Agriculture Can Grow our Economy

BUT

RAIL SERVICE MUST RESPOND TO MARKET DEMAND

OUR REPUTATION AS A GLOBAL SUPPLIER OF FOOD AND FEED PRODUCTS IS AT STAKE.

The market for Canadian grains, oilseeds and special crops is global. The domestic market is not large enough to consume the majority of Canada's agricultural production; **we must export.** Our consistent high quality, assured safety, and trusted reputation sets the benchmark that our competitors strive for. Transporting our product from farm to customer requires a complex supply chain with multiple actors to operate in a timely, efficient and cost effective way. Unfortunately, Canada's trading partners and competitors have taken notice of our transportation challenges. When grains and oilseeds are not delivered in full quantities on time, it means lost sales domestically and internationally. To safeguard Canada's reputation into the future, we must ensure our global customers that our domestic supply chain can deliver on time, every time.

FARMERS RELY ON CANADA'S RAIL SYSTEM TO GET THEIR PRODUCTS TO MARKET.

On an annual basis, **roughly 50% of Canada's total grain crop is exported, with 94% of it moving by rail.** Of these exports, 77% are exported by rail to port, 17% are direct rail (e.g. into the U.S.) and approximately 5% are by road. Close to 70% of wheat is exported, and some commodities are even more export dependent. Over 90% of Canadian canola (seed, meal and oil) is exported annually; over 90% of Canadian oats are exported to the U.S.; and Canadian pulses are exported to over 150 countries – we are the world's largest exporter of lentils and peas, and a top five exporting nation of beans. In 2014, Western Canada exported more than $20 billion in grain and oilseed products, a number that has seen sustained growth over the last five years.

OUR DOMESTIC AGRI-FOOD PROCESSING INDUSTRIES DEPEND ON RAIL SERVICE.

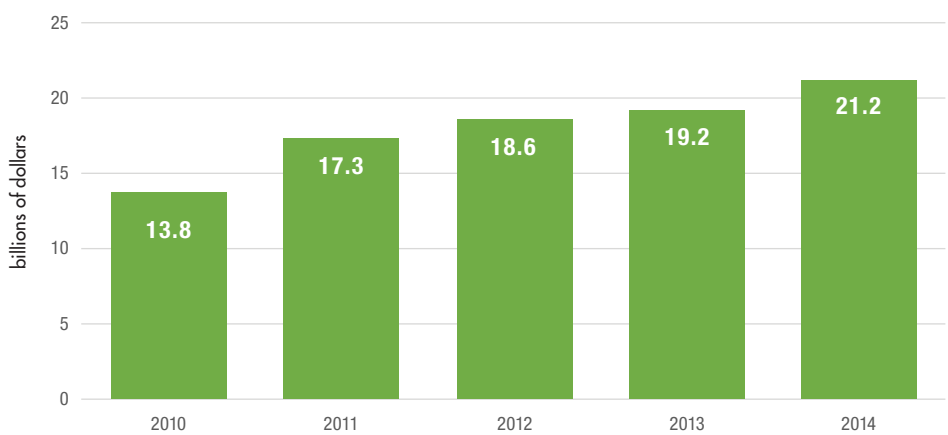
Wheat millers, canola crush plants, oat millers and barley maltsters are critically reliant on domestic shipments of raw product via the rail system. In many cases, they also depend on rail to transport the finished product to domestic and export markets. Many of these facilities operate lean production lines (employing just-in-time delivery), with smaller amounts of raw and finished product moving in and out on a timely basis. The Canadian canola processing industry in 2014 exported $1.7 billion in oil and $1.3 billion in meal into the U.S. alone.

AGRICULTURE'S GROWTH WILL CONTINUE, DRIVEN BY EXPORTS.

Western Canadian grain production has seen steady **growth of about 3% per year for more than a decade**, a trend we expect to continue. Future growth in production is not only contingent on farmers' ability to access and utilize new technology, but also our ability to capitalize on growing opportunities in established and new export markets, many supported by Canada's active trade agenda.

At home, agriculture is a significant contributor to the national economy. In 2012 it accounted for 6.7% of Canada's GDP and at the regional level, is a vital part of Canada's rural communities and western economies. When grains and oilseeds are not picked-up and delivered on time, it means lost revenue for farmers and a drop in rural economies.

Western Canadian Grain & Oilseed Exports



Source: Statistics Canada

GRAIN GROWERS OF CANADA
LES PRODUCTEURS DE GRAINS DU CANADA

Grain Growers of Canada provides a strong national voice for over 50,000 active and successful grain, oilseed and pulse producers through its 14 provincial and regional grower groups from across Canada.

Alberta Wheat COMMISSION

The Alberta Wheat Commission is a producer-directed organization dedicated to improving the long-term profitability of Alberta's 14,000 wheat producers.

Prairie Oat Growers Association

Prairie Oat Growers Association is a voluntary organization of prairie oat growers established to promote the interests of oat growers and oat marketing. It consists of producers, and associate members from the handling, milling and supply sectors.

Pulse Canada

Pulse Canada is the national industry association that represents growers, processors and traders of pulse crops (peas, beans, lentils and chickpeas) in Canada.

CANADIAN CANOLA GROWERS ASSOCIATION

CCGA represents more than 43,000 canola farmers on national and international issues, policies and programs that impact farm profitability.

GETTING GRAIN SOUTH

Movement to our neighbours needs priority

The challenges faced by Canadian oats serves as an example of agriculture's difficulties shipping to our closest customers.

Making our morning oatmeal is a North American ritual. Canadian oats supply companies in Canada, the U.S. and Mexico with great product. Indeed many Canadian crops are integrated into the milling, malting and processing businesses right across the continent. Surprisingly then, for a country so heavily dependent on trade with the U.S., our grain transportation system continues to struggle to make our only neighbour a priority, despite the demand from both America and Mexico.

All shippers know well the struggles of getting your hands on a rail car, and American traffic continues to lag well behind the other corridors. The de-prioritization of American orders is a long-standing issue; long turnaround times facing shippers moving their product to the U.S. and the smaller size of shipments to this market, means they need special attention.

During the 2013/14 crop year, rail movement volumes for oats fell compared to the five year average, even though crop production was up by almost 40%. In an attempt to maintain sales commitments for these typically smaller shipments to the U.S., farmers were forced to turn to substantially more expensive options. Oat exports to the U.S. by truck went up 69%, adding strain to an already overworked trucking system and producer car orders soared. Meanwhile, American customers turned elsewhere to fill the demand gaps. Oats were brought to the American Midwest from Sweden because that was more viable than getting them from Western Canada, while Australia has made massive gains in the Mexican market.

Even today, with many rail shipping corridors experiencing improvements, the U.S./Mexico corridor continues to see only about three-quarters of the car orders being fulfilled, and many of them delivered weeks later than requested. This is not a lingering effect of the 2014/15 crisis, but a systemic issue faced by shippers reliant on southern traffic.

Analyzing the problem is a challenge because public information regarding movement to the U.S. is woefully insufficient. There are anecdotal stories about turnaround times for cars that head south, but no concrete figures that can be relied upon to accurately assess the problem. Understanding the complexities of southern traffic would allow for a more open and productive discussion about deficiencies, as well as allow for potential solutions to be discussed.

> Canada's **reputation** as a **reliable exporter** has been damaged, and American customers must now... hedge against the unreliability of our system.

Innovative ideas have been proposed by the railways, particularly the Commercial Fleet Integration Program, which could help improve regular movement, however issues remain. Agriculture groups hope to see shippers, railways, and policy makers share an open discussion about problems and solutions.

Canada's reputation as a reliable exporter has been damaged, and American customers must now consider regularizing non-Canadian shipments to hedge against the unreliability of our system. When American customers ask Canadian shippers if they can rely on getting that order of oats or barley or other crops on time, it's hard to answer with anything but a "maybe". We need a better answer.

Only about three-quarters of the rail cars ordered for delivery to U.S. and Mexican customers are delivered and many of those arrive weeks later than requested. Our most important and closest trading partners are underserved.

Source: ATC railway performance data

STATISTICS

1,520 km

Average distance Canadian-grown grains travel to reach a Canadian port.

99%

Percentage of grain and process elevators that are served by only ONE railway.

How many routes do you have to your customer?

MISSING *the* MARK

Only **45%** of rail cars are delivered when requested and **40%** are delivered **4 weeks late or longer**.

- Delivered in week requested
- 1 – 3 weeks late
- 4 or more weeks late

DOLLARS & CENTS

$21 billion

The value of Canada's grain crop exports.

$20,000 per day

Typical demurrage cost - charges paid by suppliers, and ultimately farmers, when boats are not loaded according to contract timelines.

DID *you* KNOW?

5x HIGHER

Trucking is not an optimal solution for transporting bulk agricultural commodities to export. The cost to truck grain is 5X higher than shipping by rail and the logistics are simply impractical when shipping to port.

Myth or Fact: Setting the Record Straight on the MRE

The Maximum Revenue Entitlement (MRE), often referred to as the "revenue cap", has been in effect since August 1, 2000. It is a dynamic and elastic regulation that ensures the two major railways derive a profit and are compensated for their investments related to transporting Western Canadian grains to export positions. The complicated nature of the MRE causes a great deal of misunderstanding about how it works and perpetuates a number of misconceptions about rail service in Canada. Below we set the record straight on the MRE.

MYTH 1: The MRE sets a fixed shipping rate for grain shipped to a port

This is not the case. In fact, railways can apply differential rates to regulated grain movement as long as the overall 'average' revenue per tonne, as established under the MRE, is not exceeded. It is proportional, in that the more grain moved, the more revenue earned. In the 2013-14 crop year, the two major railways moved almost 38.5 million tonnes of regulated grain, with an average haul of 1,520 kilometres earning them $33.69 per tonne for a combined revenue of almost $1.3 billion.

MYTH 2: Competitive market forces should determine rail shipping rates

At its core, the MRE is a policy response to the lack of competitive market forces in the Western Canadian grain transportation system. It is established to counteract the monopoly market power that the railways can exert. In the absence of a true competitive market, the structure of the grain supply chain, and the distances required to move grain and oilseed products from country to export, it is intended to keep Canada competitive in global markets and to provide a degree of price protection to Western Canadian grain farmers while ensuring a reasonable return to the railways.

MYTH 3: Removing the MRE would improve rail service

Evidence from grain products that are shipped outside of the MRE prove otherwise, and clearly indicate that there is absolutely no relationship between the cost of rail freight and the provision of service. One obvious example is that Canadian grain, special crops and some value-added products (such as canola oil and meal) that are not shipped under the MRE (this includes Schedule II grains and non-regulated movements such as rail shipments to domestic locations or to the U.S. or Mexico) do not receive superior service while paying consistently higher rates.

MYTH 4: Poor railway service is linked to the regulated limits on pricing

Railway pricing and service are not linked. Extensive analysis shows that railways apply differential pricing, and shippers who pay higher freight rates are not guaranteed better service. In fact:

- Rates for grain under the MRE are not the lowest rates applied by railways to movement of Canadian commodities,
- Some other commodities pay less than grain and some pay much more, with many factors influencing rates such as: direct competition, available transportation alternatives (such as trucking), available market alternatives, location, and the value of the product and its ability to support higher freight rates, etc.

Only the railways and the Canadian Transportation Agency know what it actually costs the railways to move grain. MRE grain rates are somewhere in the middle of the pack for average rates per tonne so it is incorrect to single out grain as holding back railway profit without disclosure of their costs. It is a one-sided argument.

MYTH 5: The MRE is a hindrance to railway investment in Canada

The MRE is not a hindrance to railway investment. In fact, it is structured so that the railways are compensated for their investments in hopper car replacement and industrial developments, such as joint infrastructure projects with a company at a grain elevator or port terminal facility. The singular drive for low operating ratios, as a measure of success in the railway business, influences the approach taken to investment in capacity. Due to their market dominance, the railways do not establish capacity to meet the needs of the users of the system but at levels that will maximize railway profits through minimum investments in capacity and aggressive asset utilization.

Setting the Record Straight

The removal of the MRE would certainly increase grain rates with no guarantee of better service. It is not possible to determine the relationship between a grain company paying higher freight rates and the impact on producer price. At the sector level, higher freight costs will most certainly get passed back to producers, the degree to which is difficult to estimate.

Since the inception of the MRE, the grain industry has significantly invested in the modernization of the grain handling and transportation system which has greatly helped the railways' efficiency and bottom line. In 2014, agricultural products represented 12% of total carloads moved by Canada's railways while contributing 16% of their total revenue.

The MRE is an easy target for blame or causation of problems in the rail supply chain, but its removal would not improve service nor guarantee future investment which are the real issues.

WESTERN CANADIAN CROP PRODUCTION: SUSTAINED ANNUAL GROWTH

1% per year - average growth 1989 to 2001

3% per year - average growth 2002 to 2014

Grain production varies from year to year, but has expanded consistently during the last 25 years.

Source: Statistics Canada

FARMERS FEEL THE PINCH ON RAIL SERVICE PROBLEMS

When railways can't deliver on service, farmers are directly affected:

1. Cash prices that farmers receive drop
2. Unable to sell grain or deliver on existing grain contracts
3. Bills go unpaid when cash flow is limited
4. Spending drops in rural economies

The bulk supply chain is complex. Meeting one customer's order requires commitment by many individuals to get the right product to the right place, at the right time.

650 farmers
(each has 80 tonne delivery contract)

1,250 semi-trucks
(each truck hauls 40 tonnes)

5 unit trains
(110 rail cars @ 90 tonnes canola per car)

1 Panamax ship destined for Japan
(holds 50,000 tonnes of Canola)

Real Facts on Grain Transportation in Canada

Canada's grain, oilseed and special crop farmers critically rely on rail transportation. Every order for a grain hopper car counts. In a complex supply chain, spanning an average of 1,520 kilometres, the ability of the railways to get agricultural products to an export position is crucial to every player in the value chain – especially to the farmer.

Rail is the most economical and efficient way to ship bulk grain. Unfortunately, Canada's rail system is not consistent nor reliable and has not proven to be adept at handling the grain industry's growth. For example, 2013's record-breaking harvest should have resulted in a positive outcome for the grain industry, but subsequent poor rail performance threatened our reputation as a reliable supplier of quality products, and compromised the livelihoods of farmers and the growth of the Canadian economy.

The Information Gap

For years grain shippers have struggled to address the challenges presented by the spatial monopolies under which Canada's two national railways operate. The nature of the grain transportation system has always meant very limited competition. Of the 370 primary and process elevators in Western Canada, only four are directly served by both railways (excluding elevators affected by the temporary extension of interswitching rules). This means almost all of the elevators and process facilities in Western Canada are captive to one of the two major railways in Canada.

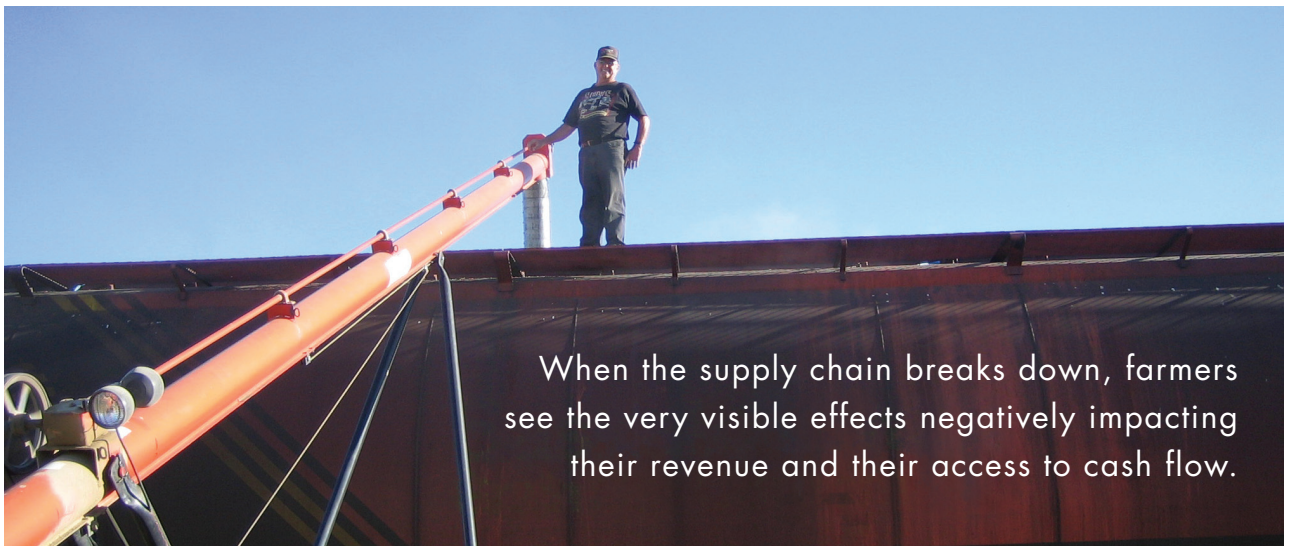
Information is critical for markets to function efficiently. Information enables better decision-making and can help solve transportation disruptions and prevent damaging public policy interventions. In the Canadian railway marketplace, one-sided data and lack of publicly available information are fundamental problems that have long existed. The two major railways report publicly on their view of supply chain performance, according to their selective metrics.

Producer groups and grain companies in the agricultural sector have long recognized the problems associated with this information gap. The weekly Performance Measurement Report from the Ag Transportation Coalition (ATC) was publicly launched in January 2015, to fill this gap until a permanent solution is implemented. The reporting brings a new level of information transparency to the grain shipping supply chain and reflects true levels of railway service by comparing weekly commercial demand (customer orders) to railway service (actual cars spotted). There now exists a report that all interested parties can use to objectively assess capacity and service– and ideally begin work towards improvement.

Service and Efficiency

Of no surprise to agricultural shippers, the weekly ATC Report shows ongoing challenges in the grain transportation system. Railway service to the grain sector is based on rationed supply and arbitrary timelines – as dictated by the railways, not those requested by the shipper. This scenario is played out at the expense of farmers, grain shippers and ultimately Canada's reputation in foreign markets.

When railway car orders are not supplied to shippers in the week that they are ordered, some grain sales will be lost and some will be deferred. Grain companies plan sales programs several months in advance, specifying contracts, chartering vessels and planning for rail car capacity. Once the railcars are ordered by the shipper they are typically planned for the next week's service, which then may or may not occur. If the cars do not arrive, this throws the supply chain between the elevator and the port into a scramble as companies attempt to move the right product to port for loading. Lost sales cannot be recovered as international buyers will obtain this grain from suppliers outside Canada. Deferred sales may be filled by the grain company in later weeks using cars supplied later on in the year by the railway, however, they can result in extra costs to the supply chain through higher inventory carrying costs, payment of contract penalties by shippers, payment of ocean demurrage for waiting vessels and loss of goodwill with overseas customers.



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The ATC Report shows that the railways are supplying less than 50% of orders in the "want week". Another issue is the direction, or corridor performance. Movement to the U.S. and Mexico this year has been severely constrained, with about 75% of orders being eventually fulfilled, but only 20% occurring in the want week.

This is not conducive to operating a complex supply chain, with several commercial players that are attempting to time delivery of product from several trains to port terminals to fill ships and execute on contracts that have been planned for months. This type of performance is completely unacceptable, regardless of sector or line of business.

Cost to Farmers and Rural Communities

The lack of railway performance has real costs (including demurrage and penalties) that are absorbed by the supply chain and ultimately by farmers. When the supply chain breaks down, farmers see the very visible effects negatively impacting their revenue and their cash flow. The actual price paid for their grain will be affected by constrained transportation supply, as the grain companies lower the net price they pay to the farmer to signal that supply is not wanted. Additionally, when grain supply is unable to move during a given crop year, it is "carried over" into the next and this can have longer-term effects on the price farmers receive. In addition, farmers do not get paid until delivery. Deferring delivery means that the farmer must carry the cost of that grain, and finance operations in lieu of expected cash flow.

Furthermore, grain, oilseeds and special crops are perishable commodities. There is inherent risk of spoilage when long-term storage is required due to inability to deliver grain.

Links to Economic Growth

Canada's grain is a significant contributor to the economy. In 2012, the agriculture and agri-food industry accounted for 6.7% of Canada's GDP. With continuing investment in new and innovative technology and crop varieties, the trend of larger harvests and expanding Canadian exports will continue to drive the Canadian economy.

Canada competes in a global marketplace, and even though our grain, oilseed and special crops are renowned for their quality, and often command premium prices, some are broadly substitutable. When reliable delivery of supply is affected, the buyer's confidence in our ability to meet reasonable delivery timelines is imperiled. As an exporting nation, this is unacceptable to the nation's farmers, the grain trade, and our global customers, and should be to policy makers as well.

Ag Transport Coalition (ATC) Weekly Performance Measurement Report

The ATC weekly report covers 90% of grain movement that originates in Western Canada. It is produced by an independent third party using grain shipper and railway industry data.

The report explains railway performance from the shipper's perspective using key measurements such as: cars ordered versus cars supplied, timeliness of railway car supply in response to weekly customer orders (e.g. "want week"), and corridor performance amongst others.

The ATC Weekly Performance Measurement Report is part of a five-year initiative supported by eight agriculture groups with matching funds from Agriculture and Agri-Food Canada.

More information on the ATC, including the weekly reports, can be found on the Ag Transport Coalition website: www.agtransportcoalition.com