

MORNING STAR



The Morning Star Packing Company

December 2005

In this issue:

- *Crop Update*
- *Market Analysis*
- *Leadership Spotlight*
- *Health Claim*
Approved by FDA

DOMESTIC AND INTERNATIONAL CROP

Unfavorable Weather Shrinks 2005 Harvest

California Crop

California growers delivered 9.6 million tons of tomatoes to processing plants this season. The crop finished 9.8% below the preseason estimates and 18% below last year's excellent 11.67 million tons. Final yield numbers will not be available until January, but expectations are that the yields missed preseason forecasts by at least 6%.

The 2005 crop faced difficulties from the get go. A wet spring hampered planting so growers rushed equipment into their fields before the ground dried. The heavy equipment impacted the soil making it difficult for the tomato plants' roots to spread out. Poor growing conditions throughout the spring were followed by a summer that was all over the map.

June was unusually cool; then July came along with an extended heat wave. For 40 days, the brutal heat burned the fruit on the vine. Although August and September were pretty mild, Sacramento's summer was the 22nd warmest of the 111 on record with the National Oceanic and Atmospheric Administration.

Despite excellent horticultural practices and hardy cultivars, the pitiful growing season and cruel heat deteriorated the quality of the tomato crop. The low yields kept processors from running at full capacity, while they struggled all season with green fruit and blemishes from blight, mold and sunburn. Although the crop averaged very high solids, the final product's viscosity characteristics were adversely affected. Bostwick levels will be higher than recorded in previous years.

International Summary

Conversion Note: 1 metric ton = 1.102 tons

In 2005, the worldwide tomato production declined over 5 million metric tons or 15% to 29.463 million metric tons according to the World Processing Tomato Council. Around the globe, countries cut back on their production because of surpluses left after last season's record crop. Global production slipped 1 million metric ton below January's forecasts because of unfavorable weather.

Only three countries, other than the United States, produce more than 2 million metric tons of processing tomatoes. Of those, only Spain increased production from last year. At 2.4 mil-

lion metric tons, the country produced 9% more than last season. Spain planned on the increase after coming up short in 2004 due to drought. Yet, the country missed its original goal of 2.5 million metric tons by 6%.

Italy estimates production at 5.3 million metric tons, a 17% reduction from last year. Although the Mediterranean country intentionally reduced its crop, a very hot June and hailstorms in July caused losses in the fields. The weather remained uncooperative and rain in September shortened the growers' ability to harvest at the end of the season. As

the world's largest exporter, Italy's short crop will effect global supply.

China suffered a 29% drop from 2004. Production fell to 3.0 million metric tons from 4.2 in 2004. Heavy rains caused some processors to close early while others ran below capacity. After missing its preseason target by more than a half million metric tons, prices from China are increasing in response to the short supply.

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MARKET ANALYSIS

Short Crop, Prices Rising

In the cycle typical of the tomato industry, a long year is followed by a short one and suddenly the market has switched from a buyer's to a seller's. Domestically, most of the product packed has already been contracted at preseason prices leaving very little opportunity for spot buying. In response to tight supply, open market paste is currently selling for 32-34¢ per pound. That pricing hasn't risen to 40¢ or more, as it did after the very short El Nino ravaged crop of 1998, proves that some product is still available for sale.

information, we will work with our customers as partners to manage inventories closely. If necessary, we can match our customers with appropriate substitute product even if it is a slightly different finish, Bostwick, or packaging specification than contracted for originally.

Our technical support experts will help our customers optimize any specification differences and maximize paste yields.

Rising Fuel Costs

Supply pressures are not the only reason prices are rising; input costs also play a variable. Although the winds and rains of Hurricane Katrina and its followers never got near the west coast, the effects were felt from rising fuel prices. Production costs of tomato paste rose about 1¢ per pound from increased natural gas costs. Diesel fuel costs affected both truckers and growers. Rising fuel prices couldn't have hit at a worse time for growers who were in the midst of harvesting. Ross Siragusa, California Tomato Growers Association president, in a September Modesto Bee article said that diesel fuel for farmers has risen \$1.99 per gallon in the last two years which adds \$4.39 per ton to the cost of producing tomatoes.

Tomato Cost Increase for 2006

Prices for bulk tomato ingredients will creep up again next year due to cost pressure coming from the fields. At \$50 per ton in 2005, it was difficult to encourage growers to contract for tomatoes. Other crops provided a potential for greater return on investment for many growers. Add poor yields, extra spraying costs, and rising diesel prices to the growing cost of this season's tomatoes, and California's tomato growers suffered significant losses.

Because contracts are priced before the season, 2005's costs increases will affect the price of 2006's contracts. Processors will likely pay between \$4-7 per ton more for raw tomatoes next year. This increase will dramatically affect the price of bulk tomato ingredients, as raw tomatoes are typically 45% of the paste production cost.

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Domestic Tomato Supply, Movement and Carryover Numbers

	2004/05	2005/06	5 Year Average (2000-2004)
Beginning Supply	15.8	14.2 (est)	14.9
Movement	11.8	—	10.9
Carry-over	4.0	—	4.0

Source: California League of Food Processors

Supplies are tight because the industry entered the season with average inventory levels. Despite the huge pack in 2004, June 2005 carry-over numbers were on par with the 5-year average. Disappearance of U.S. processed tomatoes hit a record high of 11.8 million tons during the 2004/05 marketing year. The movement beat the previous high set in 1997/98 by 3.9%. The short season, followed by record consumption, leaves 2005 beginning supply more than 700,000 tons below the 5-year average.

Tight Supply

As our October 31 letter to our customers announced, Morning Star was exposed to the same short-fall suffered across California.

Additionally, raw tomato quality affected our ability to meet color and Bostwick targets. Because supplies are short, especially on certain unique items, prorating may be necessary in order for us to treat each customer fairly.

Through open communication and realistic

LEADERSHIP SPOTLIGHT**An Interview with Entrepreneur Chris Rufer**

On paper, it's impossible to capture the full intensity of Chris Rufer's personality. Armed with penetrating blue eyes and a sharp wit, the founder and owner of The Morning Star Packing Company is full of passion and conviction. Like most successful entrepreneurs, he never tires of challenging assumptions and always believes there is room for improvement.

That Chris started his career in processed tomatoes as a truck driver, hauling tomatoes from fields to factories, is a story that legends of the American dream are based. His approach to risk-taking and implementing unconventional ideas have made Morning Star a thriving company.

Always the perfectionist, Chris pushes the factories toward their most efficient performance. To him, efficiency lays the groundwork for creating a financially stable company and consistently making quality products.

Morning Star's Future

A lot has changed in the 16 years that The Morning Star Packing Company has processed tomatoes. More paste is sold on the open market today, and competition has imitated many of the innovations introduced by Morning Star. Morning Star is no longer the new kid on the block trying to get a foot hold. Instead, the company is the one targeted by others.

These changes don't concern Chris, but of course, he thrives on these kind of competitive challenges. "Admittedly, sales growth slowed over the last 3 to 4 years," says Chris, "but we have renewed energy in the expanded sales team, and sales are growing 10-15%."

In the last two years, three new sales people joined the Morning Star team. Additionally, two technical colleagues are dedicated to helping each customer with process improvements and issues. Chris credits the sales team's dedication to the customers for the growth in sales.

With the additional volume and revenue from this growth, Chris plans to add evaporation capacity at the Los Banos plant. "In 2006, we'll expand the Los Banos plant by 20% making it the second lowest cost plant in California, behind our Williams facility," says the company's founder.

Although significant investment was made last year which enhanced the quality produced from the diced line, Chris has more plans for the

company's newest plant. "Rebuilt in 2001, Santa Nella is still a 'teenager' in terms of efficiency,. So we hope to expand the plant to full capacity in 2007, if the current market situation holds," he says.

Innovation

A portion of Morning Star's success has come from utilizing new technologies and overhauling processes. Chris is a firm believer that innovation and embracing change keeps a company strong and competitive. Currently, Morning Star's research and development team is working on new packaging, new products, and improved processing equipment.

In packaging, our customers are looking for an inexpensive, defect-free, and presentable alternative to the wooden bin. Chris says, "Except for a few large customers, the plastic bin is not for the future as designed. We are exploring several alternatives that will be more cost effective and not lock our customers into that packaging investment." Another of Chris's favorite packaging topics is Star-Pak in larger 75 gallon bags. The patented packaging is designed to help drum customers get the cost savings of bins while transitioning to the larger volume without major formulation changes.

Chris also references several new products that Morning Star is introducing to the market. Morning Star has several million pounds of tomato paste with double the lycopene concentration of regular tomato paste. The paste is made from high-lycopene tomatoes bred in Israel. Additionally, our engineers are working on ways to bring a more "fresh-like" color and flavor to tomato paste.

In the technology area, most of the equipment in use was built and modified according to Morning Star's particular requirements. Currently, our engineers are working on equipment that should innovate the way peeled and pulp products are processed.

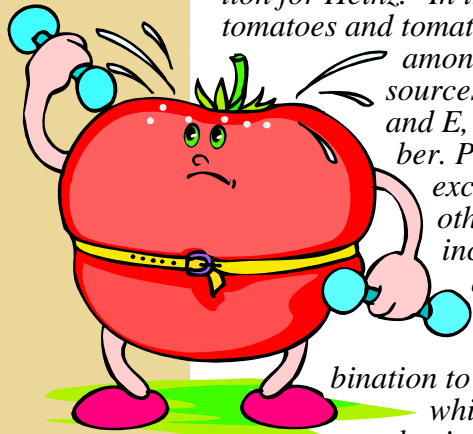
Values

Morning Star's culture embraces fairness, competitiveness, and innovation, all of which come from the core beliefs of the dynamic founder. It boils down to a organization nimble enough to adapt to technologies and markets so we can best service all our customers.

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HEALTH CLAIM**FDA Approves Health Claim for Tomatoes**

"Both fresh and processed tomatoes are treasures of nutrients, with processed tomatoes having higher levels of nutrients simply because the vegetable is concentrated," explained Ida Laquatra, Ph.D., R.D., director of nutrition for Heinz. "In the American diet, tomatoes and tomato products are



among the top food sources of Vitamins C, A and E, potassium, and fiber. Plus, tomatoes are an excellent source of other phytochemicals, including the powerful antioxidant lycopene. These nutrients work in combination to offer health benefits which we are just now beginning to understand."

Increasing the volume of tomatoes consumed around the world is an important objec-

tive for Morning Star. In July 2003, we joined with Heinz, LycoRed, and The Prostate Cancer Foundation to petition the FDA for a health claim recognizing the healing benefits of lycopene for prostate cancer. After several delays, the FDA released its findings on November 8.

"Very limited and preliminary scientific research suggests that eating one-half to one cup of tomatoes and/or tomato sauce a week may reduce the risk of prostate cancer. FDA concludes that there is little scientific evidence supporting this claim."

Although lycopene was removed from the original requested claim, the FDA did recognize the benefits of eating tomatoes. Additionally, the FDA mentioned a willingness to evaluate new information as it becomes available.

Morning Star's founder, Chris Rufer, commented, "Although the approved claim did not go as far as we would have liked, the evidence continues to mount in favor of tomatoes and the lycopene contained therein. We look forward to a more extensive claim at a later date."

THE MORNING STAR PACKING COMPANY

Los Banos

13448 Volta Road
Los Banos, CA 93635
209 826-8000

Williams

2211 Old Highway 99
Williams, CA 95987
530 473-3600

Santa Nella

12045 South Ingomar Grade
Los Banos, CA 93635
209 826-7100

