

Synopsis of Coconut Development Unit Issues and Progress

8th State & National Leadership Conference

Evolution of the FSMPC

1. In June 2008, the FSM Government acquired the operations and assets of Mobil One Micronesia Incorporated (“MOMI”) throughout the Federated States of Micronesia. Since inception the corporation has established itself as a significantly large supplier of energy in the FSM and the region. Its primary role is to secure a stable supply of petroleum and other energy products to meet core energy needs through a strategy entitled “Energy For Life”.
2. In the 2012 State of the Nation Address¹, President Mori challenged the corporation to do more in the economy, and to move towards a model that could allow private sector equity participation within the business. Since that time the company has been proactive in investigating sectors and industries that show feasible financial and economic potential. The FSMPC has expanded beyond the borders of the FSM and has a strategy to ensure that 30% of its revenues come from outside the country, with a further 10% of diversification from adjacent sectors within the country. This is to be able to prepare itself for life beyond 2023.
3. The advent of the *Coconut Tree Act*, and our success this month in securing a long term contract to supply petroleum fuels and to operate the Government of Nauru fuel terminal and airport will see us achieve this within the next three (3) years. This will ensure we consistently grow shareholder value, have predictability on future revenue streams, and present an overall low risk opportunity for investors should the future policy direction be towards the privatization of the corporation. In December 2014, the company retired the long term debt component (\$5.2MM) of the initial Bank of Guam loan covered by an FSM full faith and credit guarantee. The second component for a Line of Credit for Inventory purchases (\$4.2MM) remains in place but has no outstanding balance.
4. The FSM economy remains affected by international markets in good and bad ways. Currently we are being impacted favorably with international oil prices falling by \$60/BBL coupled with a strengthening of the USD against major currencies by approximately 10% over a similar period. Effects are trickling down into the economy, and consumers will note lower pump and electricity prices in each State. We expect domestic oil prices to settle between \$4-10/gallon and \$4-25/gallon in coming months if international prices remain at current levels. If maintained over the longer term, this will translate an annual savings in excess of \$15MM in domestic energy costs. This is positive for news for households and businesses, however negative for governments as this will translate into lower gross revenue taxes of approximately \$500k per annum.

PL18-68 : The Coconut Tree Act

5. In June 2014, the Congress of the FSM passed PL18-68 called the Coconut Tree Act. The Act was designed to enhance the capacity for the buying, selling, exporting, manufacturing, processing, and distribution of copra and other coconut tree products from the coconut tree in the Federated States of Micronesia.

1. “Our reform measure to establish and mandate PetroCorp to stabilize the supply and price of fuel is producing positive results. For this, I commend PetroCorp and encourage their continued efforts in exploring and investing in clean renewable sources of energy. With its current standing as a successful business venture in the region, and with the combined support from the national and state leadership, I urge PetroCorp to open equity participation by the private sector of our country.” State of the Nation Address, His Excellency Emanuel ‘Manny’ Mori, President of the Federated States of Micronesia, May 18th, 2012.

6. The industry is to be operated as a self-sustaining enterprise. The Act dissolved the Coconut Development Authority (CDA) and transferred its responsibilities and functions to the FSM Petroleum Corporation. The rights to, interests in, and ownership of all the assets of the CDA including but not limited to equipment and leasehold interests have been transferred to the FSMPC free of any lien or encumbrance.

The Roadmap to Coconut Industry Sustainability

7. In this paper we have identified industry ‘challenges’ and ‘roadblocks’. As an entity, we believe we can address the challenges that we currently face, however, we need Leadership assistance to remove the roadblocks that obstruct us from achieving our end goal.
8. The FSMPC has designed a three (3) Phase project aimed at revitalizing the industry. These Phases are summarized as follows:

Phase 1 – Seamless Transition

- a. The Vital Coconut Development Unit (CDU) is established;
- b. A Project Management Team is formed;
- c. Staff of the FSM CDA are transitioned into the Vital CDU Unit;

Phase II – Business as Usual

- d. Conduct preliminary technology assessments;
 - e. Increase Fresh Nuts processing capacity from 300 to 1000 nuts per day
 - f. Increase Copra² processing capacity from 50 to 5000 nuts per day³.
9. **Current Challenge #1: Existing Value Chain** - The structure of the current domestic value chain is not viable. Without domestic processing capacity, copra is exported to the RMI at a loss. By May 2015, we will have installed newly procured equipment and machinery to increase domestic copra processing capacity by 100x, and whole fresh nut processing by 30x. We will be able to process copra produced in the FSM into crude coconut oil for fuel, and coconut meal for animal feed. However, the lack of a quality based copra payment system, coupled with *low value* finished products dramatically affect industry sustainability. Falling international fuel prices also affect competitiveness of coconut oil as a diesel fuel substitute.
 10. **Current Challenge #2: Producer Groups (Copra)** – To operate profitably, we need to match processing capacity with stable copra supply and to implement quality and quantity based payment incentives. We require a minimum of 380MT⁴ to a peak of around 1100MT of copra per annum. Current shipping services are sufficient to sustain this supply chain from islands to the processing facilities. Communities that are ready to participate in the industry, and are willing to produce copra can be assured that their efforts will not be wasted, and the copra will be purchased and processed by the FSMPC.
 11. **Current Challenge #3: Buying Agents** – Due to the poor capitalization of the CDA, many Buying Agents have ceased to operate in each state. In Chuuk and Kosrae, we have no records of copra being produced or purchased

² Copra is the dried meat, or kernel, of the coconut

³ 5000 nuts per day is equivalent to approximately 1MT of copra per 8 hour day.

⁴ In 2013 the total copra procured by the CDA was 287MT. Total production capacity is estimated at 5000MT/annum.

by Agents. Buying Agents are an essential component of a functioning market and we are working hard to reestablish this private sector network, and to put faith back into the market for copra. Community production has fallen primarily due to a lack of a steady market.

Phase III – Growth and Sustainability

- a. Develop a sector vision, mission and a strategic plan;
- b. Assess and Access to Markets;
- c. Economic Cost Benefit Analysis;
- d. Confirm Processing Facility Design and Products;
- e. Develop Enhanced Transportation Strategy;
- f. Ensure Communities are ‘Trade Ready’;

*“The coconut industry development project will be **considered sustainable** when it is able to **deliver an appropriate level of benefits** for an **extended period of time** after major financial, managerial and technical assistance from the FSMPC and its sector partners are terminated”.*

12. A comprehensive assessment of international markets reveal a high demand for food grade coconut products ranging from coconut flour, virgin coconut oils and more recently coconut water. Targeted markets include Hawaii, Guam, mainland US, and Japan. Based on the supply side logistics, and to maintain capital and operational efficiency, the most appropriate processing facility will require:
 - a. 55,000 Coconuts a Day supply;
 - b. 100 Full Time Equivalent Permanent Jobs;
 - c. 200 Full Time Equivalent jobs in the informal sector for collection and post harvest handling;
 - d. Generate \$6.0MM per annum in export of Dry Virgin Coconut Oil;
 - e. Generate \$1.2MM per annum in export of High Fibre Coconut Flour;
 - f. Generate \$1.0MM per annum in export of Concentrate Coconut Water;
 - g. Generate \$0.15MM per annum in import substitution for Diesel Fuel;
13. With the proper investment and stewardship, the sector will make material impact on the FSM economy by contributing in excess of \$8MM in gross domestic product, and significantly offsetting the trade imbalance cause by the dependency on fuel imports to meet domestic energy needs.
14. **Current Challenge #4: International Market Access** - To sell *high value* finished goods into international markets require defined standards and regulatory food safety analysis. Consumers are focused on food safety which has seen the rapid growth in sales of premium priced organic produce. Each major export country has their own specific rules and regulations. An effective food safety program for FSM exports must be comprehensive, and will require collaboration between government, industry and technology leaders.
15. **Current Challenge #6: Human Capital** – To support the proposed processing facility, approximately 100 full time equivalent workers will be required across a broad range of skills. Semi-skilled, product line, process engineers, quality assurance officers, supervisors, and managers are required to support operations.

16. **Current Challenge #7: Communities are “Trade Ready”**– There is a common assumption that because coconuts are readily available within communities, and are literally ‘falling from the trees’ that communities are ready to trade. Anecdotal evidence demonstrates that this assumption has been at the root cause of failure of many community based production programs. This because:
- **Communities are seldom a homogenous unit.** There are different groups with conflicting interests, accordingly dominance/dependence relationships which need to be understood and managed. These relationships give power to the dominant (the landlord, the trader, the moneylender, the bureaucrat) and take away from the disadvantaged.
 - **Social realities are diverse.** The behavior of individuals and groups and their response to external impulses cannot be understood without an intimate understanding of their social relationships and cultural traditions. Societies use these relationships and traditions to minimize conflicts.
 - **Economic activities and wealth creation differs:** Economic problems are usually linked to the process of decision-making at the local level. They are also related to the general policy at the state and national level. An important element is the impact of national priorities vis-à-vis local resources and how these affect the economic status of different groups. The impact of what happens to an island community once there is a sudden and significant increase in disposable income? How will the community allocate this income? And how will they deal with disagreements?
17. For communities groups to be effective and sustainable, it is important to have their structures and procedures right and their objectives and the responsibilities of the members clear from the very beginning. The essential building blocks for successful group formation and development is trust building, leadership, decision-making, common development priorities, and conflict resolution as a groups.

Roadblocks - Trade Supporting Infrastructure

Transportation / Port Infrastructure:

18. To support a whole nut coconut processing facility of 55,000 nuts per day requires shipping, storage and handling infrastructure capable of moving approximately 32,000MT/annum of cargo from islands to a centralized factory. The Caroline Voyager alone is insufficient to meet the supply side requirements for the factory. While this may appear a problem, the transportation of cargo by sea remains cost competitive against the alternatives of road, rail and air. National and state level shipping services need effective coordination and route planning to ensure available freight capacity is effectively managed for the benefit of island communities.

Required Policy Consideration(s):

- support for the alignment of state and national domestic shipping strategies with the aim of increasing available cargo carrying capacity that maximizes revenue opportunities for trade ready communities and provide dependable shipping services for coconut processing facilities.
- support for increased private sector participation in the domestic shipping services to support cargo movements between

Land & Facilities

19. Allocate a minimum of five (5) acres of land to house a modern coconut processing facility.

Capital

20. The coconut industry is expected to generate significant economic benefits, including increased employment, increased gross domestic product and a sustainable livelihood program for communities in remote locations. Given the potential for privatization of the FSMPC, the coconut industry development project must be both economically viable for the FSM, as well as financial viable for the FSMPC;
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22. Required Policy Consideration:
 - a. governments support the use of grants, concessional loans and other social investment mechanisms to maintain commercial viability of the sector, such over time;
 - b. that a thorough Economic Cost Benefit Analysis (ECBA) will be commissioned by the FSMPC to quantify overall costs and benefits of the project, and the expected financial rate of return. The ECBA is to define the required support through government grants, concessional finance to maintain commercial viability;
 - c. direct relevant line departments and offices to prioritize Coconut industry funding and technical assistance with development partners.