

**EVALUATION OF THE WHOLESALE
AND RETAIL PRICE OF KOSHER
CHICKEN**

**COMMISSIONED BY
UNION OF ORTHODOX
SYNAGOGUES**

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1. BACKGROUND

The Union of Orthodox Synagogues (UOS) commissioned a financial and operational investigation into the cost of producing kosher poultry products. We carried out an exercise on behalf of the UOS and forwarded a report dated 17 December 2009, reflecting our findings on the costs of operating the then only kosher abattoir in the country. We then returned to Johannesburg in April 2010 to complete our investigations into the retail price of kosher chicken.

The report was discussed in depth at a meeting of the relevant parties on 23 April 2010 and some further analysis was requested. This was duly completed and forwarded to the UOS.

2. MANDATE

We were requested to conduct an investigation into the operation and cost structures of the then only kosher poultry abattoir in South Africa, Tenderchick. Following the investigation into the wholesale price of kosher poultry products, we were requested to conduct an investigation into the retail price of kosher poultry products.

We were to ascertain in detail the cost structure of Tenderchick's entire processing operation in comparison to that of non-kosher chicken producers within South Africa.

Where differences were identified between Tenderchick and other South African broiler producers, we were to advise of possible remedies to bring the costs of Tenderchick into line as far as possible with industry standards.

We were requested to supply reasons to the UOS for the differences in wholesale selling prices between Tenderchick and its retail customers when compared to the non-kosher equivalent, and retail selling prices between the kosher retailers and the Jewish community when compared to the non kosher equivalent.

3. INDEPENDENCE

We were given full discretion to conduct our investigations as we saw fit. We were not in any way influenced or guided by either the UOS, Tenderchick or the kosher retailers in the performance of our duties or the outcome of our investigations.

4. PROCEDURE FOLLOWED

Several meetings were held between us and representatives of the UOS and the terms and mandates of the investigation were agreed.

We then travelled to Johannesburg on November 2009 and met with senior office bearers of the UOS who explained the various kosher requirements in producing meat products, including poultry.

We then met with the owners of Tenderchick at their premises on the East Rand on November 2009 and were provided with a substantial amount of documentary evidence on how that business is operated and managed. We note that whole-hearted support was received from Tenderchick management and owners and all information requested was freely and openly provided.

We returned to the Tenderchick premises on November 2009, at the commencement of the day's operations, and observed and evaluated all the procedures carried out in preparing kosher poultry products. We spent a total of 8 hours on the premises evaluating the procedures and conducting enquiries into the financial transactions of the business. Various information was accumulated and retained for further analysis.

An interim report on the cost structures and operating procedures of Tenderchick was prepared in Cape Town and forwarded to the UOS in January 2010.

As a result of busy work schedules and other commitments, we were only able to perform our investigations into the retail price of chicken in April 2010.

We travelled to Johannesburg on 22nd April 2010 and met with the owners and management of the following retail outlets:

- Nussbaums Kosher Butchery
- Maxi Discount Kosher Butchery
- Bolbrand

We also had discussions with senior management of Blue Ribbon (Pick 'n Pay butcheries).

All the owners and managers of the above outlets were co-operative and provided all the information requested that was available. It must be noted that they all employ professional accounting firms to produce their management accounts.

We obtained as much information as possible through inspection of the premises, inquiries from management and documentary evidence. Specific information on selling prices, cost of poultry and any additional cost required to produce the final product was

obtained. It must be noted that retailers selling multiple products do not generally allocate indirect overhead between poultry and other products.

5. RESULTS OF WHOLESALE PRICE INVESTIGATION

The following factors which have an effect on the wholesale price of kosher chickens, were analysed and quantified:

- Economies of Scale – Tenderchick produces on average, less than 50,000 kosher birds per month, compared with the larger non kosher producers who slaughter on average 4,8million birds per month.
- The lower stocking density used by the suppliers of live birds, while creating a better quality bird, costs more due to lower economies of scale created by the lower stocking densities. These stocking densities are required in order to minimise an already higher than average rejection rate due to kashrut standards.
- All the chickens are slaughtered by a Beth Din slaughterer and a slaughter fee of R3.06 per bird is paid to the UOS. This equates to substantially more than for a standard non-kosher slaughterer.
- A Beth Din mashgiach (kosher supervisor) is present to check that the lungs and tendons of a sample of each batch of birds slaughtered are healthy and intact.
- These exacting standards result in a much higher than industry standard rejection rate. A factor of 7% is being recorded relative to an industry standard of about 2.5%. These rejected birds cannot easily be redirected into the non kosher market due to the evisceration process followed in a kosher plant. In addition, a non kosher bird has a deep incision cut across the entire length of its carcass to identify it as being a reject. These non kosher birds can only be cut up into low value chunk products and sold at discounted prices.
- The Kashrut standard for defeathering does not allow a hot scald. Hot scald requires that the slaughtered bird is dipped in hot water at a temperature of 52°C. The Kashrut standard dictates that any water temperature over the ambient temperature of normal potable water constitutes precooking and may thus not be used until after the koshering process is completed. As a result, the temperature of the water used in the defeathering process does not produce a completely clean and saleable chicken carcass. Approximately 70% of all feathers are removed leaving the balance of 30% to be removed manually. Once the chicken carcass has been koshered, the labour have to manually complete the defeathering process using scissors – a hugely labour intensive process taking between 2 and 3 minutes per bird per employee.

- The koshering process requires every bird to lie in coarse granular salt for an hour. Once the salt has been rinsed off the carcasses, using a triple rinse process, the carcass is considered to be kosher.
- The koshering process is slow and onerous relative to the non kosher process. Normal single line processing plants slaughter at a line speed of 6 000 birds per hour in comparison to a kosher single line processing plant which slaughters at a line speed of 975 birds per hour. This in turn creates a excessively high labour cost of R3,98 per kg relative to the industry standard of about 77cents per kg.
- Tenderchick does not process or trade on Jewish holidays. Tenderchick must consequently pay their staff for these 20 Jewish holidays together with the 12 national holidays recognised in South Africa. This further increases the labour costs.

The major production cost differences between kosher and non-kosher whole chicken are tabled below. Amounts are per Kg and exclude VAT.

DESCRIPTION	cents	cents
Industry cost of production		13,19
Direct cost of Kashrut		
Live chickens – higher reject rate	0,76	
Salt	0,25	
UOS slaughter fees	1,84	
Employment cost	1,68	4,53
Constraints due to no economies of scale		
Live birds – stocking densities		
Rent & Electricity		
Directors salaries & employment costs		
Repairs & Maintenance		
Distribution		
Other processing costs		
Insurance, admin costs		
Marketing		12,15
Tenderchick cost of production		29,87
Profit		0,20
Selling price to retail outlets excl VAT		30,07

We are of the opinion that, based on our physical observations and examinations of the financial records, Tenderchick appears to be operating within reasonable cost structures and is recovering its costs in the selling prices charged.

6. RETAIL PRICE INVESTIGATION

The following information was gathered during our initial discussions with the owners and management of the various retail butcheries:

- Poultry comprises on average about 20% to 30% of their total business other than Bolbrand which only sells poultry products..
- All the outlets add value to the original carcass – from fully cooked to kebabs. This made it difficult to determine an average selling price.
- The exercise was therefore focused on whole birds at each outlet to establish an average retail price.
- All the retailers purchased from Tenderchick. Information was obtained directly from Tenderchick in respect of some of them to verify the purchases made and the prices charged.
- Inquiries into the costs incurred in preparing and packaging the final product were made.
- It was noted that any kosher retailer (with the exception of Bolbrand) must have the facilities and staff to kosher beef and lamb carcasses received whereas all poultry received is already fully koshered, defeathered and ready for sale.
- The additional costs incurred at retail level by the butcheries in respect of poultry are thus operational in nature and relate to the preparation of specific and value added products. In some cases the carcasses are just further cleaned ie. removal of feather remnants and fat etc. – in other cases a sauce or crumbs are added or the product is cooked.

7. SALES

Tenderchick advised that they have only increased their prices to retailers once in the current year and that was in January 2009 at a rate of 3.6%. An audit of sales prices charged by Tenderchick was carried out and the prices were found to be constant for the 8 month period ended October 2009. The average gross price being charged by the company amounted to R30,56 per kg excluding VAT.

A further issue identified which has an impact on the selling price is the percentage of confidential discounts demanded by the chain stores.

An analysis of prices being charged by the retailers for kosher products follows:

These prices were collated on the 23rd April and include VAT.

Product	Nussbaums	Maxis	Bolbrand	Checkers	Spar	Norwood PnP
Whole Fresh	52.95	51.20	51.75		54.99*	49.95
Whole Frozen	N/A	N/A	N/A	34.99		34.99
Thighs	39.95	57.40	58.99		69.99*	53.95
Wings		57.40	58.99		34.99*	39.98
Drums		57.40	58.99		45.99*	
Breasts	58.95	57.40	58.99		65.99*	52.95
Braai Pack	56.95	56.80	56.99	58.99*		
Filleted Breast	140.00	134.20	139.99			147.95

*Mehadrin Commission

Analysis of Kosher Whole birds

Product	Nussbaums	Maxis	Bolbrand	Checkers	Norwood PnP
Whole Fresh	52.95	51.20	51.75	N/A	49.95
Whole Frozen	N/A	N/A	N/A	34.99	34.99
Diff in R	N/A	N/A	N/A	N/A	14.96
Diff in %	N/A	N/A	N/A	N/A	43%

The non-kosher equivalent on the same day reflect the following:

Product	Spar	Norwood PnP	Difference %*
Whole Birds	26.99	38.95	58
Thighs	36.99	42.99	40
Wings	33.99	42.95	24
Drums	34.95		55
Breasts	33.99	38.99	61
Braai Pack	29.99	33.99	74
Filleted Breast	48.99	49.95	184

*The Percentage difference has been calculated by comparing the average retail price of each product across a number of kosher retail outlets, with the average retail price across non kosher retail outlets.

The above table reflects an average difference of 52% on bone-in poultry products compared to the non-kosher equivalent. Non kosher chicken is generally sold through the chain stores and some factory shops. There aren't many private butcheries selling poultry products. The chain stores tend to use poultry as "loss leaders" to attract consumers to

their stores and are regularly offering heavily discounted deals. The gross profit percentage being achieved on non-Kosher chickens is approximately 30% on average but will fluctuate by up to 3% once confidential discounts are factored into the equation.

The average gross profit percentage being achieved in the kosher butchery retail business in respect of most poultry products appears to be approximately 36% before direct production costs.

8. SUMMARY OF PRIVATE RETAILERS

	Nussbaums	Maxi	Bolbrand
No. of months	6	6	12
Poultry as % of total	30%	6%	100%
Total Gross Profit % before direct costs	31%	25%	43%
Estimated Gross Profit - poultry	36%	35%	42%
Expenses to Sales	27%	Not available	35%
Net Profit to Sales	4%	Not available	8%

The above table attempts to make a comparison between the retailers investigated but it must be noted that each one is unique in its own right. Each have their own products and totally different cost structures.

9. ADDITIONAL COSTS

All the retailers evaluated advised that the additional costs of being kosher include the following:

- The company must pay for 20 Jewish holidays and 12 national holidays. The staff also take their leave once per annum so each employee gets paid for 47 days per annum for which no output is achieved.
- Mashgiach salaries
- UOS licence fees
- Koshering costs where operation is trading in beef and lamb ie. salt, slaughter fees and water
- Additional staff for koshering process

10. UOS FEES

A significant amount of criticism has been levelled at the UOS in the press and other media, regarding UOS fees, the implication being that the UOS is responsible for the high cost of kosher products.

As noted above, the UOS charges a slaughter fee, at wholesale level, of R3,06 per kosher slaughtered chicken. This amounts to approx. R1.84 per kg. Of these funds, approximately 65% is allocated to direct costs of kosher slaughter, being the salaries of the slaughterers, the salary of the full time kosher supervisor and the purchase of metal wing clips. The remaining 35% is allocated to indirect costs, being time and travel of Beth Din Rabbinic inspectors and general running costs of the UOS.

No other fees are charged to the wholesaler by the UOS.

At retail level, the UOS levies a monthly fee on all retail establishments. This fee covers the rights to use the Beth Din logo, regular rabbinic inspections and associated administration. The average monthly licence fee to the retail butchers is R2,600 (excl VAT) per establishment.

11. COMPETITION

The management of the UOS briefed us about the following information.

At the time of compiling the above information, Tenderchick were the only Beth Din approved kosher poultry abattoir. The reason for this is not, as many assume, that the UOS is protecting a "monopoly", but rather that nobody has come forward with an application for a competing abattoir, who can meet the kashrut standards of the Beth Din.

The UOS advise that in the past 40 years, only two applications have been made for a kosher chicken abattoir, and have not been successful due to the inability of the applicants to meet the required standard.

The policy of the UOS is to allow freedom of entry into the kosher slaughter market, provided of course that the rigid and uncompromising standards of kashrut can be maintained.

An application for a competing chicken abattoir was recently made to the UOS, and has in fact been approved. Kosher slaughter of chickens at this new abattoir is expected to begin in August 2010.

The UOS advise that applications from members of the public for either wholesale or retail butchery operations are welcome, and will be granted licences subject to Beth Din approval of kashrut standards, as well as a financial evaluation of the business and sustainability and impact on kosher consumers.

12. SUMMARY OF SUGGESTED IMPROVEMENTS/COST REDUCTION

Possible remedies to bring the costs of Tenderchick into line as far as possible with industry standards are tabled below:

- Introduce growth promoters in feed
- Negotiate live bird cost with contract growers
- Increase broiler stocking density by 2 chicks per square metre to reduce live cost
- Negotiate that employees only get remunerated for time worked
- Restructure to eliminate overtime
- Reduce confidential discount percentage with chain stores
- Slaughterers to commence working day on time
- Introduce progressive flow facilities to cut, pack, wrap, label and box all products which will enhance quality, presentation and efficiency

13. CONCLUSION

Wholesale

As noted above, *Tenderchick appears to be operating within reasonable cost structures and is recovering its costs in the selling prices charged.*

Retail

As noted above, the average gross profit percentage is approximately 36% before direct costs, with a net profit of between 4% and 8%.

This analysis has been prepared on information supplied by the management of the individual operators and our financial interpretation of this information using the standards generally followed by the industry

While every effort has been made to accurately determine and quantify all the relevant factors, the nature of an exercise like this could contain uncertainties which could impact on the overall findings. We are also not in a position to discover deliberate and concealed irregularities, if any, which might be taking place in these operations but we believe that full and complete disclosure of all material factors has been made by all parties.



MICHAEL ANDREW KINGSTON



MICHAEL JON PEPER

CURRICULUM VITAE – MICHAEL JON PEPER

- Chartered Accountant CA(SA) (UCT)
- **County Fair Foods, a division of Astral Foods Limited – April 1991 to December 2009 (18 years)**
- Employed as Financial Manager of this poultry producer with responsibility for all financial aspects of the business i.e.. management accounts, budgets, capex, taxation, internal audit, personnel.
- Promoted to Group Financial Manager with responsibility for Joint Ventures, subsidiaries and IT. Carried out several due diligence exercises leading to acquisitions. Also appointed as Principal Officer to all retirement funds operated by company. Director of two subsidiary companies.
- Promoted to Financial Executive. In addition to above assumed responsibility for all legal, environmental and contractual matters. Prepared divisional and group strategic plans.

CURRICULUM VITAE – MICHAEL ANDREW KINGSTON

- Known in the Industry as “Mr Chicken”
- Business Man of the Year – Orange Free State Province
- Poultry Man of the Year
- Chairman South African Poultry Association
- Past Directorships
 - Astral Foods Limited, Astral Operations Limited, Farmers Table (Pty) Limited, Kayfour Investments (Pty) Limited, Original Chicken Grill (Pty) Limited, Pine-Top Estate (Pty) Limited, Earlybird Farm (Pty) Limited, National Chick Limited, Ross Poultry Breeders (Pty) Limited, National Chick Swaziland (Pty) Limited
- **CAREER**
- **1974 - 1986, (12 years) Rainbow Chicken Farms (Pty) Limited**
- Started career in the company's hatchery division managing all hatcheries in Kwa-Zulu Natal.(up to 1.5 million chicks /week)
- Promoted to Parent Breeding & Hatchery Manager relocating to Rainbow Chickens Worcester.
- Promoted to Production Divisional Manager relocating to Rainbow Chickens, Rustenburg, accountable for the total construction and management of the "grass roots" complex.
- **1986 - 1994, (9 years) - Country Bird (Pty) Limited**
- Recruited to restore Company profitability after +- 8 years of losses.
- Executive General Manager accountable to the board for all aspects of the business including production, processing, marketing, engineering, administration, procurement and finance.
- **1994 – 1999, (5 years) - County Fair Foods (Tiger Brands)**
- Recruited to restore County Fair Foods to profitability (Company lost +- R20 million annually in FYs 1992 and 1993)
- As Managing Director, accountable for the entire broiler and breeding businesses, incorporating the operating functions of production, processing, marketing, engineering, human resources and finance.

- **2000 - 2009 – Companies under control of Michael Kingston**
- Ross Poultry Breeders
- Elite Breeders
- National Chicks
- County Fair Foods
- Earlybird Farms, Olifantsfontein
- Earlybird Farms, Further Processing

- As Managing Director of the Poultry Division of Astral Foods, responsible for seven companies with combined annual sales of +- \$0.5 billion and an operating profit of +- \$35 million with 4,000 employees.
- Sales volumes exceed 400,000 tons per annum, which is distributed nationally to both retailers and wholesalers.
- The capital expenditure spanning 2006 – 2008 exceed \$50 million.
- As Managing Director, accountable for Production, Processing, Sales, Marketing Finance, Strategic Planning, Budgets, Engineering and Human Resources for the seven affiliated Companies in the Group.
- As Managing Director, Executive Director of the Holding and Operating Companies of Astral Foods Limited.