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June 2008 Almond Position Report

June 2008 shipments were 102.7 million pounds. This is up about 25% from the June 2007 shipments of 82.287 million pounds.

Analysis

Carry-in from the 2006 crop year:	134 million pounds
2007 crop receipts:	1.38 billion pounds
Less 3% loss / exempt:	(41 million pounds)
Total Supply:	1.470 billion pounds
Less shipments to date:	(1.161 billion pounds)
Less estimated carry out:	(220 million pounds)
Estimated Remaining Supply:	90 million pounds

Shipments

Seller's Perspective: We were all expecting a strong June, but not this strong. Amazing shipments to countries where "warehouses are already full" and "there is no demand." Right. Fantastic performance, showing once again that when the crop is there, California can sell it. In 1998, the crop was 517 million pounds. That was 10 years ago friends....only 10 years ago. At that time, had you told a buyer that 10 years later the crop would be about 3 times larger, he would have told you that the industry would be bankrupt and people would be pulling out almonds and planting cotton. But 10 years ago, in August 1998, the price for NPS 23/25 was around \$2.30 per pound. By the end of that season, in July of 1999, NPS 23/25 was around \$1.50 per pound (and by September, prices had fallen to \$1.20 per pound, before a slow recovery started). *NPS 23/25 stayed under \$2 per pound until virtually January 2004* (there were a few months within that period where it went above \$2 per pound, but not for any sustained duration). So now we have 1.5 billion pound crops and the price for 2008 crop NPS 23/25, *offered by the second hand*, is at \$2.55 per pound. If buyers want to try to dictate prices to us after this kind of performance, we invite them to try.

Buyer's Perspective: Wow!

Commitments

Seller's Perspective: 183.6 million pounds committed leaving an uncommitted inventory of 128.5 million pounds with one month to go.

Buyer's Perspective: Strong commitments – up 54% domestically and up 75% for export. Overall, up around 65% compared to last year. But keep in mind that a big portion of these commitments will ship in August and September, which will be applied towards next year's shipments.

Domestic

Seller's Perspective: After a month off, we are pleased to announce another record.

Buyer's Perspective: Let's see what happens this coming season, with your economy in the shape it's in.

OBJECTIVE ESTIMATE AND NEW CROP MARKETING OPPORTUNITIES AND CHALLENGES

As all of you know by now, the objective estimate was released by the California Agricultural Statistics Service on June 30. The estimate was 1.5 billion pounds. Nonpareil will make up 538 million pounds of this total (36%). The nut set per tree is virtually identical to last year, indicating that the increased production is coming from the new bearing acreage. The kernel weight for all varieties is down 3%, which would indicate sizing similar or a bit smaller than the 2007 season.

Here is a quick analysis of where we expect to be on supply and demand:

Carry-in from the 2007 crop year:	220 million pounds (estimated)
2008 Objective Estimate:	1.5 billion pounds
Less 3% loss / exempt:	(45 million pounds)
Total Supply:	1.675 billion pounds

We expect total shipments for the 2007 season to be 1.25 billion pounds. For next season, we expect shipments to be around 1.375 billion pounds (10% increase). For those who doubt this number, see the first paragraph of this report. This will leave a carry-out going into 2009 of 300 million pounds.

Seller Talking Points.....

Water

For most in the industry, be it on the buying or selling side, water has been the topic du jour. Who has it, where is it, do we divert it from other crops, how much does it cost, why aren't we storing more, why didn't we build the dams, what is Judge Wanger going to do, what is going to happen to the trees, to the nuts, to next year???...etc. The talk has been widespread, fueled by emergency declarations and newspaper headlines. Consequently, prices have held steady in the face of a record new crop forecast which in years past would have led to certain price declines.

There is talk in California that the water challenges faced during the summer months, if compounded by another dry winter, could affect the size of the 2009 crop. We cannot comment on the veracity of this point. It seems overly speculative to us, but we cannot keep a Ficus plant alive in our office. So this is best left in the hands of the experts.¹

Production

Growers and processors are facing rising costs of fuel, chemicals, fertilizers, packaging materials, labor, and bees. This is resulting in higher costs of production. This is reality. What kind of pricing floor, if any, this manages to create is up for argument.

Demand and a Rising Middle Class

Sellers continue to argue that buyers (especially traditional ones who are well connected and are able to send one e-mail that goes around the trading world) are underestimating global demand. The June shipment figures and the figures for this entire season support this contention. With every record set in California, the refrain in Europe was "we don't know who is buying these almonds, the market is dead, the warehouses are full, the spot market is discounting." Someone is either building very large warehouses or is not in touch with the broader almond consuming community. The middle class segment of the global population is growing and able to consume more non-essential, luxury foodstuffs. Almonds are going to new places, and in larger

¹ Those of you who have visited our office are probably thinking: "Derco has beautiful plants." Yes, you are right. Our plants are beautiful, but they are cared for by a weekly maintenance service. Now you know and can sleep well at night. Our plants are safe.

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quantities. We have repeated this ad nauseum, but it bears repeating yet again. The demand paradigm has shifted. This is not your 1980s, 1990s or even early 2000s almond market. Don't miss the bus.

Other Nuts

The only cheaper tree nut could be hazelnuts. This may not affect European expectations much, but it will affect other countries who have a big snack market and where few importers decide which nuts will be consumed. Expect considerable demand jumps in such markets, like China.

Currency

The US Dollar is not expected to strengthen much in the coming six months. Europe is facing inflationary challenges and the European Central Bank just raised rates (July 3rd) to 4.25% in an effort to combat inflation, which is at 4% in the EC. US rates are not expected to go up for a few months, until inflation becomes a more serious concern.

Buyer Talking Points....

1.675 billion pounds available

There is no possible shortage. Increase demand by 10%, and you will have a 300 million pound carry-out. Increase demand by 18% (same as this season, difficult to do for logistical reasons), and you have 200 million pounds. The only issue for buyers this year is when to buy in order to lock in the most favorable prices. Factors that we think buyers will consider in making this determination:

- Will shipping challenges raise or lower prices? Cogent arguments can be made on either side.
- Will Nonpareil sizing really be the same as last year? What about all the talk just a few months ago that the NP looked lighter on the trees but that sizing looked better? Should we pay the premium demanded now or take our chances and wait until harvest is well under way?
- What is the down-side risk? Can BSU5% really go lower than \$1.60 per pound for any sustained period of time? If so, how much lower and for how long?
- What is the risk in buying hand-to-mouth all year long?
- What is the upside of this market? Can BSU5% really challenge the \$2 per pound level this season? How much would demand have to grow in order for this to happen? How well sold would California have to be by January? How poor would the prospects have to be for the 2009 crop, keeping in mind that there will be more new bearing acreage added?

International economic weakness and pessimistic global sentiment

Turn on the TV or the radio, and you better promptly take an anti-depressant. Otherwise, you may find your neck on the end of a rope swinging from your ceiling fan. Oil / gas prices (up); housing prices (down); food prices (up); landmark financial companies going bankrupt; food riots; water shortages; religious intolerance and ethnic strife; threats to blow up nuclear reactors; threats to annihilate countries; immigration; education (or lack thereof); global warming. Who the hell is thinking about buying almonds when stores are rationing wheat and rice?

Domestic Economy

Most of the points above apply to the US market. We just don't have many nuclear reactors to blow up....because we like our oil. God put it in the ground for us to use and damn it, that's what we're going to do. Someone shoot that Alaskan caribou that's in the way of the drilling equipment! Seriously....domestic demand has been a big driver the past few years. It has accounted for about 30% of total shipments. Will this level be sustained in the current economic environment? June shipment figures sure point to the fact that they will. Another record.

Transportation

How many more shipping lines are going to suspend / limit services to particular regions of the world? The Mediterranean service is getting hit particularly hard, with Hanjin announcing this week and end to their West Coast to Mediterranean service. How are we going to get the necessary equipment to ship the 175 million pounds or more we need to ship in October 2008? It's the middle of the summer and a missed last receiving in early July means in some cases getting rolled to a vessel for the last week of August. How much worse will the situation be in September?

But hey, don't worry. Call your local shipping representative. He or she will be happy to help you!²

Cost of carrying inventory

For this coming season, anyone who thinks that the carry-out will be less than 300 million pounds is optimistic indeed. So what does it cost to finance 300 million pounds of almonds at an average price of \$2 per pound? (hint: a lot).

Frucom, Codex Alimentarius & Aflatoxin (and other names Dr. Seuss wishes he had invented)

On June 30, 2008, Codex adopted the following aflatoxin levels that affect almonds, hazelnuts and pistachios sold in the EU:

- Aflatoxin limit was raised to 10 parts per billion in *ready to eat* almonds, hazelnuts and pistachios.
- Aflatoxin limit was raised to 15 parts per billion in almonds, hazelnuts and pistachios that are to be *subjected to sorting or other physical treatment*.

This second point seems to be an academic one at best, as customers who are retesting product at their own facilities are rejecting product today that falls under/within the current limits set *for further processing*. If anyone can explain what is getting through as "for further processing" **and what mechanism is being used to actually enforce** the higher tolerances associated with this nomenclature (assuming the proper language appears on the packaging or accompanying documentation)³, give us a call: (559) 435-2664. Otherwise, continue to feel good that there is a higher tolerance, though it really is totally open to a buyer's acceptance (influenced at times by market conditions), which makes it meaningless (more descriptive and colorful language omitted by management reviewing this report).

In any event, this is the first time that CODEX has set aflatoxin levels for tree nuts and the hope is that the EU will accept these limits and that this will become the new regulation. This would be a victory for all those who have campaigned tirelessly to bring some common sense to bureaucratic decrees. To put the importance of this raised tolerance in perspective, if the total maximum aflatoxin level had been 10 ppb on January 1, 2008, about 47% of aflatoxin rejections would never have happened.⁴

Ultimately, we are dealing with tree nuts that have been consumed since the dawn of human kind. Though it is incumbent on governments to ensure food safety and the health of its citizens, this has to be done within the realm of practicality and reason.

² This is a joke.

³ The language that needs to appear is: "Product to be subjected to sorting or other physical treatment to reduce aflatoxin contamination before consumption or use as an ingredient in foodstuffs." This is not a joke, though effective application and enforcement certainly can be argued to be one.

⁴ Thanks to the Almond Board of California for these statistics.

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"Everybody gets so much information all day long that they lose their common sense." Gertrude Stein. (And she died in 1946, *fifty years* before the internet started to gain mass exposure. What would she say today?)

Cheers to all the people who worked on this issue to get us this far. This will be a victory for common sense and Gertrude would be proud.

Conclusion

After years of experience, countless hours of research, and personal visits with friends and customers around the world, we are pleased to share with you, in algebraic terms, the analysis almond buyers use to make their purchasing decisions.

Buyer's Price = X
Seller's Price = Y
Second Hand = SH

$X = Y - \$0.05 \text{ per pound}$

But if SH is offering, then $X = Y - (\$0.05 \text{ per pound} + \text{SH discount}) \times (\text{unreliability factor} + \text{duration of contract})^5$

Happy Summer Vacations / Holidays to all of you in the Northern Hemisphere.

Best Regards,
DERCO FOODS

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