2016

FOOD REPORT

Blakes

CANADIAN LAWYERS

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2016 FOOD REPORT

Introduction

Since the early part of this century, the fast-paced development of Alberta's oil sands and the push for more pipelines across the country have driven Canada's economic fortunes. Indeed, the Toronto Stock Exchange is one of the most carbon-intensive exchanges in the world — with over 25 per cent market capitalization in the oil and gas sector. Changes in energy markets (including booming domestic production in the U.S. and decreasing global demand) have depressed energy prices, and the effects are felt in the broader Canadian economy. We are optimistic that the Canadian food, beverage and agribusiness sector presents a viable and attractive alternative for investors today for a safe harbour from the upheaval in global energy markets. As a northern latitude area, the Canadian Prairies are expected to experience temperature increases by a multiple of global averages, which in turn increases growing seasons. These environmental shifts are also expected to increase crop yields and the diversity of crops that can be cultivated. We anticipate Canada's position to continue to improve as a lead global exporter as it benefits from improving agricultural conditions in the Prairies and increasing global demand.[1]

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In 2015, the Canadian food and agribusiness sector was once again the subject of a number of high-profile transactions (see Notable Transactions, page 2). Canada continues to be a leading exporter, and a significant importer, of agricultural and agri-food products. Similarly, farmland has been a strong asset, and in recent years, we have noted increased investments in Canadian farmland assets by financial investors (e.g., Middle Eastern sovereign wealth funds and the Canada Pension Plan).

As has become customary in the last four issues of this report, in this issue, we once again present an overview of significant global and Canadian M&A transactions in the food, beverage and agribusiness sectors. We also present four feature articles. The first article highlights the push to organic pesticides. The second provides a brief primer on the regulation of the dairy industry in Canada. In our third article, we provide a short overview of the Canadian farm debt market. Finally, we conclude with a summary and some reflections on the proposed Trans-Pacific Partnership Agreement and its ramifications for the Canadian agribusiness sector.

This report was prepared by the Blakes Food, Beverage & Agribusiness group based on non-confidential information acquired through our practice and from a review of public information. The information was gathered in the first three quarters of 2015. Our goal in preparing and presenting this report is to highlight certain trends, developments and opportunities we believe will have an impact on the food, beverage and agribusiness sector going forward.

The information contained in this report is intended for general informational purposes only and does not constitute legal advice. While care has been taken to ensure the information herein is accurate, we make no representations regarding its accuracy. This report should not be relied on to replace professional advice, legal or otherwise, relating to any specific circumstances.

1 Jeff Rubin, *The Carbon Bubble: What Happens to Us When It Bursts*, Random House Canada, Toronto (2015).

Notable Transactions

Featured Canadian Transactions

Cott Acquires DS Services

On December 12, 2014, Canada-based Cott Corporation (Cott) acquired U.S.-based DS Services Holdings, Inc. (DS Services) from Crestview Partners, L.P. DS Services, a leading bottled water and coffee direct-to-consumer services provider, was bought by Cott for a value of US$1.25-billion. The purchase included the assumption of an undisclosed amount in liabilities and the issuance of Cott preferred shares. Following the acquisition, Cott is now one of the world's largest producers of beverages on behalf of retailers, brand owners and distributors. By acquiring DS Services, Cott has gained access to one of the broadest distribution networks in the United States.

Vega Sold to WhiteWave Foods

On June 9, 2015, Denver-based WhiteWave Foods Company (WhiteWave) announced that it had agreed to acquire Vega, a Vancouver-based nutrition company. Founded in 2004 and with sales of US$100-million in 2014, Vega was sold by its founding president, Charles Chang, and VGM Equity Partners for US$550-million. It is expected that Vega will strengthen WhiteWave's share of the natural and organic dairy market, adding to WhiteWaves's popular product line of Silk Milk alternatives.

SunOpta Acquires Sunrise Growers

On July 31, 2015, SunOpta Inc. (SunOpta) made a strategic acquisition of Sunrise Holdings Inc. (Sunrise Growers) from an investor group led by Paine & Partners LLC. The transaction was valued at US$450-million. U.S.-based Sunrise Growers' market share of conventional and organic frozen fruit complements the Canadian-based SunOpta, a leading global company focused on organic and non-genetically modified and specialty foods.

G3 Acquires Interest in Canadian Wheat Board

On April 15, 2015, G3 Global Grain Group (G3) acquired a 50.1 per cent stake in the Canadian Wheat Board (CWB), a Winnipeg-based grain trader. G3 purchased the interest from the Government of Canada for a price of US$250-million. G3 is a joint venture between the U.S. agricultural conglomerate Bunge Limited and the Saudi Agricultural and Livestock Investment Company. The CWB's grain handling and marketing assets were combined with those of Bunge Canada Ltd., a unit of Bunge Ltd., to form a new company called G3 Canada Ltd., a coast-to-coast grain enterprise that provides a path for farmers to deliver their product from Canadian fields to global markets. The remaining 49.9 per cent equity of the new enterprise is held in trust for, and allocated to, participating Canadian grain farmers (at no cost to the farmers), with G3 having the right to buy the farmers' stakes in the future at fair market value.

Pinnacle Foods Acquires Garden Protein International

On November 14, 2014, the U.S.-based Pinnacle Foods Inc. (Pinnacle) acquired Garden Protein International Inc. (Garden) from Garden's founder and president, Yves Potvin, and TSG Consumer Partners LLC. Pinnacle paid a purchase price of US$153.90-million for the Canadian-based Garden, which is the manufacturer of the plant-based protein brand, gardein™, one of the fastest growing frozen health and wellness brands on the U.S. market. The acquisition adds to Pinnacle's position as a leader in the shelf-stable and frozen-foods segments.

Saputo Bakery Acquired by Canada Bread

On February 2, 2015, Canada Bread Company, Limited (Canada Bread), a subsidiary of Mexico's Grupo Bimbo S.A.B. de C.V. (Grupo Bimbo), acquired the entire share capital of Saputo Bakery, Inc., a subsidiary of Montréal-based Saputo, Inc., for a purchase price of US$103.06-million. Canada Bread, itself having been acquired by Grupo Bimbo in May 2014, is a leading producer and distributor of packaged fresh bread and bakery products. Saputo Bakery, Inc., now operating under the name Vachon Bakery Inc., will continue to be a leading producer of snack cakes in Canada, bringing together its well-positioned brands and complementing Canada Bread's product portfolio and its distribution and manufacturing footprint.

Viterra Agrees to Acquire TRT-ETGO

On August 27, 2015, Viterra Inc. (Viterra), a unit of Glencore Xstrata PLC, signed a purchase agreement to acquire the shares of Twin Rivers Technologies Holdings Entreprises De Transformation De Graines Oleagineuses Du Quebec Inc. (TRT-ETGO). Viterra, one of Canada's grain industry leaders, bought TRT-ETGO from Twin Rivers Technologies LP, which was owned by Felda Global Ventures Holdings Berhad (FGV), for US$142.59-million. TRT-ETGO owns a large oilseed processing plant in Eastern Canada, in operation since 2010, which produces vegetable oil for the food and industrial markets, as well as meal for the livestock industry.

Featured Global Transactions

Heinz in Mega-Merger with Kraft

On July 2, 2015, the Kraft Heinz Company (Kraft Heinz) announced the successful completion of the merger between Kraft Foods Group, Inc. (Kraft) and the H.J. Heinz Company (Heinz), a historic transaction that brought two iconic brands together and combined two unparalleled product portfolios. Heinz, which was jointly owned by Berkshire Hathaway Inc. and 3G Capital Partners Ltd., merged with Kraft through a stock swap transaction valued at US$46.106-billion. This transaction value includes Heinz's offer of US$36.331-billion in its shares, based on a market capitalization on the last full trading day prior to the announcement of the deal, as well as US$16.5 in cash dividend per common share, restricted stock unit and performance unit. Following the merger, the original Heinz and Kraft shareholders each owned 51 per cent and 49 per cent, respectively, of Kraft Heinz. Together, Kraft Heinz becomes the third-largest food and beverage company in North America and the fifth-largest in the world.

Smucker's Acquires Big Heart Pet Brands

On March 23, 2015, The J.M. Smucker Company (Smucker's) completed its acquisition of Big Heart Pet Brands (Big Heart) from Kohlberg Kravis Roberts & Co. L.P., Vestar Capital Partners, Inc. and Centerview Partners Holdings LLC. The value of the transaction, at US$3.17-billion, does not include an additional US$2.5-billion in net debt that was paid off by Smucker's at the close of the transaction. Based in San Francisco, Big Heart is a leading producer, distributor and marketer of premium-quality, branded pet food and snacks in the United States. The acquisition complements Smucker's role as a leading marketer and manufacturer of consumer food and beverage, pet food and snacks in North America, adding to its US$8-billion annual sales.

Nomad Acquires Iglo

On June 1, 2015, Nomad Holdings Limited (Nomad), of the British Virgin Islands, completed its acquisition of Iglo Foods Holdings Limited (Iglo) with a purchase price of US$2.81-billion. Upon completion of the acquisition from Permira Advisers LLP, Nomad changed its name to Nomad Foods Ltd. (Nomad Foods). As one of Europe's leading frozen-food companies, the U.K.-based Iglo adds its core brands of Iglo, Birds Eye and Findus to Nomad Foods.

Sime Darby Plantation Acquires New Britain Palm Oil

On March 3, 2015, Sime Darby Plantations Sdn Bhd (Sime Plantation), the plantation arm of Malaysian conglomerate Sime Darby Bhd (Sime Darby), completed the acquisition of Papua New Guinea-based New Britain Palm Oil Ltd. (New Britain). New Britain is one of the world's largest fully integrated producers of sustainable palm oil, palm seeds and sugarcane. Sime Plantation paid US$1.708-billion to acquire New Britain from Kulim (Malaysia) Bhd, adding its 135,000 hectares of land to Sime Plantation's total land bank, which now brings Sime Planation's land holdings to nearly one-million hectares, across five countries.

EWOS Sold to Cargill

On August 17, 2015, U.S.-based Cargill, Inc., agreed to acquire EWOS AS (EWOS) from Altor Fund III and Bain Capital Europe III for US$1.502-billion. The purchase of EWOS, a Norwegian-based global leader in salmon nutrition, gives Cargill entry into the salmon market and strengthens Cargill's animal nutrition business as a leading player in the growing salmon feed industry, one of the most advanced segments in global aquaculture. The transaction included the acquisition of seven feed manufacturing facilities in Norway, Chile, Canada, Scotland and Vietnam, as well as two research and development centres in Norway and Chile.

Renhe Commercial Holdings Acquires Yield Smart

On June 9, 2015, Renhe Commercial Holdings Company Ltd. (Renhe) entered into an agreement to acquire the entire share capital of Yield Smart Limited (Yield Smart) for US$1.485-billion. Yield Smart is a fresh fruit and vegetable wholesaler and retailer, which operates eight markets in six cities across China. Renhe bought Yield Smart from New Amuse Ltd., a subsidiary of Shouguang Dili Agri-Products Group Company Limited, in a stock swap transaction, where the consideration consisted of Renhe assuming US$190.9-million in liabilities in addition to the issuance of US$1.295-billion worth of Renhe's ordinary shares.

Olam Buys Archer Daniels-Midland Cocoa

On December 15, 2014, Olam International Limited (Olam), a commodity trader controlled by Singapore's state investment firm, agreed to acquire Archer-Daniels-Midland Co.'s cocoa business (ADM) for US$1.3-billion. The acquisition will make Olam one of the world's top-three processors of cocoa, with the combined entity having 16 per cent of the world's processing capacity and access to 20 per cent of the global supply. On June 11, 2015, the European Commission approved the acquisition, concluding that it raised no competition concerns.

JBS Australia Acquires Primo

On March 30, 2015, JBS Australia Pty Limited (JBS Australia), the Australian arm of the Brazilian food processor JBS S.A., acquired the Primo Group (Primo) for US$1.256-billion. Primo, Australia and New Zealand's largest ham, bacon and small-goods producer, has more than 4,000 employees, five production units, seven distribution centres, and 30 retail outlets. The deal is part of JBS S.A.'s global extension from fresh meat into the value-added processed-foods industry and is expected to provide a launching pad to export protein to Asia.

MOM Brands Bought by Post

On May 4, 2015, Post Holdings, Inc. (Post) completed its acquisition of the privately held MOM Brands Company (MOM Brands) for US$1.18-billion. Post is a U.S.-based consumer packaged goods holding company, and MOM Brands has over a century of experience and is best known for selling lower-priced cereals. The acquisition results in Post having roughly 18 per cent of the ready-to-eat cereal sales in the U.S., compared to Kellogg and General Mills' combined market share of 65 per cent.

Arca Continental and Corporacion Lindley Form Alliance

On September 10, 2015, Arca Continental S.A.B. de C.V. (AC) and Corporacion Lindley S.A. (CL) signed a definitive agreement to integrate their operations. The deal involved AC acquiring a 53.16 per cent interest in CL at a price of US$758.771-million. CL, the sole Coca-Cola bottler in Peru, and AC, with operations in Mexico, Ecuador, Argentina and the U.S., will integrate with AC to form a company with revenues of roughly US$5.4-billion. The transaction was approved by The Coca-Cola Company.

Transactional Activity in 2015

The following charts present our observations with respect to transactional activity in the food, beverage and agribusiness sector.

Deals Announced

Global Deals

3,104

Canadian Deals

112

The overall volume of food, beverage and agribusiness deals announced **was up from 2,757 in 2014 to 3,104 in 2015.** However, the number of transactions involving a **Canadian party** (as either target or acquirer) **was down slightly from 119 to 112.**

Deal Values ($M)

Global Deals

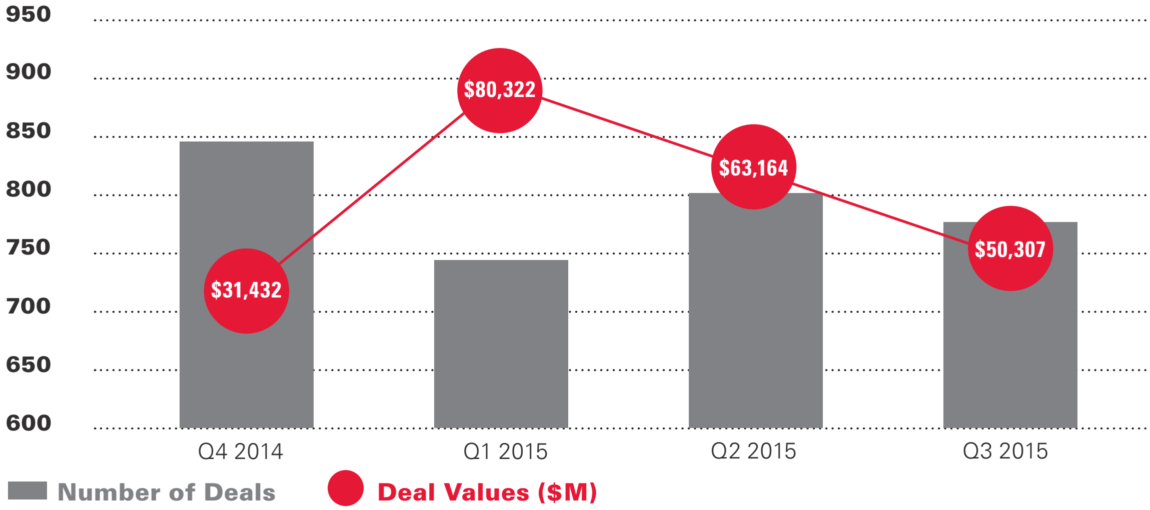
$225,225

Canadian Deals

$4,787

The total value of food, beverage and agribusiness deals was **up approximately nine per cent** over the same period in 2014. However, the value of deals involving a **Canadian party** was **down approximately 75 per cent over 2014**. The 2014 deal values were buoyed by the August 2014 merger of **Tim Hortons with Burger King, which was valued at approximately US$13-billion.**

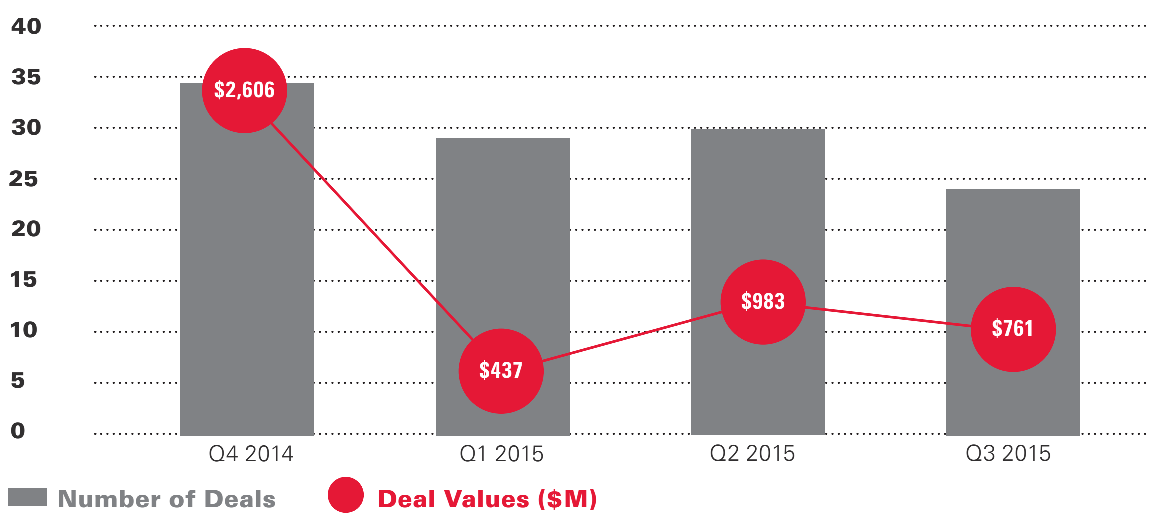
Global Deals (by Number and Value)



The total value of transactions announced in the global food, beverage and agribusiness sector was **strongest in Q1 2015 with decreases in each of Q2 and Q3 2015.**

The total number of transactions announced in the global food, beverage and agribusiness sector **dropped significantly between Q4 2014 and Q1 2015**, which is consistent with past experience as parties typically race to conclude transactions prior to calendar year-ends. Appetite for deal making **rebounded in Q2 2015 with nearly 800 announced** deals in that period, representing an approximately **10 per cent increase over Q2 2014**.

Canadian Deals (by Number and Value)

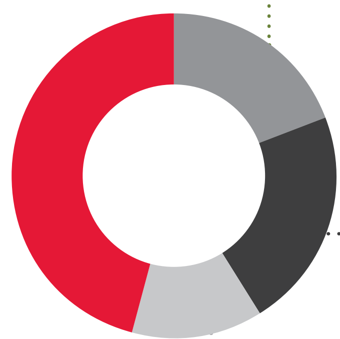


While the number of announced food, beverage and agribusiness transactions involving a Canadian party steadily declined, there was a more significant drop in transaction values (which **spiked in Q3 and Q4 2014 – largely due to the Burger King and Tim Hortons merger).**

Consistent with year-over-year trends, the number of announced food, beverage and agribusiness transactions involving a Canadian party steadily **declined between Q4 2014 and Q3 2015.**

Target Industry

Food and Beverage
46%



Agriculture and Livestock
19%

Food and Beverage Retailing
22%

Other
13%

Within the food, beverage and agribusiness sector, transactions were again **fairly evenly distributed** among subsectors. Food and production **led with just under half of all transactions.**

Target Company Status (Canada)

In the majority of Canadian deals, the target was a privately held company.

PRIVATE	PUBLIC	GOVERNMENT
82%	17%	1%

Target Company Status (Global)

Over three quarters of global tranactions in the food, beverage and agribusiness sector involved a privately held target.

PRIVATE	PUBLIC
76%	24%

Acquirer Company Status (Canada)

Slightly more than half of acquirers in Canadian food, beverage and agribusiness transactions were publicly traded companies in transactions where either the target or the acquirer was Canadian, **a modest increase over the same statistic in 2014**. A corresponding decrease is apparent in instances where the acquirer was a state-owned entity.

PRIVATE	PUBLIC	GOVERNMENT
45%	54%	1%

Acquirer Company Status (Global)

Slightly more than 60 percent of global acquirers in food, beverage and agribusiness transactions were privately held companies, with the balance being publicly traded companies. There were few (statistically insignificant) transactions involving state-owned entities.

PRIVATE	PUBLIC
63%	37%

Aquirer and Target Nations

Acquirer

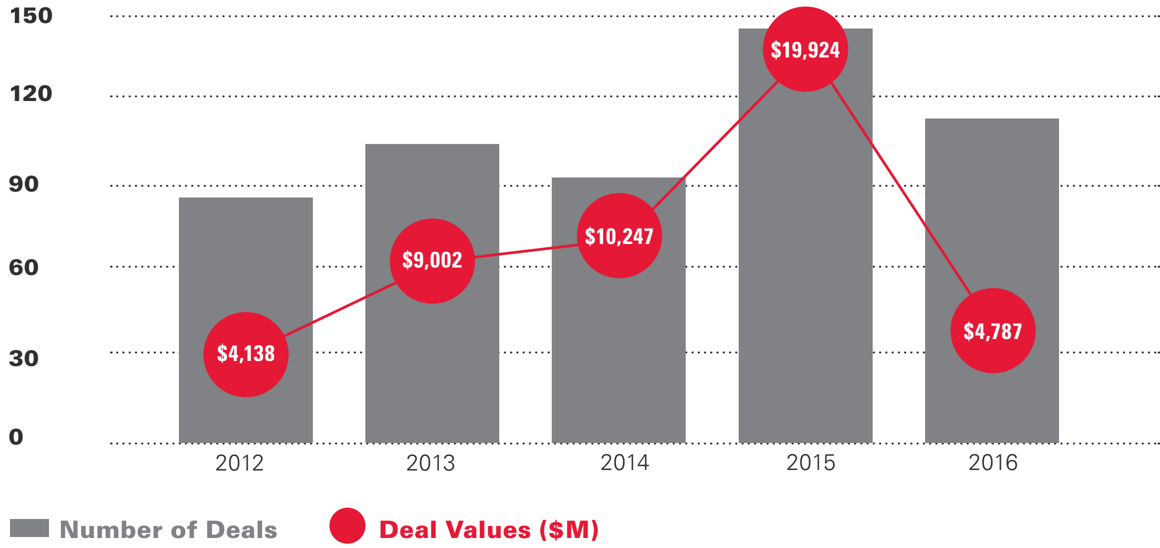
The most common home jurisdiction of the acquiring party in food, beverage and agribusiness transactions **is the United States**. China, Japan, France and Russia round out the five most common acquirer nations, while **Canada slipped to 10th** in 2015, just after Australia and ahead of Vietnam, the Netherlands, Malaysia and India.

Target

The most common home jurisdiction of the target entity in global food, beverage and agribusiness transactions **is the U.S. Canada slipped to 10th** (down from 7th in 2014), consistent with its slip as acquirer host jurisdiction.

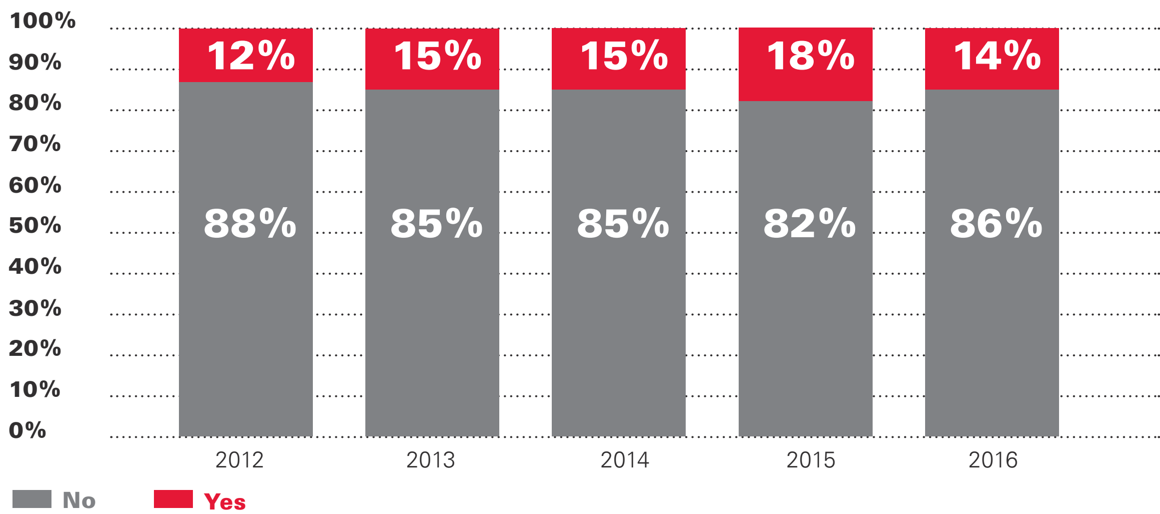
The following charts track general trends in Canadian and global food, beverage and agribusiness deals **over the last five years**. The year indicated reflects data for the prior year (i.e., "2016" reports data for Q4 2014 and Q1, Q2 and Q3 2015).

Canada Deals (by Number and Value)



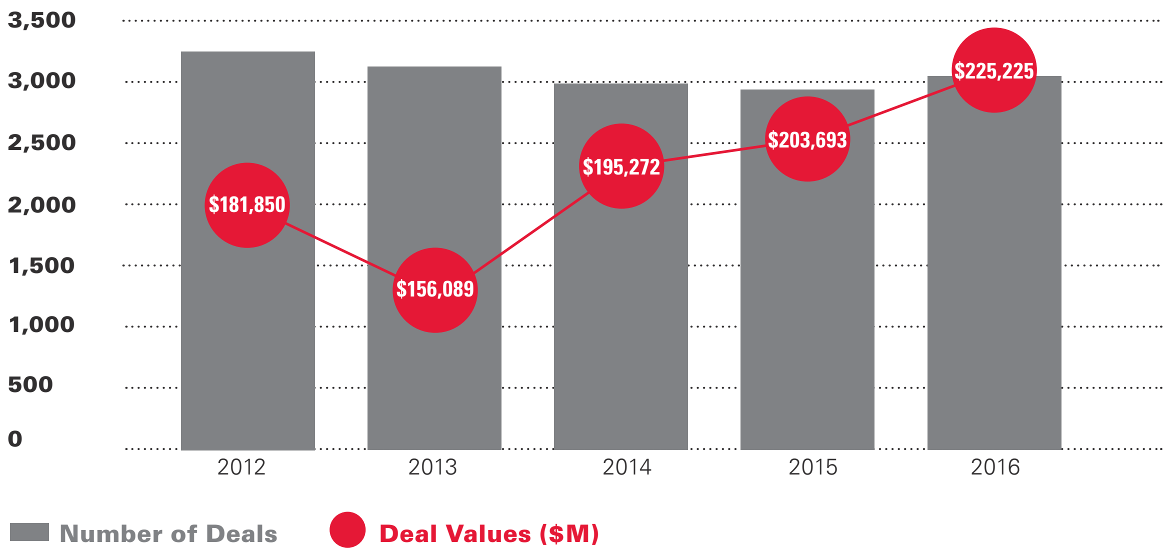
There is a noticeable decrease in deal value between 2015 and 2016, though the number of deals being done are still higher than 2014 (and prior) levels.

Financial Sponsor Involvement in Canada Deals



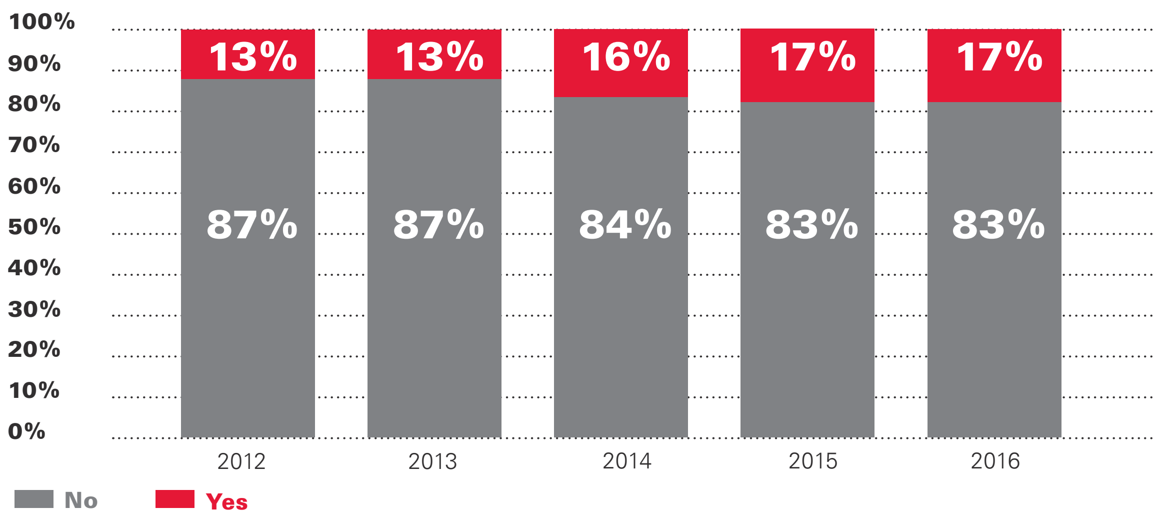
Financial sponsor involvement in Canadian food, beverage and agribusiness deals has been **consistently at or about 15 per cent** with a spike to 18 per cent in 2015.

Global Deals (by Number and Value)



We have noted **a steady increase** in global food, beverage and agribusiness deal values, coupled with an upward trend in number of deals being done.

Financial Sponsor Involvement in Global Deals



There has been **a modest but steady increase** in financial sponsor involvement in global food, beverage and agribusiness deals.

The Push Toward Organic Pesticides

Introduction

Recently, there has been a significant level of investment from seed and pesticide producers into new products referred to as organic pesticides. The organic pesticide market can be divided into four categories: microbial pesticides, microbial soil treatments, beneficial insects and other biochemicals. Currently, the largest category is microbial products, which include microbial pesticides and microbial soil treatments.[2] These products are developed from bacteria, fungi and viruses and are used to fight pests as well as increase crop yields. Beneficial insects, also known as macrobial biological products, are living organisms that are either predatory or parasitic in their actions against pests. Other biochemicals vary and often include semiochemicals that use pheromones to modify insect behaviour.[3]

Fuelling Growth

Organic pesticides have historically represented a small market consisting of four per cent sales of chemical pesticides worldwide.[4] However, the industry has a projected annual growth rate of 17 per cent and is expected to be worth C$4.5-billion by 2023.[5] Such growth rate may be attributed to technological advancement, consumer and environmental awareness, and shifts in the legal landscape.

Technological advancement has led to the discovery and development of new techniques that enable wide-scale production and use of organic pesticides, including the ability to protect seeds with organic pesticides before they are planted.[6] Organic pesticides can be expected to have enduring growth, particularly when compared to other "green" agriculture technologies. Furthermore, chemical pesticides are becoming increasingly more expensive to develop, and insects are becoming more resistant to such treatments.

In addition to technological advancement, consumers and environmentalists have raised fears over the long-term impact of chemical pesticides. Consumers are becoming more critical of synthetic products that have led producers to invest more in biological products.[7] In terms of

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2 Reisch, Marc, "Growing Profits with Microbes," Chemical and Engineering News, Volume 92, Issue 37 (September 15, 2014).

3 Phillips, Dr. Matthew, "The Biological Pesticide Market," Phillips McDougall AgriService, Agrolook (January-March 2014).

4 Bunge, Jacob, "The Race is on to Find Organic Pesticides," *The Wall Street Journal* (October 21, 2014).

5 "Biopesticides Grow Past $4.5 billion by 2023," LuxResearch (March 15, 2015).

6 *Supra* note 3.

7 Bunge, Jacob, "Monsanto Strikes Deal to Develop Plant Microbes," *The Wall Street Journal* (December 10, 2013); See also *supra* note 3.

legal developments, when significant harm is caused by a chemical pesticide, there may be pressure to ban the pesticide. Once banned, agricultural producers must look to other options that may consist of using less effective products and result in reduced yields.[8] Organic pesticides provide an alternative solution as they generally target the specific pest and may be applied in smaller doses that can reduce the pollution problems associated with chemical pesticides.[9]

Examples

Recently, producers of various sizes have entered the industry through investment, mergers, acquisitions and partnerships. Below is a brief summary of a few notable examples.

Consumers are becoming more critical of synthetic products that have led producers to invest more in biological products.

Unique Resources

In June 2015, Unique Resources Corp. acquired Bee Vectoring Technologies International Inc. (BEE). BEE owns beneficial insect technology that is designed to utilize bees as natural delivery mechanisms for powdered mixtures comprised of organic compounds that inhibit common crop diseases, while simultaneously fertilizing crops without the use of water. This process facilitates a targeted delivery of crop controls using bee pollination to replace traditional crop spraying, resulting in lowers costs, higher yield, organic products and reduced environmental impact.[10]

Monsanto

On a larger scale, Monsanto Company (Monsanto) recently formed the BioAg Alliance with Novozymes, a Danish biotech company. In this arrangement, Novozymes agreed to produce and supply microbial solutions to Monsanto, and Monsanto agreed to be responsible for marketing and selling the products.[11] In 2014, hundreds of microbial strains were tested in 170,000 plots across the U.S. and showed promising results. In 2015, further development will be done to bring products to market in corn and soy crops. BioAg Alliance has also made plans to ramp up testing of thousands of microbial strains in up to 500,000 field plots across the U.S.[12]

DuPont

On April 22, 2015, DuPont announced the acquisition of Taxon Biosciences Inc. (Taxon). Similar to the BioAg Alliance, Taxon examines soil samples to determine the effect of microbial strains. Taxon notes where a particular microbe consistently appears in soil samples from a thriving crop and attempts to determine how a crop would be affected if a microbe was added to its soil.[13] DuPont plans to test Taxon's leads in 2015 and expects to have microbial products ready for market within five years. The objective is for DuPont to use microbes to control pests and improve plant health, quality and yield.[14]

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8 McFerron, Whitney, "Bugs Invade Europe as Save-Bees Cry Spurs Pesticide Ban," Bloomberg Business, (January 8, 2015).

9 "Pesticides: Regulating Pesticides," United States Environmental Protection Agency (June 2, 2015).

10 "Unique Resources Corp. Announces Signing of the Definitive Agreement With Bee Vectoring Technology Inc., Conditional Approval by the TSXV, and Key Appointments to the Board of Directors," Stockhouse (June 1, 2015).

11 *Supra* note 6. See also: "Novozymes, Monsanto Sign $300M BioAg Alliance," North Carolina Biotechnology Center (December 10, 2013).

12 *Ibid*.

13 Charles, Dan, "Mighty Farming Microbes: Companies Harvest Bacteria to Give Crops a Boost," NPR (June 12, 2015).

14 Gillam, Carey, "DuPont Buying Microbiome Firm, Seeks Edge in Emerging Crop Products," Reuters (April 22, 2015).

Evogene and Marrone Bio Innovations

On a smaller scale, in late 2014, two start-ups signed an agreement to take advantage of strategic opportunities in the industry. Marrone Bio Innovations, Inc. (Marrone) is a California-based company researching microbes and developing microbial pesticides. Evogene Ltd. (Evogene) specializes in enhancing crop productivity for food, feed and biofuel industries. In the agreement, Evogene agreed to develop insect-resistant biotechnology seeds, and Marrone committed to develop biologically based insecticides targeting certain insects.[15]

Otter Capital

In terms of private equity, Otter Capital LLC (Otter) has repeatedly invested in firms that are developing microbes. To begin, Otter was an early investor in AgraQuest, Inc. (AgraQuest).[16] AgraQuest is a supplier of biological pest management solutions and was sold to Bayer CropScience in 2012 for C$425-million.[17] The success Otter had with AgraQuest led to further investment in April 2014, when Otter, along with Khosla Ventures, invested C$15-million in BioConsortia, Inc. (BioConsortia). BioConsortia researches how microbes can impact plant yield. In September 2014, Otter then led a C$17-million Series B financing for NewLeaf Symbiotics, Inc., which is a non-GMO biotechnology company focused on bringing beneficial plant bacteria to market.

The Future

Worldwide, there is growing pressure to limit chemicals in the environment. For example, in the European Union and Canada, governments have recently implemented regulations on the use of neonicotinoids.[18] In addition, regulators have made the approval process for chemical pesticides more difficult.

Worldwide, there is growing pressure to limit chemicals in the environment.

In addition to less stringent approval processes, the development of hybrid pesticides combining biochemical and natural products represents a potential opportunity. Hybrid pesticides are said to prolong the life of agriculture products and increase yields for farmers. Further, by combining natural products with existing chemical pesticides, pesticide manufacturers may be able to launch new product lines that are eligible for new patents.[19]

The market for organic pesticides is still relatively small. As the industry grows, pesticide manufacturers face challenges, notably ensuring that microbes work in a predictable manner.[20] However, with such growth, there may be further opportunity for mergers and acquisitions, investment, and partnerships of various shapes and sizes.

15 "Evogene and Marrone Bio Innovations Sign Multi-Year Collaborative Agreement," Marrone Bio Innovations (July 22, 2014).

16 "NewLeaf Symbiotics Raises $17 Million in Series B Financing Led by Otter Capital", Pangea Ventures Ltd. (September 15, 2014).

17 "Bayer CropScience Acquires US-Based Biological Company AgraQuest for Close to US$500 Million," Bee Care (July 3, 2012).

18 Benzie, Robert, "Ontario First in North America to Curb Bee-Killing Neonicotinoid Pesticides," *Toronto Star* (June 09, 2015).

19 Shamah, David, "Organic Pesticide Maker Raises 1M in Crowdfunding," *Times of Israel* (January 7, 2015).

20 *Supra* note 1.

Supply Management in the Canadian Dairy Industry: A Primer

Background

The dairy industry remains one of Canada's most regulated and protected industries. This dates back to the 1960s when dairy prices were at historic lows, the market was volatile and Canada had just lost its largest international market when the United Kingdom closed its borders to Canadian dairy after joining the European Common Market.[21] As a result, provincial groups of producers, who were already well organized, came together to lobby the federal government to create a national dairy system to manage the supply and pricing of dairy products across the country. In the 1970s, the government responded by introducing a regulatory regime called "supply management," which is comprised of three pillars: pricing control, supply control and import control.[22]

The Regulatory Regime

First, government regulatory agencies set prices based on factors that include the cost of production and consumers' ability to pay.[23] The type of dairy product determines whether it is the federal or provincial governments that have jurisdiction to set prices. The federal government sets prices for industrial milk (milk that is used for products such as butter, yogurt or cheese), while the provincial governments set prices for fluid milk sold within the province.[24] Fluid milk sold interprovincially falls within federal jurisdiction.[25] Canada's dairy prices are set high compared to world standards,[26] which has the effect of contracting demand.[27] The federal government carefully predicts and tracks that demand each month.[28]

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21 Goldfarb, Danielle, "Making Milk: The Practices, Players and Pressures Behind Dairy Supply Management," The Conference Board of Canada (November 2009) at 2.

22 *Ibid* at 6.

23 *Ibid* at 7-11.

24 *Ibid.*

25 *Ibid.*

26 Mussell,R. Allan; Seguin, Bob; and Sweetland, Janalee, "Canada's Supply-Managed Dairy Policy: How We Got Here" The Conference Board of Canada (August 2012) at 8.

27 *Supra* note 1 at 18.

28 "Market Sharing Quota," Canadian Dairy Commission (October 1, 2015).

Next, the federal government, through the Canadian Diary Commission, sets the total national supply of industrial milk in the form of a production quota and divides it among the provinces.[29] The provinces, through provincial boards, set the provincial supply of fluid milk and then allocate it, along with their portion of the federal production quota of industrial milk, to producers.[30] This is done through the allocation of production quota to producers. Each province administers a marketplace where production quota can be purchased, sold and traded.[31] In recent years, production quota has sold for more than C$30,000 per unit[32] (each quota unit corresponding to, approximately, the production of one cow)[33] and quota represents a major cost for producers. The cost of quotas is factored into the prices set by federal and provincial governments as part of the cost of production. As milk is produced pursuant to the quotas, provincial boards pick it up, transport it, store it and then sell it to processors who turn it into dairy products.[34]

Finally, foreign competition has historically been eliminated through import tariffs. In the past, Canada has allowed for a small amount of dairy imports at tariff rates below 7.5 per cent under special permits.[35] The amount of dairy products allowed under these permits represents a small percentage of the total dairy market in Canada.[36] For all other importers, the regular tariffs for dairy products, which are over 200 per cent,[37] have applied, essentially pricing dairy imports out of the domestic market. In some cases, alternatives to dairy products can be used in the processing of industrial milk (for instance, proteins) avoiding the high dairy tariffs. Regulatory efforts have been made to restrict the use of such alternatives, including through content requirements that mandate dairy products contain a percentage of Canadian proteins.[38]

Recently, the Canadian government has proposed to open up a small portion of the Canadian dairy market to foreign businesses. In its negotiations of the Trans-Pacific Partnership (TPP), a free trade agreement between Canada and 11 other nations throughout North America, South America, Asia and Oceania, the Canadian government agreed to open up 3.25 per cent of Canada's total dairy production to importers.[39] How this amount will be allocated if the TPP comes into force is not yet clear (for instance, if it will go to raw milk, processed dairy or finished products), but it may present an opportunity for foreign companies eager to break into Canada's dairy marketplace.[40]

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29 *Ibid.*

30 "Responsibilities," Canadian Dairy Commission (November 7, 2013).

31 See, for example: "About the BC Milk Marketing Board," BC Milk Marketing Board.

32 "Dairy Quota: A Useful Management Tool," Farm Credit Canada.

33 *Supra* note 1 at 20.

34 *Supra* note 34.

35 "Customs Tariff Schedule: Chapter 4," Canada Border Services Agency.

36 *Supra* note 1 at 24.

37 *Ibid.*

38 *Ibid* at 25.

39 "Opening Markets for Agriculture and Agri-Food Products," Foreign Affairs, Trade and Development Canada (October 5, 2015).

40 van der Linde, Damon, "Canada's 'big three' dairy processors poised to profit from TPP, though details are scarce," Financial Post (October 6, 2015).

Opportunities

Growth opportunities exist worldwide for the marketing of dairy products, especially in Asia.[41] Canada's supply management system not only controls the Canadian market for dairy products, but also hinders Canada's ability to become a dairy exporter. The high prices that processors pay for raw milk make their products too expensive to be able to compete internationally.[42] Even if selling dairy products internationally was economically viable for Canada, the World Trade Organization (WTO) has deemed dairy exports from Canada to be export-subsidized and they are, therefore, significantly restricted in volume.[43] An example of this is the excess supply of milk powder that Canada produces each year. Industrial milk is primarily processed into two byproducts: butterfat and milk powder. The demand for butterfat is higher, consistently giving rise to a surplus of milk powder, which the federal government purchases and stores.[44] Such powder is in high demand in China, but due to the WTO restriction on export-subsidized products, the Canadian government is forced to sell it domestically, at a loss, to be used in animal feed.[45]

Proponents of doing away with supply management altogether and liberalizing Canada's dairy industry recommend that the government, in some fashion, compensate producers who hold quotas, eventually leaving prices to be established by the free market.[46] In the absence of expensive quotas, the cost of production would be greatly reduced. Pricing based on market forces, rather than on the cost of production, would improve production efficiency. Though a drastic change from the status quo would undoubtedly be met with opposition from Canada's dairy producers, opening up Canada's dairy industry could create both global export opportunities for Canadian producers and import opportunities for foreign ones. Australia, New Zealand and, to some extent, the United States have already harnessed global growth opportunities in the dairy industry and made dairy exports an important part of their trade strategy.[47] An overhaul of Canada's dairy supply management regime could make Canada a player in the international dairy marketplace. However, one reality remains: any such overhaul presents significant political challenges in ensuring that producers, processors and consumers are all treated equitably.

41 Grant, Michael et al., "Reforming Dairy Supply Management: The Case for Growth," The Conference Board of Canada (March 2014) at 33 and 51.

42 *Supra* note 1 at 29.

43 *Supra* note 19 at 30.

44 *Supra* note 1 at 18.

45 *Supra* note 19 at 39.

46 *Supra* note 19 at 101-102.

47 *Ibid* at 50 and 54-55.

Agricultural Lending in Canada[48]

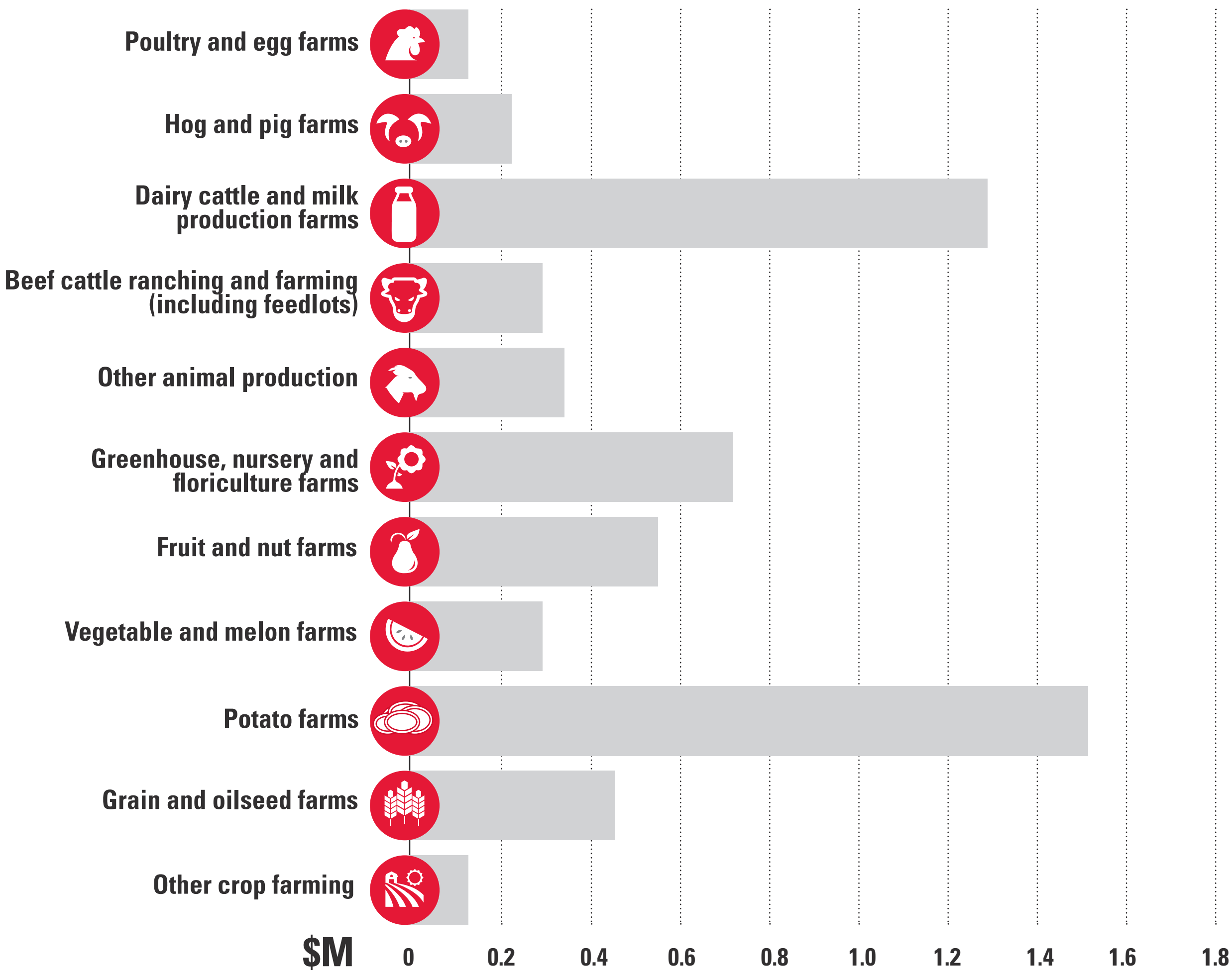
Agricultural lending accounts for approximately 10 per cent of the total value of credit outstanding in Canada, ranking third in total size (C$165.7-billion), behind only the national real estate and wholesale/retail trade sectors.[49] Farm credit comes in a wide variety of forms and types, although there are, in general, two broad streams of debt financing advanced to producers. Short-term financing is typically used in support of crop inputs such as seeds, plants and fertilizer or the maintenance of agricultural equipment and is often secured by personal property. In comparison, long-term financing is commonly employed to develop and expand agricultural operations, which may involve the purchase of additional land or the construction of farm buildings or structures. Long-term financing usually entails a real property mortgage structured to amortize over a period of time. These two types are frequently combined in a single lending arrangement, although they are also provided separately, depending on the needs of the borrower.

Farm credit in Canada is used by producers for a variety of purposes. Key applications of debt include the purchase of land, capital expenditure (construction, farm buildings, agricultural implements and farm machinery), acquiring livestock and quota, purchasing feed and crop inputs, maintaining operating capital, and hedging against ongoing or future risks. The following table shows, in relation to the most common types of Canadian farm enterprises, the varying intensity of reliance on debt of those enterprises on the basis of the latest available annual information,for the 2013 calendar year.

48 This note provides a brief overview of the current Canadian agricultural lending market, setting out some key data points, fundamental elements and important trends. Agricultural lending in Canada is a large, complex and multifaceted activity, and so this note serves simply as an outline of a few of its important aspects.

49 "Business credit outstanding, by supplier type and North American Industry Classification System," Statistics Canada (February 2, 2015).

Average Debt Liabilities in Canada Per Farm (by Farm Type)



Agricultural credit in Canada is provided by several types of lending institutions and government agencies. The following chart provides an overview of the different entities that currently provide financing to the Canadian farm market (on the basis of the latest available annual information, for the 2014 calendar year).

Farm Debt Outstanding in Canada (by Lender)

Chartered banks **36%**

Federal government agencies **28%**

Credit unions **15%**

Private individuals and supply companies **12%**

Provincial government agencies **6%**

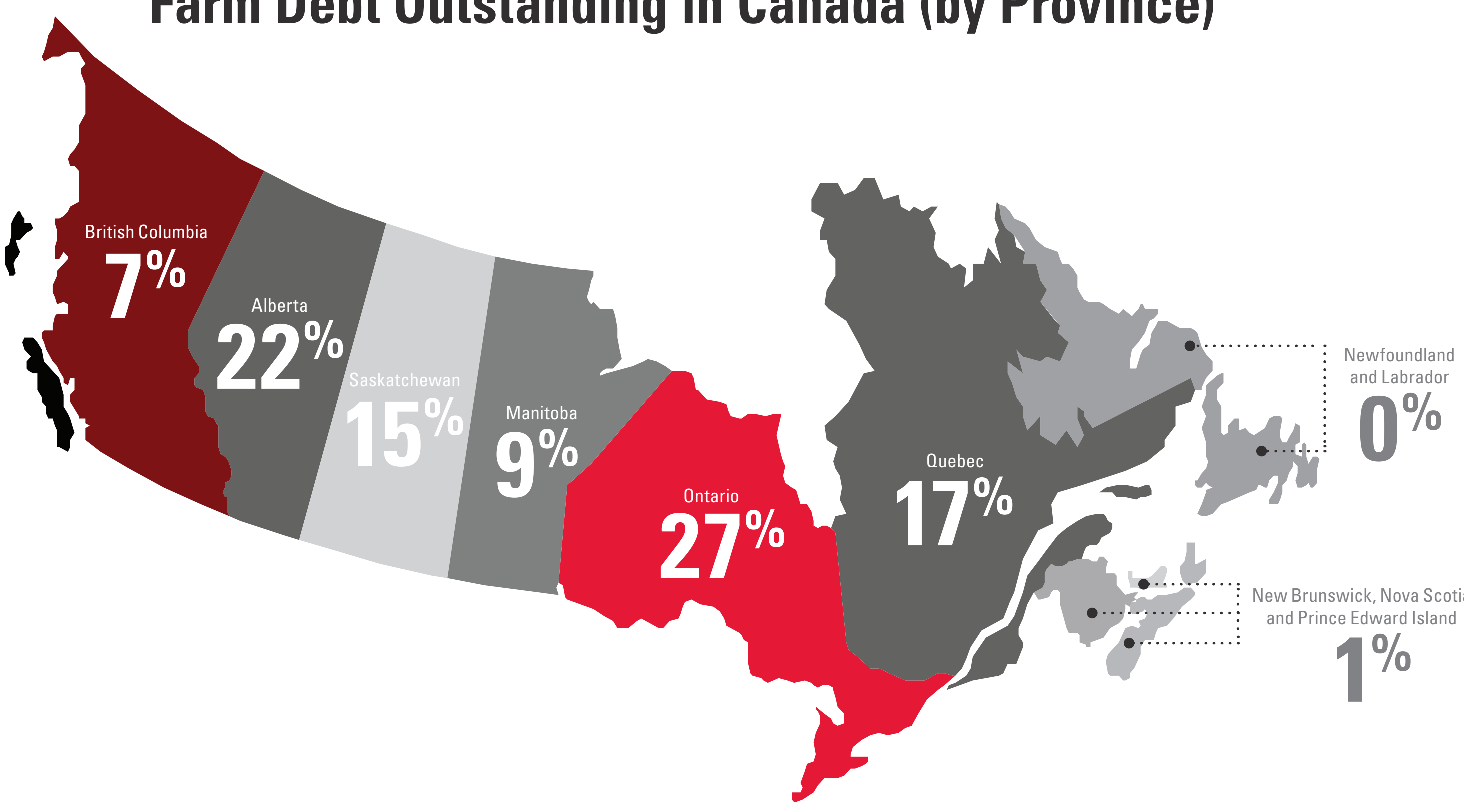
Advance payment programs **2%**

Insurance companies and other lenders **1%**

Chartered banks, federal government agencies and credit unions are by far the major lenders to the agriculture sector, with a combined total share of 79 per cent of the farm debt outstanding in 2014. Notable Canadian chartered banks involved in the agricultural sector include Bank of Montreal, Canada Imperial Bank of Commerce, HSBC Bank Canada, Royal Bank of Canada, The Bank of Nova Scotia and The Toronto-Dominion Bank. Farm Credit Canada, a federal Crown corporation, accounts for the second-largest share of Canadian farm debt, providing nearly one-third of all outstanding farm debt nationally. Farm Credit Canada was created by federal statute with a mandate to enhance rural Canada by providing financial services and products to farming operations and is the largest single government agency providing agricultural lending (as of June 2015, Farm Credit Canada held an outstanding loan portfolio of C$28.1-billion).[50] Approximately 15 per cent of the farm debt outstanding in Canada is owed to 650 different credit unions operating throughout Canada, with Vancity, Servus Credit Union and Meridian Credit Union being the three credit unions most involved in providing agricultural lending services.[51] Of the numerous provincial agencies that provide agricultural financing to agri-businesses, some of the more considerable ones are the Manitoba Agricultural Credit Corporation, the Agricultural Credit Corporation of Saskatchewan, the Alberta Agriculture Financial Services Corporation and Alberta Treasury Branches.

Agricultural financing is provided to farm enterprises throughout Canada, although it is obviously concentrated in those provinces where farming forms a large segment of economic activity. Below is a chart that illustrates the geographical breakdown of farm debt across the country (on the basis of the latest available annual information, for the 2014 calendar year).

Farm Debt Outstanding in Canada (by Province)



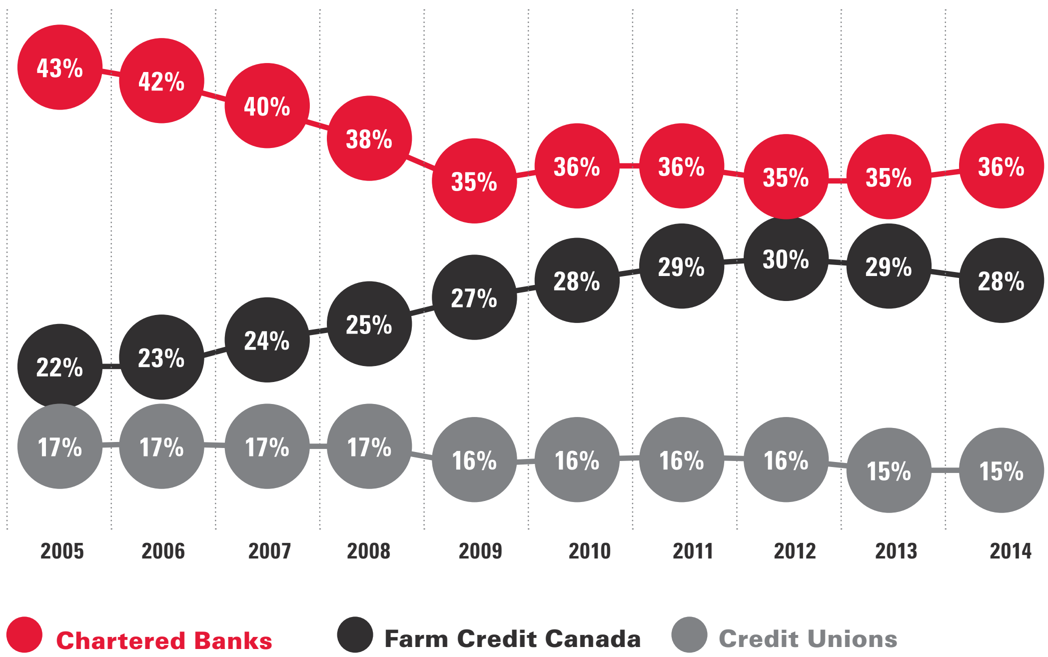
50 "First Quarter Financial Report 2015-2016," Farm Credit Canada (June 30, 2015).

51 "100 Largest Credit Unions, Second Quarter 2015," Credit Union Central of Canada (September 22, 2015).

While chartered banks continue to hold the largest share of outstanding farm debt in Canada, there has been a considerable shift from the private to the public sector. In the last 10 years, Farm Credit Canada has increased its portion of outstanding farm debt by 6.4 per cent, while the share of chartered banks has proportionately decreased by nearly seven per cent.[52] Meanwhile, the share of outstanding farm debt held by provincial agencies and credit unions has remained relatively steady through the last 10 years, especially in light of the strong presence many credit unions maintain in rural areas where local loyalties can influence choices regarding financing alternatives.[53]

The following chart illustrates the trends mentioned above, across the last 10 years.

Farm Debt Outstanding in Canada (by Per Cent Share of Financial Institution)



Overall, the Canadian agricultural credit market is large, dynamic and complex, and is **expected to continue to grow** as the Canadian farming sector expands and its borrowing needs further evolve.

52 "Farm debt outstanding, classified by lender," Statistics Canada (June 6, 2015).

53 "System Brief – Canada's Credit Unions: Supporting Canadian Agriculture," Credit Union Central of Canada (December 8, 2014).

The Trans-Pacific Partnership and Policy Reform

A Step Forward for the Canadian Agri-Food Sector

The Trans-Pacific Partnership (TPP), as announced by the Government of Canada on October 5, 2015, provides for extensive and significant decreases in foreign duties and tariffs currently applicable to the Canadian agri-food sector. In some cases, such tariffs will be completely eliminated. With 65 per cent of our current agriculture and agri-food exports going to TPP markets,[54] the potential benefits to Canadian agri-food product exporters, and to the Canadian agri-food sector generally, seem obvious.

Ultimately, Canadian success in export markets depends on our ability to be competitive in the international marketplace. Just as the TPP holds promise for expanded export opportunities for Canadian agri-food products, it also offers comparable benefits to our international competitors as they endeavour to increase their own export and market shares.

Fortunately, competitive advantages associated with a number of our agri-food export products put us in a solid position to succeed in international markets. This is evident from market data pre-dating the announcement of the TPP. For example, competitive advantages in the production of canola, lentils and dried peas translate to Canada holding more than a 40 per cent share of world exports of each of those products. While not as significant, our competitive advantages in respect of many other products, including pork, cattle, frozen potatoes and bread, mean that we hold a significant share of world exports in each of those products as well.[55]

Notwithstanding Canada's competitive advantages in respect of many agri-food products, many commentators have noted the need for reform of the Canadian agri-food policy framework to ensure our continued viability and competitiveness in the international marketplace. In particular, a shift in policy focus from income support to innovation and productivity gains has been identified as a key step in strengthening Canada's international agri-food sector competitiveness.[56]

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55 Conference Board of Canada

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Proponents of such a shift in policy orientation argue that the impact of such policy evolution will include an increase in sector income, stemming primarily from productivity gains.

In the face of … policy reform, the sector has clearly demonstrated its ability to adapt, evolve and improve.

The Canadian agri-food sector is not a stranger to policy reform that is focused on eliminating income support in favour of ensuring innovation and productivity gains. In the face of such policy reform, the sector has clearly demonstrated its ability to adapt, evolve and improve. A good example is provided by the sector's response to the abolition of the federally mandated "Crow Rate" for railcar wheat transportation in the mid-1990s. The Crow Rate effectively served to support producer incomes by subsidizing the cost of transporting wheat to international markets. While it was the subject of much debate and concern at the time, the removal of the Crow Rate resulted in significant innovation in western Canadian agricultural production and triggered a shift in production from wheat to other commodities, a shift that reflected market conditions and competitive resource allocation decisions. The elimination of the Crow Rate also contributed to the market-leading position in world exports now enjoyed by western Canadian canola, dried pea and lentil producers, with the production of pulses in Western Canada expected to be a main source of further growth in our agri-food export capabilities.

If the opportunity for greater access to international markets presented by the TPP is to be matched by policy reform oriented towards enhancing our agri-food sector's international competitiveness, it is essential to consider what specific innovation and productivity improvement-related policy shifts should be made. In that regard, there are clear indications that policy support for improving the viability of the Canadian agri-food processing sector is key. Statistics indicating that bulk unprocessed agri-food exports constitute over a third of the value of Canadian farm gate agricultural production[57] confirm the significant potential for "value-added" Canadian processing to increase income within the sector. A comparative analysis of Canada's competitive position in respect of unprocessed versus processed forms of the same commodity also points to the potential for greater economic returns stemming from policy enabling a more vertically integrated Canadian agri-food sector. For example, while Canada enjoys a significant competitive advantage in the live cattle market, our competitive advantage in respect of boneless beef is only marginal.[58] Greater productivity in our processing sector, which can be achieved through investment in both increased processing capacity and more efficient plant and equipment, will allow us to realize the benefits of greater vertical integration in our agri-food sector as we pursue the export opportunities presented by the TPP.

A good illustration of the possible benefits of a policy framework emphasizing innovation and related productivity gains relates to the TPP's proposed reduction in tariffs imposed by Japan on beef products. At first glance, a reduction in the current tariff level of 38.5 per cent to nine per cent over 15 years offers obvious benefits to Canadian beef

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58 Conference Board of Canada

producers. However, without further development of our beef processing capacity such that the Canadian beef industry is capable of shipping increased volumes of processed product to Japan, our producers will be left with simply continuing to utilize existing channels to market their cattle. This means that, in many cases, live cattle will continue to be shipped to the U.S. for slaughter, processing and further export from the U.S.

As in other sectors of our resource-based economy, we remain at risk of not realizing the value-added benefits of processing our produce prior to export. Government and private agri-food-sector engagement and cooperation in the development of effective policy to address this issue are crucial to fully realizing the longer-term opportunities presented by the TPP.

There are clear indications of strong and broadly based support for the TPP within the Canadian agri-food sector.

There are clear indications of strong and broadly based support for the TPP within the Canadian agri-food sector. The Canadian Federation of Agriculture, the Canadian Agri-Food Trade Alliance, oilseed and specialty crop producer organizations (including the Canola Council of Canada, Cereals Canada, Soy Canada and the Barley Council of Canada) and beef and pork organizations (including the Canadian Cattlemen's Association and the Canadian Pork Council) have all released public statements voicing their strong support for the TPP. Perhaps not surprisingly, responses from the Canadian supply-managed sector have been more muted, given the incursion provided for in the TPP of foreign dairy, egg, poultry and turkey production to the domestic Canadian market. As far as market participants contributing to the Canadian agri-food export market are concerned, though, the verdict is clear: the TPP presents the Canadian agri-food sector with a significant opportunity. What remains to be seen is whether policy-makers and industry can now work effectively together towards a new policy focus on innovation and productivity, including enhanced processing capacity, rather than on income support. If they can, the Canadian agri-food sector could well end up positioned for longer-term success exceeding even the most optimistic trade-related forecasted benefits of the TPP.

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