DERCO® FOODS INTERNATIONAL DIVISION

2670 West Shaw Lane, Fresno, California 93711 U.S.A.
Telephone (559) 435-2664 • Fax (559) 435-8520 • www.dercofoods.com • e-mail: derco@dercofoods.com

May 2005 Almond Position Report

May 2005 shipments were 67.335 million pounds. This is down about 3% from the May 2004 shipments of 69.279 million pounds.

Facts and Interpretations
Carry-in from last year: 148.9 million pounds
Crop receipts: 998.013 million pounds
Less 4% loss / exempt (39.9 million pounds)
Total Supply: 1.107 billion lbs
Less shipments to date: (863.158 million pounds)
Supply Remaining less carry out of 120 million lbs: 123.8 million pounds
Supply Remaining not considering any carry out: 243.8 million pounds

Seller's Perspective: Just when you thought you knew for sure where this market was headed, you realize that we are right, don't you? Prices are double what they were at this time last year, yet exports for the season are down only 5%. Overall shipments compared to last year are down only about 1.5% and we have 12% less inventory. For those of you who need to go out and cover the short sales that you made during the past few weeks, feel free to finish reading this report later.

Buyer's Perspective: Here we go again, California interpreting an overall decline as a bullish figure. With this shipment number you're just taking one step closer to the precipice. Don't worry, we'll be there to catch you when you fall......

Domestic Market
Seller's Perspective: Domestic shipments for the month are the same as last year and up 8% year to date. Someone's not telling the largest market in the world, which has not seen any price relief from currency exchange rates, that almonds are over priced.

Buyer's Perspective: Can you please remind us when those domestic contracts were made and at what levels?

Spanish Crop
Seller's Perspective: The Spanish crop looks good but at even an optimistic 60,000 tons (or 120 million pounds) it will not make as big an impact on California as some buyers claim. First, a large percentage of almonds manufactured in Spain are California almonds - which are more readily blanchable. Furthermore, a good Spanish crop is needed to provide a steady supply in the months ahead. With California looking at an 850 million pound crop, the 120 million pounds from Spain will still put us below last year's California crop total of 998 million pounds.

Buyer's Perspective: Spain is looking at a crop of between 50,000 - 60,000+ tons, depending on who you ask. Spanish growers have had a tough time during the past couple of years and it is likely that they will sell early on what they can under the high California "price protection umbrella." By taking away some of the volume for September and October shipments, this may put downward pressure on

2670 West Shaw Lane, Fresno, California 93711 U.S.A.
Telephone (559) 435-2664 • Fax (559) 435-8520 • www.dercofoods.com • e-mail: derco@dercofoods.com

California pricing. Don't discount the importance of Spain.

US Dollar

Seller's Perspective: The US Dollar has been stronger during the past month but we expect that it will remain in the $1.20 - $1.30 range against the Euro. We don't see much of a reason for the USD to break below the $1.20 level and this sentiment is echoed by the International Monetary Fund (IMF) which recently noted that $1.20 - $1.30 was a good Euro-Dollar trading range.

Buyer's Perspective: France and The Netherlands' rejections of the EU constitution and Britain's decision not to even vote on the matter has weakened the Euro during the past couple of weeks. Matters were made worse when some European ministers mentioned the possibility of discontinuing the Euro as a European currency. Most officials, including the European Central Bank president, dismissed such talk as nonsense...but a toll was taken on the Euro as it dropped to $1.2158, its lowest level in 8 months vis a vis the USD.
Complicating matters is the fact that Europe is also facing a problem with high deficits. Eleven of the twenty-five member nations have budget deficits over 3%, the maximum set by the EU for nations using the Euro. So Europeans have to walk a fine line between a properly valued Euro and a Euro that is too strong; keeping in mind that a weaker regional currency would be better for European exports. This is especially true as the Euro-zone economy is expected to grow at only 1.4% of GDP in 2005 and any help provided by exports would be welcome. If the weak Euro trend continues, it will increase in real terms the price that European importers are paying for almonds. For example, the Euro falling from a March average of 1.31 to 1.22 for the first week of June is a 7% correction, which makes California almonds 7% more expensive to import in Euros.

Demand & Shipments

Seller's Perspective: We are not in denial (contrary to what some may think) about the fact that at higher prices, shipments will slow down. As we have been saying, shipments needs to slow down by an average of about 15% a month and we are not there yet - not even close. The average slow down in shipments for the past 4 months has been 9.5%.
We feel strongly that we have under-priced our crops during the past 2 years and we refuse to do that this year. We believe in our asking price in the field. If clients want to wait, we believe that we can "out-wait" them. This is a historically slow shipping period and we're not going to confuse a "buyer who is waiting to see a trend" for a "buyer who simply is not going to buy." We only have 850 million pounds available for next year....and some of us think that figure is too high.

Buyer's Perspective: Demand is slowing and for the past several weeks, it has come to a virtual standstill. We do not believe that we can sell almonds and almond products down the chain at these historically high levels. If pricing relief does not come soon, then we are simply going to curtail our use of almonds and hope, for your sake, that we will be able to rebuild demand in the coming years as supply becomes abundant. You give too much credit to your seeming unity at origin. It is very easy for your export "cartel" to feign unity in a rising market. Wait until you see a few months of disappointing demand, a carry-out which could be larger than your estimates, and the new crop filling your warehouses. The very growers who want to hold product now will be knocking down your door to sell

2670 West Shaw Lane, Fresno, California 93711 U.S.A.
Telephone (559) 435-2664 • Fax (559) 435-8520 • www.dercofoods.com • e-mail: derco@dercofoods.com

and your "call pool" will overflow. The following significant importing countries are all down more than a token amount: Belgium, France, Germany, Spain, Czech Republic, Israel, Jordan, Kuwait, Lebanon, Saudi Arabia, China, Japan, S. Korea and Algeria. Not many major importing countries have taken considerably more almonds this year: Italy, The Netherlands, United Arab Emirates and India are among the few. Western Europe as a whole is down 5%; Eastern Europe down 3%; the Middle East down 10%; Asia down 5%; Africa down 26%; Australia down 33%; S. America down 6% (the last three regions do not have big volume).

<u>What Other Nuts Are Doing</u>

Seller's Perspective: We expect most nuts to remain firm next season. Pistachios are going into an "off" cycle in California and there is talk that the Iranian crop was damaged between 5 - 40% (with 30% seemingly the most accepted estimate). California walnuts have seen record shipments during 15 of the past 16 months and the health message for walnuts is exploding - especially in the domestic market where McDonald's is now using walnuts in a salad. The Chinese are consuming a vast majority of their own production and China is not becoming the export threat that many feared just a few years ago. Pecans are and likely will remain more expensive than almonds.

Buyer's Perspective: Hazelnuts, which you conveniently omitted, are the closest substitute to almonds. Turkey is expecting a crop of about 500,000 MTs or more and new crop prices for hazelnuts should come down. That will put pressure on almond prices to moderate also. And don't forget cashews - a cheap nut now.

<u>Financing</u>

Seller's Perspective: Knowing your clients well for the coming season is going to be important. A container of almonds is today between $160,000 - $190,000. How many containers can the average importer afford to finance? There are strong clients that meet their obligations regardless of the market. They don't gamble with other people's money. Then there are those that buy more than they can afford to pay. The key is to make sure that you are selling to reputable partners. Easier said than done.

Buyer's Perspective: You are right to worry. Banks are not eager to give bigger credit lines to their almond importing customers unless they see a considerable benefit. Prices are unlikely to increase further, despite what you may think after today's report. So banks will likely tighten their lending practices if the inventory which serves as their collateral is not reasonably certain to maintain its value. This will limit the ability of traders or importers to hold inventory and will increase the likelihood that they will be forced by financial necessity to sell below market in order to generate cash flow. Add to this a relatively quiet market with sluggish demand and you spell: F-R-E-E F-A-L-L. We also agree with the concerns of many shippers that, when this market corrects, there will be some buyers who will do all that they can to get out of contracts based on technicalities or straight out defaults. Of course those who are convinced that this market will not correct until the end of 2006 need not worry. For all others, read on.

2670 West Shaw Lane, Fresno, California 93711 U.S.A.
Telephone (559) 435-2664 • Fax (559) 435-8520 • www.dercofoods.com • e-mail: derco@dercofoods.com

Psychology

Seller's Perspective: We are confident in this market. Prices are going to hold or even firm further until we see the sustained reduction in demand.

Buyer's Perspective: A majority of the talk in the almond world is about prices being too high - we hear this from buyers and sellers alike. Industry is not buying much at these levels. Second hand is trying to sell what they can with limited success. Long positions are getting longer and more expensive to finance. June is underway and things don't look quite as dire as they did back in April for us........we seem to be managing by buying hand to mouth. Psychologically, you are ready for a correction because even you don't really believe that a $100,000 profit per container is sustainable. As Bob Dole used to say: "I know it, you know it, the American people know it."
You don't want to admit it, because you know what those 50,000 - 70,000 net new acres being planted each year mean for prices down the road and for the foreseeable future. So you want to milk every last penny out of this magnificent two-year plus market run....while making your average grower return look a bit better down the stretch. Problem is, there's not much milk left. We've had enough. So when is the correction coming? This summer, before winter or by bloom 2006 in February?

The Inevitable Correction: When Will It Come?

Seller's Perspective: We don't see any correction until February 2006 at the earliest. And absent a perfect bloom, it may not come through 2006. Don't forget, this crop is probably not even 850 million lbs and the shipment slow down we have seen is not enough. Just look at the following: If we assume that June and July shipments will be down by the average for the past 4 months (9.5%), then we will ship about 134 million lbs in June and July combined. For the season, we would have shipped about 997 million pounds - virtually the entire amount of the 2004 crop. Ignoring the committed inventory figure, that will leave us with approximately 110 million lbs going into next season. So we would have:

Projected carry in: 110 million lbs
2005 subjective estimate: 850 million lbs
Less 4% loss/exempt: (34 million lbs)
Available to ship: 926 million lbs

Adding in the Spanish crop of 120 million lbs (and for the purposes of this rough calculation, ignoring other origins), there will be 1.046 billion lbs to ship. There were 1.107 billion lbs available to ship last year just from California. You can worry about the correction...to quote Tom Bodett from the famous Motel 6 chain here in the US, "We'll keep the light on for you."

Buyer's Perspective: We think that the correction will come in October or November unless the months leading up to that time are stellar shipment months. If those working during the past few days to lower prices in the market are successful in getting other California sellers nervous, then the correction could come sooner. This admittedly seems more unlikely today (after the shipment number) than it did yesterday.
Something else to think about in addition to the timing of the correction is the magnitude of the correction. Will it come in moderation or with a vengeance? Most agree that at $1.50 - $2.00 / lb ($330

2670 West Shaw Lane, Fresno, California 93711 U.S.A.
Telephone (559) 435-2664 • Fax (559) 435-8520 • www.dercofoods.com • e-mail: derco@dercofoods.com

- $440/220) for standards, we have quite a healthy market with happy producers and robust demand. But that price is around $1.75 - $2.25 / lb below where prices are today. To put it in monetary distance, that's $75,000 - $95,000 dollars per container away. Markets, once they start falling, tend not to stop unless the underlying fundamentals change or sellers feel pain. There's a long way to go until that pain starts in earnest.

Conclusion

Since March of 2003, when blanchable standard 5% was around $1.30 / lb ($286/220), virtually every month has seen price increases. Last month we reached a level for standards around $3.80 / lb ($836/220). The reasons for this rise have been well documented: a weak US Dollar, increasing demand, a strong domestic market, high priced alternative nuts, poor Spanish crops, good marketing, and effective grower inventory management and supply allocation. The latter has served as a de facto reserve.

How many of these variables are still factors for the coming season?

- The US Dollar is at the highest level (against the Euro) that it has been for the past 8 months. Recent strengthening of the USD is less a result of perceived strength in the US economy and more an indication of European economic uncertainty, which does not have a near-term solution.
- Demand has decreased an average of 9.5% per month during the past 4 months. This may not be as big of a slow down as California is expecting, but is is nevertheless a slow down.
- The domestic market remains strong. One can argue about the timing of purchases and prices paid, but if you go by what shipments are doing, then the domestic market is still vibrant.
- Other nuts are still at high levels. Where they are going to go next year is still unclear.
- The Spanish crop is going to be good.
- Marketing continues to be one of California's fortes and the competent support by the Almond Board is as strong as ever.
- Supply allocation driven mostly by growers refusing to sell forward has proven to be an economically sound reaction to strong demand and increasing shipments. Once demand wanes, it can be argued that growers acting individually will have a motivation to sell before their neighbor does. When more than a few start thinking this way, market corrections occur.

It's a mixed bag - some of the variables continue to hold true, but others clearly are no longer valid justifications. The stars are definitely not aligned perfectly in the heavens for California growers, as they have been during the past two years.

The International Tree Nut Congress in Berlin this past month was a well-organized and well-attended event. As far as almonds were concerned, there was a prevailing sentiment of uneasiness. Importers and industrial users simply don't believe that they can pass on these prices to their customers. Several respected buyers commented that they have bought limited amounts at recent levels because their average cost is still in the $2.75 - $3.00 / lb range ($605 - $660 / 220). They wanted to make it clear that at an average cost of $3.65 / lb ($803) for blanchable standards, their purchases would be reduced dramatically.

Sellers from California were confident, but with a degree of reservation and thoughtfulness. They truly want to believe that 850 million lbs is not enough at these levels and that prices must stay firm or increase further in order to allocate supply properly. If the objective estimate on June 30 affirms the 850 million pounds figure, or if it revises it downward, then we could be in for several more months of very firm pricing. The minimum 15% decline in shipments (which we have not yet reached on average) would still sell out the new crop - leaving essentially this year's carry-in as next year's carry-out.

Can buyers truly do without? In the case of some retailers, they may well decide not to carry almonds next season. If they can't make their profit margins, they may gamble that the average customer will not start shopping elsewhere if they cannot find almonds on their store shelves. Other companies that have more capital invested in almond manufacturing and packaging facilities and equipment may not be as cavalier about discontinuing almonds. They may reduce their useage, but they are smart enough to know that the coming years are going to have plenty of almonds. They would realize that basing a business strategy on an ephemeral supply shortage would be short sighted.

This transition period is turning out to be an exciting one and more surprises like today's strong shipment numbers may be around the corner. So strap on your helmets and enjoy the ride!

Best regards
DERCO FOODS

Ago Dermenjian
DERCO FOODS
2670 West Shaw Lane
Fresno, California 93711
Tel: (559) 435-2664
Fax: (559) 435-8520
e-mail: ago@dercofoods.com