ELSEVIER

International Food and Agribusiness
Management Review 4 (2001) 309–343

International Food
and
Agribusiness
Management Review

TML Foods Inc.☆

Erna van Duren*, Carl Neggers, David Sparling

Agricultural Economics and Business, University of Guelph, Guelph, Ont., Canada NIG 2W1

"Another year like the last could finish this company. That would be disastrous for us, our employees and Melfort." Looking down the boardroom table, Tomassen Meat Limited (TML) President Rob Bailey had to agree. He quipped ". . . yes, but it's our job to make sure it isn't". The Board of Directors of TML Foods Inc. of Melfort, Sask. had convened a special meeting in April, 1999, to review 1998 results and to consider TML's strategy for the future. After record losses in 1998, the board had initiated a complete review of TML's strategic position, finances and operations. One of the directors, Cal Hagar, had taken on the role of spearheading the process and had recently completed an external environment scan. He had also guided the board's internal review of TML. The board was in the process of reviewing both, and based on their analysis it planned to set TML's strategy for taking the company into the new millennium.

Cal was leading the board through the strategic planning process. As a Director of Saskatchewan's Agri Food Equity Fund (AFEF), he had been heavily involved in TML since AFEF became TML's largest shareholder in March, 1998. Although some of the load had been taken-off Cal when Rob Bailey assumed the presidency, he still needed to provide guidance for both strategy formulation and implementation. Cal's objectives for the meeting were to assist Rob and the board in deciding on the key strategic issues and developing an integrated approach for addressing them. Rob Bailey and TML board members were to come to this meeting prepared to discuss strategy . . . and not just at 30,000 ft . . . but also in terms of specific issues.

As Rob began the meeting, his thoughts were on how closely the others' ideas resembled those on his list as well on how to manage the strategy process. He was particularly

☆ This case was prepared by Erna van Duren, Carl Neggers and David Sparling of the University of Guelph. It is intended solely for class discussion. Some names and selected details have been disguised.

* Corresponding author. Tel.: +1-519-824-4120 ext. 2100.
E-mail address: evandure@uoguelph.ca (E. van Duren).

PII: S1096-7508(01)00080-5

interested in the ideas and suggestions of the veteran TML Managers responsible for the operations, finance, marketing and human resource functions. He had asked each of these managers to come fully prepared, and be ready to present their views on overall strategy for the company as well as the role of their respective departments.

1. Background

TML Foods Inc. operated a value added red meat processing facility in Melfort, Sask. The company originated as a small butcher shop that was owned and operated by Gerald Tomassen. Gerry had been a meat salesman for 20 years, and at the age of 40, with five young children at home, he had decided to put his industry knowledge to work. Starting with $500, Gerry began with a butcher shop in Naicam in 1961, a small town of 1,500 about 50 km east of Melfort. The business grew over the next 20 years and its focus changed from a butcher shop to a meat processing plant that was provincially inspected. Subsequent expansion in 1986 and 1992 allowed TML to become federally inspected. Federal inspection status enabled TML to export outside the province, but also required the company to support at least one full-time federal inspector on site.

During that time Gerry successfully developed a strong array of traditional high quality meat products such as pork chops, bacon, beefsteaks, roasts, hams and others. TML became recognized throughout Saskatchewan for its quality products. Gerry's reputation as an honest and hard working businessman was synonymous with TML's image. Lorna Tomassen, Gerry's daughter assumed the position of President and CEO in 1989 and Gerry moved to a support role, maintaining his position on the board and providing operational guidance as required.

Starting in the 1980s, the Government of Saskatchewan, along with many other provinces and the federal government initiated several programs to facilitate and encourage exports, particularly to Asia. Lorna Tomassen was invited to participate in these trade missions and recognized new market opportunities for TML. To take advantage of the growing market in Asia and opportunities in the domestic retail-ready market TML initiated further expansion. With the support of public and private investors in the Prairie provinces and the Canadian Imperial Bank of Commerce (CIBC), the company began a $4.5 million expansion of its processing plant in 1994. This expansion included obtaining a listing on the Alberta Stock Exchange under TML Foods Inc. This listing would allow for easier entry and exit of shareholders, and possibly facilitate raising capital for future expansion. TML's expansion and new market opportunities were intended to take the company from $3–5 to $15–20 million in annual sales.

By 1996, it was obvious that TML was not successful in the export market and was in fact plagued with quality problems. Export contracts were all short-term or based on contract bids. No long-term contracts had been secured. TML's container shipments were regularly challenged at Japanese ports, with authorities citing inappropriate cuts (too lean, improper trim, etc.) or poor presentation (poor packaging). In one instance, the inspector at TML approved a $70,000 shipment but random testing at Vancouver detected problems and the shipment had to be disposed of domestically for $35,000. This ongoing situation often required further discounting on shipments that had already exited the plant at a loss. Since TML did not have a physical presence in Japan, it was difficult to challenge Japanese decisions.

TML's rapid expansion also challenged its domestic markets. The newly introduced Retail Ready steak program was an overnight success. Unfortunately, problems with raw product supplies forced TML to purchase lower grade beef in order to fill contracts. Consumers returned product to retail outlets, suggesting that it was "tougher than shoe leather". Sales declined and very quickly the Tomassen label lost its quality image.

Quality problems were attributed to overly rapid growth and inadequate organizational structures and systems. Canada's Federal Inspection Agency (CFIA) continued to cite TML's operations on a regular basis for failing to meet minimum food safety standards. Management became preoccupied with cash flow, neglecting operations and marketing issues. Competent meat cutters left to find more secure employment. After repeated quality problems, the Federated Co-op, the largest food retailer in Canada's prairie provinces, cut all ties with TML and took 30% of TML's sales with them.

2. The Agri Food Equity Fund takes over TML

The combination of high debt, low sales and poor operating efficiencies resulted in significant losses in 1996 and 1997 and plummeting share prices (Exhibit 1). As the major debt-holder, the CIBC became concerned over TML Foods' ability to service its debt and the erosion of corporate equity. This anxiety spread to the Board of Directors. Worried by the prospect of being held personally liable for TML's financial difficulties, several of the directors resigned. Seeking to reduce its risk and exposure, the CIBC initiated negotiations with the Agri Food Equity Fund in January, 1998. AFEF is a Saskatchewan government sponsored investment fund whose mandate is to facilitate the development of the province's rural economy. AFEF was established in 1994 to encourage start-up and expansion of agricultural value added processing though equity investment in small to medium-sized businesses. AFEF was initiated with an up-front portfolio of $20 million, which was to be invested over 5 years. Investments were to range from $25,000 to $1,000,000. During TML's 1994 expansion, AFEF had invested $500,000 in the form of an unsecured corporate debenture.

On March 6, 1998, the Agri Food Equity Fund purchased TML Foods' $2.68 million capital loan, the $468,000 operating loan from the CIBC for an undisclosed amount and all other securities held by CIBC. As well, AFEF took over the personal debts of Gerald (Gerry) and Lorna Tomassen, which were held by the CIBC. Both Gerald and Lorna were shareholders in TML Foods and relinquished 80% of their common stock holdings to AFEF. AFEF acquired 35% ownership in TML Foods, while holding 100% of the current and long-term debt. Of the remaining equity, the Saskatchewan Growth Fund held 15%, while the rest was widely held.

AFEF immediately took several initiatives to restore both operational and market integrity. Lorna Tomassen was removed from the presidency and offered a position on the sales team. An AFEF employee replaced Lorna temporarily. Gerry Tomassen received an

18-month severance package, but remained on the board until he retired with pomp and ceremony during the Annual Meeting in April, 1999. Four AFEF employees were placed on TML's eight-member board of directors, including Cal Hagar and Chuck Marting. Cal was an Executive Director of AFEF and Chuck was an Investment Manager. The board recruited Rob Bailey, who had formerly been with a major meat packer for the TML Presidency. In addition to articulating a new vision for TML, the new board worked to restore quality assurance standards to CFIA expectations and reduced focus on the Asian export market. Instead it refocused on markets in western Canada and northern U.S. AFEF also injected essential working capital and obtained the option to convert interest payments from cash to shares. In addition AFEF developed a conversion strategy, which gave the option to convert long-term debt to equity. Finally, AFEF secured a $250,000 operating line of credit for TML with the TD Bank by providing a fully liquid backstop guarantee.

TML's board articulated a new vision, which was "to develop and customize premium meat products for our customers, wrapped in quality and service". However, the board fell short of developing long- and short-term objectives that would focus operations and allow meaningful measurements of progress towards a successful turnaround. The board had also failed to develop an overall strategic plan, which would hi-light TML's strategic orientation and the organizational competencies it viewed as critical to business success. The new strategy needed to be complete, reflect TML's changing business environment, address its internal situation *and* set the stage for an action plan.

3. Marketing review

TML Foods developed products primarily based on traditional market consumption. Products were wrapped and sold to restaurants and retailers based on traditional product lines, rather than the changing preferences and habits of consumers. The recently appointed president and CEO, Rob Bailey, introduced a modified marketing approach to TML. Through his experience in value added product development, Rob knew the importance of considering the needs and desires of the consumer before developing new meat products.

TML was considering several product initiatives. It was contemplating moving away from "me too" products and emphasizing differentiated and branded products for targeted niches. More convenient packaging was also considered critical to future success. A cross-functional development team approach that focused on new products, with emphasis on quality and improving TML's brand name image was also being considered. Rob knew that all of these strategies would mean changes in both company operations and relationships with customers and suppliers. Exhibit 2 describes some new products that TML was considering.

TML pricing decisions were based on several criteria including competitors' price, production and distribution costs, consumer demand and desired profit. Unfortunately marketing efforts were severely constrained by cash flow. Currently, TML was restrained to a "word of mouth" marketing strategy. Several promotion initiatives were being considered. Lorna Tomassen, the Marketing Manager suggested a complete redesign of the product labels, introducing more color and information for consumers on product composition, supply chain history and special attributes. She also proposed that TML work closely with buyers to profile several new products as weekly specials. One of the other directors felt that TML should sponsor local sporting and community events as a means of increasing corporate visibility. TML had used in-store testing and promotion of new products in the past. Rob also wondered whether there was any merit in trying to push existing and new company products at the retail trade shows in Manitoba, Saskatchewan and Alberta. Having only two people in sales and marketing had limited the use of personal sales calls, particularly in Alberta where there was no permanent TML representative. Lorna suggested that it might be necessary to assign someone full-time responsibility for marketing and sales and hire an additional sales person to serve Alberta. Establishing a dedicated phone sale service was being considered as another way of freeing up time for corporate sales staff so that they could concentrate on personal selling throughout Saskatchewan. Although many of these promotional activities would have positive impact in the short-term, Rob worried that without true focus on distinct target markets the benefits would be short-lived.

Prior to the AFEF takeover of TML Foods, domestic sales were primarily through the Northwest Stores and the Arctic Co-op. Relations with Spitz Sales, a distributor to small independent retail outlets and corner store, had deteriorated to an almost unsalvageable position. TML management had been unable to respond effectively to a series of quality problems. Spitz said that at one point relations were so bad that he had trouble getting TML staff to return his calls. Since the AFEF takeover, TML had significantly improved its domestic presence, adding nine more grocery outlets, three co-packing arrangements and had restored snack food sales through Spitz and Jimmy Zees. Exhibit 3 contains additional data.

In an effort to restore TML's domestic position, the sales and marketing staff had aggressively pursued available regional distribution channels. Overcoming TML's quality tainted past had been difficult, and TML management remained unsure as to how best to manage key accounts and new product introductions. Once access to meat case space with distributors is secured, effective account management will be crucial to success TML's success. TML was also considering non-traditional marketing routes such as the Internet or electronic sales, corporate purchase plans and seasonal sales through fund-raising programs.

4. Operations review

TML Foods operated a facility in Melfort, Sask. with 30,000 ft^2 of processing space, and 8,000 ft^2 of office and other space. During the 1994/1995 expansion, equipment upgrades supported a move to more value added process. Upgrades included the installation of high-speed cutters, chill tunnels, expanded freezer storage, vacuum packaging equipment, upgraded smokers and expanded cutting and processing lines. Several attempts to run the plant as a continuous flow operation were unsuccessful and resulted in quality assurance concerns and cost overruns. The plant currently runs using batch production processes.

Current production capacity of the plant is estimated at approximately \$20 million annually. Product capacity volumes were not known. Since the 1994/1995 expansion, the plant had failed to exceed 50% operating capacity utilization. Although the move from export to domestic sales had a positive effect on plant utilization, there was still significant excess capacity.

TML continued to be unable to determine input and processing costs in a timely and accurate manner. A "best" estimate was that materials, labor and supplies constituted 72% of Cost of Goods sold with the specifics being meat (55%), supplies (6%) and labor (11%). Administrative overhead and fixed costs quickly eroded TML's profit margin, and negatively impacted its ability to compete. TML was considering several operations initiatives to improve margins and its cash flows. These included purchasing larger quantities of raw material on spot market to capture available discounts, building strategic alliances with producers and suppliers to ensure price and quality and establishing yield controls for all cutting, slicing, cooking, packaging and product formulations. TML needed more precise and complete operating information. This would require the development or purchase of production control software with better management reporting capabilities. The board had committed to a computer upgrade and the purchase of least cost sausage formulators for March, 1999.

TML's inventory management system was based on period end inventory levels and did not track raw material or work in process inventories (WIP) from receiving to finished goods. WIP inventory is only recorded and valued once every 4 weeks. Consequently, no verification of actual production yields (pump gains, smoke house shrink, etc.) is possible.

TML recently initiated tracking of WIP inventory in more detail and was intent on improving the monitoring process. The ACCPAC inventory management system in place could be modified, but not to the point of providing comprehensive inventory details (software upgrades would be required). Rob knew that ineffective inventory information was increasing both costs of production and holding charges. TML needed to address this issue as part of its overall cost control program.

Marketing on quality had direct implications for operations, both within the plant and also in term of product attributes forward and backward in the supply chain. As a federally licensed processing plant, TML supported a full time CFIA inspector on site. Growing consumer concerns with meat safety increased the market value of this status. Federal licensing required that plant operations maintain certain safety protocols. Violations resulted in citations, stoppage in processing or full plant shutdowns. CFIA inspections were highly dependent on sight and smell and thus were limited in their ability to prevent all quality problems. The U.S. moved to mandatory implementation of HACCP, a more scientific process-based system, for all exporters to the U.S. market. TML had already begun the process to attain HACCP recognition and expected to be done in July, 1999. As well, it had undergone quality audits by key buyers. Although TML fell just short of operational endorsement, it uncovered areas for improvement, including metal detection, allergy programs and meat tracking systems. All were being addressed but several of the deficiencies required capital expenditures (i.e., metal detector), which would challenge cash flows. TML wanted to raise the quality assurance bar by including raw product supply tracking and by working directly with distributors.

5. Human resources review

TML's 65 employees were guided by Rob Bailey, who assumed the job of president and CEO in June, 1998. Rob was a university-trained chemist with over 30 years of experience in the meat processing industry. Rob had held senior positions in the area of quality control, operations management and marketing. The position of Plant Manager had been vacant since November, 1998, despite TML's recruitment efforts. Peter Delaney was the Operations Manager with support from Rob Bailey. Three supervisors reported to Peter, covering all plant operators. Computer skills were lacking in operations and specific training was being introduced to improve skills in this area.

A new Quality Control Technician had been hired to assist with new product development, formulation, and government approval of labels and to work with marketing personnel on packaging and labeling concerns. A Quality Assurance Manager was also hired to lead introduction of HACCP and training of staff regarding quality issues.

Tom Crawford was hired in November, 1998 to assume the position of Chief Financial Officer. Tom was a Certified Management Accountant and had previous experience in the grain industry. Tom revitalized the accounting system and was working on improving the costing, financial reporting and planning systems.

In the areas of sales and marketing, Lorna Tomassen served as Manager, supported by sales staff in Saskatchewan and Manitoba. Lorna had spent 30 years in the meat processing industry with TML and had extensive sales experience in western Canada and Asia.

Attracting good employees to the small community of Melfort was a constant problem despite TML's commitment to retaining and developing its employees. The company offered employees a tuition reimbursement program and also supported many on the job training initiatives. TML was working with the Carlton Trail Regional Economic Development Authority, a government sponsored rural development group, on the training of 10–20 people in meat cutting. The program ran for 8 weeks and upon completion graduates were offered positions with TML Foods. Several computer skill programs were being offered for administrative and operational staff.

Although numerous skill enhancement programs were underway Rob was concerned that there might not be enough coordination and focus. He wondered whether TML should consider a more comprehensive organizational development program to increase training and development effectiveness. These programs could focus on identifying corporate skill requirements (i.e., Customer Services, Partnering Skills, etc.) and offering comprehensive group training. This would facilitate a common operating culture for TML and allow for corporate and personal growth.

There had been significant discussion surrounding the need for a corporate incentive plan to motivate staff toward achieving corporate objectives. Unfortunately, no plans or agreements had materialized. If TML was to achieve market and operational success, it needed to develop incentives that encouraged appropriate employee responses. The board needed to consider Bonus Systems, Stock Options and other programs to reward employee achievements.

Several corporate initiatives to improve the work environment were also on the table. These included sponsoring the annual employee Christmas party, providing employees with a food hamper during the Christmas season and holding an employee lunch, with management cooking and serving. TML offered all employees a standard benefit package including medical, dental and retirement plans.

TML also used the services of several key professional firms to assist in maintaining operational and financial integrity. The legal firm of Robertson Stromberg in Saskatoon handled reporting requirements to the Alberta Stock Exchange and maintained the corporate minute book. Robertson Stromberg also provided legal advice on contractual relationships. Meyers, Norris, Penny served as TML's auditors and provided an audit statement that is presented to shareholders at the annual general meeting. Several consulting firms were also employed to provide specialized analysis and recommendations on administrative and operational issues. KPMG had been hired to diagnose the accounting and costing systems at TML. Farmgate computers were hired to install the new computer network and consultants were hired to assist with the introduction of HACCP.

6. Financial review

The unaudited financial statements (Exhibit 1) painted a grim future for TML Foods. AFEF's criterion that TML generate \$12,000,000 sales before 2000 appeared increasingly ambitious.

7. External analysis

TML's board knew that TML's experience in the red meat processing industry was not unique. Since the 1960s, when Iowa Beef Processors (IBP) pioneered large-scale boxed beef production and marketing, consolidation and rationalization had been transforming the beef industry. New vertical business arrangements in the pork industry were completing the transformation of the pork side of the meat-packing industry. Although scale economies were a key driver of change in meat-packing, changes in consumers' tastes and preferences continue to have a more profound influence. These key supply and demand side drivers of change formed the context in which TML's external business threats and opportunities had to be considered. Exhibit 4 contains the data that Cal Hagar had developed for the purpose of a comprehensive SWOT analysis.

8. The task ahead

With a quick nod to Cal, Rob Bailey stood and prepared to open the meeting. TML's future would be determined by the objectives and priorities set by the board that day. Rob could feel both the tension and trepidation in the room as he began "Ladies and Gentlemen", we have a great deal of work ahead us. What are your ideas for turning TML around and rebuilding a homegrown Saskatchewan company?

Appendix A. Exhibit 1: TML Foods Inc.—unaudited financial statements (consolidated)

Exhibit 1-1: Statement of loss and deficit, year ended December 31, 1998

	1997	1998
Sales	$6305952	$5845944
Cost of goods sold		
Direct expenses	$5414095	$4856392
Indirect expenses	$646680	$800180
Total cost of goods sold	$6060775	$5656572
Gross margin	$245177	$189372
Sales expenses	$402187	$368515
Administrative expenses	$495246	$564491
Loss before amortization and long-term interest	$652256	$743634
Amortization	$262645	$271901
Interest on long-term debt	$264879	$466401
Loss from operations	$1179780	$1481936
Other (income) charges	−$364075	$15833
Net loss	$815705	$1497769
Deficit, beginning of year	$474969	$1290674
Deficit, end of year	$1209674	$2788433
Loss per share		
Basic	−$0.024	−$0.042
Fully diluted	−$0.024	−$0.042

Exhibit 1-2: Statement of changes in cash resources, year ended December 31, 1998

	1997	1998
Operating		
Net loss	−$815705	−$1497769
Amortization	$262645	$271901
Loss on disposal of property and equipment	$7602	$18988
	−$545458	−$1206880
Changes in working capital accounts		
Accounts receivable	$4007	$139782
Inventory	$168779	−$18524
Prepaid expenses	$389	−$1127
Accounts payable and accrued charges	$191663	$194636
Net cash deficiency from operations	−$180620	−$892223
Financing		
Net long-term debt	$330000	$1619762
Repayment of long-term debt	−$226613	−$62731

Exhibit 1-2: (*Continued*)

	1997	1998
Issuance of share capital	$435078	$71054
Net cash surplus from financing	$538465	$1628085
Investing		
Decrease in investments	−$6040	$17527
Increase in deferred charges	−$2115	
Purchase of property and equipment	−$244313	−$233472
Proceeds on disposal of property and equipment	$55410	$112275
Net cash deficiency from investing	−$197058	−$103671
Increase in cash resources	$160787	$632301
Cash deficiency, beginning of year	−$740174	−$579387
Cash resources (deficiency), end of year	−$579387	$52914
Components of cash resources (deficiency)		
Cash		$52914
Bank indebtedness	−$579387	
	−$579387	$52914

Exhibit 1-3: Balance sheet, year ending December 31, 1998

	1997	1998
Assets (current)		
Cash and short-term investments (note 4)		$52944
Accounts receivable	$439572	$299790
Inventory	$515324	$533848
Other	$5393	$6520
	$960289	$893072
Investments (note 5)	$32865	$15338
Deferred charges	$4290	$3185
Property and equipment (note 6)	$5105641	$4964088
Organization expenses	$27033	–
	$6130118	$5875683
Liabilities (current)		
Bank indebtedness	$579387	
Accounts payable and accrued charges	$626810	$821446
Current portion of long-term debt	$135449	$61034
	$1341646	$882480
Long-term debt (note 7)	$3509539	$5140985
Redeemable preferred shares (note 8)	$272800	$272800
	$5123985	$6296265

Exhibit 1-3: (*Continued*)

	1997	1998
Shareholder's deficit		
Share capital (note 8)	$2296807	$2367861
Deficit	−$1290674	−$27884443
	$1006133	−$420582
	$6130118	$5875683

A.1. Exhibit 1-4: TML Foods Inc.

These are the notes to the consolidated financial statements, December 31, 1998. Users of the TML case should note that these statements are unaudited and contain some inaccuracies, which must be evaluated when using them.

A.1.1. Nature of operation

TML Foods Inc. was incorporated on June 13, 1960 and is currently traded on the Alberta Stock Exchange. Though our wholly owned subsidiary Tomassen Meats Ltd. we are a federally inspected value added meat processor located in Melfort, Sask. Our new vision and mission statement is to develop and customize premium meat products for our customers, wrapped in quality and service.

A.1.2. Going concerns

These financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The company's ability to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds there from, to continue to obtain borrowings from third parties sufficient to meet current and future obligations and/or restructure the existing debt and payables.

A.1.3. Accounting policies

The financial statements have been prepared in accordance with generally accepted accounting principles and include the following significant accounting policies.

A.1.3.1. Inventory. Inventory is valued at the lower of cost and net realized value.

A.1.3.2. Deferred charges. Deferred charges relate to registration of trademarks and are recorded at cost. Amortization is claimed using the straight line method over 5 years. Accumulated amortization at December 31, 1998 amounted to $2,339 ($1,234 in 1997).

A.1.3.3. Property and equipment. Property and equipment are recorded at cost. Amortization is provided using the following methods at rates intended to amortize the cost of the assets over their estimated useful lives. The annual rates are as follows:

	Method	Rate
Buildings	Straight line	40 years
Equipment	Straight line	20 years
Automotive	Declining balance	20%
Computer equipment	Declining balance	30%
Pavement	Straight line	40 years

A.1.3.4. Government assistance. Claims for assistance under various government grant programs are reflected as a reduction of the cost of related assets (or expenses) in the period in which eligible expenditures are incurred.

A.1.3.5. Earnings per share. Basic earnings per share is calculated on the weighted average number of shares outstanding during the year. Fully diluted earnings per share is calculated on the weighted average number of shares that would have been outstanding during the respective period had all the share options been exercised at the beginning of the year, provided the resulting amounts are not anti-dilutive.

A.1.4. Cash and short-term investments

Cash and short-term investments are presented net of a bank operating loan of $160,000 which bears interest at prime rate (6.75 at December 31, 1998) and is secured by short-term investments.

A.1.5. Investments

	1997	1998
Kelsey Stock Farms Ltd.	10000	–
Life insurance accumulating fund	18473	10656
Melfort Co-operative Association	4392	4682
	32865	15338

A.1.6. Property and equipment

	1997 (Net book value)	1998		
		Cost	Accumulated amortization	Net book value
Land	46100	46100	–	46100
Buildings	1759917	2069042	265351	1803691
Equipment	2825394	3515970	883303	2632667
Automotive	54813	140710	84251	56459
Computer equipment	35690	42307	13936	28371
Pavement	37112	48576	12639	35937
Investment tax credits	346615	360863	–	360863
	5105641	6223568	1259480	4964088

A.1.7. Long-term debt

	1997	1998
Non-interest bearing loans, payable in annual installments of $13,275, due April, 2001, unsecured	53097	39822
Conditional purchase agreements payable in monthly installments of $4,808 (4,171 in 1997) including interest at 0.0% to 15.4%, over various periods, secured by equipment having a net book value of $231,893	155170	158453
Prime plus 2% demand loan, payable in monthly principal plus interest installments of $23,895	2636721	–
Term loans bearing interest at prime plus 1% (6.75% at December 31) payable in monthly principal installments at $500, due October, 2000, unsecured	–	10622
Prime plus 2% loan including interest, payable to controlling shareholder, with no set repayments terms, unsecured	–	2877361
Advances from controlling shareholder bearing interest rates of between 8.75% and 15%, with undetermined repayment terms, secured by all assets	–	1315761
Convertible debenture maturing March 1, 2003 bearing interest at a rate of 10% per annum, which is paid by issuing capital stock. This debt may be converted into common shares at a 15% discount at the holder's option any time after March 1, 1999	500000	500000
Convertible debenture maturing August 31, 2004 bearing interest at a rate of 15% per annum, which is paid by issuing capital stock. This debt may be converted into common shares at the maximum discount allowed by the exchange not to exceed 25% at the holder's option any time after September 1, 2000	300000	300000
Less current portion	3644988	5202019
	135449	61034
	3509539	5140985

As the controlling shareholder has indicated they do not intend to request payments of either principal or interest until at least January, 2000 no amounts have been calculated as current with regard to the amounts payable to this shareholder. Principal repayments over the next 4 years are estimated as follows: 61,034, 63,774; 79,042; 5,047.

A.1.8. Share capital

Authorized		
Unlimited number of common shares without nominal or per value		
Unlimited number of first preferred shares		
Unlimited number of second preferred shares		
Issued and fully paid		
35,641,156 (34,970,741 in 1997) common shares	2296807	2367861
272,800 second preferred shares—series I	272800	272800
	2569607	2640661

(a) The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges and conditions attached to the shares of each series. In 1996, the directors authorized the issuance of a maximum of 286,300 second preferred shares—series I, of which 272,800 were issued. The second preferred shares—series I are non-voting, redeemable at $1 per share, retractable after July 31, 2002, convertible into common shares at a rate of 1 to 1, and bear a 4% annual cumulative dividend.
(b) Of the common shares issued.
(c) During the year, 569,952 common shares were issued in satisfaction of interest of $47,109 accruing to June 30, 1998 on the long-term debt in note 5; 100,463 common shares were issued in satisfaction of interest of $23,945 accruing on that long-term debt for the period of October 1, 1997 to December 31, 1997.
(d) Additionally, 1,129,500 common shares have been reserved by the company for options granted to certain directors, officers and employees of the company. A total of 320,000 common shares have been reserved for options exerciseable at $0.1275 per share on or prior to October 23, 1999; 9,500 common shares have been reserved for options exerciseable at $0.165 per share on or prior to December 14, 2000; 400,000 common shares have been reserved for options exerciseable at $0.16 per share on or prior to February 23, 2001, and 400,000 common shares have been reserved for options exerciseable at $0.15 per share on or prior to January 14, 2002.

A.1.9. Income taxes

The company's effective tax rate approximates 37%. However, since losses occurring in these financial statements may not be recognized until realized in future periods, this effective rate is not reflected in the financial statements.

The company and its related subsidiaries have incurred losses of $3,816,839 ($2,649,598 in 1997) for income tax purposes which are available to reduce future years' taxable income. These losses expire as follows:

1999	1839462
2000	606755
2001	1167241
2002	202820

Federal investment tax credits of $22,693 ($22,593 in 1997) can be applied to reduce future years' federal income taxes to the extent that any are payable within 10 years of earning the credits. These tax credits expire as follows:

2003	8347
2004	14246

Provincial investment tax credits of $360,863 ($346,615 in 1997) can be applied to reduce future years' Saskatchewan income taxes to the extent that any is payable within 7 years of earning the credits. These tax credits expire as follows:

2002	159477
2003	169997
2004	17141
2005	14248

No recognition has been given in these financial statements to the potential tax savings which may result form the above items.

A.1.10. Contingent liability

The company is presently the defendant in two separate legal suits claiming damages against the company. As the outcome of these suits cannot be determined and the amounts are not determinable, they have not been recorded in the financial statements.

A.1.11. Segmented information

The company's principle business activity is the processing and distribution of meat and related food products. All of the company's operations, employees and assets are located in Canada. Sales to customers in foreign countries amounted to $1,060,995 ($1,129,556 in 1997).

A.1.12. Related party transactions

During the year ended December 31, 1998, the company accrued $382,174 ($95,000 in 1997) as interest to its controlling shareholder. All other transactions with related parties were in the normal course of business.

A.1.13. Financial instruments

A.1.13.1. Credit concentrations. Financial instruments that potentially subject the company to concentrations of credit risk consist primarily of trade accounts receivable. As at

December 31, 1998 accounts receivable included $128,254 from one company. This amount was subsequently paid in full.

Exhibit 1-4: TML Foods Inc.—monthly stock price information

Date	Volume	High	Low	Close
Nov, 1999	3500	0.03	0.03	0.03
Oct, 1999	32500	0.06	0.05	0.05
Sep, 1999	4000	0.04	0.04	0.04
Aug, 1999	2300	0.05	0.04	0.04
Jul, 1999	9500	0.05	0.05	0.05
Jun, 1999	4000	0.05	0.05	0.05
May, 1999	10000	0.08	0.05	0.05
Apr, 1999	5500	0.09	0.06	0.09
Mar, 1999	6000	0.07	0.06	0.06
Feb, 1999	2000	0.1	0.06	0.1
Jan, 1999	27200	0.08	0.06	0.08
Dec, 1998	3500	0.11	0.05	0.11
Nov, 1998	33500	0.07	0.02	0.07
Oct, 1998	2100	0.08	0.08	0.08
Sep, 1998	10200	0.1	0.08	0.08
Aug, 1998	17700	0.11	0.06	0.11
Jul, 1998	6000	0.1	0.08	0.08
Jun, 1998	11000	0.1	0.06	0.1
May, 1998	6000	0.1	0.08	0.08
Apr, 1998	45000	0.12	0.08	0.08
Mar, 1998	63000	0.18	0.12	0.12
Feb, 1998	14000	0.1	0.1	0.1
Jan, 1998	10000	0.1	0.09	0.09
Dec, 1997	11500	0.12	0.07	0.07
Nov, 1997	14000	0.18	0.14	0.14
Oct, 1997	4700	0.18	0.16	0.18
Sep, 1997	22200	0.16	0.13	0.14
Aug, 1997	12500	0.13	0.13	0.13
Jul, 1997	12000	0.14	0.12	0.12
Jun, 1997	20500	0.15	0.13	0.15
May, 1997	40400	0.2	0.18	0.2
Apr, 1997	11500	0.2	0.18	0.19
Mar, 1997	7500	0.2	0.19	0.19
Feb, 1997	11000	0.21	0.2	0.2
Jan, 1997	5200	0.2	0.19	0.2
Dec, 1996	6000	0.23	0.2	0.21
Nov, 1996	24500	0.24	0.17	0.24
Oct, 1996	6500	0.3	0.2	0.2
Sep, 1996	16000	0.35	0.3	0.33
Aug, 1996	51900	0.35	0.28	0.34
Jul, 1996	3000	0.33	0.33	0.33

Exhibit 1-4: Additional financial information—TML Stock Price

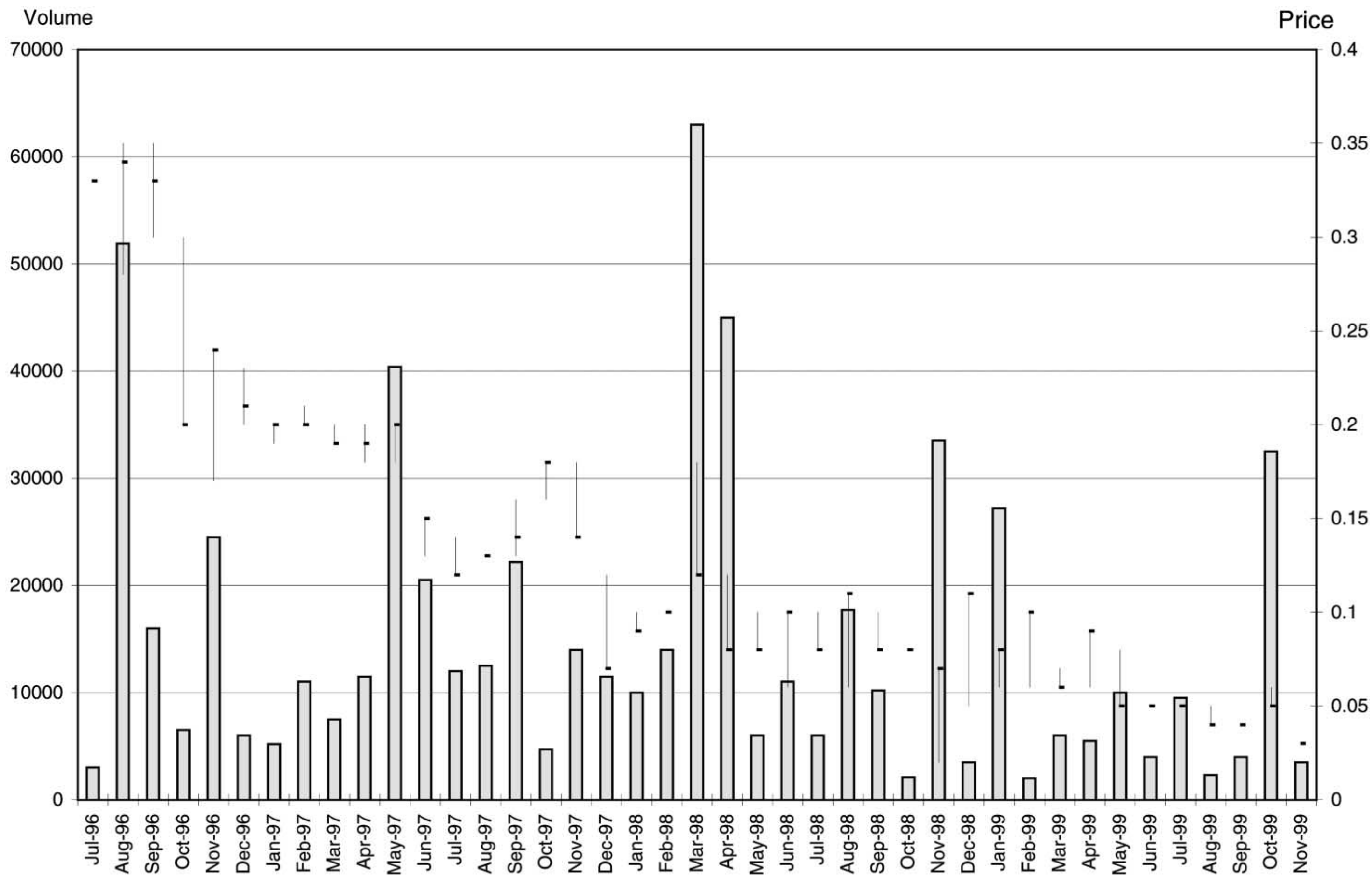

Exhibit 1-5: Additional financial information—selected ratios

	1994	1995	1996	1997
Liquidity ratios				
Current ratio	1.56	0.75	0.38	0.72
Quick ratio	0.75	0.40	0.15	0.16
Inventory turnover	12.49	11.73	13.05	11.76
Accounts receivable turnover	16.20	13.99	16.04	14.35
Leverage ratios				
Debt/asset ratio	0.33	0.62	0.89	0.84
Debt/equity ratio	0.58	1.76	9.55	5.09
Operating ratios				
Gross margin	0.12	0.09	0.02	0.04
ROA	0.08	−0.03	−0.21	−0.13
ROI	0.13	−0.09	−2.20	−0.36
Net margin	0.04	−0.02	−0.15	−0.13

Appendix B. Exhibit 2: Potential meat products under consideration by TML

Value added products are a necessity to TML. The products that TML needs to develop, market and produce successfully must add value for their ultimate consumers. The list of products described here is illustrative of the types of products that TML is considering making central to its product-market mix.

B.1. Frozen/fresh products

1. Shish-kebobs: Meat and frozen vegetables on skewers, which could be thawed and barbequed.
2. Meat patties: Pre-formed and pre-seasoned frozen meat patties.
3. Stir fry strips: Pre-seasoned strips of beef that can be used in stir fries.
4. Beef stew mix: Pieces of spiced beef, with vegetables that can be slow-cooked into a hearty, home-style stew.
5. Hams: Hams that provide smaller numbers of servings; sliced ham in resealable packaging.
6. Case ready meats: Any meat product that is pre-cut and ready to be sold by retailers.
7. Consumer ready products
   a. Individually wrapped cuts that can be microwaved (in their packages).
   b. Oven or grill ready meat.
   c. Marinated meats—i.e., shish kebobs, ribs.
   d. Specialty breakfast products—smaller sausages, sausage rounds, specialty bacon (displayed on shrink-wrap trays).

B.2. Snack foods

8. Beef jerky: Dried beef products with various types of spicing (mild, medium, hot and spicy, standard, teriyaki, etc.).
9. Pepperoni and other small serving meats such as luncheon meat and crackers.

B.3. Pre-cooked products

10. Heat and serve pot roast (microwaveable, small pot roasts).
11. Heat and serve meat loaf.
12. Heat and serve meat stew.

B.4. Take out to eat (TOTE) products

13. Similar to pre-cooked products except that they would be larger in size and marketed to retailers.

Many additional beef product ideas can be found at www.beef.org and www.meatami.org.

A note on packaging: New products must contain convenient cooking instructions, nutrition information, servings per packaging. Packaging must also be attractive, safe and convenient.

Appendix C. Exhibit 3: TML—selected marketing data

	Percentage of total sales in 1998
Grocery	
Northwest Stores (Manitoba)	22.34%
Arctic Co-op (Manitoba)	7.48%
Federated Co-op (AB, SK and MB)	13.50%
Agora (IGA, Saskatchewan)	1.22%
Grocery People (Alberta)	0.76%
Associated Groceries	1.37%
Western Grocers (Saskatchewan, Alberta)	1.22%
Costco (starting in 1999)	0
Pratts and Food Fair (starting in 1999)	0
Schwans (starting in 1999)	0
Local Saskatchewan Retail Stores (Wally)	22.60%
Local Alberta Retail Stores (Darcy) (starting 1999)	0
Snack foods	
Jimmy Zees and Best Direct	0.21%
Spitz Sales	5.30%

Appendix C. (*Continued*)

	Percentage of total sales in 1998
Co-packing	
Shirley Shishliki (starting in 1999)	0
Drake Meats (starting in 1999)	0
Teddy's Corn Beef (starting in 1999)	0
Export	
Nichimen (Japan)	4.78%
Day Lee Foods (Japan)	1.16%
Retail Store	
Plant Store (Melfort, Sask.)	5.17%

Appendix D. Exhibit 4: TML—environmental scan

As a medium sized, value added red meat processor, TML faces a number of key external threats and opportunities. These can be grouped under general and industry environments.

D.1. General environment—demographic

Key demographic trends that affect food processors are a decline in population growth rates, an aging population and increasing ethic and family diversity. These trends also affect other developed countries. Although the Canadian population is not expected to grow significantly in the coming decades, conservative estimates based on current birth and immigration rates indicate a forecast annual increase of 1.2% or about 360,000 people. Saskatchewan's population growth is expected to remain relatively flat with projections of only a 2% total increase over the next 20 years. The first of the "baby boomers" reached 50 years of age last year. This large group of consumers has maintained its profound influence on consumer behavior and this is not likely to change as they get older. Saskatchewan's population is aging somewhat faster than the Canadian population in general, with about 2.5% more senior citizens. Several characteristics typify today's "graying" population's demand for food. Currently, senior citizens are better off financially and are more willing to spend than previous retirees who survived world wars and the depression. They also have fewer household expenses have more free time and are more physically active. More than ever they are concerned with maintaining their health.

The second major demographic factor is the ethnic diversity of the population. According to Statistics Canada, before 1961, 95% of immigrants to Canada were from the U.S. and Europe. Today, Asia and the Middle East have become the major sources of immigrants. Of the 1.5 million immigrants who arrived in Canada between 1991 and 1996, 56% were Asian. This increasing ethnic blend in our population is having an impact on shifts in consumption tastes.

The third major demographic change is in the size and composition of Canadian households. The size of the Canadian household continues to fall and was 2.6 persons in the

1996 census. This decrease in household size reflects increases in the number of single-person, one parent and childless couple families. While married couple families with children continue to be the most common family type in Canada, their share is shrinking because of increases in common law and single-parent families. In 1996, there were 1.1 million single-parent families in Canada and the numbers headed by women outnumbered those headed by men by more than four to one.

An interesting demographic trend specific to Saskatchewan is the significant growth in the native Canadian Indian population. Over the next decade, the native population is expected to double, increasing its impact on the Saskatchewan market place.

D.2. General environment—economic

According to the Agriculture and Agri-Food Canada (AAFC) there are several key economic trends that are affecting the food purchasing patterns and market place behavior of Canadian consumers. Real personal disposable income is declining. A decreasing share of income is spent on food. Dual income families are now the norm.

Although inflation for all items and food in the 1990s has been low (1.6%), after adjusting the real disposable income of Canadian consumers has actually been eroding throughout the 1990s (approximately 8% points). Real spending on food and non-alcoholic beverages at retail stores is virtually unchanged. Real spending on meals in restaurants dropped in 1991 due to the introduction of the goods and services tax). Since 1994 it has recovered to near 1990 levels.

Results from Statistics Canada's 1996 Family Food Expenditure reveal that the average Canadian income before taxes was $51,000 with basic expenditures (food, shelter and clothing) accounting for about 32% of the budget. Food ranked as the fourth largest expenditure at 11.6%).

Other interesting observations include the fact the spending patterns of Canadians is now a factor of falling real personal disposable incomes rather than price inflation. Consumers are now buying goods at 1990 prices, with 1980 incomes (they want value). Results of recent industry surveys reveal 80% of working mothers are responsible for getting dinner on the table during the week, with almost one-third of the decisions being made after 4.00 h (speed and convenience are important, but not at the expense of taste).

D.3. General environment—food consumption

In general compared to 20 years ago, the food supply is providing more rice, breakfast cereals, pulses and nuts, vegetable-based fats, chicken, fish, frozen vegetables and low fat dairy products. At the same time, it is supplying less sugar, animal fats, red meats, offal, eggs, canned vegetables, cocoa, tea and alcoholic beverages (see Exhibit 4-1).

A look at consumer spending reveals an overall shift towards increased spending away from home. For example, the share of the Saskatchewan consumer dollar spent on meals in restaurants grew from 23.3% in 1982 to 30.9% in 1992 before falling to 28.3% in 1996. Table service restaurants are becoming a more important location for away from home spending, accounting for more than 50%. Spending in quick-service or fast food establishments ranks second, and now accounts for almost 25% of food expenditures.

Statistics Canada reports that Saskatchewan consumers spend the majority of their grocery dollars in supermarkets (82%). Spending in convenience stores has been falling, perhaps due to the extended hours and greater variety of fresh products being offered by supermarkets.

D.4. General environment—meat consumption

Exhibit 4-2 shows red and white meat consumption for the major meat consuming countries, while Exhibit 4-3 shows per capita meat consumption for selected years in Canada. Red meat consumption has declined steadily, while white meat consumption has had a reasonably steady growth over the 20 years.

D.5. Industry environment—global integration

As global competition intensifies, marketing and distribution is becoming a preoccupation of the larger, international corporation. Theodore Levitt, Professor at Harvard Business School, suggests that "companies should start thinking of themselves as global rather than multi-domestic. The multi-domestic operates in a number of countries and adjusts its practice in each—at high relative costs. The global company sells the same thing in the same way, everywhere". It is no longer necessary to be so respectful of local differences, tastes, quirks and religions. Push your products in the right way and the local customs will fall away. Simply put, a headache is a headache and an aspirin is an aspirin. Roberto C. Gorguintu, Chairman of Coca-Cola, notes "people around the world are today connected to each other by brand name consumer products as much as anything else". Logos on bottles, boxes and labels are global banners, instantly recognizable by millions who could not tell you the colors of the UN flag. Essentially, tastes in Saskatoon, Regina, Toronto, Vancouver, Los Angeles, Tokyo, and New York for consumer products have converged. The availability of global products means that masses of people separated by great distances now want the same things to eat, drink, play with and wear. This allows a few numbers of large corporations to position themselves to serve or satisfy these consumers' wants. The impact of globalization on the agrifood industry is still playing out.

In the meat industry, we can see large corporations such as IBP and Cargill fully integrating their operations in order to achieve both cost efficiency and control of the value chain. This integration from conception to consumption is placing increased pressure on small and medium sized processors. Incapable of competing on product price, and being squeezed for meat case shelf space, many have retreated to niche local markets or regionalized consumer tastes for specific meat products. As well, small- to medium-sized processors face financial constraints, limiting their ability to market product attributes as aggressively and as broadly with consumers. This limits their appeal to larger retailers.

D.6. Industry environment—direct competition

Major consolidation has occurred in the meat processing industry over the past decade. Maple Leaf Foods has aggressively expanded its national processing and distribution network. Although it failed in its attempt to assume control over Schneiders, it was successful in purchasing Shopsey's, Gainers and Burns. Recently, Maple Leaf (subsidiary of McCain Foods) announced a major processing expansion into Brandon, Man. with operations to begin in the later part of 1999. The Saskatchewan Wheat Pool, in an effort to expand its profit potential through diversification, purchased Fletchers Fine Foods. Later, Fletchers expanded its processing capacity by focusing on the purchasing of niche players such as Grimms, Harvest Meats, Pillars Sausage and McSweeney Snack Foods. In Saskatchewan, Intercontinental Packers shifted its processing focus and changed its name to Mitchell's Gourmet Meats. It also recently announced a $50 million joint venture expansion with Schneiders to concentrate on serving the consumer needs of the larger retail and box stores. This expansion will be significant in western Canada, and will place immense pressure on the current hog supply. Smaller processors are being forced out of larger retail and fast food chains, as they consolidate their suppliers. This consolidation is reducing the many local suppliers to fewer regional sources and is emphasizing the need for food safety, brand quality and volume. Many small domestic processors such as Drake, Fuhrmans, and Saskatoon Specialty Meats are being forced to find niche markets or to co-pack product with larger processors which are capable of serving larger regional requirements. The ability to export inter-provincially requires federal inspection and licensing, something many domestic plants do not currently possess.

The capital required to upgrade many domestic (non-federally licensed) processing facilities is in the millions of dollars. This level of investment is beyond the means of many plant owners, and with consolidation in the market place, outside investors are unlikely to respond with this level of market uncertainty.

As major processors such as Maple Leaf, Cargill, IBP and others are forcing industry consolidation, they are also vertically integrating the value chain. The large processors' focus on volume and price requires guarantees of large amounts of raw product. Securing beef and hog carcasses may become more difficult in the future as large processors ramp up production and aggressively control the available supply of animals. Price and access may be affected.

D.7. Industry environment—domestic market

As indicated, total meat consumption has declined from 102.2 kg per capita in 1976 to 89.4 kg per capita in 1996. Over the past 20 years, total Canadian red meat consumption has declined from 82.2 kg per capita to 58.6 kg per capita. This trend has been somewhat minimized by the growth in white meat consumption, which rose from 20 kg per capita to 30.8 kg per capita. This consumption shift has a direct correlation to purchasing behavior and market share.

Within the processed meat category, growth has concentrated primarily on ready cooked meats, especially smoked/cured sausages and similar products. Purchase of traditional processed meats such as bacon, ham and canned meats have been declining. And though the meat department in most supermarkets still hinges on beef, since 1980 beef has been losing market position to chicken and turkey, as can be seen from Exhibit 4-4.

In growing numbers, consumers want supermarkets to supply them with value added meat products. According to a recent study by the U.S.-based Food Marketing Institute, 65% of shoppers purchased some type of value added product at least once a month and retailers expect further growth in this regard. In the study, "value added" involved seasoning, portioning, marinating and precooking. More than 75% of retailers surveyed offered marinated and pre-seasoned meat products. Over 54% of retailers are now selling fully cooked meats and most offer fully cooked poultry. Incredibly, few retailers offer cooked ground beef, although these products were rated as the most successful cooked meat products.

Retailers surveyed indicated that poultry is their most successful marinated and pre-seasoned product and fish is the least popular. Most fully cooked meats are prepared by outside processors but a growing number of retailers are cooking meats in-house. Additional data are available in Exhibit 4-5.

D.8. Industry environment—price comparison

From Exhibit 4-6 it is apparent that in the U.S., chicken price per serving gives it a distinct advantage over beef and pork. In Canada, chicken prices are more comparable with beef and pork, however with the prevailing discussions surrounding poultry supply management, the potential for further reduction in chicken prices exists. In order to compete, beef and pork will need to attract consumers on alternative attributes to price (quality, taste, versatility, etc.).

D.9. Industry environment—distribution

Food sale patterns in the hotel, restaurant and institutional (HRI) trade are a major new factor in meat consumption. Fast food has grown from 9.7% (1960) of the industry up to 35.5% in 1994. All other HRI sectors have declined, as is indicated in Exhibit 4-7. Exhibit 4-8 shows the 10 largest franchised quick service companies in Canada. Red meats are featured in less than half of the top franchises, and 2 of the top 10 do not feature meat at all (TDL and Yogen Fruz). The same phenomenon is apparent in Exhibit 4-10 that shows the types of meat consumed away from home. Almost half of the meat consumed away from home is beef. This reflects the high consumption of ground beef at fast food restaurants. This compares to other meats such as luncheon meats, of which only 2% is consumed away from home. An interesting trend is the major growth in non-traditional food services. Almost 75% of food service growth has occurred in non-traditional markets. For example, the availability of Tim Horton donuts and coffee at Canadian Tire, or McDonalds at Esso Service stations. As well, snacks are becoming a major segment of the food service market, as can be seen from Exhibit 4-9 which shows food consumption away from home by meal or occasion.

The collective values of the three daily snacks comprise 23.2% of the day's total food expenditure. This explains the success of companies such as Tim Hortons who have a primary focus on snack-type products. Though many traditional snack foods are meatless, the production of tasty high quality meat snacks is starting to emerge (jerky, pepperoni sticks, etc.).

D.10. Industry environment—grocery sales

Grocery retailing has shown tremendous changes in meat sales. Specialty meat stores have given way to large supermarkets and to the growth of mass merchandise stores.

Supermarket sales grew from 45% of total grocery sales in 1960 to a peak of 63% in 1980. Sales have slowly been declining since the growth of warehouse clubs and mass merchandisers. The mandatory elements for meat processors to have product listed in the retail meat case include regular supply, high inventory turns, high margins per square foot, quality packaging, easy maintenance on shelves and recipes or instructions for preparing the meat.

Over the past two decades, grocery distribution has witnessed tremendous market share changes. Companies such as the Weston Group (Loblaws, Super Center) have shown to be fierce competitors while stores such as Co-op and IGA have realized major declines in market share. Exhibit 4-11 shows the top 10 Canadian Grocery Distributors in 1998. The concentration of grocery store chains varies across the country. In western Canada, Safeway, Federated Co-op and the Real Canadian Superstore hold the top positions. A new entrant sharing rapid growth is the club stores such as COSTCO. These larger stores require meat processors to sell more case-ready product, achieve a higher number of inventory turns than supermarkets and have a smaller product selection to keep inventory lower.

Home meal replacement (HMR) is making significant in-roads in grocery store sales. Seventy-five percent of supermarkets are currently offering prepared foods (fully cooked, ready to eat) up from 63%, 10 years ago. Exhibit 4-12 summarizes a survey of Canadian and U.S. supermarket managers. When asked what they thought would be the ‘‘hot’’ products in the next 5 years, their responses confirmed the growth of prepared food items, particularly a growth in chicken products, with 4 of the top 10 featuring poultry.

D.11. Industry environment—food selection and preparation trends

Consumers are often confused when they walk by the fresh meat department in a retail outlet. After looking at a wide range of sub-primal cuts, they wonder ‘‘How do I turn this into a simple meal?’’ According to Kevin Yost, Executive Director of marketing for the National Cattlemen’s Beef Association (U.S.) ‘‘The average retail meat case generally does not reflect the lifestyle of today’s consumers. As a result, many shoppers are frustrated at the point of purchase and some even walk away from the meat case altogether . . .’’ He cites these main issues for this frustration. First, traditional meat cases are laid out by species, not by how consumers typically shop. Second, consumers are overwhelmed by the array of fresh meat products. Third, consumers don’t buy a wide variety of cuts if they don’t know what to do with them once they get them home. Unprepared meat presents many customers with a problem instead of a solution to their meal needs.

A recent survey conducted by the American Meat Institute which polled 998 adults ages 18 and over found that because the majority of women now work outside the home, few have time to prepare complete meals from scratch. This has led to dramatic changes in how consumers are selecting and preparing their meals (less time available to prepare meals). Interestingly, the survey results show that over half (53%) of respondents feel they have less knowledge and fewer cooking skills today than their mothers and grandmothers had in the past. Not surprisingly then, the survey finds that despite such innovations in the meat case as fresh meat products wrapped in individual portions or pre-stuffed and marinated products, consumers still find meat preparation difficult. As a result of time constraints and the lack of cooking knowledge, more working families are using supermarket meat departments and other venues to buy more prepared foods for consumption at home. This selection and preparation shift is requiring processors to respond with more meat products that are partially or fully prepared and/or cooked.

According to research conducted by Meat Case Research and the Leo Burnett Company in 1996, the criteria in Exhibit 4-13 appear to drive consumer selection behavior of meat products. The cuts most desirable to consumers are ground beef, steaks, chicken breasts and pork chops. The less desirable cuts are top blade steak, skirt steak, pot roast, pork blade roast and ground pork.

As discussed earlier, there is an aging North American population, with changing tastes and selection criteria. It is estimated that 25% of Canadians will be over 55 years of age by the hear 2002. Many have dental and medical considerations, are less mobile, have fixed incomes and eat less or purchase smaller portions. Though this is a growing market for the food service industry, meat (or meal) processors will need to consider their specific needs to be successful. Several considerations that food processors must account for are that flavors and tastes must 2–12 times stronger, meals must be easily chewed and swallowed with an appetizing look and mouthfeel, food needs high protein, vitamins and minerals (eating less, often one meal per day), packaging must be easy to open and foods must be easy to prepare and take home.

Both Canada and the United States markets are becoming more ethnically diverse. Significant immigration from Asia, Latin America and the Middle East has had an impact on consumption patterns and purchasing behavior. The implications for the food service industry have been substantial, challenging food processors to respond with a host of non-traditional servings such as tacos, tofu and sushi.

D.12. Industry environment—new products

All available consumer surveys point to the fact that North Americans have less time for food preparation than ever before. For this reason, meat processors are focusing their resources on developing value added products that give consumers what they are looking for—convenience. One of the most significant innovations today is called "case-ready" meat, a term that applies to fresh products that supermarkets buy already pre-cut and ready to be sold. These products have longer shelf lives and give retailers the flexibility to stock the meat case so that there is always a good selection of fresh meat cuts on hand. At the same time, case-ready meats provide consumers with a significant benefit: the added assurance of safety. By using the newest packaging technologies, meat packers and processors now produce a wide range of hermetically sealed products that have not been touched by human hands since leaving the plant. These products are already trimmed, portion controlled and individually wrapped, which means there are no added steps for retailers and consumers have a variety of fresh meat products that only need to be cooked.

Then there is the explosion of what the meat industry calls "consumer-ready" products, which are designed to make the consumer's time in the kitchen as hassle-free as possible. With the focus on ease of preparation, these products include individually wrapped chicken parts that are microwaveable, oven-ready and grill-ready cuts of meat, and such ready-to-cook items as marinated pork tenderloin, kabobs, stuffed peppers and seasoned steaks. Besides being ready to cook, consumer-ready meat products often carry convenient cooking instructions printed right on the label and some even include spice packets. Suggested portion sizes, especially for pre-packaged roasts and other larger cuts, and servings per pack also provide extra convenience and cooking confidence to consumers who know very little about preparing and serving these foods.

For these reasons, consumer-ready is becoming an industry standard because it fills the bill for taste and convenience. According to industry experts, almost all poultry is now consumer-ready and meat packers and processors are making major in-roads into developing consumer-ready pork products. In fact, the newest estimates are that between one-half to two-thirds of pork products are now consumer-ready, especially such "prepared" varieties as smaller pork loins, marinated pork roasts and pork chops. Besides the dramatic increase in consumer-ready products, shoppers are also looking for portion controlled items and fully prepared foods. This has led to such innovations as lunch-type meals, which combine luncheon meats with other items to make a complete meal, and packaged, ready-to-eat entrees. At the same time, grocery stores—which are vying with restaurants for the takeout market—are offering shoppers cooked-to-order meals and such new options as "dinner in a bag" at fast food prices. A related trend in case-ready and fully prepared meat products is the explosion of ethnic specialty foods. Since restaurant patterns are an early predictor of changes in retail food choices, a 1992 survey of Americans' dining out habits conducted by Research Advantage points to future directions in ethnic meat products. Specifically, 84% of consumers say they eat Italian foods other than pizza, while 81% like Chinese dishes and 79% enjoy Mexican foods. Gaining in popularity—and spurring the development of new specialty foods—is soul food (46%), Cajun (40%), French (32%), Japanese (32%) and Caribbean (18%).

The increased availability of case-ready meat has brought about major changes in the marketing of meat with an eye towards positioning meat and poultry products as the ultimate "meal solution". Borrowing a page from the fresh prepared deli case, many supermarkets are completely revamping the meat case, expanding the offerings from raw products to ready-to-cook items and fully cooked meals.

With the help of large, multi-deck self-service cases, more stores are using a technique called "landscaping" to highlight value added and ready-to-eat products in the center of the case and thereby to transform the meat case to a meal center. Further, more stores are installing an in-store kitchen for customer use and offering cooking classes and visiting chef programs to help shoppers learn how to prepare different meat cuts.

The other major trend in meat merchandising is that more meat processors are putting brand names on their products. While branding is common place in marketing poultry and pork products, it is only now gaining a foothold with beef. However, industry experts expect branded products to proliferate at the supermarket. Those products most likely to carry a brand name will be ones that are pre-marinated, closely trimmed, stuffed or in some other way providing added value and convenience for the time-strapped consumer.

According to the Food Marketing Institute (FMI), nearly 80% of Americans say they are trying to eat more healthily than they did in the past and 42% are willing to pay more money for low fat versions of regular products. For this reason, the meat industry is taking an aggressive role in reducing the fat content of fresh and processed meats. With fresh meats, this starts with leaner animals. In the case of fresh pork, for example, the latest data on the eight most commonly consumed cuts demonstrates an average 31% reduction in total fat and a 29% reduction in saturated fat since the 1980s. Leaner cuts are also being provided directly to consumers because of closer trimming at the retail level. The National Beef Market Basket Survey (1987) finds that beef sold in supermarkets has 27% less separable fat than in the late 1970s and early 1980s. Whereas the average thickness of fat around the edge of steaks and roasts used to be 1.5 in., today it is 1/8 in. More importantly, over 40% of the beef cuts sold have been trimmed to have no external fat at all.

At the same time, new statistics show a trend towards leaner ground beef. The biggest increase is in the 86% to 90% lean category, which only accounted for the 3% of retail sales in 1994, but now is expected to exceed 20% of sales. Although representing a smaller increase in the market, the leanest category (over 90%) is expected to rise from 12.5% of sales in 1994 to 14.2% by 1997. But the biggest opportunity appears to be in the reduced fat and fat free processed meats, such as hot dogs and bologna. Because the taste, texture and cooking properties of reduced fat and fat free processed meats have improved dramatically in recent years, it is not surprising that reduced fat products are now the largest growing segment of the processed meat category. According to Marketing Intelligence Service Ltd., more than 50% of the product lines in the lunch meat and hog dog categories contain a reduced fat or nutritional claim. At the same time, the ultra low fat (97% fat free) hot dog and bologna market has grown by more than 21%.

Besides hot dogs and lunch meats, *Meat Marketing and Technology* magazine reports that there are more low fat meat snacks, such as the new kippered beef steak, which is 97% fat free. Although these products are recent innovations, they are already gaining a foothold with consumers.

D.13. Industry environment—food safety

The safety of the food supply has long been considered a responsibility of the federal government. Safe food is paramount to consumers, but it is also a major responsibility of producers, processors and retailers. If there is doubt, just interview processors, retailers and producers connected to the recent "Jack in the box" scare in Tacoma, Washington. Over 700 consumers were affected, with 125 people being admitted to hospital and at least 29 suffered kidney failure. Dean Forbes, a spokesman for Children's Hospital in Seattle, summarized public sentiment in the wake of this food processing failure. "This has been a nightmare for the parents, to think that something as benign as hamburger could kill a kid is just startling to most people". To food microbiologists, hamburgers are anything but benign. In fact, they can be teeming with microorganisms that, under certain conditions, can lead to significant health problems.Scientists concerned with food safety issues consider microbiological contaminants to pose the most serious food related health risks—*Botulism*, *Salmonella*, *E. coli* and *Staphylococcus* are the most common. The increased occurrence of food borne illness appears to be largely the result of improper handling of food, a deterioration in cooking skills, a lack of knowledge of the need to cook, a lack of realization of the dangers of pathogens and the time pressures resulting from a fast moving society. These are not specifically processors' concerns—retailers, consumers and producers are all responsible.

There are other emerging hazards, which threaten our food supply in the form of antibiotic resistant bacteria, allergies and zoonotic diseases or conditions. The practice of routinely treating animals with antibiotics and feeding medicated feed has created new forms of resistant bacteria, which may be infecting food and processed meat products. Allergies and food sensitivities have become more widespread and/or perhaps more widely diagnosed in recent years. This has become an increasingly significant problem as food and meat products become more prepared and processed.

Possibly, the greatest concern in the area of food safety that is emerging is its importance in relation to international trade. Despite all the free market chatter of recent years, trade barriers remain formidable. Some countries are proving very ingenious at locating health considerations making exporting products to those jurisdictions difficult. Exporting processors must often make deals with local entrepreneurs, legal or otherwise, to ensure market access for their products. For small- to medium-sized processors, this is a double-edged sword (pricing and access). A recent report prepared by the consulting firm Toma Bouma, for the Alberta government, identified the following global food safety concerns; the importance of trade agreements, protectionism, the rise of anti-meat lobby, confirmed scientific linkage of animal disease and human health, biotechnology (GMOs) and disease outbreaks.

D.14. Industry environment—food inspection

From 1907 through 1996, the basic meat inspection policy throughout North America involved an inspection using the senses of sight, smell and touch to determine if meat was contaminated by pathogens. This was predominantly conducted as the meat came into the plant or as leaving the plant as a finished product. Very little on-line process inspection occurred. With this type of end product inspection, any problems detected at the finished product stage meant that disbursed product within the supply chain could not easily be recalled. This was a very expensive practice and placed the consumers in a situation of potentially higher risk. Although the Hazard Analysis Critical Control Point (HACCP) system was developed in the U.S. during the late 1960s, it was not until 1996 that it became mandatory throughout the U.S. (and anyone exporting to the U.S.). This was linked to the Jack in the Box incident previously mentioned. In 1996, the U.S. Congress passed mandatory legislation requiring the use of HACCP in meat processing. This science-based system of analysis is designed to minimize and detect pathogens. The Canadian Food Inspection Agency (CFIA) has made it clear that the role of industry will be one of prime responsibility for food safety. The meat-processing establishment will be required to develop and implement a HACCP plan. All federally registered plants are being pressured to implement HACCP inspections (TML was to be HACCP certified by July, 1999).

As HACCP becomes the industry standard, processing operations not certified will be forced to upgrade operations or lose market share. As many small domestic plants are provincially licensed or public health inspected, they will need to weigh the cost/benefits for achieving federal licensing. Many will need major capital renovations and upgrades to meet certification standards and it is quite likely that alternatives such as strategic partnering, co-packing or liquidation will be considered. Over the past several years, major distributors such as Safeway, Costco and Schwanns have also abandoned products which are not processed by federally licensed plants, further hi-lighting the importance of processing integrity.

Exhibit 4-1: Share of grocery dollar by major food groups, Canada

	1982	1996
Meat	23.6%	17.1%
Cereal and bakery products	12.6%	14.9%
Dairy products	14.5%	13.7%
Fruits and nuts	10.5%	11.2%
Vegetables	8.9%	9.6%
Prepared foods	5.2%	7.2%
Beverages	6.2%	6.7%
Poultry	4.3%	4.8%
Confectionery/snacks	3.3%	4.9%
Fish	3.1%	3.3%
Sauces/condiments	1.9%	2.5%
Fats and oils	3.5%	2.4%
Eggs	1.8%	1.3%
Spices/seasonings	0.5%	0.5%

Exhibit 4-2: Comparative per capita consumption, leading meat consuming countries (pounds per capita, carcass weight) (compiled by USDA)

	1975–1979	1985–1989	1994
Beef and veal			
Uruguay	170	137	150
Argentina	189	172	146
United States	122	106	98
Australia	142	89	82
Canada	108	89	76
Czech Republic	NA	NA	74
New Zealand	135	89	64
Brazil	NA	NA	58
France	69	67	59
Italy	53	61	57
Pork			
Denmark	98	140	146
Czech Republic	NA	NA	154
Belgium–Luxembourg	92	108	116
Spain	47	85	116
Austria	98	114	111

Exhibit 4-2: (*Continued*)

	1975–1979	1985–1989	1994
Germany	108	122	103
The Netherlands	73	94	97
Taiwan	55	83	90
Poland	106	99	81
Canada	68	61	62
Poultry			
Hong Kong	45	64	95
United States	54	77	100
Israel	84	85	96
Singapore	NA	81	87
Denmark	NA	NA	78
Canada	46	58	68
Saudi Arabia	32	62	67
Taiwan	24	44	62
Australia	34	52	60
Spain	44	48	50
Lamb and mutton			
New Zealand	72	84	55
Australia	45	51	37
Greece	32	30	33
Saudi Arabia	NA	NA	31
Ireland	21	15	21
Kazakhstan	NA	NA	17
Spain	9	13	14
Turkey	18	15	13
United Kingdom	17	15	13
Canada	NA	1.8	1.1

Source: Agriculture and Agri-Food Canada, Food Bureau Family and Food Expenditure.

Exhibit 4-3: Per capita meat consumption in Canada for selected years (measured on a per carcass basis in kilograms)

Meat type	1976	1981	1986	1991	1996
Beef	50.3	39.7	38.1	33.2	30.2
Veal	2.3	1.5	1.6	1.5	1.2
Mutton/lamb	1	0.7	0.9	0.9	0.8
Pork	27	31.1	27.8	26.5	26.2
Offals	1.6	1.3	1.7	1.7	0.2
Total red meat	82.2	74.3	70.1	63.8	58.6
Stewing hen/chicken	16.1	18	20.9	23.7	26.7

Exhibit 4-3: (*Continued*)

Meat type	1976	1981	1986	1991	1996
Turkey	3.9	4.1	4.1	4.5	4.1
Total poultry	20	22.1	25	28.2	30.8
Total meat	102.2	96.4	95.1	92	89.4
Saltwater fish				5.1	6.5
Shell fish				1.1	1.6
Freshwater fish				0.2	0.2
Total fish				6.4	8.3

Source: Statistics Canada, apparent per capita consumption.

Exhibit 4-4: Market share for selected meats in the U.S. measured as percent of total expenditures on meat

	1980	1985	1990	1996
Beef	53.9	50.3	45.4	42
Pork	26.9	26.2	27	26.7
Chicken	16.1	19.5	23.1	26.5
Turkey	3.1	4	4.5	4.8

Source: Cattle-fax.

Exhibit 4-5: Meat products served at dinner percent of home meals

Fresh beef	22
Poultry	18
Processed meat (including ham)	13
Seafood/fish	7
Fresh pork	6

Source: NPD Group/National Eating Trends.

Exhibit 4-6: Beef, pork and chicken—relative price per serving in the U.S. Beef in 1987 = $2.13.

	Beef	Pork	Chicken
1987	100%	88	58%
1988	106%	86	63%
1989	115%	86	69%
1990	123%	100	69%
1991	127%	100	67%
1992	125%	93	66%
1993	127%	93	67%
1994	124%	93	69%

Exhibit 4-6: (*Continued*)

	Beef	Pork	Chicken
1995	122%	91	68%
1996	118%	104	71%
1997	119%	109	71%

Sources: USDA and cattle-fax.

Exhibit 4-7: Food consumption away from home by outlet (percent per year)

Outlet	1994	1990	1980	1970	1960
Restaurant	37.5	38.7	41	41.3	50.1
Fast food	35.5	33.6	29.3	21.2	9.7
Hotels/motels	5.9	5.7	5.4	5.8	6.2
Schools	7.3	7.3	9.7	13	13.5
Stores, bars, Vending	7.4	7.9	8.4	11.4	12.4
Recreational places	2.7	2.7	2.3	2	2.5
Others	3.5	3.7	3.9	5.3	5.6

Source: Canadian restaurant and Food Service Association.

Exhibit 4-8: Top 10 Canadian franchise food service companies

Company	Units	Sales (×$1000,000)
MacDonalds Restaurants of Canada	902	1695
Cara Operations (Swiss Chalet/Harveys)	1575	1018
The TDL Group (Tim Horton Donuts)	1197	742
KFC Canada Division of Pepsi Cola Canada Ltd.	833	630
Scotts' Food Service Inc. (Franchisor of Manchu Wok and Franchisee of KFC)	871	536
Pizza Hut of Canada	520	416
Subway Sandwiches and Salads	1070	324
A&W Food Services of Canada Inc.	480	310
Yogen Fruz World Wide Inc.	2554	287
Dairy Queens Canada Inc.	670	261
Total	9808	6218

Source: CRFA 1996 Food Service Facts; sales figures for U.S. companies or subsidiaries reflect Canadian sales only.

Exhibit 4-9: Food service consumption by mealtime in 1997, U.S.

Meals or snack that contain meat	Percentage	Snacks
Breakfast	8	
Morning snack	7.4%	7.4%
Lunch	28.8%	

Exhibit 4-9: (*Continued*)

Meals or snack that contain meat	Percentage	Snacks
Afternoon snack	8	8
Supper	41.1%	
Evening Snack	6.7%	6.7%
Total	100	22.7%

Source: Canadian Restaurant and Food Service Association.

Exhibit 4-10: Meat consumed away from home in the U.S.

Meat type	Percentage
Beef	47
Chicken	24
Pork	12
Seafood	8
Turkey	6
Mixed luncheon meats	2

Source: National Cattlemen's Association.

Exhibit 4-11: Top 10 Canadian grocery distributors—1998

Stores	Sales 1998 (×$1000,000,000)
Loblaw Cos. Ltd.	11.08
The Oshawa Group Ltd. (merging with Empire)	6.81
Provigo Inc. (merging with Loblaw)	5.96
Canada Safeway Ltd.	5.34
Price-Costco Canada Inc.	4.37
Metro-Richelieu Inc.	4.03
Jim Pattison Group (Overwaitea)	3.8
Empire Co. Ltd. (Sobeys)	3.35
The Great A&P Co. of Canada	2.78
Federated Co-ops Ltd.	2.55

Exhibit 4-12: Growth potential ratings by supermarkets over the next 5 years

Prepared food item	Canada	U.S.
BBQ chicken	90%	59%
Meal components (side dishes)	60%	73%
Grilled chicken	50%	57%
Home delivery	50%	41%
Ready-to-cook whole meals	50%	73%
National fast food operators	50%	30%

Exhibit 4-12: (*Continued*)

Prepared food item	Canada	U.S.
Fully prepared ready-to-eat meals	50%	73%
Flame roasted chicken	40%	57%
Fried chicken	40%	47%
Retailer exclusive items	40%	36%
Fresh prepared pizzas	40%	61%
Signature items	40%	70%
On-line ordering	40%	42%
Mexican food	30%	43%

Source: CCGD.

Exhibit 4-13: Meat purchasing survey—selected results, U.S.

Desirable for purchase	Less desirable for purchase
It's a family favorite	My kids don't like it
It's easy to cook	Takes too long to cook
Know how to cook it	Don't know how to cook it
It's good value	It's too expensive
It doesn't take long to prepare	Too hard to prepare
There are different recipes	No recipe for it
It's easy to find	It's hard to find

Source: Meat Case Research and the Leo Burnett Company 1996.