

SCOMM

147:8



February 22, 2007

Representative Paul Seaton
Alaska State House of Representatives
Pouch V
Juneau, Alaska 99801

Dear Representative Seaton:

During our testimony before the Alaska House Finance Fisheries Subcommittee on February 2, 2007, members of the committee requested we provide follow-up to issues brought up during that testimony. What follows is intended to be additional information for the committee on these issues:

Ferry Scheduling

In order to optimize the industry's ability to meet consumer demand for fresh fish out of the Copper River area, we request that the Alaska Marine Highway system modify slightly the operations of the F/V Chenega that runs between Cordova, Valdez, and Whittier.

Currently all indications are that the Copper River salmon fishery will open on May 14. However, the Chenega is scheduled for training runs on the 15th and 16th, with no passenger or cargo loads. *We request that the training runs on those two days be allowed to carry freight*, so that we may meet the intense consumer demand for these fish. The freight could be used as docking training for crew compliance. Freight capacity during these two days is especially urgent this year with the shortfall in Alaska Airlines freight capacity.

Our second request is that there be a minimum of two standing trailer bookings for commercial carriers on each ferry run from Cordova to Whittier over the course of the season, with a 24-hour advance booking requirement for the two trailer slots. This will allow for the industry to adequately supply the market while allowing the ferry operators sufficient leeway to manage their capacity.

Our third request is that the ferry operate through September 22, if overall traffic can warrant it.

Community Fish Meal Plants

As we referred to in our testimony, improved waste management and byproduct usage will become increasingly more important both for our customers and government regulators. The construction of additional fish meal plants, intended for the benefit of the coastal communities, will go a long way toward ensuring we meet the expectations of our customers and increasing regulatory scrutiny.

We propose that the state investigate the feasibility of a community fishmeal plant in Cordova and provide sufficient incentives/subsidies that go toward construction, boiler, and other physical plant needs. The state is the proper broker to work with all parties in the creation of a community management structure that will operate at the benefit of all stakeholders in the Cordova region. This community entity would be the proper managing agency to deal with the regulatory agencies and waste stream issues. Cordova is an especially good candidate for a fishmeal plant, in that the primary constraint on increasing production in Cordova is the lack of ability to deal with an increase in waste. This area would have the ability to process pollock, if a proper meal plant were in place there.

The electric co-op in Cordova is already configured to operate by burning converted fish oil. In experiments done in Unalaska it was shown that a 50-50 blend worked best, but power plant diesels can be run on 100 percent fish oil. Fish oil produces about 95 percent of the BTUs of diesel, and CO & PM are decreased by 16 to 60 percent. SO₂ is decreased by 30 to 78 percent and NO₂ have a slight increase of 2 to 8 percent. Also the economics of salmon meal, or "brown meal", is improving. The current fishmeal market may be lucrative enough now that a seasonal plant sized to accommodate salmon may be viable even without whitefish.

Currently no individual processor or community group has the wherewithal to take on these construction costs, although we are confident that such a plant would operate profitably. We also recommend that this plant be the first step in a larger program through which the state investigate feasibility of community-based fishmeal and byproduct operations throughout the state. The industry currently discharges too much usable waste. The combination of spiraling fuel costs, increased regulatory scrutiny, customer demands for positive environmental oversight, and the economic viability of Alaska's shoreside communities, state assistance in this area could provide a tremendous boost in all of these areas.

Remote Power Generation

Diesel-powered plants are at an inherent disadvantage in the current business climate. Freezing capacity expansion is curtailed in many areas due to the high cost of fuel in our remote locations. *We recommend some types of financial assistance and incentives for the purpose of assisting diesel-operated remote power plants in upgrading to more efficient and economical modern power generation. We also recommend that the state consider applying renewable energy funds toward this issue, and begin serious investigation into hydro power for these areas.*

Product Quality

We testified that the single greatest constraint on the Alaska salmon industry is raw material quality. The next two proposals address this issue directly and can be accomplished in time to have a positive impact on this season's harvest.

Ice Programs

Ice barges would substantially improve fish quality in both Bristol Bay and the western part of Prince William Sound. *We advocate that the state become involved in assisting the affected communities in the production of ice in all applications, particularly in assistance with ice barges and other means of producing ice that can be used on the fishing grounds.* The fish can only get worse as they are out of the water, and icing immediately is the best investment in fish quality. Another benefit of ice programs on the grounds is that these programs can be implemented in time for this season, and are scalable according to the state's funding abilities and community involvement.

RSW Tax Credits

We also propose that the tax credits for RSW installation in boats operated by Alaska-resident permit holders be reinstituted. Applicants filled the available slots in a matter of hours when this program was in place before. RSW on the boats has an enormous impact on product quality, and should be the standard of our fishing fleet.

These are all issues of vital importance to the Alaska Seafood Industry, but are issues we cannot tackle alone. We hope that these comments satisfy the committee members requests for follow-up. If any members of the committee would like further clarification, please do not hesitate to contact us.

Best regards,

Mark Palmer, President
Tom Sunderland, Director of Marketing
Ocean Beauty Seafoods

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HOUSE FISHERIES COMMITTEE Representative Paul Seaton, Chairman

February 26, 2007

Mike Nicich, Deputy Chief of Staff
Office of the Governor

Dear Mr. Nicich,

Representative Seaton, Chair of the House Fisheries Committee, has requested that I send you the attached letter from Ocean Beauty. The letter is a follow-up from the House Fisheries meeting of February 2nd. The Committee requested that Ocean Beauty get back on a number of points regarding salmon quality and marketing.

Thank you for your consideration of the points raised in this letter.

Louie Flora
House Fisheries Committee Aide,
Representative Paul Seaton, Chairman
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OCEAN BEAUTY

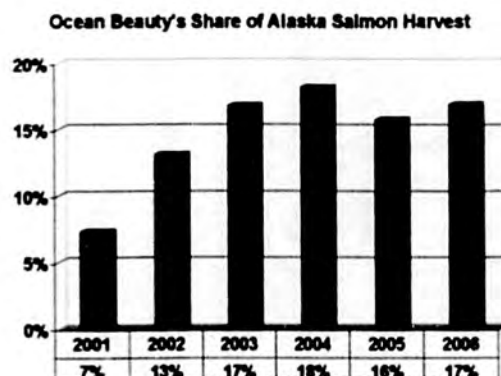
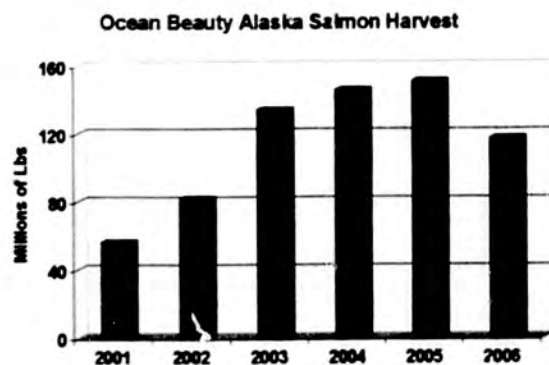
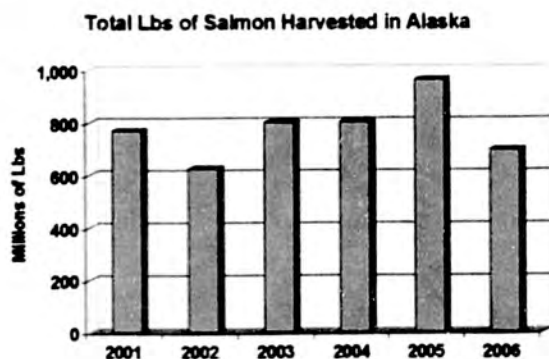
SEAFOODS, INC.

AN OVERVIEW OF OCEAN BEAUTY'S 2006 SEASON

The Alaska fisheries are universally recognized as the best managed fisheries in the world, and our annual harvest numbers provide the proof. The states resource of salmon, halibut, cod, pollock and crab are all healthy, economically viable and for the most part increasing in overall value.

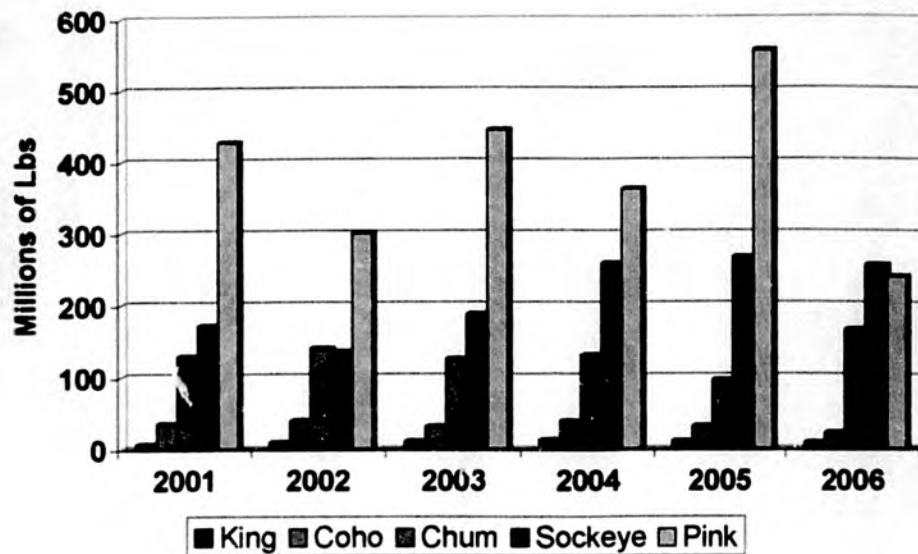
Ocean Beauty continues to grow, now employing over 2,000 people in Alaska. Our commitment to shore-side processing and the coastal communities that rely on them has never been stronger. To this end we are continuing to invest in value-added capacity and infrastructure at our plants, including a new skinless/boneless canning line in Kodiak this spring.

2006 SALMON CATCH FIGURES



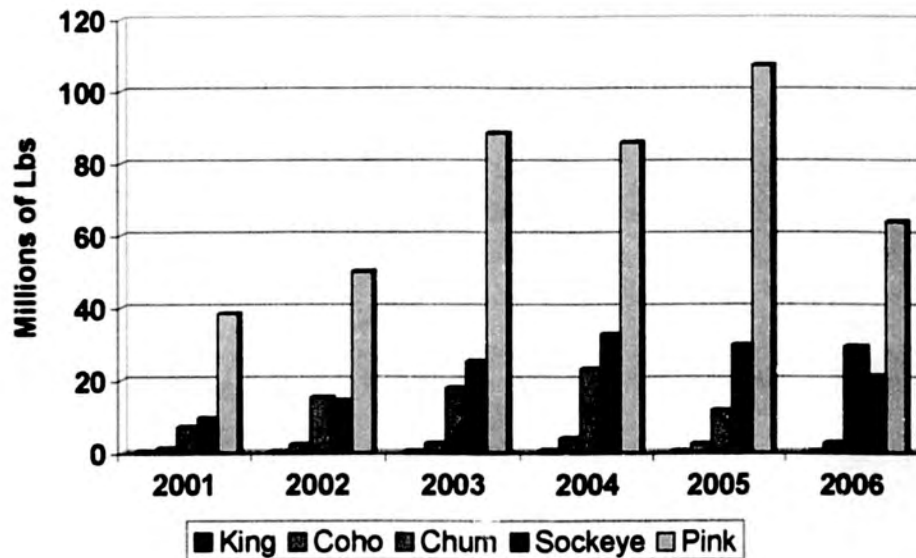
As evident in these figures, the 2006 catch was substantially lower than 2005, which is a reflection of 2006's weak pink salmon run. Despite this, Ocean Beauty's proportion of the total salmon catch increased in 2006.

Statewide Salmon Harvest by Species



The poor pink harvest in 2006 was mitigated somewhat by another very strong year for sockeye, particularly in Bristol Bay.

Ocean Beauty Salmon Harvest by Species



Because Ocean Beauty's production facilities are distributed across almost all salmon fisheries, we did somewhat better with pink salmon than the industry as a whole.

MARKET DYNAMICS

Japan: The 2006 salmon season marks the first time in Ocean Beauty's history that we did not export a single container of frozen Bristol Bay sockeye to Japan. What was once the most competitive market in the world for sockeye was unable to compete with Europe and the USA in 2006. The bright spot in Japan was in the Ikura market, where brisk sales and competitive prices allowed us to move our inventories into the market much faster than in 2005.



Eastern Europe and Russia: Eastern Europe continues to grow at a dramatic rate. With Romania and Bulgaria joining the EU in 2006 we are investigating new opportunities in these markets. Moving to protect their domestic market for salmon roe, Russia changed import regulations in 2006 that resulted in denying entry to most of the US produced salmon roe. We still feel Russia will be one of our most important markets for the future; it will just take some cooperation from a regulatory standpoint.

China: Excess manufacturing capacity and attractive labor rates continue to fuel increased demand for raw material in China. Much of the growth in domestic USA demand is the result of value added products produced in China from Alaska raw material. Ocean Beauty's exports to China doubled in 2006.

Western Europe: Sales to smokers and retail continued to increase in 2006 as both cold smoked sockeye and coho are highly sought after, particularly in the UK. Interest in a broad range of Alaskan salmon products continues to be high on the continent, including sockeye, coho, and chum fillets, chum caviar, and pink blocks. Fresh sockeye programs in the UK have successfully translated into frozen refresh programs there, expanding sales over the entire year.

2006 CANNED SALMON MARKET

Canned Pink Salmon: The combined Alaska pink pack is down 57% versus 2005's record harvest, leading to substantially higher prices. It does not appear at this point that consumers have abandoned the more expensive canned pinks, but have simply slowed down consumption as one would expect with higher prices. Now that consumers have had a year to become accustomed to higher prices, we are anticipating that we can hold on to much of the increase next year, even when the harvest returns to normal levels. We believe this will play out due to increased production of frozen pink salmon, as well as an increase in skinless/boneless forms. Inventory levels appear to be in balance with demand.

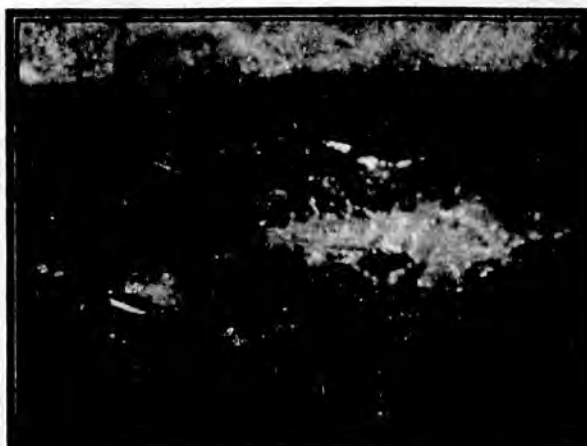
Canned Sockeye Salmon: The market price for canned sockeye has remained stable from 2005. However, the cost of production has increased faster than the industry has been able to raise prices. Particular emphasis needs to be paid to developing new markets.

USDA: The USDA purchase programs are crucial to our ability to regulate supply with demand and keep the industry out of the oversupply imbalance that has plagued canned pink salmon over the past decade. Our hope is that these purchases can be timed

to match industry needs, and be held in late summer/early fall, and post-Lenten periods. In the late summer we have a good grasp of our inventory and pricing, and can sell off excess inventory soon after harvest, minimizing our holding and storage costs. Post-Lent is excellent timing as well, allowing us to reduce year-to-year carryover and purchase aggressively.

Exports:

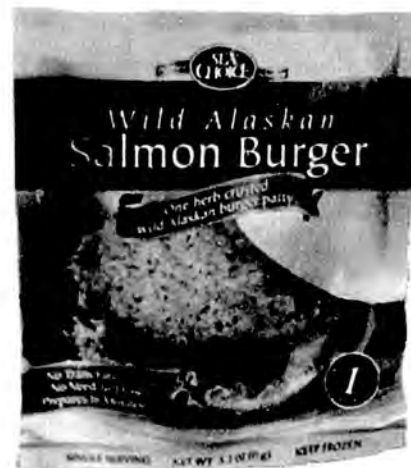
Demand for skinless/boneless sockeye and pink salmon continues to grow. King Oscar's expansion into eastern Europe has the potential to increase export demand substantially.



VALUE ADDED PROCESSING

By utilizing the tax credit for value-added salmon products (Senate Bill 164) Ocean Beauty spent an additional \$2 million in value-added processing equipment in our Kodiak and Southeast Alaska shore based plants. The result was the creation of 60 new jobs with \$900,000 in additional payroll. Almost 3 million pounds of salmon were processed into value added products that otherwise would have been placed in traditional cans or not processed at all. The ex vessel price paid to Alaskan fishermen also increased as a result of this investment.

In 2007 we have identified over \$1 million of additional spending to make significant improvements in our Value-Added capacity in Alaska.



Producing skinless/boneless products in Alaska has enabled us to improve product quality, and in the process create jobs and increase the price paid to the fishing fleet. It allows us to expand our overall production capacity, gives us the freedom to purchase more fish, and also gives us the ability to keep the plant open later in the season. In both cases, incremental jobs are created that extend later into the season.

At Excursion Inlet we have a state-of-the-art mincing operation that produces "once frozen" Alaskan wild salmon burgers. In the most recent syndicated retail grocery data (supplied by IRI for the period ending 12-3-06) the Ocean Beauty salmon burger was the fastest growing salmon burger and has claimed the #1 spot in the US retail market. This is a shore-based value-added operation that produces a product second to none in quality and, most important of all, can't be produced anywhere in the world for a lower cost than 30 miles west of Juneau.

NEW PRODUCTS

Our new product development has focused on underutilized species: pink salmon, chum salmon, and Bristol Bay sockeye. Although all species are important, we firmly hold that the only way to achieve a true renaissance in Alaska salmon is to increase the value of these species, which in 2006 comprised 85% of Alaska's salmon catch by weight. The following is a partial list of new products based on these species.



➤ Marinated Pink Salmon Portion

- Long John Silver's
- Safeway Private Label
- Kroger Private Label

➤ Single Serve Pink Salmon Portion

- Kroger
- Safeway
- Giant
- Tops
- Shaws
- Grand Union
- Harris - Teeter

➤ Salmon Burger Single Serve, 4-Pack, and 8-Packs

- Kroger
- Safeway
- BJ's
- Harris - Teeter
- Giant
- Crosby
- Big Y
- Grand Union



In addition, we continue to gain new placements of hot smoked sockeye and hot smoked sockeye cream cheese spreads, both made from Bristol Bay fish.

IMPORTANCE OF MARKETING GRANTS

The salmon marketing grants have, in our opinion, served a crucial function in opening up new markets to Wild Alaska Salmon. Ocean Beauty used these funds to develop and place a larger number of new value-added products with major customers in the US and Europe. Highlights include:

1) *Penetrating New Markets:*

In conjunction with Rieber Foods, we placed canned pink salmon in eight eastern European countries under the King Oscar brand. (Poland, Hungary, the Czech Republic, Slovakia, Romania, Latvia, Lithuania, and Estonia.) King Oscar is the #1 brand in tinned fish in these markets. These countries have the highest per capita consumption of canned seafood in the world, but up to now Alaska salmon has not been widely available. A 1% share of canned seafood in these markets would account for 64 truckloads annually.

2) *New Product Placement:*

Much of the funding we received through the Fisheries Revitalization Program and the Alaska Fisheries Marketing Board were used to gain placements of products with major retail and foodservice customers. A partial list of these customers includes:

Kroger	Long John Silver's	Hannaford
Wal*Mart	Harris Teeter	H.E. Butt
Trader Joe's	Giant	Big Y
SuperTarget	Henry's	Fresh Market
Albertson's	Stop & Shop	BI-LO
Publix	Jewel	Demoulas

OVERVIEW OF ASMI

For the last three years Ocean Beauty President Mark Palmer has had the pleasure to serve as Chairman of the Alaska Seafood Marketing Institute. Under Ray Ruitta's leadership we have made great strides to integrate ASMI, harvesters, and processors under a very focused marketing plan.



ASMI's changes in modes of communication and committee structure are proving has led to increased participation across all industry segments. These communications are now far enough in advance of marketing cycles to maximize effective planning. For example, ASMI publishes its consumer marketing activities in a comprehensive calendar on its website, available to anyone in the industry, so that industry sales representatives are aware of what ASMI is doing and can align their promotions with ASMI's support. Recurring annual events have put us on the calendar of both retail and foodservice operators during those times of the year when industry benefits the most from increased inventory movement.

We have created new marketing committees for domestic retail and foodservice, empowered them with budget creation and oversight, and have active participation and input from those chairs with the board of directors in real decision making. This change has put ASMI's committee structure in step with ASMI's staff and has vastly improved planning and budgeting.

Members of the Alaska Seafood Industry have been working through the Alaska Seafood Marketing Institute to leverage its marketing dollars and promote Alaska Seafood on the world stage. We have been very successful over the past several years raising the visibility of our Alaska Seafood brand and the value of our products. This has resulted in more dollars in the hands of our fisherman and the state of Alaska. In fact, the value of the Alaska Salmon harvest paid to fisherman alone has risen from a low of \$155M in 2002 to over \$300M this past year.

ASMI was originally established as a public-private partnership, with the State of Alaska contributing general funds to match funds put up by the Alaska seafood industry. Over the years the state withdrew funding from that partnership, but last year, for the first time in over a decade, the Legislature once again provided some general funds to support our efforts. As an industry we are pleased to see that partnership renewed, and hope that it will continue and flourish in the years ahead. Last year, the Alaska Seafood industry provided ASMI with over six and a half million dollars to promote the Alaska Seafood brand. By itself, this is a pretty modest sum for marketing a global brand but our impact can be many times greater when we work hand in hand in partnership with the state.

While prices are improving modestly, the fundamental stresses on the Alaskan salmon industry have not disappeared: We still face competition by farmed fish products; we still need to spend heavily in marketing; and high fuel costs put a drag on fishing and processing efforts. ASMI's leadership in building the Alaska Seafood brand is crucial to our future.

HARVESTER – PROCESSOR JOINT QUALITY IMPROVEMENT PROJECT

For the 2007 salmon season Ocean Beauty has developed a program aimed at increasing the availability of high quality Sockeye, Chum and King salmon harvested in Bristol Bay. This pilot program will start with two tenders to service a limited number of participating harvesters in an iced, bled, and improved handling program. Harvesters, tenders and processor will all be held to stringent guidelines that will yield a top quality fish that will compete in any market in the world.

The Bristol Bay Economic Development Corporation will be participating as Ocean Beauty's partner in developing and implementing this quality handling program. Identifying the right partner in this endeavor was its most critical component. With the BBEDC we have found a partner with shared goals and a common vision of where we would like to be in the years ahead. The aims of this project are:

- To increase the value of Bristol Bay fishery to the region.
- To increase participation of community/villages in processing.
 - The initiation of top quality value added operations.
- To increase the availability of top quality raw material.
- To create shore based employment opportunities for Bristol Bay residents.

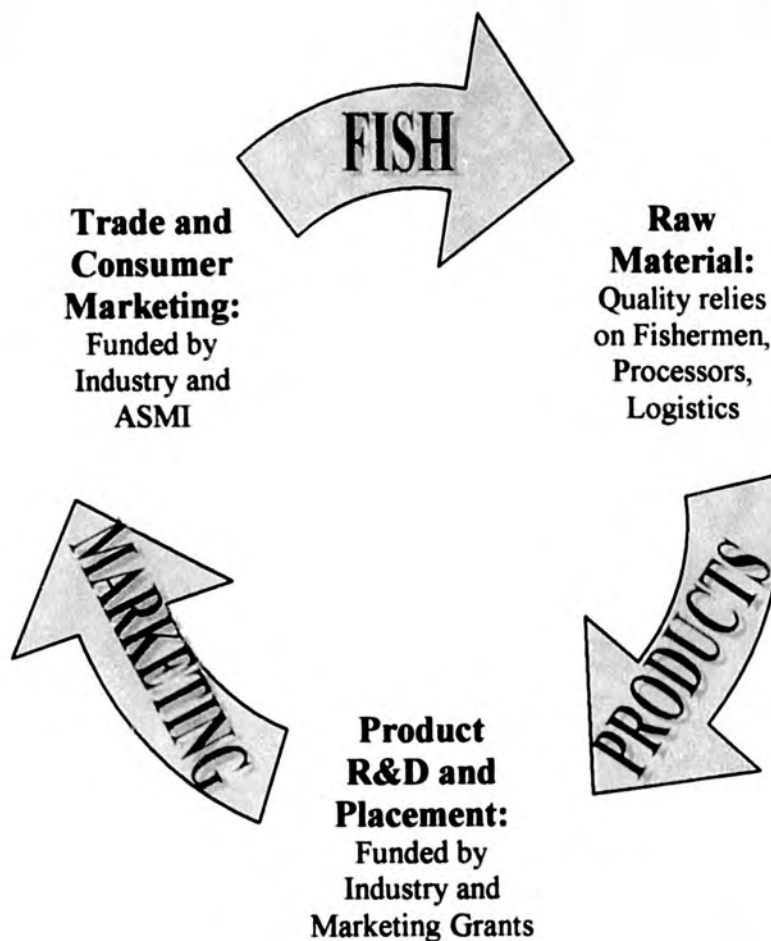
We believe that the combination of Ocean Beauty with BBEDC will expand the market for premium Bristol Bay salmon products. Aligning Ocean Beauty's brands, value added



capabilities, and direct distribution with BBEDC's support of local fishermen through slush bags, ice barges, etc., will make a substantial contribution to the overall well-being of the Bristol Bay salmon fishery and the local communities that rely on it.

THE WAY FORWARD

Every bit of progress we make is dependent on the quality of the raw material we begin with. We have developed a broad range of value-added Wild Alaskan Seafood products, and have leveraged the support of state and federal marketing grants to place these products in front of consumers. But in order to fully realize the potential of these funds, we need to improve the quality of the raw material that we receive from the fishermen, improve our processing methods, and improve the logistics of getting those products to market. Only by focusing our efforts on improving the fishing, processing, and logistics infrastructure behind the raw material will we make the most of the excellent efforts we have made in the past few years in product development and marketing.



EMERGING ISSUES FOR MARKETING ALASKAN SEAFOOD

Market-driven environmental initiatives

As you are no doubt aware, about a year ago Wal*Mart has launched a comprehensive environmental program that is having a profound impact across virtually all industries, and is now being widely imitated. Wal*Mart have created fourteen "networks" to effect these changes, one of which is dedicated to packaging, and this scorecard is how packaging efficiency will be measured. We are going to walk through what it means to mar.age through this scorecard and what these changes mean to our industry.

We work in one of the world's most pristine environments, producing the world's cleanest and healthiest food. But our production methods are in danger of becoming out of sync with how our major customers define good business practices. Led by Wal*Mart, American retailers are aligning behind initiatives intended to reduce greenhouse gas emissions, increase recycling, reduce fuel consumption, and generally reduce their impact on the environment. Safeway has joined the California Climate Action Registry and the Chicago Climate Exchange, and have publicly stated their commitment to reduce their carbon output by 25% by 2025, and the company is now one of the largest purchasers of wind energy in the US.

They are doing this because they see this as good business. They haven't been taken over by environmentalists or out of a sense of responsibility to the earth – after all, Wal*Mart's mantra is still "Always Low Prices – Always" – but because they see this as good business that will give them a competitive advantage over the competition. Wal*Mart CEO Lee Scott stated that this program is all about efficiency, and that Wal*Mart is all about efficiency, so this should give them an advantage in the marketplace. Wal*Mart is doing this because they see it as consistent with their mission of providing products at the lowest possible price.

It's only a matter of time until other customers come on line. European customers already typically have far more stringent environmental expectations than US customers.

On February 1, 2007 Wal*Mart's packaging scorecard came into effect and as of that date every supplier will be graded according to the following criteria:

CRITERIA	INDUSTRY STATUS
▪ 15% - based on GHC/CO2 per ton of production	need help
▪ 15% - based on material value	our responsibility
▪ 15% - based on product/package ratio	our responsibility
▪ 15% - based on cube utilization	our responsibility
▪ 10% - based on transportation	need help
▪ 10% - based on recycled content	our responsibility
▪ 10% - based on recovery value	our responsibility
▪ 5% - based on renewable energy	need help

- 5% - based on innovation

our responsibility

All suppliers scores will be published within Wal*Mart and buyers will have incentives to improve their group's overall score. As you can see, a full 30% of the grading criteria are comprised of areas in which we need support and could be at a disadvantage compared with non-Alaskan suppliers.

Alaskan industry faces some special challenges in order to meet these standards. The remote nature of our business, difficulty of power generation, our heavy fuel use (a can of pink salmon has a tremendously high proportion of its price wrapped up the cost of fuel) – these all add up to trouble for us unless we address these issues.

From Wal*Mart's or Safeway's or any other customer's perspective, we aren't in the Alaska seafood business, or even the seafood business at all: we are in the larger Food business. We will be compared against other manufacturers who have more streamlined and predictable business conditions. Club stores (including Wal*Mart's club channel Sam's Club) already carry Chilean canned salmon. If we can't show good progress against these packaging and environmental goals, we will be at a severe disadvantage against those manufacturers whose processes are greener than ours.

What the industry will need assistance with:

- Capital improvements aimed at improving raw material quality
- Community fish meal and fish oil plants
- Fuel efficiency programs
- Remote power generation improvements
- Renewable energy and biofuels
- State ferry system support
- Consumer communication (through ASMI)

The areas that are within industry's capacity to deal with effectively:

- Trade marketing of our own products (in-store promotions)
- Product Research and Development
- Packaging design and implementation
- Lower 48 and international logistics

We have reached the point where we have no choice but to change some of our business practices in fundamental ways in order to meet our customers' expectations. We accept the responsibility for those things that are within our control, and you should hold us accountable for success in these areas. But those areas that aren't fully within our control leave us vulnerable. If we can react to these market-driven initiatives we will be able to raise the value of Alaskan seafood. But we need to keep in mind that Alaska seafood is substitutable with other products, and if we do not meet our customers' expectations, we will inevitably see the value of Alaska seafood decline.