

FOOD PROCESSING CONTRACTS
“Path To Maintain United States Competitiveness”
Douglas R. Circle
President/CEO Circle Farms, Inc. & Frozsun Foods, Inc.

A pleasant good afternoon to everyone. My name is Douglas Circle and I am President of Circle Farms, Inc. which operates farms and processing plants for the growing and processing of strawberries and vegetables throughout central and Southern California for shipment around the world. Sunrise Growers, our fresh produce shipping company, is the 5th largest fresh strawberry shipper in California. Frozsun Foods, Inc., our processing operation, is one of the largest processors of strawberry products in the United States. We have seven (7) plants up and down the State of California. We also process fruit imported into the United States from both Canada and Mexico.

As a grower, shipper and processor, we have the opportunity to see the economics of the business from each perspective. Therefore, we are in a unique position to discuss contracts between growers and processors: how these contracts work; why they are necessary and to what extent they enable American farmers and processors to remain viable in an increasingly competitive world market.

Today I'm going to talk about the frozen strawberry business and specifically the role played by contracts in the strawberry grower's overall business plan. Contracts are often misunderstood and maligned, but in fact they are vital to both the grower and the processor.

First, what is a processing contract? Contracts are defined as the agreement between a grower and a processor for the processor to purchase the grower's partial or entire processing crop. These agreements set forth the understanding of the parties, rights, duties, specifications, passage of title, ownership issues, responsibilities and liability, food safety and good agricultural practices. They also set forth how the price paid to the grower will be determined at the time of delivery.

There are four important points I want to make about processing contracts with growers:

1. Contracts help provide a base of support for the fresh strawberry market.
2. Contracts provide growers with a predetermined revenue source for planning and financing.
3. Contracts provide the processor with stability in pricing and predictability of volume necessary to pre-sell products and plan inventory needs.
4. Finally, all of these combine to allow both the farmer and the processor to be competitive in the world market.

Most importantly, we have an awesome responsibility to the hundreds of employees of Circle Farms, Frozsun and Sunrise Growers. We also have a big responsibility to the many independent farmers who count on Sunrise to market their fresh strawberries and Frozsun to take their strawberries for processing. The contracts between Frozsun and the growers who deliver strawberries to us enable both the growers and Frozsun to plan and forecast needs.

Once the season starts, things happen very fast. The preplanning and thought that goes into the contracting process is the only thing that give us the stability of supply and price that allows us to function effectively.

Let me describe the sequence of events that go into the growing and processing of California strawberries.

Like many agricultural commodities the season for strawberries is very short and the timing for the frozen strawberry season is even shorter. Strawberry farmers in Southern California begin picking fresh strawberries in December or January. The crop builds in volume until it reaches a peak in mid April. By that time, nighttime temperatures reach a level that makes fresh shipments of strawberries to distant markets difficult because the berries ripen too quickly.

At that point, growers begin to make the switch from fresh market production to picking for the freezer. From the middle of April until the end of June, Southern California strawberry growers pick predominantly for processing. In less than 90 days over 80 percent of the year's frozen strawberries are picked and packed.

Timing, pricing, packaging and planning all have to come together in that brief moment. As the grower is making the decision to switch from fresh to freezer picking, the price offered for frozen strawberries has to be right or the grower may try to delay the switch as long as possible which can have a tremendous influence on the total pack-out.

The berries have to be immediately processed and, for the most part, put into the packaging that meets the needs of all of our diverse customers as they come in.

Frozsun frozen strawberries are found in retail packs you see in the supermarket, in frozen strawberries served in restaurants, they are served in beverages such as strawberry margaritas, daiquiris and fruit smoothies. Our frozen strawberries are also used as an ingredient in the manufacturing of strawberry ice cream, preserves, yogurt and dozens of other strawberry based products. We also sell frozen strawberries for a variety of uses in 15 countries throughout the world each with their own special requirements.

And, it is in that short 90 day period that we must know how many berries we are going to pack in one pound retail packs in the label for Safeway and how many 10 kilo containers we are going to pack for the Ohata Jam Company in Japan.

Only the contracts we write months earlier with strawberry farmers give us the predictable supply and pricing necessary to be logistically prepared when the crop comes in.

It is an interesting and sometimes frustrating transition for the strawberry farmer going from the fresh market to the processor. The fresh market is highly volatile. Prices can change dramatically with the ups and downs of the strawberry season, the influences of weather, even the volume of competing crops. The freezer market, on the other hand moves very slowly and prices only change by a matter of pennies per pound over the course of several years.

Fresh strawberries are an expandable consumable. If we produce more, people will eat more. Fresh strawberry production in California has increased 32% in the last 3 years alone. But, consumption of frozen strawberries is much more stable. In fact, frozen strawberries are virtually a commodity with a relatively fixed annual demand and prices are determined by world wide inventories.

Fresh strawberries are picked and generally shipped to market the same day and consumed within a week to ten days. Frozen strawberries are packed and some times held in inventory for up to 15 months. Because fresh strawberries need to be delivered to end-users within days, the proximity of California to the US market is a tremendous advantage to our growers. On the other hand, frozen strawberries can be grown almost anywhere in the world, processed and delivered to end users as needed. This brings strawberry growers in Mexico, China, Poland and many other counties into play in the world-wide frozen strawberry market place.

Again, the contract with the grower for processed strawberries negotiated months in advance serves as an interface between the highly volatile world of fresh strawberry marketing and the commodity like market for frozen berries.

Like any free market system, the right price is determined by competing forces. The grower needs price which is adequate to cover production and harvest costs. The processor needs a price that is competitive in the world market and can cover inventory and holding costs for many months.

As we have noted before, the processor needs the stability and predictability of a contract, but how does the grower benefit? In several ways. As we said the fresh market is highly volatile. That means that prices can go up in a good market, but they can also go down in a bad market. The “boom or bust” pricing which runs hand in hand with a supply and demand environment is unpredictable. A stable and healthy processor market supported with grower contracts provides a floor for the fresh market. If the fresh market reaches an unacceptable level, the grower has a predetermined outlet at an established price to divert fruit to processing.

Secondly, contracts provide a pre-determined revenue source for the farmer for planning and financing. Growers with contracts for frozen strawberries have a known and established income base they literally take to the bank when they are looking for financing for the farming operations. The acquisition of this fruit is executed before the plants are in the ground based upon written contracts. This is extremely important to the strawberry grower’s overall business plans since 35% of the crop is processed in California.

Growers must plan for the future in a highly competitive world market. Contracting provides the Grower with an understanding of the economic environment for their crops. This drives decision of what crops to grow, the amount or acreage of the crop to grow, Evaluation of their ability to achieve a required profit, Land and water cost decisions, advance planning for capital to farm, the ability to gain and maintain the greatest knowledge to compete.

Contracts provide the processor with stability in pricing and predictability of volume necessary to pre-sell products and plan inventory needs. Our work takes a lot of future planning and analysis to match the volume we produce with the needs of our customers. We must always be working two to five years in the future as well to project the needs of our customers, overall food industry shifts and production trends throughout the world. Finally, the processing market requires an extremely large investment to fund and maintain the inventories required of customers specific products.

For example, when we pack private label frozen strawberries for a retail customer, that product will sit in inventory until the retailer requests shipment. Most of our customers do not have their own industrial freezer storage plants or they prefer just in time delivery to reduce their costs. We can’t sell the product to someone else and we have only limited ability to encourage the retailer to move the product more quickly. On the other hand, the grower needs to be paid for the product as soon as it arrives and all of the storage costs need to be paid as they are incurred.

To review the timeline, processors normally contract one year in advance of harvest. Processors take delivery of growers’ fruit primarily in a ninety (90) day window of harvest the following year after the fresh season is over. The processor packs to a customer’s specific requirements for their private brands and then must finance and hold this inventory for 52 weeks of deliveries to customers. For example, contracting takes place in August of 2003 for the 2004 crop cycle. The inventories are held through the crop cycle until August 2005. The entire process takes 24 months and overlaps into the following calendar year.

It’s important to recognize that, in addition to contracts with growers, processors also make contracts with customers. Retail, food service, ingredients and export customers require a stable, dependable food safe supply of strawberries for their needs. The contracts with customers allow both processors and growers to plan for and provide cost effective products through advance planning, developing supplies, resources, new packaging and other innovative ideas to remain competitive. Finally, increasing the stability of the business allows for all sides to make capital investments that require longer time frame pay backs but improve the process and cost efficiency.

Our final point regarding the value of contracts is that all of these combine to allow both the farmer and the processor to maintain a competitive business in the world market. As we have said the frozen strawberry market is largely a world wide commodity market. We are competing with growers who have much lower production costs, much less government regulation, lower labor costs and often preferential tariffs.

As you can imagine, agricultural production in California is very expensive. Unfortunately, the best climate for producing strawberries is found in some of the nicest place to live – Monterey, Santa Barbara, Ventura, Orange and San Diego Counties. No only are land costs very high, but strawberries are one of the most expensive crops to grow.

California also has its own level of regulations in addition to the high standards set by the federal government. Minimum wage is \$1.60 higher in California than the Federal rate.

California has its own Environmental protection agency that often sets more stringent standards than the federal government. Finally, field sanitation regulation is stricter in California than in many other states which are stricter than those of many other countries.

So, to remain competitive in a worldwide commodity market is no easy trick, but we do have advantages of our own. Most importantly is California's climate. The western ocean exposure along our coast is unique in the world. Only about five places on the entire planet have this unique combination of latitude and ocean exposure. In California the prevailing ocean breezes come off the water and moderate temperatures. It doesn't get too hot in the summer and it doesn't get too cold in the winter – perfect strawberry weather.

In addition, California growers have invested heavily in agricultural research to develop strawberry varieties that are highly productive and satisfying to the consumer. In fact strawberry varieties developed in California are produced throughout the world. However, because they are bred for the California climate they don't perform as consistently elsewhere as they do here.

We also produce in close proximity to interstate and international transportation systems. When you look at other strawberry producing regions throughout the world they don't have the combination of climate, resources and access to transportation to match California.

It is also fair to say that the high regulatory and farming standards in California are a market advantage. Growers in the United States have raised the bar on food safety personal hygiene of harvest personnel and packaging of product to a level that many other countries have yet to match. So, California strawberry industry is the most consistent supplier of high quality frozen strawberries produced under the most stringent standards for health and safety.

In California, we have highly talented and professional farmers many of whom have been farming for generations going back, in some cases a hundred years. At Circle Farms, Inc. for example we have identified and grow sweet, firm strawberries that are a pleasure to behold, taste good and can make the trip across the country for delivery to our customers. We bring the same quality and experience to the production of frozen strawberries. Strawberries are a new crop to some competing countries so their experience and knowledge is limited to less than 20 years.

I would like to add another big advantage we have over a country such as China who is becoming a bigger factor in the world strawberry market. The United States' consumer has demanded a high quality, visually pleasing strawberry that California grower's can deliver. That is that we eat strawberries in this country and we actually know what a good strawberry should look and taste like.

Taken together -- higher costs versus production and quality advantages -- the net result is that we have to be highly efficient to be competitive. And, the contracts we have with both growers and customers allow us to achieve that goal. Without the planning, predictability and process of negotiating the right price for the grower and processor, it would be very difficult for the United States to continue to be the preeminent strawberry supplier to the world.

From the "field to the fork" with the freshest, high quality strawberries continues to be our mission and goal.

Thank you all and please continue to consume your fair share of both fresh and processed strawberries from California.

Douglas R. Circle





Value of Grower Contract

- Base of support for fresh strawberry market
- Predetermined Revenue Source
- Stability of price and volume for processor
- Ability to remain competitive in world market



Responsibility



Once the Season Starts...



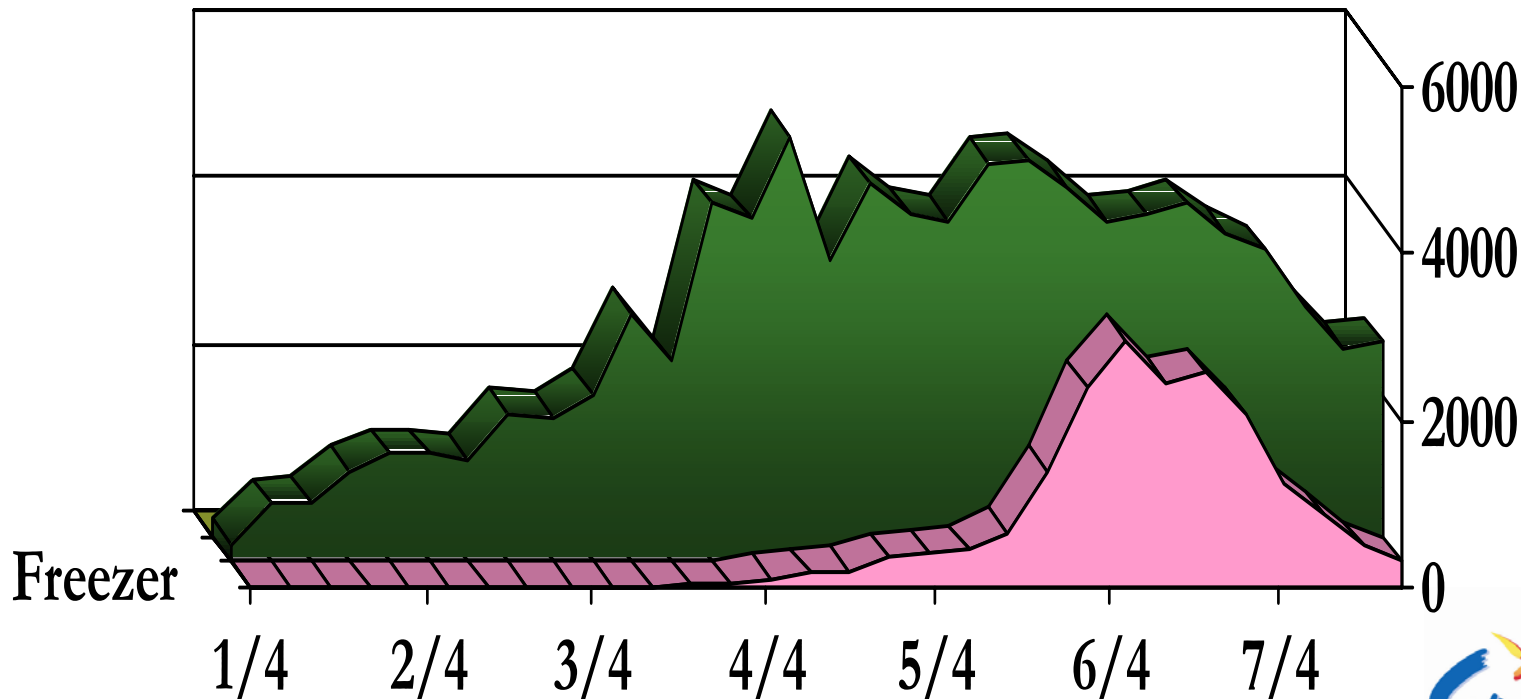
Fresh and Freezer Production

December
Start Picking

April
Peak Volume

Mid April
Switch to Freezer

May – June
80% Freezer Volume
Picked



Freezer



Immediate Packaging Decisions



Product Line





Pre-Planning Necessary to Meet Customer Needs



Fresh v. Freezer Market

Fresh

- Highly Volatile
- Expandable
Consumable
- Proximity to market
important

Freezer

- Moves Slowly
- Commodity with
relatively fixed demand
- Shipped and consumed
over a long period
- World wide distribution



Picking for Processing



Value of Grower Contract

- Base of support for fresh strawberry market



Value of Grower Contract

- Base of support for fresh strawberry market
- Predetermined Revenue Source



Planning Future Crops



Value of Grower Contract

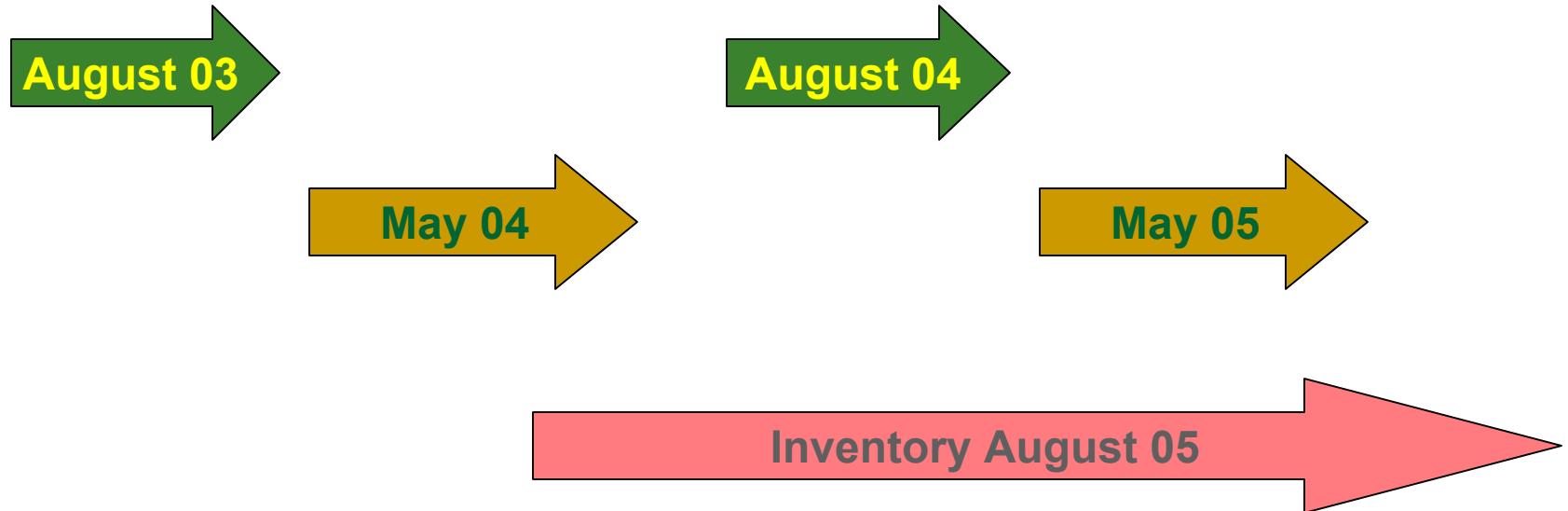
- Base of support for fresh strawberry market
- Predetermined Revenue Source
- Stability of price and volume for processor



Inventory Requirements



Contracting Timeline



Contracts with Customers



Value of Grower Contract

- Base of support for fresh strawberry market
- Predetermined Revenue Source
- Stability of price and volume for processor
- Ability to remain competitive in world market



California's Central Coast



High Regulatory Standards



Commitment to Research



Transportation Advantage



High Standards – Superior Quality



Experienced Farmers



We Know Berries



Freshest, Highest Quality

