

Make Informed Decisions

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## The Beef with Father's Day

This Father's Day consumers are probably going to be disappointed not to be able to grab a \$5.77/lb. bone-in striploin or a \$6.99/lb. ribeye from their favorite supermarket. That is fair, but the disappointment should be targeted at the coronavirus rather than a multi-billion-dollar retailer or a corner butcher. Alternatively, if by chance there are great beef deals on Father's Day, as there normally are, then it is probably almost entirely due to the multi-billion-dollar retailer or the corner butcher.

### Virus Impact

The coronavirus had a major detrimental impact on beef production in North America. This led to consumer concern about price and availability of beef. The concern is understandable. The spread of the virus resulted in several plant shutdowns or slowdowns, which in turn meant significantly reduced beef production. For example, in the United States, from the week ending March 28 to the week ending May 2, plant production declined by 36%. In Canada, over the same weeks, production was down by over 60%.

Despite those dramatic developments, consumers rarely, if ever, saw beef shortages over that period. In fact, the only time there were notably empty shelves in grocery stores this year was in March. That was when beef production was huge, but consumers were freezer loading and panic buying due to virus concerns. In other words, the empty shelves were due to consumer hoarding as opposed to production shortages. In addition, while beef advertisements and features in grocery flyers have been greatly reduced this spring, consumer price increases have been relatively modest so far this year. Furthermore, now that beef production is returning to more normal levels and hopefully staying normal, it is likely that consumers will see lower beef prices soon.

Looking back and a little bit forward, it can be easily argued that the beef supply chain performed very well during this very stressful pandemic. Despite that strong performance and the grocer's role in keeping supplies balanced, they have been blamed for hiking prices. Nothing could be further from the truth.

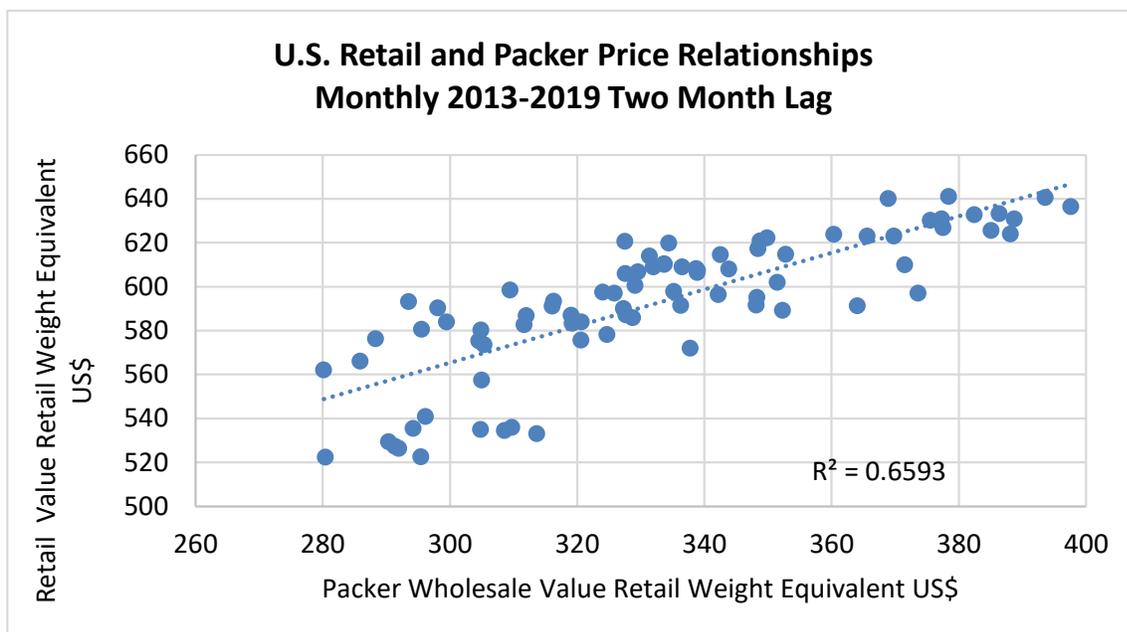
### Strong Relationship Between Retail and Wholesale

There is currently no beef price report at the packer level in Canada. It can be said with confidence, however, that beef prices at the packer or wholesale level are very similar between Canada and the United States. That statement is based on past price data reported by Canfax compared to price data reported by the United States Department of Agriculture (USDA). The overall direction of pricing, not surprisingly, is highly correlated between the two countries. It is essentially one North American market. As such, using USDA beef cutout values on a percentage change basis is a good representation of Canadian market activity at the packer or wholesale level.

In that regard, prices at the packer or wholesale level began 2020 basically unchanged from the prior year. The first quarter of 2020 saw pricing roughly the same or lower than 2019 at the packer level. For their part, retail beef prices, the prices consumers pay, as reported by StatsCan were increasing from 5-7% in the first quarter compared to Q1 2019. Beef prices were among the food price inflation leaders in the grocery store at that 5-7% pace.

The relatively high retail or consumer price inflation of the first quarter and into the second quarter were in response to price increases at the packer level in the second half of 2019. Packer prices increased by over 6% in the second half of 2019, which is roughly the magnitude of the first quarter retail price increase in Canada.

The assertion here is that as packer values go, so goes retail, albeit with a two-month lag. That assertion is based on the strong statistical relationship between monthly average retail and packer prices between 2013 and 2019, lagged two months.



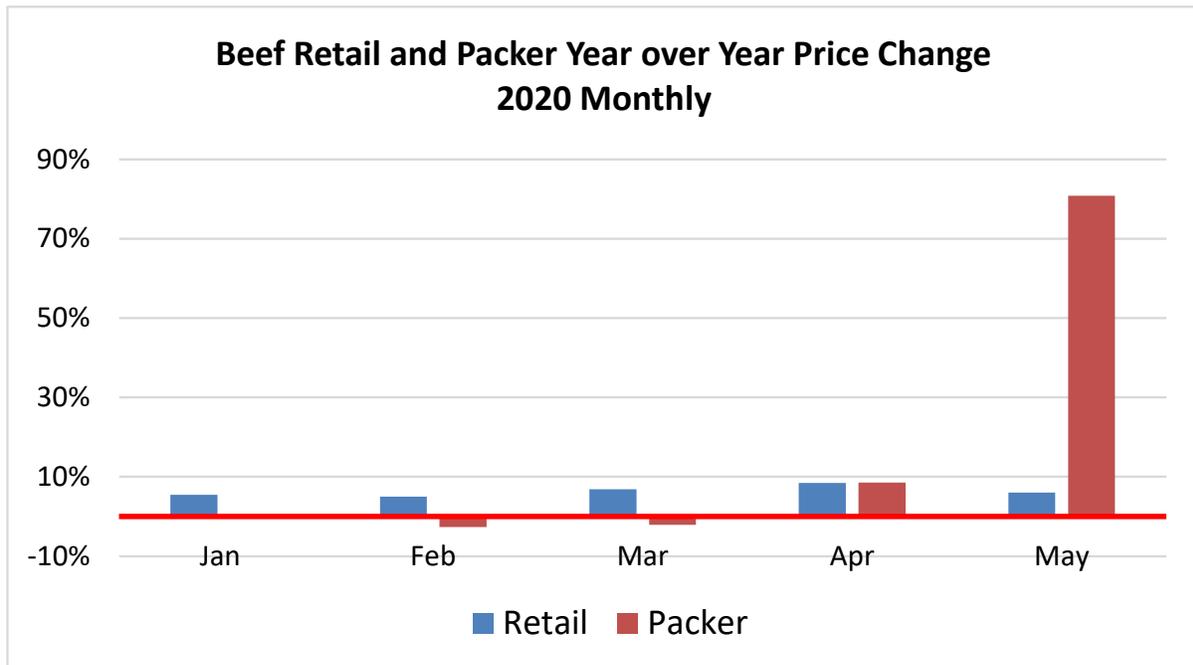
Source: USDA Compiled by Kevin Grier Market Analysis and Consulting (KGMAC)

As of April 2020, beef prices at the retail and packer level were both increasing at about 8.5%. Based on the two-month lag assertion, the retail price increase was unusually high. That is, the 8.5% increase in consumer prices in April was not provoked by packer pricing two months earlier in the first quarter. Instead the big retail consumer price increase in April was likely due to immediate beef cost increases from packers. Those packer cost increases in turn were driven by reduced production. In addition, retailers cut back on beef feature ads in flyers during April. That reduced featuring would also have resulted in higher overall retail or consumer beef price inflation.

## Virus Impact

Going into May, packer prices increased by over 80% on average compared to May 2019. That was astounding. Of course, that packer costing increase was due to the massive reduction in beef production caused by the virus-related impact on plant operations in April and May. Supplies of beef declined dramatically which resulted in packer prices increasing radically. Beef cost increases by packers due to the virus' operational impact were unprecedented. Grocers scrambled for supplies which were highly restricted due to the impact of the virus. Grocers had to pay up for whatever was available. The grocer's beef price costs rose to record levels.

Alternatively, retail price inflation for May has not yet been reported by StatsCan, but it likely increased by more than 5% but less than 10%.



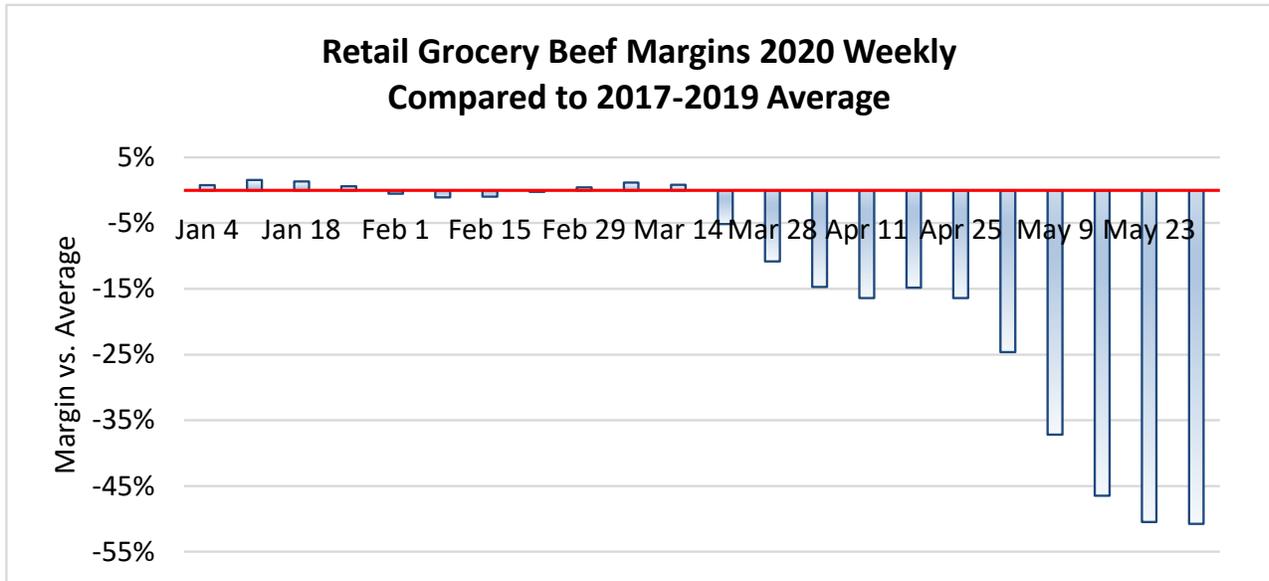
Source: Statistics Canada and USDA Compiled by KGMAC

It is just as interesting to note that while prices at the packer level skyrocketed in May, by late May and early June those prices have been in retreat. As packer production has recovered from those coronavirus depths, it has led to price declines. In fact, as of the end of the first week of June packer beef prices declined by about 40% from the peaks in mid-May. Low production drove packer prices higher, high production is driving packer prices lower. With that noted, packer prices as of early June were still well above year ago levels.

## Retailers Not Covering Costs

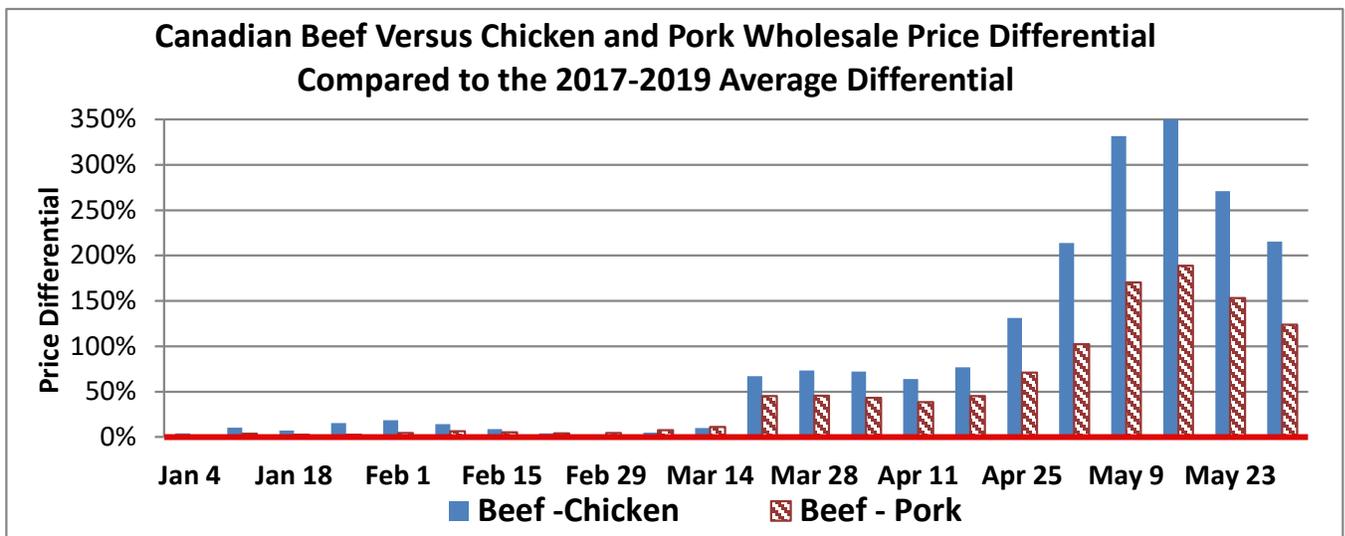
The net result for retailers from January through May was that their beef margins or profits went from normal to terrible. Margins were typical in the first quarter. That is, estimated retail beef margins in Q1 were right around the average for 2017-2019. By the second half of March and through May, however, grocery retail margins tanked sharply compared to average. Retail price increases during May were nowhere near enough to cover even a modest share of the packer costing increase.

During May retailers absorbed the massive beef cost increases through reduced margins. The beef price increases that occurred in May were small compared to the cost increases that retailers paid for beef.



Source: Statistics Canada and USDA Compiled by KGMAC

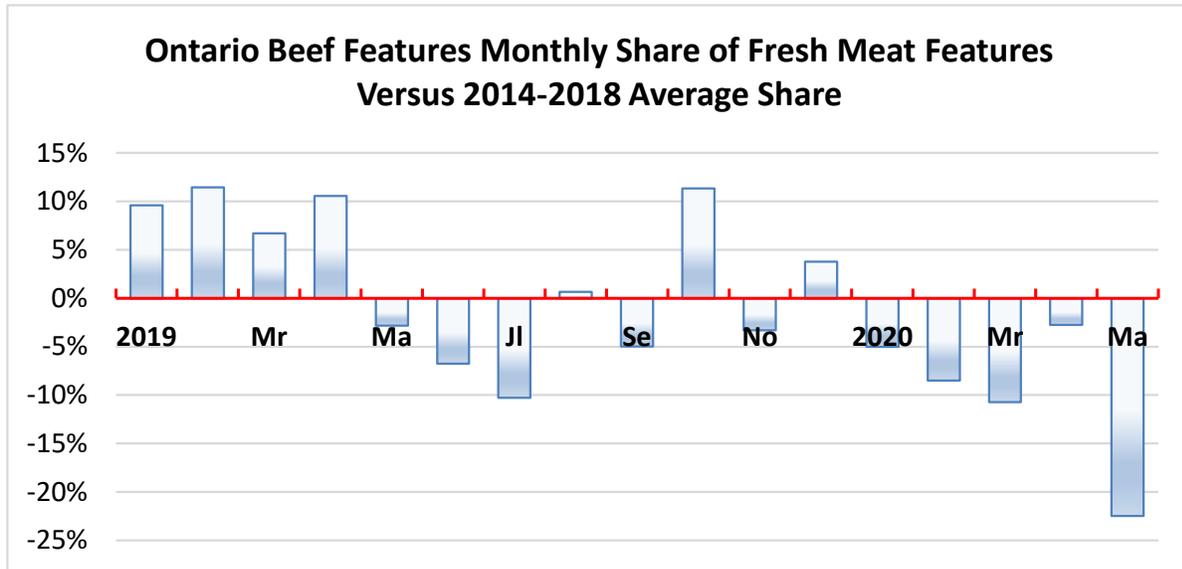
Not only were beef's costs far outpacing its revenues for grocers, but beef's cost increases were far outpacing the increases in the other two main meats. Beef's price in 2020 relative to chicken and pork was far greater than the average of 2017-2019.



Source: KGMAC

## Featuring Decline

Another important point is that given the volatility and increases in beef costs at the packer level, beef featuring by retailers has been in decline. Featuring was also in decline due to reduced production resulting from the impact of the coronavirus. Retailers are not going to feature if they are not sure they can get adequate supplies. Beef featuring as a share of beef, chicken and pork featuring in May in Ontario flyers declined severely compared to normal. The main point is that, the advertisements in the flyers that Canadian consumers love have been in steep decline when it comes to beef. That again was due to the production declines from the virus and the resulting massive price increases at the packer level.



Source: KGMAC

Not only did Ontario ad space decline, but beef's share of features on the front page of flyers all across Canada declined to record low levels in recent weeks. Beef saw very little action on the critical Victoria Day weekend. Beef will also probably be missing out on the pending Father's Day ads. In addition, it is expected that the ads will be sharply curtailed for the July 1 holiday.

This is important because, depending on the retailer merchandising strategies, features could move 35-45% of their beef volumes. A lack of featuring means a lack of beef movement

## Serious Questions

Based on the StatsCan consumer purchase basket, beef might be about 5% of total grocery store sales. That is one of the biggest single items in the store. Its total value of sale at supermarkets could be about \$4-5 billion per year. Moreover, beef has shown itself to be a critical merchandising tool. For all the big holidays last year from Victoria Day to Labor Day and Thanksgiving, beef led the way on the front of the flyer. This proves that beef drives traffic or it would not be there.

Looking ahead, retailers have some serious questions to address at a time in which given beef's high cost, it is now a margin burden. It is not performing up to par. Furthermore, it is not competitive against the other meats in terms of the purchasing cost for retailers.

Against that backdrop, retailers will now be deciding whether to increase consumer beef prices to recover lost margin and to try to keep up with their runaway costs. Given how important beef is, retailers will worry that the higher prices will drive customers away. Retailers will worry about increasing prices and then finding that competitor channels such as Walmart or Costco do not increase prices. Retailers will be concerned that if they keep prices low that packer costs may increase once again and drive margins lower, again.

Retailers will also be deciding whether to go back to beef featuring now that packer costs are coming down. Does it make sense to feature beef hard and put further pressure on margins? Is it necessary to reduce prices given that there is not likely going to be much foodservice competition during the third and possibly fourth quarters? In other words, are features really that important without concerns about foodservice taking customers away?

My bet is that regular prices will increase by another 1-5% in June and then retailers will hold the line through the summer as the packer price or costs return to more normal or lower than normal levels. July and August could even see price decreases for consumers once retailers are confident that packer costs are going to stay low. That means they will absorb the virus cost-induced beef increases of the spring and look forward, rather than backward. With that noted, however, given continuous high costing and the fact that summer features are being planned now, beef features will stay minimal through July. That is, there is not likely to be great beef ads soon. They should, however, begin to look more attractive again in August.

The main point is that this Father's Day consumers are going to be disappointed at being unable to grab a \$5.77/lb. bone-in striploin or \$6.99 ribeye. That is because retailers would have been planning the Father's Day ads during the depth of the production declines in early May. The Father's Day consumer disappointment should be targeted at the coronavirus rather than a multi-billion-dollar retailer or a corner butcher. Alternatively, if by chance there are great beef deals on Father's Day, as there normally is, then it is probably almost entirely due to the multi-billion-dollar retailer or the corner butcher.

Kevin Grier, June 2020

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