



PRODUCE

TARIFF ALERT

CURRENT TRENDS

- Tariffs of 60% to 70% are impacting U.S. apple exports to China and India
- Recalls affecting romaine lettuce utilize a new voluntary leafy greens labeling program
- Wine grapes are the fruit industry's largest product segment
- Demand for organic produce continues to increase
- The Consumer Price Index for fruits and vegetables was down just slightly in December 2019 over the prior month, indicating stable domestic pricing

PROJECTED VALUES (12-MONTH OUTLOOK)



APPROXIMATE NET RECOVERY ON COST

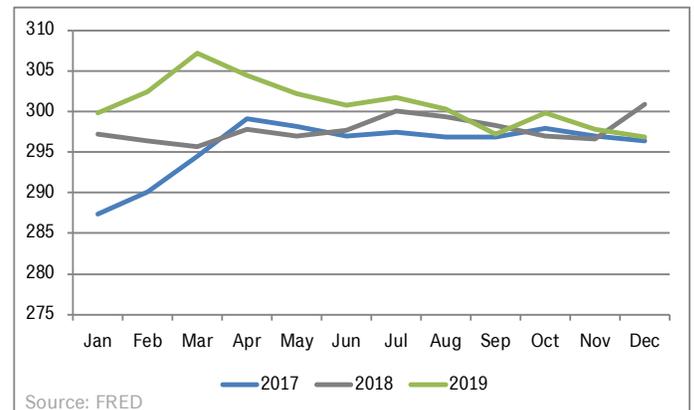
70-80%
retail packaged finished goods

65-80%
canned produce

75-85%
fresh produce (net of shrink)

45-60%
bulk frozen produce

CONSUMER PRICE INDEX FRESH FRUITS & VEGETABLES (SEASONALLY ADJUSTED)



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RECALLS HIT LETTUCE MARKET: Quality issues with romaine lettuce have continued to negatively impact the industry, with the latest recall in November 2019 the result of an E-coli contamination that caused 138 cases reported in 25 states. Similar quality issues in 2018 prompted a new voluntary leafy greens industry-labeling program in order to aid further market recalls, improve traceability, and help consumers avoid contaminated products. These labeling practices, as well as additional traceability requirements, assisted in identifying Salinas, California, as the source of the contaminated product in the latest recall. Most romaine lettuce products are now labeled with a harvest location showing where they were grown. Because the Food and Drug Administration did not have enough traceback information to identify the specific source of the contamination and stymieing a targeted recall, it requested that the industry voluntarily remove from the market and withhold distribution of Salinas-grown romaine lettuce for the remainder of the growing season. Because of a lack of specific traceback information, this was the most efficient way to ensure that contaminated romaine was off the market. Issues with product recalls can have serious and long-term business implications and can negatively impact sales throughout the supply chain from grower to retailer.

ORGANICS ON THE RISE: The continued increase in organic food sales, which has posed a significant competitive challenge to traditional foods over the past five years, is expected to continue through 2024. SPINS®, a natural foods research company, estimates that half of organic food revenue is generated from only one-fifth of U.S. consumers. For the most part, a relatively small group of consumers purchasing these products because of lifestyle commitment or health issues has historically driven the organic food trend. These consumers are very unlikely to return to the highly processed food products that have historically been staples.

Additionally, this demonstrates that there is room for expansion in this market. Organic food has been steadily moving into the mainstream in recent years. A 2018 Organic Trade Association survey found that 75 percent of supermarket categories include organic varieties and 88 percent of U.S. households purchase at least some of these products. The growing preference for organic products will likely continue to push more consumers toward fresh fruits and vegetables and away from canned or otherwise processed products.

TARIFFS IMPACT APPLE MARKETS: Tariffs have taken a toll on the U.S. apple industry over the past two years. Speakers discussed tariffs and the fall 2019 crop during the U.S. Apple Association's Apple Crop Outlook & Marketing Conference held in Chicago, Illinois, in August 2019. The U.S. Department of Agriculture (USDA) purchased \$83 million of fresh apples in fiscal 2019 as part of its trade mitigation program, but the value of fresh apple exports from the United States declined by approximately \$250 million year over year, falling from \$1.1 billion in 2017 to \$854 million in 2018, according to USDA data. For almost the entirety of the 2018 to 2019 season, U.S. apples were subject to retaliatory tariffs in three major export markets. They are headed into the 2020 season with a 70-percent tariff in India and a 60-percent tariff in China. For the 2018 to 2019 marketing season, Washington apple exports to China were down just over 22 percent

compared with the previous year. However, the 2019 U.S. crop was on the smaller side, which mitigated some of the damage. The European Union imposes seasonal tariffs on apple imports priced at or above the minimum entry price. EU tariffs are significantly lower and range from zero in the off-season, to nine-percent during peak season, August 1st to December 31st.

The current trade wars could have long-term consequences for Washington apple exports, namely brand erosion, said Todd Fryhover, President of the Washington Apple Commission. Fryhover noted, "Washington apples have been consistently present in these markets for over 20 years." Adding, "middle- and upper-income consumers flock to our product, looking for high-quality apples. But if our presence is limited due to tariffs blocking us out, and markets that are overproducing come in and overtake the shelf space, it will be extremely difficult to get that space back."

Losing a major customer can significantly impact Tier I sales in a disposition event. It is important for lenders with exposure to industries where tariffs continue to affect commodity values to monitor their clients' top customer lists to ensure that sales are not being negatively impacted and that key customers remain in place.

INCREASING DEMAND FROM WINERIES: Wineries represent a significant market for fruit farmers. Grapes are the industry's largest product segment, and wine producers buy the largest share of grapes. The U.S. Wine Production industry has been growing steadily and is expected to continue growing, benefiting grape farmers through higher prices and larger quantities sold. However, shares of production can fluctuate from year to year, because of volatility in prices and growing conditions. For example, recent wildfires in California damaged vineyards in the state's wine-growing region, and as a result the price of grapes has increased. According to the USDA's National Agricultural Statistics Service, utilized production of grapes in 2018 (the latest data available) totaled 7.6 million tons, representing a year-over-year increase of 2.7 percent.

PRIVATE LABEL CONSIDERATION: Many frozen and canned products are manufactured under a private label. Lenders should beware that manufacturers may not be permitted to sell private-label products unless they are repackaged. While in certain instances repackaging may be possible, it would incur extra time and expense in a liquidation.

PERISHABILITY FACTOR: Because of the perishability of fresh, canned, or frozen fruits and vegetables, product age and integrity are critical to recovery value. Most customers seek delivery of fresh products to stores or distribution centers within days of packaging, maximizing salability. The short shelf life of fresh produce necessitates rapid turnover in finished inventory levels. It is common for crops to be sold before the harvest, and products that are not sold fresh are also typically frozen or canned quickly. This short fulfillment cycle has a positive impact on recovery values in an orderly liquidation sale. Proper storage is key to maintaining freshness and value, which is why many processors contract with third-party cold storage facilities to manage inventory. However, lenders should beware of liens these third parties may have on inventory stored at their facilities and should consider whether inventory held at these locations should be excluded from the borrowing base to minimize risk.

REGULATORY ISSUES: In 1984, the Perishable Agricultural Commodities Act was amended to impose a statutory trust in favor of any unpaid supplier of produce to a seller. Under this revision, any seller must hold the produce and anything derived from the produce such as food products, receivables, and other proceeds in trust until the produce supplier has been paid. This provides the produce supplier with a first priority security interest in the assets, which prevails over other creditors including those holding a preexisting, perfected security interest in any personal property also included in the trust assets. A secured party should consider reserving for any outstanding payable amounts owed to these parties in order to secure the possession of the inventory in a liquidation.

The Expert: Alex Sutton



Alex Sutton provides specialized industry guidance and market research to support Gordon Brothers' Commercial and Industrial Valuations practice. Prior to this role, Alex headed AccuVal-LiquiTec's Inventory Valuation practice, which was acquired by Gordon Brothers in 2015, where his team produced reports used primarily for financing and financial reporting. Read his full bio [here](#)



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