Washington Apples: We've Seen This Movie Before

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The apple doesn't fall far from the salmon fishery.

Pattern recognition is one of the most effective tools for avoiding repeated mistakes. By observing commonalities between similar but not identical situations, we can evaluate how decisions made in an earlier instance might be altered to improve the outcome the next time around.

In our recent article ["Drivers of Industry Consolidation – Learnings from Alaska Salmon"] we profiled the arduous consolidation journey that was experienced by the Alaska wild salmon sector over the past 25 years. Paying close attention to the attributes that defined that difficult landscape allows us to see that similar circumstances have emerged in a different market right here in our backyard. The state of the Pacific Northwest apple industry today is strikingly similar to the landscape of the Alaska wild salmon industry in 2000. What have we learned from the last 25 years in one industry that could improve the outlook for the next era of Pacific Northwest apples?

Commodity Market Challenges

The recent challenges of the Pacific Northwest apple industry are well documented. Publications including The Seattle Times, Good Fruit Grower, and others have produced comprehensive commentaries on the topic.

Many operators, some having been around for generations, now find themselves on the brink of insolvency and grasping to navigate a market that has shifted dramatically.

During a strong period of prosperity, institutional capital flooded the market via acquisitions and growth financings from 2017 through 2022. Since then, the industry has experienced a significant decline in profitability. Many operators, some having been around for generations, now find themselves on the brink of insolvency and grasping to navigate a market that has shifted dramatically.

As we dig deeper into the drivers of these market challenges, we see nearly perfect overlap with those that drove the Alaska wild salmon industry to its current consolidated state:

Flat or Declining Demand:

Wild salmon faces pressure from farmed salmon and replacement proteins like chicken and beef. Meanwhile, domestic per capita fresh apple consumption has decreased by 2.2 lbs per person since the 1990s according to USDA data.

Changing Consumer Tastes:

Farm-raised salmon is tough to compete with on quality for the price. For apples, preferences frequently shift to new varieties, making it difficult to predict future consumer tastes and plan accordingly.

Limited Differentiation:

In both sectors, products are often viewed as commodities rather than unique offerings, making it challenging for any individual producer to command premium prices.

Overproduction and Oversupply:

Each industry saw near-record production volumes over a multi-year period, causing prices to plummet for a sustained period of time as the market reacted to the excess supply.

Volatile Volumes:

Biological impacts on the salmon harvest and weather sensitivity in the apple harvest can drastically affect harvest yields and quality, contributing to extreme swings in actual vs. expected volumes year in and year out.

Rising Labor and Input Costs:

Both markets experienced a dramatic increase in labor costs relative to demand or pricing, putting a squeeze on already thin margins. In the case of apples in 2023, labor costs consumed 99% of grower profits according to a labor cost study for Washington Apples.

Limited Automation:

While operators in both industries pursued or are pursuing automation in the hunt for improved margins, truly transformative automation is expensive and requires a long-term view that many do not have the luxury of adopting.

Global Market Influences:

With seafood and produce being global markets, both industries experienced pressures from international trade and political volatility.

Path to Sustainable Balance

The path to long term sustainability for any commodity industry is through the pursuit of the lowest unit-level production costs. Many of the possible steps on that path are out of the industry's control, and others would take unprecedented levels of collaboration. Theoretically, everyone in the Pacific Northwest apple market could collectively decide to voluntarily eliminate excess acreage, but few are willing to be the first mover in that wave.

That is understandable, of course, when an operator has a large fixed cost element to their cost structure. For that individual operator, the pathway to lower unit costs can only realistically run through maximizing volume. Taking operations offline also cuts volume, which can be a death sentence.

Key agricultural lenders have started to take a different tune and are becoming less patient and more willing to move on from multi-decade relationships. In some cases, operators will not have access to their operating lines to start the next season, effectively shutting them down.

Operators of lower efficiency packing operations could decide to shutter their facilities and allocate their fruit to more efficient plants, but that requires walking away from all they have invested in their own packing capacity, which is a tough pill to swallow. Automation could be another path to margin enhancement, but improving automation in the field and warehouse is a capital-intensive and long-term strategy only available to those best-capitalized businesses.

Experts closest to the industry believe that crop production needs to reduce by at least 10% and as much as 20%.

Some of the largest operators have already been proactively removing underperforming acreage in a commendable effort to do their part to right-size the industry. Still, there is no group raising their hand to produce 15 million fewer boxes next year, which is what some believe it would take to better align supply with demand.

So what realistic remedies remain? Government intervention and increased marketing spend for better awareness have often been pursued with minimal success. Further consolidation among growers, packing houses, and marketing desks is likely the most impactful lever left to pull. Consolidation is often not the desired route. In fact, nearly every instance of consolidation in the Alaska wild salmon sector occurred as a last resort, when owners had exhausted all options and lenders began to force their hands. Those breaking points typically coincided with a dramatic decline in resource prices, similar to what has been seen in apple prices for the past two seasons.

In addition to the difficult operating environment for the Pacific Northwest apple industry over the past few years, capital is becoming scarcer. Key agricultural lenders have started to take a different tune and are becoming less patient and more willing to move on from multi-decade relationships. In some cases, operators will not have access to their operating lines to start the next season, effectively shutting them down. Institutional equity investors have not seen the returns they had hoped for, and they aren't going to come in to save the day. The industry will need to correct its structural problems with little or no help from outside capital.

Knowing Your Position in the Market

Some operators in the Alaska wild salmon sector saw the writing on the wall and were proactive about their role in the industry's consolidation. Those early movers were able to preserve some economic value either as an acquisition target, merger partner, or patient acquiror. Similarly, participants in the Pacific Northwest apple industry must be thinking about their role in the eventual industry landscape.

Well-capitalized operators and those with well-utilized facilities can view this as an opportunity to preserve their capital and healthy balance sheets while remaining opportunistic to acquire smaller operations that can further improve capacity utilization, throughput, and unit costs.

For those surviving but barely getting by, they can consider mergers or strategic combinations with other comparable growers and processors to leverage shared resources and optimize capacity utilization across the combined footprint.

Under-capitalized operators or those with heavily under-utilized facilities can use this as an opportunity to get ahead of the curve and evaluate which partner or acquiror fits best with their business. As uncomfortable as it may be, having those discussions now can be the difference between having a choice in what happens or being required to follow a lender's mandate.

Getting Ahead of the Curve

The lessons from the Alaska wild salmon industry serve as a roadmap for Pacific Northwest apple producers. By understanding the trends and challenges facing their industry, operators can take proactive measures to position themselves strategically in the marketplace. Those that embrace change early will improve the likelihood of success in a consolidated landscape.

While the journey is far from easy, the Pacific Northwest apple industry stands at a critical juncture. This inflection point is the time for industry participants to recognize that while change is uncomfortable, it may also be an opportunity to define the industry's successful path forward to ensure legacies are preserved for future generations.

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