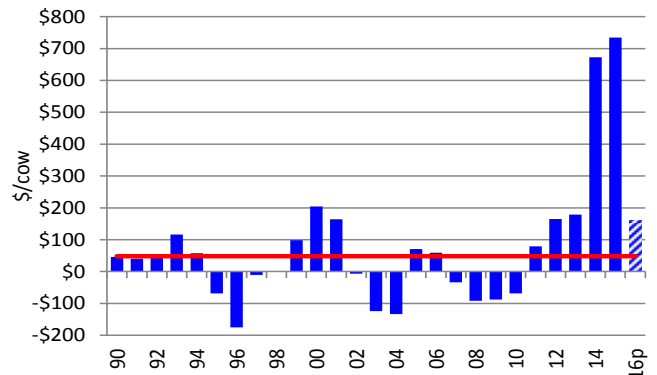
Source: CanFax

Calf prices continued to decline throughout the third quarter. Alberta 550 lb steer prices dropped for the eighth consecutive month to \$201/cwt in August, down 38% or \$123/cwt from a year ago and 38% or \$124/cwt from the peak of \$325 in June 2015. Prices are now below the 5-year average (\$208/cwt in August) for the first time since early 2014. In Ontario, 550 lb calf prices stabilized in June at \$214/cwt but have moved 12% lower to \$187/cwt in August. This is 40% or \$126/cwt below last year and 43% or \$139/cwt lower than the June 2015 peak of \$326/cwt.

U.S. 850 lb feeder steers also had a weak rally up 1% from US\$137/cwt (Cdn\$179/cwt) in July to US\$139/cwt (Cdn\$180/cwt) in August. U.S. 550 lb steer calves were up 2% from US\$156/cwt (Cdn\$204) to US\$159 (Cdn\$206) during the same period.

The decline in calf prices combined with higher hay prices last winter has reduced cow-calf profits in 2016. Alberta cow-calf returns are projected to drop 78% from 2015 to \$161/cow. Despite this, estimated returns remain positive and are in line with 2012-2013. Producers who have lower per unit production costs will still see reasonable profits to encourage expansion. However, high cost producers may be considering liquidation.

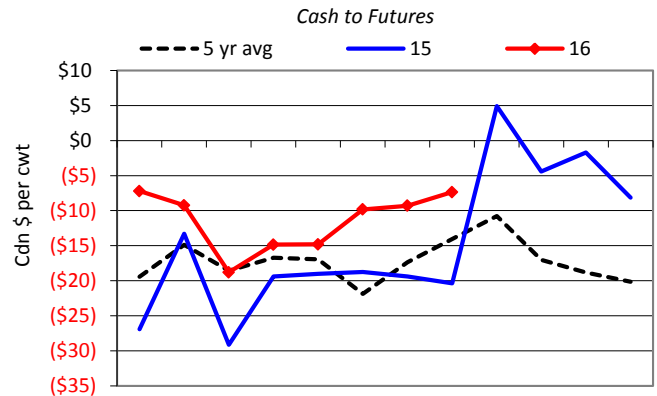
Alberta Cow/Calf Returns



Source: Canfax Research

The feeder cash to future basis strengthened in the third quarter from -\$9.82/cwt in June to -\$7.37/cwt in August. So far in 2016, the basis has been stronger than 2015 and the 5-year average in most of the year. Seasonally, the feeder basis tends to be the strongest in late summer/early fall before weakening in the fourth quarter. If this seasonality holds in 2016, the basis could trend between last year's record strong levels and the 5-year average moving forward.

Alberta 850 lb Feeder Steer Basis



Source: Canfax

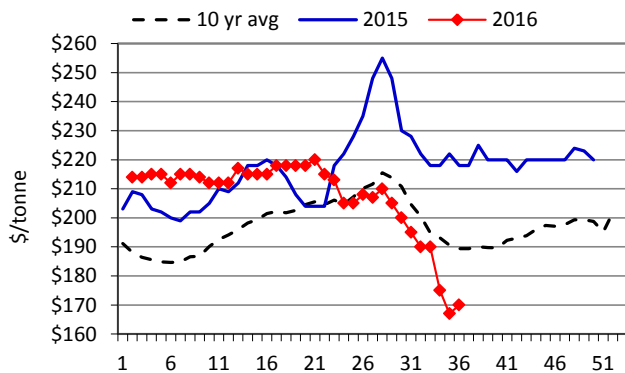
Feeder exports moved below year-ago level after the short uptick in May. YTD feed exports totaled 149,540 head, down 39% from 2015 and down 10% from the 5-year average. Exports moved seasonally lower in the second and third quarter, with monthly volumes down from 42,000 head in April to 7,000 head in July.

FEED GRAINS

Feeder prices generally move inversely with feed grain prices. The current feed grain outlook is supportive to the feeder market going into the fall run; but may be offset by equity losses as feedlots looks to build in margins.

Canadian barley production is projected to increase 5.8% to 8.7 million tonnes. Corn for grain is projected to decline 8.9% to 12.35 million tonnes as drought in Ontario reduced yield. Lethbridge barley prices have been under pressure since June and moved sharply lower in August. In the first week of September, Lethbridge barley was trading at \$166-170/tonne. This is 22% below last year and 10% below the 10-year average of \$189/tonne.

Lethbridge Barley Price - Weekly High



Source: Alberta Ag, AB Canola Prod. Comm.

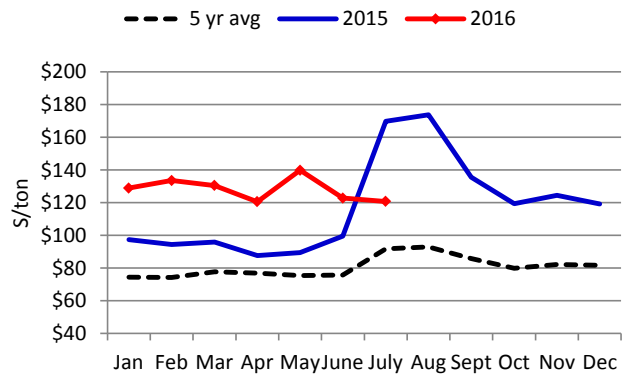
In addition to the large production, rains throughout western Canada this summer has reduced quality, with more going for feed. As of the first week of September, 16% of the crop in Alberta has been harvested and 20% is swath, while 64% remain standing.

Ample grass availability has been keeping cattle on pasture and is expected to support hay supplies. In Alberta, preliminary hay yields on dryland are estimated at 1.3 tons per acre up 44% from the 5-year average (0.9 tons/acre); while irrigated hay yield at 1.5 tons per acre is up 7% from the 5-year average (1.4 tons/acre). However, hay quality is deteriorating as a result of frequent showers and high humidity. Quality

of the first cut in Alberta is rated at 61% good to excellent compared to the 5-year average of 69%, and irrigated hay quality is rated as 45% good to excellent compared to the 5-year average of 65%.

Alberta hay prices moved lower throughout summer from the peak of \$140/ton in May to \$121/ton in July. Prices are currently 29% lower than a year ago, but remain 32% higher than the 5-year average. Although there are increasing concerns in hay quality, higher hay yield this year should limit upside risk for hay prices.

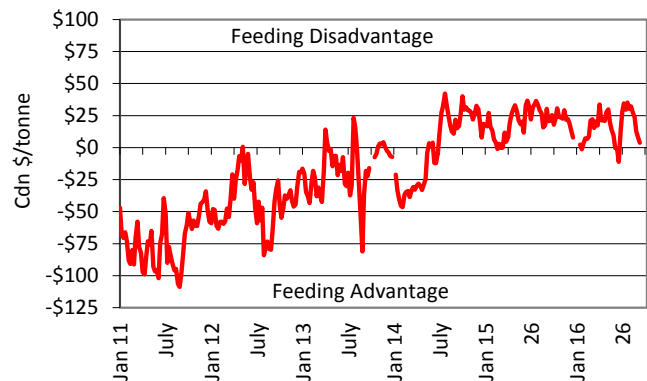
Alberta Hay Prices



Source: Alberta Agriculture

In the U.S., corn production is projected to increase 11% to a record 15 billion bushels. Corn prices are projected to range between US\$2.90-3.50/bu, down 11% from 2015. Omaha corn prices are currently down 14% from last year at US\$3.05/bu (equivalent to Cdn\$166/tonne). The U.S. remains at a feeding advantage to western Canada, but the barley/corn spread has narrowed from \$35/tonne in late July to \$4/tonne in early September, which should keep feeders in Canada.

Alberta Barley/Omaha Corn Price Equivalent Spread



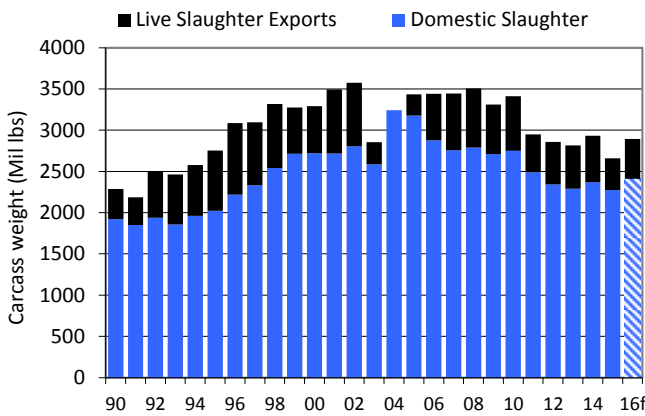
Source: Cattle-Fax, Alberta Ag

BEEF PRODUCTION

Canadian beef production (domestic plus live slaughter exports) is projected to be up 9% in 2016 to be just 1% below 2014. This almost completely reverses the sharp decline seen last year and is in line with the 2011-14 average of 2.89 billion pounds.

Domestic beef production is up 9% YTD with fed production up 8% and non-fed production up 10%. Production from live slaughter exports are also up 26% with larger fed exports supported by marketings and the removal of mandatory Country of Origin Labeling increasing U.S. plan flexibility.

Canadian Beef Production

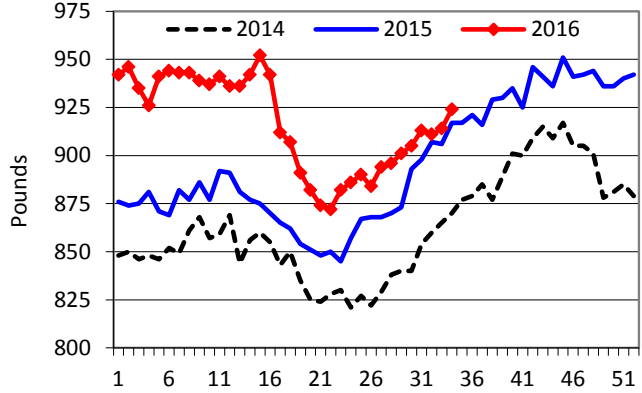


Source: Canfax Research

From January through August federally inspected slaughter of fed cattle is up 4%. In addition, exports are up 39%. Larger fed cattle marketings were made possible by reduced feeder exports starting September 2015. Over the last year there have been 250,250 head fewer feeder exports. This is equivalent to a 5% increase in fed cattle marketings for 2016. But as feeder exports are expected to be discouraged this fall by a strong basis this will also increase fed marketings going into 2017.

In addition, to larger marketings steer carcass weights have been record high. Weights were between 925-950 lbs from mid-Sept 2015 through April 2016. A poor fed to feeder swap encouraged feedlots to keep cattle on feed more days and a mild winter contributed to excellent performance. While carcass weights dropped seasonally in May and June the low at 874 lbs was 29 lbs heavier than the 2015 low. Record large carcass weights contributed to larger production throughout the first half of the year.

Cdn Weekly Steer Carcass Weight

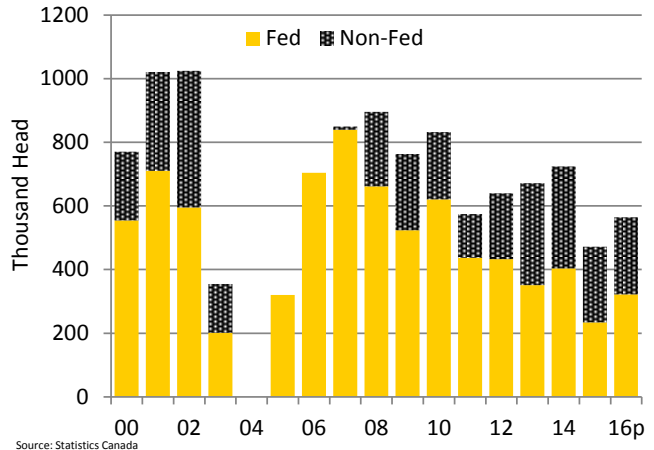


Source: AAFC, CBGA

In August, carcass weights are only 4-8 lbs heavier than last year. As the fed to feeder swap adjusted with lower feed grain prices, feedlots have gotten more current. In addition, larger placements of heifers since March are anticipated to pull the average carcass weight down throughout the fall with weights potentially dropping below last year. This will help offset some of the larger marketings projected in the fourth quarter.

Beef production is being supported by higher non-fed (cow and bull) slaughter as well. Federally inspected non-fed slaughter is up 8% from January through August. But this is where regional differences become apparent with the west up 11% while the east is down 6%. It is surprising to see eastern cow slaughter down 5% or 2,500 head given the current dry conditions being reported. While cow exports out of the east are up 9% or 4,600 head. An additional 2,100 head of cows being marketed is very small.

Slaughter Cattle Exports



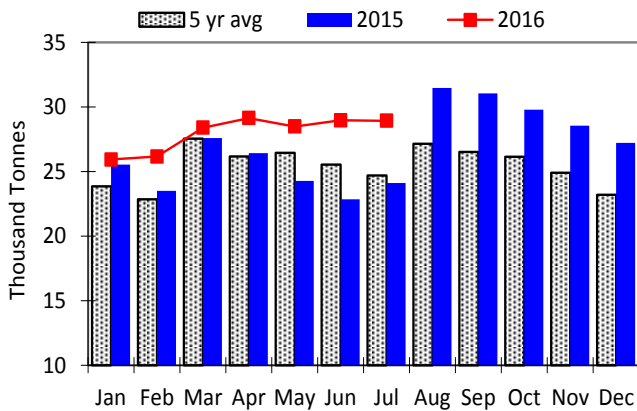
Source: Statistics Canada

BEEF TRADE

EXPORTS

Larger domestic production and an attractive exchange rate are supporting beef exports in 2016. From January through July exports are up 12.5% in volume and 1% in value. Monthly volumes have gone from being up a modest 2-3% in the first quarter to up 17-27% in May, June, July.

Canadian Monthly Beef and Veal Exports

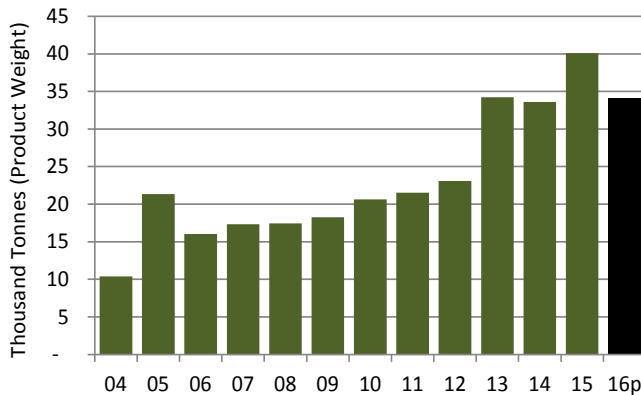


Source: Statistics Canada

Exports to the **U.S.** are up 15.6% in volume and 4% in value, representing 77% of the total volume. Trade with the U.S. continues to be important even as they see larger production.

Exports to **Japan** are up 31% in volume and 55% in value. Total Japanese imports are up with larger volumes from Canada and the U.S. – gaining market share over Australia and New Zealand.

Exports to China, Hong Kong & Macau



Source: Statistics Canada, CFIA

Exports to **mainland China and Hong Kong** are down 13% in volume and 27% in value. While in 2015, Chinese authorities cracked down on smuggling giving

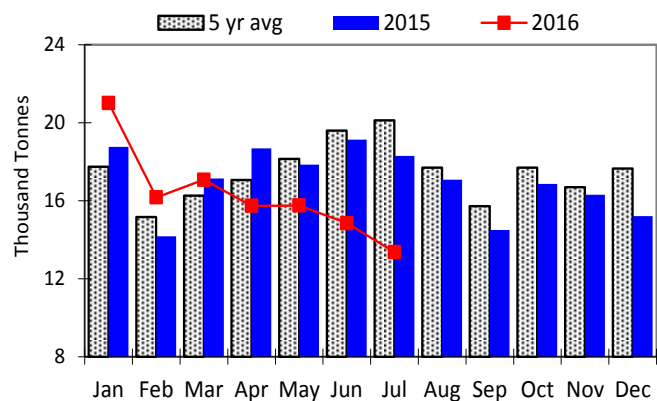
an advantage to countries like Canada that had official access. In 2016, they have increased testing of ractopamine and are pushing trade back into the grey channels. In addition, the Canadian Food Inspection Agency (CFIA) “*Canadian Beta Agonist-Free Beef Certification Program*” has been in place voluntarily since early 2016 and is expected to be formally added to the Meat Hygiene Manual soon.

Exports to **Mexico** are down 29% in volume and 37% in value. OTM access is scheduled to come into effect October 1, 2016. However, this market has changed a lot over the last 13 years.

IMPORTS

From January through July, beef imports are down 8% in volume and 13% in value. Monthly beef imports have been declining from 21,000 tonnes in January to 13,400 tonnes in July, 27% below year ago levels. The decline from March through July was counter-seasonal with the 5-year average seeing monthly volumes usually increase over that period. While imports from the U.S. have seasonally increased the drop in total imports came from reduced volumes from Australia. Imports from Australia are down 17.5% YTD. Monthly volumes are down from 6,000 tonnes in January to 1,555 tonnes in July, to be the smallest since February 2014.

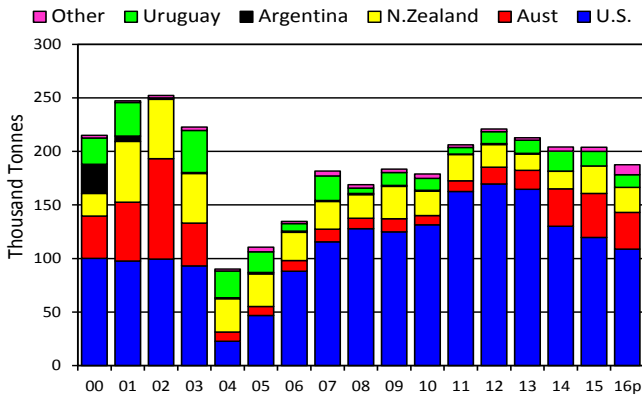
Canadian Monthly Beef and Veal Imports



Source: Statistics Canada

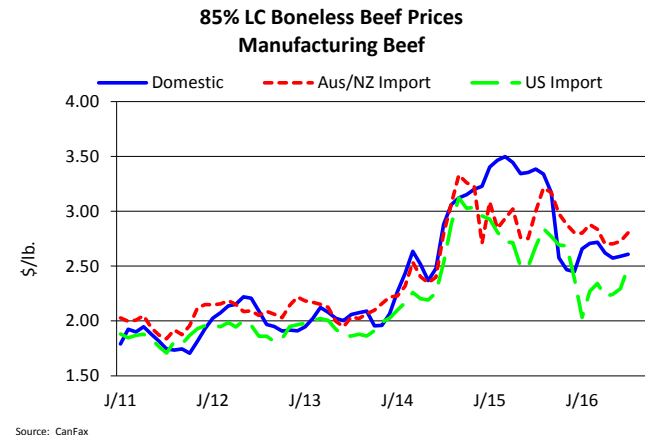
Seasonally monthly import volumes drop from July to make a low in September before rebounding in the fourth quarter. Any rebound in the fourth quarter is anticipated to come from the U.S. as they see larger production. Currently volumes from the U.S. are on track to be the lowest since 2006 and almost in line with the 2000-03 average around 100,000 tonnes.

Canadian Beef Imports



Domestic 85% trim is currently priced below Australia and New Zealand, discouraging imports from those destinations. Lean manufacturing trim has been steady around \$250/cwt over the last 10 months. Despite a 14.4% increase in domestic non-fed beef production reduced imports have kept the market stable.

In contrast, to the stable lean trim market 50% trim continue to be volatile ranging between \$64-136/cwt in 2016. Prices have dipped to or below \$70/cwt three separate times in February, May and August. Highs, at or over \$110/cwt, have been reached in January, March and June through July.



PROVINCIAL CATTLE INVENTORY - JULY 1, 2016 (1,000 HEAD)

	Year	Bulls	Beef Cows	Dairy Cows	Dairy Heifers	Beef Hfr Br.	Beef Hfr Sitr.	Steers > 1 Yr	Calves < 1 yr	Total
Atlantic Provinces	2015	2.7	43.3	61.3	27.6	5.1	13.5	16.0	57.5	227.0
	2016	3.1	43.4	60.0	27	5.8	12.9	15.9	57.8	225.9
Quebec	2015	12.2	177.8	350.4	148.7	20.1	43.6	83.3	333.9	1,170.0
	2016	12.4	179.6	351.1	150.5	21.2	44.9	87.7	337.6	1,185.0
Ontario	2015	19.3	276.3	301.6	166.1	40.9	175.4	289.2	474.2	1,743.0
	2016	19.4	268.1	303.0	167.1	41.5	168.0	283.2	488.8	1,739.1
Manitoba	2015	24.9	450.3	42.9	19.6	64.2	61.2	83.6	458.3	1,205.0
	2016	24.6	459.3	42.4	19.1	70.2	60.2	83.0	491.2	1,250.0
Saskatchewan	2015	60.9	1,147.0	27.4	11.3	202.5	140.6	225.7	899.6	2,715.0
	2016	61.5	1,158.6	26.4	11.7	210.0	128.9	197.4	950.5	2,745.0
Alberta	2015	88.7	1,509.1	81.4	36.8	248.1	724.6	939.5	1,686.8	5,315.0
	2016	88.7	1,499.3	82.5	37.3	257.7	751.8	923.6	1,729.1	5,370.0
British Columbia	2015	12.7	195.7	72.8	35.0	33.4	37.0	46.3	227.1	660.0
	2016	13.2	203.1	74.0	35.7	35.4	35.6	49.8	243.2	690.0
CANADA	2015	221.4	3,799.5	937.8	445.1	614.3	1,195.9	1,683.6	4,137.4	13,035.0
	2016	222.9	3,811.4	939.4	448.4	641.8	1,202.3	1,640.6	4,298.2	13,205.0
% change CANADA	15 to 16	0.7%	0.3%	0.2%	0.7%	4.5%	0.5%	-2.6%	3.9%	1.3%

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