The Morning Star Packing Company

April 2008

In this issue:

- *Domestic Crop -Drip Irrigation*
- *International Crop*
- *Market Analysis*
- *Sales Veteran, Kelly Haywood*

DOMESTIC CROP

Price of Raw Tomatoes Increases to Record Level

By April, growers are in the thick of planting transplant tomatoes to their fields. And this year they should be feeling optimistic about their crops. So far, Mother Nature has awarded growers with nearly normal rainfall with appropriate breaks in the weather, allowing them to prepare their fields correctly, sow their direct-seeded fields in a timely fashion and begin transplanting in early March.

Seedling carefully planted in a field. *Transplanting began in early March this year. Normally, growers begin transplanting much later in the spring when threat of frost is significantly behind them. But transplanting has such a* ***proven economic benefit*** *that growers are willing to risk frost damage over planting seeds directly.*

After the bumper crop of 2007, California processors require fewer tons for 2008. The California Tomato Growers Association predicts **10.6 million tons**, a 12% drop from last season's near record. Based on fewer acres and lower yields than last year, the CTGA expectation is more likely than the 11.8 million ton forecast, released by the California Agricultural Statistics Service in January. (Next release May 30th)

For the third year in a row, the field price of processed tomatoes is up dramatically. Growers and processors agreed to a **record $70 per ton**, up 11% from last year's $63 per ton. Processors are paying 40% more for tomatoes this year than in 2005. (See Market Analysis inside for its effect on the cost of paste.)

It's unusual for growers and processors to agree on a price increase in December, especially on the heels of a crop which exceeded its preseason expectations. But rising input costs, high prices for competing crops, and sketchy water supplies made the increase inevitable. Processors agreed to the price early to improve their chances of contracting enough acreage.

Farming input costs, like labor, fuel, fertilizer, and seed, have all escalated in California. A study released by the University of California in March estimated the cash cost of growing processed tomatoes has conservatively increased 30% since 2001.

Probably the biggest driver of increasing field prices for tomatoes is **competition from crops that can be grown on the same land.** Acreage available for growing row crops, like tomatoes, has decreased in the last two decades. California's farmland has either been paved over or confined to multi-season tree or grape crops.

The decreased availability of land has become more of an issue as **profitability for grain crops** has improved recently. After years of depressed pricing, demand for wheat and corn is soaring, driving the prices for these commodities to near record levels. Prices for wheat, corn and soybeans are all up over 25% from a year ago.

The surge in demand comes from a rush to make corn-based biofuels and swelling demand for grains in China, India and other emerging markets. The resulting shortage pushed up grain prices worldwide, helping drive food prices higher. California farmers, who could grow tomatoes, are seeing more attractive returns by using their land for grain crops which are less risky.

Tomatoes are a thirsty crop and after California's drought last year, many tomato growers were concerned there would not be enough water for their crops. But nearly normal rainfall and snowpack have softened concerns over water allocations. Unfortunately, water rights for a threatened species of fish, the Delta smelt, and long-term crops like trees and grapes come before those of tomato growers. Tomato growers are using more well water for their fields and fields on drip irrigation require less water, which could prove critical in the drier south.

Drip Irrigation and The Solids Incentive Program

Drip irrigation substantially improves the yields of California's tomato fields, especially in the arid southern regions or on ground with poor soil. Drip systems consistently add 3 to 10 tons per acre to a field's output. Additionally, tomatoes require less water, survive harsh weather better, and suffer fewer disease problems, because water is delivered directly to the roots from piping installed under the tomato beds. The subterranean systems are expensive initially, but growers reap the benefits for about seven years.

Depending on the quality of the land, some growers can regularly get yields of more than 50 tons per acre by installing drip systems. Unfortunately Natural Tomato Soluble Solids (NTSS) drop as field yields get high. Less NTSS is very uneconomical for paste producers who buy tomatoes by the ton but produce and sell based on solids.

To protect our customers from the inefficient side effect of high yields, Morning Star implemented a "solids incentive program" with growers several years ago. A target is created based on the average NTSS by variety in each county. Growers who outperform the target are paid bonuses, while underperformers are penalized. The payments or deductions are tiered, growing with distance from the target and top out at just under $6 per ton.

Conversion Notes:
1 metric ton (MT) = 1.102 tons
1 hectare = 2.47 acres

International Crop

European Union Sees Effects of Subsidy Reform

Global production forecasts for 2008 are up 5.1% over last year to 35.5 million metric tons (MT), according to the World Processing Tomato Council. Excluding California, forecasts are up 9% to 24.8 million MT.

The uptick in global tomato production is not surprising given most regions missed expectations last year. But increasing volume is unexpected in light of subsidy reforms in the European Union. Concerns of decline in EU production by 30% or more have proven unwarranted.

Price of Processed Tomatoes in Five EU Countries
(Euro per Metric Ton)

	2007	2008	% Change
France	47.0	70.0	49%
Greece	50.0	80.0	60%
Italy	49.0	79.5	62%
Spain	49.0	75.0	53%
Portugal	49.5	71.0	43%
Weighted Average	**49.0**	**77.5**	**58%**

Source: Tomato News, March 2008

European Union Decoupling

Five EU countries (Italy, Spain, Portugal, Greece and France) produce processed tomatoes and make up 24% of the world's total. This year those five countries expect to produce 8.7 million MT, up 3% from last season and only 3% below their average 3-year production.

Italy expects to produce 4.7 million MT, an improvement of 2% from last year. **Spain** forecasts production at 1.85 million MT an increase of 6%, while **Portugal** expects to fall 3% to 1 million MT. **Greece** expects to improve production 9% to 700,000 MT. **France** processes 120,000 MT, up 21%.

While radical reform in Common Agricultural Program (CAP) isn't effecting volume much, it is significantly impacting processor costs to procure tomatoes. Contract prices for tomatoes in the EU skyrocketed an average 58% (see table). *The Italian price of 79.5€ per metric ton is the American equivalent of $105 per ton.*

CAP subsidies are being decoupled from production to give each farm a single payment based on area by 2013. To lessen the impact of the change, payments will be transitioned over the next three years, reaching the single payment goal before the deadline. During the transition, each country receives its normal CAP allotment to pay tomato growers. But instead of a subsidy based on production, growers will receive two subsidies — a *decoupled* and *coupled* payment.

The *decoupled* payment is static and based on the average payments growers received during a historical three year period. Farmers are paid even if they don't plant tomatoes this year.

The *coupled* payment will only go to farmers currently growing tomatoes. Most countries will pay growers based on the hectares of tomatoes planted. Because the total pool of money for the payment is set, the more hectares planted in the country means growers receive less money per hectare, or vice versa.

With the exception of Greece, the countries will split their allocation from CAP 50/50 for the two payments. Greece will likely allocate 70% of its money to static payments and the remaining 30% linked to volume.

China and Turkey

Production in **China** forecasts 5.6 million MT, a 22% increase over last year's blight damaged crop. **Turkey** expects a 27% increase in production to 2.1 million MT. If attained, Turkish production would exceed to its 2003 peak.

MARKET ANALYSIS

Input Economics Press Bulk Tomato Prices Upward

A record price for raw tomatoes, global shortages, a weak dollar, and input cost inflation are pushing up the price of bulk tomato products this season. For 2008 pack, buyers can expect to pay in the neighborhood of 42-44¢ per pound for 31% NTSS paste in bins. Paste packed in drums sells for 3¢ more per pound due to the higher packaging costs. Bulk diced tomatoes in bins are selling for 21-23¢ per pound, also with a 3¢ increase for drums.

Input prices up

Packers anticipate the **cost to produce tomato paste to increase approximately 4¢ per pound** over last season, due to rising input costs. Since 50% of tomato paste cost comes from tomatoes, the additional $7 per ton for raw tomatoes adds about 2.3¢ per pound to paste production costs above last year. The second largest cost (10-12%) comes from natural gas. At $1 per therm, natural gas inflation contributes an additional 1.2¢ per pound. Minimum wage increases, rising fuel prices and other costs add together another 0.5¢ per pound.

Domestic Disappearance Up

According to the California League of Food Processors' supply and March 1 inventory report, the 9 month **disappearance of domestic tomato inventories is up 11%** from last year. On par with the 5-year average movement, nearly 8.4 million fresh equivalent tons have left supplier warehouses from June 2007 to March 2008.

Unfortunately, last year's plentiful production, coupled with the weak movement over the 06/07 marketing season, created a surplus. The CLFP report shows packers have the equivalent of 7.3 million fresh tons of tomatoes on-hand in their warehouses, which is 20% more than the 5-year average.

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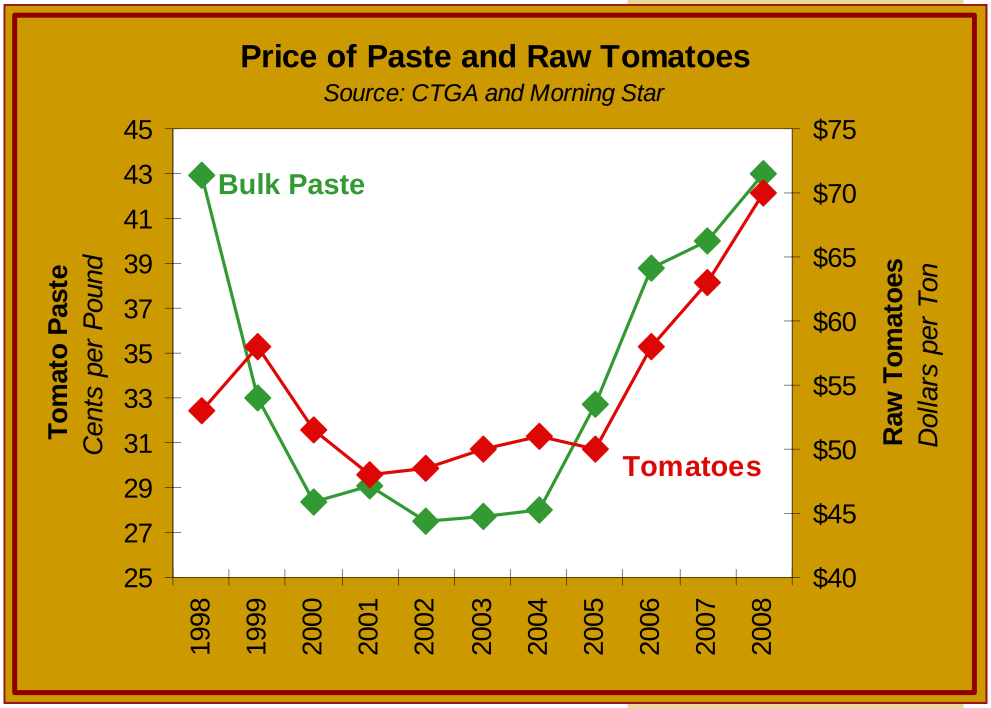

International Opportunities Strong

International interest in California tomato paste is the strongest seen in years. Around the world, countries are reporting no availability of 2007 product. California is one of the few regions with available supply.

Global consumption is thought to be growing by 3% annually, according to experts at FoodNews' Tomato Forum held in Turkey last October. Missing last year's forecasts means global inventories have not kept up with increasing demand. California's paste is also more affordable internationally because the weakening dollar favors US exports.

Additionally, the price of EU tomato products, which make up nearly a fourth of the world's production, will be higher. Processors will need to pass along skyrocketing raw tomato costs to their customers. As outlined in the International Crop section on the prior page, subsidy reforms forced processors to pay 58% more for tomatoes this year. The changing economics in Europe can only lead to additional export opportunities for large producers like Turkey, China, and the US.

Colleague Profile

Kelly Haywood — Pillar for Sales Department

Sometimes, when you listen to Kelly Haywood talk about her life, it sounds like the wild west. And it's not just because she has three young girls at home (ages 3, 5, and 11). More than once, Morning Star's veteran sales colleague has protected her family by firing a shotgun at rattlesnakes that slithered onto the porch or coiled under the BBQ. "Well, that's what happens when you live in the middle of nowhere, five miles down a dirt road," she says of her former rustic home outside of Maxwell.

It is Kelly's ability to tackle problems in that straight-forward, practical manner which make her a valuable asset on the sales team. The only sales person based in our northern operation, Kelly balances the responsibility of maintaining relationships with her numerous customers, directly and through brokers, as well as planning and adjusting the pack for our Williams plant, the world's largest tomato factory.

Although Kelly is the youngest member of our sales team, she's been with the company the longest. Just a few years after earning her BA in Agricultural Business Management from Cal Poly, San Luis Obispo, Kelly started up the customer service department for our sister canning company in 1998. The positive feedback from customers lead our owner, Chris Rufer, to comment, "I've gotten more compliments about Kelly than any other colleague ever."

When the canning operation closed in Yuba City and moved south in 2000, Chris created a sales position for Kelly at Morning Star. Quickly, she built her own network of customers and took on additional projects.

Coming up on her eighth processing season at Williams, Kelly has witnessed exciting changes in Morning Star's sales department. New people have replaced old bringing with them revitalized energy and ideas.

SALES TEAM

Kelly Haywood	530-473-3626
Paul Maxon	209-827-5518
Karolina Splinter	209-829-5090
Becky Wahlberg	209-827-5508
Greg Wuttke	209-827-5513

OUR PRODUCTS

- **Hot Break Tomato Paste** (28% and 31% NTSS)
- **Organic Hot Break Paste** (31% NTSS)
- **Cold Break Tomato Paste** (31% and 37% NTSS)
- **Organic Cold Break Paste** (31% NTSS)
- **Concentrated Crushed** (26% and 28% NTSS)
- **Diced Tomatoes** (3/8", 1/2", and 3/4" cut)
- **Fire Roasted Diced Tomatoes** (3/8", 1/2", and 3/4" cut)
- **Organic Diced Tomatoes** (1/2" and 3/4" cut)
- **Ground Tomatoes in Puree**
- **Tomato Puree** (1.07)
- **Chili Sauce**
- **Ketchup**
- **Custom Formulated Products**

THE MORNING STAR PACKING COMPANY

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