Expanding the U.S. Organic Grain Sector:

Challenges and Opportunities

Presented by Peter Golbitz, President

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Growing demand for organic has put pressure on supply

- Retail sales of organic products reached $50 billion in 2016[1]
  - *now 5% of total retail food sales*
- Farm sales of all organic products were $7.6 billion in 2016[2]
- Sales of field crops were $763 million[2]
- Growing demand outpacing domestic supply and production increases
- U.S. is becoming reliant on imports – particularly for feed grains

1-Organic Trade Association – U.S. Organic, State of the Industry
2-USDA NASS, September 2017

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Good news - U.S. organic acres are increasing…

- USDA NASS' latest report estimated that U.S. organic acres grew to over 5.0 million in 2016
- Field crops production grew to 1.7 million acres
- Corn acres were at 213,934
- Soybean acres were at 124,591
- Number of certified farm operations growing, as well as average acres per farm

US Certified Organic Farms and Acres	2014	2015	2016	CAGR
Total Acres	3,642,933	4,361,849	5,019,496	17.4%
Field Crop Acres	1,399,501	1,458,706	1,684,047	9.7%
Corn Acres	167,812	166,841	213,934	12.9%
Soy Acres	98,832	94,841	124,591	12.3%
Farms	12,595	12,818	14,185	6.1%
Aver Acres/Farm	289	340	354	10.6%

Source: USDA NASS, Organic Survey

But, the market is increasingly dependent on imports

- Even with increased farms and acres, U.S. imports of organic goods grew by 21.4% in 2017 to reach $2.1 billion
- With exports relatively flat at $565 million, the U.S. had an organic "trade gap" of $1.5 billion dollars in 2017

	2013	2014	2015	2016	2017
Imports	$1,376,825	$1,274,790	$1,585,133	$1,716,022	$2,082,931
Exports	$532,386	$553,128	$544,950	$551,530	$565,063

Source: USDA FAS – Global Agricultural Trade System (GATS)

U.S. exports are primarily fruits and vegetables

- The top 10 organic exports from the U.S. were fruit and vegetable products, with the exception of roasted coffee which was likely made with imported beans

Top Ten Organic Exports in 2017		
Organic Product	**Thousand $**	**% of Total**
Apples	$ 95,728	16.9%
Lettuce	$ 71,530	12.7%
Strawberries	$ 42,252	7.5%
Grapes	$ 41,603	7.4%
Spinach	$ 38,127	6.7%
Carrots	$ 34,666	6.1%
Tomato Sauce	$ 27,766	4.9%
Berries	$ 23,046	4.1%
Cauliflower	$ 17,475	3.1%
Coffee	$ 17,172	3.0%
Total Top Ten	**$ 409,365**	**72.4%**
All Other	**$ 155,699**	**27.6%**
Total All Exports	**$ 565,064**	**100.0%**

Source: USDA FAS – Global Agricultural Trade System (GATS)

Organic imports are a mixed bag, including feed grain

- The top ten imported items included a variety of tropical products, along with some seasonal fruits and vegetables
- Two somewhat 'odd' products in the list included soybeans and feed corn
- Odd, because the U.S. is the world's largest producer of both of these important crops and they won't be eaten directly by humans – *they're imported for animal feed*

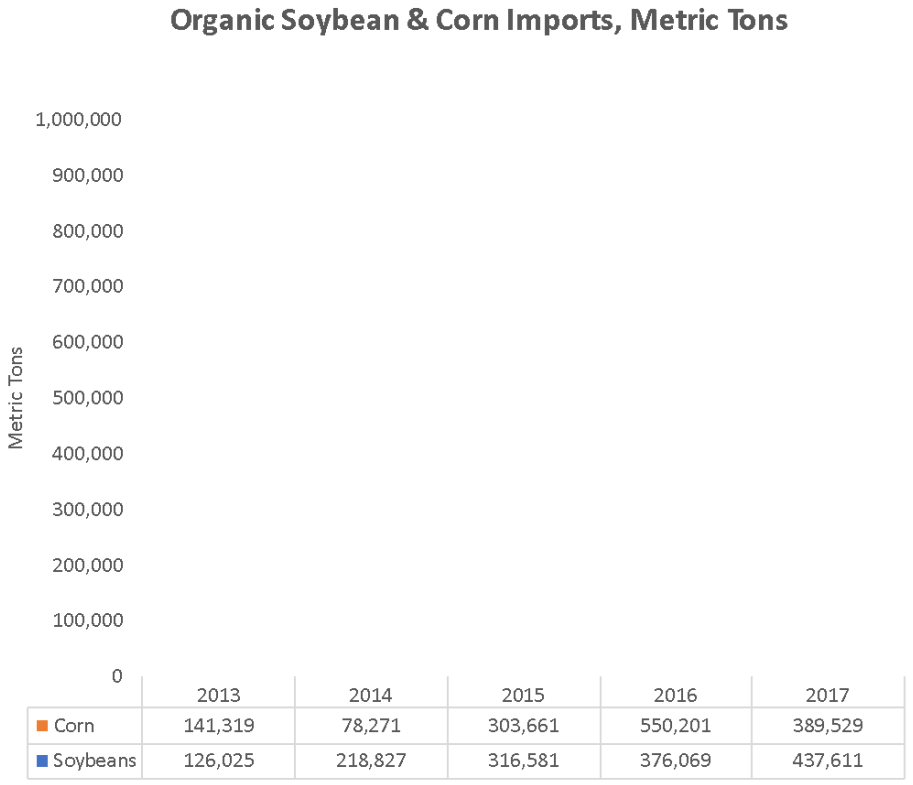
Top Ten Organic Imports in 2017

Organic Import	Thousand $	% of Total
Coffee	$ 357,956	17.2%
Olive Oil	$ 296,325	14.2%
Soybeans	$ 271,605	13.0%
Bananas	$ 232,259	11.2%
Avocado	$ 134,661	6.5%
Honey	$ 128,873	6.2%
Corn (Feed)	$ 121,993	5.9%
Sugar	$ 95,086	4.6%
Wine	$ 71,204	3.4%
Apples	$ 66,780	3.2%
Total Top Ten	**$ 1,776,742**	**85.3%**
All Other	**$ 306,189**	**14.7%**
Total All Imports	**$ 2,082,931**	**100.0%**

Source: USDA FAS – Global Agricultural Trade System (GATS)

Imports of organic feed grain accelerating

- Imports of soybeans and corn for feed have been growing at an average rate of 33% per year for the past five years to reach 827 TMT or over 41,000 full container loads in 2017
- Virtually all of this grain is going into the feed stream
- Leading exporters to the U.S. include Turkey, Argentina, Romania, India, Canada and Ukraine



	2013	2014	2015	2016	2017
Corn	141,319	78,271	303,661	550,201	389,529
Soybeans	126,025	218,827	316,581	376,069	437,611

Source: USDA FAS – Global Agricultural Trade System (GATS)

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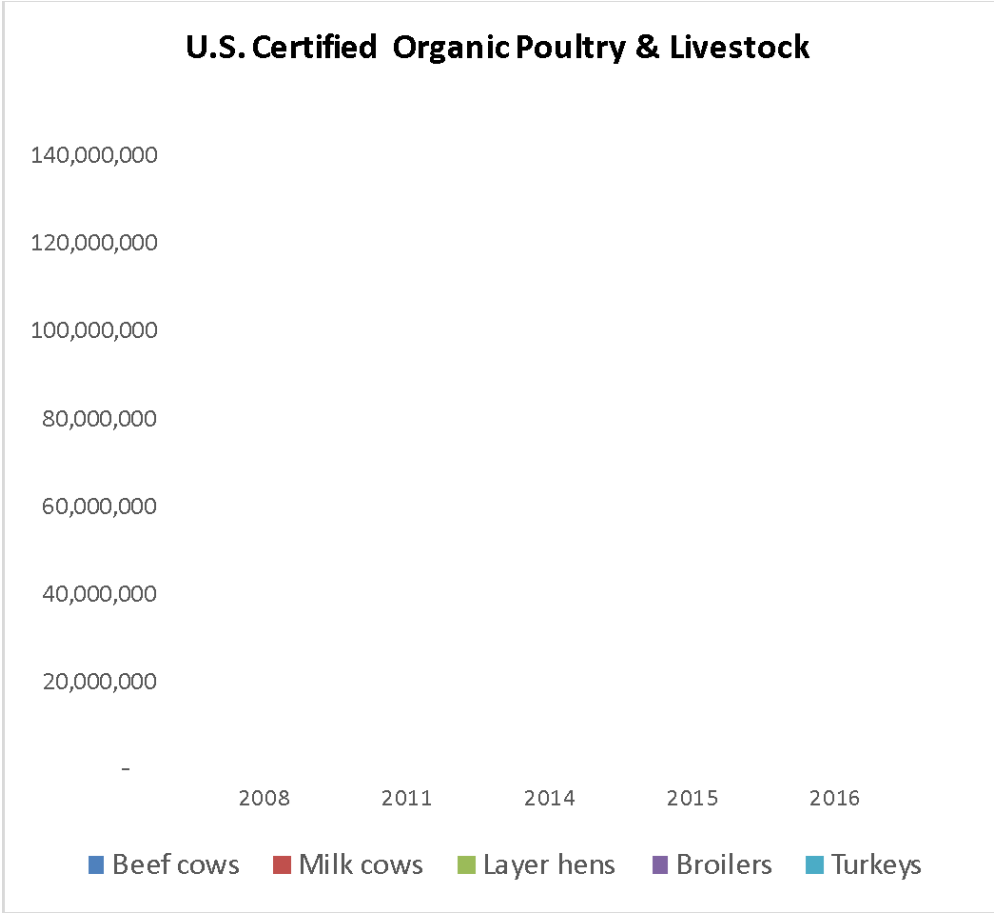
Chickens are the primary drivers for organic feed

- Production of organic broilers more than doubled between 2015 and 2016



Source: USDA NASS & ERS

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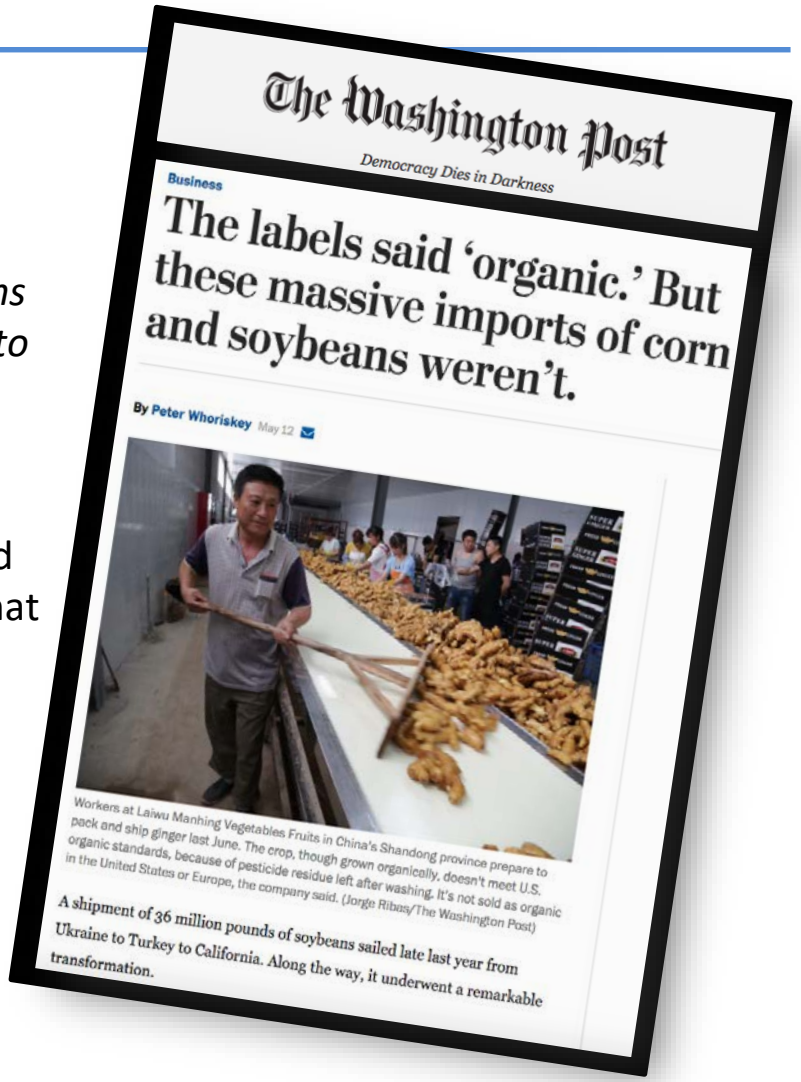
Rapid growth in imports led to questions…

- Where is all of this grain coming from?
- How could the costs be so low coming from half-way around the world?
- Was this grain meeting USDA NOP requirements?
- How could supply be growing so quickly?
- Were countries exporting more organic grain than they grew?
- Who was verifying the paper trail?
- Could these imports put the U.S. organic foods market at risk?
- Do low priced imports create a disincentive for domestic producers?

Washington Post breaks story on fraudulent imports

- On May 12th last year, the Washington Post reported that:
  - *"A shipment of 36 million pounds of soybeans sailed late last year from Ukraine to Turkey to California. Along the way, it underwent a remarkable transformation."*
  - The journalist, who was alerted to potential issues by an industry expert, simply followed the paper trail to discover that shipments that started off as conventional, ended up being re-labeled along with way and were accompanied by fraudulent organic certificates
  - While this news seemed shocking to many, industry insiders had suspected that there was fraud in this supply chain – prices were too low and supply just can't come on that quickly given time for transition



The Washington Post

Democracy Dies in Darkness

Business

The labels said 'organic.' But these massive imports of corn and soybeans weren't.

By Peter Whoriskey May 12

Workers at Laiwu Manhing Vegetables Fruits in China's Shandong province prepare to pack and ship ginger last June. The crop, though grown organically, doesn't meet U.S. organic standards, because of pesticide residue left after washing. It's not sold as organic in the United States or Europe, the company said. (Jorge Ribas/The Washington Post)

A shipment of 36 million pounds of soybeans sailed late last year from Ukraine to Turkey to California. Along the way, it underwent a remarkable transformation.

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U.S. Organic feed supply dangerously dependent on imports

- Imports growing more quickly than U.S. production
- In 2016 imported organic corn made up 46% of the U.S. supply, for soybeans, imports were 75% of supply
- U.S. organic poultry market likely at greatest risk for constrained growth due to limited feed supply
- U.S. buyers of organic feedstuffs need to make investments in U.S. production, logistical infrastructure and processing – imports should be used as stop-gap measure – processors should not become reliant upon these for future growth

Organic Corn and Soybean Supply - Bushels	2014	2015	2016
Corn			
US	18,596,637	18,468,287	25,562,804
Imported	3,081,373	11,954,526	21,660,309
Total Supply	**21,678,010**	**30,422,813**	**47,223,113**
% US	85.8%	60.7%	54.1%
% IMP	14.2%	39.3%	45.9%
Soybeans			
US	3,249,058	3,183,364	4,602,376
Imported	8,039,704	11,631,168	13,816,771
Total Supply	**11,288,762**	**14,814,532**	**18,419,147**
% US	28.8%	21.5%	25.0%
% IMP	71.2%	78.5%	75.0%

Source: USDA FAS – Global Agricultural Trade System (GATS), USDA NASS Organic Surveys

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What has happened since the fraud was uncovered?

- *May, 2017*
  - *Washington Post* article published
- *June, 2017*
  - *Organic Trade Association* convenes a *Global Organic Supply Chain Integrity Task Force* to develop recommendations to industry on best practices to ensure integrity of organic imports
  - USDA-NOP initiates posting of enforcement actions on a rolling basis making AMS appeal decisions, NOP suspensions and revocations, and NOP Settlement Agreements available to public more quickly
- *August, 2017*
  - OTA sends letter to Sec. of Ag. Sonny Purdue requesting increased oversight of organic imports
  - USDA Agricultural Marketing Service (AMS) National Organic Program (NOP) sends formal request to National Organic Standards Board (NOSB) to provide recommendations on improving oversight and control procedures used by AMS
  - USDA AMS reported that they had:
    - Conducted new audits of certifiers in Turkey and Eastern Europe
    - Revoked certification of a Turkish organic handler
    - Requested certifiers operating in Turkey and Eastern Europe to implement additional monitoring
    - Increased training of complex supply chains with certified handlers
    - Worked with USDA Animal and Plant Health Inspection Service (APHIS) to identify better ways to oversee organic products at Port of Entry

What has happened since the fraud was uncovered ?

Continued…

- *August, 2017 - continued*
  - USDA AMS worked with U.S. Customs and Border Protection (CBP) to explore technology solutions to better track organic products as they cross border
  - OTA prepares recommendation on closing some loopholes for "excluded operations" for consideration by NOSB at their fall, 2017 meeting
- *September, 2017*
  - OTA participates in a FIBL hosted anti-fraud initiative activity in Ukraine
  - Rep. John Faso (D-NY) introduces a bi-partisan bill, the *Organic Farmer and Consumer Protection Act* which would improve oversight of global organic trade and an improved system to ensure organic integrity
  - Office of Inspector General publishes report identifying issues with AMS controls over NOP's international trade agreements, imported product approvals and related issues – AMS accepts findings and additional responsibilities required
- *October, 2017*
  - AMS produces and asks for comments on, an interim instruction document intended for use by USDA Accredited Certifying Agents that recommends best practices to ensure oversight of organic products
- *November, 2017*
  - NOSB at fall meeting convenes panel on imports that includes AMS NOP, APHIS, CBP and USDA Marketing and Agreements Division

What has happened since the fraud was uncovered ?

Continued…

- *November, 2017 - continued*
  - NOSB Compliance, Accreditation and Certification Subcommittee consider proposal re: excluded operations in the supply chain (uncertified handlers)
- *December, 2017*
  - USDA NOP compiles a list of information about fraudulent certificates that have been publicly announced into an easy-to-search spreadsheet
- *February, 2018*
  - OTA presents the work of its task force and best practice guide to certifiers at the 2018 Accredited Certifying Association's training as part of a collaborative effort to develop best practices used by certifiers and industry
  - OTA submits industry authored organic complaint template to NOP to help harmonize industry submitted B2B complaints and increase efficiency for NOP processing and investigation
  - The executive branch's proposed budget document includes an increase in NOP funding of $3 million to protect against fraudulent organic imports. Funding would be used to implement information technology enhancements at ports of entry

What are the opportunities for U.S. producers?

- U.S. feed buyers imported 827 TMT of organic soybeans and corn in 2017, equivalent to 31.4 million bushels
- This grain was worth $394 million at U.S. ports
- Based on average organic yields, this grain represented nearly 600 thousand acres that U.S. producers could have grown
- With the additional land needed for rotational crops, we need at least 2 to 3 million additional organic acres just to meet today's needs – and this will continue to grow

2017 Value of Imported Soybean and Corn & Acre Equivalent

	Metric Tons	Bushels	Acre Equiv*	Value	Aver $/bu
Corn	389,529	15,335,737	156,647	$ 121,993,000	$ 7.95
Soybeans	437,611	16,077,843	435,714	$ 271,605,000	$ 16.89
TOTAL	**827,140**	**31,413,580**	**592,361**	**$ 393,598,000**	

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Organic production brings higher producer returns

- U.S. organic grain producers received on average, a 94% premium for their crop in 2015 and a 109% premium in 2016
- These premiums have been consistent over the past 5 years, although they have been depressed in the past 2 years for soybeans and corn likely due to lower cost imports of soybeans and corn

Prices Received by Farmers and Premiums for Organic Grains 2015-2016

	ORGANIC/1		CONVENTIONAL/2		Organic Premium	
CROP	2015	2016	2015	2016	2015	2016
CORN $/BU	$ 6.99	$ 6.41	$ 3.61	$ 3.35	94%	91%
WHEAT $/BU	$ 12.05	$ 10.15	$ 4.89	$ 3.89	146%	161%
SOYBEANS $/BU	$ 19.65	$ 17.05	$ 8.95	$ 9.50	120%	80%
BARLEY $/BU	$ 7.09	$ 5.53	$ 5.52	$ 4.96	28%	11%
OATS $/BU	$ 4.24	$ 4.91	$ 2.12	$ 2.06	100%	138%
SORGHUM $/BU	$ 5.95	$ 6.30	$ 3.31	$ 2.75	80%	129%
SUNFLOWER $/LB	$ 0.38	$ 0.43	$ 0.20	$ 0.17	92%	150%

1/Organic prices calculated from USDA NASS 2015 and 2016 Organic Survey - total reported
2/Conventional prices - average prices received by farmers - USDA ERS

With a 75% yield compared to conventional crops, but with a 100% premium for the grain, the average organic producer can achieve gross revenues of 50% more per acre than, and higher profit, than a conventional farmer

Challenges facing organic producers

- Transitioning land to organic production takes time and resources:
  - 3 years to transition land
  - Certification and training expenses
  - Soil amendments, seed availability
  - Developing new crop rotation practices
  - Identify key buyers – look for long-term contracts through the transition and beyond
- Not all producers or land suited for organic production
  - Organic farming requires a holistic mind-set, and patience
  - Proximity to markets and other organic producers is a big plus

Update on a ‘Certified Transitional’ program

- Last year, OTA developed and USDA approved, a program to certify land and crops in “transition” to organic
- Objective was to help producers receive a premium to offset some of the risk and costs involved during the first two years of transitioning land to organic
- However, the Western Organic Dairy Producers Alliance threatened to sue USDA if it implemented the program - industry now waits for USDA to decide how to proceed
- Meanwhile, Kashi (Kellogg) initiated its own program (with QAI) for “Transitional” and announced this week that in its first year, the program has been extremely successful and paid out over $1 million in transitional premiums and is helping to convert thousands of acres to organic

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Some seeds to carry in your pocket…

- **Demand for organically produced agricultural products is increasing and looks to be poised for long-term growth**
- **Organic production can increase producer returns, improve soil health and add to biodiversity on farms**
- **Expansion of the organic feed supply is key to further development of organic dairy, meat, poultry and eggs**
- **Imports are needed but the organic industry and USDA need to work together to decrease reliance on imports and increase oversight to avoid fraud**
- **Investments are needed in domestic supply chain infrastructure and logistics to increase efficiency and provide producers with improved access to markets**
- **Buyers should work closely with organic producers to develop long-term production and supply contracts to help stabilize markets and support producers through the transition phase – *We need more U.S. organic acres!***

Questions… comments? peter.golbitz@agromeris.com

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