Shrimp Industry

Hilco Perspectives

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INDUSTRY MONITORING POINTS

A number of company operating models purchase products based on forecasted customer levels. Should a company experience financial difficulty, replenishment ultimately would cease. Lack of replenishment would cause a significant alteration of the inventory composition, resulting in a greater concentration of aged and slower-turning inventory for non-forecasted sales. Therefore, diligent monitoring of in-transit inventories compared to previous-year levels at companies in the industry should be considered. Because shrimp harvest periods vary depending on country of origin, month-to-month monitoring should be avoided where possible, as false indications are likely to present themselves.

Shrimp Outlook in 2011

By Dean Hogencamp

Shrimp pricing fell slightly over the first quarter of 2011, compared to 10-year highs experienced in November 2010. Prices remained steady given limited product imports (seasonally driven) and lower supplier inventory. Given market volatility, customers remain spot market participants, as they remain reluctant to take long positions. Supply remains an underlying factor for steady price levels due to weather in Thailand (flooding likely has affected early production) and Vietnam (weather issues likely will delay the start of seasonal production), which could lead to potential supply concerns.

Disease (i.e., white spot syndrome [WSS]) severely impacted aqua-shrimp production in Mexico (import volumes declined 40% over the prior year), with supply concerns keeping prices steady. WSS continues to impact aqua farmers, with Ecuador and Thailand experiencing production impacts due to the virus in 2009/2010. This non-treatable disease, which has been a problem since 2000, spreads quickly through ponds with a 100% kill rate within a 7- to 10-day period. While farmers exercise preventative measures (e.g., sterilizing ponds, monitoring feedstock, and altering production start times and harvesting periods), such outbreaks present supply concerns, which, in turn, drive price instability.

While the U.S. economy remains fragile, shrimp imports in the first quarter of 2011 increased 3% over the prior year, with increases experienced within shell-on (single-digit growth) and peeled (double-digit growth) product. Conversely, cooked and breaded offerings experienced double-digit volume declines, given existing supply level/demand concerns within the marketplace.

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By product size, larger shrimp sizes (ranging from 16 to 20 shrimp per pound [16-20s] through 31 to 40 shrimp per pound [31-40s]) experienced volume growth; however, less than 15 shrimp per pound (U/15s), 41-50s, 51-60s, and 61-70s saw declines in volume. Given current and planned increases to supply levels, inflationary pressures within the domestic marketplace should be monitored; erosion within con-

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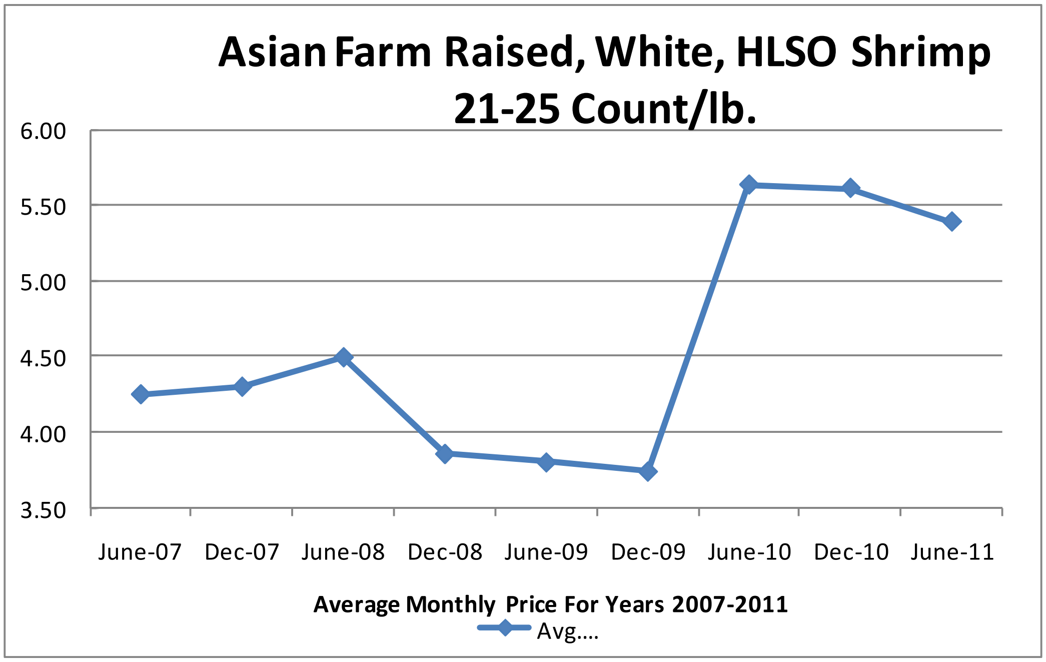
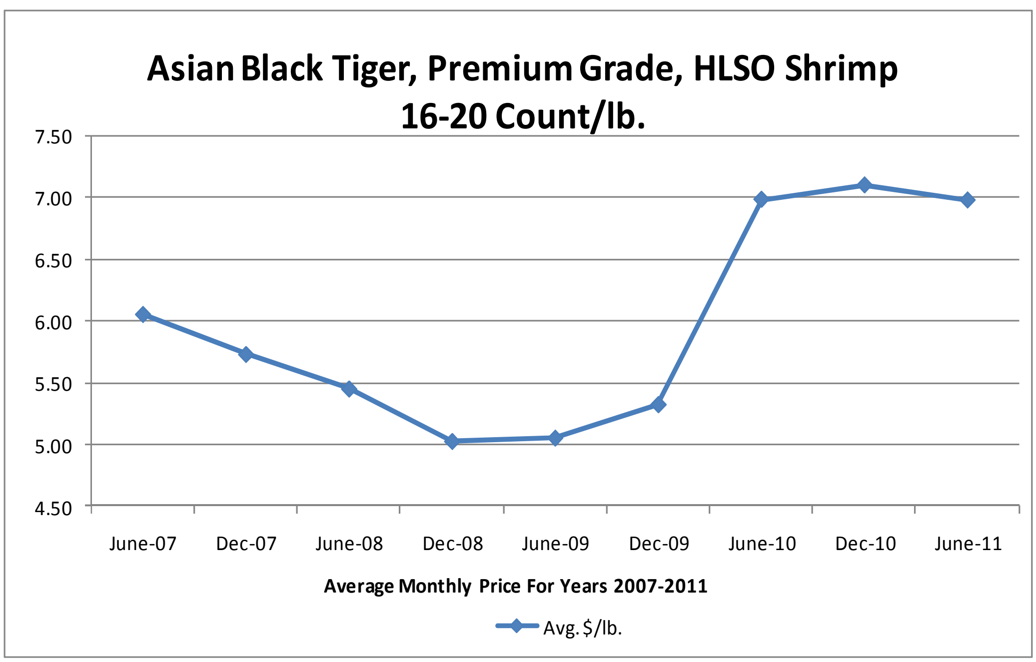
sumer discretionary spending will impact demand, placing pressure on price levels.

Macroeconomic Factors

In March 2011, the U.S. International Trade Commission passed a vote to extend the tariffs on freshwater shrimp from Vietnam, China, Brazil, India, and Thailand for an additional five years. The duties vary by the country of origin; for example, producers from Vietnam pay from 3.0% to 25.8% on farm-grown shrimp, according to the U.S. Department of Commerce's (DoC) International Trade Administration. The People's Republic of China's rates range from 0.0% to 112.8%; Brazil's from 7.0% to 67.8%; India's from 79.0% to 110.9%; and Thailand's from 1.1% to 57.6%. Such tariffs are applied to specific exporters, as opposed to countries as a whole, as not all exporters were found to be equally responsible based on findings by the DoC. Lenders should take notice of the significant variation within tariffs by country and producer. This is particularly true if in-transit inventories are considered part of the borrowing facility, as cash outlays would be required not only for freight and drayage fees, but also for tariffs. This cash outlay can be considerable, depending on the product's source.





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2011 OUTLOOK

Pricing for the second half of 2011 will be based entirely on supply and demand in the marketplace. Because producers typically target production based on current price levels, additional supply likely will be seen toward the latter half of the year. Should consumer spending levels remain constant, supply levels likely would outpace market demand, placing pressure on pricing.

Fishmeal pricing has increased approximately 10% since early 2011. Fishmeal is utilized by aqua-producers for feedstock in shrimp ponds. Current levels to date remain commensurate with those of 2010; however, they have increased 54% compared to 2009 levels. Continued increases to fishmeal pricing would impact aqua pricing, as producers likely would pass through such increases.

Exchange Rate Pressure

Continued devaluation of the dollar would place upward pressure on shrimp pricing. Indonesia, the second-largest importer of shrimp to the U.S. in 2010 (volumes totaled 134.7 million pounds), has seen the rupiah appreciate 7% over the dollar since January 2011. Mexico, the sixth-largest importer of shrimp to the U.S. in 2010 (volumes totaled 51.9 million pounds), has seen the peso appreciate 5% over the dollar since January 2011. Thailand maintained the dominant share of imports into the U.S. in 2010, with approximately 444.8 million pounds (36% of total U.S. shrimp imports), and has remained currency-neutral to the U.S. for 2011.

Shrimp Product Composition

Product composition remains a key driver for appraisal recovery values. Composition types can be identified in three primary classifications: commodity-like, private label, and value added.

- **Commodity-like** products include headless shell-on (HSLO), shell-on (SO), peeled and deveined (P/D), and peeled and undeveined (PUD). Active markets exist for these products within Pacific Whites (penaeus vannamei), black tigers (Asian), and Mexican whites/browns. These products are offered as either individually quick frozen (IQF) or block frozen. These commodity-like products typically are sold under company-branded names either into the retail or foodservice distribution channels.
- **Private-label** products are imported in customer-branded packaging. Competitors looking to establish a relationship with existing private-label customers have, in the past, shown willingness to absorb remaining inventory levels from liquidating companies; however, market pricing relative to carrying costs would drive actual appraisal recovery values.
- **Value-added** products consist of company-branded products, including breaded, skewered, butterflied, and seasoned shrimp. Because value-added products allow companies to differentiate themselves from their competition, higher margins typically are realized; however, this also presents elevated inventory-related risks, as the universe to sell value-added (non-commodity products) to alternative customers may be limited. Customer penetration (retail versus foodservice) ultimately drives appraisal recovery values, as the ability for customers to replace such products readily would dictate the required discounting structure.

IQF shrimp product

Hilco has appraised more than 20 seafood wholesalers/importers within the past 12 months, with inventory levels ranging from $1 million to $100 million. Because most of these companies are privately held, identification has been withheld in compliance with confidentiality agreements. Hilco's EVS segment has appraised the trade names for some of the largest seafood processors, while the M&E segment has appraised 137 seafood processing plants.