

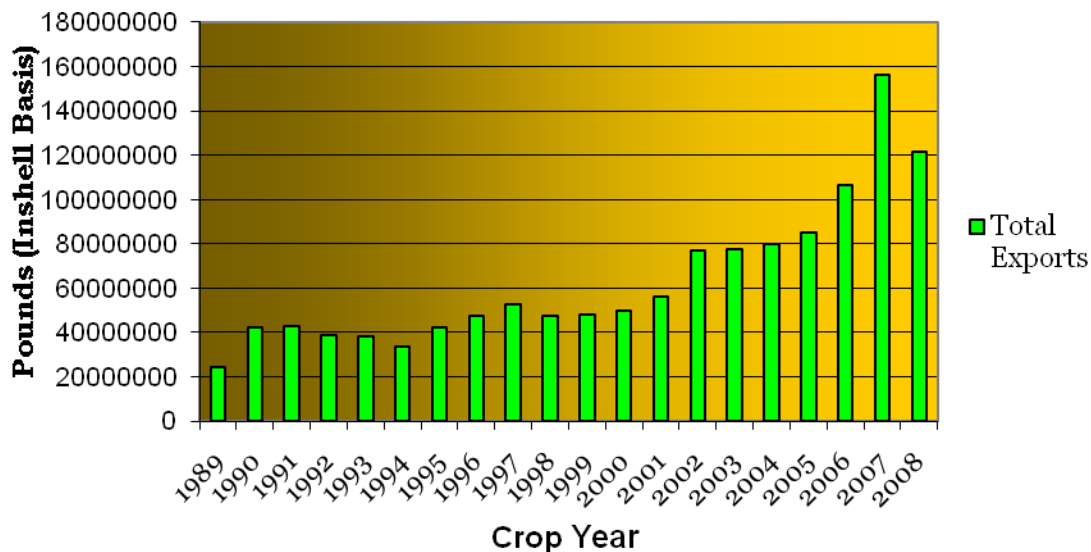
Be Careful What You Wish For! - by Daniel J. Zedan, President, Nature's Finest Foods, Ltd., PO Box 17, Wayne, IL 60184; ph: 630-377-2628, fax: 630-377-3250, email: dzedan@aol.com; website: www.nffonline.com

Change is inevitable. As General Eric Shinseki, Chief of Staff, US Army once noted, 'If you don't like change, you're going to like irrelevance even less.' During the last century, the Pecan industry has experienced a number of changes; the change from hand to mechanical cracking, the grafting of better yielding varieties, the introduction of Pecans to West Texas, New Mexico and Arizona, the introduction of the Quantz cracker, the development of color, infra-red and laser sorters, just to name a few. However, when it comes to the magnitude of the potential impact to the health and well-being of the industry, those changes pale in comparison to the change the industry is currently experiencing. I am referring to the change that started in 2001 and has slowly, but steadily, changed how the industry finances and sells its product.

Prior to 2001, the vast majority of inshell Pecans were purchased and financed by the Shellers. While the Grower certainly had to finance the growing of the crop, it was the Sheller who would have to pay for the crop based on what he felt the shelled meats could be sold for. In that process, he had to figure not only his processing and financing costs but what it would take to market the product at a profit while having to compete against the other nut alternatives available to food processors. Unlike his chief rivals, Almonds and Walnuts, which operated under federal marketing orders giving them what seemed like an almost unlimited supply of money for marketing, research and promotion, as well as providing for a unique way of financing the purchase of raw materials from the Grower, the Pecan Sheller had to do this all on his own. This was generally done through local banks who would loan up to 75% of the value of the inshell, based on *their* evaluation of the market, as long as the Sheller could come up with 25% of the financing in cold hard cash. While the system was not perfect, it did allow the Shelling industry to not only serve and grow markets in North America, but after 1990, they were able to also develop substantial new markets in Europe, Asia and the Middle East. In addition, when the US Government decided that all fats were bad, thereby causing the consuming public to shun all nuts, it was the Shelling industry that supplied the bulk of the financing necessary to fund the Loma Linda University study which proved that the fats in Pecans were healthy. Further studies, again primarily financed by the Shellers, provided additional data to back up additional health claims relative to the consumption of Pecans. Millions of dollars were spent in the development of those markets and the financing of the studies. However, after losing well over 50 million dollars on the 2000/2001 Pecan crop, equivalent to a loss of 200 million dollars worth of purchasing power, most of the major banks decided that it was no longer worth the risk to finance the purchase of inshell Pecans and subsequently withdrew their support for the industry. This forced the Shelling industry to look for new ways to finance their inshell purchases; one of which was to work out financing arrangements with the Growers. This was not an easy evolution as for years the Growers and Shellers had been involved in a 'tit-for-tat' love-hate relationship. 'On-year' crops would often lead to lower prices being paid to the Growers, who having felt that the Shellers had cheated them, would often charge significantly higher prices in the 'off-year' leading the Shellers to feel that they had been taken advantage of. This tit-for-tat back and forth also extended to the belief that the Growers would deliberately provide false data to the USDA for their Crop estimates and that the Shellers would deliberately provide false data to the USDA for their Cold Storage reports. These relationships, while not totally to blame, often lead to wide swings in year-to-year market prices. Due to the losses sustained during 2001/2002, between 2002 and 2009, while the Shellers were still able to finance their meat inventories through their local banks, the financing of their inshell inventories began to depend more and more on the Growers.

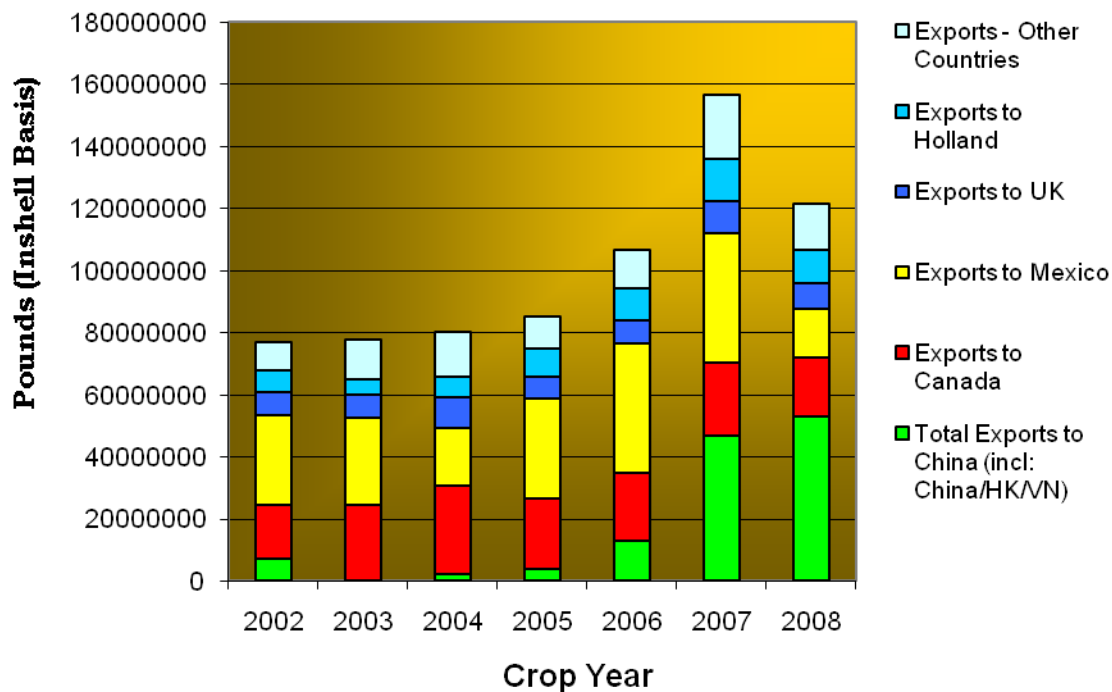
At the same time, and primarily as a result of inroads made by the Almond and Walnut Marketing Boards in China, Chinese buyers began to develop an interest in inshell Pecans. Preparing the inshell Pecans in much the same manner as had been developed for inshell Almonds and Walnuts, Chinese consumers developed a fondness for the unique flavor of roasted and flavored inshell Pecans. As such, in 2002, the Chinese started to purchase significant quantities of inshell. Because the Shellers controlled the bulk of the inshell inventories, those purchases were made primarily from the Shellers. Having spent millions of dollars to develop and maintain both the domestic and European markets, the Shellers only sold their excess inventories. Not only did this help to stabilize pricing in the short run, in the long run it helped to minimize wide swings in year to year pricing between on and off year crops. This was particularly true for the 2005 and 2007 crop years. Had the Shelling industry not been able sell off their excess inventory to the Chinese, meat prices could have plummeted to historic lows. Instead, meat prices remained stable as the Shellers continued to increase consumption while insuring that their core constituency had an uninterrupted supply of meats at competitive prices (relative to Almonds and Walnuts).

However, in the fall of 2007, due to a worldwide shortage of Walnuts, for the first time since 1979 Pecans were priced below Walnuts. At one point, shelled Pecans were selling for close to \$2.00/lb less than shelled Walnuts. Faced with increasing demand for Pecans in China, and unable to get sufficient quantities of Walnuts, Chinese buyers found that they could no longer rely on the limited supply of Pecans being offered for sale by the Shellers. Sales to China increased 400% over 2006 levels with the Chinese promising to purchase even more in 2008. To satisfy their demand, Chinese delegations came to the orchards of Georgia, Texas and New Mexico to establish direct relationships with the Growers. At the same time, several Grower organizations began to focus their marketing efforts on the rapidly growing Chinese market. As a result, in 2008, the bulk of the Chinese inshell purchases were made directly from the Grower. Faced with the option of getting cash for their crop or having to deal with the Shellers in some form of a financing relationship, the Growers understandably chose to sell to the Chinese. Due to the large carryover from the 2007 crop (201.3 million pounds, inshell basis), even though the Chinese purchased 27% of the US crop, there was still enough supply to handle the core domestic customer base. However, for the first time since 1998, total Pecan exports were down.



Not only were total exports down, but Pecan exports were down in every major importing country except China.

Exports by Country



While some of the decline in exports can be attributed to the downturn in the world economy and lower prices for Almonds and Walnuts later in the year, the industry didn't experience similar declines during earlier periods of economic unrest, even after the 9/11 market crash. A large part of the problem had to do with the lack of sufficient meat inventories to handle both the domestic and foreign markets. Because the Chinese only buy the biggest and highest yielding inshell, which when shelled yield Mammoth and Junior Mammoth Halves, supplies of both had been in short supply for two years. Further, those are also the most popular sizes among domestic and foreign buyers. As such, by August 2009, prices on both items had firmed dramatically and by the time the 2009 harvest got underway, there was a price difference of almost \$1.10/lb between Fancy Pieces and Fancy Jr. Mammoth Halves; a differential never before seen in the industry. Faced with such shortages, and because the domestic market makes up such a significant part of overall demand, the Shellers had little choice but to reduce their export sales and supply their core domestic customers first.

With the beginning of the 2009 harvest, the situation only became worse. Due to adverse weather throughout the growing region, what was supposed to be a good 'on-year' crop quickly turned into a less than average 'on-year' crop. By December, the Chinese had already increased their purchases by more than 300% over the same period a year earlier shipping more than the total amount shipped out of the entire 2008 crop. No longer able to dictate inshell prices, the Shellers, either unwilling to pay what were perceived as extremely high levels for an 'on-year' crop, or unable to secure sufficient financing to pay said prices, sat on the sidelines and purchased only what they could afford. In the interim, sales to China

continued to increase along with the prices being paid. By the time the Shellers did enter the market, there was no longer sufficient quantities of inshell to handle the anticipated domestic and foreign demand and long time customers were faced with near record high prices; and this was the 'on' year.

As stated earlier, change is inevitable and it often comes in phases. In the case of the Pecan industry, the first phase of the change that started back in 2001 is now complete. What the Growers have openly wished for has finally come to pass; *they now control market pricing*. While the following may be an inconvenient truth, it is a fact: there are no major companies, or any business schools anywhere in the world, that advocate the selling of 30% of one's production to a single customer, *especially if you have no control over that customer*. But that is exactly what has happened to the Pecan industry over the past two years. While every segment of the industry deserves to make a profit, the desire for short term profits over long term market gains and industry stability, especially at the expense of the industry's core customer base, could eventually lead to disaster. With so many other nut options, once a customer is lost, it is extremely expensive to get them back. Regardless of what many within the industry would like to believe, buyers don't need Pecans for their confections, baked goods or snack items. Sure, you can't put Almonds into Pecan pie or Walnuts in Butter Pecan Ice Cream, but those two items make up only a small percentage of total Pecan meat sales. Markets that took decades to develop could be lost in a matter of a few years. Have the leaders of the various Grower groups stopped to consider what will happen when the dollar starts to strengthen against the yen? What happens if the current trade dispute with China expands to other commodities? What happens if the US decides to supply more aid to Taiwan over the strong objections of the Chinese government? What happens if some of the inshell being shipped to China is shelled over there and then sent back to the US for sale? On several occasions, the Almond and Walnut industry have learned the answers to these questions and at no time did they like the answers. As Tom Stevenson correctly pointed out in his January *On the Farm* article in *Pecan South*, it's about time that the various segments of the industry started to work together to solve the problems facing our industry. The decade's old 'tit-for-tat' back and forth should no longer be tolerated. There must be a concerted effort to insure accurate crop estimates and cold storage figures. This includes getting the US Government to stop 'double counting' US inshell shipped to Mexico for processing because it won't be long before they're double counting product coming back from China. If the current industry leadership is either unable or unwilling to work together to solve the industry's problems, than it should be replaced. To quote Tom Stevenson, 'Open your eyes and see the possibilities instead of lamenting that the "good old days are gone". The future is now.'