COVID-19 and Canadian Agriculture

March 25, 2020

Since the beginning of March, Bonnefield has been carefully monitoring the evolution of the COVID-19 pandemic domestically and abroad. We have spoken with numerous investors and farmers regarding the impact of the situation as it continues to develop. Below, we provide some insights into how we believe the spread of the virus, and the corresponding economic slowdown, are impacting the Canadian agricultural community.

In preparing this summary, we solicited feedback from multiple sources including farmers, input suppliers, processors, traders, and academics. While the situation will impact every operator differently, there were consistent themes that came through during our interviews. It is important to note that the situation is still evolving, and it is impossible to predict how things will continue to unfold. For example, since March 2nd, the CAD/USD exchange rate has dropped 8.4% from $0.7487 to $0.6905[1], and over the last two weeks the Canadian government has changed its travel and border policies almost daily. All of this is to say that these general themes will not remain static and Bonnefield will continue to monitor the situation and its impact on the farm sector.

A General Theme of Cautious Optimism

One common theme amongst the farmers from whom we've received feedback, is a feeling of optimism for the crop year ahead and plans to conduct their businesses as usual. Much of their planning for the upcoming season has been completed and they are gearing up for seeding or spraying, which is to commence in the coming weeks. They understand that these are uncertain times, but they believe that the agricultural industry is better insulated to weather a global pandemic than many others (hospitality, airlines, etc.). The primary concerns for farmers are the overriding levels of uncertainty and potential disruptions in the supply chain.

The agricultural supply chain is complex, integrated and global. As an example, delays at a shipping port in China can cause a mechanical part for a cultivator produced in Belgium from reaching the purchaser at a farm in Alberta. To date, delays within the supply chain appear to be minor, but it is impossible to predict how the spread of the virus and individual government reactions will impact this flow. Thus, many farmers appear to be taking proactive steps to insulate their operations from any future, unpredicted disruptions. These measures include amassing slightly larger stocks of inputs, chemicals, and spare parts than they might in a normal year.

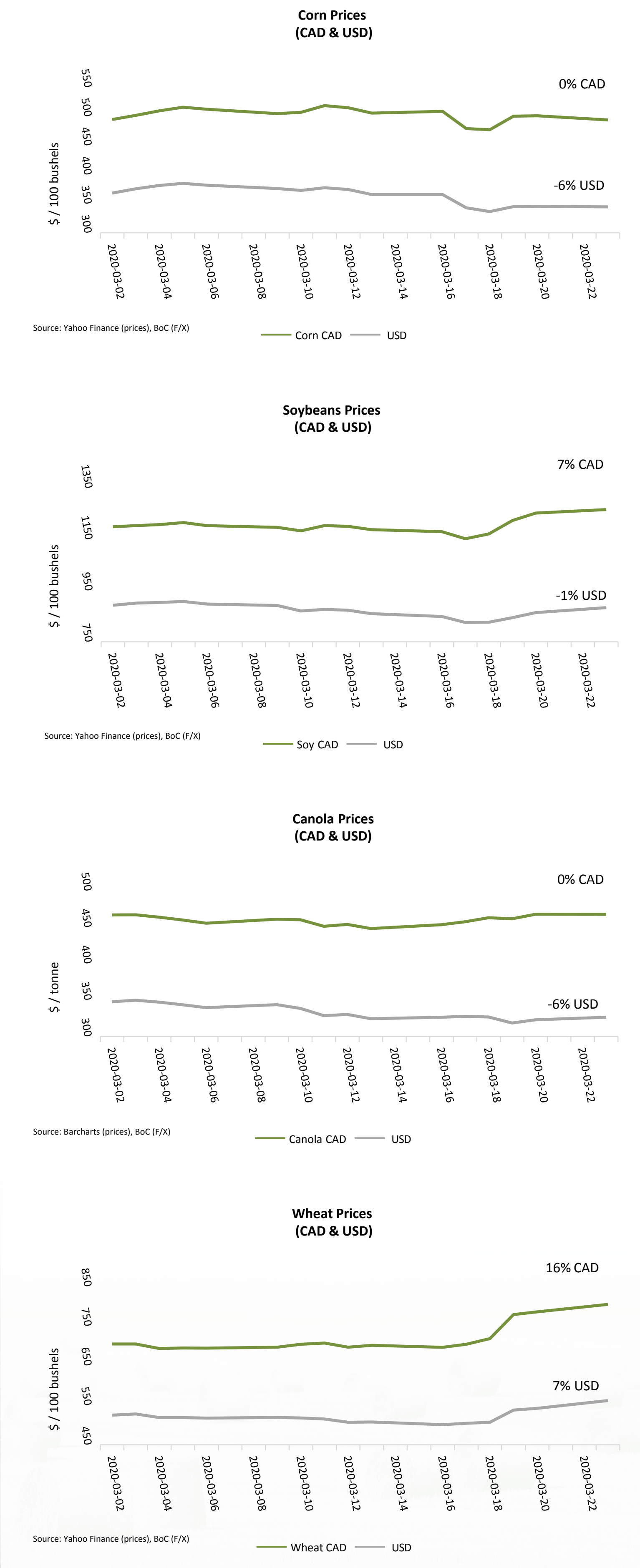
Potential Impacts On Specific Parts of Farm Operations

Food Demand

The common adage is that "people need to eat" regardless of the economic environment. Through the first couple of weeks of this crisis, there does not appear to be a dip in domestic food demand. However, one development that has been playing out is a shift in consumer buying patterns – with a large portion of food service and restaurant spending shifting to retail (groceries). This trend started around March 8th and gained momentum up until March 19th[2] when Ontario and Alberta officially closed dine-in restaurants and bars[3]. This trend towards food spending at home is also consistent with past recessions[4] as consumers tend to tighten their spending. Many expect this change in the source of food demand will continue for at least the duration of the economic slowdown. There is some concern amongst farmers and processors whose sales are primarily focused in the food service sector. Some are attempting to broaden their sales base to focus on retail channels, with varying degrees of success.

One interesting development during this period of adjustment was the well documented stock-outs that were occurring at grocery stores across the country. Many retailers were offering open tickets to farmers who had inventory and could meet demand, where some of our produce farmers told us that they were shipping 3-4 times their normal shipment levels for this time of year. This spike in demand seems to have waned as buying patterns start normalizing, albeit at a slightly higher level than pre-COVID 19. The stock-outs appear to be more of a temporary disruption as a result of consumer fear of future mobility. Most within the sector expect the current demand levels to persist into the near and medium term.

Figure 1: Commodity Price Fluctuations (March 2-23, 2020)



Prices

Crop prices, specifically as they relate to price at the farm gate, should be separated into commodity and contract crops as they track differently.

Commodity crops, or those traded in the public markets (e.g. corn, soybeans, wheat, canola) have experienced varying degrees of volatility since the outbreak of the virus. Canola, corn and soybeans prices have seen declines of 6%, 6%, and 1% respectively since March 2nd (Figure 1). Conversely, wheat prices have actually increased by 7%. At the same time, we have seen a strengthening US Dollar amidst the global economic slowdown and heightened uncertainty. This stands to benefit export-dependent countries, including Canada. We've seen that over this same time period, Canadian farmers have significantly benefited from a weakening Canadian dollar as it relates to commodity prices.
While it's challenging to predict future commodity prices, many farmers expect that longer-term, volatility should temper and prices should fall into a trading pattern reflective of global supply and demand. Weather patterns and global crop yields should be the primary drivers behind on`going price changes for these various crops.

Contract crops, including potatoes, peppers, apples, and blueberries are not traded on the public market. Depending on the crop, there can be a variety of end users or uses, including the fresh market, further processing, or individual quick freezing (IQF). Some of these contracts are negotiated up to a year in advance of the planting season, while others are purchased on a spot market during the season. In either case, pricing is based on forecasted supply and demand. For those crops and farmers for which pricing has been negotiated in advance, the current situation will not impact this year's crop price. If anything, it will impact the negotiation for next year. Bonnefield had multiple farmers confirm that even with the volatility in demand over the last couple of weeks, both sides were honouring the contracted price. For spot-priced crops, the bigger driver of expected pricing will be growing conditions and crop yields in other parts of the world, making them similar to commodity crops.

In both cases, farmers are primarily price-takers in the market, but this current situation has drastically changed the longer-term price outlook for most crops.

Inputs, Chemical, Fertilizer

Farmers have been somewhat fortunate with the timing of the COVID-19 outbreak, as many have already purchased their inputs for the coming year including seed, chemical and fertilizer. To date, input suppliers in most growing regions of the country don't appear to have experienced any significant slowdowns. Their supply chains haven't been significantly impacted and they continue to deliver product. They do acknowledge that any restrictive measures that may have unintended consequences on rail, port or truck services, domestically or abroad, could seriously change this dynamic[5]. Prices of these inputs will likely increase over time as a result of the stronger USD.

Equipment/Planting

Many large capital expenditures, including machinery, irrigation and tile drainage equipment, are sourced from the United States or abroad. This also pertains to permanent crop growers (orchards, vineyards) who often replant some of their acres on a rolling basis. The weakened Canadian dollar will make these types of purchases, or even equipment rentals, more expensive. Depending on their specific farm needs, some farmers may decide to delay some of these purchases, if not completely necessary, until there is some relief on the currency front.

Labour

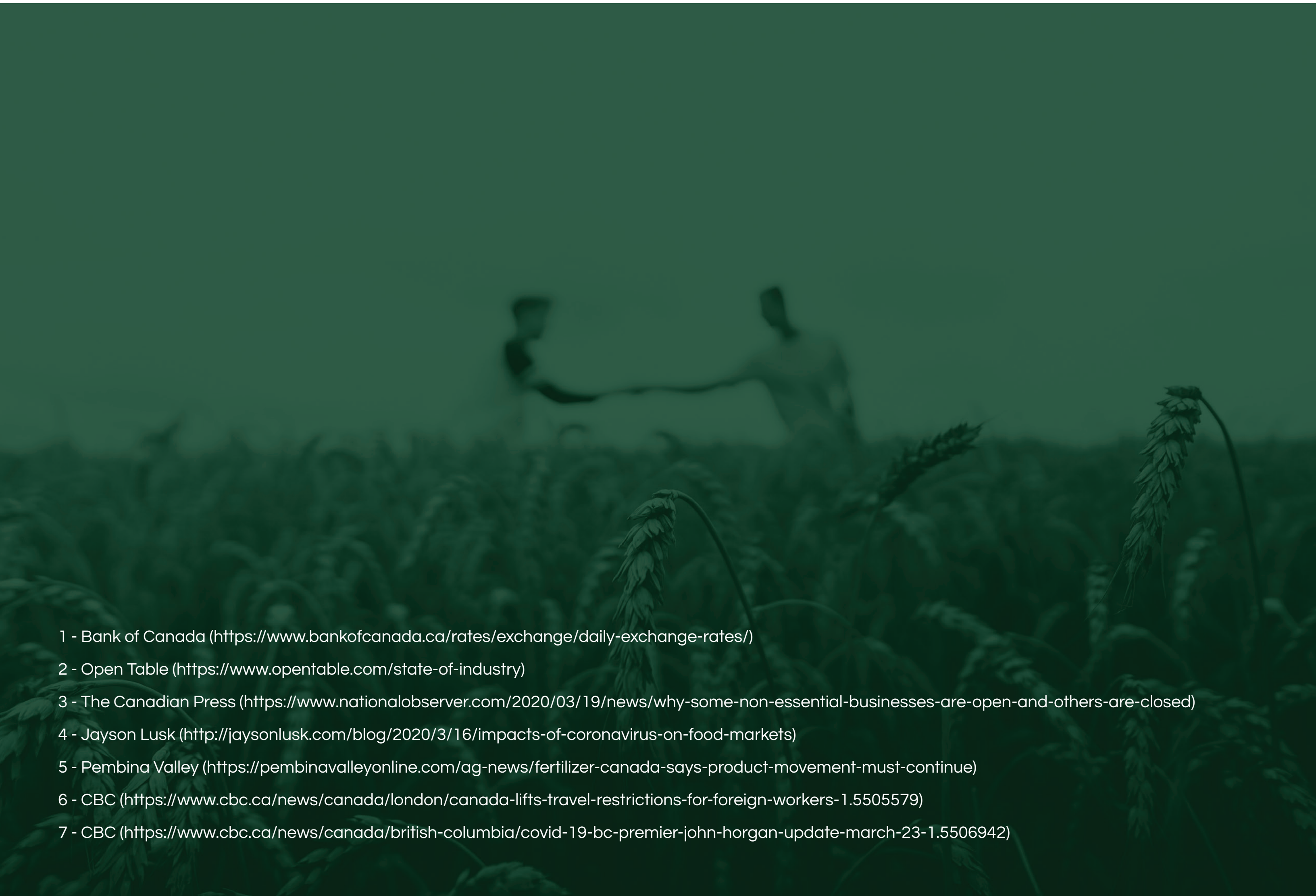
The biggest concern for most farmers we spoke with related to the labour situation. Again, depending on crop and farm type, labour needs can vary drastically. Usually permanent crop and produce growers have operations which require a greater amount of on-farm labour compared with many commodity-centric operations. Much of this labour is sourced from foreign countries, making any type of government-imposed travel restrictions potentially damaging. The last two weeks provided a great deal of uncertainty for many growers, but at the time of publication the federal government has announced that they have lifted travel restrictions on temporary foreign workers relating to the farm industry[6]. These workers will have to adhere to the two-week isolation period, consistent with others who have traveled outside of Canada. Farmers are planning accordingly and hope that there are no upcoming changes to this program.

Banks

Also, at the time of publication, the federal government has announced an additional $5 billion credit program to support farmers[7]. It appears to be a broad platform intended to help any farmers with potential cash flow challenges. Furthermore, in our discussions with farmers, the other commercial banks appear open for business within the sector for proven operators. This fact, together with the drop in interest rates, may make this an appealing time for some farmers to refinance or capitalize parts of their operations.

SUMMARY

While we are far from certain as to what will happen next, Canadian farmers and the food supply chain appear to be well suited to handle what lies ahead. One of the tenets of our investment philosophy is the overall resiliency of this sector compared to other parts of the economy. It has been quite encouraging to hear the feedback from the farm community and we believe that as consumers and investment partners, we are in good hands.



1 - Bank of Canada (https://www.bankofcanada.ca/rates/exchange/daily-exchange-rates/)

2 - Open Table (https://www.opentable.com/state-of-industry)

3 - The Canadian Press (https://www.nationalobserver.com/2020/03/19/news/why-some-non-essential-businesses-are-open-and-others-are-closed)

4 - Jayson Lusk (http://jaysonlusk.com/blog/2020/3/16/impacts-of-coronavirus-on-food-markets)

5 - Pembina Valley (https://pembinavalleyonline.com/ag-news/fertilizer-canada-says-product-movement-must-continue)

6 - CBC (https://www.cbc.ca/news/canada/london/canada-lifts-travel-restrictions-for-foreign-workers-1.5505579)

7 - CBC (https://www.cbc.ca/news/canada/british-columbia/covid-19-bc-premier-john-horgan-update-march-23-1.5506942)