



CALAVO GROWERS INCORPORATED SANTA PAULA, CALIFORNIA



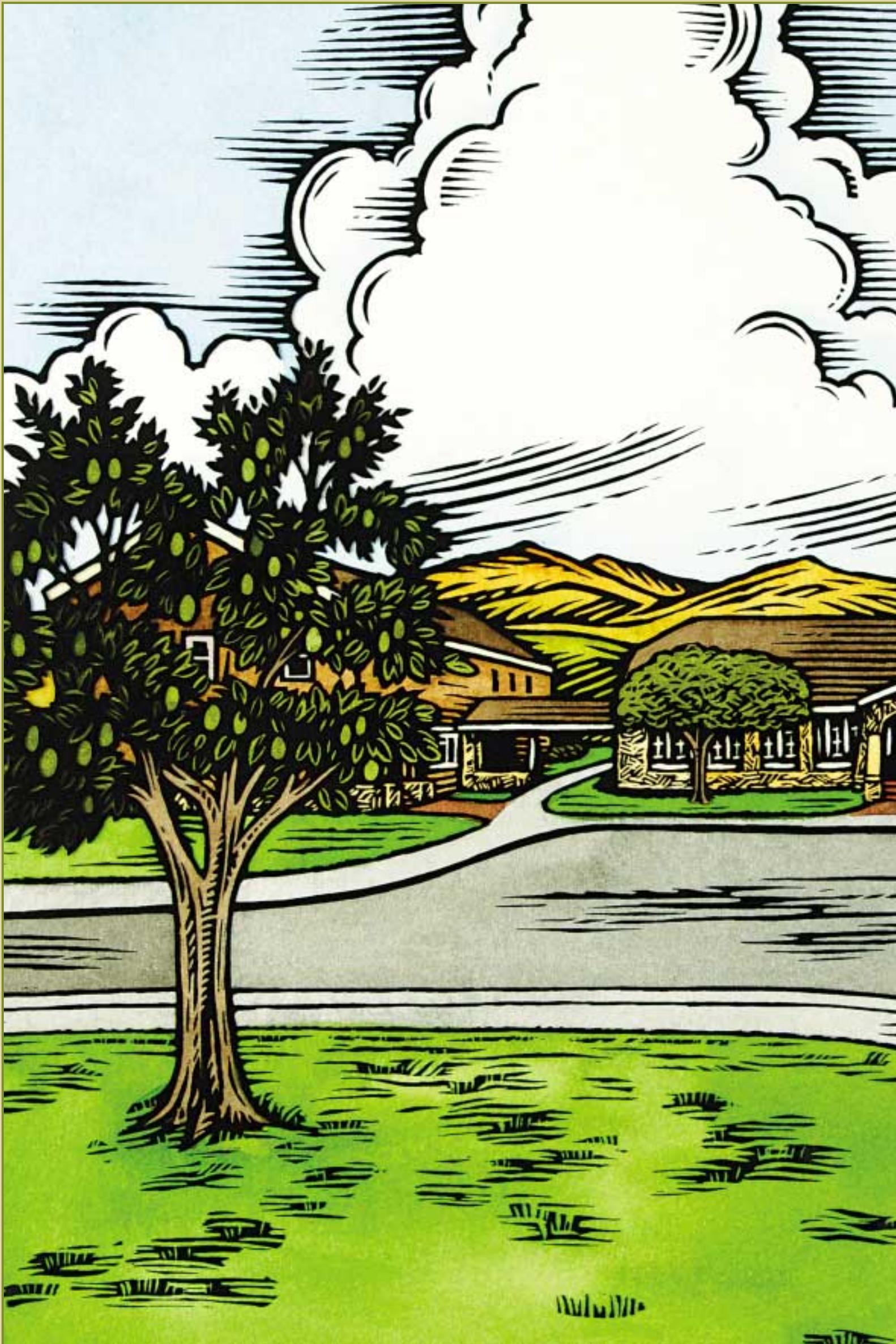
FY 2004 ANNUAL REPORT

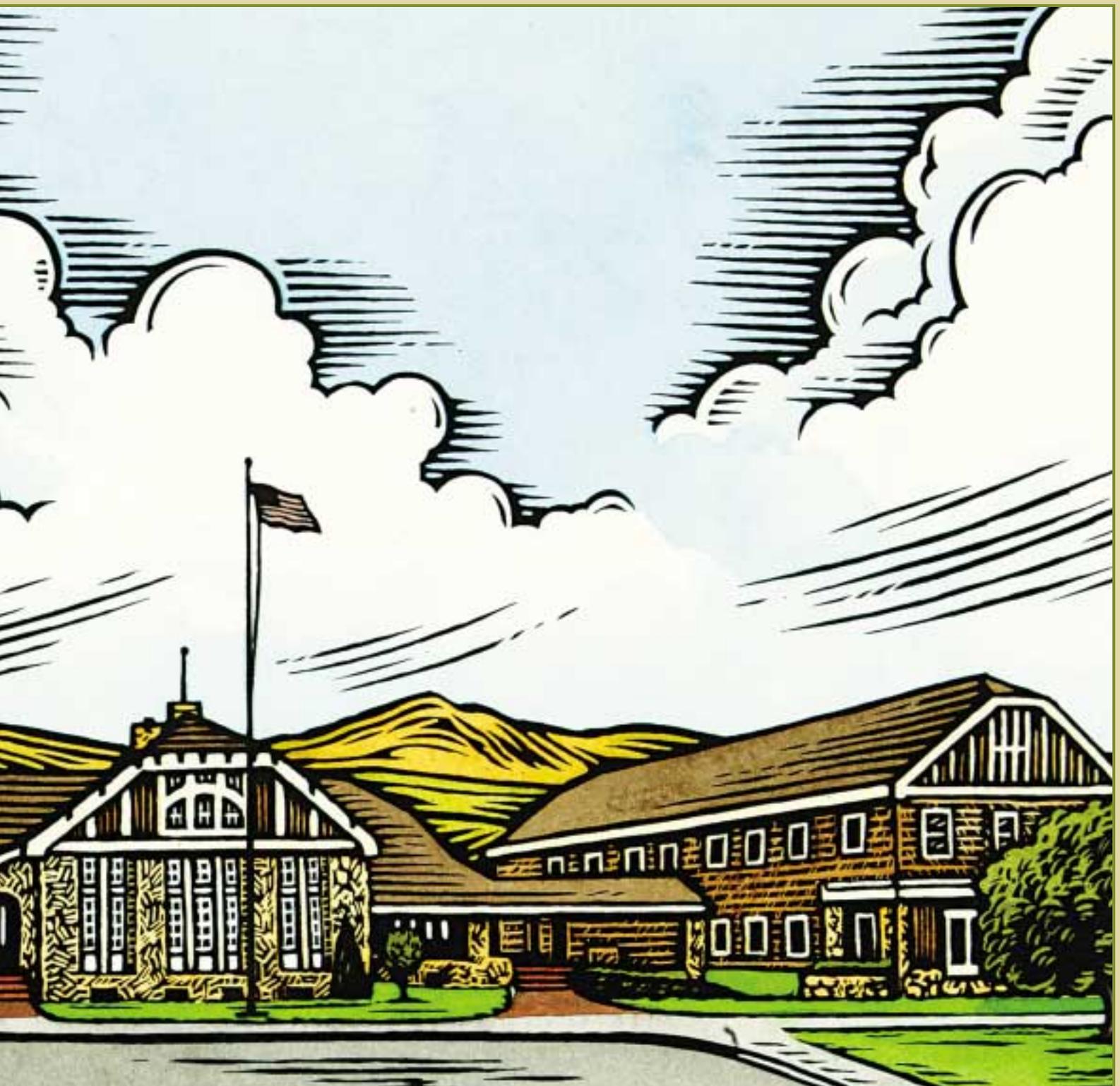


Our Annual Report on Form 10-K contains statements relating to future results of Calavo Growers, Inc. (including certain projections and business trends) that are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities 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 below under the caption “Risks Related to Our Business” 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.

"CALAVO"

“ We are growing. We are profitable. We are the global leader in an industry we founded 80 years ago and continue at the forefront of today. We spent our first 77 years as a grower-owned agricultural cooperative only to emerge as a nimble, for-profit corporation that operates worldwide. We are evolving—at an ever-faster pace—making strategic acquisitions and restructuring segments of our business to bring greater efficiencies to our operations. As we do so, we are committed to delivering grower returns that are among the highest in our industry. We remain focused on building shareholder value. Fiscal 2004, during which we celebrated our milestone 80th anniversary, was a transformative year for us. And yet, it is—in a manner of speaking—only still the beginning. We are Calavo Growers, Inc., and this is our story...”





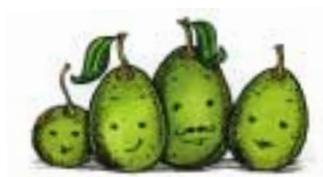
The sun rises, chasing away the cooling coastal breezes and warming the fertile earth of the avocado groves which stretch from Temecula and Fallbrook northward to Santa Paula and on to San Luis Obispo. Much like the red-orange orb that bursts open over the Topa Topa Mountains, so, too, does a new day dawn for Calavo Growers, Inc. In a most fitting beginning to its next 80 years, the company is relocating its corporate headquarters to Santa Paula, California—the very heart of its largest growing region—in March 2005. Is the move an affirmation of the company’s formidable agricultural roots? Without a doubt it is, as the new locale puts the company’s “ear” closer to its growers, making us even more responsive to changing industry conditions while placing us proximate to one of our two California packinghouses. Now, customers, shareholders and suppliers can trace first-hand the avocado journey from panicle blossom to the packinghouse, discovering first-hand what makes Calavo distinctive and our products so synonymous with quality. Where once Calavo employees and managers looked out their headquarter windows to see concrete, steel and glass, now their collective gaze will be trained at acre-upon-acre of verdant avocado and citrus fields. The company surges ahead to meet its promising future, every bit as sturdy and enduring as the stone and rough-hewn timber of its new headquarters, its new home. Calavo Growers, Inc., too, has found its own place in the sun.

IN OCTOBER 2001, CALAVO GROWER-MEMBERS VOTED OVERWHELMINGLY FOR CONVERSION TO FOR-PROFIT STATUS, PAVING THE WAY FOR THE COMPANY TO BECOME PUBLICLY TRADED.



CALAVO PACKED 152 MILLION POUNDS OF CALIFORNIA AVOCADOS IN FISCAL 2004.

To Our Shareholders



IN THE COMPANION VOLUME, WE COMMEMORATE OUR MILESTONE ANNIVERSARY WITH A HISTORICAL FABLE THAT ENCOMPASSES HIGHLIGHTS FROM THE COMPANY'S FIRST 80 YEARS, AS SEEN THROUGH THE EYES OF OUR NEWEST "COLLEAGUE," CAL THE AVOCADO. DURING FISCAL 2004, THOUGH, OUR MANAGEMENT TEAM WAS BUSY LOOKING FORWARD—NOT BACK—TO LAY A SOLID FOUNDATION FOR CALAVO GROWERS, INC.'S NEXT 80 YEARS. WE PRESSED AHEAD WITH AN AMBITIOUS AGENDA OF INITIATIVES AND COUNT AMONG OUR ACCOMPLISHMENTS:

- Posting record revenues for the third consecutive year with sales surging through the quarter-billion dollar mark;
- Completing successfully the restructuring of processed-product operations anchored by commencement of operations at our impressive new facility in Mexico;
- Concluding and integrating the acquisition of Maui Fresh International—our first acquisition since becoming publicly traded in 2002—which substantially diversifies Calavo's range of product offerings;
- Reinvigorating our core California avocado business to drive Calavo's profitability as it recovered from cyclical downturn the prior year; and
- Introducing our family of outstanding ultra-high pressure guacamole products in the retail marketplace and enjoying excellent initial acceptance from consumers.

Whew! Quite an aggressive 12-month to-do list, wouldn't you say?

RECORD SALES, SOLID PROFITABILITY

Particularly gratifying to me, however, is that even as your company aggressively moved forward with a strategic agenda intended to drive our industry leadership still further, we did so while maintaining strong profitability. In fiscal 2004, Calavo registered net income of \$6.2 million, or \$0.46 per diluted share, which compares with \$7.2 million, equal to \$0.55 per diluted share, a year ago. Results in the most recent year were restrained, in part, by approximately \$1 million in costs related to the aforementioned restructuring of our processed-products segment specifically for employee separation, freight and facility costs and accounted for on our income statement as special charges, selling, general and administrative (SG&A), and cost of sales, respectively. Per share results reflect five percent greater number of shares outstanding following the all-stock acquisition of Maui Fresh in November 2003.

Revenues leaped 11 percent last year to a new historic high of \$274.2 million, eclipsing the previous record of \$246.8 million posted in fiscal 2003. The top line was propelled principally by a resurgent California avocado business segment, where year-over-year sales rose by more than \$12 million; increased sales of Mexican and Dominican Republic-grown avocados; and initial-year revenue contributions from Maui Fresh.

Even with our resource-intensive slate of initiatives, we remained firmly committed to invoking a rigorous cost discipline last year. In that vein, SG&A as a percentage of total revenues declined slightly in fiscal 2004, even after providing for the substantial, aforementioned costs related to our processed-unit restructuring. With respect to our financial condition, the Calavo balance sheet is flexible, liquid and long-term debt free. Shareholders' equity last year grew by \$6.8 million, equal to 18 percent, to nearly \$44 million.

To put the company's financial health in perspective—and of considerable pride to me—the entire \$10 million-plus cost associated with our processed-product unit restructuring, including construction of the new state-of-the-art manufacturing facility, was financed entirely from Calavo's treasury and robust cash flow—and without leveraging the balance sheet. In recognition of our solid performance, the board of directors increased the annual cash dividend on our common stock by 20 percent to \$0.30 per share, which was paid to shareholders on January 5, 2005. The company's cash dividend has risen 50 percent since 2002, indicative of the board's commitment to shareholder returns.

CALIFORNIA AVOCADO VOLUME RISES SHARPLY

As anticipated, our California avocado business segment rebounded soundly from the cyclically smaller harvest that characterized fiscal 2003. Nearly 25 percent more fruit poured into our Santa Paula and Temecula packinghouses last year, with our total volume topping 152 million pounds. Industry estimates place our share of the California market for fiscal 2004 at approximately 35 percent, in line with prior-year figures. Packinghouses, as a rule, thrive on volume—it breeds productivity and operating efficiencies that reduce costs by spreading them across a greater number of pounds. Consequently, we place considerable precedence on grower relations—specifically retention and recruitment—as a pivotal component of our growth strategy to build market share by adding incremental volume that can drive operating results higher.

Calavo's current number of growers totals about 2,200, and a key part of my job description remains regular communication with them. We are proud that our stellar grower returns—routinely among the industry's best—along with our vast array of resources and the caché of being aligned with the global brand leader continue to attract growers of all sizes. This was reaffirmed subsequent to fiscal-year end—with very positive implications for my volume postulate above—when Limoneira Company, an integrated agribusiness operation and the

second-largest avocado grower in the world, signed an agreement for Calavo to pack and market its fruit. Limoneira's own storied California history stretches back more than a century and is a complementary fit with our company. Calavo now proudly packs and distributes the crops of the number one and two producers of avocados: Irvine Company and Limoneira, respectively.

MEXICAN AVOCADO SALES RISE; DOMINICAN MARKET OPENS

International avocado sales remained particularly strong last year, driven principally by greater volume of Mexican fruit packed both for export into the United States and other markets, as well as for distribution within the country. We remain squarely the market leader for Mexican fruit, packing nearly one-third of all avocados shipped to the U.S. last year. Fiscal 2004 also marked Calavo's first year of sourcing avocados from the Dominican Republic and sales of fruit from the island nation reached \$7.0 million – suffice to say, a very promising start. Our company is widely acknowledged and admired for its ability to forge alliances with global growers; the opening of the Dominican market is evidence of this core Calavo strength.

MAUI MAKES SOLID FIRST-YEAR CONTRIBUTION

The acquisition of Maui Fresh, completed at the beginning of fiscal 2004, was smoothly integrated into the company and diversified Calavo well beyond avocados and papayas. Although accounting for a comparatively small portion of our overall business, Maui Fresh made solid revenue and profit contribution to Calavo last fiscal year. In addition to substantially broadening our product offerings—20-plus items from tropical fruits to chilies—Maui provides us a stronger toehold in the all-important and fast-growing Hispanic market in the U.S., where per-capita avocado consumption is far higher and considered a staple in most households.

AMBITIOUS PROCESSED-UNIT RESTRUCTURING COMPLETED

In a span of slightly more than 18 months, Calavo completed a comprehensive restructuring of its processed-products unit late last year that streamlines and brings new-found operating efficiencies to the division. Last February, we opened the doors of and began ramping up our new 90,000-plus square foot production facility in Uruapan, Michoacan, Mexico. In August, the company wound up processed operations in Mexicali, Baja California Norte, Mexico, the second of two plants (the other being Santa Paula, California) shuttered as part of the transition. The new facility is located in the heart of the Mexican growing region and proximate to Calavo's Uruapan packinghouse, the principal source for fruit, and ended the inefficient two-step process of pulping and converting to finished product in separate plants.

The transition was not without its share of challenges—optimizing production, subcontracting during the transition to meet demand and rebuilding inventories, among them—but we emerge from the other end of the restructuring as a stronger company. Calavo expects to recognize considerable cost reductions from transportation, elimination of duplicative overhead and labor

and services. A second machine for processing ultra-high pressure guacamole is presently being relocated from Mexicali, and will join equipment already in service at Uruapan to substantially boost production output for this high-demand product in fiscal 2005.

ULTRA-HIGH PRESSURE GUACAMOLE GAINS SALES STRENGTH

New capacity comes as we are beginning to gain significant traction in the retail segment, to which sales commenced last year, for our ultra-high pressure guacamole. Most notably, the highly selective Trader Joe's chain has enjoyed success marketing the product under its own Hot and Spicy label. Since I believe good news shouldn't wait, subsequent to fiscal-year end we secured distribution of ultra-high pressure processed guacamole in Stater Bros. markets, which will be sold under the Calavo name. The expansion into the retail channel complements the strong market acceptance that the product has enjoyed since its introduction in the institutional and food-service sector. As I write this letter, it is Super Bowl weekend and tens of thousands—if not millions—of football fans will consume our ultra-high pressure processed guacamole in restaurants and at parties and mistake it for fresh-made. It simply tastes that great—I'm an even bigger fan of our guacamole product than I am of football.

WELL-POSITIONED TO MEET USDA RULE CHANGE

The issue that overshadowed all else in our industry last year was the United States Department of Agriculture's pronouncement allowing for the year-round importation of Mexican Hass avocados to all 50 states, and which took effect on February 5, 2005. Exempt from the rule for a period of two years are growing states: California, Florida and Hawaii. The previous USDA rule, established in 1996, permitted the six-month import of Mexican-grown Hass to 31 states. The USDA decision to fully open the U.S. market was something of inevitability and should come as no surprise to those who closely follow the avocado industry.

Recognizing this trend, Calavo has been on the ground in Mexico since the 1990s when we opened our Uruapan packinghouse, which was joined by the company's new processed facility last year. We consider ourselves to have a deep understanding of the market there and, as in California, enjoy strong local relations with growers. In short, we are extremely well positioned as a company—on both sides of the border—to respond and meet the challenges of an evolving marketplace. That said, it is entirely too early to prognosticate—and I simply will not do so—on the effects, if any, resulting from year-round importation of Mexican fruit. I watch the issue as a large California grower myself but say this as the company's chief executive: Calavo will always act in a manner consistent with the best interests of all stakeholders—shareowners, growers, customers and employees.

A STRONG, VIBRANT INDUSTRY, AN EVEN STRONGER CALAVO

I also do not overreact to the USDA action because I remain truly encouraged by the fundamental strength of the California avocado industry. As a whole, there is a strong base of growers in an industry enjoying healthy returns. New plantings of avocado acreage are on the rise, according to industry statistics. Couple these points with a growing Hispanic population within the United States, increased acceptance and usage of avocados in mainstream dishes and an upswing in consumption overall—with about half of all households buying regularly—and you can understand why I am ebullient.

Here within the company, I have considerable confidence that the best is yet to come, as well. Let me share a few of the reasons why. With our processed restructuring complete, we turn our attention again to spurring growth—internally and through opportunistic acquisitions that may emerge. We are continuing to explore ways in which Maui Fresh can tap into Calavo's resources—namely our customer base and distribution—to invigorate its sales. Global opportunities—both sourcing and selling—are within our reach as the market leader and because of our infrastructure and resources. The Dominican Republic business is a strong case-in-point.

In heading this great company, I am charged with oversight of a formidable legacy—and I never forget that. I am proud, humbled and at times even awed to be at its reins. Consequently and to paraphrase a historic passage, I do not feel that I inherited this company from its founders or those who preceded me; instead, I am borrowing it from those who will follow me. As such, I remain committed to shaping and leaving behind a bigger, more broadly based Calavo that will lead the avocado industry for the next 80 years.

As we cross this milestone, it is appropriate to reflect and reminisce about those who came before us and made it possible to reach these heights. I extend immense thanks, as well, to a dedicated management team, loyal employees and committed board of directors. I convey appreciation to our growers, customers and shareholders alike for their steadfast support. We will work diligently to justify your faith.

Sincerely,



Lee E. Cole
Chairman, President and
Chief Executive Officer
February 14, 2005



FROM LEFT TO RIGHT: **Scott N. Van Der Kar** General Manager, Van Der Kar Family Farms (Pinehill Ranch) Carpinteria, California • **George H. “Bud” Barnes** Avocado Grower, Valley Center, California • **J. Link Leavens** General Manager, Leavens Ranches Ventura, California • **Lecil E. Cole** Chairman of the Board, President, Chief Executive Officer, Calavo Growers, Inc. Santa Paula, California • **Donald M. Sanders** President, S&S Grove Management Escondido, California



IN MEMORIAM: We remember our friend and fellow Director **Roy V. Keenan** Avocado Grower, Temecula, California (1935-2004). He was an active board member from (1994-2004). He shall be missed.

FROM LEFT TO RIGHT: **Alva V. Snider** Avocado Grower, Fallbrook, California • **Mike Hause** President/Chief Executive Officer, Santa Clara Valley Bank Santa Paula, California • **Dorcas H. Mc Farlane** Owner & Operator, J.K. Thille Ranches Santa Paula, California • **John M. Hunt** Manager, Embarcadero Ranch Goleta, California • **Fred J. Ferrazzano** President & Chief Executive Officer, Ferrazzano Farms Escondido, California

Financial Results

REVENUES

(dollars in millions)



NET INCOME

(dollars in millions)



EARNINGS PER SHARE

(in dollars)



SHAREHOLDERS' EQUITY

(dollars in millions)



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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, 2004 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, (In thousands, except per share data)	2004	2003	2002	2001	2000
INCOME STATEMENT DATA:⁽¹⁾					
Net sales	\$ 274,218	\$ 246,761	\$ 242,671	\$ 217,704	\$ 220,712
Gross margin	25,404	25,465	25,823	18,808	19,554
Net income	6,210	7,160	6,915	3,838	4,476
Basic and diluted net income per share ⁽²⁾	\$ 0.46	\$ 0.55	\$ 0.60	\$ 0.37	\$ 0.43
BALANCE SHEET DATA AS OF END OF PERIOD:					
Working capital	20,353	20,735	18,833	9,799	12,559
Total assets	67,398	53,689	55,132	52,368	46,537
Short-term debt	22	24	3,222	16,241	9,486
Long-term debt, less current portion ⁽³⁾	34	61	3,180	3,429	3,820
Shareholders' equity	43,937	37,147	30,556	20,029	21,066
CASH FLOWS PROVIDED BY (USED IN):					
Operations	4,460	15,222	8,135	1,161	2,958
Investing ⁽⁴⁾	(8,474)	(4,475)	(2,078)	(2,029)	(1,685)
Financing	(725)	(6,293)	(7,193)	1,433	(1,239)
OTHER DATA:					
Dividends per share ⁽²⁾	\$ 0.30	\$ 0.25	\$ 0.20	\$ 0.50	\$ —
Net book value per share	\$ 3.25	\$ 2.87	\$ 2.38	\$ 2.01	\$ 2.13
Pounds of California avocados sold	152,725	122,950	158,187	163,891	123,399
Pounds of international avocados sold	69,410	70,348	69,512	44,935	42,300
Pounds of processed avocados products sold	13,317	14,707	14,248	14,788	14,962

⁽¹⁾ Operating results for fiscal year 2004 include the acquisition of Maui. For fiscal year 2004, Maui's net sales, gross margins, and net income were as follows: \$19.8 million, \$1.4 million, and \$0.5 million.

⁽²⁾ Dividends per share for fiscal 2001 represent the payment of our dividend to shareholders for the results of our fiscal 2000 operations. We did not declare a cash dividend in connection with our fiscal 200 operating results. In December 2001, we declared a 5% stock dividend payable February 15, 2002 for all shareholders of record as of February 1, 2002. Basic and diluted earnings per share for all periods presented have been restated to reflect the 5% stock dividend. Dividends per share and net book value per share are computed based on the actual shares outstanding.

⁽³⁾ 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.

⁽⁴⁾ 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.

Managements 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.

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. We report these operations in three business segments: California avocados, international avocados and other perishable food products and processed products. We report our financial results on a November 1 to October 31 fiscal year basis to coincide with the California avocado harvest season.

In order to diversify our product lines and increase synergies within the marketplace, we acquired all the outstanding common shares of Maui Fresh International, Inc. (Maui) for 576,924 shares of our common stock valued at \$4.05 million in November 2003, plus acquisition costs of \$65,000. Maui is a specialty produce company servicing a wide array of retail, food service, and terminal market wholesale customers with over 20 different specialty commodities. The value of our common stock issued in conjunction with the acquisition was based on the average quoted market price of our common stock for three days before and after the announcement date.

As security for certain potential contingencies, such as unrecorded liabilities, we held approximately 58,000 shares issued in conjunction with such acquisition for one full year from the acquisition date. As no contingencies developed, which was in accordance with our expectations, we are in the process of releasing these shares to the original Maui shareholders.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The differences from the previously reported amounts of goodwill and intangible assets of \$867,000 resulted from the finalization of our valuation information in the second quarter of fiscal 2004.

(in thousands)	2004
Fixed assets	\$ 114
Goodwill	3,591
Intangible assets	867
Total assets acquired	<u>4,572</u>
Current liabilities	110
Deferred tax liabilities	347
Net assets acquired	<u>\$ 4,115</u>

Our California avocado business grades, sizes, packs and cools avocados grown in California for delivery to our customers. We presently operate two packinghouses in Southern California. These packinghouses handled approximately 35% of the California avocado crop during the 2004 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.

Our international and perishable food products business procures avocados grown in Mexico, Chile, and the Dominican Republic, as well as other various commodities, including papayas, tomatoes, chili peppers, pineapples, and ginger. We operate a packinghouse in Mexico that handled approximately 31% of the Mexican avocado crop bound for the United States market during the 2003-2004 Mexican harvest season, based on our estimates. Additionally, during the 2003-2004 Chilean avocado harvest season, we handled approximately 10% of the Chilean avocado crop, based on our estimates. Our strategy is to procure and sell the internationally 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.

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. We believe that this restructuring will provide 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, respectively.

For fiscal year 2004, we have incurred costs related to this restructuring approximating \$1,013,000. Our income statement for the year ended October 31, 2004 includes \$741,000 as cost of sales, \$185,000 as special charges, and \$87,000 as selling, general and administrative expenses.

These costs are comprised of the following components as of and for the year ended October 31, 2004:

(in thousands)	Restructuring charges	Amounts paid	Non-cash charges	Reserves remaining to be utilized
Special charges - employee separation costs	\$ 185	\$ (185)	\$ —	\$ —
Selling, general and administrative – freight	87	(87)	—	—
Cost of sales - facility operating costs	741	(672)	(69)	—
	<u>\$ 1,013</u>	<u>\$ (944)</u>	<u>\$ (69)</u>	<u>\$ —</u>

Special charges recorded during the year ended October 31, 2004 consist entirely of employee separation costs. All employee separation costs were paid in cash and represent final payments to 93 production and 8 managerial/administrative employees formerly working at our Mexicali processing facility. We have not recorded a significant charge relating to the write-down of production assets being held at our Mexicali production facility, as substantially all such assets were re-commissioned at our new facility in Uruapan or their carrying value was less than their fair value.

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 California avocado and international and perishable food product businesses are highly seasonal and are characterized by rapid 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.

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). We have realigned our businesses to combine within our California avocado segment the results of operations of both the California avocados grown

previously by members and those that were procured from non-members. We believe that this presentation provides an enhanced view of the results of our California operations and a better framework to evaluate the results of our various operations.

Recent Developments

Dividend Payment

In January 2005, we paid a \$0.30 per share dividend in the aggregate amount of \$4,052,000 to shareholders of record on November 15, 2004.

Corporate Headquarters Building

In August 2004, we entered into an agreement to sell our corporate headquarters building located in Santa Ana, California for \$3.4 million. Such transaction, however, fell out of escrow in November 2004. Then, in December 2004, we re-entered escrow with a different buyer, to sell our corporate headquarters building for the same sales price. Escrow related to such transaction is expected to close in the second quarter of fiscal 2005, which is when we expect to complete the move of our corporate headquarters. We estimate that this transaction will result in a pre-tax gain on sale of approximately \$3.0 million, if such transaction is consummated according to terms. We currently plan to relocate our corporate offices to Santa Paula, California.

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.

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.

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,	2004	2003	2002
Net sales	100.0%	100.0%	100.0%
Gross margins	9.3%	10.3%	10.6%
Selling, general and administrative	5.8%	6.0%	5.7%
Operating income	3.4%	4.3%	4.9%
Other income, net	0.2%	0.4%	0.3%
Net income	2.3%	2.9%	2.8%

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.

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:

(Dollars in thousands)	2004	Change	2003	Change	2002
Net sales:					
California avocados	\$ 163,486	9.3%	\$ 149,635	(9.4)%	\$ 165,077
International avocados and perishable food products	94,423	25.3%	75,347	27.5%	59,083
Processed products	32,749	1.2%	32,360	8.0%	29,960
Eliminations	(16,440)		(10,581)		(11,449)
Total net sales	<u>\$ 274,218</u>	11.1%	<u>\$ 246,761</u>	1.7%	<u>\$ 242,671</u>
As a percentage of net sales:					
California avocados	59.0%		60.6%		68.0%
International avocados and perishable food products	31.6%		28.0%		22.2%
Processed products	9.4%		11.4%		9.8%
	<u>100.0%</u>		<u>100.0%</u>		<u>100.0%</u>

Net sales for the year ended October 31, 2004, when compared to 2003, grew by approximately \$27.5 million, or 11.1%, principally as a result of growth experienced by our California avocados and International avocados and perishable food products segments. In particular, growth in our net sales reflects an increasing percentage of our business being generated by our International avocados and perishable food product segments, which was driven primarily by additional sales related to the acquisition of Maui Fresh International, Inc. ("Maui").

Net sales generated by our International avocados and perishable food products business depends principally on the availability of Chilean and Mexican grown avocados in the U.S. markets. Currently, Mexican grown avocados are significant during our first two fiscal quarters. Chilean grown avocados are significant during our 1st and 4th fiscal quarters. In 1996, the United States Department of Agriculture ("USDA") established a protocol whereby Mexican grown Hass avocados were permitted to be

imported, on a restricted basis, into the United States. Restrictions imposed on the marketing of the fruit, due to phytosanitary concerns, limited the marketing of Mexican Hass avocados to 31 states, from the middle of October to the middle of April. In November 2004, however, the USDA published a rule allowing Hass avocado imports from Mexico into all 50 states, with the exception of California, Florida, and Hawaii. The exception extends for two years. For the remaining 47 states, however, avocados exports are set to start February 1, 2005. While we believe that we are well positioned to respond to such legislation, we are unable to project the impact, if any, the adoption of this new rule would have on our financial condition and results of operations.

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

	Year ended October 31, 2004				Year ended October 31, 2003			
	California avocados	International avocados and perishable food products	Processed products	Total	California avocados	International avocados and perishable food products	Processed products	Total
Third-party sales:								
California avocados	\$ 150,159	\$ —	\$ —	\$ 150,159	\$ 140,795	\$ —	\$ —	\$ 140,795
Imported avocados	—	54,589	—	54,589	—	56,306	—	56,306
Papayas	—	6,846	—	6,846	—	2,920	—	2,920
Specialities and tropicals	—	14,233	—	14,233	—	30	—	30
Processed - food service	—	—	27,352	27,352	—	—	28,545	28,545
Processed - retail and club	—	—	4,285	4,285	—	—	5,165	5,165
Total fruit and product sales to third-parties	150,159	75,668	31,637	257,464	140,795	59,256	33,710	233,761
Freight and other charges	11,946	10,968	534	23,448	8,997	10,079	290	19,366
Total gross sales to third-parties	162,105	86,636	32,171	280,912	149,792	69,335	34,000	253,127
Less sales incentives	(131)	(48)	(6,515)	(6,694)	(157)	(251)	(5,958)	(6,366)
Total net sales to third-parties	161,974	86,588	25,656	274,218	149,635	69,084	28,042	246,761
Intercompany sales	1,512	7,835	7,093	16,440	—	6,263	4,318	10,581
Net sales	<u>\$ 163,486</u>	<u>\$ 94,423</u>	<u>\$ 32,749</u>	290,658	<u>\$ 149,635</u>	<u>\$ 75,347</u>	<u>\$ 32,360</u>	257,342
Intercompany sales eliminations			(16,440)				(10,581)	
Consolidated net sales			<u>\$ 274,218</u>				<u>\$ 246,761</u>	

	Year ended October 31, 2003				Year ended October 31, 2002			
	California avocados	International avocados and perishable food products	Processed products	Total	California avocados	International avocados and perishable food products	Processed products	Total
Third-party sales:								
California avocados	\$ 140,795	\$ —	\$ —	\$ 140,795	\$ 153,878	\$ —	\$ —	\$ 153,878
Imported avocados	—	56,306	—	56,306	—	43,715	—	43,715
Papayas	—	2,920	—	2,920	—	2,658	—	2,658
Specialities and tropicals	—	30	—	30	—	42	—	42
Processed - food service	—	—	28,545	28,545	—	—	24,964	24,964
Processed - retail and club	—	—	5,165	5,165	—	—	5,141	5,141
Total fruit and product sales to third-parties	140,795	59,256	33,710	233,761	153,878	46,415	30,105	230,398
Freight and other charges	8,997	10,079	290	19,366	11,381	7,540	217	19,138
Total gross sales to third-parties	149,792	69,335	34,000	253,127	165,259	53,955	30,322	249,536
Less sales incentives	(157)	(251)	(5,958)	(6,366)	(182)	(150)	(6,533)	(6,865)
Total net sales to third-parties	149,635	69,084	28,042	246,761	165,077	53,805	23,789	242,671
Intercompany sales	—	6,263	4,318	10,581	—	5,278	6,171	11,449
Net sales	\$ 149,635	\$ 75,347	\$ 32,360	257,342	\$ 165,077	\$ 59,083	\$ 29,960	254,120
Intercompany sales eliminations				(10,581)				(11,449)
Consolidated net sales				\$ 246,761				\$ 242,671

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.

California Avocados

Net sales delivered by the business increased by approximately \$12.3 million, or 8.2%, from fiscal 2003 to 2004. This increase in sales reflects a 24.2% increase in pounds of avocados sold, partially offset by a decrease in our average selling prices when compared to the same prior year period. This increase in pounds sold was consistent with the increase in the overall harvest of the California avocado crop for the 2003/2004 season. Our market share of California avocados remained consistent at 34.7% for fiscal year 2004, compared to 34.2% for the same period in the prior year.

For fiscal year 2004, average selling prices, on a per carton basis, for California avocados were 18.0% lower when compared to the same prior year period. This pricing structure primarily reflects the impact of a larger California avocado harvest. For fiscal year 2005, we believe that the year-round introduction of imported avocados in the U.S. marketplace will put increasing pressure on sales prices, principally as a result of an increase in volume.

Net sales delivered by the business decreased by approximately \$15.4 million, or 9.4%, from fiscal 2002 to 2003. This decrease in sales primarily reflects a 22.3% decrease in avocados sold, partially offset by a significant improvement in the average selling prices of avocados when compared to fiscal 2002. The decrease in pounds sold is consistent with the decrease in the overall harvest of the California avocado crop for the 2002/2003 season, as well as a shift in growing areas where we do not command as significant a market share. Despite this decrease in volume, we continued to maintain our leadership role in packing and marketing California grown avocados. Our market share of first grade Hass variety avocados was approximately 34% and 37% during fiscal 2003 and 2002. For the 2002/2003 season, we attribute such decrease in market share primarily to the aforementioned shift into growing areas where we do not command as significant a market share among growers.

For fiscal year 2003, average selling prices, on a per carton basis, for California avocados were 19.0% higher when compared to fiscal year 2002. We attribute some of the increase in these average selling prices to increasing demand for California grown avocados in the U.S. marketplace and a reduced volume of avocados. We believe that our investments in focused marketing activities, combined with promotional programs established by the California Avocado Commission, have generally had a positive effect on average sales prices. Our strategy is to continue to develop marketing opportunities that favorably position avocados packed by Calavo with our customers by emphasizing existing value-added services, such as fruit bagging and ripening. We believe that these and other value-added strategies are critical elements in sustaining competitive average selling prices.

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. The California Avocado Commission, which receives its funding from California avocado growers, has historically shouldered the promotional and advertising costs supporting avocado sales. The new Hass Avocado Board now 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. 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 2004 and 2003, we remitted approximately \$3.3 million and \$2.4 million to the Hass Avocado Board representing our share of such marketing expenses.

International and Perishable Food Products

For fiscal year 2004, when compared to the same period in the prior year, sales to third-party customers increased by approximately \$17.5 million, or 25.3%, from \$69.1 million to \$86.6 million. The increased sales to third-parties by our international and perishable food products business were primarily driven by the additional sales related to the acquisition of Maui in November

2003, as well as increased sales of Mexican and Dominican Republic grown avocados in the U.S., Japanese, and/or European marketplace. These increases, however, were partially offset by decreased sales of Chilean grown avocados. We believe that sales of Mexican grown avocados will continue to show a growing trend. We intend to leverage our position as the largest packer of Mexican grown avocados for export markets to improve the overall performance of this business.

For fiscal year 2004, the additional sales related to the acquisition of Maui totaled approximately \$19.8 million (approximately \$1.5 million of such sales were related to California avocados). Also, sales of Mexican and Dominican Republic sourced fruit increased \$4.1 million and \$6.9 million for fiscal year 2004, when compared to the same prior year period, primarily as a result of a 9.8% and 100% increase in pounds of Mexican and Dominican Republic fruit handled. Such increases, however, were partially offset by decreases in Chilean fruit sales. For fiscal year 2004, sales of Chilean sourced fruit decreased \$12.3 million when compared to the same prior period. This was primarily the result of a 42.1% decrease in the volume of Chilean fruit handled, when compared to the same prior year period. Pricing during fiscal year 2004 was fairly stable as well, when compared to fiscal 2003.

For fiscal year 2003, when compared to fiscal year 2002, sales to third-party customers increased by approximately \$15.3 million, or 28.4%, from \$53.8 million to \$69.1 million. The increased sales to third parties by our International and perishable foods products business were primarily driven by a greater volume of Chilean and Mexican grown avocados penetrating into the U.S., Japan and Europe marketplaces. The volume of fruit handled increased by 4.1 million pounds of Chilean grown avocados, or 16.3%, and 9.3 million pounds of Mexican grown avocados, or 30.3%, for fiscal 2003 when compared to fiscal 2002. Pricing during fiscal 2003 was fairly stable as well, when compared to fiscal 2002.

During fiscal year 2003, we sourced a significantly greater volume of Mexican grown avocados from our Uruapan, Mexico packinghouse. During fiscal 2003, the volume of fruit related to shipments to the U.S. marketplace increased by approximately 2.5 million pounds, or 13.8%, as compared to fiscal 2002. In addition, net sales resulting from the sale of Mexican grown avocados were also favorably impacted by increased demand from Japanese and European customers. During fiscal 2003, the volume of fruit related to shipments to Japan and Europe increased by approximately 6.7 million pounds, or 76.8%, as compared to fiscal 2002.

Processed Products

Net sales to third-party customers decreased by approximately \$2.3 million, or 8.5%, from \$28.0 million for fiscal year 2003 to

\$25.7 million for fiscal year 2004. The decrease in net sales to third-party customers is primarily attributable to a decrease in 1.4 million pounds of product sold, or 9.5%, and an increase in sales incentives and promotional activities paid of \$0.6 million, or 8.5%, partially offset by an increase in the sales price per product pound sold of \$0.09, or 3.9%. During fiscal year 2004, the decrease in pounds sold primarily relates to a lack of inventory to meet customer demand. Such lack of inventory was primarily related to reduced production capabilities during construction of our new processed facility. As a result, and, in order to maintain good customer relationships, we increased our sales incentives and promotional activities paid.

Net sales to third-party customers increased by approximately \$4.2 million, or 17.9%, from \$23.8 million for fiscal 2002 to \$28.0 million for fiscal 2003. The increase in fiscal 2003 net sales to third-party customers is primarily attributable to an increase in 0.5 million pounds of product sold, or 3.2%, an increase in the sales price per product pound sold of \$0.18, and a decrease in sales incentives and paid promotional activities of \$0.6 million or 8.8%. During fiscal 2003, we experienced an increase in demand for our frozen processed products as one of our competitors exited from the business. As a result of the increase in demand for our product, we decreased our sales incentives and promotional activities paid.

During fiscal year 2002, we purchased and commissioned new ultra high pressure treatment equipment designed to manufacture processed avocado products that are not frozen. During fiscal year 2004, we operated two separate high pressure lines, consisting of one ultra high pressure machine manufacturing guacamole in Mexicali and another in Uruapan. The machine in Mexicali was commissioned for operations in October 2002 and ran near capacity during fiscal 2003 through the closure date of Mexicali, which was August 2004. The machine in Uruapan, which has a much larger capacity than the Mexicali machine, was commissioned for operations in July 2004 and ran at about 40% capacity through October 2004. We anticipate that we will operate such high pressure machine at or near full capacity during fiscal year 2005. We plan to re-commission the high pressure machine that was located in Mexicali to Uruapan during fiscal 2005 as well. 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 \$5.5 million for fiscal year 2004. We believe that the introduction of these fresh guacamole products will, in the long-term, successfully address a growing market segment.

Gross Margins

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

(Dollars in thousands)	2004	Change	2003	Change	2002
Gross Margins:					
California avocados	\$ 17,102	15.0%	\$ 14,873	(13.9)%	\$ 17,281
International avocados and perishable food products	4,958	(9.1)%	5,457	50.2%	3,711
Processed products	3,344	(33.3)%	5,017	3.9%	4,831
Total gross margins	<u>\$ 25,404</u>	0.2%	<u>\$ 25,347</u>	(1.4)%	<u>\$ 25,823</u>
Gross profit percentages:					
California avocados	10.6%		9.9%		10.5%
International avocados and perishable food products	5.7%		7.9%		6.9%
Processed products	13.0%		17.9%		20.3%
Consolidated	9.3%		10.3%		10.6%

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, decreased 1.0% for fiscal year 2004 when compared to fiscal year 2003. This decrease was principally attributable to decreased profitability in our international avocados and perishable food products operating segment and our processed product segment, partially offset by increased profitability in our California avocado segment. Consolidated gross margin, as a percent of sales, decreased 0.3% for fiscal year 2003 when compared to fiscal year 2002. This decrease was principally a result of decreases in the gross profit percentages realized by our California avocado and processed products segments, which were partially offset by increased gross profit percentages achieved by our international avocado and perishable food products segment.

Gross margins and gross profit percentages for our California avocado business 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 2004 was primarily related to a significant increase in pounds of fruit handled. During fiscal year 2004, when compared to fiscal year 2003, fruit handled by our California packinghouses increased approximately 31.4%. This had the effect of reducing our per pound costs, which, as a result, positively impacted gross margins. The decrease in our gross margin percentage during fiscal year 2003 was primarily related to a higher average return per pound paid to our growers. Our growers received an average return of \$1.03 per pound, as compared to \$0.86 per pound in fiscal 2002. The volume of avocados delivered by our growers decreased, however, by approximately 34.4 million pounds. During fiscal 2004, freight and handling costs increased by approximately \$1.5 million, from \$3.5 million in fiscal 2003 to \$5.0 million during fiscal 2004. During fiscal 2003, freight and handling costs decreased by approximately \$0.7 million, from \$4.2 million in fiscal 2002 to \$3.5 million. We continue to review our packinghouse processes for potential improvements in packing efficiencies and more favorable production yields.

The gross margin and gross profit percentage for our international avocado and perishable food products business are dependent on the volume of fruit we handle and the competitiveness of the returns that we provide to third-party domestic packers. For example, the gross margins we earn on avocados procured from Chile and the Dominican Republic, as well as papayas grown in Hawaii, are generally based on a commission agreed to with each packer that is subject to incentive provisions. These provisions provide for us to deliver returns to these packers that are competitive with those delivered by other handlers. Accordingly, the gross margin results for this business are a function of the volume handled and the competitiveness of the sales prices that we realize as compared to others. 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 2004, we generated gross margins of \$1.5 million from the sale of fresh produce products that were packed by third parties, whereas gross margins for fiscal year 2003 were \$2.3 million. For fiscal year 2003, we generated gross margins of \$2.3 million from the sale of fresh produce products that were packed by third parties, whereas gross margins for fiscal year 2002 were only \$1.4 million.

Our business with Mexican growers differs in that we operate a packinghouse in Mexico and purchase avocados directly from the field. Consequently, 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 2004, our gross margins generated from the sale of Mexican avocados deteriorated from approximately \$2.2 million in fiscal year 2003 to \$1.5 million in fiscal year 2004, principally as a result of an increase in fruit costs. This increase in fruit costs had the effect of increasing our per pound costs, which, as a result, adversely affected gross margins. Further, we experienced an increase in sales of non-exported fruit, which typically generate lower margins than exported fruit. These decreases, however, were partially offset by increases in fruit volume during fiscal year 2004, which had the effect of reducing our per pound costs. During fiscal year 2003, our gross margins generated from the sale of Mexican avocados improved from approximately \$1.8 million in fiscal year 2002 to \$2.2 million in fiscal year 2003, principally as a result of increases in the pounds packed at our facility. For fiscal year 2004, the additional gross margin related to the acquisition of Maui totaled approximately \$1.4 million (approximately \$0.2 million of such gross margin was related to California avocados).

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 2004, the processed products gross profit percentages decreased primarily as a result of inefficiencies experienced in the start-up process of our newly constructed facility in Uruapan, Mexico and the winding down of the operations at our Mexicali, Mexico facility. Such inefficiencies primarily relate to subcontracting costs and duplicative overhead costs. Additionally, our processed product segment experienced higher fruit costs, as well as an increase in the sale of products that generate a lower gross margin than those sold in the prior year. During fiscal year 2003, the decrease in the gross margin percentage is primarily related to higher fruit costs, as well as inefficiencies related to the relocation of production from Santa Paula, California and Mexicali, Mexico to our newly constructed facility in Uruapan, Mexico. Additionally, as a result of the closure of our Santa Paula processed facility and greater than expected increase in demand for our products, we depleted our inventory at a rate greater than initially planned. Therefore, we entered into agreements and/or discussions with two processed avocado product suppliers to supplement our existing inventory levels. This had the effect of decreasing our gross margin percentage due to higher costs and inefficiencies related to sourcing this product from outside suppliers. We anticipate that the gross profit percentage for our processed product segment will continue to experience fluctuations primarily due to the uncertainty of fruit costs that will be used in the production process.

Selling, General and Administrative

(Dollars in thousands)	2004	Change	2003	Change	2002
Selling, general and administrative	\$ 15,920	8.7%	\$ 14,651	6.4%	\$ 13,881
Percentage of net sales	5.8%		5.9%		5.7%

Selling, general and administrative expenses include costs of marketing and advertising, sales expenses, and other general and administrative costs. For fiscal year 2004, selling, general and administrative expenses increased by \$1.3 million, or 8.7%, compared to fiscal year 2003. The increased general and administrative costs related principally to selling, general and administrative expenses incurred by Maui. Maui's selling, general and administrative expenses totaled approximately \$0.7 million for fiscal year 2004. Additionally, we also experienced higher costs of corporate functions, such as accounting, information systems, and human resources (totaling approximately \$0.8 million). These

increased costs were partially offset by reduced employee compensation expenses of approximately \$0.5 million, which was primarily related to a reduction in bonuses during fiscal year 2004 as compared to fiscal year 2003.

Selling, general and administrative expenses increased by approximately \$0.9 million from fiscal 2002 to 2003. The increase is attributable principally to \$0.4 million of additional marketing expenses, \$0.3 million of transportation costs associated with the relocation of the processed product operations, and \$0.2 million in incentives paid to employees.

Other Income, Net

(Dollars in thousands)	2004	Change	2003	Change	2002
Other income, net	\$ 478	(46.2)%	\$ 889	27.0%	\$ 700
Percentage of net sales	0.2%		0.4%		0.3%

Other income, net includes interest income and expense generated primarily in connection with our financing activities, as well as certain other transactions that are outside of the course of normal operations. During fiscal year 2004, other income, net includes

interest accrued on notes receivable from directors and officers of approximately \$0.2 million. During fiscal year 2003, other income, net includes interest accrued on notes receivable from directors and officers of approximately \$0.3 million.

Provision for Income Taxes

(Dollars in thousands)	2004	Change	2003	Change	2002
Provision for income taxes	\$ 3,567	(17.4)%	\$ 4,319	(24.6)%	\$ 5,727
Percentage of income before provision for income taxes	36.5%		37.6%		45.3%

The effective income tax rate for fiscal year 2004 and 2003 is higher than the federal statutory rate principally due to state taxes. Our effective income tax rate decreased from 37.6% in fiscal year 2003 to 36.5% in fiscal year 2004 primarily as a result of a favorable reduction in our foreign tax rates during fiscal year 2004 when compared to fiscal year 2003. Our effective income tax rate decreased from 45.3% in fiscal year 2002 to 37.6% in fiscal year 2003 primarily as a result of a reduction in non-deductible transaction costs and a favorable reduction in our state and foreign tax rates during fiscal year 2003 when compared to fiscal year 2002. The effective income tax rate for fiscal year 2002 is higher than the federal statutory rate principally due to state and foreign taxes and certain non-recurring transaction costs related to our conversion from a cooperative to a for-profit corporation that were non-deductible for tax purposes.

QUARTERLY RESULTS OF OPERATIONS

The following table presents our operating results for each of the eight fiscal quarters in the period ended October 31, 2004. 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. Our effective income tax rate decreased in our 4th fiscal quarter of 2003 primarily as a result of a favorable reduction in our foreign tax rate.

(in thousands, except per share amounts)	Three months ended							
	Oct. 31, 2004	July 31, 2004	Apr. 30, 2004	Jan. 31, 2004	Oct. 31, 2003	July 31, 2003	Apr. 30, 2003	Jan. 31, 2003
STATEMENT OF OPERATIONS DATA								
Net sales	\$ 65,436	\$ 83,318	\$ 76,421	\$ 49,043	\$ 63,780	\$ 81,359	\$ 57,393	\$ 44,229
Cost of sales	59,425	74,833	68,625	45,931	58,483	72,203	50,422	40,306
Gross margin	6,011	8,485	7,796	3,112	5,297	9,156	6,971	3,923
Selling, general and administrative	4,416	3,777	4,012	3,715	3,411	3,919	4,130	3,191
Restructuring charge	185				3	5	98	
Operating income (loss)	1,410	4,708	3,784	(603)	1,883	5,232	2,743	732
Other income, net	167	91	106	114	274	294	206	115
Income before provision (benefit) for income taxes	1,577	4,799	3,890	(489)	2,157	5,526	2,949	847
Provision (benefit) for income taxes	467	1,739	1,556	(195)	471	2,287	1,214	347
Net income (loss)	\$ 1,110	\$ 3,060	\$ 2,334	\$ (294)	\$ 1,686	\$ 3,239	\$ 1,735	\$ 500
Net income (loss) per share:								
Basic	\$ 0.08	\$ 0.23	\$ 0.17	\$ (0.02)	\$ 0.13	\$ 0.25	\$ 0.13	\$ 0.04
Diluted	\$ 0.08	\$ 0.23	\$ 0.17	\$ (0.02)	\$ 0.13	\$ 0.25	\$ 0.13	\$ 0.04
Number of shares used in per share computation:								
Basic	13,507	13,507	13,507	13,469	12,930	12,930	12,930	12,856
Diluted	13,591	13,594	13,589	13,469	12,970	12,960	12,960	12,887

LIQUIDITY AND CAPITAL RESOURCES

Operating activities for fiscal 2004, 2003 and 2002 provided cash flows of \$4.5 million, \$15.2 million, and \$8.1 million. Fiscal year 2004 operating cash flows reflect our net income of \$6.2 million, net noncash charges (depreciation and amortization, losses, and stock compensation expense) of \$2.7 million and a net decrease in the non-cash components of our working capital of approximately \$4.4 million.

Fiscal year 2004 decreases in operating cash flows, caused by working capital changes, include an increase in accounts receivable of \$4.6 million, an increase in inventory of \$3.4 million, an increase in advance to suppliers of \$1.8 million, a net increase in income tax receivable of \$0.9 million, and an increase in deferred income taxes of \$0.3 million, partially offset by a decrease in prepaid expenses and other assets of \$2.8 million, an increase in payable to growers of \$2.4 million, an increase in trade accounts payable and accrued expenses of \$1.3 million, and a decrease in loans to growers of \$0.1 million.

Increases in our accounts receivable balance as of October 31, 2004, when compared to October 31, 2003, primarily reflect the additional receivables related to the acquisition of Maui, as well as a significantly higher volume of California avocado sales recorded in the month of October 2004, as compared to October 2003. Similarly, the amounts payable to our growers also reflects the increase in the volume of California avocados marketed in the month of October 2004, as compared to October 2003. These volume levels are consistent with the harvests experienced in previous years. Additionally, increases in our inventory balance as of October 31, 2004, when compared to October 31, 2003, primarily reflect a significantly higher amount of finished processed product, as we began building our inventories during fiscal year 2004 in conjunction with the completion of our processed product Uruapan facility.

Increase in advances to suppliers as of October 31, 2004, when compared to October 31, 2003, primarily relates to delays in the start of the Chilean avocado harvest, which resulted in slower collections on our advances. Increases in our trade accounts payable and accrued expenses as of October 31, 2004, when compared to October 31, 2003, primarily reflect the additional trade accounts payable and accrued expenses from the acquisition of Maui. The decrease in prepaid expenses and other assets as of October 31, 2004, when compared to October 31, 2003, was primarily a result of the capitalization of a deposit and progress payments related to our large high pressure machine in Uruapan, as such machine was placed into service during fiscal year 2004.

Cash used in investing activities was \$8.5 million, \$4.5 million, and \$2.1 million for fiscal years 2004, 2003, and 2002. Fiscal year 2004 cash flows used in investing activities include capital expenditures of \$8.4 million, principally related to the construction of our new processed operations facility in Uruapan, Michoacan, Mexico.

Cash used in financing activities was \$0.7 million, \$6.3 million, and \$7.2 million for fiscal years 2004, 2003, and 2002. Cash used during fiscal year 2004 primarily included the payment of a dividend totaling \$3.4 million, partially offset by additional short-term borrowings of \$2.0 and collections on notes receivable of \$0.7 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, 2004 and 2003 totaled \$0.6 million and \$5.4 million. Our working capital at October 31, 2004 was \$20.4 million compared to \$20.7 million at October 31, 2003. The overall working capital decrease primarily reflects additional short-term borrowings and the decrease in our cash balance.

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 January 2004, we renewed our two short-term, non-collateralized, revolving credit facilities. These credit facilities expire in January 2006 and April 2006 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 2.9% and 2.0% at October 31, 2004 and 2003. Under these credit facilities, we had \$2 million and \$0 outstanding as of October 31, 2004 and 2003. The credit facilities contain various financial covenants with which we were in compliance at October 31, 2004.

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, 2004:

Payments due by period Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years
Long-term debt obligations (including interest)	\$ 65	\$ 24	\$ 32	\$ 9
Short-term borrowings	2,000	2,000	—	—
Defined benefit plan	330	55	165	110
Operating lease commitments	2,588	862	1,452	274
Total	\$ 4,983	\$ 2,941	\$ 1,649	\$ 393

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.

We did not have any significant commitments for capital expenditures as of October 31, 2004.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents, accounts receivable, short and long-term loans to growers, notes receivable from shareholders, accounts payable, 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, 2004.

IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 2 of Notes to Consolidated Financial Statements.

(All amounts in thousands) Expected maturity date October 31,	2004	2005	2006	2007	2008	Total	Fair Value
Assets:							
Cash and cash equivalents ⁽¹⁾	\$ 636	\$ —	\$ —	\$ —	\$ —	\$ 636	\$ 636
Accounts receivable, net ⁽¹⁾	21,131	—	—	—	—	21,131	21,131
Loans to growers ⁽¹⁾	209	—	—	—	—	209	209
Advances to suppliers ⁽¹⁾	2,413	—	—	—	—	2,413	2,413
Notes receivable from shareholders ⁽²⁾	210	211	2,462	—	—	2,883	2,883
Liabilities:							
Payable to growers ⁽¹⁾	\$ 5,789	\$ —	\$ —	\$ —	\$ —	\$ 5,789	\$ 5,789
Accounts payable ⁽¹⁾	2,490	—	—	—	—	2,490	2,490
Fixed-rate long-term obligations ⁽³⁾	23	13	8	8	4	56	58

⁽¹⁾ We believe the carrying amounts of cash and cash equivalents, accounts receivable, loans to growers, advances to suppliers, payable to growers and accounts payable 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 7.0%. 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 \$79,000.

⁽³⁾ Fixed rate long-term obligations bear interest rates ranging from 3.3% to 8.2%, with a weighted-average interest rate of 4.9%. We believe that loans with a similar risk profile would currently yield a return of 4.2%. 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 \$2,000.

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. Consequently, 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. We do not believe, however, 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 ended October 31, 2004 do not exceed \$0.1 million.

Consolidated Balance Sheets

(in thousands, except per share amounts)	2004	October 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 636	\$ 5,375
Accounts receivable, net of allowances of \$1,087 (2004) and \$700 (2003)	21,131	16,560
Inventories, net	11,375	8,021
Prepaid expenses and other current assets	4,598	4,487
Loans to growers	209	353
Advances to suppliers	2,413	624
Income taxes receivable	803	—
Deferred income taxes	1,775	1,379
Total current assets	42,940	36,799
Property, plant, and equipment, net	17,427	13,121
Building held for sale	1,658	—
Goodwill	3,591	—
Other assets	1,782	3,769
	\$ 67,398	\$ 53,689
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Payable to growers	\$ 5,789	\$ 3,446
Trade accounts payable	2,490	1,534
Accrued expenses	8,234	7,777
Income tax payable	—	51
Short-term borrowings	2,000	—
Dividend payable	4,052	3,232
Current portion of long-term obligations	22	24
Total current liabilities	22,587	16,064
Long-term liabilities:		
Long-term obligations, less current portion	34	61
Deferred income taxes	840	417
Total long-term liabilities	874	478
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Common stock (\$0.001 par value, 100,000 shares authorized; 13,507 and 12,930 shares outstanding at October 31, 2004 and 2003)	14	13
Additional paid-in capital	28,822	24,727
Notes receivable from shareholders	(2,883)	(3,563)
Retained earnings	17,984	15,970
Total shareholders' equity	43,937	37,147
	\$ 67,398	\$ 53,689

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

(in thousands, except per share amounts)	Year Ended October 31,		
	2004	2003	2002
Net sales	\$ 274,218	\$ 246,761	\$ 242,671
Cost of sales	248,814	221,414	216,848
Gross margin	25,404	25,347	25,823
Selling, general and administrative	15,920	14,651	13,881
Restructuring charge	185	106	—
Operating income	9,299	10,590	11,942
Other income, net	478	889	700
Income before provision for income taxes	9,777	11,479	12,642
Provision for income taxes	3,567	4,319	5,727
Net income	<u>\$ 6,210</u>	<u>\$ 7,160</u>	<u>\$ 6,915</u>
Net income per share:			
Basic	<u>\$ 0.46</u>	<u>\$ 0.55</u>	<u>\$ 0.60</u>
Diluted	<u>\$ 0.46</u>	<u>\$ 0.55</u>	<u>\$ 0.60</u>
Number of shares used in per share computation:			
Basic	13,497	12,911	11,562
Diluted	<u>13,582</u>	<u>12,944</u>	<u>11,604</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(in thousands)	Common Stock		Additional Paid-in Capital	Notes Receivable From Shareholders	Retained Earnings	Total
	Shares	Amount				
BALANCE, OCTOBER 31, 2001	9,967	10	10,158	—	9,861	20,029
Exercise of stock options, and income tax benefit of \$36	1,040	1	5,236	(4,789)	—	448
Stock Dividend	549	1	2,166	—	(2,167)	—
Issuance of common stock in connection with Employee Stock Purchase Plan	279	—	1,952	(1,952)	—	—
Issuance of common stock in connection with Rights Offering, net of offering costs of \$290	1,000	1	4,709	—	—	4,710
Collections on shareholder notes receivable	—	—	—	1,021	—	1,021
Dividend declared to shareholders	—	—	—	—	(2,567)	(2,567)
Net income	—	—	—	—	6,915	6,915
BALANCE, OCTOBER 31, 2002	12,835	13	24,221	(5,720)	12,042	30,556
Exercise of stock options, and income tax benefit of \$72	95	—	547	—	—	547
Collections on shareholder notes receivable	—	—	—	2,157	—	2,157
Additional costs related to Rights Offering	—	—	(41)	—	—	(41)
Dividend declared to shareholders	—	—	—	—	(3,232)	(3,232)
Net income	—	—	—	—	7,160	7,160
BALANCE, OCTOBER 31, 2003	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
BALANCE, OCTOBER 31, 2004	13,507	\$ 14	\$ 28,822	\$ (2,883)	\$ 17,984	\$ 43,937

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Year Ended October 31, (in thousands)	2004	2003	2002
Cash Flows from Operating Activities:			
Net income	\$ 6,210	\$ 7,160	\$ 6,915
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,648	2,024	1,957
Provision for losses on accounts receivable	25	19	35
Stock compensation expense	46	—	—
Loss on disposal of property, plant, and equipment	—	32	29
Gain on sale of investments held to maturity	—	(163)	—
Effect on cash of changes in operating assets and liabilities:			
Accounts receivable	(4,596)	1,328	1,855
Inventories, net	(3,354)	4,440	(3,386)
Prepaid expenses and other assets	2,654	506	(1,937)
Loans to growers	144	114	652
Advances to suppliers	(1,789)	1,911	(163)
Income taxes receivable	(803)	360	(60)
Deferred income taxes	(320)	(226)	(566)
Payable to growers	2,343	(2,922)	(555)
Trade accounts payable and accrued expenses	1,303	588	3,359
Income tax payable	(51)	51	—
Net cash provided by operating activities	4,460	15,222	8,135
Cash Flows from Investing Activities:			
Proceeds from sale of investments held to maturity	—	2,060	—
Direct costs of acquisition of Maui Fresh International, Inc.	(65)	—	—
Acquisitions of property, plant, and equipment	(8,409)	(6,535)	(1,973)
Proceeds from sale of short-term investments	—	2,223	—
Purchases of short-term investments	—	(2,223)	(105)
Net cash used in investing activities	(8,474)	(4,475)	(2,078)
Cash Flows from Financing Activities:			
Dividend paid to shareholders	(3,376)	(2,567)	—
Proceeds from (repayments of) short-term borrowings, net	2,000	(3,000)	(12,800)
Proceeds from issuance of common stock	—	—	4,710
Payments on long-term obligations	(29)	(3,317)	(536)
Proceeds from stock option exercises	—	475	412
Proceeds from collection of shareholder notes receivable	680	2,157	1,021
Additional rights offering costs	—	(41)	—
Net cash used in financing activities	(725)	(6,293)	(7,193)
Net increase (decrease) in cash and cash equivalents	(4,739)	4,454	(1,136)
Cash and cash equivalents, beginning of year	5,375	921	2,057
Cash and cash equivalents, end of year	\$ 636	\$ 5,375	\$ 921
Supplemental Information -			
Cash paid during the year for:			
Interest	\$ 66	\$ 179	\$ 443
Income taxes	\$ 4,899	\$ 4,170	\$ 6,362
Noncash Investing and Financing Activities:			
Exercise of stock options using shareholder notes receivable	\$ —	\$ —	\$ 4,789
5% Stock dividend	\$ —	\$ —	\$ 2,167
Tax receivable increase related to stock option exercise	\$ —	\$ 72	\$ 36
Stock purchases using shareholder notes receivable	\$ —	\$ —	\$ 1,952
Declared dividends payable	\$ 4,052	\$ 3,232	\$ 2,567
Acquisition of property under capital lease	\$ —	\$ —	\$ 68

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	\$ 4,050

See accompanying notes to consolidated financial statements.

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 two operating facilities in southern California and 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. We report these operations in three different business segments: (1) California avocados, (2) international avocados and perishable food products and (3) processed products.

In order to diversify our product lines and increase synergies within the marketplace, we acquired all the outstanding common

shares of Maui Fresh International, Inc. (Maui) for 576,924 shares of our common stock valued at \$4.05 million in November 2003, plus acquisition costs of \$65,000. Maui is a specialty produce company servicing a wide array of retail, food service, and terminal market wholesale customers with over 20 different specialty commodities. The value of our common stock issued in conjunction with the acquisition was based on the average quoted market price of our common stock for three days before and after the announcement date.

As security for certain potential contingencies, such as unrecorded liabilities, we held approximately 58,000 shares issued in conjunction with such acquisition for one full year from the acquisition date. As no contingencies developed, which was in accordance with our expectations, we are in the process of releasing these shares to the original Maui shareholders.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The differences from the previously reported amounts of goodwill and intangible assets of \$867,000 resulted from the finalization of our valuation information in the second quarter of fiscal 2004.

(in thousands)	2004
Fixed assets	\$ 114
Goodwill	3,591
Intangible assets	867
Total assets acquired	<u>4,572</u>
Current liabilities	110
Deferred tax liabilities	347
Net assets acquired	<u>\$ 4,115</u>

Pro forma statement of operations information is not presented, as the acquisition was not deemed to be a material business combination.

Conversion to a For-Profit Corporation

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. Concurrent with this transaction, the Cooperative was merged into Calavo, with Calavo emerging as the surviving entity. These transactions had the effect of converting the legal structure of the business from a not-for-profit cooperative to a for-profit corporation. Accordingly, the accompanying consolidated financial statements give retroactive effect, for all periods presented, to the merger, as a combination of entities with common shareholders, accounted for in a manner similar to a pooling of interests.

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.; and Calavo Foods de Mexico S.A. de C.V. 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 on a weighted-average basis, which approximates the first-in, first-out method, or market. Costs included in inventory primarily include the following: fruit, picking and hauling, overhead, labor, materials and freight.

Loans to Growers

We sponsor a grower loan program. Pursuant to this program, we provide loans to growers, bearing interest at prevailing market rates and repayable generally within a 12-month period. These loans are secured by the growers' avocado crops. We periodically evaluate the ability of these growers to repay advances in order to evaluate the possible need to record an allowance. No significant allowance was required at October 31, 2004.

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. The principal estimated useful lives are:

buildings and improvements - 7 to 30 years; leasehold improvements - the lesser of the term of the lease or 7 years; equipment - 7 years; information systems hardware and software - 36 to 60 months. Significant renewals and betterments are capitalized and replaced units are written off. 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. Pursuant to SOP 98-1, we capitalized \$254,000 and \$88,000 of software development and acquisition costs in 2004 and 2003 relating to systems supporting our business infrastructure.

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. We performed our annual assessment of goodwill and determined that no impairment existed as of October 31, 2004.

Included in other assets in the accompanying consolidated financial statements are the following intangible assets: customer-related intangibles of \$590,000 (accumulated amortization of \$88,000 at October 31, 2004), brand name intangibles of \$275,000 and other identified intangibles totaling \$2,000 (accumulated amortization of \$1,000 at October 31, 2004). The customer-related intangibles and other identified intangibles are being amortized over five and two 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 anticipate recording amortization expense of approximately \$119,000 per annum from fiscal 2005 through fiscal 2008, with the remaining amortization expense of approximately \$27,000 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 have not identified any significant impairment as of October 31, 2004.

Long-lived assets held for sale are reported at the lower of carrying amount or fair value less cost to sell.

Advances to Suppliers

We advance funds to third-party growers primarily in California and Mexico for various farming needs. These advances are generally secured with a crop lien or other collateral owned by the grower. We continuously evaluate the ability of these growers to repay advances and the fair value of the collateral in order to evaluate the possible need to record an allowance. No such allowance was required at October 31, 2004.

Accrued Expenses

Included in accrued expenses at October 31, 2004 and 2003 are accrued management bonuses of approximately \$0.7 million and \$1.0 million.

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, 2004, 2003 and 2002 in the financial statements pursuant to consignment arrangements are as follows (in thousands):

	2004	2003	2002
Sales	\$ 26,878	\$ 33,675	\$ 27,960
Cost of Sales	25,985	31,900	26,608
Gross Margin	<u>\$ 893</u>	<u>\$ 1,775</u>	<u>\$ 1,352</u>

Advertising Expense

Advertising costs are expensed when incurred. Such costs in fiscal 2004, 2003, and 2002 were approximately \$213,000, \$223,000, and \$245,000.

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, promotional allowances and income taxes. On an ongoing basis, 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 13,497,000, 12,911,000, and 11,562,000 for fiscal years 2004, 2003, and 2002. 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 85,000, 33,000 and 42,000 for fiscal years 2004, 2003 and 2002. There were no anti-dilutive options for fiscal years 2004, 2003 and 2002.

Stock-Based Compensation

As permitted by SFAS No. 123, Accounting for Stock-Based Compensation, which was amended by SFAS No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure, the Company accounts for stock-based compensation under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (“APB 25”) and related interpretations.

Year ended October 31,	2004	2003	2002
Net Income:			
As reported	\$ 6,210	\$ 7,160	\$ 6,915
Add: Total stock-based compensation expense determined under APB 25 and related interpretations, net of tax effects	28	—	—
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax effects	(28)	—	(703)
Pro forma	<u>\$ 6,210</u>	<u>\$ 7,160</u>	<u>\$ 6,212</u>
Net income per share, as reported:			
Basic	\$ 0.46	\$ 0.55	\$ 0.60
Diluted	\$ 0.46	\$ 0.55	\$ 0.60
Net income per share, pro forma:			
Basic	\$ 0.46	\$ 0.55	\$ 0.54
Diluted	\$ 0.46	\$ 0.55	\$ 0.54

For purposes of pro forma disclosures under SFAS No. 123, the estimated fair value of the options is assumed to be amortized to compensation expense over the options' vesting period. The fair

value of the options granted in fiscal year 2004 and 2002 has been estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2004	2002
Risk-free interest rate	3.3%	2.0%
Expected volatility	26.9%	130%
Dividend yield	20%	—%
Expected life (years)	5	1.1
Weighted-average fair value of options granted	\$ 3.01	\$ 1.04

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because options held by our directors have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, 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 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, 2004 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, accounts payable, and fixed-rate long-term obligations approximate fair value due to the short maturity of these financial instruments.

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, 2004.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (SFAS 151), to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) should be recognized as current period charges, and that fixed production overheads should be allocated to inventory based on normal capacity of production facilities. This statement is effective for the Company's fiscal year beginning November 1, 2005. We are in the process of evaluating whether the adoption of SFAS 151 will have a significant impact on our overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* (SFAS 153). The amendments made by SFAS 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement shall be applied prospectively. We do not expect the adoption of SFAS 153 will have a significant impact on our overall results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)). SFAS 123(R) requires the recognition of compensation cost relating to share-based payment transactions in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued as of the grant date, based on the estimated number of awards that are expected to vest. SFAS 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* (Opinion 25). Statement 123(R) is effective for the interim period that begins August 1, 2005. As a public company, we are allowed to select from three alternative transition methods—each having different reporting implications. We have not completed our evaluation or determined the impact of adopting SFAS 123(R).

Comprehensive Income

Comprehensive income is defined as all changes in a company's net assets, except changes resulting from transactions with shareholders. There was no significant difference between comprehensive income and net income for the fiscal years ended October 31, 2004, 2003, and 2002.

Reclassifications

Certain items in the prior period financial statements have been reclassified to conform to the current period presentation.

3. INVENTORIES

Inventories consist of the following (in thousands):

October 31,	2004	2003
Fresh fruit	\$ 3,424	\$ 2,918
Packing supplies and ingredients	2,081	1,974
Finished processed foods	5,870	3,129
	<u>\$ 11,375</u>	<u>\$ 8,021</u>

Cost of goods sold for fiscal year 2004, 2003, and 2002 includes inventory write-downs of \$285,000, \$82,000 and \$63,000. Write-downs in fiscal year 2004 primarily related to improper handling of product, which we believe related to a subcontractor's error. We are currently in discussions with such subcontractor regarding the handling of our product and will recognize recoveries, if any, when realized. For fiscal years 2003 and 2002, our write-downs were primarily related to reduced customer demand and the discontinuance of various supplies for certain processed avocado products.

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 exceeds the foreseeable demand, the value of inventory that at the time of the review 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.

4. PROPERTY, PLANT, AND EQUIPMENT

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

October 31,	2004	2003
Land	\$ 948	\$ 1,177
Buildings and improvements	13,342	9,800
Leasehold improvements	228	176
Equipment	28,387	23,680
Information systems - Hardware and software	3,927	3,001
Construction in progress	1,675	5,054
	<u>48,507</u>	<u>42,888</u>
Less accumulated depreciation and amortization	<u>(31,080)</u>	<u>(29,767)</u>
	<u>\$ 17,427</u>	<u>\$ 13,121</u>

The net book value of our corporate headquarters building, totaling approximately \$1.7 million, is recorded as Building held for sale in the accompanying balance sheet. See note 15 for further discussion. Depreciation expense was \$2.6 million, \$2.0 million and \$2.0 million for fiscal years 2004, 2003, and 2002.

5. OTHER ASSETS

During 1999, we established a Grower Development Program whereby funds could be advanced to growers in exchange for their commitment to deliver a minimum volume of avocados on an annual basis. As of October 31, 2004 and 2003, total cumulative advances made to growers subject to this program totaled approximately \$2,113,000, and we advanced no additional amounts in fiscal year 2004 pursuant to this program. Advances are amortized, through fiscal year 2006, to cost of goods sold over the term of the related agreement. The financial statements for fiscal years 2004, 2003 and 2002 include a charge of approximately \$322,000, \$308,000 and \$293,000 representing the amortization of these advances.

6. SHORT-TERM BORROWINGS

In January 2004, we renewed our two short-term, non-collateralized, revolving credit facilities. These credit facilities

expire in January 2006 and April 2006 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 2.9% and 2.0% at October 31, 2004 and 2003. Under these credit facilities, we had \$2 million and \$0 outstanding as of October 31, 2004 and 2003. The credit facilities contain various financial covenants with which we were in compliance at October 31, 2004.

7. EMPLOYEE BENEFIT PLANS

We sponsor two defined contribution retirement plans for salaried and hourly employees. Expenses for these plans approximated \$409,000, \$411,000, and \$402,000 for fiscal years 2004, 2003 and 2002, 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 and actuarial losses approximated \$49,000, \$59,000, and \$126,000 for the years

ended October 31, 2004, 2003, and 2002, which are included in selling, general and administrative expenses in the accompanying financial statements.

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

	2004	2003
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 506	\$ 502
Interest cost	30	32
Actuarial loss	19	27
Benefits paid	(55)	(55)
Projected benefit obligation at end of year (unfunded)	<u>\$ 500</u>	<u>\$ 506</u>

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

	2004	2003
Projected benefit obligation	\$ 500	\$ 506
Unrecognized net (gain) loss	—	(49)
Recorded pension liabilities	<u>\$ 500</u>	<u>\$ 457</u>

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

	2004	2003	2002
Discount rate on projected benefit obligation	6.25%	6.25%	6.75%

8. COMMITMENTS AND CONTINGENCIES

Commitments and Guarantees

We lease facilities and certain equipment under non cancelable operating leases expiring at various dates through 2009. We are

2005	\$ 862
2006	836
2007	616
2008	273
2009	1
	<u>\$ 2,588</u>

Rental expenses amounted to approximately \$1,121,000, \$1,163,000, and \$1,296,000 for the years ended October 31, 2004, 2003, and 2002.

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.

In June 2003, in order to facilitate the operations of one of our processed avocado product suppliers, we entered into a contract guaranteeing payment of certain invoices rendered to such supplier. The term of this guarantee is from June 2003 through December 2004, but can be cancelled at any time at our discretion. Additionally, the maximum amount subject to guarantee at any one time cannot exceed \$90,000. As of October 31, 2004, no amounts or orders were outstanding and all amounts owed by such supplier related to this guarantee have been remitted. We did not record a liability at inception related to this guarantee contract as we do not believe that we will make any future payments under such guarantee and the fair value was insignificant.

committed to make minimum cash payments under these agreements as of October 31, 2004 as follows (amounts in thousands):

Litigation

We are not involved in litigation which we 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 \$6,846,000, \$2,920,000, and \$2,658,000 for the years ended October 31, 2004, 2003, and 2002, resulting in gross margins of approximately \$864,000, \$281,000 and \$272,000. Net amounts due to this entity approximated \$113,000, \$278,000, and \$119,000 at October 31, 2004, 2003, and 2002.

Certain members of our Board of Directors market avocados through Calavo pursuant to our customary marketing agreements. During the years ended October 31, 2004 and 2003, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors, was \$4.7 million and \$4.5 million. Accounts payable to these Board members were \$0.3 million and \$0.3 million as of October 31, 2004 and 2003.

10. INCOME TAXES

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

	2004	2003	2002
Current:			
Federal	\$ 3,018	\$ 3,639	\$ 4,540
State	844	825	1,181
Foreign	25	81	572
Total current	3,887	4,545	6,293
Deferred	(320)	(226)	(566)
Total income tax provision	\$ 3,567	\$ 4,319	\$ 5,727

At October 31, 2004 and 2003, gross deferred tax assets totaled approximately \$2,061,000 and \$1,634,000, while gross deferred tax liabilities totaled approximately \$1,126,000 and \$672,000. Deferred income taxes reflect the net of temporary differences between the

carrying amount of assets and liabilities for financial reporting and income tax purposes. Significant components of our deferred taxes as of October 31, 2004 and 2003 are as follows:

	2004	2003
Allowances for accounts receivable	\$ 679	\$ 543
Inventories	647	273
State taxes	257	271
Accrued liabilities	192	292
Current deferred income taxes	1,775	1,379
Property, plant, and equipment	(739)	(614)
Intangible assets	(339)	—
Retirement benefits	217	197
Other	21	—
Long-term deferred income taxes	\$ (840)	\$ (417)

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:

	2004	2003	2002
Federal statutory tax rate	35%	35%	35%
State taxes, net of federal effects	5	4	6
Foreign income taxes greater (less) than U.S.	(3)	(1)	2
Benefit of lower federal tax brackets	(1)	(1)	(1)
Other	—	1	3
	36%	38%	45%

We intend to reinvest our foreign earnings, which approximated \$2.4 million at October 31, 2004, indefinitely. As a result, we have not provided any deferred income taxes on such unremitted earnings.

For fiscal years 2004 and 2003, income before income taxes related to domestic operations was approximately \$9.0 million and \$11.1 million. For fiscal years 2004 and 2003, income before income taxes related to foreign operations was approximately \$0.8 million and \$0.4 million.

We are currently under examination by the Internal Revenue Service for the years ended October 31, 2002 and October 31, 2003, as well as the Mexican tax authorities for the tax year ended December 31, 2002. We do not believe that the settlement of such examinations will have a material adverse impact on our financial statements.

11. SEGMENT INFORMATION

We operate and track results in three reportable segments - California avocados, international avocados and perishable foods

products, and processed products. These three business segments are presented based on our management structure and information used by our president to measure performance and allocate resources. The California avocados segment includes all operations that involve the distribution of avocados grown in California. The international avocados and perishable foods products segment includes both operations related to distribution of fresh avocados grown outside of California and distribution of other perishable food items. Additionally, the results of operations related to Maui have also been included in international avocados and perishable foods products segment. The processed products segment represents all operations related to the purchase, manufacturing, and distribution of processed avocado products. Those costs that can be specifically identified with a particular product line are charged directly to that product line. Costs that are not segment specific are generally allocated based on five-year average sales dollars. We do not allocate assets or specifically identify them to our operating segments.

(All amounts are presented in thousands)

	California avocados	International avocados and perishable food products	Processed products	Inter-segment eliminations	Total
YEAR ENDED OCTOBER 31, 2004					
Net sales	\$ 163,486	\$ 94,423	\$ 32,749	\$ (16,440)	\$ 274,218
Cost of sales	146,384	89,465	29,405	(16,440)	248,814
Gross margin	17,102	4,958	3,344	—	25,404
Selling, general and administrative	7,190	3,850	4,880	—	15,920
Restructuring charge	—	—	185	—	185
Operating income (loss)	9,912	1,108	(1,721)	—	9,299
Other income, net	334	125	19	—	478
Income (loss) before provision (benefit) for income taxes	10,246	1,233	(1,702)	—	9,777
Provision (benefit) for income taxes	3,738	450	(621)	—	3,567
Net income (loss)	\$ 6,508	\$ 783	\$ (1,081)	\$ —	\$ 6,210

YEAR ENDED OCTOBER 31, 2003					
Net sales	\$ 149,635	\$ 75,347	\$ 32,360	\$ (10,581)	\$ 246,761
Cost of sales	134,762	69,890	27,343	(10,581)	221,414
Gross margin	14,873	5,457	5,017	—	25,347
Selling, general and administrative	6,705	2,951	4,995	—	14,651
Restructuring charge	—	—	106	—	106
Operating income (loss)	8,168	2,506	(84)	—	10,590
Other income, net	714	162	13	—	889
Income (loss) before provision (benefit) for income taxes	8,882	2,668	(71)	—	11,479
Provision (benefit) for income taxes	3,341	1,004	(26)	—	4,319
Net income (loss)	\$ 5,541	\$ 1,664	\$ (45)	\$ —	\$ 7,160

YEAR ENDED OCTOBER 31, 2002					
Net sales	\$ 165,077	\$ 59,083	\$ 29,960	\$ (11,449)	\$242,671
Cost of sales	147,796	55,372	25,129	(11,449)	216,848
Gross margin	17,281	3,711	4,831	—	25,823
Selling, general and administrative	6,729	2,779	4,373	—	13,881
Operating income	10,552	932	458	—	11,942
Other income (expense), net	523	256	(79)	—	700
Income before provision for income taxes	11,075	1,188	379	—	12,642
Provision for income taxes	5,017	538	172	—	5,727
Net income	\$ 6,058	\$ 650	\$ 207	\$ —	\$ 6,915

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

	Year ended October 31, 2004			Total
	California avocados	International avocados and perishable food products	Processed products	
Third-party sales:				
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	150,159	75,668	31,637	257,464
Freight and other charges	11,946	10,968	534	23,448
Total third-party sales	162,105	86,636	32,171	280,912
Less sales incentives	(131)	(48)	(6,515)	(6,694)
Total net sales to third-parties	161,974	86,588	25,656	274,218
Intercompany sales	1,512	7,835	7,093	16,440
Net sales before eliminations	\$ 163,486	\$ 94,423	\$ 32,749	290,658
Intercompany sales eliminations				(16,440)
Consolidated net sales				\$ 274,218

	Year ended October 31, 2003			Total
	California avocados	International avocados and perishable food products	Processed products	
Third-party sales:				
California avocados	\$ 140,795	\$ —	\$ —	\$ 140,795
Imported avocados	—	56,306	—	56,306
Papayas	—	2,920	—	2,920
Specialities and tropicals	—	30	—	30
Processed - food service	—	—	28,545	28,545
Processed - retail and club	—	—	5,165	5,165
Total fruit and product sales to third-parties	140,795	59,256	33,710	233,761
Freight and other charges	8,997	10,079	290	19,366
Total third-party sales	149,792	69,335	34,000	253,127
Less sales incentives	(157)	(251)	(5,958)	(6,366)
Total net sales to third-parties	149,635	69,084	28,042	246,761
Intercompany sales	—	6,263	4,318	10,581
Net sales before eliminations	\$ 149,635	\$ 75,347	\$ 32,360	257,342
Intercompany sales eliminations				(10,581)
Consolidated net sales				\$ 246,761

	Year ended October 31, 2002			Total
	California avocados	International avocados and perishable food products	Processed products	
Third-party sales:				
California avocados	\$ 153,878	\$ —	\$ —	\$ 153,878
Imported avocados	—	43,715	—	43,715
Papayas	—	2,658	—	2,658
Specialities and tropicals	—	42	—	42
Processed - food service	—	—	24,964	24,964
Processed - retail and club	—	—	5,141	5,141
Total fruit and product sales to third-parties	153,878	46,415	30,105	230,398
Freight and other charges	11,381	7,540	217	19,138
Total third-party sales	165,259	53,955	30,322	249,536
Less sales incentives	(182)	(150)	(6,533)	(6,865)
Total net sales to third-parties	165,077	53,805	23,789	242,671
Intercompany sales	—	5,278	6,171	11,449
Net sales before eliminations	\$ 165,077	\$ 59,083	\$ 29,960	254,120
Intercompany sales eliminations				(11,449)
Consolidated net sales				\$ 242,671

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

	United States	Mexico	Consolidated
2004	\$ 11,761	\$ 12,697	\$ 24,458
2003	\$ 9,951	\$ 6,939	\$ 16,890

Sales to customers outside the United States were approximately \$16.2 million, \$15.7 million and \$9.8 million for the three years ended October 31, 2004.

12. STOCK-BASED COMPENSATION

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

The Directors Stock Option Plan

Participation in the directors 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.

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, 2004 and 2003.

During fiscal 2004, directors made principal payments of \$416,000 related to these notes and we have recorded interest income of \$189,000. During fiscal 2003, directors made principal payments of

\$1,661,000 related to these notes and we have recorded interest income of \$269,000. As of October 31, 2004, we have accrued interest receivable of \$109,000 related to these notes, which is included in prepaid expenses and other current assets.

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 accordance with APB 25, we are recording compensation expense of approximately \$151,000 over the vesting period of three years from the grant date. During fiscal year 2004, we recognized \$46,000 of compensation expense with respect to stock option awards pursuant to APB 25.

A summary of stock option activity follows (shares in thousands):

	Year ended October 31, 2003	
	Number of Shares	Weighted-Average Exercise Price
Outstanding at beginning of period	200	\$ 5.00
Exercised	(95)	5.00
Outstanding at end of period	105	\$ 5.00
Exercisable at end of period	105	\$ 5.00
	Year ended October 31, 2004	
	Number of Shares	Weighted-Average Exercise Price
Outstanding at beginning of period	105	\$ 5.00
Granted	50	7.00
Outstanding at end of period	155	\$ 5.65
Exercisable at end of period	105	\$ 5.00
Weighted-average fair value of options granted during the year		\$ 3.02

The following table summarizes stock options outstanding and exercisable at October 31, 2004 (shares in thousands):

Range of Exercise Prices	Outstanding		
	Number of Shares	Contractual Life (Years)	Average Remaining Weighted-Average Exercise Price
\$ 5.00 - \$ 7.00	155	2.73	\$ 5.65

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. Accordingly, 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. The notes have been presented as a reduction of shareholders' equity as of October 31, 2004 and October 2003.

During fiscal 2003, employees made principal payments of \$496,000 related to these notes, and we have recorded interest income of \$97,000. During fiscal 2004, employees made principal payments of \$263,000 related to these notes, and we have recorded

interest income of \$46,000. As of October 31, 2004, we have accrued interest receivable of \$25,000 related to these notes, which is included in prepaid expenses and other current assets.

13. DIVIDENDS

In January 2005, we paid a \$0.30 per share dividend in the aggregate amount of \$4,052,000 to shareholders of record on November 15, 2004. In January 2004, we paid a \$0.25 per share dividend in the aggregate amount of \$3,376,000 to shareholders of record on November 17, 2003.

14. PROCESSED PRODUCT SEGMENT RESTRUCTURING

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. We believe that this restructuring will provide 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.

For fiscal year 2004, we have incurred costs related to this restructuring approximating \$1,013,000. Our income statement for the year ended October 31, 2004 includes \$741,000 as cost of sales, \$185,000 as special charges, and \$87,000 as selling, general and administrative expenses. These costs are comprised of the following components as of and for the year ended October 31, 2004:

(in thousands)

	Restructuring charges	Amounts paid	Non-cash charges	Reserves remaining to be utilized
Special charges - employee separation costs	\$ 185	\$ (185)	\$ —	\$ —
Selling, general and administrative - freight	87	(87)	—	—
Cost of sales - facility operating costs	741	(672)	(69)	—
	<u>\$ 1,013</u>	<u>\$ (944)</u>	<u>\$ (69)</u>	<u>\$ —</u>

Special charges recorded during the year ended October 31, 2004 consist entirely of employee separation costs. All employee separation costs were paid in cash and represent final payments to 93 production and 8 managerial/administrative employees formerly working at our Mexicali processing facility. We have not recorded a significant charge relating to the write-down of production assets being held at our Mexicali production facility, as substantially all such assets were re-commissioned at our new facility in Uruapan or their carrying value was less than their fair value.

15. CORPORATE HEADQUARTERS BUILDING

In August 2004, we entered into an agreement to sell our corporate headquarters building located in Santa Ana, California for \$3.4 million. Such transaction, however, fell out of escrow in November 2004. Then, in December 2004, we re-entered escrow, with a different buyer, to sell our corporate headquarters building for the same sales price. Escrow related to such transaction is expected to close in the second quarter of fiscal 2005, which is when we expect to complete the move of our corporate headquarters. We estimate that this transaction will result in a pre-tax gain on sale of approximately \$3.0 million, if such transaction is consummated according to terms. We currently plan to relocate our corporate offices to Santa Paula, California.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Calavo Growers, Inc.
Santa Ana, CA

We have audited the accompanying consolidated balance sheets of Calavo Growers, Inc. and subsidiaries (the "Company") as of October 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended October 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the financial position of Calavo Growers, Inc. and subsidiaries as of October 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

*Costa Mesa, California
January 12, 2005*

REPORT OF MANAGEMENT

Our management is responsible for preparing the accompanying financial statements and for ensuring their integrity and objectivity. The statements were prepared in accordance with accounting principles generally accepted in the United States of America and fairly represent the transactions and financial position of the company. The financial statements include amounts that are based on management's best estimates and judgments.

Our statements have been audited by Deloitte & Touche LLP, our independent registered public accounting firm, selected by the Audit Committee and approved by our shareholders. Management has made available to Deloitte & Touche LLP all of our financial records and related data, as well as minutes of stockholder and director meetings.



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

Our management has established and maintains a system of internal accounting controls that is designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded and executed in accordance with management's authorization, and the books and records accurately reflect the disposition of assets. The system of internal controls includes appropriate division of responsibility.

The Audit Committee is composed of directors who are not officers or employees. It meets regularly with members of management and the independent registered public accounting firm to discuss the adequacy of our system of internal controls, financial statements, and the nature, extent and results of the audit effort. Furthermore, our independent registered public accounting firm has free and direct access to the Audit Committee without the presence of management.



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

COMMON STOCK MARKET INFORMATION

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.

Fiscal 2003	High	Low
First Quarter	\$ 7.95	\$ 6.60
Second Quarter	\$ 7.27	\$ 6.70
Third Quarter	\$ 7.25	\$ 6.69
Fourth Quarter	\$ 11.04	\$ 6.94
Fiscal 2004	High	Low
First Quarter	\$ 11.60	\$ 9.75
Second Quarter	\$ 10.90	\$ 9.80
Third Quarter	\$ 13.00	\$ 10.08
Fourth Quarter	\$ 12.27	\$ 10.50

As of October 31, 2004, there were approximately 1,430 stockholders of record of our common stock.

During the year ended October 31, 2004, (i) we did not repurchase any shares of our common stock, and (ii) we did not issue any shares of common stock that were not registered under the Securities Act of 1933, except for our issuance of 576,924 shares in November 2003 in connection with our acquisition of Maui Fresh International as disclosed by us in our Annual Report on Form 10-K for the year ended October 31, 2003.

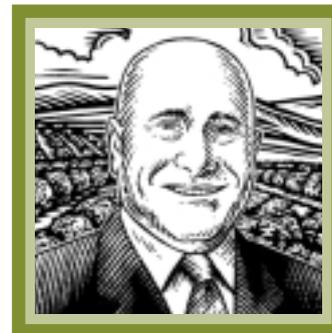
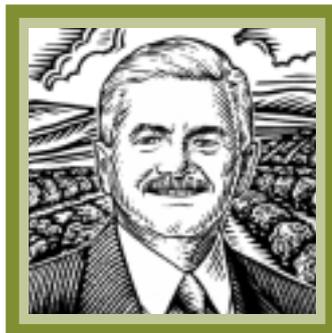
DIVIDEND POLICY

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 5, 2004, we paid a \$0.25 per share dividend in the aggregate amount of \$3,376,000 to shareholders of record on November 17, 2003.

On January 3, 2005, we paid a \$0.30 per share dividend in the aggregate amount of \$4,052,000 to shareholders of record on November 15, 2004.

Senior Management



Top row, left to right

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

Al Ahmer Vice President, Processed Sales

Bottom row, left to right

Al Thorne Vice President, Fresh Operations

Jim Wallace Vice President, Human Resources & Corporate Communications

Rob Wedin Vice President, Fresh Sales & Marketing

Profile

Celebrating its 80th anniversary in 2004, Calavo Growers, Inc. is the leading packer and distributor of avocados throughout the United States and in other countries globally. In addition to being the world's most recognized and respected avocado brand, the company packs and markets other perishable fruit and vegetables and manufactures processed-avocado products.

The company's three principal business units—California Avocados, International Avocados and Perishable Products, and Processed Products—supply wholesale, retail and restaurant-institutional foodservice customers. Maui Fresh International, a wholly owned subsidiary of Calavo, markets tropical fruits and vegetables, chilies, hothouse and other commodity-produce items under its own well-recognized brand name.

Calavo packs and distributes approximately 35 percent of the California avocado crop. Additionally the company sources fruit from Mexico, the Dominican Republic and Chile to satisfy year-round domestic avocado demand, for export and for use in processed products.

Founded in 1924 as a grower-owned cooperative, Calavo today is publicly traded on the Nasdaq National Market System under the ticker symbol CVGW and employs more than 600 people. The company operates packing facilities in Temecula and Santa Paula, California, as well as a third packinghouse and newly constructed processed-product manufacturing plant in Uruapan, Michoacan, Mexico.

OFFICERS AND MANAGEMENT

LECIL E. COLE

Chairman of the Board,
President &
Chief Executive Officer

ARTHUR J. BRUNO

Chief Operating Officer,
Chief Financial Officer,
Corporate Secretary

ALBERT E. THORNE

Vice President,
Fresh Operations

ROB WEDIN

Vice President,
Fresh Sales & Marketing

AL AHMER

Vice President,
Processed Sales &
Operations

JAMES M. WALLACE

Vice President,
Human Resources &
Corporate Communications

SCOTT H. RUNGE

Treasurer

JAMES E. SNYDER

Corporate Controller

PRINCIPAL BOARD COMMITTEES

Executive Committee

LECIL E. COLE

Chairman

J. LINK LEAVENS

First Vice Chairman

SCOTT N. VAN DER KAR

Second Vice Chairman

ALVA V. SNIDER

MICHEAL D. HAUSE

Audit Committee

MICHEAL D. HAUSE

Chairman

JOHN M. HUNT

ALVA V. SNIDER

FRED J. FERRAZZANO

GEORGE H. BARNES

Nominating & Governance Committee

JOHN M. HUNT

Chairman

GEORGE H. BARNES

FRED J. FERRAZZANO

ALVA V. SNIDER

Compensation Committee

FRED J. FERRAZZANO

Chairman

GEORGE H. BARNES

MICHEAL D. HAUSE

JOHN M. HUNT

ALVA V. SNIDER

Operating Directors & Managers

CARLOS T. VASQUEZ

Director,
Field Operations

ROBIN OSTERHUES

Director of
Corporate Marketing

RANDY ROZZATTI

Director, Systems
Analysis & Planning

BRUCE SPURRELL

Director of Administrative
Services & Purchasing

FRANCISCO OROZCO

Packinghouse Manager, Temecula

MICHAEL F. DERR

Packinghouse Manager,
Santa Paula

DIONISIO ORTIZ

Vice President,
Calavo de Mexico Operations

MICHAEL ANGELO

Director of National Fresh Sales

CORPORATE INFORMATION

HEADQUARTERS

Calavo Growers, Inc.
2530 Red Hill Avenue
Santa Ana, California 92705
Telephone 949.223.1111
Fax 949.660.6088
www.calavo.com

NEW HEADQUARTERS

EFFECTIVE APRIL 05

Calavo Growers, Inc.
1141A Cummings Road
Santa Paula, California 93060
Telephone 805.525.1245
www.calavo.com

GENERAL COUNSEL

Troy & Gould, P.C.
Los Angeles, California

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Deloitte & Touche LLP
Costa Mesa, California

INVESTOR & CORPORATE RELATIONS COUNSEL

Foley/Freisleben LLC
Los Angeles, California

FORM 10-K

A copy of the company's annual report as filed upon Form 10-K is available upon request to the vice president, corporate communications or online from the Securities and Exchange Commission at www.sec.gov.

TRANSFER AGENT AND REGISTRAR

U.S. Stock Transfer Corporation
Glendale, California

COMMON STOCK LISTING

Shares of the company's common stock are listed on the Nasdaq National Market System under the symbol CVGW.



PACKED AND SHIPPED BY

CALAVO GROWERS INCORPORATED · SANTA PAULA · CALIFORNIA · 93060