



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, 2006

Commission file number: 000-33385

**CALAVO GROWERS, INC.**

(Exact name of registrant as specified in its charter)

California  
(State of incorporation)

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

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

93060  
(Zip code)

Registrant's telephone number, including area code: (805) 525-1245  
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.001 Par Value per Share

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 o 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 o 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 o

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated Filer  Non-accelerated filer o

Indicate by check mark if whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No

Based on the closing price as reported on the Nasdaq National Market, the aggregate market value of the Registrant's Common Stock held by non-affiliates on April 30, 2006 (the last business day of the Registrant's most recently completed second fiscal quarter) was approximately \$119.4 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, 2006 was 14,292,833.

**Documents Incorporated by Reference**

Portions of the Registrant's Proxy Statement for the 2007 Annual Meeting of Shareholders, which we intend to hold on April 25, 2007, 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, 2006.

## TABLE OF CONTENTS

### PART I

[Item 1. Business](#)

[Item 1A. Risk Factors](#)

[Item 1B. Unresolved Staff Comments](#)

[Item 2. Properties](#)

[Item 3. Legal Proceedings](#)

[Item 4. Submission of Matters to a Vote of Security Holders](#)

### PART II

[Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities](#)

[Item 6. Selected Financial Data](#)

[Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations](#)

[Item 7A. Quantitative and Qualitative Disclosures About Market Risk](#)

[Item 8. Financial Statements and Supplementary Data](#)

[Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure](#)

[Item 9A. Controls and Procedures](#)

[Item 9B. Other Information](#)

### PART III

[Item 10. Directors and Executive Officers of the Registrant](#)

[Item 11. Executive Compensation](#)

[Item 12. Security Ownership of Certain Beneficial Owners and Management](#)

[Item 13. Certain Relationships and Related Transactions](#)

[Item 14. Principal Accountant's Fees and Services](#)

### Part IV

[Item 15. Exhibits and Financial Statement Schedules](#)

### SIGNATURES

### EXHIBIT INDEX

[EXHIBIT 10.14](#)

[EXHIBIT 23.1](#)

[EXHIBIT 23.2](#)

[EXHIBIT 31.1](#)

[EXHIBIT 31.2](#)

[EXHIBIT 32](#)

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## CAUTIONARY STATEMENT

This Annual Report on Form 10-K contains statements relating to future results of Calavo Growers, Inc. (including certain projections and business trends) that are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the “safe harbor” created by those sections. Forward-looking statements frequently are identifiable by the use of words such as “believe,” “anticipate,” “expect,” “intend,” “will,” and other similar expressions. Our actual results may differ materially from those projected as a result of certain risks and uncertainties. These risks and uncertainties include, but are not limited to: increased competition, general economic and business conditions, energy costs and availability, conducting substantial amounts of business internationally, pricing pressures on agricultural products, adverse weather and growing conditions confronting avocado growers, new governmental regulations, as well as other risks and uncertainties, including those set forth in Item 1A. Risk Factors and elsewhere in this Annual Report on Form 10-K and those detailed from time to time in our other filings with the Securities and Exchange Commission. These forward-looking statements are made only as of the date hereof, and we undertake no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise.

**PART I**

**Item 1. Business**

**General development of the business**

We engage in the procurement and marketing of avocados and other perishable foods and the preparation and distribution of processed avocado products. Our expertise in marketing and distributing avocados, processed avocados, and other perishable foods allows us to deliver a wide array of fresh and processed food products to food distributors, produce wholesalers, supermarkets, and restaurants on a worldwide basis. Through our three operating facilities in Southern California, our distribution centers in Texas and New Jersey (our New Jersey facility commenced operations in the first quarter of fiscal 2007), and our two facilities in Mexico, we sort, pack and/or ripen avocados procured in California and Mexico and prepare processed avocado products. Additionally, we procure avocados internationally, principally from Chile and the Dominican Republic, and distribute other perishable foods, such as Hawaiian grown papayas. We currently report our operations in two business segments, (1) fresh products and (2) processed products, down from three business segments disclosed in the prior year. See footnote 11 in our consolidated financial statements for further information about our business segments.

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. All references herein to us for periods prior to the merger refer to the business and operations of the Cooperative.

In February 2003, our Board of Directors approved a plan whereby the operations of our processed products business would be relocated. The plan called for the closing of our Santa Paula, California and Mexicali, Baja California Norte processing facilities and the relocation of these operations to a new facility in Uruapan, Michoacan, Mexico. 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 were closed in February 2003 and August 2004. We incurred no costs related to this restructuring during fiscal 2006.

In November 2003, we acquired all the outstanding common shares of Maui Fresh International, Inc. (Maui). Maui distributes a multi-product line of produce through retail, food service and terminal market wholesale channels. Maui has significant operations in Santa Paula, California, Nogales, Arizona, and Hawaii. Maui packs and distributes a diversified line, comprised of more than 20 commodities, including tropical, speciality, and exotic fruits, chilies and hothouse-grown items, as well as other conventional fruits and vegetables.

In March 2005, we completed the sale of our old corporate headquarters building (located in Santa Ana) for \$3.4 million. This transaction resulted in a pre-tax gain on sale of approximately \$1.7 million. In conjunction with such sale, we relocated our corporate offices to Santa Paula, California in March 2005. Total expenses related to such relocation approximated \$0.4 million.

In June 2005, in order to increase our market share of California avocados and increase synergies within the marketplace, we entered into a stock purchase agreement with Limoneira Company (Limoneira). Pursuant to such agreement, we acquired approximately 15.1% of Limoneira's outstanding common stock for \$23.45 million and Limoneira acquired approximately 6.9% of our outstanding common stock for \$10 million. The transaction was settled by a net cash payment by us of \$13.45 million. Additionally, such agreement also provided for: (1) Calavo to lease office space from Limoneira in Santa Paula, California for a period of 10 years at an initial annual gross rental of approximately \$0.2 million (subject to annual CPI increases, as defined), (2) Calavo to market Limoneira's avocados and (3) Calavo and Limoneira to use good faith reasonable efforts to maximize avocado packing efficiencies for both parties by consolidating their fruit packing operations. Various opportunities are currently being considered, including the use of existing packing facilities, an investment in existing vacant facilities, and/or an investment in a new consolidated facility for both parties. Limoneira primarily engages in growing citrus and avocados, picking and hauling citrus, and packing lemons. The issuances of the shares discussed above are exempt from registration under federal and state securities laws.

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, ut

## Table of Contents

SRD shall have overall management responsibility for the operations of Maui Fresh at the Terminal Market. We will use the equity method to account for our investment.

Our principal executive offices are located at 1141-A Cummings Road, Santa Paula, California 93060; telephone (805) 525-1245.

At October 31, 2006, we employed approximately 750 employees worldwide.

### **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 and 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.

The Hass variety is the predominant avocado variety marketed on a worldwide basis. California grown Hass avocados are available year-round, with peak production periods occurring between February through September. Other varieties have a more limited picking season and generally command a lower price. Approximately 2,300 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 36% of the 2006 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, at times, 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 costs are 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 periodically determined and revised based on our estimated per pound packing and operating costs, as well as our operating profit. Significant competitive pressures dictate that we set the packing and marketing fee at the lowest possible level to attract new and retain existing grower business. We believe that, if net proceeds paid ceased to be competitive, growers would 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 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:

## Table of Contents

- 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 new to avocados. The most significant and compelling reason we choose to invest in 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.
- From time to time, we market our avocados under joint promotion programs with other food manufacturers. Under these programs, we seek to increase the promotional exposure of our products by providing certain sales incentives. These incentives will be offered in conjunction with various promotional campaigns designed to advertise the products of all parties involved. We believe these programs will help us minimize our advertising costs, as they will be shared with other parties, while still achieving recognition in the marketplace.

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. The consolidation in the supermarket industry has led to fewer, but bigger buyers. From time to time, sales are transacted via e-commerce. We believe that our largest customers will require us and our competitors to implement one or more e-commerce distribution solutions to facilitate their procurement and inventory management programs. In our judgment, the shift to e-commerce by our largest customers will favorably impact larger handlers like us, which have the ability and financial resources to support these strategies. 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. Again, 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 2006, our 5 and 25 largest customers represented approximately 21% and 42% of our total consolidated revenues. During fiscal years 2006, 2005 and 2004 none of our California avocado customers represented more than 10% of total consolidated revenues.

We leverage our expertise in the handling and marketing of California avocados to our non-California sourced avocados and perishable food products. We believe that the sales generated from these sources complement our offering of California avocados to our customers and stabilize the supply of avocados during seasons of low California production. Sales generated from these sources include avocados grown outside of California and other perishable food products, such as papayas, tomatoes, ginger, and pineapple. We primarily import and market avocados from Mexico and Chile. We handle some of these products on a consignment basis for the suppliers. Pursuant to these arrangements, from time to time, we make advances to Chilean packers and Mexican growers. Historically, we made such advances related to both pre-harvest and post-harvest activities, but our focus during fiscal 2006 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 resale 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. We do not anticipate making significant pre-season advances during fiscal 2007.

Net sales generated by non-California sourced avocados depend principally on the availability of Chilean and Mexican grown avocados in the U.S. markets. In November 2004, the United States Department of Food and Agriculture (USDA) published a rule allowing Hass avocado imports from Mexico into all 50 states year round (up from 31 states for only a six month period), except for California, Florida, and Hawaii. We expect the restriction on such states to be lifted in February 2007. For the remaining 47 states, however, Mexico was able to deliver its fruit for all of fiscal 2006 and 2005. The implementation of this rule resulted in a significant increase in the sale of Mexican sourced fruit during fiscal 2005, as compared to fiscal 2004. See Item 7 for a detailed description of such increase.

In 1998, we invested in the Mexican avocado market by building a packinghouse in Uruapan, Mexico. We believe that our continued success in marketing Mexican avocados is largely dependent upon securing a reliable, high-quality supply of avocados at

## [Table of Contents](#)

reasonable prices. The Mexican avocado harvest is both complimentary and competitive with the California market, as the Mexican harvest typically runs 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 2006, we packed and distributed approximately 18% 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.

In recent years, the volume of avocados exported by Chilean growers to the United States has continued to increase. Chilean growers continue to increase/monitor avocado plantings to capitalize on returns available in the worldwide avocado markets. 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 2006, we distributed approximately 7% of the Chilean imports into the United States, based on our estimates.

In recent years, our distribution of other perishable food products has generally been limited to papayas procured from a Hawaiian packing operation, which is owned by the Chairman of our Board of Directors, Chief Executive Officer and President. The acquisition of Maui, however, expanded our perishable food products to include additional papayas, tomatoes, chili peppers, pineapples, and ginger. While Maui has numerous product offerings, the aforementioned commodities account for the majority of its sales.

Maui has operations in Arizona, California, and Hawaii. The primary focus of these operations is the growing, shipping and distribution of fresh produce. Maui primarily sources its products from the United States and Mexico and has customers located primarily in the United States and Canada. These customers are principally in the retail, foodservice, and wholesale sectors. Maui does not experience significant fluctuations in sales related to seasonality.

### **Processed Products**

In the 1960's and early 1970's, 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 the food service industry. Our customers include both companies in the food service industry and the retail business. Sales 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 2006, our 5 and 25 largest customers represented approximately 7% and 12% of our total consolidated revenues. During fiscal years 2006, 2005 and 2004 none of our processed product customers represented more than 10% of total consolidated revenues.

The processed product segment was originally conceived as a mechanism to stabilize the price of California avocados by reducing the volume of avocados available to the marketplace. 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.

In February 2003, our Board of Directors approved a plan whereby the operations of our processed products 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.

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 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.

During fiscal year 2006, we primarily operated one high-pressure line designed to manufacture processed avocado products that are not frozen (guacamole) in Uruapan. This machine ran at about 80% capacity during fiscal 2006. We anticipate that we will



## [Table of Contents](#)

operate such high-pressure machine at a similar capacity during fiscal year 2007. We presently own another, much smaller, high-pressure machine, also located in Uruapan, that was used occasionally during fiscal 2006. We anticipate trading such smaller machine in for credit towards another large high-pressure machine (similar to the large machine that is currently in use in Uruapan), once we receive the second high-pressure machine. This second large high-pressure machine was ordered in July 2006 and is expected to be received during our second fiscal quarter of 2007. Utilizing avocado pulp and chunks, these high-pressure machines allow us to deliver fresh guacamole to retail and food service customers. Sales of our high-pressure product totaled approximately \$13.9 million and \$8.7 million for fiscal years 2006 and 2005.

Although the additions of these product offerings are fairly recent, we believe that these high pressure machines will position our company to deliver the widest available array of processed avocado products to our customers. Consequently, we believe we are currently the only single source company supplying the complete range of processed avocado products, including frozen guacamole, ultra high pressure treated guacamole, and frozen avocado halves to foodservice and retail customers.

### **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 brand name and related logos. We also utilize the following trademarks in conducting our business: Avo Fresco, Bueno, Calavo Gold, Celebrate the Taste, El Dorado, Fresh Ripe, Select, Taste of Paradise, The First Name in Avocados, Tico, Mfresh, and Triggered Avocados, and ProRipeVIP™.

### **Working Capital Requirements**

Generally, we make payments to our California 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. We generally experience larger levels of commercial bank borrowings during the California Hass avocado crop harvesting season.

Non-California sourced avocados and perishable food products often requires 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 and are generally concentrated during the Chilean Hass avocado crop harvesting season.

With respect to our processed products 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 processed products within thirty days in advance of shipment.

### **Research and Development**

We do not undertake significant research and development efforts. Research and development programs, if any, are limited to the continuous process of refining and developing new techniques to enhance the effectiveness and efficiency of our processed products operations and the handling, ripening, storage, and packing of fresh avocados.

### **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.

## [Table of Contents](#)

The USDA regulates and reviews imported food products. In particular, the USDA regulates the distribution of Mexican avocados within 47 states in the U.S. by requiring avocado importers and handlers to execute compliance agreements. These agreements represent an acknowledgment by handlers of the distribution restrictions placed on Mexican avocados and are used as a tool to ensure compliance with existing regulations. From time to time, we have been approached by USDA representatives in their oversight of the compliance agreement process. We continue to consult with USDA representatives to ensure that our systems of internal control provide a high level of reliability in securing compliance agreements on behalf of our customers.

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. Nevertheless, there is no guarantee that we will be able to comply with any future laws and regulations or requirements for necessary permits and licenses. Our failure to comply with applicable laws and regulations or obtain any necessary permits and licenses could subject us to civil remedies including fines, injunctions, recalls or seizures, as well as potential criminal sanctions.

### **Employees**

As of October 31, 2006, we had approximately 750 employees, of which approximately 230 were located in the United States and 520 were located in Mexico. None of Calavo's United States employees are covered by a collective bargaining agreement. Approximately 450 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.

The following is a summary of the number of "salaried" and "hourly" employees as of October 31, 2006.

<b>Location</b>	<b>Salaried</b>	<b>Hourly</b>
United States	95	135
Mexico	54	466
<b>TOTAL</b>	<b>149</b>	<b>601</b>

Although agriculture is a seasonal industry, avocados have a wider window of production than most perishable commodities. Consequently, we employ hourly personnel more routinely throughout the year when compared to other agriculture-dependent companies.

### **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 are 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, New Zealand, the Dominican Republic, 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. Generally, an increase in foreign grown avocados in the markets we distribute in has the effect of lowering prices for California grown avocados and adversely impacting our results from operations.

## Table of Contents

- California avocado 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. 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;
- Changes in legal or regulatory requirements affecting foreign investment, loans, taxes, imports, and exports; and
- Currency exchange rate fluctuations which, 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.

*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.

*We are subject to rapidly 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. Our results of operations may be adversely affected if we are unable to comply with existing and modified regulations.

*Our business could be adversely affected if we lost key members of our management.*

We are dependent on the efforts and performance of our current directors and officers. If we were to lose any key members of management, our business could be adversely affected. You should read the information under “Executive Officers” in this Annual Report for additional information about our management.

*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

## Table of Contents

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.

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

None.

### **Item 2. Properties**

We lease our corporate headquarters building. Additionally, we own two packinghouses and one distribution and ripening facility (our former processing facility) in California, lease one facility in New Jersey, operate in a distribution center in Texas, own one processing facility in Mexico, and lease one packinghouse in Mexico.

In March 2005, we completed the sale of our corporate headquarters building (located in Santa Ana, CA) for \$3.4 million. In conjunction with such sale, we relocated our corporate offices to Santa Paula, California in March 2005. We currently lease our corporate headquarters from Limoneira (see note 12 to the consolidated financial statements).

Our two California facilities handle avocados delivered to us by California and Chilean growers. The Temecula, California facility was built in 1985 and has been improved in capacity and efficiency since then. The Santa Paula, California facility was purchased in 1955 and has had recent equipment improvements equivalent to our Temecula facility. We believe that the combined annual capacity of the two packinghouses, under normal workweek operations, is sufficient to pack the annually budgeted volume of California avocados delivered to us by our growers.

Our Santa Paula, California processing facility was built in 1975 and had a major expansion in 1988. In conjunction with our restructuring plan, which was approved in February 2003, this facility ceased operating as a processed product avocado processing facility and now functions primarily as a ripening, storage and shipping facility for our fresh avocado operation. Additionally, it also serves to store certain processed avocado products as well. Also, effective December 2005, we sort and pack certain tropical 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.

Our leased Swedesboro, New Jersey facility primarily ripens, sorts, packs and ships avocados. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.

Our distribution center located in San Antonio, Texas is neither leased nor owned, but rather operates pursuant to a usage agreement whereby we pay handling and distribution fees. This facility primarily ripens, sorts, packs and ships fresh avocados under our supervision. We believe that the annual capacity of this facility will be sufficient to handle our budgeted annual production needs.

Our owned processing facility in Uruapan, Michoacan, Mexico was constructed pursuant to our restructuring plan approved in February 2003. This facility commenced operations in February 2004. We believe that the annual capacity of this facility will be sufficient to process our budgeted annual production needs.

Our Uruapan, Mexico packinghouse, owned by the same landlord as our former Mexicali facility, was also built to our specifications. We are committed to leasing the facility through 2008 and have the option to purchase such facility at the end of the lease term. 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. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of our shareholders during the quarter ended October 31, 2006.

#### Executive Officers

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.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Lecil E. Cole	66	Chairman of the Board, Chief Executive Officer and President
Arthur J. Bruno	56	Chief Operating Officer, Chief Financial Officer and Corporate Secretary
Robert J. Wedin	57	Vice President, Sales and Fresh Marketing
Alan C. Ahmer	58	Vice President, Processed Product Sales and Production
Michael A. Browne	47	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 and Hawaii on which avocados, papayas, 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 processed products business. In September 2003, Mr. Ahmer's new title became Vice-President, Processed Products 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."

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 National Market.

<b>Fiscal 2006</b>	<b>High</b>	<b>Low</b>
First Quarter	\$10.50	\$9.59
Second Quarter	\$11.00	\$9.51
Third Quarter	\$11.94	\$9.37
Fourth Quarter	\$10.24	\$9.04

  

<b>Fiscal 2005</b>	<b>High</b>	<b>Low</b>
First Quarter	\$12.38	\$10.10
Second Quarter	\$11.81	\$ 9.76
Third Quarter	\$10.92	\$10.00
Fourth Quarter	\$10.25	\$ 8.66

As of October 31, 2006, there were approximately 1,400 stockholders of record of our common stock.

During the year ended October 31, 2006, we did not issue any shares of common stock that were not registered under the Securities Act of 1933.

**Dividend Policy**

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

On January 3, 2007, we paid a \$0.32 per share dividend in the aggregate amount of \$4,573,000 to shareholders of record on December 15, 2006.

On January 3, 2006, we paid a \$0.32 per share dividend in the aggregate amount of \$4,564,000 to shareholders of record on December 15, 2005.

**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, 2006 are derived from the audited consolidated financial statements of Calavo Growers, Inc. and our predecessor, Calavo Growers of California.

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.

	Fiscal Year Ended October 31, 2005				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
<b>Income Statement Data: (1)</b>					
Net sales	\$273,910	\$258,822	\$274,218	\$246,761	\$242,671
Gross margin	29,271	21,734	25,404	25,465	25,823
Net income	5,788	3,322	6,210	7,160	6,915
Basic and diluted net income per share	\$ 0.40	\$ 0.24	\$ 0.46	\$ 0.55	\$ 0.60
<b>Balance Sheet Data as of End of Period:</b>					
Working capital	\$ 12,023	\$ 17,618	\$ 20,353	\$ 20,735	\$ 18,833
Total assets(4)	107,494	108,482	67,398	53,689	55,132
Short-term debt(4)	1,308	1,313	22	24	3,222
Long-term debt, less current portion(2)(4)	10,406	11,719	34	61	3,180
Shareholders’ equity(4)	58,943	64,746	43,937	37,147	30,556
<b>Cash Flows Provided by (Used in):</b>					
Operations	\$ 7,819	\$ 5,568	\$ 4,460	\$ 15,222	\$ 8,135
Investing(3)(4)	(4,663)	(11,941)	(8,474)	(4,475)	(2,078)
Financing(4)	(4,239)	6,870	(725)	(6,293)	(7,193)
<b>Other Data:</b>					
Dividends per share	\$ 0.32	\$ 0.32	\$ 0.30	\$ 0.25	\$ 0.20
Net book value per share	\$ 4.12	\$ 4.51	\$ 3.25	\$ 2.87	\$ 2.38
Pounds of California avocados sold	218,460	104,950	152,725	122,950	158,187
Pounds of non-California avocados sold	70,063	103,830	69,410	70,348	69,512
Pounds of processed avocados products sold	20,489	15,628	13,317	14,707	14,248

- (1) Operating results for fiscal years 2006, 2005, and 2004 include the acquisition of Maui Fresh International, Inc. For fiscal years 2006, 2005, and 2004, Maui’s net sales, gross margins, and net income were as follows: (2006) \$22.1 million, \$1.4 million, and \$0.2 million, (2005) \$21.7 million, \$1.1 million, and \$0.4 million, and (2004) \$19.8 million, \$1.4 million, and \$0.5 million.
- (2) In July 2003, our Board of Directors approved the retirement of our Industrial Development Revenue Bond. The bonds were initially floated to provide the financing to construct our Temecula, California packinghouse. We repaid the final \$2.8 million in principal under the indenture in September 2003.
- (3) Cash flows used in investing activities for fiscal 2004 and 2003 include the effect of constructing a processing facility in Uruapan, Michoacan, Mexico. The Uruapan facility commenced operations in February 2004.
- (4) Total assets, short-term debt, long-term debt, equity, cash flows used in investing activities, and cash flows provided by financing activities for fiscal 2005 include the effect of the stock purchase agreement with Limoneira Company. See Note 12 to the consolidated financial statements.

## 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, processed avocado products, and other perishable food products throughout the United States and elsewhere in the world. 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 a competitive return to our growers. This reputation has enabled us to expand our product offering to include avocados sourced on an international basis, processed avocado products, and other perishable foods. During the second quarter of fiscal 2006, we examined our California avocados and international avocados and perishable food products reporting segments. We concluded that these two reporting segments have similar economic characteristics, production processes, customers and distribution methods. Therefore, in accordance with the aggregation criteria of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, we combined these two operating segments into one reportable segment, fresh products. As a result, we now report our operations in two different business segments: (1) fresh products and (2) processed products. See footnote 11 in our consolidated financial statements for further discussion. We report our financial results on a November 1 to October 31 fiscal year basis to coincide with the California avocado harvest season.

On October 9, 2001, we completed a series of transactions whereby common and preferred shareholders of Calavo Growers of California, an agricultural marketing cooperative association, exchanged all of their outstanding shares for shares of our common stock. Concurrently with this transaction, the Cooperative was merged into us with 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. The merger and the conversion were approved on an overwhelming basis by both the Cooperative's shareholders and our board of directors. Prior to the merger, the Cooperative reported results of operations as constituting either member (the packing and distribution of avocados procured from either members or associate members) or non-member business (non-member business included both the processed product business and the sourcing and distribution of all crops that were not procured from the Cooperative's members).

In August 2006, we entered into a joint venture agreement with San Rafael Distributing (SRD) for the purpose of 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 shall have overall management responsibility for the operations of Maui Fresh at the Terminal Market. Therefore, pursuant to Accounting Principle Board (APB) 18 and Emerging Issues Task Force (EITF) 03-16, we believe that our level of economic influence is that of "significant." As such, we will use the equity method to account for our investment. See note 16 to our consolidated financial statements for additional information.

Our Fresh Products business grades, sizes, packs, cools, and ripens (if desired) avocados grown in California for delivery to our customers. We presently operate three packinghouses in Southern California. These packinghouses handled approximately 36% of the California avocado crop during the 2006 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 are fixed. Our strategy calls for continued efforts in retaining existing growers, aggressively recruiting new growers, and procuring a larger percentage of the California avocado crop to improve our results from operations.

Additionally, our Fresh products business also procures avocados grown in Mexico and Chile, as well as other various commodities, including papayas, tomatoes, chili peppers, pineapples, and ginger. We operate a packinghouse in Mexico that, together with certain co-packers that we frequently purchase fruit from, handled approximately 18% 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 2005-2006 Mexican season, based on our estimates. Additionally, during the 2005-2006 Chilean avocado season, we handled approximately 7% of the Chilean avocado crop, based on our estimates. Our strategy is to procure and sell non-Californian grown avocados to complement our distribution efforts of California grown avocados. We believe that the introduction of these avocados, although competitive at times with California grown avocados, 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.



## Table of Contents

Our processed products business procures avocados, processes avocados into a wide variety of guacamole products, and distributes the processed product to our customers. In February 2003, our Board of Directors approved a plan whereby the operations of our processed products business would be relocated. The plan called for the closing of our Santa Paula, California and Mexicali, Baja California Norte processing facilities and the relocation of these operations to a new facility in Uruapan, Michoacan, Mexico. 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 were closed in February 2003 and August 2004. During fiscal 2005, we incurred costs related to this restructuring approximating \$0.4 million, which are recorded in our income statement as both cost of sales (\$0.3 million) and selling, general and administrative expenses (\$0.1 million). All the above amounts have been paid and we do not expect any additional operating costs related to this restructuring.

Processed products customers include both food service industry and retail businesses. Our strategy calls for the development of new guacamole recipes and other processed avocado products that address the diverse taste of today's consumers. We also 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.

Our Fresh Products business is highly seasonal and is characterized by crop volume and price changes. Furthermore, the operating results of all of our businesses, including our processed products business, have been, and will continue to be, affected by substantial 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 processed products 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*

In January 2007, we paid a \$0.32 per share dividend in the aggregate amount of \$4.6 million to shareholders of record on December 15, 2006.

#### *Short-term borrowings*

In October 2006, we renewed and extended one of our short-term, non-collateralized, revolving credit facilities. This credit facility now expires in February 2010. Under the terms of this agreement, we are advanced funds for working capital purposes. Total credit available under this short-term borrowing agreement was \$12 million, with an average interest rate of 6.2% at October 31, 2006. Under this credit facility, we had no amounts outstanding as of October 31, 2006. The credit facility contains various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at October 31, 2006, except for the working capital covenants with which we obtained appropriate waivers.

#### *Retirement of Common Stock*

In December 2005, we repurchased 120,000 shares of our common stock at an average price per share of \$10.00 from the estate of a deceased former member of our Board of Directors.

#### *Operating Lease*

In August 2006, we entered into an operating lease agreement with Columbia New Jersey Commodore Industrial, LLC to rent approximately 30,000 square feet of building space in Swedesboro, New Jersey. This lease enables us to not only invest in our ProRipeVIP™ avocado ripening program, but also expand our refrigeration and storage capabilities. The lease has a term of approximately 15 years and includes scheduled rent increases. Pursuant to FASB Technical Bulletin 85-3, our straight-line rent expense for such lease will approximate \$13,000 per month for the duration of such lease. This facility commenced operations during the first quarter of fiscal 2007.

## 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 average length of time between the product shipment date and the date on which we pay the customer the promotional allowance. The product of this lag factor and our historical promotional allowance payment rate is the basis for the promotional allowance included in accrued expenses on our balance sheet. Actual amounts may differ from these estimates and such differences are recognized as an adjustment to net sales in the period they are identified.

*Income Taxes.* Our effective income tax rate and the tax bases of assets and liabilities are based on estimates of taxes which will ultimately be payable. Deferred taxes are recorded to give recognition to temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. Valuation allowances are established when it is deemed, more likely than not, that the benefit of deferred tax assets will not be realized.

*Goodwill and acquired intangible assets.* The purchase method of accounting for business combinations requires us to make use of estimates and judgments to allocate the purchase price paid for acquisitions to the fair value of the net tangible and identifiable intangible assets. Goodwill is tested for impairment annually, or when a possible impairment is indicated, using the fair value based test prescribed by Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. The impairment test requires us to compare the fair value of business reporting units to carrying value, including goodwill. We primarily use an “income approach” (which considers the present value of future cash flows) in combination with a “market approach” (which considers what other purchasers in the marketplace have paid for similar businesses) to determine fair value. Future cash flows typically include operating cash flows for the business for five years and an estimated terminal value. Management judgment is required in the estimation of future operating results and to determine the appropriate terminal values. Future operating results and terminal values could differ from the estimates and could require a provision for impairment in a future period.

*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.

*Revenue recognition.* Sales of products and related costs of products sold are recognized when persuasive evidence of an arrangement exists, shipment has been made, title passes, the price is fixed or determinable and collectibility 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.

[Table of Contents](#)**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,		
	2006	2005	2004
Net sales	100.0%	100.0%	100.0%
Gross margins	10.7%	8.4%	9.3%
Selling, general and administrative	7.3%	7.2%	5.8%
Operating income	3.4%	1.2%	3.4%
Interest Income	0.1%	0.1%	0.1%
Interest Expense	(0.3)%	(0.2)%	0.0%
Other income, net	0.2%	0.9%	0.1%
Net income	2.1%	1.3%	2.3%

**Net Sales**

We believe that the fundamentals for our products continue to be favorable. Government census studies continue to indicate a shift in the demographics of the U.S. population in which larger portions of the population descend from a Hispanic origin. Avocados are considered a staple item purchased by Hispanic consumers and their acceptance as part of American cuisine continues to spur demand for our products. We anticipate avocado products will further penetrate the United States marketplace driven by growth in the Hispanic community and general acceptance in American cuisine. 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.

Sales of products and related costs of products sold are recognized when persuasive evidence of an arrangement exists, shipment has been made, title passes, the price is fixed or determinable and collectibility 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 table summarizes our net sales by business segment:

	2006	Change	2005 (Dollars in thousands)	Change	2004
<b>Net sales:</b>					
Fresh products	\$ 236,889	2.9%	\$ 230,289	(7.4)%	\$ 248,562
Processed products	37,021	29.7%	28,533	11.2%	25,656
Total net sales	<u>\$ 273,910</u>	5.8%	<u>\$ 258,822</u>	(5.6)%	<u>\$ 274,218</u>
<b>As a percentage of net sales:</b>					
Fresh products	86.5%		89.0%		90.6%
Processed products	13.5%		11.0%		9.4%
	<u>100.0%</u>		<u>100.0%</u>		<u>100.0%</u>

Net sales for the year ended October 31, 2006, when compared to 2005, increased by approximately \$15.1 million, or 5.8%, principally as a result of an increase in both our fresh products and processed products segments. The increase in sales for both segments was primarily driven by a significant increase in total pounds sold.

Net sales generated by Fresh products segment are significantly impacted by the availability of Chilean and Mexican grown avocados in the U.S. markets. In November 2004, the USDA published a rule allowing Hass avocado imports from Mexico into all 50 states year round (up from 31 states for only a six month period), except for California, Florida, and Hawaii. We expect the restriction on such states to be lifted in February 2007. For the remaining 47 states, however, Mexico was able to deliver its fruit for all of fiscal 2005. The implementation of this rule resulted in a significant increase in the sale of Mexican sourced fruit during fiscal 2005.

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

[Table of Contents](#)

	Year ended October 31, 2006			Year ended October 31, 2005		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	\$ 140,995	\$ —	\$ 140,995	\$ 104,481	\$ —	\$ 104,481
Imported avocados	51,211	—	51,211	81,756	—	81,756
Papayas	4,811	—	4,811	6,251	—	6,251
Specialities and tropicals	9,724	—	9,724	13,777	—	13,777
Processed — food service	—	34,021	34,021	—	28,307	28,307
Processed — retail and club	—	10,454	10,454	—	6,766	6,766
Total fruit and product sales to third-parties	206,741	44,475	251,216	206,265	35,073	241,338
Freight and other charges	30,156	637	30,793	24,129	258	24,387
Total gross sales to third-parties	236,897	45,112	282,009	230,394	35,331	265,725
Less sales incentives	(8)	(8,091)	(8,099)	(105)	(6,798)	(6,903)
Total net sales to third-parties	236,889	37,021	273,910	230,289	28,533	258,822
Intercompany sales	9,532	6,227	15,759	15,850	6,166	22,016
Net sales	<u>\$ 246,421</u>	<u>\$ 43,248</u>	289,669	<u>\$ 246,139</u>	<u>\$ 34,699</u>	280,838
Intercompany sales eliminations			(15,759)			(22,016)
Consolidated net sales			<u>\$ 273,910</u>			<u>\$ 258,822</u>
	Year ended October 31, 2005			Year ended October 31, 2004		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	\$ 104,481	\$ —	\$ 104,481	\$ 150,159	\$ —	\$ 150,159
Imported avocados	81,756	—	81,756	54,589	—	54,589
Papayas	6,251	—	6,251	6,846	—	6,846
Specialities and tropicals	13,777	—	13,777	14,233	—	14,233
Processed — food service	—	28,307	28,307	—	27,352	27,352
Processed — retail and club	—	6,766	6,766	—	4,285	4,285
Total fruit and product sales to third-parties	206,265	35,073	241,338	225,827	31,637	257,464
Freight and other charges	24,129	258	24,387	22,914	534	23,448
Total gross sales to third-parties	230,394	35,331	265,725	248,741	32,171	280,912
Less sales incentives	(105)	(6,798)	(6,903)	(179)	(6,515)	(6,694)
Total net sales to third-parties	230,289	28,533	258,822	248,562	25,656	274,218
Intercompany sales	15,850	6,166	22,016	9,347	7,093	16,440
Net sales	<u>\$ 246,139</u>	<u>\$ 34,699</u>	280,838	<u>\$ 257,909</u>	<u>\$ 32,749</u>	290,658
Intercompany sales eliminations			(22,016)			(16,440)
Consolidated net sales			<u>\$ 258,822</u>			<u>\$ 274,218</u>

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

*Fresh Products*

Net sales delivered by the business increased by approximately \$6.6 million, or 2.9%, from fiscal 2005 to 2006. This increase is primarily related to an increase in California avocados sales, partially offset by a decrease in Mexican and Chilean avocado sales.

Sales of California sourced avocados increased \$36.5 million for fiscal 2006, when compared to the same prior period. This increase was primarily related to a 108.1% increase in pounds of avocados sold, partially offset by a decrease in our average selling prices. This increase in pounds sold was consistent with the expected increase in the overall harvest of the California avocado crop for the 2005/2006 season. Our market share of California avocados remained consistent at 35.6% for the year ended October 31, 2006, compared to 34.4% for the same period in the prior year. Based on estimates generated from the California Avocado Commission, we expect the California avocado crop for the 2006/2007 season to be substantially smaller than the 2005/2006 crop.

For fiscal year 2006, average selling prices, on a per carton basis, for California avocados were 35.6% lower when compared to the same prior year period. This pricing structure primarily reflects the impact of a larger California avocado harvest, as well as a 7.0% increase in the sale of grade two Hass avocados in proportion to grade one Hass avocados sales. Grade two Hass avocados generally sell for significantly less than grade one Hass avocados. For fiscal year 2007, we believe that the demand for California avocados will remain strong in the U.S. marketplace, and, as a result, such is expected to have a positive impact on sales prices. California avocados are primarily sold in the U.S. marketplace.

Sales of Mexican sourced avocados decreased \$13.0 million for fiscal year 2006, when compared to the same prior year period. This decrease was primarily related to a 19.7% decrease in pounds of Mexican avocados sold, due primarily to the large California crop discussed above. Our average selling prices, on a per carton basis, of Mexican avocados experienced a marginal decrease of 3.9% for fiscal 2006 when compared to the same prior period.

Sales of Chilean sourced avocados decreased \$13.6 million for fiscal year 2006, when compared to the same prior year period. This decrease was primarily related to a 67.7% decrease in pounds of Chilean avocados sold. This decrease was primarily related to

## [Table of Contents](#)

the size of the Chilean avocado crop, as well as the timing of the delivery to the United States. Our average selling prices, on a per carton basis, of Chilean avocados experienced a marginal increase of 4.0% for fiscal 2006 when compared to the same prior period.

Mexican and Chilean grown avocados are primarily sold in the U.S., Japanese, and/or European marketplace. We anticipate that sales of Mexican grown avocados will increase in fiscal 2007 primarily as a result of the smaller California avocado crop discussed above. We are unable to predict, however, the impact related to the USDA published rule that will allow Hass avocado imports from Mexico into all 50 states (up from 47 states) effective February 2007. In any case, we intend to leverage our position as the largest packer of Mexican grown avocados for export markets to improve the overall performance of these sales.

Sales of papayas decreased \$1.4 million for fiscal year 2006, when compared to the same prior year period. This decrease was primarily related to a 38.6% decrease in the volume of papaya fruit sold. This decrease was primarily related to adverse weather conditions negatively affecting the current year papaya crop. Such decrease, however, was partially offset by an increase in average selling prices of papayas, on a per carton basis, which increased approximately 44.5% when compared to the same prior year period. We attribute some of this increase in average selling prices to significantly fewer pounds sold in the U.S. marketplace. We anticipate our papaya results to increase in fiscal 2007, as we expect an increase in the related papaya crop.

Net sales delivered by the business decreased by approximately \$18.3 million, or 7.4%, from fiscal 2004 to 2005. This decrease is primarily related to a decrease in California avocados sales, partially offset by an increase in Mexican and Chilean avocado sales.

Sales of California sourced avocados decreased \$49.9 million for fiscal 2005, when compared to the same prior period. This decrease was primarily related to a 31.3% decrease in pounds of avocados sold, partially offset by an increase in our average selling prices. This decrease in pounds sold was consistent with the expected decrease in the overall harvest of the California avocado crop for the 2004/2005 season. Our market share of California avocados remained consistent at 34.4% for the year ended October 31, 2005, compared to 34.7% for the same period in the prior year.

For fiscal year 2005, average selling prices, on a per carton basis, for California avocados were 6.7% higher when compared to the same prior year period. This pricing structure primarily reflected the impact of a smaller California avocado harvest, partially offset by an increase in foreign-sourced fruit in the U.S. marketplace.

Sales of Mexican sourced avocados increased \$24.7 million for fiscal year 2005, when compared to the same prior year period. This increase was primarily related to a 62.8% increase in pounds of Mexican avocados sold. This increase was primarily related to the smaller California crop discussed above, as well as the USDA published rule that allowed Hass avocado imports from Mexico into 47 U.S. states, up from 31 U.S. states, effective February 2005. Pricing during fiscal 2005 was stable when compared to fiscal 2004.

Sales of Chilean sourced avocados increased \$6.1 million for fiscal year 2005, when compared to the same prior year period. This increase was primarily related to a 65.7% increase in pounds of Chilean avocados sold. This increase was primarily related to the size of the Chilean avocado crop. Pricing during fiscal 2005 was stable when compared to fiscal 2004.

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 sold in the U.S. marketplace, including imported and California grown fruit. 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 California avocado and international avocado businesses. During fiscal 2006, 2005 and 2004, on behalf of avocado growers, we remitted approximately \$1.7 million, \$1.5 million and \$2.9 million to the California Avocado Commission. During fiscal 2006, 2005 and 2004, we remitted approximately \$4.7 million, \$2.4 million and \$3.3 million to the Hass Avocado Board.

### *Processed Products*

Net sales increased by approximately \$8.5 million, or 29.7% for fiscal 2006, when compared to the same prior period. The increase in net sales is primarily attributable to an increase of 4.9 million pounds of product sold, or 31.1%. Such increase was partially offset, however, by a decrease in the net selling price totaling \$0.02 per product pound sold, or 1.1%. During fiscal year 2006, the increase in pounds sold primarily relates to an increase in the sale of our high-pressure guacamole product, which increased approximately 37% when compared to the same prior year period. The decrease in our net average selling price primarily relates to a change in our product mix.

Net sales increased by approximately \$2.9 million, or 11.2% for fiscal 2005, when compared to the same prior year period. The increase was primarily attributable to an increase of 2.3

## [Table of Contents](#)

million pounds of product sold, or 17.4%, net of a decrease in sales incentives and promotions paid, totaling \$0.07 per pound of product sold, or 14.3%. Such increase, however, was partially offset by a decrease in the sales price per product pound sold of \$0.09, or 4.7%. During fiscal year 2005, the increase in pounds sold primarily related to an increase in the sale of our high-pressure guacamole product, which increased 56.2% when compared to the same prior year period. The decrease in our average selling price and sales incentives and promotional activities paid primarily related to a change in our product mix.

During fiscal year 2006, we primarily operated one high-pressure line designed to manufacture processed avocado products that are not frozen (guacamole) in Uruapan. This machine ran at about 80% capacity during fiscal 2006. We anticipate that we will operate such high-pressure machine at a similar capacity during fiscal year 2007. We presently own another, much smaller, high-pressure machine, also located in Uruapan, that was used occasionally during fiscal 2006. We anticipate trading such smaller machine in for credit towards another large high-pressure machine (similar to the large machine that is currently in use in Uruapan), once we receive the second high-pressure machine. This second large high-pressure machine was ordered in July 2006 and is expected to be received during our second fiscal quarter of 2007. Utilizing avocado pulp and chunks, these high-pressure machines allow us to deliver fresh guacamole to retail and food service customers. Sales of our high-pressure product totaled approximately \$13.9 million and \$8.7 million for fiscal years 2006 and 2005.

### **Gross Margins**

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

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
<b>Gross Margins:</b>					
Fresh products	\$ 18,673	9.4%	\$ 17,071	(22.6)%	\$ 22,060
Processed products	10,598	127.3%	4,663	39.4%	3,344
Total gross margins	<u>\$ 29,271</u>	34.7%	<u>\$ 21,734</u>	(14.4)%	<u>\$ 25,404</u>
<b>Gross profit percentages:</b>					
Fresh products	7.9%		7.4%		8.9%
Processed products	28.6%		16.3%		13.0%
Consolidated	10.7%		8.4%		9.3%

Our cost of goods sold 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. Consolidated gross margin, as a percent of sales, increased 2.3% for fiscal year 2006 when compared to fiscal year 2005. This increase was principally attributable to increased profitability in fresh products segment, as well as our processed product segment. Consolidated gross margin, as a percent of sales, decreased 0.9% for fiscal year 2005 when compared to fiscal year 2004. This decrease was principally attributable to decreased profitability in our fresh products segment, partially offset by increased profitability in our processed product segment.

Gross margins and gross profit percentages related to California avocados are largely dependent on production yields achieved at our packinghouses, current market prices of avocados, and the volume of avocados packed. The increase in our gross margin percentage during fiscal year 2006 was primarily related to a significant increase in pounds of fruit sold, partially offset by an increase in the cost of fruit. During fiscal year 2006, when compared to fiscal year 2005, we experienced a 108.1% increase in pounds of avocados sold. This had the effect of decreasing our per pound costs, which, as a result, positively impacted gross margins.

The decrease in our gross margin percentage during fiscal year 2005 was primarily related to a significant decrease in pounds of fruit sold. During fiscal year 2005, when compared to fiscal year 2004, we experienced a 31.3% decrease in pounds of avocados sold. This had the effect of increasing our per pound costs, which, as a result, negatively impacted gross margins. Such higher per pound cost was partially offset, however, by an increase in our packing and marketing fee (which is charged to cover our costs and a profit).

The gross margin and gross profit percentage for consignment sales, including primarily Chilean avocados, as well as Hawaiian grown papayas, is dependent on the volume of fruit we handle and the competitiveness of the returns that we provide to third-party packers. The gross margin we earn is generally based on a commission agreed to with each packer. Accordingly, the gross margin results for these products are a function of the volume handled and the competitiveness of the sales prices that we realize. 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 year 2006, 2005, and 2004, we generated gross margins of \$1.2 million, \$1.7 million, and \$1.8 million from the sale of fresh produce products that were packed by third parties.

## Table of Contents

Our business with Mexican growers differs in that we operate a packinghouse in Mexico and purchase avocados directly from the field. Alternatively, we may also purchase Mexican avocados directly from co-packers located in Mexico as well. In either case, the gross margin and gross profit percentages generated by our Mexican operations are significantly impacted by the volume of avocados handled by our packinghouse and the cost of the fruit. During fiscal year 2006, our gross margins generated from the sale of Mexican avocados decreased from approximately \$3.8 million in fiscal year 2005 to \$0.8 million in fiscal year 2006. Such decrease is primarily related to both the significant decrease in the volume of Mexican avocados sold, totaling 19.7% (primarily related to the large California crop discussed above), as well as an increase in Mexican fruit costs. Collectively, these items contributed to a higher per pound cost, which negatively affected gross margins.

During fiscal year 2005, our gross margins generated from the sale of Mexican avocados increased from approximately \$1.5 million in fiscal year 2004 to \$3.8 million in fiscal year 2005. We did not experience a significant fluctuation in our gross margin percentage for fiscal 2005 as compared to fiscal 2004 related to our Mexican operations.

Gross margins and gross profit percentages for our processed products business are largely dependent on the pricing of our final product and the cost of avocados used in preparing guacamole. During fiscal year 2006, the processed products gross profit percentages increased primarily as a result of lower fruit costs and increases in total pounds produced, both of which had the effect of reducing our per pound costs. During fiscal year 2005, the processed products gross profit percentages increased primarily as a result of efficiencies related to the relocation of production from Santa Paula, California and Mexicali, Mexico to our newly acquired facility in Uruapan, Mexico. Such efficiencies include the elimination of duplicative overhead, as well as lower production costs. Additionally, our processed product segment experienced lower fruit costs. Such improvements, however, were partially offset by an increase in the sale of products that generate a lower gross margin than those sold in the prior year.

### ***Selling, General and Administrative***

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
Selling, general and administrative	\$19,954	7.3%	\$18,588	16.8%	\$15,920
Percentage of net sales	7.3%		7.2%		5.8%

Selling, general and administrative expenses include costs of marketing and advertising, sales expenses, and other general and administrative costs. For fiscal year 2006, selling, general and administrative expenses increased by \$1.4 million, or 7.3%, compared to the same period for fiscal 2005. This increase was primarily related to higher corporate costs, including, but not limited to, costs related to an increase in stock-based compensation (totaling approximately \$0.6 million), an increase in management bonuses (totaling approximately \$1.1 million), and an increase in employee compensation costs (totaling approximately \$0.5 million). Such higher corporate costs were partially offset by a decrease in auditing/Sarbanes-Oxley costs (totaling approximately \$0.2 million), a decrease in bad debt expense (totaling approximately \$0.5 million), and a decrease in corporate moving expenses (totaling approximately \$0.3 million).

For fiscal year 2005, selling, general and administrative expenses increased by \$2.7 million, or 16.8%, compared to the same period for fiscal 2004. This increase was primarily related to higher corporate costs, including, but not limited to, costs related to implementing provisions required under section 404 of the Sarbanes-Oxley Act (totaling approximately \$2.2 million), an increase in bad debt expense (totaling approximately \$0.5 million), and corporate moving expenses (totaling approximately \$0.4 million). Such higher corporate costs were partially offset by a decrease in employee compensation costs (totaling approximately \$0.7 million).

### ***Interest income***

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
Interest income	\$356	2.3%	\$348	(10.3)%	\$388
Percentage of net sales	0.1%		0.1%		0.1%

Interest income is primarily generated from overnight investments, loans to growers, and our notes receivable from shareholders. During fiscal years 2006, 2005 and 2004, interest income includes interest accrued on notes receivable from directors and officers of approximately \$0.2 million for each year presented.

[Table of Contents](#)**Interest expense**

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
Interest expense	\$(943)	136.3%	\$(399)	504.5%	\$(66)
Percentage of net sales	(0.3)%		(0.2)%		0.0%

Interest expense is primarily generated from our short-term borrowings as well as our term loan agreement with Farm Credit West, PCA. The increase in interest expense is primarily related to the non-collateralized term loan agreement with Farm Credit West, PCA that we entered into in July 2005 to finance the purchase of our Limoneira Stock. Pursuant to such agreement, we borrowed \$13.0 million, which is to be repaid in 10 annual installments of \$1.3 million. Such annual installments began July 2006 and continue through July 2015. Interest is paid monthly, in arrears, and began in August 2005, and will continue through the life of the loan. Such loan bears interest at a fixed rate of 5.70%.

**Other Income, Net**

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
Other income, net	\$599	(75.1)%	\$2,408	1,443.6%	\$156
Percentage of net sales	0.2%		0.9%		0.1%

Other income, net includes dividend income, as well as certain other transactions that are outside of the course of normal operations. During fiscal 2006 and 2005, we received \$0.4 million and \$0.2 million as dividend income from Limoneira. During fiscal year 2005, other income, net includes the gain on the sale of our corporate facility totaling approximately \$1.7 million.

**Provision for Income Taxes**

	<u>2006</u>	<u>Change</u>	<u>2005</u> (Dollars in thousands)	<u>Change</u>	<u>2004</u>
Provision for income taxes	\$3,620	66.0%	\$2,181	(38.9)%	\$3,567
Percentage of income before provision for income taxes	38.5%		39.6%		36.5%

The effective income tax rate for fiscal year 2006 and 2005 is higher than the federal statutory rate principally due to state taxes. Our effective income tax rate decreased from 39.6% in fiscal year 2005 to 38.5% in fiscal year 2006 primarily as a result of a favorable decrease in our foreign tax rates during fiscal year 2006 when compared to fiscal year 2005. Our effective income tax rate increased from 36.5% in fiscal year 2004 to 39.6% in fiscal year 2005 primarily as a result of an unfavorable increase in our foreign tax rates during fiscal year 2005 when compared to fiscal year 2004.



## Quarterly Results of Operations

The following table presents our operating results for each of the eight fiscal quarters in the period ended October 31, 2006. 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. The California crop is highly seasonal and is characterized by crop volume and price changes. Historically, we receive and sell a substantially lesser number of California avocados in our first fiscal quarter.

	Three months ended							
	Oct. 31, 2006	July 31, 2006	Apr. 30, 2006	Jan. 31, 2006	Oct. 31, 2005	July 31, 2005	Apr. 30, 2005	
(in thousands, except per share amounts)								
<b>Statement of Operations Data</b>								
Net sales	\$ 76,880	\$ 78,954	\$ 67,429	\$ 50,647	\$ 62,246	\$ 88,699	\$ 60,206	\$ 47,671
Cost of sales	69,896	68,738	58,768	47,237	58,013	79,505	53,851	45,719
Gross margin	6,984	10,216	8,661	3,410	4,233	9,194	6,355	1,952
Selling, general and administrative	5,163	5,284	5,063	4,444	4,943	4,825	4,307	4,513
Operating income (loss)	1,821	4,932	3,598	(1,034)	(710)	4,369	2,048	(2,561)
Other income (expense), net	292	(136)	10	(75)	213	153	1,909	82
Income before provision (benefit) for income taxes	2,113	4,796	3,608	(1,109)	(497)	4,522	3,957	(2,479)
Provision (benefit) for income taxes	775	1,870	1,419	(444)	20	1,603	1,490	(932)
Net income (loss)	<u>\$ 1,338</u>	<u>\$ 2,926</u>	<u>\$ 2,189</u>	<u>\$ (665)</u>	<u>\$ (517)</u>	<u>\$ 2,919</u>	<u>\$ 2,467</u>	<u>\$ (1,547)</u>
Net income (loss) per share:								
Basic	\$ 0.09	\$ 0.21	\$ 0.15	\$ (0.05)	\$ (0.04)	\$ 0.21	\$ 0.18	\$ (0.11)
Diluted	\$ 0.09	\$ 0.21	\$ 0.15	\$ (0.05)	\$ (0.04)	\$ 0.21	\$ 0.18	\$ (0.11)
Number of shares used in per share computation:								
Basic	14,292	14,171	14,282	14,352	14,371	14,171	13,507	13,507
Diluted	14,319	14,237	14,343	14,352	14,371	14,237	13,580	13,507

## Liquidity and Capital Resources

Operating activities for fiscal 2006, 2005 and 2004 provided cash flows of \$7.8 million, \$5.6 million, and \$4.5 million. Fiscal year 2006 operating cash flows reflect our net income of \$5.8 million, net noncash charges (depreciation and amortization, income from subsidiary, loss on disposal of fixed assets, and stock compensation expense) of \$2.7 million and a net increase in the non-cash components of our working capital of approximately \$0.6 million.

Fiscal year 2006 decreases in operating cash flows, caused by working capital changes, include an increase in accounts receivable of \$5.0 million, an increase in prepaid expenses and other assets of \$2.0 million, an increase in income tax receivable of \$1.2 million, an increase in inventory of \$0.5 million, and an increase in advance to suppliers of \$0.3 million, partially offset by an increase in payable to growers of \$4.6 million, an increase in trade accounts payable and accrued expenses of \$2.9 million and a net decrease in deferred income taxes totaling \$0.9 million.

Increases in our accounts receivable balance as of October 31, 2006, when compared to October 31, 2005, primarily reflect a significantly higher volume of California avocado sales recorded in the month of October 2006, as compared to October 2005. Similarly, the amounts payable to our growers also reflects the increase in the volume of California avocados received in the month of October 2006, as compared to October 2005. These volume level fluctuations are consistent with the harvests experienced in the related years. Additionally, the increase in our prepaid expenses and other assets as of October 31, 2006, when compared to October 31, 2005, is primarily related to advances made pursuant to our Grower Development Program. The increase in our income tax receivable is primarily related to estimated payments made in fiscal 2006, as well as overpayments of taxes made in the prior year that were credited during fiscal 2006.

Increases in our trade accounts payable and accrued expenses as of October 31, 2006, when compared to October 31, 2005, primarily reflect accruals for bonuses to employees, additional accruals for vendors used in the ordinary course of California business, as well as accruals related to purchased fruit.

Cash used in investing activities was \$4.7 million, \$11.9 million, and \$8.5 million for fiscal years 2006, 2005, and 2004. Fiscal year 2006 cash flows used in investing activities include capital expenditures of \$4.5 million, principally related to the construction of coolers for our ProRipeVIP™ avocado ripening program, payments for Aweta AFS technology and equipment, and the acquisition of avocado bins.

Cash used in financing activities was \$4.2 million, and \$0.7 million for fiscal years 2006 and 2004, while cash provided by financing activities was \$6.9 million for fiscal year 2005. Cash used during fiscal year 2006 primarily includes the payment of a

## [Table of Contents](#)

dividend totaling \$4.6 million, a payment related to our long-term obligation of \$1.3 million, as well as a \$1.2 million payment to retire 120,000 shares of our common stock. These cash usages were partially offset, however, by proceeds from our short-term borrowings totaling \$2.4 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, 2006 and 2005 totaled \$0.1 million and \$1.1 million. Our working capital at October 31, 2006 was \$12.0 million compared to \$17.6 million at October 31, 2005. The overall working capital decrease primarily reflects additional short-term borrowings, as well as additional accrued expenses and trade accounts payable.

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. In October 2006, we renewed and extended one of our short-term, non-collateralized, revolving credit facilities. Our two credit facilities now expire in February 2010 and April 2008 and are with separate banks. Under the terms of these agreements, we are advanced funds for working capital purposes. Total credit available under the combined short-term borrowing agreements was \$24 million, with a weighted-average interest rate of 6.2% and 4.8% at October 31, 2006 and 2005. Under these credit facilities, we had \$3.8 million and \$1.4 million outstanding as of October 31, 2006 and 2005. The credit facilities contain various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at October 31, 2006, except for the working capital covenants with which we obtained appropriate waivers.

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, 2006:

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	4-5 years	More than 5 years
Long-term debt obligations (including interest)	\$ 12,381	\$ 1,382	\$ 4,128	\$ 2,748	\$ 4,123
Short-term borrowings	3,804	3,804	—	—	—
Defined benefit plan	414	47	141	94	132
Operating lease commitments	5,670	1,279	1,638	746	2,007
Total	<u>\$ 22,269</u>	<u>\$ 6,512</u>	<u>\$ 5,907</u>	<u>\$ 3,588</u>	<u>\$ 6,262</u>

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, research, and promotion efforts.

We have commitments for capital expenditures totaling approximately \$1.1 million as of October 31, 2006.

### Impact of Recently Issued Accounting Pronouncements

See Note 2 of Notes to Consolidated Financial Statements.

[Table of Contents](#)**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Our financial instruments include cash and cash equivalents, accounts receivable, notes receivable from shareholders, payable to growers, accounts payable, current 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, 2006.

(All amounts in thousands)

	Expected maturity date October 31,						Total	Fair Value
	2007	2008	2009	2010	2011	Thereafter		
<b>Assets</b>								
Cash and cash equivalents (1)	\$ 50	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 50	\$ 50
Accounts receivable (1)	24,202	—	—	—	—	—	24,202	24,202
Notes receivable from shareholders (2)	2,430	—	—	—	—	—	2,430	2,278
<b>Liabilities</b>								
Payable to growers (1)	\$ 6,334	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 6,334	\$ 6,334
Accounts payable (1)	4,046	—	—	—	—	—	4,046	4,046
Current borrowings pursuant to credit facilities (1)	3,804	—	—	—	—	—	3,804	3,804
Fixed-rate long-term obligations (3)	1,308	1,306	1,300	1,300	1,300	5,200	11,714	10,768

- (1) We believe the carrying amounts of cash and cash equivalents, accounts receivable, 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.
- (2) Notes receivable from shareholders bear interest at 7.0%. We believe that a portfolio of loans with a similar risk profile would currently yield a return of 9.25%. We project the impact of an increase or decrease in interest rates of 100 basis points would result in a change of fair value of approximately \$40,000.
- (3) Fixed-rate long-term obligations bear interest rates ranging from 3.3% to 5.7% with a weighted-average interest rate of 5.7%. We believe that loans with a similar risk profile would currently yield a return of 7.7%. We project the impact of an increase or decrease in interest rates of 100 basis points would result in a change of fair value of approximately \$434,000.

We were not a party to any derivative instruments during the fiscal year. It is currently our intent not to use derivative instruments for speculative or trading purposes. Additionally, we do not use any hedging or forward contracts to offset market volatility.

Our Mexican-based operations transact business in Mexican pesos. Funds are transferred by our corporate office to Mexico on a weekly basis to satisfy domestic cash needs. Consequently, the spot rate for the Mexican peso has a moderate impact on our operating results. However, we do not believe that this impact is sufficient to warrant the use of derivative instruments to hedge the fluctuation in the Mexican peso. Total foreign currency gains and losses for each of the three years in the period ended October 31, 2006 do not exceed \$0.1 million.

**Item 8. Financial Statements and Supplementary Data**

**CALAVO GROWERS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except share amounts)**

	<u>October 31,</u>	
	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 50	\$ 1,133
Accounts receivable, net of allowances of \$1,833 (2006) and \$2,688 (2005)	24,202	19,253
Inventories, net	10,569	10,096
Prepaid expenses and other current assets	4,934	5,879
Advances to suppliers	1,406	1,141
Income taxes receivable	2,268	893
Deferred income taxes	2,348	2,651
Total current assets	<u>45,777</u>	<u>41,046</u>
Property, plant, and equipment, net	19,908	16,897
Investment in Limoneira	33,879	45,634
Investment in Maui Fresh, LLC	229	—
Goodwill	3,591	3,591
Other assets	4,110	1,314
	<u>\$ 107,494</u>	<u>\$ 108,482</u>
<b>Liabilities and shareholders' equity</b>		
Current liabilities:		
Payable to growers	\$ 6,334	\$ 1,753
Trade accounts payable	4,046	1,892
Accrued expenses	13,689	12,482
Short-term borrowings	3,804	1,424
Dividend payable	4,573	4,564
Current portion of long-term obligations	1,308	1,313
Total current liabilities	<u>33,754</u>	<u>23,428</u>
Long-term liabilities:		
Long-term obligations, less current portion	10,406	11,719
Deferred income taxes	4,391	8,589
Total long-term liabilities	<u>14,797</u>	<u>20,308</u>
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common stock (\$0.001 par value, 100,000 shares authorized; 14,293 and 14,362 shares outstanding at October 31, 2006 and 2005)	14	14
Additional paid-in capital	37,109	37,240
Notes receivable from shareholders	(2,430)	(2,636)
Accumulated other comprehensive income	6,293	13,386
Retained earnings	17,957	16,742
Total shareholders' equity	<u>58,943</u>	<u>64,746</u>
	<u>\$ 107,494</u>	<u>\$ 108,482</u>

See accompanying notes to consolidated financial statements.

**CALAVO GROWERS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(in thousands, except per share amounts)**

	<b>Year Ended October 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net sales	\$ 273,910	\$ 258,822	\$ 274,218
Cost of sales	244,639	237,088	248,814
Gross margin	29,271	21,734	25,404
Selling, general and administrative	19,954	18,588	15,920
Restructuring charge	—	—	185
Operating income	9,317	3,146	9,299
Equity in earnings from Maui Fresh, LLC	79	—	—
Interest income	356	348	388
Interest expense	(943)	(399)	(66)
Other income, net	599	2,408	156
Income before provision for income taxes	9,408	5,503	9,777
Provision for income taxes	3,620	2,181	3,567
Net income	<u>\$ 5,788</u>	<u>\$ 3,322</u>	<u>\$ 6,210</u>
Net income per share:			
Basic	<u>\$ 0.40</u>	<u>\$ 0.24</u>	<u>\$ 0.46</u>
Diluted	<u>\$ 0.40</u>	<u>\$ 0.24</u>	<u>\$ 0.46</u>
Number of shares used in per share computation:			
Basic	<u>14,304</u>	<u>13,892</u>	<u>13,497</u>
Diluted	<u>14,354</u>	<u>13,985</u>	<u>13,582</u>

*See accompanying notes to consolidated financial statements.*

**CALAVO GROWERS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**(All amounts in thousands)**

	Year ended October 31,		
	2006	2005	2004
Net income	\$ 5,788	\$ 3,322	\$ 6,210
Other comprehensive income (loss), before tax:			
Unrealized holding gains (losses) arising during period	(11,755)	22,184	—
Income tax (expense) benefit related to items of other comprehensive income (loss)	4,662	(8,798)	—
Other comprehensive income (loss), net of tax	(7,093)	13,386	—
Comprehensive income (loss)	<u>\$ (1,305)</u>	<u>\$ 16,708</u>	<u>\$ 6,210</u>

*See accompanying notes to consolidated financial statements.*

**CALAVO GROWERS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in thousands)

	Common Stock		Additional Paid-in Capital	Notes Receivable From Shareholders	Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount					
<b>Balance, October 31, 2003</b>	12,930	\$ 13	\$ 24,727	\$ (3,563)	\$ —	\$ 15,970	\$ 37,147
Purchase acquisition	577	1	4,049	—	—	—	4,050
Stock compensation expense	—	—	46	—	—	—	46
Collections on shareholder notes receivable	—	—	—	680	—	—	680
Dividend declared to shareholders	—	—	—	—	—	(4,196)	(4,196)
Net income	—	—	—	—	—	6,210	6,210
<b>Balance, October 31, 2004</b>	13,507	14	28,822	(2,883)	—	17,984	43,937
Exercise of stock options and income tax benefit of \$59	55	—	334	—	—	—	334
Stock compensation expense	—	—	84	—	—	—	84
Issuance of stock to Limoneira	1,000	1	9,999	—	—	—	10,000
Unrealized gain on Limoneira investment, net	—	—	—	—	13,386	—	13,386
Retirement of common stock	(200)	(1)	(1,999)	—	—	—	(2,000)
Collections on shareholder notes receivable	—	—	—	247	—	—	247
Dividend declared to shareholders	—	—	—	—	—	(4,564)	(4,564)
Net income	—	—	—	—	—	3,322	3,322
<b>Balance, October 31, 2005</b>	14,362	14	37,240	(2,636)	13,386	16,742	64,746
Exercise of stock options and income tax benefit of \$146	51	—	403	—	—	—	403
Stock compensation expense	—	—	666	—	—	—	666
Unrealized loss on Limoneira investment, net	—	—	—	—	(7,093)	—	(7,093)
Retirement of common stock	(120)	—	(1,200)	—	—	—	(1,200)
Collections on shareholder notes receivable	—	—	—	206	—	—	206
Dividend declared to shareholders	—	—	—	—	—	(4,573)	(4,573)
Net income	—	—	—	—	—	5,788	5,788
<b>Balance, October 31, 2006</b>	<u>14,293</u>	<u>\$ 14</u>	<u>\$ 37,109</u>	<u>\$ (2,430)</u>	<u>\$ 6,293</u>	<u>\$ 17,957</u>	<u>\$ 58,943</u>

See accompanying notes to consolidated financial statements.

**CALAVO GROWERS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended October 31,		
	2006	2005	2004
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 5,788	\$ 3,322	\$ 6,210
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,035	2,862	2,648
Provision for losses on accounts receivable	14	475	25
Income from Maui Fresh, LLC	(79)	—	—
Stock compensation expense	666	84	46
Loss (gain) on disposal of property, plant, and equipment	23	(1,668)	—
Effect on cash of changes in operating assets and liabilities:			
Accounts receivable	(4,963)	1,403	(4,596)
Inventories, net	(473)	1,279	(3,354)
Prepaid expenses and other assets	(1,969)	(723)	2,798
Advances to suppliers	(265)	1,272	(1,789)
Income taxes receivable	(1,229)	(31)	(803)
Deferred income taxes	767	(1,925)	(320)
Payable to growers	4,581	(4,036)	2,343
Trade accounts payable and accrued expenses	2,923	3,254	1,303
Income tax payable	—	—	(51)
Net cash provided by operating activities	<u>7,819</u>	<u>5,568</u>	<u>4,460</u>
<b>Cash Flows from Investing Activities:</b>			
Direct costs of acquisition of Maui Fresh International, Inc.	—	—	(65)
Acquisitions of property, plant, and equipment	(4,513)	(1,874)	(8,409)
Cash settlement of the acquisition of Limoneira stock, net of our common stock issued	—	(13,450)	—
Investment in Maui Fresh, LLC	(150)	—	—
Proceeds from sale of building	—	3,383	—
Net cash used in investing activities	<u>(4,663)</u>	<u>(11,941)</u>	<u>(8,474)</u>
<b>Cash Flows from Financing Activities:</b>			
Dividend paid to shareholders	(4,564)	(4,052)	(3,376)
Proceeds from (repayments of) short-term borrowings, net	2,380	(576)	2,000
Proceeds from issuance of long-term debt	—	13,000	—
Payments on long-term obligations	(1,318)	(24)	(29)
Retirement of common stock	(1,200)	(2,000)	—
Proceeds from stock option exercises	257	275	—
Proceeds from collection of shareholder notes receivable	206	247	680
Net cash provided by (used in) financing activities	<u>(4,239)</u>	<u>6,870</u>	<u>(725)</u>
Net increase (decrease) in cash and cash equivalents	(1,083)	497	(4,739)
Cash and cash equivalents, beginning of year	1,133	636	5,375
Cash and cash equivalents, end of year	<u>\$ 50</u>	<u>\$ 1,133</u>	<u>\$ 636</u>
<b>Supplemental Information -</b>			
Cash paid during the year for:			
Interest	<u>\$ 943</u>	<u>\$ 399</u>	<u>\$ 66</u>
Income taxes	<u>\$ 4,091</u>	<u>\$ 3,875</u>	<u>\$ 4,899</u>
<b>Noncash Investing and Financing Activities:</b>			
Tax receivable increase related to stock option exercise	<u>\$ 146</u>	<u>\$ 59</u>	<u>\$ —</u>
Declared dividends payable	<u>\$ 4,573</u>	<u>\$ 4,564</u>	<u>\$ 4,052</u>
Issuance of our common stock in Limoneira transaction	<u>\$ —</u>	<u>\$ 10,000</u>	<u>\$ —</u>
Construction in progress included in trade accounts payable and accrued expenses	<u>\$ 438</u>	<u>\$ 396</u>	<u>\$ —</u>
Unrealized holding gains (losses)	<u>\$ (11,755)</u>	<u>\$ 22,184</u>	<u>\$ —</u>

In November 2003, the Company acquired all of the outstanding common shares of Maui Fresh International, Inc. for 576,924 shares of the Company's common stock, valued at \$4.05 million, plus acquisition costs of \$65,000. See Note 1 for further explanation. The following table summarizes the estimated fair values of the non-cash assets acquired and liabilities assumed at the date of acquisition.

(in thousands)	2004
Fixed assets	\$ 114
Goodwill	3,526
Intangible assets	867
Total non-cash assets acquired	4,507
Current liabilities	110
Deferred tax liabilities assumed	347
Net non-cash assets acquired	<u>\$ 4,050</u>

See accompanying notes to consolidated financial statements.





**CALAVO GROWERS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of the business**

***Business***

Calavo Growers, Inc. (Calavo, the Company, we, us or our) procures and markets avocados and other perishable commodities and prepares and distributes processed avocado products. Our expertise in marketing and distributing avocados, processed avocados, and other perishable foods allows us to deliver a wide array of fresh and processed food products to food distributors, produce wholesalers, supermarkets, and restaurants on a worldwide basis. Through our three operating facilities in southern California, our distribution center in Texas, and our two facilities in Mexico, we sort and pack avocados procured in California and Mexico and prepare processed avocado products. Additionally, we procure avocados internationally, principally from Mexico, Chile, and the Dominican Republic, and distribute other perishable foods, such as Hawaiian grown papayas. During the second quarter of fiscal 2006, we combined our California avocados and international avocados and perishable food products reporting segments. As a result, we now report our operations in two business segments: (1) fresh products and (2) processed products. See footnote 11 for further explanation.

**2. Basis of Presentation and Summary of Significant Accounting Policies**

The accompanying consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

Our consolidated financial statements include the accounts of Calavo Growers, Inc. and our wholly owned subsidiaries, Calavo Foods, Inc. Calavo de Mexico S.A. de C.V. Calavo Foods de Mexico S.A. de C.V. and Maui Fresh International, Inc. (Maui). All intercompany accounts and transactions have been eliminated.

***Cash and Cash Equivalents***

We consider all highly liquid financial instruments purchased with an original maturity date of three months or less to be cash equivalents. The carrying amounts of cash and cash equivalents approximate their fair values.

***Inventories***

Inventories are stated at the lower of cost or market. Cost is computed on a weighted-average basis, which approximates the first-in, first-out method; market is based upon estimated replacement costs. Costs included in inventory primarily include the following: fruit, picking and hauling, overhead, labor, materials and freight.

***Property, Plant, and Equipment***

Property, plant, and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method. Leasehold improvements are stated at cost and amortized over the lesser of their estimated useful lives or the term of the lease, using the straight-line method. Useful lives are as follows: buildings and improvements — 7 to 50 years; leasehold improvements — the lesser of the term of the lease or 7 years; equipment — 7 to 25 years; information systems hardware and software – 3 to 15 years. Significant repairs and maintenance that increase the value or extend the useful life of our fixed asset are capitalized. Replaced units are written off. Ordinary maintenance and repairs are charged to expense.

We capitalize software development costs for internal use in accordance with Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Capitalization of software development costs begins in the application development stage and ends when the asset is placed into service. We amortize such costs using the straight-line basis over estimated useful lives. The net book value of capitalized computer software costs was \$1.5 million and \$1.3 million as of October 31, 2006 and 2005 and the related depreciation expense was \$0.2 million and \$0.3 million for the fiscal years ended October 31, 2006 and 2005.

***Goodwill and Acquired Intangible Assets***

The purchase method of accounting for business combinations requires us to make use of estimates and judgments to allocate the purchase price paid for acquisitions to the fair value of the net tangible and identifiable intangible assets. Goodwill is tested for impairment annually, or when a possible impairment is indicated, using the fair value based test prescribed by Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. The impairment test requires us to compare the fair

## Table of Contents

value of business reporting units to carrying value, including goodwill. We primarily use an “income approach” (which considers the present value of future cash flows) in combination with a “market approach” (which considers what other purchasers in the marketplace have paid for similar businesses) to determine fair value. Future cash flows typically include operating cash flows for the business for three to five years and an estimated terminal value. Management judgment is required in the estimation of future operating results and to determine the appropriate terminal values. Future operating results and terminal values could differ from the estimates and could require a provision for impairment in a future period. We performed our annual assessment of goodwill and determined that no impairment existed as of October 31, 2006.

Included in other assets in the accompanying consolidated financial statements are the following intangible assets: customer-related intangibles of \$590,000 (accumulated amortization of \$324,000 at October 31, 2006), brand name intangibles of \$275,000 and other identified intangibles totaling \$2,000 (accumulated amortization of \$2,000 at October 31, 2006). The customer-related intangibles are being amortized over five years. The intangible asset related to the brand name currently has an indefinite remaining useful life and, as a result, is not currently subject to amortization. We performed our annual assessment of the brand name intangible and determined that no impairment existed as of October 31, 2006. We anticipate recording amortization expense related to customer-related intangibles of approximately \$119,000 per annum from fiscal 2007 and fiscal 2008, with the remaining amortization expense of approximately \$28,000 recorded in fiscal 2009.

### **Long-lived Assets**

Long-lived assets, including fixed assets and intangible assets (other than goodwill), are continually monitored and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. The determination of recoverability is based on an estimate of undiscounted cash flows expected to result from the use of an asset and its eventual disposition. The estimate of undiscounted cash flows is based upon, among other things, certain assumptions about future operating performance, growth rates and other factors. Estimates of undiscounted cash flows may differ from actual cash flows due to, among other things, technological changes, economic conditions, changes to the business model or changes in operating performance. If the sum of the undiscounted cash flows (excluding interest) is less than the carrying value, an impairment loss will be recognized, measured as the amount by which the carrying value exceeds the fair value of the asset. We have evaluated our long-lived assets and determined that no impairment existed as of October 31, 2006.

### **Investments**

We account for non-marketable investments using the equity method of accounting if the investment gives us the ability to exercise significant influence over, but not control, an investee. Significant influence generally exists when we have an ownership interest representing between 20% and 50% of the voting stock of the investee. Under the equity method of accounting, investments are stated at initial cost and are adjusted for subsequent additional investments and our proportionate share of earnings or losses and distributions. Additional investments by other parties in the investee, if any, will result in a reduction in our ownership interest, and the resulting gain or loss will be recorded in our consolidated statements of income. See Note 16.

### **Marketable Securities**

We account for marketable securities in accordance with provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). SFAS 115 addresses the accounting and reporting for investments in fixed maturity securities and for equity securities with readily determinable fair values. Our marketable securities consist of our investment in Limoneira stock (see Note 12). These securities are carried at fair value as determined from quoted market prices. The estimated fair value, cost, and gross unrealized gain related to such investment was \$33.9 million, \$23.5 million and \$10.4 million as of October 31, 2006. The estimated fair value, cost, and gross unrealized gain related to such investment was \$45.7 million, \$23.5 million and \$22.2 million as of October 31, 2005.

### **Advances to Suppliers**

We advance funds to third-party growers primarily in Chile and Mexico for various farming needs. Typically, we obtain collateral (i.e. fruit, fixed assets, etc.) that approximates the value at risk, prior to making such advances. We continuously evaluate the ability of these growers to repay advances in order to evaluate the possible need to record an allowance. No such allowance was required at October 31, 2006, nor October 31, 2005.

## [Table of Contents](#)

### **Accrued Expenses**

Included in accrued expenses at October 31, 2006 are un-vouchered receipts and management bonuses of approximately \$2.3 million and \$1.0 million. Included in accrued expenses at October 31, 2005 are un-vouchered receipts of \$1.0 million and no management bonus accrual.

### **Revenue Recognition**

Sales of products and related costs of products sold are recognized when persuasive evidence of an arrangement exists, shipment has been made, title passes, the price is fixed or determinable and collectibility 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.

### **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 average length of time between the product shipment date and the date on which we pay the customer the promotional allowance. The product of this lag factor and our historical promotional allowance payment rate is the basis for the promotional allowance included in accrued expenses on our balance sheet. Actual amounts may differ from these estimates and such differences are recognized as an adjustment to net sales in the period they are identified.

### **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.

### **Consignment Arrangements**

We enter into consignment arrangements with avocado growers and packers located outside of the United States and growers of certain perishable products in the United States. Although we generally do not take legal title to 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, the accompanying financial statements include sales and cost of sales from the sale of avocados and perishable products procured under consignment arrangements. Amounts recorded for each of the fiscal years ended October 31, 2006, 2005 and 2004 in the financial statements pursuant to consignment arrangements are as follows (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Sales	\$ 10,127	\$ 27,171	\$ 27,346
Cost of Sales	8,943	25,456	25,500
Gross Margin	<u>\$ 1,184</u>	<u>\$ 1,715</u>	<u>\$ 1,846</u>

### **Advertising Expense**

Advertising costs are expensed when incurred. Such costs in fiscal 2006, 2005, and 2004 were approximately \$0.4 million, \$0.3 million, and \$0.2 million.

### **Other income, net**

Included in other income, net is dividend income totaling \$0.4 million and \$0.2 million for fiscal years 2006 and 2005. We did not have significant dividend income for fiscal year 2004.

### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Among the significant estimates affecting the financial statements are those related to valuation allowances for accounts receivable, goodwill, grower advances, inventories, long-lived assets, valuation of and estimated useful lives of identifiable intangible assets, stock-based compensation, promotional allowances and income taxes. On an ongoing basis,

## [Table of Contents](#)

management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

### **Income Taxes**

We account for income taxes under the provisions of SFAS No. 109, *Accounting for Income Taxes*. This statement requires the recognition of 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, SFAS No. 109 requires 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.

### **Basic and Diluted Net Income per Share**

Basic earnings per share is calculated using the weighted-average number of common shares outstanding during the period without consideration of the dilutive effect of stock options. The basic weighted-average number of common shares outstanding was 14,304,000, 13,892,000, and 13,497,000 for fiscal years 2006, 2005, and 2004. Diluted earnings per common share is calculated using the weighted-average number of common shares outstanding during the period after consideration of the dilutive effect of stock options, which were 50,000, 93,000, and 85,000 for fiscal years 2006, 2005 and 2004. There were no anti-dilutive options for fiscal years 2006, 2005 and 2004.

### **Stock-Based Compensation**

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*. This pronouncement amends SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) requires that companies account for awards of equity instruments issued to employees under the fair value method of accounting and recognize such amounts in their statements of operations. We adopted SFAS No. 123(R) on November 1, 2005 using the modified prospective method and, accordingly, have not restated the consolidated statements of operations for prior interim periods or fiscal years. Under SFAS No. 123(R), we are required to measure compensation cost for all stock-based awards at fair value on the date of grant and recognize compensation expense in our consolidated statements of operations over the service period that the awards are expected to vest.

Prior to the adoption of SFAS No. 123(R), we accounted for employee stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25, as permitted by SFAS No. 123 and SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*. Under the intrinsic value method, the difference between the market price on the date of grant and the exercise price is charged to the statement of operations over the vesting period. Prior to the adoption of SFAS No. 123(R), we recognized compensation cost only for stock options issued with exercise prices set below market prices on the date of grant and provided the necessary pro forma disclosures required under SFAS No. 123.

During the year ended October 31, 2005 and 2004, we recognized \$84,000 and \$50,000 of compensation expense with respect to stock option awards pursuant to APB 25, which was charged to the consolidated statement of operations. For the years ended October 31, 2005 and 2004, had stock-based compensation been accounted for based on the estimated grant date fair values, as defined by SFAS No. 123, the Company's net income and net income per share would have been the following pro forma amounts (in thousands, except per share amounts):

	Year ended October 31,	
	2005	2004
<b>Net Income:</b>		
As reported	\$ 3,322	\$ 6,210
Add: Total stock-based compensation expense determined under APB 25 and related interpretations, net of tax effects	51	28
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax effects	(54)	(28)
Pro forma	<u>\$ 3,319</u>	<u>\$ 6,210</u>

## [Table of Contents](#)

	Year ended October 31,	
	2005	2004
Net income per share, as reported:		
Basic	\$ 0.25	\$ 0.46
Diluted	\$ 0.25	\$ 0.46
Net income per share, pro forma:		
Basic	\$ 0.25	\$ 0.46
Diluted	\$ 0.25	\$ 0.46

The fair value of the options granted in fiscal year 2005 and 2004 has been estimated at the date of grant using the Black-Scholes and lattice-based option pricing model with the following assumptions:

	2005	2004
Risk-free interest rate	4.1%	3.3%
Expected volatility	27.6%	26.9%
Dividend yield	3.2%	20%
Expected life (years)	3	5
Weighted-average fair value of options granted	\$1.65	\$3.01

In December 2003, our Board of Directors approved the issuance of options to acquire a total of 50,000 shares of our common stock to two members of our Board of Directors. Each option to acquire 25,000 shares vests in substantially equal installments over a three-year period, has an exercise price of \$7.00 per share, and has a term of five years from the grant date. The market price of our common stock at the grant date was \$10.01. In December 2005, however, these stock option agreements were modified to shorten the option terms, as defined. Such modifications were contemplated primarily as a result of Section 409A of the tax code and did not result in a significant change in fair value.

Under SFAS No. 123(R), we now record in our consolidated statements of operations (i) compensation cost for options granted, modified, repurchased or cancelled on or after November 1, 2005 under the provisions of SFAS No. 123(R) and (ii) compensation cost for the unvested portion of options granted prior to November 1, 2005 over their remaining vesting periods using the amounts previously measured under SFAS No. 123 for pro forma disclosure purposes.

In August 2005, our Board of Directors approved the issuance of options to acquire a total of 400,000 shares of our common stock to various employees of the Company. The options vest if the closing price of our common stock is at least \$11.00 per share at any time throughout the life of the option. At no time, however, may any options vest within one year from the date of grant. Additionally, such options have an exercise price of \$9.10 per share and a term of 5 years from the grant date. The market price of our common stock at the grant date was \$9.10. In April 2006, the price of our common stock reached \$11/per share. Therefore, all 400,000 options related to our stock option grant that took place in August 2005 vested in August 2006 (for those persons still employed). The achievement of this market condition resulted in a decrease in the initial, estimated derived service period. As a result, we recorded total stock-based compensation expense related to this stock option grant of \$616,000 during the year ended October 31, 2006. During the year ended October 31, 2006, we recognized total stock-based compensation expense of \$666,000 for stock options in our consolidated statement of operations.

The value of each option award that contains a market condition is estimated using a lattice-based option valuation model, while all other option awards are valued using the Black-Scholes-Merton option valuation model. We primarily consider the following assumptions when using these models: (1) expected volatility, (2) expected dividends, (3) expected term and (4) risk-free rate. Such models also consider the intrinsic value in the estimation of fair value of the option award. Forfeitures are estimated when recognizing compensation expense, and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

There were no options granted during the year ended October 31, 2006.

The Black-Scholes-Merton and lattice-based option valuation models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because options held by our directors and employees have characteristics significantly different from those of traded options, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of these options.

### **Foreign Currency Translation and Remeasurement**

Our foreign operations are subject to exchange rate fluctuations and foreign currency transaction costs. The functional currency of our foreign subsidiaries is the United States dollar. As a result, monetary assets and liabilities are translated into U.S. dollars at

## [Table of Contents](#)

exchange rates as of the balance sheet date and non-monetary assets, liabilities and equity are translated at historical rates. Sales and expenses are translated using a weighted-average exchange rate for the period. Gains and losses resulting from those remeasurements are included in income. Gains and losses resulting from foreign currency transactions are also recognized currently in income. Total foreign currency gains and losses for each of the three years ended October 31, 2006 do not exceed \$0.1 million.

### ***Fair Value of Financial Instruments***

We believe that the carrying amounts of cash and cash equivalents, accounts receivable, notes receivable from shareholders, and accounts payable approximates fair value based on either their short-term nature or on terms currently available to the Company in financial markets. We believe that our fixed-rate long-term obligations have a fair value of approximately \$10.8 million as of October 31, 2006, with a corresponding carrying value of approximately \$11.7 million.

### ***Derivative Financial Instruments***

We do not presently engage in derivative or hedging activities. In addition, we have reviewed agreements and contracts and have determined that we have no derivative instruments, nor do any of our agreements and contracts contain embedded derivative instruments, as of October 31, 2006.

### ***Recent Accounting Pronouncements***

In May 2005, the FASB issued Statement of Financial Accounting Standard (SFAS) 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS No. 154 applies to all voluntary changes in accounting principles and requires retrospective application (a term defined by the statement) to prior periods' financial statements, unless it is impracticable to determine the effect of a change. It also applies to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will adopt SFAS No. 154 as of the beginning of fiscal 2007 and do not expect that the adoption of SFAS No. 154 will have a material impact on our financial condition or results of operations.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140*. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We will adopt SFAS No. 155 on November 1, 2006 and do not expect that the adoption will have a material impact on our financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* (FIN 48). This interpretation clarifies the application of SFAS No. 109, *Accounting for Income Taxes*, by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements and also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, but earlier adoption is permitted. We will adopt FIN 48 no later than November 1, 2007. We are currently assessing the impact the adoption of FIN 48 will have on our financial position and results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108 on Quantifying Misstatements. SAB No. 108 requires companies to use both a balance sheet and an income statement approach when quantifying and evaluating the materiality of a misstatement, and contains guidance on correcting errors under the dual approach. SAB No. 108 also provides transition guidance for correcting errors existing in prior years. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged. We do not believe that the adoption of SAB 108 will have a significant impact on our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, clarifies the definition of fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the application of SFAS No. 157 may change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will adopt SFAS No. 157 in the first quarter of

## [Table of Contents](#)

fiscal 2009. We are currently assessing the impact the adoption of SFAS No. 157 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS No. 158 requires company plan sponsors to display the net over- or under-funded position of a defined benefit postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations or actuarial gains/losses reported as a component of other comprehensive income in shareholders' equity. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. We will adopt SFAS No. 158 as of the end of fiscal 2007. We are currently assessing the impact the adoption of SFAS No. 158 will have on our financial position and results of operations.

### **Comprehensive Income (Loss)**

Comprehensive income (loss) is defined as all changes in a company's net assets, except changes resulting from transactions with shareholders. For the fiscal year ended October 31, 2006, other comprehensive loss includes the unrealized loss on our Limoneira investment totaling \$7.1 million, net of income taxes. Limoneira's stock price at October 31, 2006 equaled \$196 per share. For the fiscal year ended October 31, 2005, other comprehensive income includes the unrealized gain on our Limoneira investment totaling \$13.4, net of income taxes. Limoneira's stock price at October 31, 2005 equaled \$264 per share. There was no significant difference between comprehensive income and net income for the fiscal year ended October 31, 2004.

### **3. Inventories**

Inventories consist of the following (in thousands):

	October 31,	
	2006	2005
Fresh fruit	\$ 4,961	\$ 3,525
Packing supplies and ingredients	2,380	2,015
Finished processed foods	3,228	4,556
	<u>\$ 10,569</u>	<u>\$ 10,096</u>

Cost of goods sold for fiscal years 2005 and 2004 include inventory write-downs of \$0.1 million, \$0.3 million. Write-downs in fiscal 2005 primarily related to a reduction in the cost of pulp used in certain processed avocado products. Write-downs in fiscal year 2004 primarily related to improper handling of product, which we believe related to a subcontractor's error. We did not have any write-downs in fiscal 2006.

We assess the recoverability of inventories through an ongoing review of inventory levels in relation to sales and forecasts, and product marketing plans. When the inventory on hand, at the time of the review, exceeds the foreseeable demand, the value of inventory that is not expected to be sold is written down. The amount of the write-down is the excess of historical cost over estimated realizable value (generally zero). Once established, these write-downs are considered permanent adjustments to the cost basis of the excess inventory.

The assessment of the recoverability of inventories and the amounts of any write-downs are based on currently available information and assumptions about future demand and market conditions. Demand for processed avocado products may fluctuate significantly over time, and actual demand and market conditions may be more or less favorable than our projections. In the event that actual demand is lower than originally projected, additional inventory write-downs may be required.

We may retain and make available for sale some or all of the inventories which have been written down. In the event that actual demand is higher than originally projected, we may be able to sell a portion of these inventories in the future. We generally scrap inventories which have been written down and are identified as obsolete.



## [Table of Contents](#)

### 4. Property, Plant, and Equipment

Property, plant, and equipment consist of the following (in thousands):

	October 31,	
	2006	2005
Land	\$ 947	\$ 952
Buildings and improvements	13,840	13,611
Leasehold improvements	171	212
Equipment	31,793	28,889
Information systems — Hardware and software	4,324	3,997
Construction in progress	2,841	1,349
	53,916	49,010
Less accumulated depreciation and amortization	(34,008)	(32,113)
	<u>\$ 19,908</u>	<u>\$ 16,897</u>

In March 2005, we completed the sale of our corporate headquarters building for \$3.4 million. This transaction resulted in a pre-tax gain on sale of approximately \$1.7 million, which is included in other income, net. In conjunction with such sale, we relocated our corporate offices to Santa Paula, California in March 2005. Total expenses related to such relocation approximated \$0.4 million. Depreciation expense was \$1.9 million, \$2.7 million and \$2.6 million for fiscal years 2006, 2005, and 2004.

### 5. Other Assets

During 1999, we established a Grower Development Program whereby funds can be advanced to growers in exchange for their commitment to deliver a minimum volume of avocados on an annual basis. These commitments to deliver fruit generally extend over a multi-year period. During fiscal 2006 and as of October 31, 2006, we advanced \$3.3 million (\$1.2 million was paid in cash, the remainder via receivable restructuring) to certain growers. Advances are not repaid and are amortized to cost of goods sold over the term of the related agreements, up to a maximum of approximately 11 years. The financial statements for fiscal years 2006, 2005 and 2004 include a charge of approximately \$298,000, \$322,000 and \$322,000 representing the amortization of these advances. During fiscal 2005, no amounts were advanced pursuant to this program and \$0.3 million was included in other assets as of October 31, 2005.

### 6. Short-Term Borrowings

In October 2006, we renewed and extended one of our short-term, non-collateralized, revolving credit facilities. Our two credit facilities now expire in February 2010 and April 2008 and are with separate banks. Under the terms of these agreements, we are advanced funds for working capital purposes. Total credit available under the combined short-term borrowing agreements was \$24 million, with a weighted-average interest rate of 6.2% and 4.8% at October 31, 2006 and 2005. Under these credit facilities, we had \$3.8 million and \$1.4 million outstanding as of October 31, 2006 and 2005. The credit facilities contain various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at October 31, 2006, except for the working capital covenants with which we obtained appropriate waivers.

### 7. Employee Benefit Plans

We sponsor two defined contribution retirement plans for salaried and hourly employees. Expenses for these plans approximated \$502,000, \$399,000, and \$409,000 for fiscal years 2006, 2005 and 2004, which are included in selling, general and administrative expenses in the accompanying financial statements.

We also sponsor a non-qualified defined benefit plan for two retired executives. Pension expenses, net of actuarial gains, approximated \$46,000 for the year ended October 31, 2006. Pension expenses and actuarial losses approximated \$65,000 and \$49,000 for the years ended October 31, 2005, and 2004. These amounts are included in selling, general and administrative expenses in the accompanying financial statements.

## Table of Contents

Components of the change in projected benefit obligation for fiscal year ends consist of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 510	\$ 500
Interest cost	29	28
Actuarial loss (gain)	(75)	37
Benefits paid	(50)	(55)
Projected benefit obligation at end of year (unfunded)	<u>\$ 414</u>	<u>\$ 510</u>

The following is a reconciliation of the unfunded status of the plans at fiscal year ends included in accrued expenses (in thousands):

	<u>2006</u>	<u>2005</u>
Projected benefit obligation	\$ 414	\$ 510
Unrecognized net (gain) loss	—	—
Recorded pension liabilities	<u>\$ 414</u>	<u>\$ 510</u>

Significant assumptions used in the determination of pension expense consist of the following:

	<u>2006</u>	<u>2005</u>
Discount rate on projected benefit obligation	6.00%	6.00%

## **8. Commitments and Contingencies**

### ***Commitments and guarantees***

We lease facilities and certain equipment under non cancelable operating leases expiring at various dates through 2021. We are committed to make minimum cash payments under these agreements as of October 31, 2006 as follows (in thousands):

2007	\$ 1,279
2008	585
2009	547
2010	506
2011	381
Thereafter	2,372
	<u>\$ 5,670</u>

In August 2006, we entered into an operating lease agreement with Columbia New Jersey Commodore Industrial, LLC to rent approximately 30,000 square feet of building space in Swedesboro, New Jersey. This lease enables us to not only invest in our ProRipeVIPTM avocado ripening program, but also expand our refrigeration and storage capabilities. The lease has a term of approximately 15 years and includes scheduled rent increases. Pursuant to FASB Technical Bulletin 85-3, our straight-line rent expense for such lease will approximate \$13,000 per month for the duration of such lease. This facility commenced operations during the first quarter of fiscal 2007.

Total rent expense amounted to approximately \$1.5 million, \$1.2 million and \$1.1 million for the years ended October 31, 2006, 2005, and 2004. Rent to Limoneira, for our corporate office, amounted to approximately \$0.2 million and \$0.1 million for fiscal year 2006 and 2005. We are committed to rent our corporate facility through fiscal 2015 at an annual rental of \$0.2 million per annum. See footnote 12 for further explanation.

We indemnify our directors and have the power to indemnify each of our officers, employees and other agents, to the maximum extent permitted by applicable law. The maximum amount of potential future payments under such indemnifications is not determinable. No amounts have been accrued in the accompanying financial statements.

We have commitments for capital expenditures totaling approximately \$1.1 million as of October 31, 2006.

### Litigation

We are currently under examination by the Mexican tax authorities (Hacienda) for the tax year ended December 31, 2000. During the first quarter of fiscal 2005, we received an assessment totaling approximately \$2.0 million from Hacienda related to the amount of income at our Mexican subsidiary. Based primarily on discussions with legal counsel and the evaluation of our claim, we believe that Hacienda's position has no merit and that the Company will prevail. Accordingly, no amounts have been provided in the financial statements as of October 31, 2006. We pledged our processed products building located in Uruapan, Michoacan, Mexico as collateral to the Hacienda in regards to this assessment.

We are also involved in litigation arising in the ordinary course of our business that we do not believe will have a material adverse impact on our financial statements.

### 9. Related-Party Transactions

We sell papayas procured from an entity owned by the Chairman of our Board of Directors and CEO. Sales of papayas amounted to approximately \$4,822,000, \$6,251,000, and \$6,846,000 for the years ended October 31, 2006, 2005 and 2004, resulting in gross margins of approximately \$285,000, \$510,000, and \$864,000. Net amounts due to this entity approximated \$213,000 and \$79,000 at October 31, 2006, and 2005.

Certain members of our Board of Directors market avocados through Calavo pursuant to our customary marketing agreements. During the years ended October 31, 2006, 2005 and 2004, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors, was \$17.2 million, \$5.2 million, and \$4.7 million. Accounts payable to these Board members were \$0.6 million and \$0.2 million as of October 31, 2006 and 2005.

In August 2005, we repurchased 200,000 shares of our common stock at an average price per share of \$10.00 from the estate of a deceased former member of our Board of Directors. In December 2005, we repurchased another 120,000 shares of our common stock at an average price per share of \$10.00 from the same estate.

See Note 12 for discussion related to our investment in Limoneira. During fiscal 2006 and 2005, we received \$0.4 million and \$0.2 million as dividend income from Limoneira.

### 10. Income Taxes

The income tax provision consists of the following for the years ended October 31 (in thousands):

	2006	2005	2004
Current:			
Federal	\$ 2,423	\$ 3,046	\$ 3,018
State	598	767	844
Foreign	63	293	25
Total current	3,084	4,106	3,887
Deferred	536	(1,925)	(320)
Total income tax provision	\$ 3,620	\$ 2,181	\$ 3,567

At October 31, 2006 and 2005, gross deferred tax assets totaled approximately \$2.9 million and \$3.1 million, while gross deferred tax liabilities totaled approximately \$4.9 million and \$9.1 million. Deferred income taxes reflect the net of temporary differences between the carrying amount of assets and liabilities for financial reporting and income tax purposes.

## Table of Contents

Significant components of our deferred taxes as of October 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Allowances for accounts receivable	\$ 1,779	\$ 2,065
Inventories	292	325
State taxes	62	80
Accrued liabilities	215	181
Current deferred income taxes	<u>2,348</u>	<u>2,651</u>
Property, plant, and equipment	(541)	217
Intangible assets	(231)	(282)
Unrealized Gain, Limoneira investment	(4,136)	(8,798)
Retirement benefits	177	218
Stock-based compensation	340	56
Long-term deferred income taxes	<u>\$ (4,391)</u>	<u>\$ (8,589)</u>

A reconciliation of the significant differences between the federal statutory income tax rate and the effective income tax rate on pretax income is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Federal statutory tax rate	35%	35%	35%
State taxes, net of federal effects	5	5	5
Foreign income taxes greater (less) than U.S.	(1)	1	(3)
Benefit of lower federal tax brackets	(1)	(1)	(1)
Other	<u>—</u>	<u>—</u>	<u>—</u>
	<u>38%</u>	<u>40%</u>	<u>36%</u>

We intend to reinvest our accumulated foreign earnings, which approximated \$3.3 million at October 31, 2006, indefinitely. As a result, we have not provided any deferred income taxes on such unremitted earnings.

For fiscal years 2006, 2005 and 2004, income before income taxes related to domestic operations was approximately \$8.9 million, \$4.8 million, and \$9.0 million. For fiscal years 2006, 2005 and 2004, income before income taxes related to foreign operations was approximately \$0.5 million, \$0.7 million and \$0.8 million.

### **11. Segment Information**

During the second quarter of fiscal 2006, we examined our California avocados and international avocados and perishable food products reporting segments. We concluded that these two reporting segments have similar economic characteristics, production processes, customers and distribution methods. Therefore, in accordance with the aggregation criteria of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, we combined these two operating segments into one reportable segment, fresh products. As a result, we now report our operations in two different business segments: (1) fresh products and (2) processed products. These two business segments are presented based on how information is used by our president to measure performance and allocate resources. The fresh products segment includes all operations that involve the distribution of avocados grown both inside and outside of California, as well as the distribution of other non-processed, perishable food products. The processed products segment represents all operations related to the purchase, manufacturing, and distribution of processed avocado products. Additionally, selling, general and administrative expenses and other income, net are no longer charged directly, nor allocated to, a specific product line. These items are now evaluated by our president only in aggregate. We do not allocate assets, or specifically identify them to, our operating segments. Prior period amounts have been reclassified to conform to the current period presentation.

	<u>Fresh products</u>	<u>Processed products</u>	<u>Inter-segment eliminations</u>	<u>Total</u>
<b>Year ended October 31, 2006</b>				
Net sales	\$ 246,421	\$ 43,248	\$ (15,759)	\$ 273,910
Cost of sales	<u>227,748</u>	<u>32,650</u>	<u>(15,759)</u>	<u>244,639</u>
Gross margin	<u>\$ 18,673</u>	<u>\$ 10,598</u>	<u>\$ —</u>	<u>\$ 29,271</u>

[Table of Contents](#)

	<u>Fresh products</u>	<u>Processed products</u>	<u>Inter-segment eliminations</u>	<u>Total</u>
(All amounts are presented in thousands)				
<b>Year ended October 31, 2005</b>				
Net sales	\$ 246,139	\$ 34,699	\$ (22,016)	\$ 258,822
Cost of sales	229,068	30,036	(22,016)	237,088
Gross margin	<u>\$ 17,071</u>	<u>\$ 4,663</u>	<u>\$ —</u>	<u>\$ 21,734</u>
<b>Year ended October 31, 2004</b>				
Net sales	\$ 257,909	\$ 32,749	\$ (16,440)	\$ 274,218
Cost of sales	235,849	29,405	(16,440)	248,814
Gross margin	<u>\$ 22,060</u>	<u>\$ 3,344</u>	<u>\$ —</u>	<u>\$ 25,404</u>

The following table sets forth sales by product category, by segment (in thousands):

	<u>Year ended October 31, 2006</u>		
	<u>Fresh products</u>	<u>Processed products</u>	<u>Total</u>
Third-party sales:			
California avocados	\$ 140,995	\$ —	\$ 140,995
Imported avocados	51,211	—	51,211
Papayas	4,811	—	4,811
Specialities and tropicals	9,724	—	9,724
Processed — food service	—	34,021	34,021
Processed — retail and club	—	10,454	10,454
Total fruit and product sales to third-parties	<u>206,741</u>	<u>44,475</u>	<u>251,216</u>
Freight and other charges	30,156	637	30,793
Total third-party sales	236,897	45,112	282,009
Less sales incentives	(8)	(8,091)	(8,099)
Total net sales to third-parties	236,889	37,021	273,910
Intercompany sales	9,532	6,227	15,759
Net sales before eliminations	<u>\$ 246,421</u>	<u>\$ 43,248</u>	289,669
Intercompany sales eliminations			(15,759)
Consolidated net sales			<u>\$ 273,910</u>
	<u>Year ended October 31, 2005</u>		
	<u>Fresh products</u>	<u>Processed products</u>	<u>Total</u>
Third-party sales:			
California avocados	\$ 104,481	\$ —	\$ 104,481
Imported avocados	81,756	—	81,756
Papayas	6,251	—	6,251
Specialities and tropicals	13,777	—	13,777
Processed — food service	—	28,307	28,307
Processed — retail and club	—	6,766	6,766
Total fruit and product sales to third-parties	<u>206,265</u>	<u>35,073</u>	<u>241,338</u>
Freight and other charges	24,129	258	24,387
Total third-party sales	230,394	35,331	265,725
Less sales incentives	(105)	(6,798)	(6,903)
Total net sales to third-parties	230,289	28,533	258,822
Intercompany sales	15,850	6,166	22,016
Net sales before eliminations	<u>\$ 246,139</u>	<u>\$ 34,699</u>	280,838
Intercompany sales eliminations			(22,016)
Consolidated net sales			<u>\$ 258,822</u>

[Table of Contents](#)

	Year ended October 31, 2004		
	Fresh Products	Processed Products	Total
<b>Third-party sales:</b>			
California avocados	\$ 150,159	\$ —	\$ 150,159
Imported avocados	54,589	—	54,589
Papayas	6,846	—	6,846
Specialities and tropicals	14,233	—	14,233
Processed — food service	—	27,352	27,352
Processed — retail and club	—	4,285	4,285
Total fruit and product sales to third-parties	225,827	31,637	257,464
Freight and other charges	22,914	534	23,448
Total third-party sales	248,741	32,171	280,912
Less sales incentives	(179)	(6,515)	(6,694)
Total net sales to third-parties	248,562	25,656	274,218
Intercompany sales	9,347	7,093	16,440
Net sales before eliminations	<u>\$ 257,909</u>	<u>\$ 32,749</u>	290,658
Intercompany sales eliminations			(16,440)
Consolidated net sales			<u>\$ 274,218</u>

Long-lived assets attributed to geographic areas as of October 31 are as follows (in thousands):

	United States	Mexico	Consolidated
2006	\$50,014	\$11,703	\$61,717
2005	\$55,587	\$11,849	\$67,436

Sales to customers outside the United States were approximately \$13.8 million, \$15.9 million and \$16.2 million for the three years ended October 31, 2006.

## 12. Investment in Limoneira Company

In order to increase our market share of California avocados and increase synergies within the marketplace, we entered into a stock purchase agreement with Limoneira Company (Limoneira) in June 2005. Pursuant to such agreement, we acquired approximately 15.1% of Limoneira's outstanding common stock for \$23.45 million and Limoneira acquired approximately 6.9% of our outstanding common stock for \$10 million. The transaction was settled by a net cash payment by us of \$13.45 million. Additionally, such agreement also provided for: (1) Calavo to lease office space from Limoneira in Santa Paula, California for a period of 10 years at an initial annual gross rental of approximately \$0.2 million (subject to annual CPI increases, as defined), (2) Calavo to market Limoneira's avocados and (3) Calavo and Limoneira to use good faith reasonable efforts to maximize avocado packing efficiencies for both parties by consolidating their fruit packing operations. Various opportunities are currently being considered, including the use of existing packing facilities, an investment in existing vacant facilities, and/or an investment in a new consolidated facility for both parties.

As a result of the ownership percentage acquired in Limoneira, we recognize only dividends received from Limoneira as income. Such investment is reported at fair value at the balance sheet date. Fair value is determined based on quoted market prices. Unrealized gains and losses related to such investment are reported in other comprehensive income. Based on the overall state of the stock market, the availability of buyers for the shares when we want to sell, and other restrictions, at any point in time the amounts ultimately realized upon liquidation of these securities may be significantly different than the carrying value.

### 13. Long-Term Obligations

Long-term obligations at fiscal year ends consist of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Farm Credit West, PCA	\$ 11,700	\$ 13,000
Other	14	32
	<u>11,714</u>	<u>13,032</u>
Less current portion	<u>(1,308)</u>	<u>(1,313)</u>
	<u>\$ 10,406</u>	<u>\$ 11,719</u>

In July 2005, we entered into a non-collateralized term loan agreement with Farm Credit West, PCA to finance the purchase of our Limoneira Stock. Pursuant to such agreement, we borrowed \$13.0 million, which is to be repaid in 10 annual installments of \$1.3 million. Such annual installments began July 2006 and continue through July 2015. Interest is paid monthly, in arrears, and began in August 2005, and will continue through the life of the loan. Such loan bears interest at a fixed rate of 5.70%.

Such loan contains various financial covenants, the most significant relating to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined). We were in compliance with all such covenants at October 31, 2006, except for the working capital covenants with which we obtained appropriate waivers.

At October 31, 2006, annual debt payments are scheduled as follows (in thousands):

	<u>Total</u>
Year ending October 31:	
2007	\$ 1,308
2008	1,306
2009	1,300
2010	1,300
2011	1,300
Thereafter	5,200
	<u>\$ 11,714</u>

### 14. Stock-Based Compensation

In November 2001, our Board of Directors approved two stock-based compensation plans.

#### *The Directors Stock Option Plan*

Participation in the director's stock option plan is limited to members of our Board of Directors. The plan makes available to the Board of Directors, or a plan administrator, the right to grant options to purchase up to 3,000,000 shares of common stock. In connection with the adoption of the plan, the Board of Directors approved an award of fully vested options to purchase 1,240,000 shares of common stock at an exercise price of \$5.00 per share. We anticipate terminating this plan during fiscal 2007. Outstanding options would not be impacted by such termination.

In January 2002, members of our Board of Directors elected to exercise options to purchase approximately 1,005,000 shares of common stock. The exercise price was paid by delivery of full-recourse promissory notes with a face value of \$4,789,000 and by cash payments of approximately \$236,000. These notes and the related security agreements provide, among other things, that each director pledge as collateral the shares acquired upon exercise of the stock option, as well as additional shares of common stock held by the directors with a value equal to 10% of the loan amount, if the exercise price was paid by means of a full-recourse note. The notes, which bear interest at 7% per annum, provide for annual interest payments with a final principal payment due March 1, 2007. Directors will be allowed to withdraw shares from the pledged pool of common stock prior to repayment of their notes, as long as the fair value of the remaining pledged shares is at least equal to 120% of the outstanding note balance. The notes have been presented as a reduction of shareholders' equity as of October 31, 2006 and October 31, 2005.

In December 2003, our Board of Directors approved the issuance of options to acquire a total of 50,000 shares of our common stock to two members of our Board of Directors. Each option to acquire 25,000 shares vests in substantially equal installments over a three-year period, has an exercise price of \$7.00 per share, and has a term of five years from the grant date. The market price of our common stock at the grant date was \$10.01. In December 2005, the related stock option agreements were modified to shorten the option terms, as defined. Such modifications were contemplated primarily as a result of Section 409A of the tax code. During the

## [Table of Contents](#)

year ended October 31, 2006 and 2005, we recognized approximately \$50,000 of compensation expense with respect to these stock option awards.

A summary of stock option activity follows (in thousands, except for per share amounts):

	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at October 31, 2005	100	\$ 6.00	
Exercised	(51)	\$ 5.04	
Outstanding at October 31, 2006	49	\$ 7.00	\$ 138
Exercisable at October 31, 2006	34	\$ 7.00	\$ 94

The weighted average remaining life of such outstanding options is 2.14 years and the total intrinsic value of options exercised during the year ended October 31, 2006 was \$0.2 million. At October 31, 2006, the total unrecognized compensation cost related to such unvested stock options awards was approximately \$8,000, which is expected to be recognized over the remaining period of two months. The total fair value of shares vested during the year ended October 31, 2006 was approximately \$163,000.

### ***The Employee Stock Purchase Plan***

The employee stock purchase plan was approved by our Board of Directors and shareholders. Participation in the employee stock purchase plan is limited to employees. The plan provides the Board of Directors, or a plan administrator, the right to make available up to 2,000,000 shares of common stock at a price not less than fair market value. In March 2002, the Board of Directors awarded selected employees the opportunity to purchase up to 474,000 shares of common stock at \$7.00 per share, the closing price of our common stock on the date prior to the grant. The plan also permits us to advance all or some of the purchase price of the purchased stock to the employee upon the execution of a full-recourse note at prevailing interest rates. These awards expired in April 2002, with 84 participating employees electing to purchase approximately 279,000 shares.

The purchase price was paid by delivery of full-recourse promissory notes with a face value of \$1,352,000 and by cash payments of approximately \$600,000. These notes and the related security agreements provide, among other things, that each employee pledge as collateral the shares acquired. The notes, which bear interest at 7% per annum, provide for annual interest and principal payments for a period of two to four years. As of October 31, 2006, all outstanding note balances have been paid in full.

### ***The 2005 Stock Incentive Plan***

The 2005 Stock Incentive Plan of Calavo Growers, Inc. (the "2005 Plan") was approved by our Board of Directors and shareholders. The 2005 Plan authorizes the granting of the following types of awards to persons who are employees, officers, consultants, advisors, or directors of Calavo Growers, Inc. or any of its affiliates:

- "Incentive stock options" that are intended to satisfy the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder;
- "Non-qualified stock options" that are not intended to be incentive stock options; and
- Shares of common stock that are subject to specified restrictions

Subject to the adjustment provisions of the 2005 Plan that are applicable in the event of a stock dividend, stock split, reverse stock split or similar transaction, up to 2,500,000 shares of common stock may be issued under the 2005 Plan and no person shall be granted awards under the 2005 Plan during any 12-month period that cover more than 500,000 shares of common stock.

In August 2005, our Board of Directors approved the issuance of options to acquire a total of 400,000 shares of our common stock to various employees of the Company. As discussed in footnote 2, these options vested in August 2006. See footnote 2 for further explanation. These options have an exercise price of \$9.10 per share and a term of 5 years from the grant date. The market price of our common stock at the grant date was \$9.10. During the year ended October 31, 2006, 9,000 options have been forfeited, and the total intrinsic value of options outstanding was \$0.3 million. No options have been exercised as of October 31, 2006.

## **15. Dividends**

In January 2007, we paid a \$0.32 per share dividend in the aggregate amount of \$4.6 million to shareholders of record on December 15, 2006. In January 2006, we paid a \$0.32 per share dividend in the aggregate amount of \$4.6 million to shareholders of record on December 15, 2005.



## **16. Joint Venture in Maui Fresh International, LLC**

In August 2006, we entered into a joint venture agreement with San Rafael Distributing (SRD) for the purpose of the wholesale 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 LLC) and commenced operations in August 2006. SRD and Calavo each have an equal one-half ownership interest in Maui Fresh, but SRD shall have overall management responsibility for the operations of Maui Fresh at the Terminal Market. Therefore, pursuant to Accounting Principles Board (APB) 18 and Emerging Issues Task Force (EITF) 03-16, we believe that our level of economic influence is that of “significant.” As such, we will use the equity method to account for our investment.

Contributions of Calavo to Maui Fresh included the following: (1) the licensing of certain trademarks to Maui Fresh, (2) the transfer and assignment of its existing customer accounts at the Terminal Market to Maui Fresh, (3) to provide sufficient staffing, as defined, and (4) to deposit the sum of approximately \$0.2 million to provide for the initial working capital for Maui Fresh.

Contributions of SRD to Maui Fresh included the following: (1) to transfer all property owned by SRD and located on the Terminal Market premises to Maui Fresh, (2) transfer all existing customer accounts at the Terminal Market to Maui Fresh, (3) SRD has overall management responsibility for the operations of Maui Fresh at the Terminal Market, and (4) to provide certain staffing, as defined. Additionally, SRD has contributed, via both cash and non-cash items, amounts that approximated Calavo’s contribution.

Commencing on the first anniversary of this agreement and continuing thereafter during the term of the agreement, Calavo shall have the unconditional right, but not the obligation, to purchase the one-half interest in Maui Fresh owned by SRD at a purchase price to be determined pursuant to the agreement. The term of the agreement is for five years, which may be extended, or terminated early, as defined. As of October 31, 2006, we have advanced Maui Fresh approximately \$0.4 million for working capital purposes. These advances were made at our own discretion.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Calavo Growers, Inc.

We have audited the accompanying consolidated balance sheet of Calavo Growers, Inc. and subsidiaries (the “Company”) as of October 31, 2006, and the related consolidated statements of income, comprehensive income (loss), shareholders’ equity, and cash flows for the year then ended. Our audit also included the 2006 financial statement schedule listed at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Calavo Growers, Inc. and subsidiaries at October 31, 2006, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related 2006 financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, Calavo Growers, Inc. changed its method of accounting for Share-Based Payments in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) on November 1, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Calavo Growers Inc.’s internal control over financial reporting as of October 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 15, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Woodland Hills, California

January 15, 2007

[Table of Contents](#)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Calavo Growers, Inc.

We have audited the accompanying consolidated balance sheet of Calavo Growers, Inc. and subsidiaries (the “Company”) as of October 31, 2005, and the related consolidated statements of income, comprehensive income, shareholders’ equity, and cash flows for each of the two years in the period ended October 31, 2005. Our audits also included the financial statement schedule listed at Item 15(a)(2) as of October 31, 2005 and October 31, 2004 and for each of the two years in the period ended October 31, 2005. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiaries as of October 31, 2005, and the results of their operations and their cash flows for each of the two years in the period ended October 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule as of October 31, 2005 and 2004 and for each of the two years in the period ended October 31, 2005, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

January 31, 2006

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of October 31, 2006.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of the end of the period covered by this report based on the framework set forth in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework set forth in *Internal Control — Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of October 31, 2006. Our management's assessment of the effectiveness of our internal control over financial reporting as of October 31, 2006 has been audited by Ernst and Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Calavo Growers, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Calavo Growers, Inc. maintained effective internal control over financial reporting as of October 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Calavo Growers, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Calavo Growers, Inc. maintained effective internal control over financial reporting as of October 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Calavo Growers, Inc. maintained, in all material respects, effective internal control over financial reporting as of October 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Calavo Growers, Inc. as of October 31, 2006, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity and cash flows for the year then ended of Calavo Growers, Inc. and our report dated January 15, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Woodland Hills, California

January 15, 2007

### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended October 31, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information**

None.

### **PART III**

Certain information required by Part III is omitted from this Annual Report because we will file a definitive Proxy Statement for the Annual Meeting of Shareholders pursuant to Regulation 14A of the Securities Exchange Act of 1934 (the "Proxy Statement"), not later than 120 days after the end of the fiscal year covered by this Annual Report, and the applicable information included in the Proxy Statement is incorporated herein by reference.

### **Item 10. Directors and Executive Officers of the Registrant**

Information regarding our executive officers is set forth under "Executive Officers" in Part I., Item 4 of this Annual Report.

The remaining information required by Item 401 of Regulation S-K is incorporated herein by reference to the sections of the Proxy Statement entitled "Election of Directors" and "Audit Committee."

Information required by Item 405 of Regulation S-K is incorporated herein by reference to the section of the Proxy Statement entitled "Section 16(a) Beneficial Ownership Reporting Compliance."

We have adopted a code of ethics that applies to all of our directors, officers and employees. A copy of the code of ethics is posted on our Internet site at <http://www.calavo.com>. In the event that we make any amendment to, or grant any waiver of, a provision of the code of ethics that applies to our principal executive officer or principal financial officer and that requires disclosure under applicable SEC rules, we intend to disclose such amendment or waiver and the reasons for the amendment or waiver on our Internet site.

### **Item 11. Executive Compensation**

Information required by Item 402 of Regulation S-K is incorporated herein by reference to the sections of the Proxy Statement entitled "Executive Compensation" and "Directors' Compensation."

### **Item 12. Security Ownership of Certain Beneficial Owners and Management**

Information required by Items 201(d) and 403 of Regulation S-K is incorporated herein by reference to the sections of the Proxy Statement entitled "Equity Compensation Plan Information" and "Security Ownership of Certain Beneficial Owners and Management."

## [Table of Contents](#)

### **Item 13. Certain Relationships and Related Transactions**

The information required by this Item is incorporated herein by reference to the section of the Proxy Statement entitled “Certain Relationships and Related Transactions.”

### **Item 14. Principal Accountant’s Fees and Services**

Information required by this Item is incorporated herein by reference to the section of the Proxy Statement entitled “Principal Accountant Fees and Services.”

## **Part IV**

### **Item 15. Exhibits and Financial Statement Schedules**

#### **(a) (1) Financial Statements**

The following consolidated financial statements as of October 31, 2006 and 2005 and for each of the three years in the period ended October 31, 2006 are included herewith:

Consolidated Balance Sheets, Consolidated Statements of Income, Consolidated Statements of Comprehensive Income, Consolidated Statements of Cash Flows, Consolidated Statements of Shareholders’ Equity, Notes to Consolidated Financial Statements, Report of Ernst & Young LLP, Independent Registered Public Accounting Firm, and Report of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.

#### **(2) Supplemental Schedules**

Schedule II — Valuation and Qualifying Accounts

All other schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule, or because the required information is included in the consolidated financial statements or notes thereto.

#### **(3) Exhibits**

<u>Exhibit Number</u>	<u>Description</u>
2.1	Agreement and Plan of Merger and Reorganization dated as of February 20, 2001 between Calavo Growers, Inc. and Calavo Growers of California. <sup>1</sup>
2.2	Agreement and Plan of Merger dated as of November 7, 2003 Among Calavo Growers, Inc., Calavo Acquisition, Inc., Maui Fresh International, Inc. and Arthur J. Bruno, Robert J. Bruno and Javier J. Badillo <sup>7</sup>
3.1	Articles of Incorporation of Calavo Growers, Inc. <sup>1</sup>
3.2	Amended and Restated Bylaws of Calavo Growers, Inc. <sup>3</sup>
10.1	Form of Marketing Agreement for Calavo Growers, Inc. <sup>8</sup>
10.2	Marketing Agreement dated as of April 1, 1996 between Tropical Hawaiian Products, Inc., a Hawaiian corporation, and Calavo Growers of California. <sup>1</sup>
10.3	Stock Purchase Agreement dated as of June 1, 2005, between Limoneira Company and Calavo Growers, Inc. <sup>4</sup>
10.4	Lease Agreement dated as of November 21, 1997, between Tede S.A. de C.V., a Mexican corporation, and Calavo de Mexico, S.A. de C.V., a Mexican corporation, including attached Guaranty of Calavo Growers of California dated December 16, 1996. <sup>1</sup>
10.5	Lease agreement dated as of February 15, 2005, between Limoneira Company and Calavo Growers, Inc. <sup>4</sup>
10.6	Standstill agreement dated June 1, 2005, between Limoneira Company and Calavo Growers, Inc. <sup>4</sup>
10.7	Standstill agreement dated June 1, 2005 between Calavo Growers, Inc. And Limoneira Company <sup>4</sup>

## Table of Contents

<u>Exhibit Number</u>	<u>Description</u>
10.8	Term Loan Agreement dated July 1, 2005, between Farm Credit West, PCA, and Calavo Growers, Inc. <sup>5</sup>
10.9	2005 Stock Incentive Plan Of Calavo Growers, Inc. <sup>6</sup>
10.10	Calavo Supplemental Executive Retirement Agreement dated March 11, 1989 between Egidio Carbone, Jr. and Calavo Growers of California. <sup>1</sup>
10.11	Amendment to the Calavo Growers of California Supplemental Executive Retirement Agreement dated November 9, 1993 Between Egidio Carbone, Jr. and Calavo Growers of California. <sup>1</sup>
10.12	2001 Stock Option Plan for Directors. <sup>2</sup>
10.13	2001 Stock Purchase Plan for Officers and Employees. <sup>2</sup>
10.14	Line of Credit Agreement between Farm Credit West, PCA and Calavo Growers, Inc., dated October 5, 2006
10.15	Business Loan Agreement between Bank of America, N.A. and Calavo Growers, Inc., dated January 30, 2004 <sup>12</sup>
10.16	Renewal Notice for Business Loan Agreement, dated January 30, 2004, Between Bank of America and Calavo Growers, Inc., dated November 18, 2005 <sup>9</sup>
10.17	Form of Stock Option Agreement <sup>11</sup>
16	Letter re change in certifying accountant <sup>10</sup>
21.1	Subsidiaries of Calavo Growers, Inc. <sup>1</sup>
23.1	Consent of Ernst & Young LLP.
23.2	Consent of Deloitte & Touche LLP.
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-15(e) or Rule 15d-15(e)
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-15(e) or Rule 15d-15(e)
32	Certification of Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350

1 Previously filed on April 24, 2001 as an exhibit to the Registrant's Registration Statement on Form S-4, File No. 333-59418, and incorporated herein by reference.

2 Previously filed on December 18, 2001 as an exhibit to the Registrant's Registration Statement on Form S-8, File No. 333-75378, and incorporated herein by reference.

3 Previously filed on December 19, 2002 as an exhibit to the Registrant's Report on Form 8-K, and incorporated herein by reference.

4 Previously filed on June 9, 2005 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.

5 Previously filed on September 9, 2005 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.

6 Previously filed on March 21, 2005 as an exhibit to the Registrant's Definitive Proxy Statement on Form DEF14A and incorporated herein by reference.

7 Previously filed on January 23, 2004 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.

8 Previously filed on January 28, 2003 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.

9 Previously filed on February 1, 2006 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.

10 Previously filed on July 3, 2006 as an exhibit to the Registrant's Report on Form 8-K and incorporated herein by reference.

11 Previously filed on September 11, 2006 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.

12 Previously filed on January 15, 2005 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.

### (b) Exhibits

See subsection (a) (3) above.

### (c) Financial Statement Schedules

See subsection (a) (1) and (2) above.





## SCHEDULE II

**CALAVO GROWERS, INC.**  
**VALUATION AND QUALIFYING ACCOUNTS (in thousands)**

	<u>Fiscal year ended October 31:</u>	<u>Balance at beginning of year</u>	<u>Additions(1)</u>	<u>Deductions(2)</u>	<u>Balance at end of year</u>
Allowance for customer deductions	2004	\$ 659	\$3,817	\$3,454	\$1,022
	2005	1,022	6,791	5,663	2,150
	2006	2,150	5,147	5,952	1,345
Allowance for doubtful accounts	2004	41	25	1	65
	2005	65	475	2	538
	2006	538	56	106	488

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(1) Charged to net sales (customer deductions) or costs and expenses (doubtful accounts).

(2) Write-off of assets or collection of previously written-off assets

## EXHIBIT INDEX

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2.2	Agreement and Plan of Merger dated as of November 7, 2003 Among Calavo Growers, Inc., Calavo Acquisition, Inc., Maui Fresh International, Inc. and Arthur J. Bruno, Robert J. Bruno and Javier J. Badillo <sup>7</sup>
3.1	Articles of Incorporation of Calavo Growers, Inc. <sup>1</sup>
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32	Certification of Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350

<sup>1</sup> Previously filed on April 24, 2001 as an exhibit to the Registrant's Registration Statement on Form S-4, File No. 333-59418, and incorporated herein by reference.

<sup>2</sup> Previously filed on December 18, 2001 as an exhibit to the Registrant's Registration Statement on Form S-8, File No. 333-75378, and incorporated



## Table of Contents

- 3 Previously filed on December 19, 2002 as an exhibit to the Registrant's Report on Form 8-K, and incorporated herein by reference.
- 4 Previously filed on June 9, 2005 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.
- 5 Previously filed on September 9, 2005 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.
- 6 Previously filed on March 21, 2005 as an exhibit to the Registrant's Definitive Proxy Statement on Form DEF14A and incorporated herein by reference.
- 7 Previously filed on January 23, 2004 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.
- 8 Previously filed on January 28, 2003 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.
- 9 Previously filed on February 1, 2006 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.
- 10 Previously filed on July 3, 2006 as an exhibit to the Registrant's Report on Form 8-K and incorporated herein by reference.
- 11 Previously filed on September 11, 2006 as an exhibit to the Registrant's Report on Form 10Q and incorporated herein by reference.
- 12 Previously filed on January 15, 2005 as an exhibit to the Registrant's Report on Form 10K and incorporated herein by reference.

**LINE OF CREDIT AGREEMENT**

**THIS LINE OF CREDIT AGREEMENT** ("Line of Credit Agreement") is entered into as of October 5, 2006, between **FARM CREDIT WEST, PCA**, Visalia, California ("FCW") and **CALAVO GROWERS, INC.**, Santa Paula, California (the "Company").

**SECTION 1. The Credit Facility.** On the terms and conditions set forth in this Line of Credit Agreement, FCW agrees to make advances to the Company during the period set forth below in an aggregate principal amount not to exceed \$12,000,000.00 (the "Commitment"). The Line of Credit Agreement and Commitment is executed, delivered and accepted not in payment of but for the purpose of amending, restating and replacing the following described obligations, and renewing any unpaid balance(s) evidenced thereby: Note dated August 17, 2005, in the principal amount of \$12,000,000.00. Furthermore, the Commitment also evidences an additional loan advance(s) to the extent the Commitment under this Line of Credit Agreement exceeds the renewed unpaid balance(s) referred to above.

**SECTION 2. Sale of Interest.** The Company acknowledges that FCW has the option to participate all or a portion of the Commitment with one or more lenders, including CoBank, ACB ("CoBank"). All advances hereunder shall be made by CoBank as agent for FCW and all repayments by the Company hereunder shall be made to CoBank as agent for FCW.

**SECTION 3. Purpose.** The purpose of the Commitment is to finance the ongoing operating needs of the Company.

**SECTION 4. Term.** The term of the Commitment shall be from the date hereof, up to and including February 1, 2010.

**SECTION 5. Availability.** Subject to the provisions of Section 25, advances will be made available on any day on which FCW, CoBank, and the Federal Reserve Banks are open for business upon the telephonic or written request of the Company. Requests for advances must be received no later than 12:00 Noon, Company's local time, on the date the advance is desired. Advances will be made available by CoBank by wire transfer of immediately available funds to such account or accounts as may be authorized by the Company. The Company shall furnish to CoBank a duly completed and executed copy of a CoBank Delegation and Wire and Electronic Transfer Authorization Form, and CoBank shall be entitled to rely on (and shall incur no liability to the Company in acting on) any request or direction furnished in accordance with the terms thereof.

**SECTION 6. Interest and Fees.**

**(A) Interest.** The Company agrees to pay interest on the unpaid balance of the Commitment in accordance with the following interest rate option:

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**(1) 7-Day LIBOR Index Rate.** At a rate (rounded upward to the nearest 1/100th% and adjusted for reserves required on “Eurocurrency Liabilities” (as hereinafter defined) for banks subject to “FRB Regulation D” (as hereinafter defined) or required by any other federal law or regulation) per annum equal at all times to 100 basis points (1.00%) above the annual rate quoted by the British Bankers Association (the “BBA”) at 11:00 a.m. London time for the offering of seven (7) day of U.S. dollars deposits, as published by Bloomberg or another major information vendor listed on BBA’s official website on the first U.S. Banking Day (as hereinafter defined) in each week with such rate to change weekly on such day. The rate shall be reset automatically, without the necessity of notice being provided to the Company or any other party, on the first U.S. Banking Day of each succeeding week and each change in the rate shall be applicable to all balances subject to this option and information about the then current rate shall be made available upon telephonic request. For purposes hereof (a) “U.S. Banking Day” shall mean a day on which CoBank is open for business, dealings in U.S. dollar deposits are being carried out in the London interbank market, and banks are open for business in New York City and London, England; (b) “Eurocurrency Liabilities” shall have meaning as set forth in “FRB Regulation D”; and (c) “FRB Regulation D” shall mean Regulation D as promulgated by the Board of Governors of the Federal Reserve System, 12 CFR Part 204, as amended.

**(2) LIBOR.** At a fixed rate per annum equal to “LIBOR” (as hereinafter defined) plus 100 basis points (1%). Under this option: (1) rates may be fixed for “Interest Periods” (as hereinafter defined) of 1, 2, 3, 6, 9 or 12 months as selected by the Company; (2) amounts may be fixed in increments of \$100,000.00 or multiples thereof; (3) the maximum number of fixes in place at any one time shall be 10; and (4) rates may only be fixed on a “Banking Day” (as hereinafter defined) on 3 Banking Days’ prior written notice. For purposes hereof: (a) “LIBOR” shall mean the rate (rounded upward to the nearest sixteenth) and adjusted for reserves required on “Eurocurrency Liabilities” (as hereinafter defined) for banks subject to “FRB Regulation D” (as herein defined) or required by any other federal law or regulation) quoted by the British Bankers Association (the “BBA”) at 11:00 a.m. London time 2 Banking Days before the commencement of the Interest Period for the offering of U.S. dollar deposits in the London interbank market for the Interest Period designated by the Company; as published by Bloomberg or another major information vendor listed on BBA’s official website; (b) “Banking Day” shall mean a day on which CoBank is open for business, dealings in U.S. dollar deposits are being carried out in the London interbank market, and banks are open for business in New York City and London, England; (c) “Interest Period” shall mean a period commencing on the date this option is to take effect and ending on the numerically corresponding day in the next calendar month or the month that is 2, 3, 6, 9 or 12 months thereafter, as the case may be; provided, however, that: (i) in the event such ending day is not a Banking Day, such period shall be extended to the next Banking Day unless such next Banking Day falls in the next calendar month, in which case it shall end on the preceding Banking Day; and (ii) if there is no numerically corresponding day in the month, then such period shall end on the last Banking Day in the relevant month; (d) “Eurocurrency Liabilities” shall have meaning as set forth in “FRB

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Regulation D”; and (e) “FRB Regulation D” shall mean Regulation D as promulgated by the Board of Governors of the Federal Reserve System, 12 CFR Part 204, as amended.

The Company shall select the applicable rate option at the time it requests a loan hereunder and may, subject to the limitations set forth above, elect to convert balances bearing interest at the 7-Day LIBOR Index Rate option to the LIBOR rate option. Upon the expiration of any fixed rate period, interest shall automatically accrue at the 7-Day LIBOR Index Rate option provided for above unless the amount fixed is repaid or fixed for an additional period in accordance with the terms hereof. Notwithstanding the foregoing, rates may not be fixed in such a manner as to cause the Company to have to break any fixed rate balance in order to pay any installment of principal. All elections provided for herein shall be made telephonically or in writing and must be received by 12:00 Noon Company’s local time. Interest shall be calculated on the actual number of days each loan is outstanding on the basis of a year consisting of 360 days and shall be payable monthly in arrears by the 20th day of the following month or on such other day in such month as FCW shall require in a written notice to the Company.

**(B) Commitment Fee.** In consideration of the Commitment, the Company agrees to pay to FCW a commitment fee on the average daily unused portion of the Commitment at the rate of 0.15% per annum (calculated on a 360 day basis based on utilization, which is defined as outstanding advances plus issued and outstanding letters of credit divided by the total available amount of the Commitment), payable quarterly in arrears by the 20th day following each quarter. Such fee shall be payable for each quarter (or portion thereof) occurring during the original or any extended term of the Commitment.

**SECTION 7. Repayment and Maturity.** The unpaid principal balance of the Commitment shall mature and be due and payable on February 1, 2010 (the “Maturity Date”).

**SECTION 8. Promissory Note.** The Company’s obligation to repay the Commitment shall be evidenced by a promissory note in the form attached hereto as Exhibit A (“Note”).

**SECTION 9. Manner and Time of Payment.** CoBank shall maintain a record of all loans, the interest accrued thereon, and all payments made with respect thereto, and such record shall, absent proof of manifest error, be conclusive evidence of the outstanding principal and interest on the loans. All payments shall be made by wire transfer of immediately available funds, by check, or by automated clearing house or other similar cash handling processes as specified by separate agreement between the Company and CoBank. Wire transfers shall be made to ABA No. 307088754 for advice to and credit of CoBank (or to such other account as CoBank may direct by notice). The Company shall give CoBank telephonic notice no later than 12:00 Noon Company’s local time of its intent to pay by wire and funds received after 3:00 p.m. Company’s local time shall be credited on the next business day. Checks shall be mailed to CoBank, Department 167, Denver, Colorado 80291-0167 (or to such other place as CoBank may direct by notice). Credit for payment by check will not be given until the later of: (a) the day on which CoBank receives immediately available funds; or (b) the next business day after receipt of

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the check all as set forth in the Servicing Agreement between Borrower, FCW, and CoBank in form attached hereto as Exhibit B.

**SECTION 10. Capitalization.** The Company has purchased a \$1,000.00 stock investment under FCW's capitalization plan. The Company understands that FCW's stock is at risk and that any reference to "FCW equities" or to "stock or participation certificates required by Lender's bylaws" in any document, agreement or Loan Document shall mean the FCW stock investment described herein.

**SECTION 11. Patronage.** The Commitment is eligible for patronage under the plan and in accordance with the provisions of FCW's bylaws and its practices and procedures related to patronage distribution and as set forth in Section 27.

**SECTION 12. Security.** The Company's obligations under this Line of Credit Agreement and the Note shall be secured by a statutory first lien on all equity which the Company may now own or hereafter acquire in FCW. With the exception of the security referenced in the preceding sentence, the Company's obligations under this Line of Credit Agreement and the Note shall be unsecured.

**SECTION 13. Conditions Precedent.** FCW's obligation to make advances hereunder is subject to the condition precedent that FCW receive, in form and content satisfactory to FCW, each of the following:

**(A) Line of Credit Agreement.** A duly executed copy of this Line of Credit Agreement and all instruments and documents contemplated hereby.

**(B) Evidence of Authority.** Such certified board resolutions, evidence of incumbency, and other evidence that FCW may require that this Line of Credit Agreement and the Note have been duly authorized and executed.

**(C) Fees and Other Charges.** All fees and other charges provided for herein.

**(D) Evidence of Insurance.** Such evidence as FCW may require that the Company is in compliance with Section 15(C) hereof.

**(E) Event of Default.** That no "Event of Default" (as defined in Section 18 hereof) or event which with the giving of notice and/or the passage of time would become an Event of Default hereunder (a "Potential Default"), shall have occurred and be continuing.

**SECTION 14. Representations and Warranties.**

**(A) Line of Credit Agreement.** The Company represents and warrants to FCW that as of the date of this Line of Credit Agreement:

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**(1) Compliance.** The Company and, to the extent contemplated hereunder, each “Subsidiary” (as defined below), is in compliance with all of the terms of this Line of Credit Agreement, and no Event of Default or Potential Default exists hereunder.

**(2) Subsidiaries.** The Company has the following Subsidiaries: Calavo Foods, Inc. (CFI); Maui Fresh International, Inc.; Calavo de Mexico S.A. de C.V.; and Calavo Foods de Mexico S.A. de C.V. For purposes hereof, a “Subsidiary” shall mean a corporation of which shares of stock having ordinary voting power to elect a majority of the board of directors or other managers of such corporation are owned, directly or indirectly, by the Company.

**(3) Conflicting Agreements.** This Line of Credit Agreement and the Note (collectively, at any time, the “Loan Documents”), do not conflict with, or require the consent of any party to, any other agreement to which the Company is a party or by which it or its property may be bound or affected, and do not conflict with any provision of the Company’s bylaws, articles of incorporation, or other organizational documents.

**(4) Compliance.** The Company and, to the extent contemplated hereunder, each Subsidiary, if any, is in compliance with all of the terms of the Loan Documents.

**(5) Binding Agreement.** The Loan Documents create legal, valid, and binding obligations of the Company which are enforceable in accordance with their terms, except to the extent that enforcement may be limited by applicable bankruptcy, insolvency, or similar laws affecting creditors’ rights generally.

**SECTION 15. Affirmative Covenants.** Unless otherwise agreed to in writing by FCW, while this Line of Credit Agreement is in effect, the Company agrees to and with respect to Subsections 15(A) through 15(F) hereof, agrees to cause each Subsidiary, if any, to:

**(A) Corporate Existence, Licenses.** (i) Preserve and keep in full force and effect its existence and good standing in the jurisdiction of its incorporation or formation; (ii) qualify and remain qualified to transact business in all jurisdictions where such qualification is required, and (iii) obtain and maintain all licenses, certificates, permits, authorizations, approvals, and the like which are material to the conduct of its business or required by law, rule, regulation, ordinance, code, order, and the like (collectively, “Laws”).

**(B) Compliance with Laws.** Comply in all material respects with all applicable Laws, including, without limitation, all Laws relating to environmental protection. In addition, the Company agrees to cause all persons occupying or present on any of its properties, and to cause each Subsidiary, if any, to cause all persons occupying or present on any of its properties, to comply in all material respects with all environmental protection Laws.

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**(C) Insurance.** Maintain insurance with insurance companies or associations acceptable to FCW in such amounts and covering such risks as are usually carried by companies engaged in the same or similar business and similarly situated, and make such increases in the type or amount of coverage as FCW may request. At FCW's request, all policies (or such other proof of compliance with this Subsection as may be satisfactory to FCW) shall be delivered to FCW.

**(D) Property Maintenance.** Maintain all of its property that is necessary to or useful in the proper conduct of its business in good working condition, ordinary wear and tear excepted.

**(E) Books and Records.** Keep adequate records and books of account in which complete entries will be made in accordance with generally accepted accounting principles ("GAAP") consistently applied.

**(F) Inspection.** Permit FCW or its agents, upon reasonable notice and during normal business hours or at such other times as the parties may agree, to examine its properties, books, and records, and to discuss its affairs, finances, and accounts, with its respective officers, directors, employees, and independent certified public accountants.

**(G) Reports and Notices.** Furnish to FCW:

**(1) Annual Financial Statements.** As soon as available, but in no event more than 90 days after the end of each fiscal year of the Company occurring during the term hereof, annual consolidated and consolidating financial statements of the Company and its consolidated Subsidiaries, if any, prepared in accordance with GAAP consistently applied. Such financial statements shall: (a) be audited by independent certified public accountants selected by the Company and acceptable to FCW; (b) be accompanied by a report of such accountants containing an opinion thereon acceptable to FCW; (c) be prepared in reasonable detail and in comparative form; and (d) include a balance sheet, a statement of income, a statement of retained earnings, a statement of cash flows, and all notes and schedules relating thereto.

**(2) Interim Financial Statements.** As soon as available, but in no event more than 45 days after the end of each fiscal quarter, a consolidated balance sheet of the Company and its consolidated Subsidiaries, if any, as of the end of such quarter, a consolidated statement of income for the Company and its consolidated Subsidiaries, if any, for such period and for the period year to date, and such other interim statements as FCW may specifically request, all prepared in reasonable detail and in comparative form in accordance with GAAP consistently applied and certified by an authorized officer or employee of the Company acceptable to FCW.

**(3) Notice of Default.** Promptly after becoming aware thereof, notice of the occurrence of an Event of Default or a Potential Default.

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**(4) Notice of Non-Environmental Litigation.** Promptly after the commencement thereof, notice of the commencement of all actions, suits, or proceedings before any court, arbitrator, or governmental department, commission, board, bureau, agency, or instrumentality affecting the Company or any Subsidiary which, if determined adversely to the Company or any such Subsidiary, could have a material adverse effect on the financial condition, properties, profits, or operations of the Company or any such Subsidiary.

**(5) Notice of Environmental Litigation.** Promptly after receipt thereof, notice of the receipt of all pleadings, orders, complaints, indictments, or any other communication alleging a condition that may require the Company or any Subsidiary to undertake or to contribute to a cleanup or other response under environmental Laws, or which seek penalties, damages, injunctive relief, or criminal sanctions related to alleged violations of such Laws, or which claim personal injury or property damage to any person as a result of environmental factors or conditions.

**(6) Bylaws and Articles.** Promptly after any change in the Company's bylaws or articles of incorporation (or like documents), copies of all such changes, certified by the Company's Secretary.

**(7) Other Information.** Such other information regarding the condition or operations, financial or otherwise, of the Company or any Subsidiary as FCW may from time to time reasonably request, including but not limited to copies of all pleadings, notices, and communications referred to in Subsections 15(G)(4) and (5) above.

**(8) Financial Certificate.** Together with each set of financial statements furnished to FCW pursuant to Section 15(G)(1), and each quarterly statement submitted pursuant to Section 15(G)(2) for a period corresponding to a period for which one or more of the financial covenants set forth in Section 17 hereof are required to be tested, a certificate of an officer or employee of the Company acceptable to FCW setting forth calculations showing compliance with each of the financial covenants that require compliance at the end of the period for which the statements are being furnished.

**(H) Certain Organizational Changes.** Provide FCW with prior notice (and as early as practicable) of any merger, consolidation reorganization under a different provision of law, acquisition of all or a material part of the assets of another organization, change of name, adoption of any trade name, or creation of any Subsidiary, affiliate or material joint venture(s). For purposes of this covenant, joint venture transaction(s), which alone or in the aggregate exceed \$1,000,000, are considered material.

**SECTION 16. Negative Covenants.** Unless otherwise agreed to in writing by FCW, which agreement will not be unreasonably withheld, while this Line of Credit Agreement is in effect, the Company will not:

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**(A) Borrowings.** Create, incur, assume, or allow to exist, directly or indirectly, any indebtedness or liability for borrowed money (including trade or bankers' acceptances), letters of credit, or the deferred purchase price of property or services (including capitalized leases), except for: (i) debt to FCW; (ii) accounts payable to trade creditors incurred in the ordinary course of business; and (iii) current operating liabilities (other than for borrowed money) incurred in the ordinary course of business; (iv) debt of the Company to Bank of America in an amount not to exceed \$12,000,000.00 and all extensions, renewals, and refinancings thereof; (v) (vi) letters of credit issued by any bank for the account of the Company in an aggregate face amount not to exceed \$5,000,000.00 at any one time outstanding; and (vii) capitalized leases existing on the date hereof existing from time to time.

**(B) Liens.** Create, incur, assume, or allow to exist any mortgage, deed of trust, pledge, lien (including the lien of an attachment, judgment, or execution), security interest, or other encumbrance of any kind upon any of its property, real or personal (collectively, "Liens"). The foregoing restrictions shall not apply to: (i) Liens in favor of FCW or CoBank; (ii) Liens for taxes, assessments, or governmental charges that are not past due; (iii) Liens and deposits under workers' compensation, unemployment insurance, and social security Laws; (iv) Liens and deposits to secure the performance of bids, tenders, contracts (other than contracts for the payment of money), and like obligations arising in the ordinary course of business as conducted on the date hereof; (v) Liens imposed by Law in favor of mechanics, materialmen, warehousemen, and like persons that secure obligations that are not past due; and (vi) easements, rights-of-way, restrictions, and other similar encumbrances which, in the aggregate, do not materially interfere with the occupation, use, and enjoyment of the property or assets encumbered thereby in the normal course of its business or materially impair the value of the property subject thereto.

**(C) Transfer of Assets.** Sell, transfer, lease, or otherwise dispose of any of its assets, except in the ordinary course of business.

**(D) Contingent Liabilities.** Assume, guarantee, become liable as a surety, endorse, contingently agree to purchase, or otherwise be or become liable, directly or indirectly (including, but not limited to, by means of a maintenance agreement, an asset or stock purchase agreement, or any other agreement designed to ensure any creditor against loss), for or on account of the obligation of any person or entity, except by the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of the Company's business.

**(E) Change in Business.** Engage in any business activities or operations substantially different from or unrelated to the Company's present business activities or operations.

**SECTION 17. Financial Covenants.** Unless otherwise agreed to in writing, while this Line of Credit Agreement is in effect:

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**(A) Working Capital.** The Company will maintain, on a consolidated basis, current assets in excess of current liabilities of at least Fifteen Million Dollars (\$15,000,000), measured on a quarterly basis.

**(B) Tangible Net Worth.** The Company will maintain, on a consolidated basis, a “Tangible Net Worth” equal to at least Thirty-Two Million Five Hundred Thousand Dollars (\$32,500,000.00), measured on a quarterly basis. “Tangible Net Worth” means the value of total assets (including leaseholds and leasehold improvements and reserves against assets but excluding goodwill, patents, trademarks, trade names, organization expense, unamortized debt discount and expense, capitalized or deferred research and development costs, deferred marketing expenses, and other like intangibles, and monies due from affiliates, officers, directors, employees, shareholders, members or managers) less total liabilities, including but not limited to accrued and deferred income taxes, but excluding the non-current portion of Subordinated Liabilities. “Subordinated Liabilities” means liabilities subordinated to the Borrower’s obligations to FCW in a manner acceptable to FCW in its sole discretion.

**(C) EBITDA.** The Company will maintain an “EBITDA” of at least Seven Million Five Hundred Thousand Dollars (\$7,500,000.00). “EBITDA” means net income, less income or plus loss from discontinued operations and extraordinary items, plus income taxes, plus interest expense, plus depreciation, depletion, and amortization. This covenant will be calculated at the end of each reporting period for which FCW requires financial statements, using the results of the twelve-month period ending with that reporting period. The current portion of long-term liabilities will be measured as of the last day of the calculation period.

**SECTION 18. Events of Default.** Each of the following shall constitute an “Event of Default” under this Line of Credit Agreement:

**(A) Payment Default.** The Company should fail to make any payment when due.

**(B) Representations and Warranties.** Any representation or warranty made or deemed made by the Company herein or in the Note, application, agreement, certificate, or other document related to or furnished in connection with this Line of Credit Agreement or the Note, shall prove to have been false or misleading in any material respect on or as of the date made or deemed made.

**(C) Certain Affirmative Covenants.** The Company or, to the extent required hereunder, any Subsidiary should fail to perform or comply with Sections 15(A) through 15(G)(2), and 15(G)(6) and such failure continues for 15 days after written notice thereof shall have been delivered by FCW to the Company.

**(D) Other Covenants and Agreements.** The Company or, to the extent required hereunder, any Subsidiary should fail to perform or comply with any other covenant or agreement contained herein or in any other Loan Document or shall use the proceeds of any loan for an unauthorized purpose.

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**(E) Cross-Default.** The Company should, after any applicable grace period, breach or be in default under the terms of any other agreement between the Company and FCW.

**(F) Other Indebtedness.** The Company or any Subsidiary should fail to pay when due any indebtedness to any other person or entity for borrowed money or any long-term obligation for the deferred purchase price of property (including any capitalized lease), or any other event occurs which, under any agreement or instrument relating to such indebtedness or obligation, has the effect of accelerating or permitting the acceleration of such indebtedness or obligation, whether or not such indebtedness or obligation is actually accelerated or the right to accelerate is conditioned on the giving of notice, the passage of time, or otherwise.

**(G) Judgments.** A judgment, decree, or order for the payment of money shall be rendered against the Company or any Subsidiary and either: (i) enforcement proceedings shall have been commenced; (ii) a Lien prohibited under Section 10(B) hereof shall have been obtained; or (iii) such judgment, decree, or order shall continue unsatisfied and in effect for a period of 20 consecutive days without being vacated, discharged, satisfied, or stayed pending appeal.

**(H) Insolvency.** The Company or any Subsidiary shall: (i) become insolvent or shall generally not, or shall be unable to, or shall admit in writing its inability to, pay its debts as they come due; or (ii) suspend its business operations or a material part thereof or make an assignment for the benefit of creditors; or (iii) apply for, consent to, or acquiesce in the appointment of a trustee, receiver, or other custodian for it or any of its property or, in the absence of such application, consent, or acquiescence, a trustee, receiver, or other custodian is so appointed; or (iv) commence or have commenced against it any proceeding under any bankruptcy, reorganization, arrangement, readjustment of debt, dissolution, or liquidation Law of any jurisdiction.

**(I) Material Adverse Change.** Any material adverse change occurs, as reasonably determined by FCW, in the Company's financial condition, results of operation, or ability to perform its obligations hereunder or under any instrument or document contemplated hereby.

**SECTION 19. Remedies.** Upon the occurrence and during the continuance of an Event of Default or any Potential Default, FCW shall have no obligation to continue to extend credit to the Company and may discontinue doing so at any time without prior notice. For all purposes hereof, the term "Potential Default" means the occurrence of any event which, with the passage of time or the giving of notice or both would become an Event of Default. In addition, upon the occurrence and during the continuance of any Event of Default, FCW may, upon notice to the Company, terminate any commitment and declare the entire unpaid principal balance of the loans, all accrued interest thereon, and all other amounts payable under this Line of Credit Agreement, all Supplements, and the other Loan Documents to be immediately due and payable. Upon such a declaration, the unpaid principal balance of the loans and all such other amounts

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shall become immediately due and payable, without protest, presentment, demand, or further notice of any kind, all of which are hereby expressly waived by the Company. In addition, upon such an acceleration:

**(A) Enforcement.** FCW may proceed to protect, exercise, and enforce such rights and remedies as may be provided by this Line of Credit Agreement, any other Loan Document or under Law. Each and every one of such rights and remedies shall be cumulative and may be exercised from time to time, and no failure on the part of FCW to exercise, and no delay in exercising, any right or remedy shall operate as a waiver thereof, and no single or partial exercise of any right or remedy shall preclude any other or future exercise thereof, or the exercise of any other right. Without limiting the foregoing, FCW may hold and/or set off and apply against the Company's obligations to FCW any cash collateral held by FCW, or any balances held by FCW for the Company's account (whether or not such balances are then due).

**(B) Application of Funds.** CoBank may apply all payments received by it to the Company's obligations to FCW in such order and manner as FCW may elect in its sole discretion.

In addition to the rights and remedies set forth above: (i) if the Company fails to make any payment when due, then at FCW's option in each instance, such payment shall bear interest from the date due to the date paid at 2% per annum in excess of the rate(s) of interest that would otherwise be in effect on that loan; and (ii) after the maturity of any loan (whether as a result of acceleration or otherwise), the unpaid principal balance of such loan (including without limitation, principal, interest, fees and expenses) shall automatically bear interest at 2% per annum in excess of the rate(s) of interest that would otherwise be in effect on that loan. All interest provided for herein shall be payable on demand and shall be calculated on the basis of a year consisting of 365 days.

**SECTION 20. Broken Funding Surcharge.** Notwithstanding any provision contained in the Note giving the Company the right to repay any loan prior to the date it would otherwise be due and payable, the Company agrees to provide three Business Days' prior written notice for any prepayment of a fixed rate balance and that in the event it repays any fixed rate balance prior to its scheduled due date or prior to the last day of the fixed rate period applicable thereto (whether such payment is made voluntarily, as a result of an acceleration, or otherwise), the Company will pay to CoBank a surcharge in an amount equal to the greater of: (i) an amount which would result in FCW being made whole (on a present value basis) for the actual or imputed funding losses incurred by FCW as a result thereof; or (ii) \$300.00. Notwithstanding the foregoing, in the event any fixed rate balance is repaid as a result of the Company refinancing the loan with another lender or by other means, then in lieu of the foregoing, the Company shall pay to CoBank a surcharge in an amount sufficient (on a present value basis) to enable FCW to maintain the yield it would have earned during the fixed rate period on the amount repaid. Such surcharges will be calculated in accordance with methodology established by FCW (a copy of which will be made available to the Company upon request).

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**SECTION 21. Complete Agreement, Amendments.** This Line of Credit Agreement, the Note, and all other instruments and documents contemplated hereby and thereby, are intended by the parties to be a complete and final expression of their agreement. No amendment, modification, or waiver of any provision hereof or thereof, and no consent to any departure by the Company herefrom or therefrom, shall be effective unless approved by FCW and contained in a writing signed by or on behalf of FCW, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. Additionally, any headings used in this Line of Credit Agreement are inserted only as a matter of convenience and for reference, and in no way define, limit or describe the scope or intent of any term or provision. As used herein, the word "including" means "including without limitation" and/or "including but not limited to".

**SECTION 22. Applicable Law.** Except to the extent governed by applicable federal law, this Line of Credit Agreement and the Note shall be governed by and construed in accordance with the laws of the State of California, without reference to choice of law doctrine.

**SECTION 23. Notices.** All notices hereunder shall be in writing and shall be deemed to be duly given upon delivery if personally delivered or sent by telegram or facsimile transmission, or 3 days after mailing if sent by express, certified or registered mail, to the parties at the following addresses (or such other address for a party as shall be specified by like notice):

If to FCW, as follows:

Farm Credit West, PCA  
2929 W. Main Street, Suite A  
Visalia, CA 93291-5700

Attention: James Neeley  
Fax No.: 559-627-4728

If to the Company, as follows:

Calavo Growers, Inc.  
Attn: Vice President-Finance  
1141-A Cummings Road  
Santa Paula, CA 93060  
Fax No: (805) 921-3232

**SECTION 24. Taxes and Expenses.** To the extent allowed by law, the Company agrees to pay all reasonable out-of-pocket costs and expenses (including the fees and expenses of counsel retained by FCW) incurred by FCW in connection with the administration, collection, and enforcement of this Line of Credit Agreement and the other Loan Documents, including, without limitation, all costs and expenses incurred in perfecting, maintaining, determining the priority of, and releasing any security for the Company's obligations to FCW, and any stamp, intangible, transfer, or like tax payable in connection with this Line of Credit Agreement or any other Loan Document.

**SECTION 25. Effectiveness and Severability.** This Line of Credit Agreement shall continue in effect until: (i) all indebtedness and obligations of the Company under this Line of

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Credit Agreement, the Note, and all other Loan Documents shall have been paid or satisfied; and (ii) FCW has no commitment to extend credit to or for the account of the Company hereunder. Any provision of this Line of Credit Agreement or any other Loan Document which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or thereof.

**SECTION 26. Successors and Assigns.** This Line of Credit Agreement, the Note, and the other Loan Documents shall be binding upon and inure to the benefit of the Company and FCW and their respective successors and assigns, except that the Company may not assign or transfer its rights or obligations under this Line of Credit Agreement, the Note or any other Loan Document without the prior written consent of FCW.

**SECTION 27. Participations.** From time to time, FCW may sell to one or more banks, financial institutions or other lenders a participation in all or a portion of the Commitment or other extensions of credit made pursuant to this Line of Credit Agreement. However, no such participation shall relieve FCW of any commitment made to the Company hereunder, or any obligation FCW may have to pay patronage due the Company from FCW under the provisions of the bylaws of FCW and its practices and procedures related to patronage distribution. In connection with the foregoing, FCW may disclose information concerning the Company and its Subsidiaries to any participant or prospective participant, provided that such participant or prospective participant agrees to keep such information confidential. Accordingly, all interests in the Commitment that is included in a sale of participation interests shall not be entitled to patronage distributions. A sale of participation interest may include certain voting rights of the participants regarding the Commitment hereunder (including without limitation the administration, servicing and enforcement thereof). FCW agrees to give written notification to the Company of any sale of participation interests.

**IN WITNESS WHEREOF**, the parties have caused this Line of Credit Agreement to be executed by their duly authorized officers as of the date shown above.

**FARM CREDIT WEST, PCA**

By: /s/ James Neeley

Title: Sr. Vice President

**CALAVO GROWERS, INC., a California Corporation**

By: /s/ Arthur J. Bruno  
Arthur J. Bruno

Title: Chief Operating Officer, Chief  
Financial Officer & Corporate  
Secretary

By: /s/ Scott H. Runge  
Scott H. Runge

Title Treasurer

**PROMISSORY NOTE**

\$12,000,000.00

October 5, 2006

FOR VALUE RECEIVED, on the Maturity Date as set forth in that certain Line of Credit Agreement dated October 5, 2006, or in any amendments thereto (the "Line of Credit Agreement"), the undersigned promises to pay to the order of Farm Credit West, PCA (the "Payee"), or order, at the place and in the manner set forth in the Line of Credit Agreement, the principal amount of TWELVE MILLION DOLLARS (\$12,000,000.00). The undersigned promises to pay interest on the principal amount hereof remaining unpaid from time to time from the date hereon until the date of payment in full, payable as provided below under "Repayment Terms".

This note is given for advances to be made by Payee to the undersigned from time to time in accordance with the terms and conditions of the Line of Credit Agreement, all the terms and conditions of which are incorporated herein by reference. Advances, accrued interest, and payments shall be posted by the Payee upon an appropriate accounting record, shall be prima facie evidence as to all such amounts and shall be binding on the undersigned absent manifest error. The total of such advances may not exceed the face amount of this note. This note is executed, delivered and accepted not in payment of but for the purpose of amending, restating and replacing the following described obligations, and renewing any unpaid balance(s) evidenced thereby: note dated August 27, 2006, in the principal amount of \$12,000,000.00. Furthermore, this note also evidences an additional loan advance(s) to the extent the note under exceeds the renewed unpaid balance(s) referred to above.

**Repayment Terms:** The undersigned shall pay to Payee, Thirty-nine (39) monthly interest only payments, in the amount billed, beginning on November 01, 2006; and One (1) installment of interest in the amount billed plus principal of any amount necessary to pay the note in full on February 1, 2010. Payments, other than those required as specified in this Section or in the Line of Credit Agreement, may be made at any time and in any amount during the term of this note, unless limited or prohibited herein or unless otherwise required by FCW in writing. This note is due and payable in full on February 1, 2010 ("Maturity Date"), at which time the undersigned shall pay the unpaid principal balance and all accrued interest in full. Any amount of principal hereof which is not paid when due, whether at stated maturity, by acceleration or otherwise, shall bear interest from the date when due until said principal is paid in full, payable on demand, at a rate per annum set forth in the Line of Credit Agreement.

The makers or endorsers hereof hereby waive presentment for payment, demand, protest, and notice of dishonor and nonpayment of this note, and all defenses on the ground of delay or of any extension of time for the payment hereof which may be hereafter given by the holder or holders hereof to them or either of them or to anyone who has assumed the payment of this note, and it is specifically agreed that the obligations of said makers or endorsers shall not be in anyway affected or altered to the prejudice of the holder or holders hereof by reason of the assumption of payment of the same by any other person or entity.

The undersigned hereby promises to pay all costs and expenses of any rightful holder hereof incurred in collecting the undersigned's obligations hereunder or in enforcing or attempting to enforce any of such holder's rights hereunder, including reasonable attorneys' fees and disbursements, whether or not an action is filed in connection therewith.

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THIS NOTE SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF CALIFORNIA. REPRESENTATIVES OF FCW ARE NOT AUTHORIZED TO MAKE ANY ORAL AGREEMENTS OR ASSURANCES. DO NOT SIGN THIS NOTE IF YOU BELIEVE THAT THERE ARE ANY AGREEMENTS OR UNDERSTANDING BETWEEN YOU AND FCW THAT ARE NOT SET FORTH IN WRITING IN THIS NOTE, THE LINE OF CREDIT AGREEMENT OR OTHER LOAN DOCUMENTS EVIDENCING THE COMMITMENT.

**CALAVO GROWERS, INC.**

By /s/ Arthur J. Bruno  
Arthur J. Bruno,  
Chief Operating Officer, Chief Financial  
Officer & Corporate Secretary

By /s/ Scott H. Runge  
Scott H. Runge, Treasurer

**INDORSEMENT** — The within Note is hereby indorsed by the payee named in the body of said Note as if the name of the payee were actually executed under the indorsement.

PAY TO THE ORDER OF U.S. AgBANK, FCB, Wichita, Kansas

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EXHIBIT A

PROMISSORY NOTE

\$12,000,000.00

October 5, 2006

FOR VALUE RECEIVED, on the Maturity Date as set forth in that certain Line of Credit Agreement dated October 5, 2006, or in any amendments thereto (the "Line of Credit Agreement"), the undersigned promises to pay to the order of Farm Credit West, PCA (the "Payee"), or order, at the place and in the manner set forth in the Line of Credit Agreement, the principal amount of TWELVE MILLION DOLLARS (\$12,000,000.00). The undersigned promises to pay interest on the principal amount hereof remaining unpaid from time to time from the date hereon until the date of payment in full, payable as provided below under "Repayment Terms".

This note is given for advances to be made by Payee to the undersigned from time to time in accordance with the terms and conditions of the Line of Credit Agreement, all the terms and conditions of which are incorporated herein by reference. Advances, accrued interest, and payments shall be posted by the Payee upon an appropriate accounting record, shall be prima facie evidence as to all such amounts and shall be binding on the undersigned absent manifest error. The total of such advances may not exceed the face amount of this note. This note is executed, delivered and accepted not in payment of but for the purpose of amending, restating and replacing the following described obligations, and renewing any unpaid balance(s) evidenced thereby: note dated August 17, 2005, in the principal amount of \$12,000,000.00. Furthermore, this note also evidences an additional loan advance(s) to the extent the note under exceeds the renewed unpaid balance(s) referred to above.

**Repayment Terms:** The undersigned shall, pay to Payee, Thirty-nine (39) monthly interest-only payments, in the amount billed, beginning on November 01, 2006; and One (1) installment of interest in the amount billed plus principal of any amount necessary to pay the note in full on February 1, 2010. Payments, other than those required as specified in this Section or in the Line of Credit Agreement, may be made at any time and in any amount during the term of this note, unless limited or prohibited herein or unless otherwise required by FCW in writing. This note is due and payable in full on February 1, 2010 ("Maturity Date"), at which time the undersigned shall pay the unpaid principal balance and all accrued interest in full. Any amount of principal hereof which is not paid when due, whether at stated maturity, by acceleration or otherwise, shall bear interest from the date when due until said principal is paid in full, payable on demand, at a rate per annum set forth in the Line of Credit Agreement.

The makers or endorsers hereof hereby waive presentment for payment, demand, protest, and notice of dishonor and nonpayment of this note, and all defenses on the ground of delay or of any extension of time for the payment hereof which may be hereafter given by the holder or holders hereof to them or either of them or to anyone who has assumed the payment of this note, and it is specifically agreed that the obligations of said makers or endorsers shall not be in anyway affected or altered to the prejudice of the holder or holders hereof by reason of the assumption of payment of the same by any other person or entity.

The undersigned hereby promises to pay all costs and expenses of any rightful holder hereof incurred in collecting the undersigned's obligations hereunder or in enforcing or attempting to enforce any of such holder's rights hereunder, including reasonable attorneys' fees and disbursements, whether or not an action is filed in connection therewith.

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THIS NOTE SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF CALIFORNIA. REPRESENTATIVES OF FCW ARE NOT AUTHORIZED TO MAKE ANY ORAL AGREEMENTS OR ASSURANCES. DO NOT SIGN THIS NOTE IF YOU BELIEVE THAT THERE ARE ANY AGREEMENTS OR UNDERSTANDING BETWEEN YOU AND FCW THAT ARE NOT SET FORTH IN WRITING IN THIS NOTE, THE LINE OF CREDIT AGREEMENT OR OTHER LOAN DOCUMENTS EVIDENCING THE COMMITMENT.

**INDORSEMENT** — The within Note is hereby indorsed by the payee named in the body of said Note as if the name of the payee were actually executed under the indorsement.

PAY TO THE ORDER OF U.S. AgBANK, FCB, Wichita, Kansas

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**EXHIBIT B**

**SERVICING AGREEMENT**

**October 5, 2006**

Pursuant to Section 9 of the Line of Credit Agreement dated October 5, 2006 ("Line of Credit Agreement") between Farm Credit West, PCA and CALAVO GROWERS, Inc., a California Corporation, the undersigns acknowledges and confirms the agreement to have CoBank, ACB perform the services as described below:

**Manner and Time of Payment.** CoBank shall maintain a record of all loans, the interest accrued thereon, and all payments made with respect thereto, and such record shall, absent proof of manifest error, be conclusive evidence of the outstanding principal and interest on the loans. All payments shall be made by wire transfer of immediately available funds, by check, or by automated clearing house or other similar cash handling processes as specified by separate agreement between the Calavo Growers ("Company") and CoBank. Wire transfers shall be made to ABA No. 307088754 for advice to and credit of CoBank (or to such other account as CoBank may direct by notice). The Company shall give CoBank telephonic notice no later than 12:00 Noon Company's local time of its intent to pay by wire and funds received after 3:00 pm. Company's local time shall be credited on the next business day. Checks shall be mailed to CoBank, Department 167, Denver, Colorado 80291-0167 (or to such other place as CoBank may direct by notice). Credit for payment by check will not be given until the later of: (a) the day on which CoBank receives immediately available funds; or (b) the next business day after receipt of the check.

**Farm Credit West, PCA**

**CALAVO GROWERS, INC.**

By: /s/ James K. Neeley  
James K. Neeley, Sr. Vice President

By: /s/ Arthur Bruno

CoBank, ACB

By: /s/ Scott Runge

By: /s/ Ed Nishio  
Edward H. Nishio, V.P.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8 No. 333-75378) pertaining to the 2001 Stock Option Plan for Directors and 2001 Stock Purchase Plan for Officers and Employees
- (2) Registration Statement (Form S-8 No. 333-132175) pertaining to the 2005 Stock Incentive Plan of Calavo Growers, Inc.

of our reports dated January 15, 2007, with respect to the consolidated financial statements and schedule of Calavo Growers, Inc., Calavo Growers, Inc. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Calavo Growers, Inc., included in its Annual Report (Form 10-K) for the year ended October 31, 2006.

/s/ Ernst & Young LLP

Woodland Hills, California  
January 15, 2007



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statements on Forms S-8 No. 333-75378 and No. 333-132175 of our report dated January 31, 2006, with respect to the consolidated balance sheet of Calavo Growers, Inc. as of October 31, 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the two-year period ended October 31, 2005, and the related financial statement schedule as listed in Item 15 of this Form 10-K for each of the years in the two-year period ended October 31, 2005, which report appears in the October 31, 2006, annual report on Form 10-K of Calavo Growers, Inc.

/s/ Deloitte & Touche LLP

Los Angeles, California  
January 12, 2007

## CERTIFICATION

I, Lecil E. Cole, certify that:

1. I have reviewed this annual report on Form 10-K of Calavo Growers, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present, in all material respects, the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 15, 2007

/s/ Lecil E. Cole

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Lecil E. Cole  
Chairman of the Board of Directors, President and Chief  
Executive Officer

## CERTIFICATION

I, Arthur J. Bruno, certify that:

1. I have reviewed this annual report on Form 10-K of Calavo Growers, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present, in all material respects, the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 15, 2007

/s/ Arthur J. Bruno

Arthur J. Bruno

Chief Operating Officer and Chief Financial Officer

WRITTEN STATEMENT OF CHIEF EXECUTIVE OFFICER  
AND CHIEF FINANCIAL OFFICER

Each of the undersigned, the Chairman of the Board and Chief Executive Officer and Chief Operating Officer, Chief Financial Officer, and Corporate Secretary of Calavo Growers, Inc. (the Company), hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his knowledge, the Company's Annual Report on Form 10-K for the year ended October 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the Report), fully complies with the requirements of Section 13(a) or 15 (d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: January 15, 2007

/s/ Lecil E. Cole

Lecil E. Cole  
Chairman of the Board and Chief Executive Officer

/s/ Arthur J. Bruno

Arthur J. Bruno  
Chief Operating Officer, Chief Financial Officer and  
Corporate Secretary