

CALAVO GROWERS INC  
Form 10-K  
January 17, 2012

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended October 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

Commission file number: 000-33385

**CALAVO GROWERS, INC.**

(Exact name of registrant as specified in its charter)

California  
(State of incorporation)

1141-A Cummings Road, Santa Paula, CA  
(Address of principal executive offices)

Registrant's telephone number, including area code: (805) 525-1245

33-0945304  
(I.R.S. Employer Identification No.)

93060  
(Zip code)

Edgar Filing: CALAVO GROWERS INC - Form 10-K

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name Of Each Exchange On Which Registered
Common Stock, \$0.001 Par Value per Share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark if whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Based on the closing price as reported on the Nasdaq Global Select Market, the aggregate market value of the Registrant's Common Stock held by non-affiliates on April 30, 2011 (the last business day of the Registrant's most recently completed second fiscal quarter) was approximately \$262.9 million. Shares of Common Stock held by each executive officer and director and by each shareholder affiliated with a director or an executive officer have been excluded from this calculation because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The number of outstanding shares of the Registrant's Common Stock as of November 30, 2011 was 14,770,433.

Documents Incorporated by Reference

Portions of the Registrant's Proxy Statement for the 2012 Annual Meeting of Shareholders, which we intend to hold on April 25, 2012 are incorporated by reference into Part III of this Form 10-K. The definitive Proxy Statement will be filed within 120 days after October 31, 2011.



**CAUTIONARY STATEMENT**

This Annual Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7, contains forward-looking statements that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, the results of Calavo Growers, Inc and its consolidated subsidiaries (CG) may differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, any projections of revenue, margins, expenses, earnings, earnings per share, tax provisions, cash flows, currency exchange rates, the impact of acquisitions or other financial items; any statements of the plans, strategies and objectives of management for future operations, including execution of restructuring and integration plans; any statements regarding current or future macroeconomic trends or events and the impact of those trends and events on CG and its financial performance; any statements regarding pending investigations, claims or disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. Risks, uncertainties and assumptions include the impact of macroeconomic trends and events; the competitive pressures faced by CG's businesses; the development and transition of new products and services (and the enhancement of existing products and services) to meet customer needs; integration and other risks associated with business combinations; the hiring and retention of key employees; the resolution of pending investigations, claims and disputes; and other risks that are described herein, including, but not limited to, the items discussed in Risk Factors in Item 1A of this report, and that are otherwise described or updated from time to time in CG's Securities and Exchange Commission reports. CG assumes no obligation and does not intend to update these forward-looking statements.

---

**PART I**

**Item 1. Business**

**General development of the business**

Calavo Growers, Inc. (Calavo, the Company, we, us or our), is a global leader in the avocado industry and an expanding provider of value-added fresh food. Our expertise in marketing and distributing avocados, prepared avocados, and other perishable foods allows us to deliver a wide array of fresh and prepared food products to food distributors, produce wholesalers, supermarkets, convenience stores, and restaurants on a worldwide basis. We procure avocados principally from California, Mexico, and Chile. Through our various operating facilities, we sort, pack, and/or ripen avocados, tomatoes and/or Hawaiian grown papayas. Additionally, we also produce salsa and prepare ready-to-eat produce and deli products. We distribute our products both domestically and internationally and report our operations in two different business segments: Fresh products and Calavo Foods. See Note 11 in our consolidated financial statements for further information about our business segments. Our principal executive offices are located at 1141-A Cummings Road, Santa Paula, California 93060; telephone (805) 525-1245.

On October 9, 2001, we completed a series of transactions whereby common and preferred shareholders of Calavo Growers of California (the Cooperative), an agricultural marketing cooperative association, exchanged all of their outstanding shares for shares of our common stock. Concurrent with this transaction, the Cooperative was merged into us with Calavo Growers, Inc. (Calavo) emerging as the surviving entity. These transactions had the effect of converting the legal structure of the business from a non-profit cooperative to a for-profit corporation.

In June 2011, Calavo, CG Mergersub LLC (Newco), Renaissance Food Group, LLC (RFG) and Liberty Fresh Foods, LLC, Kenneth Catchot, Cut Fruit, LLC, James Catchot, James Gibson, Jose O. Castillo, Donald L. Johnson and RFG Nominee Trust (collectively, the Sellers) entered into an Agreement and Plan of Merger dated May 25, 2011 (the Acquisition Agreement), which sets forth the terms and conditions pursuant to which Calavo would acquire a 100 percent ownership interest in RFG. Pursuant to the Acquisition Agreement, Newco, a newly formed Delaware limited liability company and wholly-owned subsidiary of Calavo, merged with and into RFG, with RFG as the surviving entity. RFG is a fresh-food company that produces, markets, and distributes nationally a portfolio of healthy, high quality products for consumers via the retail and foodservice channels. See Note 17 in our consolidated financial statements for further information.

In February 2010, Calavo, Calavo Salsa Lisa, LLC (CSL), Lisa's Salsa Company (LSC) and Elizabeth Nicholson and Eric Nicholson, entered into an Asset Purchase and Contribution Agreement, dated February 8, 2010 (the Acquisition Agreement), which sets forth the terms and conditions pursuant to which Calavo acquired a 65 percent ownership interest in newly created CSL which acquired substantially all of the assets of LSC. Elizabeth Nicholson and Eric Nicholson, through LSC, hold the remaining 35 percent ownership of CSL. LSC is a regional producer in the upper Midwest of Salsa Lisa refrigerated salsas. We believe that this line of salsas will further diversify our product offerings and will be a natural complement to our ultra-high-pressure guacamole, as well as our Calavo tortilla chips.

In June 2009, we (through a wholly owned subsidiary: Calavo Inversiones (Chile) Limitada) entered into a joint venture agreement with Exportadora M5, S.A. (M5) for the purpose of selling and distributing Chilean sourced avocados, as well as other perishable commodities. Such joint venture operates under the name of Calavo de Chile and commenced operations in July 2009. M5 and Calavo each have an equal one-half ownership interest in Calavo de Chile, but M5 has overall management responsibility for the operations of Calavo De Chile.

In June 2007, we entered into a distribution agreement with Agricola Belher (Belher) of Mexico, a well-established quality producer of fresh vegetables, primarily tomatoes, for export to the U.S. market. Pursuant to such distribution agreement, Belher agreed, at their sole cost and expense, to harvest, pack, export, ship, and deliver tomatoes exclusively to our company, primarily our Arizona facility. In exchange, we agreed to sell and distribute such tomatoes, make advances to Belher for operating purposes, provide additional advances as shipments are made during the season (subject to limitations, as defined), and return the proceeds from such tomato sales to Belher, net of our commission and aforementioned advances. The agreement also allows for us to advance additional amounts to Belher at our sole discretion. In June 2011, we entered into an addendum that extended the distribution agreement with Belher. This agreement expires in July 2019.

We also entered into an infrastructure agreement in June 2007 with Belher, which was extended through the addendum in June 2011, in order to significantly increase production yields and fruit quality. Pursuant to this agreement, we made advances to be used solely for the acquisition, construction, and installation of improvements to and on certain land owned/controlled by Belher, as well as packing line equipment. Advances incur interest at 4.7% and 6.5% at October 31, 2011 and 2010. We have advanced a total of \$4.2 million and \$2.4 million as of October 31, 2011 and 2010 (\$0.8 million and \$1.2 million included in prepaid expenses and other

current assets and \$3.4 million and \$1.2 million included in other long-term assets). Belher is to annually repay these advances in no less than 20% increments through July 2016. Interest is to be paid monthly or annually, as defined. Belher may prepay, without penalty, all or any portion of the advances at any time. In order to secure their obligations pursuant to both agreements discussed above, Belher granted us a first-priority security interest in certain assets, including cash, inventory and fixed assets, as defined.

In August 2006, we entered into a joint venture agreement with San Rafael Distributing (SRD) for the purpose of the marketing, sale and distribution of fresh produce from the existing location of SRD at the Los Angeles Wholesale Produce Market (Terminal Market), located in Los Angeles, California. Such joint venture operates under the name of Maui Fresh International, LLC (Maui Fresh) and commenced operations in August 2006. SRD and Calavo each have an equal one-half ownership interest in Maui Fresh, but SRD has overall management responsibility for the operations of Maui Fresh at the Terminal Market.

#### **Available information**

We maintain an Internet website at <http://www.calavo.com>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and other information related to us, are available, free of charge, on our website as soon as reasonably practicable after we electronically file those documents with, or otherwise furnish them to, the Securities and Exchange Commission. Our Internet website and the information contained therein, or connected thereto, is not and is not intended to be incorporated into this Annual Report on Form 10-K.

#### **Fresh products**

Calavo was founded in 1924 to market California avocados. In California, the growing area stretches from San Diego County to Monterey County, with the majority of the growing areas located approximately 100 miles north and south of Los Angeles County. The storage life of fresh avocados is limited. It generally ranges from one to four weeks, depending upon the maturity of the fruit, the growing methods used, and the handling conditions in the distribution chain.

We sell avocados to a diverse group of supermarket chains, wholesalers, food service and other distributors, under the Calavo family of brand labels, as well as private labels. From time to time, some of our larger customers seek short-term sales contracts that formalize their pricing and volume requirements. Generally, these contracts contain provisions that establish a price floor and/or ceiling during the contract duration. In our judgment, the shift by our customers to drafting sales contracts benefits large handlers like us, which have the ability to fulfill the terms of these contracts. During fiscal year 2011, our 5 and 25 largest fresh customers represented approximately 22% and 44% of our total consolidated revenues. During fiscal year 2010, our 5 and 25 largest fresh customers represented approximately 24% and 48% of our total consolidated revenues. During fiscal year 2011 none of our fresh customers represented more than 10% of total consolidated revenues. During fiscal year 2010, one fresh customer represented approximately 11% of our total consolidated revenues. During fiscal year 2009 none of our fresh customers represented more than 10% of total consolidated revenues.

The Hass variety is the predominant avocado variety marketed on a worldwide basis. Generally, California grown Hass avocados are available year-round, with peak production periods occurring between January through October. Other varieties have a more limited picking season and generally command a lower price. Approximately 1,900 California growers deliver avocados to us, generally pursuant to a standard marketing agreement. Over the past several years, our share of the California avocado crop has remained strong, with approximately 28% of the 2011 shipped California avocado crop handled by us, based on data published by the California Avocado Commission. We attribute our solid foothold in the California industry principally to the competitiveness of the per pound returns we pay and the communication and service we maintain with our growers.

California avocados delivered to our packinghouses are graded, sized, packed, cooled and, frequently, ripened for delivery to customers. Our ability to estimate the size, as well as the timing of the delivery of the annual avocado crop, has a substantial impact on both our costs and the sales price we receive for the fruit. To that end, our field personnel maintain direct contact with growers and farm managers and coordinate harvest plans. The feedback from our field-managers is used by our sales department to prepare sales plans used by our direct sales force.

A significant portion of our California avocado handling costs is fixed. As a result, significant fluctuations in the volume of avocados delivered have a considerable impact on the per pound packing costs of avocados we handle. Generally, larger crops will result in a lower per pound handling cost. We believe that our cost structure is geared to optimally handle larger avocado crops. Our strategy calls for continued efforts in aggressively recruiting new growers, retaining existing growers, and procuring a larger percentage of the California avocado crop.

California avocados delivered to us are grouped as a homogenous pool on a weekly basis based on the variety, size, and grade. The proceeds we receive from the sale of each separate avocado pool, net of a packing and marketing fee to cover our costs and a profit, are paid back to the growers once each month. The packing and marketing fee we withhold is determined by our Chief Executive Officer and is revised from time to time based on our estimated per pound packing and operating costs, as well as our operating profit. This fee is a fixed rate per pound packed. Significant competitive pressures dictate that our grower returns are set at the highest possible level to attract new and retain existing grower business. We believe that, if net proceeds paid ceased to be competitive, growers would simply choose to deliver their avocados to alternate competitive handlers. Consequently, we strive to deliver growers the highest return possible on avocados delivered to our packinghouses.

The California avocado market is highly competitive with 9 major avocado handlers. A marketing order enacted by the state legislature is in effect for California grown avocados and provides the financial resource to fund generic advertising and promotional programs. Avocados handled by us are identifiable through packaging and the Calavo brand name sticker.

We also import avocados from Mexico, Chile, Peru, New Zealand and the Dominican Republic. Our strategy is to increase our market share of currently sourced avocados to all accepted marketplaces. We believe our diversified avocado sources provide a level of supply stability that may, over time, help solidify the demand for avocados among consumers in all markets we distribute to.

We typically purchase Mexican avocados from growers and packers located in Mexico. The purchase price we pay for fruit acquired from Mexican growers is generally negotiated for substantially all the fruit in a particular grove. Once a purchase price is agreed to, the fruit is then harvested and delivered to our packinghouse located in Uruapan, Michoacán, Mexico. Once delivered, such fruit is weighed, graded, sized, packed, and cooled for shipment, primarily to the United States. Fruit purchased directly from Mexican packers is used as a supplemental source and is packed to our standards for shipment to either our customers or our operating facilities. In either case, the purchase price of Mexican avocados is generally based on our estimated selling prices of such fruit, less anticipated packing and/or selling costs and our desired margin. We believe these two sources allow us to maximize both the timely acquisition, as well as purchase price, of Mexican fruit.

Similar to California avocados, a significant portion of our handling costs for Mexican avocados are fixed. As a result, significant fluctuations in the volume of Mexican avocados delivered to our packinghouse can have a considerable impact on the per pound packing costs of avocados we handle. Generally, larger crops will result in a lower per pound handling cost. We believe that our cost structure for Mexican avocados is geared to optimally handle larger avocado crops.

We believe that our continued success in marketing Mexican avocados is largely dependent upon securing a reliable, high-quality supply of avocados at reasonable prices, and keeping the handling costs low as we ship the Mexican avocados to our packinghouses. We are subject to USDA and other regulatory inspections to ensure the safety and the quality of the fruit being delivered from Mexico. The Mexican avocado harvest, which is often considerably larger than the California avocado harvest, is both complimentary and competitive with the California market, as the Mexican harvest is near year round (most significant from September to June). As a result, it is common for Mexican growers to monitor the supply of avocados for export to the United States in order to obtain higher field prices. During 2011, we packed and distributed approximately 23% of the avocados exported from Mexico into the United States and approximately 5% of the avocados exported from Mexico to countries other than the United States, based on our estimates.

We also handle avocados from Chile and Peru, most of which are on a consignment basis with our growers. Pursuant to our joint venture agreement with M5, Calavo de Chile is now the primary contact with our Chilean avocado sources. Our commission percentage is approximately 8%. Additionally, from time to time, we may purchase Chilean sourced avocados. Pursuant to our consignment arrangements, we occasionally make advances to both Chilean and Peruvian growers. Historically, we made such advances related to both pre-harvest and post-harvest activities, but our focus during fiscal 2010 and 2011 was primarily related to post-harvest activities. Typically, we obtain collateral (i.e. fruit, fixed assets, etc.) that approximates the value at risk, prior to making such advances. Historical experience demonstrates that providing post-harvest advances results in our acquiring full market risk for the product, as it is possible (although unlikely) that our sale proceeds may be less than the amounts we paid to the grower. This is a result of the high level of volatility inherent in the avocado and perishable food markets, which are subject to significant pricing declines based on the availability of fruit in the market. In the event that we do make a pre-season advance, our ability to recover such pre-harvest advance would be largely dependent on the growers' ability to deliver avocados to us, as well as the inherent risks of farming, such as weather and pests.

Sales of Chilean grown avocados have generally been significant during our 4<sup>th</sup> and 1<sup>st</sup> fiscal quarters. Additionally, with the Chilean harvesting season being complimentary to the California season (August through February), Chilean avocados are able to command competitive retail pricing in the market. During 2011, we distributed approximately 5% of the total Chilean avocados imported into the United States, based on our estimates.

We have developed a series of marketing and sales initiatives primarily aimed at our largest customers that are designed to differentiate our products and services from those offered by our competitors. Some of these key initiatives are as follows:

We continue to have success with our ProRipeVIP avocado ripening program. This proprietary program allows us to deliver avocados evenly ripened to our customers' specifications. We have invested in the Aweta AFS (acoustic firmness sensor) technology and equipment. ProRipeVIP is the next generation of selling conditioned avocados that have firmness determined via soundwaves. This technology is fairly new to avocados. The most significant and compelling reason we invested in the Aweta systems is because the acoustic sensors measure firmness of the entire piece of fruit, as opposed to competitive mechanical tests that use pressure and calculated averages to measure firmness. We believe that ripened avocados help our customers address the consumers' immediate needs and accelerate the sale of avocados through their stores. We currently have three Aweta systems in use in the United States, which, we believe, can effectively meet our customers' demand for conditioned fruit.

We have developed various display techniques and packages that appeal to consumers and, in particular, impulse buyers. Some of our techniques include the bagging of avocados and the strategic display of the bags within the produce section of retail stores. Our research has demonstrated that consumers generally purchase a larger quantity of avocados when presented in a bag as opposed to the conventional bulk displays. We also believe that the value proposition of avocados in a bag provides for a higher level of sales to grocery stores.

Perishable food products include various commodities, including tomatoes, papayas, and pineapples. The majority of our sales are generated from tomatoes and papayas. Tomatoes are primarily handled on a consigned basis, while papayas are handled on a pooling basis, similar to the California avocado pool previously described. Sales of our diversified Fresh products do not generally experience significant fluctuations related to seasonality. We believe our efforts in distributing our other various commodities complement our offerings of avocados.

#### **Calavo Foods**

The Calavo Foods segment was originally conceived as a mechanism to stabilize the price of California avocados by reducing the volume of avocados available to the marketplace. In the 1960s and early 1970s, we pioneered the process of freezing avocado pulp and developed a wide variety of guacamole recipes to address the diverse tastes of consumers and buyers in both the retail and food service industries. One of the key benefits of frozen products is their long shelf-life. With the introduction of low cost processed products delivered from Mexican based processors, however, we realigned the segment's strategy by shifting the fruit procurement and pulp processing functions to Mexico. In 1995, we invested in a processing plant in Mexicali, Mexico to derive the benefit of competitive avocado prices available in Mexico.

Through January 2003, the primary function of our Mexicali processed operation was to produce pulp for our Santa Paula plant. Our processing facility in Santa Paula, California would receive the pulp from Mexicali, add ingredients, and package the product in various containers. The product would then be frozen for storage with shipment to warehouses and, ultimately, to our customers. From January 2003 to August 2004, however, our Mexicali processed operations became primarily focused on our individually quick frozen (IQF) avocado half product line and one of our ultra high-pressure lines. Our IQF line provides food service and retail customers with peeled avocado halves that are ripe and suitable for immediate consumption. These halves were frozen, packaged and shipped out of Mexicali to warehouses located in the U.S., and, ultimately, to our customers.

In February 2003, our Board of Directors approved a plan whereby the operations of our Calavo Foods business would be relocated. The plan called for the closing of our Santa Paula, California and Mexicali, Baja California Norte (Mexicali) processing facilities and relocating these operations to a new facility in Uruapan, Michoacan, Mexico (Uruapan). This restructuring has provided for cost savings in the elimination of certain transportation costs, duplicative overhead structures, and savings in the overall cost of labor and services. The Uruapan facility commenced operations in February 2004 and the Santa Paula and Mexicali facilities ceased production in February 2003 and August 2004. Net sales of frozen products, typically sold to foodservices customers, represented approximately 51% and 54% of total Calavo Foods segment sales for the years ended October 31, 2011 and 2010.

We utilize ultra high pressure machines which are designed to cold pasteurize our guacamole products. Using high pressure only, this procedure substantially destroys the cells of any bacteria that could lead to spoilage, food safety, or oxidation issues. Once the procedure is complete, our packaged guacamole is cased and shipped to various retail and food service customers throughout the markets we service. In fiscal year 2010, we put a second 215L ultra high pressure machine into service. These machines, which are located in Uruapan, pressurize all guacamole product lines, including all frozen products, which began in fiscal 2010. A 3<sup>rd</sup> ultra high pressure machine, with a larger capacity of 350L, was put into service during our second fiscal quarter of 2011, but experienced a serious mechanical failure shortly after installation. In the first quarter of 2012, this machine was replaced with a new 350L capacity machine. We estimate our operating capacity for the two 215L machines that were operational at year end to be approximately 95%.





We estimate that our operating capacity for all three ultra high pressure machines to be 71% and we believe this reasonable given our current sales projections and expected growth. Net sales of our ultra high pressure (fresh) products, typically sold to retail customers, represented approximately 49% and 46% of total guacamole products within the Calavo Foods segment sales for the years ended October 31, 2011 and 2010.

Sales in the U.S. and Canada are made principally through a commissioned nationwide broker network, which is supported by our regional sales managers. We believe that our marketing strength is distinguished by providing quality products, innovation, year-round product availability, strategically located warehouses, and market relationships. During fiscal year 2011, our 5 and 25 largest processed product customers represented approximately 9% and 17 % of our total consolidated revenues. During fiscal year 2010, our 5 and 25 largest processed product customers represented approximately 6% and 11% of our total consolidated revenues. During fiscal years 2011, 2010 and 2009 none of our processed product customers represented more than 10% of total consolidated revenues.

In February 2010, we entered into an Acquisition Agreement, which sets forth the terms and conditions pursuant to which we acquired a 65 percent ownership interest in newly created CSL which acquired substantially all of the assets of LSC. Elizabeth Nicholson and Eric Nicholson, through LSC, hold the remaining 35 percent ownership of CSL. LSC is a regional producer in the upper Midwest of Salsa Lisa refrigerated salsas. We believe that this line of salsa will further diversify our product offerings and will be a natural complement to our ultra-high-pressure guacamole, as well as our Calavo tortilla chips.

In June 2011, Calavo, CG Mergersub LLC (Newco), Renaissance Food Group, LLC (RFG) and Liberty Fresh Foods, LLC, Kenneth Catchot, Cut Fruit, LLC, James Catchot, James Gibson, Jose O. Castillo, Donald L. Johnson and RFG Nominee Trust (collectively, the Sellers) entered into an Agreement and Plan of Merger dated May 25, 2011 (the Acquisition Agreement), which sets forth the terms and conditions pursuant to which Calavo would acquire a 100 percent ownership interest in RFG. Pursuant to the Acquisition Agreement, Newco, a newly formed Delaware limited liability company and wholly-owned subsidiary of Calavo, merged with and into RFG, with RFG as the surviving entity. RFG is a fresh-food company that produces, markets, and distributes nationally a portfolio of healthy, high quality products for consumers via the retail channel. See Note 17 in our consolidated financial statements for further information.

#### **Sales and Other Financial Information by Business Segment and Product Category**

Sales and other financial information by business segment are provided in Note 11 to our consolidated financial statements that are included in this Annual Report.

#### **Patents and Trademarks**

Our trademarks include the Calavo and RFG brand name and related logos. We also utilize the following trademarks in conducting our business: Avo Fresco, Bueno, Calavo Gold, Calavo Salsa Lisa, Salsa Lisa, Celebrate the Taste, El Dorado, Fresh Ripe, Select, Taste of Paradise, The First Name in Avocados, Tico, Mfresh, Maui Fresh International, Triggered Avocados, ProRipeVIP , Garden Highway Fresh Cut, Garden Highway, and Garden Highway Chef Essentials.

#### **Working Capital Requirements**

Generally, we make payments to our avocado growers and other suppliers in advance of collecting all of the related accounts receivable. We generally bridge the timing between vendor payments and customer receipts by using operating cash flows and commercial bank borrowings. In addition, we provide crop loans and other advances to some of our growers, which are also funded through operating cash flows and borrowings.

Non-California sourced avocados and perishable food products often require working capital to finance the payment of advances to suppliers and collection of accounts receivable. These working capital needs are also financed through the use of operating cash flows and bank borrowings.

With respect to our Calavo Foods business, we require working capital to finance the production of our processed avocado products, building and maintaining an adequate supply of finished product, and collecting our accounts receivable balances. These working capital needs are financed through the use of operating cash flows and bank borrowings.

#### **Backlog**

Our customers do not place product orders significantly in advance of the requested product delivery dates. Customers typically order perishable products two to ten days in advance of shipment, and typically order Calavo Foods within thirty days in advance of shipment.



## Research and Development

Prior to the acquisition of RFG, we did not undertake significant research and development efforts. Research and development programs, if any, were limited to the continuous process of refining and developing new techniques to enhance the effectiveness and efficiency of our Calavo Foods operations and the handling, ripening, storage, and packing of fresh avocados. With the acquisition of RFG, however, we have an increased emphasis on research and development for new and improved products which is driven by customer requests, changes in product specifications, customer and market research and/or innovative ideas generated by our own team of experts with food processing and culinary backgrounds. We solicit customer and supplier input, review process and product trends and conduct sensory and shelf life testing, all to expand the category and drive new sales for our customers. Research and development costs are charged to cost of sales when incurred. Total research and development costs for fiscal years 2011, 2010, and 2009, were less than \$0.1 million.

## Compliance with Government Regulations

The California State Department of Food and Agriculture oversees the packing and processing of California avocados and conducts tests for fruit quality and packaging standards. All of our packages are stamped with the state seal as meeting standards. Various states have instituted regulations providing differing levels of oversight with respect to weights and measures, as well as quality standards.

As a manufacturer and marketer of processed avocado products, our operations are subject to extensive regulation by various federal government agencies, including the Food and Drug Administration (FDA), the USDA and the Federal Trade Commission (FTC), as well as state and local agencies, with respect to production processes, product attributes, packaging, labeling, storage and distribution. Under various statutes and regulations, these agencies prescribe requirements and establish standards for safety, purity and labeling. In addition, advertising of our products is subject to regulation by the FTC, and our operations are subject to certain health and safety regulations, including those issued under the Occupational Safety and Health Act. Our manufacturing facilities and products are subject to periodic inspection by federal, state and local authorities.

As a result of our agricultural and food processing activities, we are subject to numerous environmental laws and regulations. These laws and regulations govern the treatment, handling, storage and disposal of materials and waste and the remediation of contaminated properties.

We seek to comply at all times with all such laws and regulations and to obtain any necessary permits and licenses, and we are not aware of any instances of material non-compliance. We believe our facilities and practices are sufficient to maintain compliance with applicable governmental laws, regulations, permits and licenses.

## Employees

As of October 31, 2011, we had 1,509 employees, of which 672 were located in the United States and 837 were located in Mexico. We do not have a significant number of United States employees covered by a collective bargaining agreement. 710 of Calavo's Mexican employees are represented by a union. We consider the relationship with our employees to be good and we have never experienced a significant work stoppage. With the acquisition of RFG, we added 57 salaried employees and 193 hourly employees in the United States as of October 31, 2011.

The following is a summary of the number of salaried and hourly employees as of October 31, 2011.

Location	Salaried	Hourly	Total
United States	175	497	672
Mexico	127	710	837
<b>TOTAL</b>	<b>302</b>	<b>1,207</b>	<b>1,509</b>

**Item 1A. Risk Factors**

**Risks Related to Our Business**

*We are subject to increasing competition that may adversely affect our operating results.*

The market for avocados and processed avocado products is highly competitive and affects each of our businesses. Each of our businesses is subject to competitive pressures, including the following:

California avocados are impacted by an increasing volume of foreign grown avocados being imported into the United States. Recently, there have been significant plantings of avocados in Mexico, Chile, the Dominican Republic, Peru and other parts of the world, which have had, and will continue to have, the effect of increasing the volume of foreign grown avocados entering the United States market.

California avocados are subject to competition from other California avocado handlers. If we are unable to consistently pay California growers a competitive price for their avocados, these growers may choose to have their avocados marketed by alternate handlers.

Non-California sourced avocados and perishable food products are impacted by competitors operating in Mexico. Generally, handlers of Mexican grown avocados operate facilities that are substantially smaller than our facility in Uruapan, Mexico. If we are unable to pack and market a sufficient volume of Mexican grown avocados, smaller handlers will have a lower per unit cost and be able to offer Mexican avocados at a more competitive price to our customers.

Non-California sourced avocados and perishable food products are also subject to competition from other California avocado handlers that market Chilean grown avocados. If we are unable to consistently pay Chilean packers a competitive price for their avocados, these packers may choose to have their avocados marketed by alternate handlers.

*We are subject to the risks of doing business internationally.*

We conduct a substantial amount of business with growers and customers who are located outside the United States. We purchase avocados from foreign growers and packers, sell fresh avocados and processed avocado products to foreign customers, and operate a packinghouse and a processing plant in Mexico. In the most recent years, there has been an increase in organized crime in Mexico. This has not had an impact on our operations, but this does increase the risk of doing business in Mexico. We are also subject to regulations imposed by the Mexican government, and also to examinations by the Mexican tax authorities (See Note 8 in the consolidated financial statements). Significant changes to these government regulations and to assessments by the Mexican tax authorities can have a negative impact on our operations and operating results in Mexico. For additional information about our non-California sourced fruit, see the **Business** section included in this Annual Report.

Our current international operations are subject to a number of inherent risks, including:

Local economic and political conditions, including disruptions in trading and capital markets;

Restrictive foreign governmental actions, such as restrictions on transfers of funds and trade protection measures, including export duties and quotas and customs duties and tariffs; and

Changes in legal or regulatory requirements affecting foreign investment, loans, taxes, imports, and exports  
*Currency exchange fluctuations may impact the results of our operations.*

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

Currency exchange rate fluctuations, depending upon the nature of the changes, may make our domestic-sourced products more expensive compared to foreign grown products or may increase our cost of obtaining foreign-sourced products. Because we do not hedge against our foreign currency exposure, our business has increased susceptibility to foreign currency fluctuations.

*We and our growers are subject to the risks that are inherent in farming.*

Our results of operations may be adversely affected by numerous factors over which we have little or no control and that are inherent in farming, including reductions in the market prices for our products, adverse weather and growing conditions, pest and disease problems, and new government regulations regarding farming and the marketing of agricultural products.

*Our earnings are sensitive to fluctuations in market prices and demand for our products.*

Excess supplies often cause severe price competition in our industry. Growing conditions in various parts of the world, particularly weather conditions such as windstorms, floods, droughts and freezes, as well as diseases and pests, are primary factors affecting market prices because of their influence on the supply and quality of product.

Fresh produce is highly perishable and generally must be brought to market and sold soon after harvest. The selling price received for each type of produce depends on all of these factors, including the availability and quality of the produce item in the market, and the availability and quality of competing types of produce.

In addition, general public perceptions regarding the quality, safety or health risks associated with particular food products could reduce demand and prices for some of our products. To the extent that consumer preferences evolve away from products that we produce for health or other reasons, and we are unable to modify our products or to develop products that satisfy new consumer preferences, there will be a decreased demand for our products.

*Increases in commodity or raw product costs, such as fuel, packaging, and paper, could adversely affect our operating results.*

Many factors may affect the cost and supply of fresh produce, including external conditions, commodity market fluctuations, currency fluctuations, changes in governmental laws and regulations, agricultural programs, severe and prolonged weather conditions and natural disasters. Increased costs for purchased fruit have in the past negatively impacted our operating results, and there can be no assurance that they will not adversely affect our operating results in the future.

The price of various commodities can significantly affect our costs. Fuel and transportation cost is a significant component of the price of much of the produce that we purchase from growers, and there can be no assurance that we will be able to pass on to our customers the increased costs we incur in these respects.

The cost of paper is also significant to us because some of our products are packed in cardboard boxes. If the price of paper increases and we are not able to effectively pass these price increases along to our customers, then our operating income will decrease.

*We are subject to the risk of product liability claims.*

The sale of food products for human consumption involves the risk of injury to consumers. Such injuries may result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, storage, handling or transportation phases. While we are subject to governmental inspection and regulations and believe our facilities comply in all material respects with all applicable laws and regulations, we cannot be sure that consumption of our products will not cause a health-related illness in the future or that we will not be subject to claims or lawsuits relating to such matters. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential customers and our corporate and brand image.

*We are subject to possible changing USDA and FDA regulations which govern the importation of foreign avocados into the United States and the processing of processed avocado products.*

The USDA has established, and continues to modify, regulations governing the importation of avocados into the United States. Our permits that allow us to import foreign-sourced avocados into the United States generally are contingent on our compliance with these regulations. Our results of operations may be adversely affected if we are unable to comply with existing and modified regulations and are unable to secure avocado import permits in the future.

The FDA establishes, and continues to modify, regulations governing the production of processed avocado products, such as the new Food Safety Modernization Act, which implements mandatory preventive controls for food facilities and compliance with mandatory produce safety standards. Our results of operations may be adversely affected if we are unable to comply with these existing and modified regulations.

*The acquisition of other businesses could pose risks to our operating income.*

We intend to review acquisition prospects that would complement our business. While we are not currently a party to any agreement with respect to any acquisitions, we may acquire other businesses in the future. Future acquisitions by us could result in accounting charges, potentially dilutive issuances of equity securities, and increased debt and contingent liabilities, any of which could have a material adverse effect on our business and the market price of our common stock. Acquisitions entail numerous risks, including the assimilation of the acquired operations, diversion of management's attention to other business concerns, risks of entering markets in which we have limited prior experience, and the potential loss of key employees of acquired organizations. We may be unable to successfully integrate businesses or the personnel of any business that might be acquired in the future, and our failure to do so could have a material adverse effect on our business and on the market price of our common stock.

*Our ability to competitively serve our customers is a function of reliable and low cost transportation. Disruption of the supply of these services and/or significant increases in the cost of these services could impact our operating income.*

We use multiple forms of transportation to bring our products to market. They include ocean, truck, and air-cargo. Disruption to the timely supply of these services or dramatic increases in the cost of these services for any reason including availability of fuel for such services, labor disputes, or governmental restrictions limiting specific forms of transportation could have an adverse effect on our ability to serve our customers and consumers and could have an adverse effect on our financial performance.

*We depend on our infrastructure to have sufficient capacity to handle our annual production needs.*

We have an infrastructure that has sufficient capacity for our production needs, but if we lose machinery or facilities due to natural disasters or mechanical failure, we may not be able to operate at a sufficient capacity to meet our production needs. This could have a material adverse effect on our business, which could impact our results of operations and our financial condition.

*We depend on our key personnel and if we lose the services of any of these individuals, or fail to attract and retain additional key personnel, we may not be able to implement our business strategy or operate our business effectively.*

Our future success largely depends on the contributions of our management team. We believe that these individuals' expertise and knowledge about our industry and their respective fields and their relationships with other individuals in our industry are critical factors to our continued growth and success. We do not carry key person insurance. The loss of the services of any member of our senior management team could have a material adverse effect on our business and prospects. Our success also depends upon our ability to attract and retain additional qualified sales, marketing and other personnel.

*A portion of our workforce is unionized and labor disruptions could decrease our profitability.*

While we believe that our relations with our employees are good, we cannot assure you that we will be able to negotiate collective bargaining agreements on favorable terms, or at all, and without production interruptions, including labor stoppages. A prolonged labor dispute, which could include a work stoppage, could have a material adverse effect on the portion of our business affected by the dispute, which could impact our business, results of operations and financial condition.

*System security risks, data protection breaches, cyber-attacks and systems integration issues could disrupt our internal operations or services provided to customers, and any such disruption could reduce our expected revenue, increase our expenses, damage our reputation and adversely affect our stock price.*

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate or compromise our confidential information or that of third parties, create system disruptions or cause shutdowns. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack our products or otherwise exploit any security vulnerabilities of our products. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including bugs and other problems that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution or other critical functions.

Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and





resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales, lower margins or lost customers resulting from these disruptions have adversely affected in the past, and in the future could adversely affect, our financial results, stock price and reputation.

### **Risks Related to Our Common Stock**

*The value of our common stock may be adversely affected by market volatility.*

The trading price of our common stock fluctuates and may be influenced by many factors, including:

Our operating and financial performance and prospects;

The depth and liquidity of the market for our common stock;

Investor perception of us and the industry and markets in which we operate;

Our inclusion in, or removal from, any equity market indices;

Changes in earnings estimates or buy/sell recommendations by analysts; and

General financial, domestic, international, economic and other market conditions;

*Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from executing our growth strategy.*

The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on many factors, including:

Market acceptance of our products; and

The existence of opportunities for expansion.

If our capital resources are not sufficient to satisfy our liquidity needs, we may seek to sell additional equity or obtain additional debt financing. The sale of additional equity would result in dilution to our shareholders. Additional debt would result in increased expenses and could result in covenants that would restrict our operations. With the exception of our existing credit facility, we have not made arrangements to obtain additional financing. We may not be able to obtain additional financing, if required, in amounts or on terms acceptable to us, or at all.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

We lease our corporate headquarters building from Limoneira Company (Limoneira) located in Santa Paula, California. In addition, RFG leases their corporate office in Ranch Cordova, California. We have numerous facilities throughout the United States, and two facilities in Mexico. See the following table for a summary of our locations:

*United States Locations:*

*Packinghouses:*

<b>Leased or Owned:</b>	<b>City</b>	<b>State</b>	<b>Description</b>
Owned	Santa Paula	California	Handles California, Mexican, and Chilean avocados. The facility was purchased in 1955 and has had equipment improvements substantially equivalent to our Temecula facility. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Owned	Temecula	California	Handles California, Mexican, and Chilean avocados. The facility was built in 1985 and has been improved in capacity and efficiency since then. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.

**Operating and Distributing Facilities:**

<b>Leased or Owned:</b>	<b>City</b>	<b>State</b>	<b>Description</b>
Owned	Santa Paula	California	Operates as a ripening, storage and shipping facility for our fresh avocado operations. Additionally, it also serves to store and ship certain processed avocado products as well. Also, effective December 2005, we sort and pack certain diversified commodities as well. We believe that the annual capacity of this facility will be sufficient to pack and ripen, if necessary, the expected annual volume of avocados and specialty commodities delivered to us.
Leased	Swedesboro	New Jersey	Primarily ripens, sorts, packs, and ships avocados. Additionally, it also serves to store and ship certain tropical commodities as well. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Leased	Garland	Texas	Primarily ripens, sorts, packs and ships fresh avocados. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Leased	Nogales	Arizona	Primarily ripens, sorts, packs and ships, tomatoes, and other diversified commodities as well. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Leased	Hilo	Hawaii	Primarily sorts, packs, and ships papayas. We believe that the annual capacity will be sufficient to handle our budgeted annual production needs.
Owned	Hilo	Hawaii	Primarily provides irradiation services for produce grown in Hawaii. We believe that the annual capacity will be sufficient to handle our budgeted annual production needs.
Leased	St. Paul	Minnesota	CSL facility that produces salsa. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Leased	Houston	Texas	RFG facility that primarily processes cut fruits and vegetables, salads, sandwiches, and wraps. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.
Leased	Sacramento	California	RFG facility that primarily processes cut fruits and vegetables, salads, sandwiches, and wraps. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.

**Mexico Locations:****Packinghouse and Processing Facility:**

<b>Leased or Owned:</b>	<b>City</b>	<b>State</b>	<b>Description</b>
Owned	Uruapan	Michoacan	Our processing facility was constructed pursuant to our restructuring plan approved in February 2003 and has undergone improvements since then. We believe that the annual capacity of this facility will be sufficient to process our budgeted annual production needs.
Owned	Uruapan	Michoacan	Handles avocados delivered to us by Mexican growers. The facility, which was previously leased, was built in 1985 and has been improved in capacity and efficiency since then. We believe that the annual capacity of this facility will be sufficient to process our budgeted annual production needs.

**Item 3. Legal Proceedings**

From time to time, we become involved in legal proceedings that are related to our business operations. We are not currently a party to any legal proceedings that could have a material adverse effect upon our financial position or results of operations.

**Item 4. [Removed and Reserved.]**

**Executive Officers of the Registrant**

The following table sets forth the name, age and position of individuals who hold positions as executive officers of our company. There are no family relationships between any director or executive officer and any other director or executive officer of our company. Executive officers are elected by the Board of Directors and serve at the discretion of the Board.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Lecil E. Cole	72	Chairman of the Board, Chief Executive Officer and President
Arthur J. Bruno	61	Chief Operating Officer, Chief Financial Officer and Corporate Secretary
Robert J. Wedin	62	Vice President, Sales and Fresh Marketing
Alan C. Ahmer	63	Vice President, Processed Product Sales and Production
Michael A. Browne	53	Vice President, Fresh Operations

*Lecil E. Cole* has been a member of our board of directors since February 1982 and has served as Chairman of the Board since 1988. Mr. Cole has also served as our Chief Executive Officer and President since February 1999. He served as an executive of Safeway Stores from 1964 to 1976 and as Chairman of Central Coast Federal Land Bank from 1986 to 1996. Mr. Cole has served as Chairman and President of Hawaiian Sweet, Inc. and Tropical Hawaiian Products, Inc. since 1996. Mr. Cole farms approximately 4,400 acres in California on which avocados and cattle are produced and raised.

*Arthur J. Bruno* has served as our Chief Financial Officer and Corporate Secretary since October 2003. During fiscal 2004, Mr. Bruno also assumed the title and responsibilities of Chief Operating Officer. From 1988 to 2003, Mr. Bruno served as the president and co-founder of Maui Fresh International, Inc. Mr. Bruno is a Certified Public Accountant.

*Robert J. Wedin* has served as our Vice President since 1993. Mr. Wedin joined us in 1973 at our then Santa Barbara packinghouse. Beginning in 1990, Mr. Wedin served as a director of the California Avocado Commission for a period of ten years. Mr. Wedin currently is a board member of ProduceSupply.org and serves as a member of that organization's executive committee.

*Alan C. Ahmer* has served as our Vice President since 1989. Mr. Ahmer joined us in 1979 as a regional sales manager in our Calavo Foods business. In September 2003, Mr. Ahmer's new title became Vice-President, Calavo Foods Sales and Production.

*Michael A. Browne* has served as our Vice President since 2005. From 1997 until joining us, Mr. Browne served as the founder and co-owner of Fresh Directions International, a closely held multinational fresh produce company, which marketed fresh avocados from Mexico, Chile, and the Dominican Republic. Mr. Browne joined us in May 2005.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

In March 2002, our common stock began trading on the OTC Bulletin Board under the symbol CVGW. In July 2002, our common stock began trading on the Nasdaq National Market under the symbol CVGW and currently trades on the Nasdaq Global Select Market.

The following tables set forth, for the periods indicated, the high and low sales prices per share of our common stock as reported on the Nasdaq Global Select Market.

<b>Fiscal 2011</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 23.80	\$ 20.99
Second Quarter	\$ 23.55	\$ 19.70
Third Quarter	\$ 21.74	\$ 18.70
Fourth Quarter	\$ 22.88	\$ 17.90
<b>Fiscal 2010</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 18.58	\$ 14.99
Second Quarter	\$ 18.74	\$ 15.85
Third Quarter	\$ 21.06	\$ 15.25
Fourth Quarter	\$ 21.83	\$ 18.68

As of November 30, 2011, there were approximately 1,042 stockholders of record of our common stock.

During the year ended October 31, 2011, we did not issue any shares of common stock that were not registered under the Securities Act of 1933, except for the shares issued with the acquisition of RFG, which is discussed in Note 17 of the Consolidated Financial Statements. We did not repurchase any shares of our common stock.

**Dividend Policy**

Our dividend policy is to provide for an annual dividend payment, as determined by the Board of Directors. We anticipate paying dividends in the first quarter of our fiscal year.

On December 12, 2011, we paid a \$0.55 per share dividend in the aggregate amount of \$8,123,000 to shareholders of record on December 2, 2011.

On December 13, 2010, we paid a \$0.55 per share dividend in the aggregate amount of \$8,092,000 to shareholders of record on December 1, 2010.

**Item 6. Selected Financial Data****SELECTED CONSOLIDATED FINANCIAL DATA**

The following summary consolidated financial data (other than pounds information) for each of the years in the five-year period ended October 31, 2011 are derived from the audited consolidated financial statements of Calavo Growers, Inc.

Historical results are not necessarily indicative of results that may be expected in any future period. The following data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes thereto that are included elsewhere in this Annual Report.

	2011	Fiscal Year Ended October 31,			2007
		2010	2009	2008	
	(In thousands, except per share data)				
<b>Income Statement Data: (1)(2)</b>					
Net sales	\$ 522,529	\$ 398,351	\$ 344,765	\$ 361,474	\$ 302,984
Gross margin	42,861	51,530	44,533	33,181	31,772
Net income	10,954	17,640	13,611	7,725	7,330
Basic net income per share	\$ 0.75	\$ 1.22	\$ 0.94	\$ 0.54	\$ 0.51
Diluted net income per share	\$ 0.75	\$ 1.22	\$ 0.94	\$ 0.53	\$ 0.51
<b>Balance Sheet Data as of End of Period(1):</b>					
Working capital	\$ 8,642	\$ 14,801	\$ 12,052	\$ 15,413	\$ 16,334
Total assets	185,323	150,198	122,749	134,422	127,920
Current portion of long-term obligations	5,448	1,369	1,366	1,362	1,307
Long-term debt, less current portion	18,244	6,089	13,908	25,351	13,106
Shareholders' equity	95,780	88,257	69,487	65,517	74,003
<b>Cash Flows Provided by (Used in):</b>					
Operations	\$ 7,866	\$ 19,979	\$ 22,504	\$ 5,296	\$ 4,629
Investing(1)(3)	(20,907)	(9,502)	(6,497)	(7,454)	(7,950)
Financing	14,751	(10,288)	(16,641)	2,700	4,238
<b>Other Data:</b>					
Dividends declared per share	\$ 0.55	\$ 0.55	\$ 0.50	\$ 0.35	\$ 0.35
Net book value per share	\$ 6.52	\$ 6.04	\$ 4.79	\$ 4.52	\$ 5.15
Pounds of California avocados sold	84,913	170,650	53,000	92,165	91,038
Pounds of non-California avocados sold	156,973	123,700	162,950	123,740	135,723
Pounds of processed avocados products sold	18,811	21,651	21,259	22,274	22,556

- (1) Operating results for fiscal 2011 and balance sheet data as of end of period include the acquisition of RFG from the date of acquisition of June 1, 2011. For fiscal year 2011, RFG net sales, gross margins, and net income before taxes were \$56.7 million, \$4.3 million and \$1.2 million. We have paid the Sellers \$14.2 million in cash, net of adjustments based on RFG's financial condition at closing. See Note 17 to our consolidated financial statements for further discussion of this acquisition.
- (2) Operating results for fiscal 2011 and 2010 include the acquisitions of CSL from the date of acquisition of February 8, 2010. For fiscal year 2011, CSL's net sales and gross losses were \$1.8 million and \$0.3 million. Net loss was not significant. For fiscal year 2010, CSL's net sales and gross losses were \$0.8 million and \$0.4 million. Net loss was not significant. See Note 16 to our consolidated financial statements for further discussion of this acquisition.
- (3) For fiscal year 2011, we made a \$3.0 million infrastructure advances to Agricola Belher. For fiscal year 2010, we did not make an infrastructure advances to Agricola Belher. We collected \$1.2 million and \$1.8 million in fiscal years 2011 and 2010 related to infrastructure advances.

---

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion and analysis of our financial condition and results of operations together with Selected Consolidated Financial Data and our consolidated financial statements and notes thereto that appear elsewhere in this Annual Report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to, those presented under Risks related to our business included in Item 1A and elsewhere in this Annual Report.*

**Overview**

We are a leader in the distribution of avocados, prepared avocado products, and other perishable food products throughout the United States. Our history and expertise in handling California grown avocados has allowed us to develop a reputation of delivering quality products, at competitive prices, while providing competitive returns to our growers. This reputation has enabled us to expand our product offerings to include avocados sourced on an international basis, prepared avocado products, and other perishable foods. We report our operations in two different business segments: (1) Fresh products and (2) Calavo Foods. See Note 11 to our consolidated financial statements for further discussion.

Our Fresh products business grades, sizes, packs, cools, and ripens (if desired) avocados for delivery to our customers. We presently operate two packinghouses and three operating and distributing facilities that handle avocados across the United States. These packinghouses handled approximately 28% of the California avocado crop during the 2011 fiscal year, based on data obtained from the California Avocado Commission. Our operating results and the returns we pay our growers are highly dependent on the volume of avocados delivered to our packinghouses, as a significant portion of our costs is fixed. Our strategy calls for continued efforts to retain and recruit growers that meet our business model. Additionally, our Fresh products business also procures avocados grown in Chile, Mexico and Peru, as well as other various commodities, including tomatoes, papayas, and pineapples. We operate a packinghouse in Mexico that, together with certain co-packers that we frequently purchase fruit from, handled approximately 23% of the Mexican avocado crop bound for the United States market and approximately 5% of the avocados exported from Mexico to countries other than the United States during the 2010-2011 Mexican season, based on our estimates. Additionally, during the 2010-2011 Chilean avocado season, we handled approximately 5% of the Chilean avocado crop, based on our estimates. Our strategy is to increase our market share of currently sourced avocados to all accepted marketplaces. We believe our diversified avocado sources provides a level of supply stability that may, over time, help solidify the demand for avocados among consumers in the United States and elsewhere in the world. We believe our efforts in distributing our other various commodities, such as those shown above, complement our offerings of avocados. From time to time, we continue to explore distribution of other crops that provide reasonable returns to the business.

Our Calavo Foods business procures avocados, processes avocados into a wide variety of guacamole products, and distributes the processed product to our customers. All of our prepared avocado products are now cold pasteurized and include both frozen and fresh guacamole. Due to the long shelf-life of our frozen guacamole and the purity of our fresh guacamole, we believe that we are well positioned to address the diverse taste and needs of today's customers. Additionally, we also prepare various fresh salsa products and ready-to-eat produce and deli products. See Note 16 and Note 17 for additional information related to the acquisitions of CSL and RFG. Customers include both food service industry and retail businesses. We continue to seek to expand our relationships with major food service companies and develop alliances that will allow our products to reach a larger percentage of the marketplace.

Net sales of frozen products represented approximately 51% and 54% of total processed segment sales for the years ended October 31, 2011 and 2010. Net sales of our ultra high pressure products represented approximately 49% and 46% of total processed segment sales for the years ended October 31, 2011 and 2010.

The operating results of all of our businesses have been, and will continue to be, affected by quarterly and annual fluctuations and market downturns due to a number of factors, such as pests and disease, weather patterns, changes in demand by consumers, the timing of the receipt, reduction, or cancellation of significant customer orders, the gain or loss of significant customers, market acceptance of our products, our ability to develop, introduce, and market new products on a timely basis, availability and cost of avocados and supplies from growers and vendors, new product introductions by our competitors, change in the mix of avocados and Calavo Foods we sell, and general economic conditions. We believe, however, that we are currently positioned to address these risks and deliver favorable operating results for the foreseeable future.



### ***Recent Developments***

#### *Dividend Payment*

On December 12, 2011, we paid a \$0.55 per share dividend in the aggregate amount of \$8,123,000 to shareholders of record on December 2, 2011.

#### *Contingencies*

*Hacienda Suits* We are currently under examination by the Mexican tax authorities (Hacienda) for the tax years ended December 31, 2004, and 2005.

During the third quarter of fiscal year 2011, we received an update from our outside legal counsel regarding the examination of the tax year ended December 31, 2004. The appellate court upheld a lower court's decision on the two remaining items that we previously received an unfavorable ruling on. Based on discussions with our legal counsel, however, we believe that there were certain administrative errors made by the appellate court and that one of the outstanding tax issues will be resolved in favor of the Company, while the other remaining issue remains unsettled. The total assessment related to this examination is estimated to be approximately \$2.4 million. Based on discussion with our legal counsel, we believe that it is more likely than not that we will be successful in our defense and our tax position will be upheld based solely on the technical merits of the tax position. As such, no accrual has been recorded as of October 31, 2011.

In the first quarter of fiscal 2011, we received an assessment totaling approximately \$720,000 related to the tax year ended December 31, 2005. This assessment relates to depreciation expense taken on our 2005 tax return. Based on discussions with legal counsel, we believe that the Hacienda's position is without merit and do not believe that the resolution of this examination will have a significant impact on our results of operations.

The Hacienda has concluded their examination for the year ended December 31, 2007, noting no changes. In addition, during the fourth quarter of fiscal 2011, the examination of the tax year ended December 31, 2000 was settled by the court in our favor.

#### *RFG acquisition*

Calavo, CG Mergersub LLC (Newco), Renaissance Food Group, LLC (RFG) and Liberty Fresh Foods, LLC, Kenneth Catchot, Cut Fruit, LLC, James Catchot, James Gibson, Jose O. Castillo, Donald L. Johnson and RFG Nominee Trust (collectively, the Sellers) entered into an Agreement and Plan of Merger dated May 25, 2011 (the Acquisition Agreement), which sets forth the terms and conditions pursuant to which Calavo would acquire a 100 percent ownership interest in RFG. Pursuant to the Acquisition Agreement, Newco, a newly formed Delaware limited liability company and wholly-owned subsidiary of Calavo, merged with and into RFG, with RFG as the surviving entity. RFG is a fresh-food company that produces, markets, and distributes nationally a portfolio of healthy, high quality products for consumers via the retail channel. The acquisition closed on June 1, 2011.

Pursuant to the Acquisition Agreement and based on the fair value of Calavo's common stock on June 1, 2011, we agreed to pay on the closing date approximately \$16 million, payable in a combination of cash and shares of unregistered Calavo common stock, as described below in greater detail. In addition, if RFG attains specified financial goals for certain 12-month periods prior to the fifth anniversary of the closing, we have agreed to pay RFG up to an additional approximate \$84 million in earn-out consideration, based on the fair value of Calavo's common stock on June 1, 2011, payable in cash and shares of unregistered Calavo common stock, as described below in greater detail. As a result, if the maximum earn-out consideration is earned, the total consideration payable to RFG pursuant to the Acquisition Agreement could be approximately \$100 million. The fair value of consideration is currently being determined by the Company and will be less than the maximum consideration noted above.

The Acquisition Agreement contains covenants, representations and warranties of Calavo and RFG that are customary for transactions of this type. Prior to entering into the Acquisition Agreement, and other than with respect to the Acquisition Agreement, neither we, nor any of our officers, directors, or affiliates had any material relationship with RFG or the Sellers.

We have paid the Sellers \$14.2 million in cash, net of adjustments based on RFG's financial condition at closing, and issued the Sellers 43,000 shares of unregistered Calavo common stock.

If RFG's earnings before interest, taxes, depreciation and amortization (EBITDA) for any 12-month period commencing after the closing date and ending prior to the fifth anniversary of the closing date, are equal to or greater than \$8 million, and RFG has concurrently reached a corresponding revenue achievement, we have agreed to pay the Sellers \$5 million in cash and to issue to the Sellers 827,000 shares of unregistered Calavo common stock, representing total consideration of approximately \$24 million. This



represents the maximum that can be awarded pursuant to the 1<sup>st</sup> earn-out payment. In the event that the maximum EBITDA and revenue achievements have not been reached within five years after the closing date, but RFG's 12-month EBITDA during such period equals or exceeds \$6 million and RFG has concurrently reached a corresponding revenue achievement, a sliding-scale, as defined, will be used to calculate payment. The minimum amount to be paid in the sliding-scale related to the 1<sup>st</sup> earn-out payment is approximately \$14 million, payable in both cash and shares of unregistered Calavo common stock. RFG has five years to achieve any consideration pursuant to the 1<sup>st</sup> earn-out payment.

Assuming that the maximum earn-out payment has been achieved in the 1<sup>st</sup> earn-out payment, if RFG's EBITDA, for a 15-month period commencing after the closing date and ending prior to the fifth anniversary of the closing date, is equal to or greater than \$15 million for each of the 12-month periods therein, and RFG has concurrently reached a corresponding revenue achievement, we have agreed to pay the Sellers \$50 million in cash and to issue to the Sellers 434,783 shares of unregistered Calavo common stock, representing total consideration of approximately \$60 million. This represents the maximum that can be awarded pursuant to the 2<sup>nd</sup> earn-out payment. In the event that the maximum EBITDA and revenue achievements have not been reached within five years after the closing date, but RFG's 12-month EBITDA during such period equals or exceeds \$10 million, and RFG has concurrently reached a corresponding revenue achievement, a sliding-scale will be used to calculate payment. The minimum amount to be paid in the sliding-scale related to the 2<sup>nd</sup> earn-out payment is approximately \$27 million, payable in both cash and shares of unregistered Calavo common stock. RFG has five years to achieve any consideration pursuant to the 2<sup>nd</sup> earn-out payment.

The following table summarizes the estimated fair values of the assets acquired, liabilities assumed, and equity issued at the date of acquisition (in thousands). We obtained third-party valuations for the long-term assets acquired and incurred approximately \$0.3 million in acquisition costs, which have been expensed in selling, general and administrative expenses in the period incurred. For the two months ended July 31, 2011, since the acquisition of RFG, total selling, general and administrative expenses for RFG was \$1.2 million.

**At June 1, 2011**

Current assets	\$ 10,491
Property, plant, and equipment	4,580
Goodwill	14,264
Other assets	117
Intangible assets	8,690
Total assets acquired	38,142
Current liabilities	(12,292)
Contingent consideration	(7,774)
Long-term obligations	(2,894)
Additional paid-in capital	(952)
Net non-cash assets acquired	\$ 14,230

Of the \$8,690,000 of intangible assets, \$7,400,000 was assigned to customer relationships with a life of 8 years, \$920,000 to trademarks and trade names with a life of 8 years, \$200,000 to non-competition agreements with a life of 5 years, and \$170,000 to trade secrets with a life of 3 years. As discussed above, we will be required to pay a maximum of approximately \$100 million if RFG achieves specified revenue targets. The fair value of this contingent consideration was determined based on a probability weighted method, which incorporates management's forecasted revenue, and the likelihood of the revenue targets being achieved.

*Term Revolving Credit Agreements and Term Loan Agreements*

Effective May 31, 2011, the Company and Farm Credit West, PCA (FCW), entered into a Term Revolving Credit Agreement (Revolving Agreement). Under the terms of the Revolving Agreement, we are advanced funds for working capital purposes, the purchase and installation of capital items, as well as other corporate needs of the Company. Total credit available under the borrowing agreement is \$40 million, up from \$30 million, and expires on February 1, 2016. This increase was at our request and not due to any immediate cash flows needs.

Effective September 30, 2011, the Company and Bank of America, N.A. (BoA), entered into an agreement, Amendment No. 4 to Loan Agreement (the Agreement), which amended our existing credit facility with BoA. Under the terms of the Agreement, we are advanced funds primarily for working capital purposes. Total credit available under the borrowing agreement is now \$25 million, up from \$15 million and now expires on February 1, 2016. This increase was at our request and not due to any immediate cash flows needs.

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

In addition, the Agreement includes a variable rate term loan in the amount of approximately \$7.1 million dollars. These proceeds were used to retire approximately 50% of the outstanding balance (as of September 30, 2011) of the term loan owed to FCW related to the purchase of RFG (see discussion below). This effectively split the funding of the amounts due at closing for that acquisition between both banks. The credit facility and term loan contain various financial covenants, the most significant relating to Tangible Net Worth (as defined), Fixed Charge Coverage Ratio (as defined) and Current Ratio (as defined).

Effective May 31, 2011, the Company and FCW entered into a Term Loan Agreement (Term Agreement). Under the terms of the Term Agreement, we were advanced \$15 million for the purchase of Renaissance Food Group, LLC. Under the terms of the Term Agreement, we are required to make 60 monthly principal and interest payments, in the amount billed, beginning on July 1, 2011 and pay the account in full as of June 1, 2016. There is no prepayment penalty associated with this Term Agreement. Approximately 50% of the outstanding balance was paid off with the proceeds from the term loan from BoA (see discussion above).

The Term Agreement contain various financial covenants, the most significant relating to tangible net worth (as defined), Fixed Charge Coverage Ratio (as defined) and Current Ratio (as defined).

### **Critical Accounting Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we re-evaluate all of our estimates, including those related to the areas of customer and grower receivables, inventories, useful lives of property, plant and equipment, promotional allowances, income taxes, retirement benefits, and commitments and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions as additional information becomes available in future periods.

Management has discussed the development and selection of critical accounting estimates with the Audit Committee of the Board of Directors and the Audit Committee has reviewed our disclosure relating to critical accounting estimates in this Annual Report.

We believe the following are the more significant judgments and estimates used in the preparation of our consolidated financial statements.

*Promotional allowances.* We provide for promotional allowances at the time of sale, based on our historical experience. Our estimates are generally based on evaluating the relationship between promotional allowances and gross sales. The derived percentage is then applied to the current period's sales revenues in order to arrive at the appropriate debit to sales allowances for the period. The offsetting credit is made to accrued liabilities. When certain amounts of specific customer accounts are subsequently identified as promotional, they are written off against this allowance. Actual amounts may differ from these estimates and such differences are recognized as an adjustment to net sales in the period they are identified. A 1% change in the derived percentage for the entire year would impact results of operations by approximately \$0.5 million.

*Income Taxes.* We account for deferred tax liabilities and assets for the future consequences of events that have been recognized in our consolidated financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and tax bases of our assets and liabilities result in a deferred tax asset, we perform an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

As a multinational corporation, we are subject to taxation in many jurisdictions, and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. If we ultimately determine that the payment of these liabilities will be unnecessary, the liability will be reversed and we will recognize a tax benefit during the period in which it is determined the liability no longer applies. Conversely, we record additional tax charges in a period in which it is determined that a recorded tax liability is less than the ultimate assessment is expected to be.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations themselves are subject to change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from management's estimates, which could result in the need to record additional tax liabilities or potentially reverse previously recorded tax liabilities.

*Goodwill and acquired intangible assets.* Goodwill, defined as unidentified asset(s) acquired in conjunction with a business acquisition, is tested for impairment on an annual basis and between annual tests whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill is tested at the reporting unit level, which is defined as an operating segment or one level below the operating segment. Goodwill impairment testing is a two-step process. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and the second step of the impairment test would be unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test must be performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to that excess. Goodwill impairment testing requires significant judgment and management estimates, including, but not limited to, the determination of (i) the number of reporting units, (ii) the goodwill and other assets and liabilities to be allocated to the reporting units and (iii) the fair values of the reporting units. The estimates and assumptions described above, along with other factors such as discount rates, will significantly affect the outcome of the impairment tests and the amounts of any resulting impairment losses. We performed our annual assessment of goodwill and determined that no impairment existed as of October 31, 2011.

*Allowance for accounts receivable.* We provide an allowance for estimated uncollectible accounts receivable balances based on historical experience and the aging of the related accounts receivable. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

## Results of Operations

The following table sets forth certain items from our consolidated statements of income, expressed as percentages of our total net sales, for the periods indicated:

	Year ended October 31,		
	2011	2010	2009
Net sales	100.0%	100.0%	100.0%
Gross margins	8.2%	12.9%	12.9%
Selling, general and administrative	4.7%	5.8%	6.6%
Operating income	3.5%	7.1%	6.3%
Interest income	0.0%	0.1%	0.1%
Interest expense	(0.2)%	(0.2)%	(0.3)%
Other income, net	0.0%	0.1%	0.1%
Net income	2.1%	4.4%	3.9%

### Net Sales

We believe that the fundamentals for our products continue to be favorable. Firstly, Americans are eating more avocados. Over the last 10 years, United States (U.S.) consumption of avocados has expanded at a compounded annual growth rate of 7% and we do not anticipate this growth significantly changing. We believe that the healthy eating trend that has been developing in the United States contributes to such growth, as avocados, which are cholesterol and sodium free, are dense in fiber, vitamin B6, antioxidants, potassium, folate, and contain unsaturated fat, which help lower cholesterol. Also, a growing number of research studies seem to suggest that phytonutrients, which avocados are rich in, help fight chronic illnesses, such as heart disease and cancer.

Additionally, we believe that the demographic changes in the U.S. will greatly impact the consumption of avocados and avocado-based products. The Hispanic community currently accounts for approximately 16% of the U.S. population, and the total number of Hispanics is estimated to triple by the year 2050. Avocados are considered a staple item purchased by Hispanic consumers, as the per-capita avocado consumption in Mexico is estimated to be more than seven-fold that of the U.S.

We anticipate avocado products will further penetrate the United States marketplace driven by year-round availability of fresh avocados due to imports, a rapid growing Hispanic population, and the promotion of the health benefits of avocados. As the largest marketer of avocado products in the United States, we believe that we are well positioned to leverage this trend and to grow all segments of our business. Additionally, we also believe that avocados and avocado based products will further penetrate other marketplaces that we currently operate in, as interest in avocados continues to expand.

In October 2002, the USDA announced the creation of a Hass Avocado Board to promote the sale of Hass variety avocados in the U.S. marketplace. This board provides a basis for a unified funding of promotional activities based on an assessment on all avocados



## Edgar Filing: CALAVO GROWERS INC - Form 10-K

sold in the U.S. marketplace. The California Avocado Commission, which receives its funding from California avocado growers, has historically shouldered the promotional and advertising costs supporting avocado sales. We believe that the incremental funding of promotional and advertising programs in the U.S. will, in the long term, positively impact average selling prices and will favorably impact our avocado businesses. During fiscal 2011, 2010 and 2009, on behalf of avocado growers, we remitted approximately \$1.8 million, \$2.0 million and \$0.6 million to the California Avocado Commission. During fiscal 2011, 2010 and 2009, we remitted approximately \$4.8 million, \$5.6 million and \$3.8 million to the Hass Avocado Board related to avocados.

Additionally, through the acquisition of RFG, we substantially expanded and accelerated the company's presence in the fast-growing refrigerated fresh packaged foods category through an array of retail product lines for produce, deli, meat and food service departments.

We also believe that our diversified fresh products, specifically tomatoes and papayas, are positioned for future growth and expansion.

The tomato is the fourth most popular fresh-market vegetable behind potatoes, lettuce, and onions in the United States. Although stabilizing in the first decade of the 2000s, annual average fresh-market tomato consumption remains well above that of the previous decade. Over the past few decades, per capita use of tomatoes has been on the rise due to the enduring popularity of salads, salad bars, and bacon-lettuce-tomato and submarine sandwiches. Perhaps of greater importance has been the introduction of improved tomato varieties, heightened consumer interest in a wider range of tomatoes, a surge of new immigrants who eat vegetable-intensive diets, and expanding national emphasis on health and nutrition.

Papayas have become more popular as the consumption in the United States has more than doubled in the past decade. Papayas have high nutritional benefits. They are rich in Anti-oxidants, the B vitamins, folate and pantothenic acid; and the minerals, potassium and magnesium; and fiber. Together, these nutrients promote the health of the cardiovascular system and also provide protection against colon cancer.

Sales of products and related costs of products sold are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectability is reasonably assured. Service revenue, including freight, ripening, storage, bagging and palletization charges, is recorded when services are performed and sales of the related products are delivered. We provide for sales returns and promotional allowances at the time of shipment, based on our experience.

The following tables set forth sales by product category and sales incentives, by segment (dollars in thousands):

	Year ended October 31, 2011			Year ended October 31, 2010		
	Fresh products	Calavo Foods <sup>(1)</sup>	Total	Fresh products	Calavo Foods	Total
Third-party sales:						
Avocados	\$ 376,104	\$	\$ 376,104	\$ 287,808	\$	\$ 287,808
Tomatoes	23,903		23,903	41,595		41,595
Papayas	13,245		13,245	11,278		11,278
Pineapples	4,278		4,278	3,838		3,838
Other Fresh products	3,276		3,276	3,617		3,617
Calavo Foods - food service		37,431	37,431		40,654	40,654
Calavo Foods - retail and club <sup>(1)</sup>		73,924	73,924		17,473	17,473
<b>Total gross sales</b>	<b>420,806</b>	<b>111,355</b>	<b>532,161</b>	<b>348,136</b>	<b>58,127</b>	<b>406,263</b>
Less sales incentives	(148)	(9,484)	(9,632)	(84)	(7,828)	(7,912)
<b>Net sales</b>	<b>\$ 420,658</b>	<b>\$ 101,871</b>	<b>\$ 522,529</b>	<b>\$ 348,052</b>	<b>\$ 50,299</b>	<b>\$ 398,351</b>

	Year ended October 31, 2010			Year ended October 31, 2009		
	Fresh products	Calavo Foods	Total	Fresh products	Calavo Foods	Total
Third-party sales:						
Avocados	\$ 287,808	\$	\$ 287,808	\$ 259,558	\$	\$ 259,558
Tomatoes	41,595		41,595	14,067		14,067
Papayas	11,278		11,278	9,118		9,118



Edgar Filing: CALAVO GROWERS INC - Form 10-K

Pineapples	3,838		3,838	13,341		13,341
Other Fresh products	3,617		3,617	4,219		4,219
Calavo Foods - food service		40,654	40,654		36,493	36,493
Calavo Foods - retail and club		17,473	17,473		15,554	15,554
Total gross sales	348,136	58,127	406,263	300,303	52,047	352,350
Less sales incentives	(84)	(7,828)	(7,912)	(68)	(7,517)	(7,585)
Net sales	\$ 348,052	\$ 50,299	\$ 398,351	\$ 300,235	\$ 44,530	\$ 344,765

- (1) Includes net sales of \$56.7 million in fiscal 2011 related to the recently acquired business Renaissance Food Group, LLC (RFG). See Note 17 for additional information related to the acquisition of RFG.

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

Net sales to third parties by segment exclude inter-segment sales and cost of sales. For fiscal years 2011, 2010, and 2009, inter-segment sales and cost of sales for Fresh products totaling \$15.8 million, \$11.7 million and \$14.1 million were eliminated. For fiscal years 2011, 2010, and 2009, inter-segment sales and cost of sales for Calavo Foods totaling \$34.3 million \$9.4 million, and \$7.8 million were eliminated.

The following table summarizes our net sales by business segment:

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
<b>Net sales:</b>					
Fresh products	\$ 420,658	20.9%	\$ 348,052	15.9%	\$ 300,235
Calavo Foods <sup>(1)</sup>	101,871	102.5%	50,299	13.0%	44,530
<b>Total net sales</b>	<b>\$ 522,529</b>	<b>31.2%</b>	<b>\$ 398,351</b>	<b>15.5%</b>	<b>\$ 344,765</b>
<b>As a percentage of net sales:</b>					
Fresh products	80.5%		87.4%		87.1%
Calavo Foods	19.5%		12.6%		12.9%
	100.0%		100.0%		100.0%

(1) Includes net sales of \$56.7 million in fiscal 2011 related to recently acquired RFG. See Note 17 in the Notes to the Consolidated Condensed Financial Statements for additional information related to the acquisition of RFG.

Net sales for the year ended October 31, 2011, when compared to 2010, increased by \$124.2 million, or 31.2%, principally as a result of an increase in both our Fresh products and Calavo Foods segments.

While the procurement of fresh avocados related to our Fresh products segment is very seasonal, our Calavo Foods business is generally not subject to a seasonal effect. The significant increase in sales of our Calavo Foods business for the year ended October 31, 2011, when compared to 2010, is primarily related to the sales of our newly acquired business, RFG, on June 1, 2011. This increase was partially offset, however, by a decrease in sales related to our guacamole products. This was primarily due to a decrease in total pounds of product sold.

Net sales to third parties by segment exclude value-added services billed by our Uruapan packinghouse and our Uruapan processing plant to the parent company. All intercompany sales are eliminated in our consolidated results of operations.

### *Fresh products*

Fiscal 2011 vs. Fiscal 2010:

Net sales delivered by the business increased by approximately \$72.6 million, or 20.9%, from fiscal 2010 to 2011. This increase in Fresh product sales during fiscal 2011 was primarily related to an increase in sales of Mexican sourced avocados. This increase was partially offset, however, by decreased sales from tomatoes and California sourced avocados. See details below.

Sales of Mexican sourced avocados increased \$98.1 million, or 81.9%, for the year ended October 31, 2011, when compared to the same prior year period. The increase in Mexican sourced avocados was due to a combination of an increase in pounds sold and an increase in the sales price per carton. Mexican sourced avocados sales reflect an increase in 33.8 million pounds of avocados sold, or 29.1%, when compared to the same prior year period. We attribute most of this increase in volume to the significant decrease in the California avocado crop (see below). In addition, the sales price per carton increased by approximately 40.9%. We attribute this increase primarily to a lower overall volume of avocados in the marketplace, as well as a steady to higher demand for avocados when compared to the same prior year period.

Mexican grown avocados are primarily sold in the U.S., Japanese, and/or European marketplace. We anticipate that sales of Mexican grown avocados will decrease in fiscal 2011, due to a higher volume of avocados in the marketplace which will decrease overall sales prices.

Partially offsetting the overall increase was a decrease in sales of tomatoes of \$17.7 million, or 42.5%, for the year ended October 31, 2011, when compared to the same prior year period. The decrease in sales for tomatoes was primarily due to a decrease in volume by 36.1% when

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

compared to the same prior year period. This significant decrease was mainly due to a freeze in Mexico that resulted in less units in the marketplace. In addition, tomatoes had a decrease in the average selling price per carton of approximately 10.1%, when compared to the same prior year period.

Sales of California sourced avocados decreased \$10.3 million, or 6.4%, for the year ended October 31, 2011, when compared to the same prior year period. The decrease in California sourced avocados was due to a decrease of 75.8 million pounds of avocados

sold or 47.2%, when compared to the same prior year period. We attribute most of this decrease in volume to the smaller California avocado crop in the current year. Partially offsetting this decrease, California sourced avocado sales reflect an increase in the sales price per carton of approximately 77.1%, when compared to the same prior year period. We attribute this increase primarily to a lower overall volume of avocados in the marketplace, as well as a higher demand for avocados, when compared to the same prior year period.

California avocados are primarily sold in the U.S. marketplace. We anticipate that sales volume of California grown avocados will increase in fiscal 2011, due to a larger expected avocado crop.

Fiscal 2010 vs. Fiscal 2009:

Net sales delivered by the business increased by approximately \$47.8 million, or 15.9%, from fiscal 2009 to 2010. This increase was primarily related to an increase in sales of California sourced avocados (due primarily to a significant increase in cartons sold) as well as tomatoes (due primarily to an increase in units sold and an increase in per unit sales price). These increases were partially offset, however, by decreased sales from Mexican sourced avocados (due primarily to a decrease in cartons sold and a decrease in sales price per unit), pineapples (due primarily to a decrease in units sold), as well as Chilean sourced avocados (due primarily to a decrease in cartons sold and a decrease in sales price per unit).

Sales of California sourced avocados increased \$87.2 million, or 119.1%, for fiscal year 2010, when compared to the same prior year period. California sourced avocado sales reflect a 222.0% increase in pounds of avocados sold, when compared to the same prior year period. The increase in California sourced avocados was primarily related to the larger California avocado crop for fiscal 2010. Our market share of California avocados decreased to 30% for fiscal year 2010, when compared to a 31% market share for the same prior year period. The average selling price, on a per carton basis, of California avocados sold decreased approximately 31.8% when compared to the same prior year period. We attribute this decrease to the higher overall volume of California avocados in the marketplace. California avocados are primarily sold in the U.S. marketplace. We anticipate that sales of California grown avocados will significantly decrease in fiscal 2011, due to a significantly smaller expected avocado crop.

Sales of tomatoes increased \$27.5 million, or 195.7%, for fiscal year 2010, when compared to the same prior year period. The increase in sales for tomatoes is due to an increase in the average per carton selling price of 128.1%, in addition to a 29.6% increase in the number of units sold. We attribute most of the increase in the per carton selling price to the lower volume of tomatoes in the U.S. marketplace (due to weather conditions in Florida) for fiscal 2010, as compared to the same prior period. We attribute most of the increase in units sold to growers supplying us with significantly more volume, due primarily to market conditions. We do not anticipate a significant change in the sales of tomatoes for fiscal 2011, based on current weather conditions in Florida.

Partially offsetting such increases described above was a decrease in sales of Mexican sourced avocados, which decreased \$49.0 million, or 29.0%, for fiscal year 2010, when compared to the same prior year period. The decrease in Mexican sourced avocados was primarily related to the decrease in the volume of Mexican fruit sold by 29.1 million pounds, or 20.1%, when compared to the same prior year period. In addition, Mexican sourced avocados had a decrease in the average selling price per carton of approximately 11.2%, when compared to the same prior year period. As mentioned above, we attribute most of this decrease in volume and price to the increase in volume of California sourced avocados in the U.S. marketplace during fiscal year 2010, as compared to the same prior year period.

Sales of pineapples decreased \$9.5 million, or 71.2%, when compared to the same prior year period. The decrease in sales for pineapples was primarily due to a decrease in volume by 73.2% when compared to the same prior year period. This decrease is primarily related to the expiration of our agreement with Maui Pineapple Company (Maui) in December 2009, which was primarily related to Maui exiting the pineapple business. We do not anticipate a significant change in pineapple sales during fiscal 2011.

Sales of Chilean sourced avocados decreased \$9.5 million, or 57.2% for fiscal year 2010, when compared to the same prior year period. The volume of Chilean fruit sold decreased by approximately 7.8 million pounds, or 51.1%, when compared to the same prior year period. This decrease was primarily related to the smaller Chilean avocado crop in fiscal year 2010 when compared to the crop in fiscal year 2009. In addition to the increase in pounds sold, our average selling prices, on a per carton basis, experienced a decrease of 12.4% for fiscal 2010, when compared to the same prior period. We attribute most of this decrease in volume and price to the increase in volume of California sourced avocados in the U.S. marketplace during fiscal year 2010, as compared to the same prior year period.

### *Calavo Foods*

#### Fiscal 2011 vs. Fiscal 2010:

Calavo Foods sales for the year ended October 31, 2011, when compared to the same period for fiscal 2010, increased \$51.6 million, or 102.5%. The significant increase in sales of our Calavo Foods business for the year ended October 31, 2011, when compared to the corresponding prior year period, is due to addition of the recently acquired RFG, which contributed approximately \$56.7 million for the year ended October 31, 2011, when compared to the same prior year period. This increase was partially offset, by a decrease in sales related to our prepared guacamole products. This decrease was primarily related to a 13.1% decrease in total pounds sold. The decrease in pounds sold primarily related to a decrease in the pounds sold of our frozen guacamole products, which decreased approximately 18.5%, and a decrease in the sale of our refrigerated guacamole products (formerly high-pressure, see below), which decreased approximately 6.7% when compared to the same prior year period. In an effort to enhance product safety and quality in the segment, we implemented changes in our food safety standards that added steps in our manufacturing process during the first quarter of fiscal 2011. As a result, there was a temporary disruption, which adversely impacted supply and sales in the segment. In addition, sales were impacted, as substantially all guacamole products are now high-pressured for food safety purposes and that the packaging requested from certain customers does not allow for high pressured products. This resulted in the discontinuance of sales to some high-volume, low-margin customers. The net average selling price increased 4.9% during the year ended October 31, 2011, when compared to the same prior year period. This increase is primarily related to a change in sales mix and a price increase that went into effect in July 2011 on substantially all products. We believe that retail sales, as a percentage of total net Calavo Foods sales, will increase in the future.

#### Fiscal 2010 vs. Fiscal 2009:

Net sales increased by approximately \$5.8 million, or 13.0% for fiscal 2010, when compared to the same prior period. This increase is primarily related to a 1.8% increase in total pounds sold for fiscal year 2010 and an increase in the average net selling price per pound of 2.4%, when compared to the same prior year period. The increase in average net selling price is primarily related to a change in sales mix. In addition, the recently acquired CSL contributed approximately \$0.8 million for fiscal year 2010.

We currently have two 215L ultra high pressure machines located in Uruapan. Starting in fiscal year 2010, we have begun using the two 215L ultra high pressure machines to pressurize all product lines within Calavo Foods (including frozen products). This has caused our operating capacity for these two 215L ultra high pressure machines to be approximately 80% as of October 31, 2010. Our estimated combined operating capacity for these two machines was approximately 59% as of October 31, 2009. Net sales of our ultra high pressure (fresh) products, typically sold to retail customers, represented approximately 46% and 47% of total processed segment sales for the years ended October 31, 2010 and 2009.

We believe that these ultra high pressure machines will enable our company to deliver the widest available array of prepared avocado and other products to our customers. Consequently, we believe that we are positioned to expand our ultra high pressure product line to include more avocado related products, mangoes and other readily available fruit products. We anticipate a marginal increase in sales related to our Calavo Foods.

### ***Gross Margins***

Our cost of sales consists predominantly of fruit costs, packing materials, freight and handling, labor and overhead (including depreciation) associated with preparing food products, and other direct expenses pertaining to products sold. Gross margins decreased by approximately \$8.7 million, or 16.8%, for the year ended October 31, 2011, when compared to the same period for fiscal 2010. This decrease was attributable to both our Fresh products and our Calavo Foods segments.

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

The following table summarizes our gross margins and gross profit percentages by business segment:

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
<b>Gross Margins:</b>					
Fresh products	\$ 31,838	(17.2%)	\$ 38,443	32.2%	\$ 29,076
Calavo Foods <sup>(1)</sup>	11,023	(15.8%)	13,087	(15.3%)	15,457
<b>Total gross margins</b>	<b>\$ 42,861</b>	<b>(16.8%)</b>	<b>\$ 51,530</b>	<b>15.7%</b>	<b>\$ 44,533</b>
<b>Gross profit percentages:</b>					
Fresh products	7.6%		11.0%		9.7%
Calavo Foods	10.8%		26.0%		34.7%
Consolidated	8.2%		12.9%		12.9%

(1) Includes gross margin of \$4.3 million in fiscal 2011 related to recently acquired RFG. See Note 17 in the Notes to the Consolidated Condensed Financial Statements for additional information related to the acquisition of RFG.

### *Fresh products*

#### Fiscal 2011 vs. Fiscal 2010:

During fiscal year 2011, as compared to the same prior year period, the decrease in our Fresh products segment gross margin percentage was primarily related to higher costs associated with California sourced avocados. This was caused by fewer pounds being sold by approximately 47.2%, increasing our per pound costs, which, as a result, negatively impacted gross margins. This decrease was primarily related to the smaller California avocado crop. Contributing to the decrease in the gross margin percentage was higher Mexican sourced avocado fruit costs year-over-year by approximately 55.2%. We were able to increase the selling prices of Mexican sourced avocados, but not at the same rate at which fruit costs increased. We attribute this increase primarily to a lower overall volume of avocados in the marketplace, in conjunction with a steady-to-higher demand for avocados, when compared to the same prior year period. The combined effect of these negatively impacted gross margins. In addition, despite the recent strengthening of the U.S. Dollar to Mexican Peso exchange rate, on a year to date basis, the U.S. Dollar to Mexican Peso exchange rate weakened during fiscal 2011, when compared to the same prior period. All of these combined had the effect of increasing our per pound costs, which, as a result, negatively impacted gross margins.

Any significant fluctuations in the exchange rate between the U.S. Dollar and the Mexican Peso may have a material impact on future gross margins for our Fresh and Calavo Foods segments.

The gross margin and/or gross profit percentage for consignment sales, including certain Chilean avocados and tomatoes, are dependent on the volume of fruit we handle, the average selling prices, and the competitiveness of the returns that we provide to third-party growers/packers. The gross margin we earn is generally based on a commission agreed to with each party, which usually is a percent of the overall selling price. Although we generally do not take legal title to such avocados and perishable products, we do assume responsibilities (principally assuming credit risk, inventory loss and delivery risk, and limited pricing risk) that are consistent with acting as a principal in the transaction. Accordingly, our results of operations include sales and cost of sales from the sale of avocados and perishable products procured under consignment arrangements. For fiscal years 2011, we generated gross margins of \$3.5 million from the sale of fresh produce products that were packed by third parties. This is a \$2.5 million decrease in gross margin for consigned sales compared to previous year. This decrease is due to a decrease in tomato sales of 42.5% for fiscal 2011, when compared to the same prior year period. The decrease in sales for tomatoes was primarily due to a decrease in volume by 36.1% when compared to the same prior year period. This significant decrease was mainly due to a freeze in Mexico that resulted in less units. In addition, tomatoes had a decrease in the average selling price per carton of approximately 10.1%, when compared to the same prior year period.

#### Fiscal 2010 vs. Fiscal 2009:

During fiscal year 2010, as compared to the same prior year period, the increase in our Fresh products segment gross margin and gross margin percentage was primarily related to an increase in the gross margin percentage for California avocados. This was due to a significant increase in the volume of California avocados sold, which increased 222.0%. This increase was primarily related to the larger California avocado crop. This had the effect of decreasing our per pound costs, which, as a result, positively impacted gross margins. Partially offsetting this increase in gross margin was a decrease in margins for Mexican sourced avocados due to a similar fruit cost year-over-year, but at a lower selling price, for

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

Mexican sourced avocados. We believe this decrease in selling price is primarily related to a significantly higher volume of non-Mexican fruit in the U.S marketplace, which put downward pressure on carton selling prices. As a result of this downward pressure, we were not able to purchase Mexican sourced fruit as effectively (in

relation to the selling price) as we were able to in the same prior year period. Additionally, we experienced a decrease in the volume of Mexican sourced avocados sold by 29.1 million pounds or 20.1%, which we believe was primarily related to the aforementioned pricing pressure. In addition, the U.S. Dollar to Mexican Peso exchange rate weakened during fiscal 2010, when compared to the same prior period. All of these combined had the effect of increasing our per pound costs, which, as a result, negatively impacted gross margins.

As mentioned above, the weakening of the U.S. Dollar compared to the Mexican Peso negatively affected our gross margin for fiscal year 2010. Any significant fluctuations in the exchange rate between the U.S. Dollar and the Mexican Peso may have a material impact on future gross margins for our fresh and Calavo Foods segments.

The gross margin and gross profit percentage for consignment sales, including certain Chilean avocados and tomatoes, are dependent on the volume of fruit we handle, the average selling prices, and the competitiveness of the returns that we provide to third-party growers/packers. The gross margin we earn is generally based on a commission agreed to with each party, which usually is a percent of the overall selling price. Although we generally do not take legal title to such avocados and perishable products, we do assume responsibilities (principally assuming credit risk, inventory loss and delivery risk, and limited pricing risk) that are consistent with acting as a principal in the transaction. Accordingly, our results of operations include sales and cost of sales from the sale of avocados and perishable products procured under consignment arrangements. For fiscal years 2010, we generated gross margins of \$6.0 million from the sale of fresh produce products that were packed by third parties. This is a \$3.2 million increase in gross margin for consigned sales compared to previous year. This increase is due to an increase in tomato sales of 195.7% for fiscal 2010, when compared to the same prior year period. The increase in sales for tomatoes is due to an increase in the average per carton selling price of 128.1%, in addition to a 29.6% increase in the number of units sold. We attribute most of the increase in the per carton selling price to the lower volume of tomatoes in the U.S. marketplace (due to weather conditions in Florida) for fiscal 2010, as compared to the same prior period. We attribute most of the increase in units sold to growers supplying us with significantly more volume, due primarily to market conditions.

#### *Calavo Foods*

##### Fiscal 2011 vs. Fiscal 2010:

Gross profit percentages for Calavo Foods for the year ended October 31, 2011, as compared to the same prior year period, decreased primarily as a result of significantly higher fruit costs. Fruit costs increased 55.2% for the year ended October 31, 2011, when compared to the same prior year period. We attribute this increase primarily to a lower overall volume of avocados in the marketplace, in conjunction with a steady-to-higher demand for avocados, when compared to the same prior year period. As discussed above, material fluctuations in fruit costs can have a significant impact on gross margins in the Calavo Foods segment. The increase in our production costs was primarily related to the aforementioned change (see net sales discussion) in the food safety standards that added steps in our manufacturing process during the first quarter of fiscal 2011. In addition, in the fourth quarter of 2011, our 350L ultra high pressure machine experienced a mechanical failure. This restricted the amount of product that could be produced, which lowered our overall volume and increasing our production costs. We have replaced this machine in the first quarter of 2012, and believe our operating capacity to be sufficient to meet our production needs. We anticipate that the gross profit percentage for our Calavo Foods segment will continue to experience significant fluctuations during the next year primarily due to the uncertainty of the cost of fruit that will be used in the production process.

Partially offsetting the decrease in margins was the addition of the recently acquired RFG, which contributed approximately \$4.3 million in margins for the year ended October 31, 2011, when compared to the same prior year period.

In addition, the U.S. Dollar to Mexican Peso exchange rate weakened during fiscal 2011, as compared to the corresponding prior year period. This had the effect of increasing our per pound costs, which, as a result, negatively impacted gross margins. Any significant fluctuation in the exchange rate between the U.S. Dollar and the Mexican Peso may have a material impact on future gross margins for our Fresh product and Calavo Foods segments.

##### Fiscal 2010 vs. Fiscal 2009:

Gross margin percentages for our Calavo Foods business are largely dependent on the pricing of our final product and the cost of avocados used in preparing guacamole. The Calavo Foods gross profit percentages for the fiscal year 2010, when compared to the same prior year period, decreased \$2.4 million or 15.3%, primarily as a result of higher fruit and operating costs, partially offset by an increase in total pounds sold by 1.8%. We anticipate that the gross profit percentage for our Calavo Foods segment will continue to experience significant fluctuations during the next fiscal year primarily due to the uncertainty of the cost of fruit that will be used in the production process.



**Selling, General and Administrative**

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
Selling, general and administrative <sup>(1)</sup>	\$ 24,527	5.9%	\$ 23,168	1.7%	\$ 22,791
Percentage of net sales	4.7%		5.8%		6.6%

(1) Includes selling, general and administrative expenses of \$3.1 million in fiscal 2011 related to recently acquired RFG. See Note 17 in the Notes to the Consolidated Condensed Financial Statements for additional information related to the acquisition of RFG.

Selling, general and administrative expenses include costs of marketing and advertising, sales expenses and other general and administrative costs. Selling, general and administrative expenses increased \$1.4 million, or 5.9%, for the year ended October 31, 2011, when compared to the same prior year period. This increase was related to the acquisition of RFG which contributed \$3.1 million in selling, general and administrative expenses for the year ended October 31, 2011. The remaining is a decrease of \$1.7 million, which is due to lower corporate costs, including, but not limited to, management bonuses (totaling approximately \$3.2 million), and a decrease in the contingent consideration liability related to the acquisition of CSL (totaling approximately \$0.6 million, see Note 16 of the consolidated financial statements), partially offset by increases in salaries and employee benefits (totaling approximately \$1.2 million), broker commission (totaling approximately \$0.3 million), audit fees (totaling approximately \$0.2 million), consulting fees (totaling approximately \$0.2 million), legal fees (totaling approximately \$0.1 million) and employee benefits (totaling approximately \$0.1 million).

For fiscal year 2010, selling, general and administrative expenses increased \$0.4 million or 1.7% when compared to the same period for fiscal 2009. This increase was primarily related to higher corporate costs, including, but not limited to, costs related to an increase in management bonuses (totaling approximately \$0.9 million), and an increase in directors fees (totaling approximately \$0.3 million). Such higher corporate costs were partially offset, however, by lower salaries and employee benefits (totaling approximately \$0.4 million), lower audit fees (totaling approximately \$0.3 million) and a decrease in bad debt expense (totaling approximately \$0.1 million).

**Interest income**

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
Interest income	\$ 191	(30.3%)	\$ 274	(28.1%)	\$ 381
Percentage of net sales	0.0%		0.1%		0.1%

Interest income was primarily generated from loans to growers. The decrease in interest income in fiscal 2011 as compared to 2010 is due to the principal balances being paid off by Agricola Belher for infrastructure advances.

**Interest expense**

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
Interest expense	\$ 1,016	21.8%	\$ 834	(24.7%)	\$ 1,108
Percentage of net sales	(0.2%)		(0.2%)		(0.3%)

Interest expense is primarily generated from our line of credit borrowings, as well as our term loan agreements with FCW and BoA. In 2011, we entered into a loan agreement with FCW in connection with the acquisition of RFG. For fiscal 2011, as compared to fiscal 2010, the increase in interest expense was primarily related to a higher average outstanding balance under our term loan agreements and our non-collateralized, revolving credit facilities with FCA and BoA.

For fiscal 2010, as compared to fiscal 2009, the decrease in interest expense was primarily related to a lower average outstanding balance and an overall decrease in interest rates under our non-collateralized, revolving credit facilities with Farm Credit West, PCA and Bank of America, N.A.



**Other Income, Net**

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
Other income, net	\$ 137	(68.1)%	\$ 430	63.5%	\$ 263
Percentage of net sales	0.0%		0.1%		0.1%

Other income, net includes dividend income, as well as certain other transactions that are outside of the normal course of operations. During fiscal 2011, 2010, and 2009, we received \$0.2 million, \$0.2 million, and \$0.1 million as dividend income from Limoneira. Partially offsetting dividend income within other income for fiscal year 2011, was the disposal of Property, Plant and Equipment not fully amortized for a loss of approximately \$0.1 million.

**Provision for Income Taxes**

	2011	Change	2010	Change	2009
	(Dollars in thousands)				
Provision for income taxes	\$ 7,249	(36.1)%	\$ 11,341	35.4%	\$ 8,277
Percentage of income before provision for income taxes	39.8%		39.1%		37.8%

The effective income tax rate for fiscal years 2011, 2010, and 2009 is higher than the federal statutory rate principally due to state taxes. Our effective income tax rate increased from 37.8% in fiscal year 2009 to 39.1% in fiscal year 2010 primarily as a result of an increase in foreign taxes, partially offset by a decrease in our average state tax rate.

**Quarterly Results of Operations**

The following table presents our operating results for each of the eight fiscal quarters in the period ended October 31, 2011. The information for each of these quarters is derived from our unaudited interim financial statements and should be read in conjunction with our audited consolidated financial statements included in this Annual Report. In our opinion, all necessary adjustments, which consist only of normal and recurring accruals, have been included to fairly present our unaudited quarterly results. Historically, we receive and sell a substantially lesser number of California avocados in our first fiscal quarter.

	Three months ended							
	Oct. 31, 2011	July 31, 2011	Apr. 30, 2011	Jan. 31, 2011	Oct. 31, 2010	July 31, 2010	Apr. 30, 2010	Jan. 31, 2010
(in thousands, except per share amounts)								
<b>Statement of Operations Data</b>								
Net sales	\$ 147,349	\$ 165,141	\$ 118,720	\$ 91,319	\$ 107,234	\$ 114,578	\$ 109,219	\$ 67,320
Cost of sales	133,917	153,801	109,300	82,650	92,940	99,303	96,133	58,445
Gross margin	13,432	11,340	9,420	8,669	14,294	15,275	13,086	8,875
Selling, general and administrative	7,033	6,844	5,635	5,015	7,035	5,514	5,455	5,164
Operating income	6,399	4,496	3,785	3,654	7,259	9,761	7,631	3,711
Other income (expense), net	(271)	(105)	223	22	169	181	233	36
Income before provision for income taxes	6,128	4,391	4,008	3,676	7,428	9,942	7,864	3,747
Provision for income taxes	2,540	1,689	1,634	1,386	2,733	4,045	3,090	1,473
Net income	3,588	2,702	2,374	2,290	4,695	5,897	4,774	2,274
Add: Net loss-noncontrolling interest	52	11	30	21	55	50	19	
Net income-Calavo Growers, Inc	\$ 3,640	\$ 2,713	\$ 2,404	\$ 2,311	\$ 4,750	\$ 5,947	\$ 4,793	\$ 2,274

Edgar Filing: CALAVO GROWERS INC - Form 10-K

Basic	\$ 0.25	\$ 0.18	\$ 0.16	\$ 0.16	\$ 0.32	\$ 0.41	\$ 0.33	\$ 0.16
Diluted	\$ 0.25	\$ 0.18	\$ 0.16	\$ 0.16	\$ 0.32	\$ 0.41	\$ 0.33	\$ 0.16
Number of shares used in per share computation:								
Basic	14,769	14,755	14,726	14,723	14,710	14,651	14,572	14,505
Diluted	14,781	14,767	14,734	14,736	14,722	14,676	14,598	14,572

**Liquidity and Capital Resources**

Operating activities for fiscal 2011, 2010 and 2009 provided cash flows of \$7.9 million, \$20.0 million, and \$22.0 million. Fiscal year 2011 operating cash flows reflect our net income of \$11.0 million, net noncash charges (depreciation and amortization, income from unconsolidated entities, provision for losses on accounts receivable, interest on deferred compensation, deferred income taxes, and stock compensation expense) of \$5.6 million and a net decrease from changes in the non-cash components of our working capital accounts of approximately \$8.7 million.

Fiscal year 2011 increases in operating cash flows, caused by working capital changes, includes a decrease in payable to growers of \$4.9 million, a decrease in trade accounts payable and accrued expenses of \$4.2 million, an increase in advances to suppliers of \$1.8 million, an increase in inventory of \$2.1 million, and an increase in income tax receivable of \$1.9 million, partially offset by a decrease in accounts receivable of \$4.3 million, and a decrease in prepaid expenses and other current assets of \$1.9 million.

The decrease in our trade accounts payable and accrued expenses primarily reflect a contingent consideration accrual related to our acquisition of RFG (see note 17 to our Consolidated Financial Statements), and a decrease in management bonuses in fiscal year 2011, compared to the previous year. The decrease in payable to our growers primarily reflects a decrease in California fruit delivered in the month of October 2011, as compared to the month of October 2010. The increase in our inventory balance is primarily related to an increase in Mexico avocado inventory on hand at October 31, 2011, as compared to the same prior year period. The decrease in our accounts receivable balance as of October 31, 2011, when compared to October 31, 2010, primarily reflects less California avocado sales recorded in the month of October 2011, as compared to October 2010.

Cash used in investing activities was \$20.9 million, \$9.5 million, and \$6.0 million for fiscal years 2011, 2010, and 2009. Fiscal year 2011 cash flows used in investing activities includes the acquisition of RFG net of cash acquired of \$13.4 million, capital expenditures of \$4.8 million, and infrastructure advances to Agricola Belher of \$3.0 million. Such payments were partially offset by distributions received of \$0.3 million from our joint venture Maui Fresh International, LLC.

Cash provided by financing activities was \$14.8 million for fiscal year 2011. Cash used in financing activities was \$10.3 million and \$16.6 million for fiscal years 2010 and 2009. Cash provided during fiscal year 2011 primarily includes proceeds from issuance of long-term obligations of \$22.1 million, proceeds from our non-collateralized, revolving credit facilities totaling \$9.7 million, and \$0.9 million provided by the exercise of stock options. Partially offsetting these proceeds, however, were payments on long-term debt obligations of \$9.8 million and a payment of a dividend of \$8.1 million.

Our principal sources of liquidity are our existing cash reserves, cash generated from operations and amounts available for borrowing under our existing credit facilities. Cash and cash equivalents as of October 31, 2011 and 2010 totaled \$2.8 million and \$1.1 million. Our working capital at October 31, 2011 was \$8.6 million, compared to \$14.8 million at October 31, 2010.

We believe that cash flows from operations and available credit facilities will be sufficient to satisfy our future capital expenditures, grower recruitment efforts, working capital and other financing requirements. We will continue to evaluate grower recruitment opportunities and exclusivity arrangements with food service companies to fuel growth in each of our business segments.

Effective May 31, 2011, the Company and FCW, entered into a Term Revolving Credit Agreement (Revolving Agreement). Under the terms of the Revolving Agreement, we are advanced funds for working capital purposes, the purchase and installation of capital items, as well as other corporate needs of the Company. Total credit available under the borrowing agreement is \$40 million, up from \$30 million, and expires on February 1, 2016. This increase was at our request and not due to any immediate cash flows needs. The credit facility and term loan contain various financial covenants, the most significant relating to tangible net worth (as defined), Fixed Charge Coverage Ratio (as defined) and Current Ratio (as defined).

Effective September 30, 2011, the Company and Bank of America, N.A. (BoA), entered into an agreement, Amendment No. 4 to Loan Agreement (the Agreement), which amended our existing credit facility with BoA. Under the terms of the Agreement, we are advanced funds primarily for working capital purposes. Total credit available under the borrowing agreement is now \$25 million, up from \$15 million and now expires on February 1, 2016. This increase was at our request and not due to any immediate cash flows needs.

Under the terms of these agreements, we are advanced funds for both working capital and long-term productive asset purchases. Total credit available under these combined borrowing agreements was \$65 million, with a weighted-average interest rate of 1.6% and 2.3% at October 31, 2011 and 2010. Under these credit facilities, we had \$17.9 million and \$8.2 million outstanding as October 31, 2011 and 2010. These credit facilities contain various financial covenants, the most significant relating to Tangible Net Worth (as defined), Current Ratio (as defined), and Fixed Charge Coverage Ratio (as defined). We were in compliance with all such covenants at October 31, 2011.

## Edgar Filing: CALAVO GROWERS INC - Form 10-K

The following table summarizes contractual obligations pursuant to which we are required to make cash payments. The information is presented as of our fiscal year ended October 31, 2011:

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations (including interest)	\$ 25,626	\$ 6,164	\$ 11,571	\$ 7,379	\$ 512
Revolving credit facilities	17,860	17,860			
Defined benefit plan	245	42	84	84	35
Operating lease commitments	19,686	2,662	5,210	4,381	7,433
<b>Total</b>	<b>\$ 63,417</b>	<b>\$ 26,728</b>	<b>\$ 16,865</b>	<b>\$ 11,844</b>	<b>\$ 7,980</b>

The California avocado industry is subject to a state marketing order whereby handlers are required to collect assessments from the growers and remit such assessments to the California Avocado Commission (CAC). The assessments are primarily for advertising and promotions. The amount of the assessment is based on the dollars paid to the growers for their fruit, and, as a result, is not determinable until the value of the payments to the growers has been calculated.

With similar precision, amounts remitted to the Hass Avocado Board (HAB) in connection with their assessment program (see Item 7 for further discussion), are likewise not determinable until the fruit is actually delivered to us. HAB assessments are primarily used to fund marketing and promotion efforts.

### *Recently Adopted Accounting Pronouncements*

In June 2009, the Financial Accounting Standards Board (FASB) issued revised guidance for the accounting of transfers of financial assets. This guidance is intended to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. The adoption of this accounting guidance did not have a material impact on our financial position, results of operations or liquidity.

In June 2009, the FASB issued revised guidance for the accounting of variable interest entities, which replaces the quantitative-based risks and rewards approach with a qualitative approach that focuses on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance. This accounting guidance also requires an ongoing reassessment of whether an entity is the primary beneficiary and requires additional disclosures about an enterprise's involvement in variable interest entities. The adoption of this accounting guidance did not have a material impact on our financial position, results of operations or liquidity.

### *Recently Issued Accounting Standards*

In June 2011, the FASB issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this standard will only impact the presentation of our consolidated financial statements and will have no impact on the reported results.

In May 2011, the FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. We do not believe that adoption of this guidance will have a material impact on our financial position and results of operations.

In December 2010, the FASB issued an update to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The



qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This accounting guidance will be effective for financial statements issued for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years. Early adoption is not permitted. We do not believe that adoption of this guidance will have a material impact on our financial position and results of operations.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Our financial instruments include cash and cash equivalents, accounts receivable, payable to growers, accounts payable, current and long-term borrowings pursuant to our credit facilities with financial institutions, and long-term, fixed-rate obligations. All of our financial instruments are entered into during the normal course of operations and have not been acquired for trading purposes. The table below summarizes interest rate sensitive financial instruments and presents principal cash flows in U.S. dollars, which is our reporting currency, and weighted-average interest rates by expected maturity dates, as of October 31, 2011.

(All amounts in thousands)	Expected maturity date October 31,						Total	Fair Value
	2012	2013	2014	2015	2016	Thereafter		
<b>Assets</b>								
Cash and cash equivalents (1)	\$ 2,774	\$	\$	\$	\$	\$	\$ 2,774	\$ 2,774
Accounts receivable (1)	36,101						36,101	36,101
Advances to suppliers (1)	3,349						3,349	3,349
<b>Liabilities</b>								
Payable to growers (1)	\$ 5,082	\$	\$	\$	\$	\$	\$ 5,082	\$ 5,082
Accounts payable (1)	7,038						7,038	7,038
Current borrowings pursuant to credit facilities (1)	17,860						17,860	17,860
Fixed-rate long-term obligations (2)	5,448	5,384	5,264	4,952	2,153	491	23,692	23,430

- (1) We believe the carrying amounts of cash and cash equivalents, accounts receivable, advances to suppliers, payable to growers, accounts payable, and current borrowings pursuant to credit facilities approximate their fair value due to the short maturity of these financial instruments.