

American Pecan Council

Marketing Order 7 CFR 986

Advisable Marketing Policy 2017 Crop Year

The American Pecan Council was established on August 4, 2016 (Federal Register Vol. 81, No 150). Under the auspices of the US Department of Agriculture, Agricultural Marketing Service, Specialty Crops Division, newly elected industry representatives to the Council were seated during a conference call on November 3, 2016, per the selection order dated October 24, 2016. Subsequent meetings were held to establish a budget, various committees, select an accumulator and public Council member, reporting requirements, headquarters location, personnel requirements, possible marketing strategies and to address various other industry issues. Due to the constraints of getting reporting forms through the public comment process, to date, none of the reporting forms have been approved. As such, several of the reporting requirements of the Marketing Order will not be able to be addressed in this, the Council's first, Marketing Policy Report. In some cases, estimates will be made based on published USDA NASS and FAS data, with all figures being reported on an inshell basis assuming a meat to inshell conversion ratio of 44% (all future reports will be based on a 50% conversion ratio). It should be noted that even had the reports been available for use, and the data collected as required, many of the reporting requirements could not have been met as the Marketing Order requires that a Marketing Policy Report be submitted at least one month *before* the final data can be collected, analyzed and published. As such, some of the projections are based on currently available information and historical data.

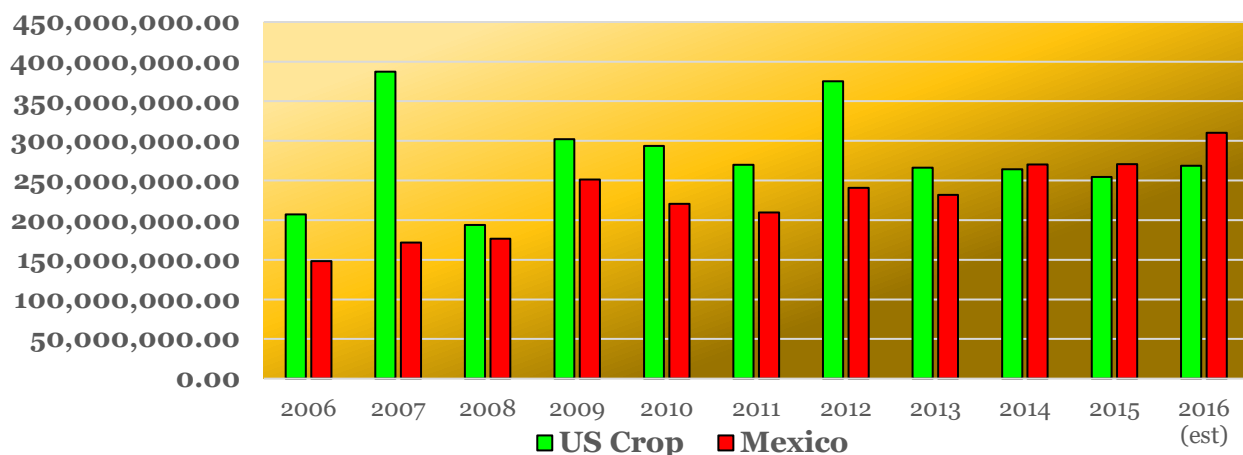
Pecan Production

The official US Department of Agriculture, National Agricultural Statistics Service (USDA/NASS) Non-citrus Fruits and Nuts 2016 Summary was released on June 27, 2017. For the purposes of this advisable marketing policy document, all US pecan production data was taken from the information contained in that document. It is also important to note that the figures contained in this Marketing Policy Report are conservative in nature as the USDA NASS published data reflects production from only eight of the fifteen producing states. Further, data from Georgia does not include any production data from orchards of less than thirty acres. The combination of the two thereby understates the actual size of the crop by approximately fifteen to twenty million pounds. Again, for the purposes of this document, all production data will come from the 2016 summary.

Unlike almonds and walnuts which have no production competition in the Western Hemisphere, the US Pecan Industry both relies on, and competes with, production from

Mexico. Further, depending on the crop year, Native and Seedling pecans, which grow wild in all but three of the producing states, can make-up a significant portion of the crop. Market conditions dictate whether these nuts get ‘picked-up’ and brought to market, a phenomenon that almonds, walnuts, pistachios, hazelnuts and peanuts do not have to contend with when it comes to pricing and supply. For example, in 2014, Native/Seedling pecans made up approximately 14% of the crop. However, in 2016, they accounted for less than 7% of the crop (18.8 million pounds of Natives, 249.97 million pounds of improved varieties).¹

For the past three years, Mexico has produced more pecans than the United States (crop size expressed in inshell equivalent pounds).



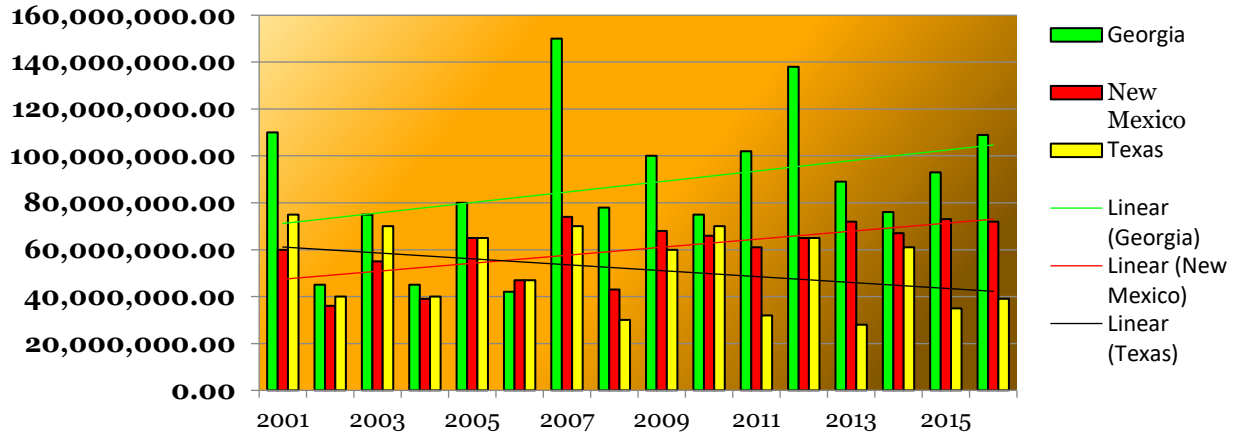
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Even though several states have seen increases in the number of trees being planted, as well as a commensurate increase in production (most notably Arizona, New Mexico and Georgia), due to the alternate bearing nature of pecans, US production has remained relatively flat since 2012. As a result of the severe drought that impacted the Southwestern growing region from 2009-2011, the alternate bearing cycle in several of the impacted states has shifted. While this has temporarily eliminated large swings in the supply of US pecans, it is one of the reasons for the industry’s inability to increase domestic sales.

Texas, which for decades had been the second largest producing state, has seen a steady decline in their production and has fallen to third behind Georgia and New Mexico. Without a significant increase in plantings in the state, this trend will continue.

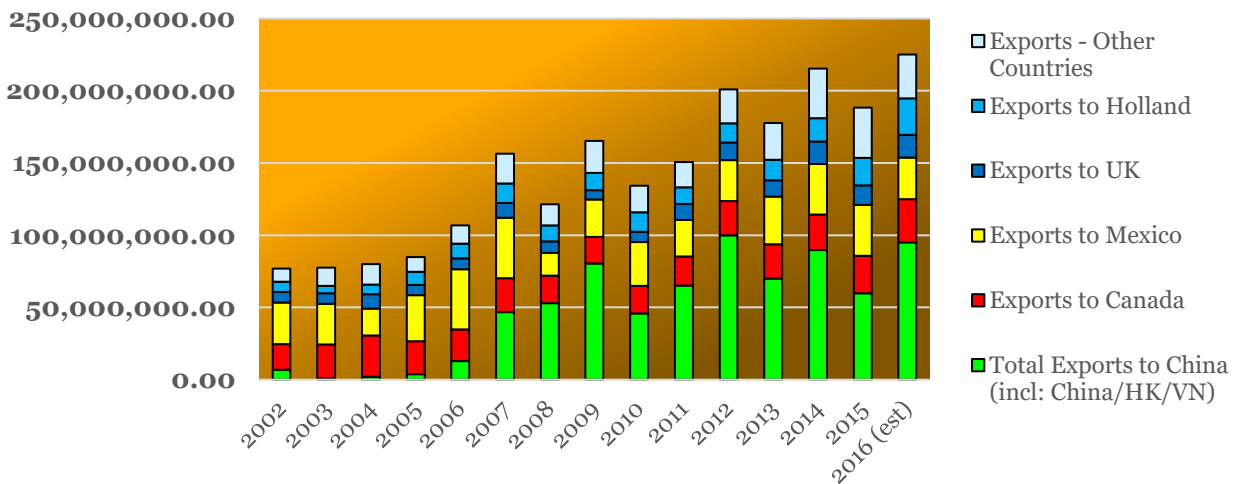
¹ USDA NASS Noncitrus Fruits & Nuts 2016 Summary (June 2017). All data contained in this Marketing Policy Report is based on a USDA Crop Year; October 1 through September 30

² Graph Source: USDA NASS, Mexico’s Agricultural Information Service



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On October 1, 2016, the industry carried 129,097,400 lbs into the 2016 crop.⁴ US production added 268,770,000 lbs. Mexico exported 235,604,383 lbs⁵ to the US, or 75.95%⁶ of their total production, resulting in a total marketable supply to the US industry of 633,471,783 lbs. While 2016 available supply exceeded 2015 supply by almost 42 million pounds, prices soared to record highs in both December 2016 and January 2017 primarily driven by overseas demand, especially from China, and remained at near record levels through the balance of the marketing year. Based on currently available information, exports were up approximately 16% over the same period a year ago.⁷



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³ Graph Source: USDA NASS

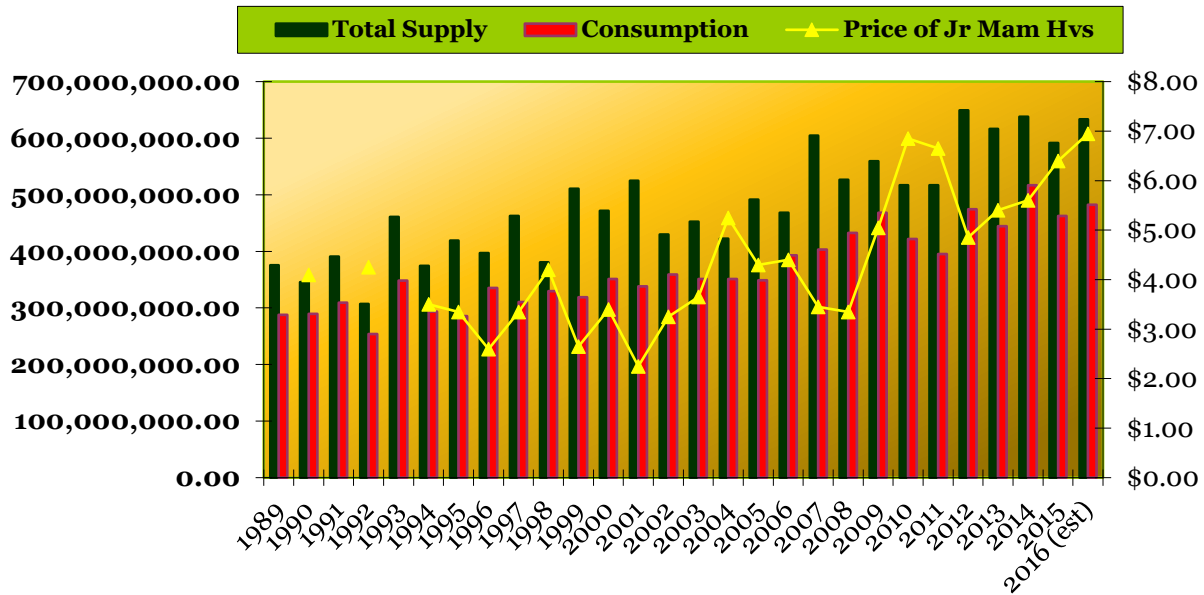
⁴ USDA Cold Storage Holdings, released October 2016

⁵ USDA Market News, July 31, 2017 Final

⁶ According to Mexico's Agricultural Information Service, the 2016 Mexican crop was 310,213,653 lbs. inshell basis

⁷ All references to prior year data in this Marketing Policy Report are based on 'crop year' comparisons, not calendar year.

⁸ Graph Source: USDA FAS

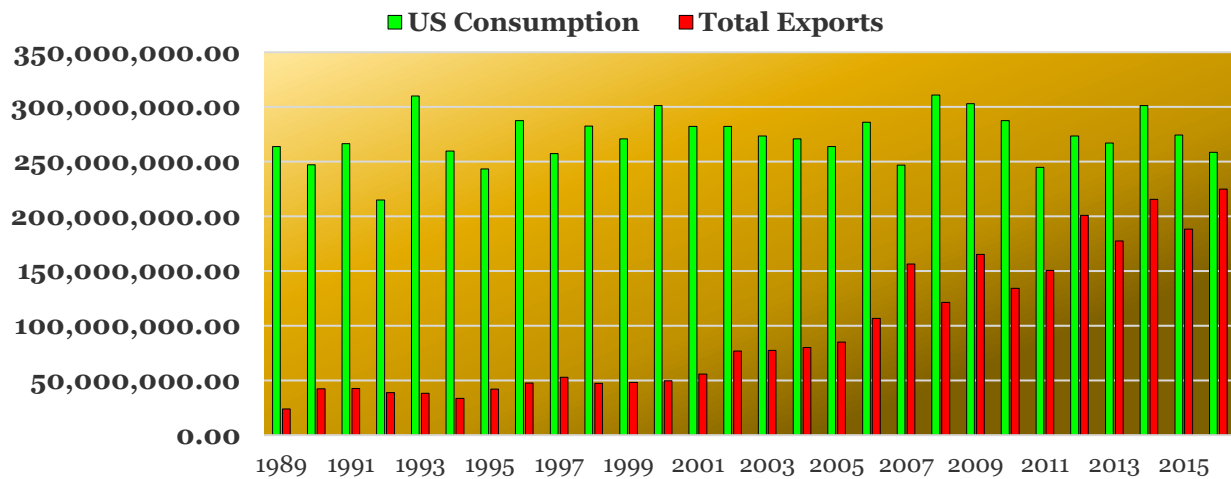


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Every pound of product that was exported, however, meant one less pound that was available for sale in the domestic market. Pecans are a cash crop, and since China’s entry into the US Pecan Market, US Sheller’s have been unable to match prices paid by Chinese buyers.¹⁰ Faced with insufficient raw material, and prices for walnuts and almonds significantly below the price of pecans, the industry again turned to Mexico to satisfy expected demand. This resulted in a record number of pecans being imported from Mexico; 235,604,383 pounds. As stated earlier, US Sheller’s processed and marketed 75.95% of Mexico’s pecan crop. However, even with the additional pecans, US demand could not be satisfied falling 6% below 2015 levels. Since 2008, US domestic consumption has fallen over 17%. While one of the primary goals of the American Pecan Council is to increase domestic consumption of pecans, until pecan supplies increase, this trend is expected to continue.

⁹ Graph Source: USDA NASS, USDA FAS, USDA Cold Storage Holdings, Nature’s Finest Foods, Ltd.

¹⁰ Chinese buyers consistently purchase inshell pecans at prices significantly higher than the shelled pecans can be sold for on the world market. China only buys the largest and highest yielding inshell, the same inshell that will yield Jumbo, Jr. Mammoth and Mammoth Pecan Halves. China (China, Hong Kong, Vietnam) paid an average price of \$2.78/lb for inshell pecans during the 2016 crop year. Assuming 50% yield, and a 3% mill loss, that equates to a shelled meat price of \$5.91/lb. Assuming \$1.30/lb of shelling related costs, the Sheller must be able to sell the shelled meats at no less than \$7.21/lb to break even. At no time in the past two years has the average shelled pecan price been within \$0.70/lb of that price.



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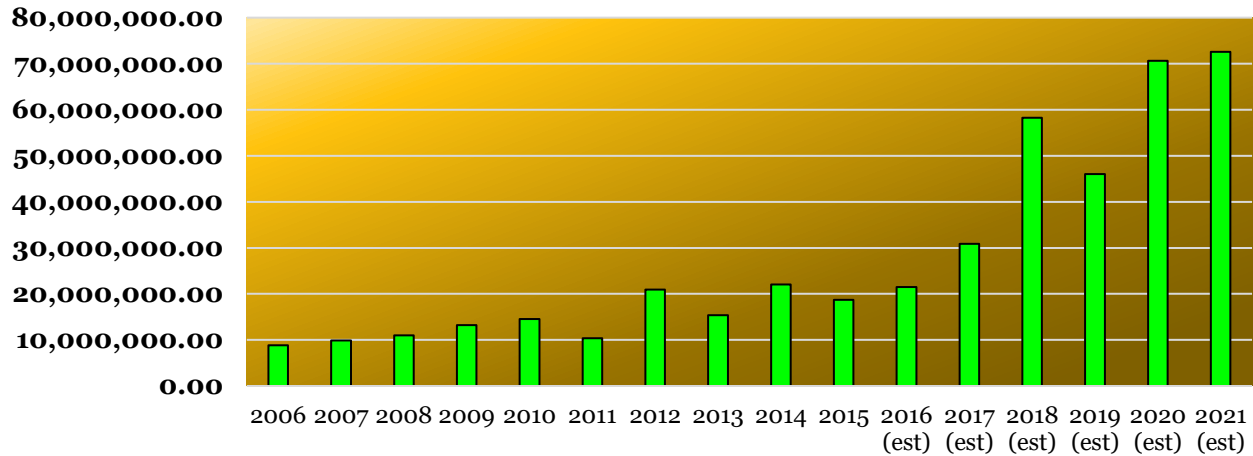
Competition

While the US Pecan Industry has become increasingly dependent on Mexican pecans, Mexico has also become their fiercest competitor. Unencumbered by US regulations, food safety standards and health care costs, and benefitting from the use of growth hormones that are banned by the EPA in the United States¹² and an hourly wage one-tenth that of the US, Mexican Processors continue to make inroads into the lucrative US Market; many being able to sell directly to US retailers and manufacturers.

US Growers have also seen an increase in competition from overseas, especially from South Africa. China's appetite for pecans has resulted in significantly higher returns to the grower leading to increased plantings around the world. Countries currently growing pecans include Mexico, South Africa, Australia, China, Peru and Argentina. Brazil, Chili and several other African countries are also looking at pecans as a new revenue source. Apart from China, all the other producing countries, or potential producers, are located in the Southern Hemisphere. Because their harvest occurs five to six months before the US, available supply, and prices paid to secure those crops, has a direct impact on prices paid to US Growers, especially those in Georgia. As those crops increase in size, so will the competition for China's business. South Africa's production is growing at the fastest pace and is expected to triple within the next five to eight years.

¹¹ Graph Source: USDA NASS, USDA FAS, Nature's Finest Foods, Ltd.

¹² Both Mexico and South Africa benefit from the use of Paclobutrazol (PBZ), a triazole. The most common trade name for the product is Cultar. The application of this, and similar products, is banned in the US for use on any food crops.



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Based on currently available data, world supply is expected to be as follows:

Country	2016	2017 (est.)
United States	268,770,000	313,000,000
Mexico	310,213,653	248,170,918
South Africa	21,494,850	30,864,400
Australia	5,731,960	6,393,340
US Carry-In	129,097,400	151,000,000
World Supply	735,307,863	749,428,658

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It should be noted that, while this Marketing Policy Report has presented an estimate for 2017 Carry-In, that figure is usually not determined until the release of the September Cold Storage Holdings in late October. The above figure is based on the July Cold Storage Holdings adjusted forward based on historical disappearance in August and September. As mentioned earlier, because none of the Council’s reporting forms have been approved, there is no way to know how much of the estimated carry-in is committed or available for sale.

2017 Projections

Unlike almonds and walnuts, pecans have a built-in consumption base. For example, there are no acceptable substitutes for pecans in pecan pie, butter pecan ice cream or pecan turtles, all three of which are leaders in their respective product categories.

¹³ Graph Source: Golden Peanut & Tree Nut, SA; Nature’s Finest Foods, Ltd

¹⁴ Chart Source: USDA NASS, Stahmann Farms, Australia, Golden Peanut & Tree Nut-SA, Bester-SA, Mtebeni Valley Farms-SA, Agricultural Information Service-Mexico, Texas Pecan Producers, Nature’s Finest Foods, Ltd.

Among the major North American ice cream manufacturers, butter pecan generally ranks as one of their highest sellers behind only vanilla and chocolate. Pecan turtles are the number one confectionary item with every major confectioner producing some version of this classic product. Because walnuts and pecans compete in over 60% of the channels of distribution, price becomes a key factor in any effort to increase consumption. However, having a better shelf life, richer flavor, increased versatility and perceived quality value, pecans are the preferred ingredient.

2017 could present some challenges for the Pecan Industry. While the supply situation is expected to be similar to 2016, pecans will again be competing against significantly lower priced alternatives. Both the almond and walnut industries are expected to harvest record crops. Based on current projections, price differentials could be as much as \$3.00 per pound.

	2016	2017 (est.)
Carry -In	129,097,400	151,000,000
US Crop	268,770,000	282,000,000
Mexican Imports to US	235,604,383	180,000,000
Supply Available to US Marketers	633,471,783	613,000,000

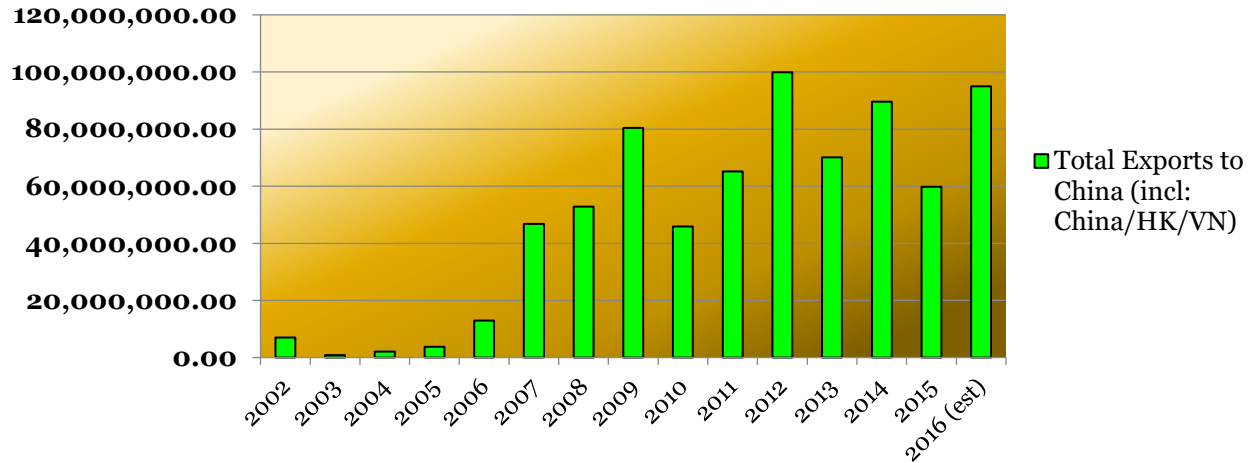
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Coming off a year of near record prices, a year in which China purchased a near record number of pecans¹⁶, and going into the year with a similar supply, one of the biggest questions is how will China respond. Historically, China attempts to average their inventory costs by purchasing heavier quantities in alternating years, usually years of lower prices, thereby minimizing the severe price swings that the rest of the industry can experience from one crop year to the next.

China has also been planting large numbers of pecan trees. While their 2016 harvest was not significant and had little or no impact on the world market, as their orchards begin to come into production, thereby allowing Chinese Growers to supply more of their own demand, US Growers will be forced to look to other markets to sell their production.

¹⁵ Chart Source: USDA NASS, FAS, USDA Market News, Texas Pecan Growers, Nature's Finest Foods, Ltd. **NOTE: The US Crop figure above is based on an averaging the first three industry estimates (313 million pounds) and assumes a collection rate of 80%; i.e. 282 million pounds.**

¹⁶ On Monday, August 28, 2017, the US Department of Commerce, Census Bureau, reported that there were errors found in the data submitted for China, Vietnam and Hong Kong; inshell pecans were incorrectly reported as shelled pecans/meats. Census is adjusting the 2016 crop totals to reflect the error. As of this writing, the extent of the error is not known. However, it is possible that the amount of product exported to China could be significantly reduced.



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As noted earlier, several data requirements of the Marketing Order cannot be met in this initial Marketing Policy Report. The following is a breakdown of those requirements:

1. In addition to reporting the breakdown of Improved vs. Native varieties (paragraph 1, page 2), the Council is required to report the number of substandard pecans received. The USDA NASS does not collect data on substandard pecans, and none is available from other sources.
2. This Marketing Policy Report contains no data on grower-cleaned vs. handler-cleaned inshell. The USDA NASS does not collect such data, and none is available from other sources.
3. This Marketing Policy Report contains no price projections for the coming crop. The USDA NASS does not publish such data, and none is available from other sources.
4. This Marketing Policy Report contains no discussion of preferable handler inventory for the coming year. The USDA NASS does not publish such data, and none is available from other sources.

As part of the industry’s continuing effort to develop new markets for their pecans, as well as increasing market visibility in those markets already served, the American Pecan Council is committed to working with other industry organizations, including but not limited to US Pecan, the National Pecan Sheller’s Association, the Peanut and Tree Nut Processors Association and the International Nut and Dried Fruit Council, to increase

¹⁷ Chart Source: USDA FAS

awareness and knowledge of the versatility, health benefits and value of adding pecans to the world's diet.

Summary

While there may be issues that the American Pecan Council cannot solve, i.e. cheap imports from Mexico, overseas competition, high overseas tariffs and currency fluctuations just to name a few, the industry can finally speak with one voice, finance and coordinate research projects, develop marketing strategies, identify and provide funding for the development of new markets and begin to provide the industry with sound reliable data. There is still a lot of work to be done, forms to be approved, changes made to the Marketing Order, etc., but the future of the US Pecan Industry looks bright.