

CALAVO GROWERS INC  
Form 10-Q  
September 11, 2006

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended July 31, 2006**

**OR**

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

**Commission file number: 000-33385**

**CALAVO GROWERS, INC.**

**(Exact name of registrant as specified in its charter)**

**California**

(State of incorporation)

**33-0945304**

(I.R.S. Employer Identification No.)

**1141-A Cummings Road**

**Santa Paula, California 93060**

(Address of principal executive offices) (Zip code)

**(805) 525-1245**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

No

Registrant's number of shares of common stock outstanding as of July 31, 2006 was 14,291,833

**Table of Contents**

**CAUTIONARY STATEMENT**

This Quarterly Report on Form 10-Q contains statements relating to our future results (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, 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 but not limited to those set forth in Part I., Item 1A, *Risk Factors*, in our Annual Report on Form 10-K for the fiscal year ended October 31, 2005, 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.

**Table of Contents**

**CALAVO GROWERS, INC.  
INDEX**

	PAGE
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements (unaudited):</u></b>	
<u>Consolidated Condensed Balance Sheets July 31, 2006 and October 31, 2005</u>	4
<u>Consolidated Condensed Statements of Income Three Months and Nine Months Ended July 31, 2006 and 2005</u>	5
<u>Consolidated Condensed Statements of Comprehensive Income Three Months and Nine Months Ended July 31, 2006 and 2005</u>	6
<u>Consolidated Condensed Statements of Cash Flows Nine Months Ended July 31, 2006 and 2005</u>	7
<u>Notes to Consolidated Condensed Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 4. Controls and Procedures</u>	27
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	28
<u>Item 6. Exhibits</u>	29
<u>Signatures</u>	30
<u>EXHIBIT 10.17</u>	
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

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

	<b>July 31, 2006</b>	<b>October 31, 2005</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 107	\$ 1,133
Accounts receivable, net of allowances of \$2,327 (2006) and \$2,688 (2005)	30,749	19,253
Inventories, net	10,743	10,096
Prepaid expenses and other current assets	5,113	5,879
Advances to suppliers	161	1,141
Income tax receivable		893
Deferred income taxes	2,651	2,651
Total current assets	49,524	41,046
Property, plant, and equipment, net	18,651	16,897
Investment in Limoneira	35,954	45,634
Goodwill	3,591	3,591
Other assets	2,335	1,314
	<b>\$ 110,055</b>	<b>\$ 108,482</b>
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Payable to growers	\$ 12,540	\$ 1,753
Trade accounts payable	3,203	1,892
Accrued expenses	12,046	12,482
Income tax payable	823	
Short-term borrowings	1,753	1,424
Dividend payable		4,564
Current portion of long-term obligations	1,308	1,313
Total current liabilities	31,673	23,428
Long-term liabilities:		
Long-term obligations, less current portion	10,412	11,719
Deferred income taxes	4,750	8,589
Total long-term liabilities	15,162	20,308
Commitments and contingencies Shareholders equity:		
Common stock, \$0.001 par value; 100,000 shares authorized; 14,292 (2006) and 14,362 (2005) issued and outstanding	14	14
Additional paid-in capital	36,899	37,240
Notes receivable from shareholders	(2,430)	(2,636)
Accumulated other comprehensive income	7,545	13,386
Retained earnings	21,192	16,742

Total shareholders' equity	63,220	64,746
	\$ 110,055	\$ 108,482

*The accompanying notes are an integral part of these consolidated condensed financial statements.*

4

---

**Table of Contents**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net sales	\$ 78,954	\$ 88,699	\$ 197,030	\$ 196,576
Cost of sales	68,738	79,505	174,743	179,075
Gross margin	10,216	9,194	22,287	17,501
Selling, general and administrative	5,284	4,825	14,791	13,645
Operating income	4,932	4,369	7,496	3,856
Other income (expense), net	(136)	153	(201)	2,144
Income before provision for income taxes	4,796	4,522	7,295	6,000
Provision for income taxes	1,870	1,603	2,845	2,161
Net income	\$ 2,926	\$ 2,919	\$ 4,450	\$ 3,839
Net income per share:				
Basic	\$ 0.20	\$ 0.21	\$ 0.31	\$ 0.28
Diluted	\$ 0.20	\$ 0.21	\$ 0.31	\$ 0.28
Number of shares used in per share computation:				
Basic	14,292	14,171	14,308	13,729
Diluted	14,351	14,237	14,365	13,796

*The accompanying notes are an integral part of these consolidated condensed financial statements.*

**Table of Contents**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income	\$ 2,926	\$ 2,919	\$ 4,450	\$ 3,839
Other comprehensive income (loss), before tax:				
Unrealized holding gains (losses) arising during period	(5,531)	17,517	(9,680)	17,517
Income tax (expense) benefit related to items of other comprehensive income (loss)	2,194	(6,919)	3,839	(6,919)
Other comprehensive income (loss), net of tax	(3,337)	10,598	(5,841)	10,598
Comprehensive income (loss)	\$ (411)	\$ 13,517	\$ (1,391)	\$ 14,437

*The accompanying notes are an integral part of these consolidated condensed financial statements.*



**Table of Contents**

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

	<b>Nine months ended July 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 4,450	\$ 3,839
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,554	2,223
Gain on sale of building		(1,725)
Stock based compensation	549	38
Provision for losses on accounts receivable	44	400
Effect on cash of changes in operating assets and liabilities:		
Accounts receivable	(11,540)	(12,964)
Inventories, net	(647)	(4,118)
Prepaid expenses and other assets	(344)	643
Advances to suppliers	980	12
Income taxes receivable	953	803
Payable to growers	10,787	12,241
Trade accounts payable and accrued expenses	349	2,382
Income taxes payable	823	200
Net cash provided by operating activities	7,958	3,974
<b>Cash Flows from Investing Activities:</b>		
Purchase of Limoneira stock		(13,450)
Proceeds received from sale of building		3,383
Acquisitions of and deposits on property, plant, and equipment	(2,693)	(1,436)
Net cash used in investing activities	(2,693)	(11,503)
<b>Cash Flows from Financing Activities:</b>		
Payment of dividend to shareholders	(4,564)	(4,052)
Proceeds from (payments on) short-term borrowings, net	329	(1,133)
Proceeds from issuance of long-term debt		13,000
Exercise of stock options	250	60
Retirement of common stock	(1,200)	
Collection on notes receivable from shareholders	206	225
Payments on long-term obligations	(1,312)	(21)
Net cash provided by (used in) financing activities	(6,291)	8,079
Net increase (decrease) in cash and cash equivalents	(1,026)	550
Cash and cash equivalents, beginning of period	1,133	636
Cash and cash equivalents, end of period	\$ 107	\$ 1,186
<b>Supplemental Information -</b>		
Cash paid during the period for:		
Interest	\$ 804	\$ 179

Income taxes	\$ 1,032	\$ 863
<b>Noncash Investing and Financing Activities:</b>		
Tax benefit related to stock option exercise	\$ 60	\$ 23
Construction in progress included in trade accounts payable	\$ 526	\$
Issuance of our common stock in Limoneira transaction	\$	\$ 10,000
Unrealized holding gains (losses)	\$ (9,680)	\$ 17,517

*The accompanying notes are an integral part of these consolidated condensed financial statements.*

**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)****1. Description of the business*****Business***

Calavo Growers, Inc. (Calavo, the Company, we, us or our) procures and markets avocados and other perishable commodities and prepares and distributes processed avocado products. Our expertise in marketing and distributing avocados, processed avocados, and other perishable foods allows us to deliver a wide array of fresh and processed food products to food distributors, produce wholesalers, supermarkets, and restaurants on a worldwide basis. Through our three operating facilities in southern California 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. During the second quarter of fiscal 2006, we combined our California avocados and international avocados and perishable food products reporting segments. As a result, we now report our operations in two different business segments: (1) fresh products and (2) processed products. See footnote 2 for further explanation.

The accompanying consolidated condensed financial statements are unaudited. In the opinion of management, the accompanying consolidated condensed financial statements contain all adjustments necessary to present fairly our financial position, results of operations, and cash flows. Such adjustments consist of adjustments of a normal recurring nature. Interim results are subject to significant seasonal variations and are not necessarily indicative of the results of operations for a full year. Our operations are sensitive to a number of factors, including weather-related phenomena and their effects on industry volumes, prices, product quality, and costs. Operations are also sensitive to fluctuations in currency exchange rates in both sourcing and selling locations, as well as economic crises and security risks in developing countries. These statements should also be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2005.

***Recent Accounting Standards***

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. This FSP is effective for reporting periods beginning after December 15, 2005. The adoption of this FSP did not have a material impact on its financial position or results of operations.

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

**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

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

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

***Stock Based Compensation***

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

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

During the three and nine month periods ended July 31, 2005, we recognized \$13,000 and \$38,000 of compensation expense with respect to stock option awards pursuant to APB 25, which was charged to the consolidated statement of operations. For the three and nine months ended July 31, 2005, had stock-based compensation been accounted for based on the estimated grant date fair values, as defined by SFAS No. 123, the Company's net income and net income per share would have been the following pro forma amounts (in thousands, except per share amounts):

**Table of Contents**

**CALAVO GROWERS, INC.**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

	<b>Three months ended July 31, 2005</b>	<b>Nine months ended July 31, 2005</b>
Net Income:		
As reported	\$ 2,919	\$ 3,839
Add: Total stock-based compensation expense determined under APB 25 and related interpretations, net of tax effects	8	24
Deduct: Total stock based compensation expense determined under fair value based method for all awards, net of tax effects	(8)	(24)
Pro forma	\$ 2,919	\$ 3,839
Net income per share, as reported:		
Basic	\$ 0.21	\$ 0.28
Diluted	\$ 0.21	\$ 0.28
Net income per share, pro forma:		
Basic	\$ 0.21	\$ 0.28
Diluted	\$ 0.21	\$ 0.28

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

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

In April 2006, the price of our common stock reached \$11/per share. Therefore, all 400,000 options related to our stock option grant that took place in August 2005 vested in August 2006 (for those persons still employed). The achievement of this market condition resulted in a decrease in the initial, estimated derived service period. As a result, we recorded total stock-based compensation expense related to this stock option grant of \$312,000 and \$507,000 during the three and nine month periods ended July 31, 2006. The final compensation expense charge was \$104,000 for the month of August 2006 related to this stock option grant. During the three and nine months ended July 31, 2006, we recognized total stock-based compensation expense of \$323,000 and \$549,000 for stock options in our consolidated statement of operations.

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

There were no options granted during the three and nine months periods ended July 31, 2006 and July 31, 2005.



**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

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

**2. Information regarding our operations in different segments**

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

	<b>Fresh Products</b>	<b>Processed products</b>	<b>Inter-segment eliminations</b>	<b>Total</b>
	(All amounts are presented in thousands)			
<b>Nine months ended July 31, 2006</b>				
Net sales	\$ 177,035	\$ 31,916	\$ (11,921)	\$ 197,030
Cost of sales	162,527	24,137	(11,921)	174,743
Gross margin	\$ 14,508	\$ 7,779		\$ 22,287

	<b>Fresh Products</b>	<b>Processed products</b>	<b>Inter-segment eliminations</b>	<b>Total</b>
	(All amounts are presented in thousands)			
<b>Nine months ended July 31, 2005</b>				
Net sales	\$ 187,321	\$ 25,645	\$ (16,390)	\$ 196,576
Cost of sales	173,147	22,418	(16,390)	179,075
Gross margin	\$ 14,174	\$ 3,327		\$ 17,501

	<b>Fresh Products</b>	<b>Processed products</b>	<b>Inter-segment eliminations</b>	<b>Total</b>
	(All amounts are presented in thousands)			
<b>Three months ended July 31, 2006</b>				
Net sales	\$ 70,071	\$ 11,924	\$ (3,041)	\$ 78,954
Cost of sales	62,744	9,035	(3,041)	68,738

Gross margin	\$ 7,327	\$ 2,889		\$ 10,216
--------------	----------	----------	--	-----------

	<b>Fresh Products</b>	<b>Processed products</b>	<b>Inter-segment eliminations</b>	<b>Total</b>
--	---------------------------	-------------------------------	---------------------------------------	--------------

(All amounts are presented in thousands)

**Three months ended July 31, 2005**

Net sales	\$ 84,738	\$ 10,188	\$ (6,227)	\$ 88,699
Cost of sales	76,833	8,899	(6,227)	79,505
Gross margin	\$ 7,905	\$ 1,289		\$ 9,194



**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

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

	Nine months ended July 31, 2006			Nine months ended July 31, 2005		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	\$ 96,429	\$	\$ 96,429	\$ 84,775	\$	\$ 84,775
Imported avocados	39,919		39,919	56,072		56,072
Papayas	3,705		3,705	5,040		5,040
Specialties and Tropicals	7,315		7,315	11,580		11,580
Processed food service		24,923	24,923		20,527	20,527
Processed retail and club		7,840	7,840		4,856	4,856
Total fruit and product sales to third-parties	147,368	32,763	180,131	157,467	25,383	182,850
Freight and other charges	22,306	464	22,770	18,423	134	18,557
Total third-party sales	169,674	33,227	202,901	175,890	25,517	201,407
Less sales incentives	(49)	(5,822)	(5,871)	(83)	(4,748)	(4,831)
Total net sales to third-parties	169,625	27,405	197,030	175,807	20,769	196,576
Intercompany sales	7,410	4,511	11,921	11,514	4,876	16,390
Net sales before eliminations	\$ 177,035	\$ 31,916	208,951	\$ 187,321	\$ 25,645	212,966
Intercompany sales eliminations			(11,921)			(16,390)
Consolidated net sales			\$ 197,030			\$ 196,576

	Three months ended July 31, 2006			Three months ended July 31, 2005		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	\$ 51,722	\$	\$ 51,722	\$ 54,700	\$	\$ 54,700
Imported avocados	4,919		4,919	14,036		14,036
Papayas	1,114		1,114	1,617		1,617
Specialties and Tropicals	2,273		2,273	3,096		3,096
Processed food service		9,224	9,224		7,773	7,773
Processed retail and club		3,163	3,163		2,116	2,116
Total fruit and product sales to third-parties	60,028	12,387	72,415	73,449	9,889	83,338
Freight and other charges	8,633	178	8,811	6,887	116	7,003

Edgar Filing: CALAVO GROWERS INC - Form 10-Q

Total third-party sales	68,661	12,565	81,226	80,336	10,005	90,341
Less sales incentives	(9)	(2,263)	(2,272)	(42)	(1,600)	(1,642)
Total net sales to third-parties	68,652	10,302	78,954	80,294	8,405	88,699
Intercompany sales	1,419	1,622	3,041	4,444	1,783	6,227
Net sales before eliminations	\$ 70,071	\$ 11,924	81,995	\$ 84,738	\$ 10,188	94,926
Intercompany sales eliminations			(3,041)			(6,227)
Consolidated net sales			\$ 78,954			\$ 88,699

**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)****3. Inventories**

Inventories consist of the following (in thousands):

	<b>July 31, 2006</b>	<b>October 31, 2005</b>
Fresh fruit	\$ 5,298	\$ 3,525
Packing supplies and ingredients	2,406	2,015
Finished processed foods	3,039	4,556
	<b>\$ 10,743</b>	<b>\$ 10,096</b>

During the three and nine month periods ended July 31, 2006 and 2005, we were not required to, and did not, record any provisions to reduce our inventories to the lower of cost or market.

**4. Related party transactions**

We sell papayas obtained from an entity owned by our Chairman of the Board of Directors, Chief Executive Officer and President. Sales of papayas procured from the related entity amounted to approximately \$3,705,000, and \$5,040,000 for the nine months ended July 31, 2006 and 2005, resulting in gross margins of approximately \$311,000 and \$424,000. Sales of papayas procured from the related entity amounted to approximately \$1,114,000, and \$1,617,000 for the three months ended July 31, 2006 and 2005, resulting in gross margins of approximately \$108,000 and \$175,000. Included in accrued liabilities are approximately \$301,000 and \$79,000 at July 31, 2006 and October 31, 2005 due to this entity.

Certain members of our Board of Directors market avocados through Calavo pursuant to marketing agreements substantially similar to the marketing agreements that we enter into with other growers. During the nine months ended July 31, 2006 and 2005, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors was \$12.4 million and \$6.3 million. During the three months ended July 31, 2006 and 2005, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors was \$6.2 million and \$4.2 million.

**5. Other assets**

Included in other assets in the accompanying consolidated condensed financial statements are the following intangible assets: customer-related intangibles of \$590,000 (accumulated amortization of \$295,000 at July 31, 2006), brand name intangibles of \$275,000 and other identified intangibles totaling \$2,000 (accumulated amortization of \$2,000 at July 31, 2006). The customer-related intangibles are being amortized over five years. The other identified intangibles are fully amortized as of July 31, 2006. 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 \$29,000 for the remainder of fiscal 2006 and approximately \$118,000 per annum for fiscal 2007 through fiscal 2008, with the remaining amortization expense of approximately \$30,000 recorded in fiscal 2009.

**Table of Contents****CALAVO GROWERS, INC.****NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)****6. 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. We anticipate terminating this plan during the fourth quarter of fiscal 2006. Outstanding options would not be impacted by such termination.

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

In December 2003, our Board of Directors approved the issuance of options to acquire a total of 50,000 shares of our common stock to two members of our Board of Directors. Each option to acquire 25,000 shares vests in substantially equal installments over a three-year period, has an exercise price of \$7.00 per share, and has a term of five years from the grant date. The market price of our common stock at the grant date was \$10.01. In December 2005, the related stock option agreements were modified to shorten the option terms, as defined. Such modifications were contemplated primarily as a result of Section 409A of the tax code. During the three months ended July 31, 2006 and 2005, we recognized approximately \$13,000 of compensation expense with respect to these stock option awards. During the nine months ended July 31, 2006 and 2005, we recognized approximately \$38,000 of compensation expense with respect to these stock option awards.

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

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding at October 31, 2005	100	\$ 6.00	
Exercised	(50)	\$ 5.00	
Outstanding at July 31, 2006	50	\$ 7.00	\$ 147
Exercisable at July 31, 2006	34	\$ 7.00	\$ 100

The weighted average remaining life of such outstanding options is 2.39 years and the total intrinsic value of options exercised during the nine months ended July 31, 2006 was \$0.1 million. At July 31, 2006, the total unrecognized compensation cost related to such unvested stock options awards was approximately \$21,000, which is expected to be recognized over the remaining period of five months. The total fair value of shares vested during the nine months ended July 31, 2006 was approximately \$50,000.

**Table of Contents**

**CALAVO GROWERS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

***The Employee Stock Purchase Plan***

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

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

***The 2005 Stock Incentive Plan***

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

Incentive stock options that are intended to satisfy the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, and the regulations thereunder;

Non-qualified stock options that are not intended to be incentive stock options; and

Shares of common stock that are subject to specified restrictions

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

In August 2005, our Board of Directors approved the issuance of options to acquire a total of 400,000 shares of our common stock to various employees of the Company. As discussed in footnote 1, these options vested in August 2006. See footnote 1 for further explanation. These options have an exercise price of \$9.10 per share and a term of 5 years from the grant date. The market price of our common stock at the grant date was \$9.10. During the nine months ended July 31, 2006, 9,000 options have been forfeited, and the total intrinsic value of options outstanding was \$0.3 million.

**Table of Contents**

**CALAVO GROWERS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**7. Joint Venture in Maui Fresh International, LLC**

During the third quarter of fiscal 2006, we entered into a joint venture agreement with San Rafael Distributing (SRD) for the purpose of the wholesale marketing, sale and distribution of fresh produce from the existing location of SRD at the Los Angeles Wholesale Produce Market (Terminal Market), located in Los Angeles, California. Such joint venture operates under the name of Maui Fresh International, LLC (Maui Fresh) and commenced operations in August 2006. SRD and Calavo each have an equal one-half ownership interest in Maui Fresh, but SRD shall have overall management responsibility for the operations of Maui Fresh at the Terminal Market. Therefore, pursuant to APB 18 and EITF 03-16, we believe that our level of economic influence is that of significant. As such, we will use the equity method to account for our investment.

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

Contributions of SRD to Maui Fresh included the following: (1) to transfer all property owned by SRD and located on the Terminal Market premises to Maui Fresh, (2) transfer all existing customer accounts at the Terminal Market to Maui Fresh, (3) SRD has overall management responsibility for the operations of Maui Fresh at the Terminal Market, and (4) to provide certain staffing, as defined.

Commencing on the first anniversary of this agreement and continuing thereafter during the term of the agreement, Calavo shall have the unconditional right, but not the obligation, to purchase the one-half interest in Maui Fresh owned by SRD at a purchase price to be determined pursuant to the agreement. The term of the agreement is for five years, which may be extended, or terminated early, as defined.

**8. Other events**

*Dividend payment*

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

*Grower Development Program*

Pursuant to our Grower Development Program, whereby funds can be advanced to growers in exchange for their commitment to deliver a minimum volume of avocados on an annual basis, which generally extends over a multi-year period (i.e. 10 years), we advanced approximately \$1.2 million during the nine months of fiscal 2006. We expect to advance an additional \$2.0 million, via debt restructuring, in October 2006. Advances are not repaid and are amortized to cost of goods sold over the term of the related agreement. Amortization related to the advances described above are not expected to commence until October 2006.

*Contingencies*

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

**Table of Contents**

**CALAVO GROWERS, INC.**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

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

*Management Incentive Plan*

Pursuant to our 2006 Management Incentive Plan Program (the MIP Program ), we recorded approximately \$0.5 million of compensation expense during the nine months ended July 31, 2006. Amounts accrued pursuant to our MIP Program are not expected to be paid until fiscal 2007.

*Operating Lease*

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

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This information should be read in conjunction with the unaudited consolidated condensed financial statements and the notes thereto included in this Quarterly Report, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report on Form 10-K for the year ended October 31, 2005 of Calavo Growers, Inc. (we, Calavo, or the Company). Certain prior year amounts have been reclassified to conform with the current period presentation.

***Recent Developments***

*Dividend payment*

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

*Grower Development Program*

Pursuant to our Grower Development Program, whereby funds can be advanced to growers in exchange for their commitment to deliver a minimum volume of avocados on an annual basis, which generally extends over a multi-year period (i.e. 10 years), we advanced approximately \$1.2 million during the nine months of fiscal 2006. We expect to advance an additional \$2.0 million, via debt restructuring, in October 2006. Advances are not repaid and are amortized to cost of goods sold over the term of the related agreement. Amortization related to the advances described above are not expected to commence until October 2006.

*Contingencies*

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

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

*Management Incentive Plan*

Pursuant to our 2006 Management Incentive Plan Program (the MIP Program), we recorded approximately \$0.5 million of compensation expense during the nine months ended July 31, 2006. Amounts accrued pursuant to our MIP Program are not expected to be paid until fiscal 2007.

*Operating Lease*

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



**Table of Contents**

*Joint Venture in Maui Fresh International, LLC*

During the third quarter of fiscal 2006, we entered into a joint venture agreement with San Rafael Distributing (SRD) for the purpose of the wholesale marketing, sale and distribution of fresh produce from the existing location of SRD at the Los Angeles Wholesale Produce Market (Terminal Market), located in Los Angeles, California. Such joint venture operates under the name of Maui Fresh International, LLC (Maui Fresh) and commenced operations in August 2006. SRD and Calavo each have an equal one-half ownership interest in Maui Fresh, but SRD shall have overall management responsibility for the operations of Maui Fresh at the Terminal Market. Therefore, pursuant to APB 18 and EITF 03-16, we believe that our level of economic influence is that of significant. As such, we will use the equity method to account for our investment.

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

Contributions of SRD to Maui Fresh included the following: (1) to transfer all property owned by SRD and located on the Terminal Market premises to Maui Fresh, (2) transfer all existing customer accounts at the Terminal Market to Maui Fresh, (3) SRD has overall management responsibility for the operations of Maui Fresh at the Terminal Market, and (4) to provide certain staffing, as defined.

Commencing on the first anniversary of this agreement and continuing thereafter during the term of the agreement, Calavo shall have the unconditional right, but not the obligation, to purchase the one-half interest in Maui Fresh owned by SRD at a purchase price to be determined pursuant to the agreement. The term of the agreement is for five years, which may be extended, or terminated early, as defined.

**Table of Contents****Net Sales**

The following table summarizes our net sales by business segment for each of the three and nine month periods ended July 31, 2006 and 2005:

(in thousands)	Three months ended July 31,			Nine months ended July 31,		
	2006	Change	2005	2006	Change	2005
Net sales to third-parties:						
Fresh products	\$ 68,652	(14.5)%	\$ 80,294	\$ 169,625	(3.5)%	\$ 175,807
Processed products	10,302	22.6%	8,405	27,405	32.0%	20,769
Total net sales	\$ 78,954	(11.0)%	\$ 88,699	\$ 197,030	0.2%	\$ 196,576
As a percentage of net sales:						
Fresh products	87.0%		90.5%	86.1%		89.4%
Processed products	13.0%		9.5%	13.9%		10.6%
	100.0%		100.0%	100.0%		100.0%

Net sales for the third quarter of fiscal 2006, compared to fiscal 2005, decreased by \$9.7 million, or 11.0%; whereas net sales for the nine months ended July 31, 2006, compared to fiscal 2005, increased by \$0.5 million, or 0.2%. The decrease in fresh product sales during the third quarter of fiscal 2006 was primarily related to decreased sales in Mexican sourced avocados. The decrease in fresh product sales during the nine months ended July 31, 2006 was primarily driven by decreased sales related to Chilean, The Dominican Republic, and Mexican sourced avocados, partially offset by increased sales related to avocados sourced from California. While the procurement of fresh avocados related to our fresh products segment is very seasonal, our processed products business is generally not subject to a seasonal effect. For the related three and nine month period, the increase in net sales to third parties delivered by our processed products business was due primarily to an increase in total pounds of product sold.

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

**Fresh products**

Net sales delivered by the business decreased by approximately \$11.6 million, or 14.5%, for the third quarter of fiscal 2006, when compared to the same period for fiscal 2005. This decrease is primarily related to a decrease in sales of Mexican grown avocados in the U.S., Japanese, and/or European marketplace, as well as a decrease in papaya sales in the U.S marketplace. The volume of Mexican fruit sold decreased by approximately 9.2 million pounds, or 61.5%, when compared to the same prior year period. This decrease was primarily in the U.S. marketplace and was primarily related to the large California avocado crop discussed below. There was no significant difference in the average selling price, on a per carton basis, of Mexican avocados sold when compared to the same prior year period. The volume of papaya fruit sold decreased by approximately 0.8 million pounds, or 116.2%, when compared to the same prior year period. This decrease was primarily related to adverse weather conditions negatively affecting the current year's papaya crop. Such decrease, however, was partially offset by an increase in average selling prices of papayas, on a per carton basis, which increased approximately 40.2% when compared to the same prior year period. We attribute some of this increase in average selling prices to significantly fewer pounds sold in the U.S. marketplace.

The decreased sales related to Mexican sourced fruit discussed above for the third quarter of fiscal 2006, when compared to the same period for fiscal 2005, was partially offset by an increase in sales related to avocados sourced from California. California avocados sales reflect a reduction in average selling prices, partially offset by a 60.4% increase in pounds of avocados sold, when compared to the same prior year period. The increase in pounds is consistent with the expected increase in the overall harvest of the California avocado crop for the 2005/2006 season.

Our market share of California avocados remained fairly stable at 34.4% in the third quarter of fiscal 2006, when compared to a 35.2% market share for the same prior year period. Average selling prices, on a per carton basis, for

20

---

**Table of Contents**

California avocados for the third quarter of fiscal 2006 were 42.1% lower when compared to the same prior year period. We attribute some of this decrease in average selling prices to significantly more pounds sold in the U.S. marketplace, as well as a 6.1% increase in the sale of grade two Hass avocados when compared to the same prior year period. Grade two Hass avocados generally sell for significantly less than grade one Hass avocados.

Net sales decreased by approximately \$6.2 million, or 3.5%, for the nine months ended July 31, 2006, when compared to the same period for fiscal 2005. This decrease is primarily related to a decrease in sales of Mexican and Chilean grown avocados in the U.S., Japanese, and/or European marketplace. The volume of Mexican fruit sold decreased by approximately 7.5 million pounds, or 14.4%, when compared to the same prior year period. This decrease was primarily in the U.S. marketplace and was primarily related to the large California avocado crop discussed below. The volume of Chilean fruit sold decreased by approximately 10.4 million pounds, or 59.9%, when compared to the same prior year period. This decrease is primarily related to the size of the Chilean avocado crop, as well as the timing of the delivery to the United States. There was no significant difference in the average selling price, on a per carton basis, of Mexican avocados sold when compared to the same prior year period.

The decreased sales related to non-California sourced fruit discussed above for the nine months ended July 31, 2006, when compared to the same period for fiscal 2005, was partially offset by an increase in sales related to avocados sourced from California. California avocados sales reflect a 53.9% increase in pounds of avocados sold, partially offset by lower average selling prices, when compared to the same prior year period. The increase in pounds is consistent with the expected increase in the overall harvest of the California avocado crop for the 2005/2006 season. Our market share of California avocados increased to 34.4% for the first nine months of fiscal 2006, when compared to a 33.0% market share for the same prior year period. Average selling prices, on a per carton basis, for California avocados for the first nine months of fiscal 2006 were 26.8% lower when compared to the same prior year period. We attribute some of this decrease in average selling prices to significantly more pounds sold in the U.S. marketplace, as well as a 7.5% increase in the sale of grade two Hass avocados when compared to the same prior year period.

We anticipate that California avocado sales will experience a seasonal decrease during the fourth fiscal quarter of 2006, as compared to the third fiscal quarter of 2006. We anticipate that net sales related to non-California sourced fruit will gradually increase during the fourth fiscal quarter of 2006, as compared to the third fiscal quarter of 2006. This is consistent with the cyclical nature of the availability of foreign sourced avocados in the U.S. marketplace, as well as the seasonal nature of the California avocado crop.

*Processed products*

For the quarter ended July 31, 2006, when compared to the same period for fiscal 2005, sales to third-party customers increased by approximately \$1.9 million, or 22.6%. This increase is primarily related to a 25.6% increase in total pounds sold. Our average net selling prices remained fairly consistent during the second quarter ended July 31, 2006 when compared to the same prior year period.

For the first nine months of fiscal 2006, when compared to the same period for fiscal 2005, sales to third-party customers increased by approximately \$6.6 million, or 32.0%. This increase is primarily related to a 33.8% increase in total pounds sold, as our ultra high pressure products have experienced widespread acceptance in both the retail and foodservice sectors. Our average net selling prices remained fairly consistent during the first nine months ended July 31, 2006 when compared to the same prior year period.

Our ultra high pressure products continue to experience solid demand. During the third quarter ended July 31, 2006, sales of high pressure product totaled approximately \$4.1 million, as compared to \$2.6 million for the same prior year period. We believe that the introduction of these fresh guacamole products will, in the long-term, successfully address a growing market segment.

**Table of Contents****Gross Margins**

The following table summarizes our gross margins and gross profit percentages by business segment for each of the three and nine month periods ended July 31, 2006 and 2005:

(in thousands)	Three months ended July 31,			Nine months ended July 31,		
	2006	Change	2005	2006	Change	2005
Gross margins:						
Fresh products	\$ 7,327	(7.3)%	\$ 7,905	\$ 14,508	2.4%	\$ 14,174
Processed products	2,889	124.1%	1,289	7,779	133.8%	3,327
Total gross margins	\$ 10,216	11.1%	\$ 9,194	\$ 22,287	27.3%	\$ 17,501
Gross profit percentages:						
Fresh products	10.7%		9.8%	8.6%		8.1%
Processed products	28.0%		15.3%	28.4%		16.0%
Consolidated	12.9%		10.4%	11.3%		8.9%

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. Gross margins increased by approximately \$1.0 million, or 11.1%, and \$4.8 million, or 27.3%, for the third quarter and first nine months of fiscal 2006 when compared to the same periods for fiscal 2005. These increases were primarily attributable to improvements in both our fresh products and/or our processed products segments.

For the third quarter and first nine months of fiscal 2006, as compared to the same prior year period, gross margin percentage, related to our fresh products segment, increased. Such increases were primarily driven by a significant increase in pounds of California fruit sold. For the third quarter and first nine months of fiscal 2006, we experienced a 60.4% and 53.9% increase in fruit sold. This had the effect of decreasing our per pound production costs, which, as a result, positively impacted gross margins. The resulting higher gross margins for California avocados were partially offset, however, by decreases in Mexican and Chilean sourced fruit and the lower gross margins resulting therefrom. For the first nine months of fiscal 2006, the volume of Chilean fruit decreased 59.9%, and the volume of Mexican fruit decreased 61.5% and 14.4% for the third quarter and nine months of 2006 when compared to the same prior year period. Additionally, we also experienced an increase in Mexican fruit costs. Collectively, these items contributed to a higher per pound cost, which negatively affected gross margins.

The processed products gross profit percentages for the third quarter and first nine months of fiscal 2006, increased primarily as a result of lower fruit costs and increases in total pounds produced, which had the effect of reducing our per pound costs. We anticipate that the gross profit percentage for our processed product segment will continue to experience significant fluctuations during the next fiscal quarter primarily due to the uncertainty of the cost of fruit that will be used in the production process.

**Table of Contents*****Selling, General and Administrative***

(in thousands)	Three months ended July 31,			Nine months ended July 31,		
	2006	Change	2005	2006	Change	2005
Selling, general and administrative	\$5,284	9.5%	\$4,825	\$14,791	8.4%	\$13,645
Percentage of net sales	6.7%		5.4%	7.5%		6.9%

Selling, general and administrative expenses include costs of marketing and advertising, sales expenses and other general and administrative costs. Selling, general and administrative expenses increased \$0.5 million, or 9.5%, for the three months ended July 31, 2006, when compared to the same period for fiscal 2005. This increase was primarily related to higher corporate costs, including, but not limited to, an increase in employee compensation expenses (totaling approximately \$0.3 million) and an increase in stock based compensation (totaling approximately \$0.3 million). For the first nine months ended July 31, 2006, when compared to the same prior year period, selling, general and administrative expenses increased by \$1.1 million, or 8.4%. This increase was primarily related to higher corporate costs, including, but not limited to, an increase in employee compensation expenses (totaling approximately \$0.6 million) and an increase in stock based compensation (totaling approximately \$0.5 million).

***Other Income (expense), net***

(in thousands)	Three months ended July 31,			Nine months ended July 31,		
	2006	Change	2005	2006	Change	2005
Other income (expense), net	\$(136)	(188.9)%	\$153	\$(201)	(109.4)%	\$2,144
Percentage of net sales	(0.2)%		0.2%	(0.1)%		1.1%

Other income (expense), net, includes interest income and expense generated in connection with our financing and operating activities, as well as certain other transactions that are outside of the course of normal operations. For the three and nine months ended July 31, 2006, other income (expense), net includes dividends from Limoneira totaling \$0.2 million and \$0.1 million. For the nine months ended July 31, 2005, other income (expense), net, includes the gain on the sale of our corporate facility totaling approximately \$1.7 million.

***Provision for Income Taxes***

(in thousands)	Three months ended July 31,			Nine months ended July 31,		
	2006	Change	2005	2006	Change	2005
Provision for income taxes	\$1,870	16.7%	\$1,603	\$2,845	31.7%	\$2,161
Percentage of income before provision for income taxes	39.0%		35.4%	39.0%		36.0%

For the first nine months of fiscal 2006, our provision for income taxes was \$2.8 million, as compared to \$2.2 million recorded for the comparable prior year period. We expect our effective tax rate to approximate 39% during fiscal 2006. Such increase from the prior year is primarily related to changes in our foreign tax rate.

**Table of Contents**

**Liquidity and Capital Resources**

Cash provided by operating activities was \$8.0 million for the nine months ended July 31, 2006, compared to \$4.0 million for the similar period in fiscal 2005. Operating cash flows for the nine months ended July 31, 2006 reflect our net income of \$4.5 million, net non-cash charges (depreciation and amortization, stock compensation expense and provision for losses on accounts receivable) of \$2.1 million and a net increase in the noncash components of our working capital of approximately \$1.4 million.

These working capital increases include an increase in payable to growers of \$10.8 million, a decrease in advances to suppliers of \$1.0 million, a decrease in income tax receivable of \$1.0 million, an increase in income tax payable of \$0.8 million, and an increase in trade accounts payable and accrued expenses of \$0.4 million, partially offset by an increase in accounts receivable of \$11.5 million, an increase in inventory of \$0.7 million, and an increase in prepaid expenses and other current assets of \$0.4 million.

The increase in our accounts receivable balance, as of July 31, 2006, when compared to October 31, 2005, primarily reflects higher sales recorded in the month of July 2006, as compared to October 2005. The increase in payable to our growers primarily reflects an increase in fruit delivered in the month of July 2006, as compared to October 2005. Similar to the increase in payable to growers, the increase in inventory is also primarily related to an increase in fruit delivered in the month of July 2006, as compared to October 2005, but was partially offset by a decrease in finished processed foods, primarily driven by sales exceeding production during such time period. The decrease in income tax receivable and the increase in income tax payable primarily relates to income from operations through the nine months ended July 31, 2006. The decrease in advances to suppliers is primarily related to less outstanding advances to foreign avocado suppliers as of July 31, 2006, as compared to October 31, 2005.

Cash used in investing activities was \$2.7 million for the nine months ended July 31, 2006 and related principally to the purchase of property, plant and equipment items.

Cash used in financing activities was \$6.3 million for the nine months ended July 31, 2006, which related principally to the payment of a \$4.6 million dividend, our first payment, totaling \$1.3 million, related to our term loan agreement for the purchase of the Limoneira stock, and the retirement of common stock of \$1.2 million. Such payments were partially offset, however, by \$0.3 million of net borrowings from our lines of credit.

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 July 31, 2006 and October 31, 2005 totaled \$0.1 million and \$1.1 million. Our working capital at July 31, 2006 was \$17.9 million, compared to \$17.6 million at October 31, 2005. Overall working capital remained consistent from October 31, 2005.

We continue to have success with our ProRipeVIP avocado ripening program. This proprietary program allows us to deliver avocados with desired degrees of ripeness to our customers. In conjunction with such program, we intend to not only invest in additional Aweta AFS (acoustic firmness sensor) technology and equipment, but also expand our refrigeration and storage capabilities. Total estimated capital required related to our current expansion plans totals approximately \$2.8 million. We are currently negotiating long-term financing for substantially all of the capital required. No assurances can be provided, however, that such financing will be available at favorable terms, if any at all.

We believe that cash flows from operations, available credit facilities, and expected long-term 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. We have two short-term, non-collateralized, revolving credit facilities. These credit facilities expire in February 2007 and April 2008 and are with separate banks. Under the terms of these agreements, we are advanced funds for working capital purposes. Total credit available under the combined short-term borrowing agreements was \$24 million, with a

**Table of Contents**

weighted-average interest rate of 6.3% and 4.8% at July 31, 2006 and October 31, 2005. Under these credit facilities, we had \$1.8 million and \$1.4 million outstanding as of July 31, 2006 and October 31, 2005. The credit facilities contain various financial covenants with which we were in compliance at July 31, 2006. The most significant financial covenants relate to working capital, tangible net worth (as defined), and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) (as defined) requirements.

The following table summarizes contractual obligations pursuant to which we are required to make cash payments (in thousands):

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments due by period</b>			
		<b>Less than 1 year</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>More than 5 years</b>
Long-term debt obligations (including interest)	\$ 12,403	\$ 9	\$ 4,149	\$ 2,748	\$ 5,497
Payable to growers	12,540	12,540			
Short-term borrowings	1,753	1,753			
Defined benefit plan	469	14	165	110	180
Operating lease commitments	2,910	272	1,550	414	674
<b>Total</b>	<b>\$ 30,075</b>	<b>\$ 14,588</b>	<b>\$ 5,864</b>	<b>\$ 3,272</b>	<b>\$ 6,351</b>

**Impact of Recently Issued Accounting Pronouncements**

See footnote 1 to the consolidated condensed financial statements that are included in this Quarterly Report on Form 10-Q.



**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our financial instruments include cash and cash equivalents, accounts receivable, notes receivable from shareholders, payable to growers, accounts payable, current borrowings pursuant to our credit facilities with financial institutions, and long-term, fixed-rate obligations. All of our financial instruments are entered into during the normal course of operations and have not been acquired for trading purposes. The table below summarizes interest rate sensitive financial instruments and presents principal cash flows in U.S. dollars, which is our reporting currency, and weighted-average interest rates by expected maturity dates, as of July 31, 2006.

(All amounts in thousands)	Expected maturity date July 31,						Total	Fair Value
	2006	2007	2008	2009	2010	Thereafter		
<b>Assets</b>								
Cash and cash equivalents (1)	\$ 107	\$	\$	\$	\$	\$	\$ 107	\$ 107
Accounts receivable (1)	30,749						30,749	30,749
Notes receivable from shareholders (2)		2,430					2,430	2,430
<b>Liabilities</b>								
Payable to growers (1)	\$12,540	\$	\$	\$	\$	\$	\$12,540	\$12,540
Accounts payable (1)	3,203						3,203	3,203
Current borrowings pursuant to credit facilities (1)	1,753						1,753	1,753
Fixed-rate long-term obligations (3)	9	1,309	1,302	1,300	1,300	6,500	11,720	10,665

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

(2) Notes receivable from shareholders bear interest at 7.0%. We believe that a portfolio of loans with a

similar risk profile would currently yield a return of 10.50%. We project the impact of an increase or decrease in interest rates of 100 basis points would result in a change of fair value of approximately \$40,000.

- (3) Fixed-rate long-term obligations bear interest rates ranging from 3.3% to 8.2% with a weighted-average interest rate of 5.7%. We believe that loans with a similar risk profile would currently yield a return of 7.7%. We project the impact of an increase or decrease in interest rates of 100 basis points would result in a change of fair value of approximately \$481,000.

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

Our Mexican-based operations transact business in Mexican pesos. Funds are transferred by our corporate office to Mexico on a weekly basis to satisfy domestic cash needs. Consequently, the spot rate for the Mexican peso has a moderate impact on our operating results. However, we do not believe that this impact is sufficient to warrant the use of derivative instruments to hedge the fluctuation in the Mexican peso. Total foreign currency gains and losses for each of the three years in the period ended October 31, 2005 do not exceed \$0.1 million.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

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

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

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are involved in litigation in the ordinary course of business, none of which we believe will have a material adverse impact on our financial position or results from operations.

28

---

**Table of Contents**

**ITEM 6. EXHIBITS**

- 10.17 Form of Stock Option Agreement.
  
- 31.1 Certification of Chief Executive Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  
- 31.2 Certification of Principal Financial Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  
- 32 Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Calavo Growers, Inc.  
(Registrant)

Date: September 8, 2006

By /s/ Lecil E. Cole

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

Date: September 8, 2006

By /s/ Arthur J. Bruno

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

**Table of Contents**

INDEX TO EXHIBITS

Exhibit Number	Description
10.17	Form of Stock Option Agreement.
31.1	Certification of Chief Executive Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.