OPINION

Railway raise of 9.5 per cent for hauling grain highlights need for review

INVEST ▸ **Grain farmers will be paying more so investors are attracted to CN and CP shares**

BY DOUG FALLER

Recently the Canadian Transportation Agency (CTA) announced that Prairie grain farmers will pay 9.5 per cent more to ship their grain. Based on the 2011 total freight bill under the revenue cap of $952 million, a 9.5 per cent increase means another $90 million straight out of the pockets of Prairie farmers.

Based on 31 million tonnes shipped in 2011, the average freight rate was $31.71 per tonne. A 9.5 per cent increase means another $2.92 per tonne in freight, or about $3 per seeded acre.

Most of the 9.5 per cent increase has little to do with the actual costs of hauling grain. In fact, the price index for the actual costs of hauling grain went up by only 1.6 per cent. Most of the increase — about 7.9 per cent — is a result of two changes in accounting methodology made by the CTA to the way it calculates the railways' corporate costs.

According to the CTA website, the first change is based on recommendations from the railways to change the way the CTA calculates the "cost of equity" component of the cost of capital.

According to the CTA: "Cost of capital is defined as an estimate of the total return on net investment that is required by shareholders and debt holders so that debt costs can be paid and equity investors can be provided with an adequate return on investment consistent with the risks assumed for the period under consideration…

"The new methodology is nearly identical to the previous methodology, but differs in establishing the cost rate of equity…"

So, the change to the CTA's cost of equity calculation has been done to ensure that CN and CP shareholders are provided an "adequate return on investment consistent with the risks assumed."

Grain farmers will be paying more so investors are attracted to CN and CP shares.

But, is investing in CN and CP actually risky?

APAS has learned from discussions at industry events that major investment firms in Western Canada have been advising their clients to invest in CN and CP.

When we asked why, the answer was simple: "Barrier to entry." In other words, the railways have a monopoly; they have a captive market in grain and face no meaningful competition — as farmers have always known.

Thus, there is very little risk investing in CN and CP as the trend in their share values and dividend payments attest.

From January 1, 2003 to May 1, 2012, CN share price has gone up about 400 per cent while CP share price has gone up nearly 250 per cent. From 2001 to 2012, CN dividends on their shares have increased every year, a total of 388 per cent, while CP dividends have increased eight of 11 years, a total of 275 per cent. The revenue cap for grain has never prevented the railways from meeting their cost of equity.

The second accounting change is the way the CTA determines how much the railways get to cover their pensions. Grain farmers will now pay more for funding CN and CP pension plans.

This is not due to more employees. CN employed about the same number in 2011 as in 2002. However, the cost to cover pensions to senior management may have gone up. For example, the CEO of Canadian Pacific is entitled to a pension at age 65 of $1.122 million, according to its 2011 annual meeting information.

Is it really true that CN and CP need more money from farmers to fund their pension plans?

Net income after taxes for CN and CP combined in 2011 was $3.027 billion. The net income after tax for two railways was at least 25 per cent higher than the net income before tax for all Prairie grain farmers combined in 2011, which was a record year for farm net income. The revenue cap for grain does not limit the railway profitability to cover their pension plans.

Who is taking care of the grain farmers' cost of equity or their pensions?

> *Is it really true that CN and CP need more money from farmers to fund their pension plans?*

The 2010 Travacon study showed that in 2007-08 and 2008-09 farmers were paying $6.57 per tonne more to the railways than they should be for freight. Deducting that amount from the 2011 average freight rate of $30.71 gets you down to a "reasonable" grain freight rate of about $24 per tonne.

Not only has the freight bill been too high for years under the revenue cap, grain farmers are now being asked to pay an additional $3 per tonne.

As APAS continues to call for a full costing review, the need grows.

Farmers could understand a 1.6 per cent increase in the revenue cap based on a rising price index for actual costs. But an extra 7.9 per cent to increase railway profits by another $75 million so shareholders are happy and million-dollar CEO pensions are safe is another matter.

Doug Faller is policy manager for Agricultural Producers Association of Saskatchewan (APAS)

Defending America in a cow-eat-cow world

FAIRNESS ▸ **Misplaced anger and a raw deal south of the border**

BY SHERI MONK
AF STAFF | PINCHER CREEK

"Schadenfreude" is when an individual takes pleasure in the misfortune of others. Although the word is German, the behaviour it describes is global, and it was alive and well in Canada when we learned the U.S. had discovered a new case of BSE. Facebook lit up like a Christmas tree as folks in the business on our side of the line started joyfully posting about how we ought to school them some by shutting down the border.

Really? Have we learned nothing at all? It is a simple economic truth that we need the U.S. more than they need us. We will not be able to change that unless we're prepared to downsize our herd faster than a bull would shrink if he sat on an igloo.

And there are more complicated truths that cannot be ignored. An economic hiccup in the U.S. can feel like a tsunami in Canada — we just don't have the density or volume to absorb as many big hits. And the BSE announcement came on the heels of the pink slime fiasco, compounding the fear of a virulent market recoil.

While some may have found it intensely gratifying to ride that irresistible high horse around the corral once or twice, it was entirely illogical. Why? The border was reopened to our UTM cattle in 2005, two years after BSE. America fully let us back in later in 2007, when OTM cattle were allowed to cross. Since that time, Canada has found another nine cases — and that's while the border remained fully open.

As bitter and angry as many still are over BSE, that anger is misplaced when directed at the Americans. If anything, they've had a raw deal because of our BSE. Canada's first positive case of BSE was discovered in 1993 — 10 years before the second case. The six-year-old cow was an import from the U.K., brought in when she was just six months old. America's first case was in 2003, seven months after our first case. Wait! How can we have had two first cases? Simple — we never had to count the first one in our tally because it was an import.

America's first case was in a six-year-old dairy cow that had been born, bred and imported from Canada only two years earlier. But this BSE cow was counted and immediately, export markets shunned America and all of her beef — no matter where it was born. There would only be three more cases in the U.S. — and all subsequent positive cases were atypical BSE, not classic BSE which is known to be spread through feed and is known to cause vCJD in people. In contrast, all but two of Canada's cases have been classic BSE.

> *While some may have found it intensely gratifying to ride that irresistible high horse around the corral once or twice, it was entirely illogical.*

We really don't know yet precisely what causes the two atypical strains of BSE. Some believe it is spontaneous, like the CJD that develops sporadically in humans and is not related to ingesting bovine BSE. But it is different, and we know for sure it isn't the classic BSE that terrified beef eaters across the globe when we saw it rise like a new plague from the decimated ranks of the U.K. cattle business.

You know who else watched the BSE disaster unfold across the pond? Originally it was Agriculture Canada, but later the Canadian Food Inspection Agency (CFIA). You know what they did? Absolutely nothing. In the U.K., the first BSE cow appeared in 1984, and the cause of BSE was first identified in 1986. In 1988, the feed connection was discovered and ruminant-to-ruminant feed was banned. All the while, we were still allowing like U.K. imports to come in.

Finally, in 1990, Canada closed its border to the U.K. cattle trade, and the plan to monitor the imports was as stupid as it was naive — imported cattle were supposed to be checked on every six months by a vet. A BSE-infected cow can go from symptomatic to death in eight weeks. There were no restrictions on slaughter, and no followup to ensure the cattle were actually being looked at. Many never were.

In 1993, the first BSE cow was found. Sadly, she was but one of 160 head imported between 1982 and 1990. The CFIA panicked, and attempted to find the rest of the imports they had so negligently failed to track. Only half were still alive. Eleven were exported to the U.S. and the others had made it into the human food chain and more importantly, rendered into the feed chain. It wasn't until 1997 that Canada enacted its first feed ban — nearly 10 years after the U.K.

There's a reason why the BSE class action against the federal government led by lawyer Cameron Pallett hasn't gone away — the evidence of near-criminal ineptitude is overwhelming. The truth is that our government failed us, and the U.S. has never, ever had a case of classic BSE — unless you count the one we gave them. Indulging in a little schadenfreude may be fun, but it's the furthest thing from fair.

sherimonk@gmail.com