

## 62nd Annual Membership Meeting Special Edition

The Board of Directors and staff would like to acknowledge and thank the members and guests who attended our 62nd Annual Membership Meeting last Tuesday in Sacramento. We apologize for scheduling our Annual Meeting during Thanksgiving week; however, the DoubleTree Hotel booked a three-day convention on our date, which required us to move our meeting to the week of Thanksgiving. We may have a similar scheduling conflict next year and are evaluating our alternatives.

### President's Report

#### 2005 Crop Marketing Year

To fully appreciate the dynamics of the 2005 crop-marketing year, we first need to review and understand the situation as we began marketing your 2005 crop rice. With the 2003 crop, we had a supply situation that led to highly elevated milled rice prices. With the record 2004 crop, we had a complete reversal and a supply situation that led to very low milled rice prices. That low price platform was where California started the 2005 crop-marketing year.

Recognizing the prospect of a more reasonable supply situation in California, FRC initiated an aggressive campaign to raise prices for the 2005 crop in all markets where we participate. As we have discussed on numerous occasions, we sell in three basic market sectors, consumer products, food processor and export. This is our "mutual fund" concept of marketing your crop.

At the beginning of the 2005 crop-marketing year, prices in the consumer products market segment were at rock bottom as a result of the 2004 crop market supply imbalance. FRC initiated a series of monthly price increases beginning in August 2005 even before the crop was harvested and by January 2006 had raised prices in this sector by about \$3/cwt paddy basis. Pricing in the consumer products segment occurs throughout the year, which is different than other market segments. Milled rice prices in this sector remained reasonably stable from February forward, which sets the stage nicely for what we think will be a very profitable market segment for the 2006 crop marketing year. Approximately 45% of our total sales are in domestic consumer products.

As we move forward, our marketing staff is focused on opportunities in the growing popularity of Asian food. Our target is for continued growth in this market sector with emphasis on special varieties and value added processes. Both should fit our model well give our membership's interest in special varieties and our proven track record on special processes in our milling operations.

As I reported at last year's Annual Meeting, the food processor market sector at the beginning of the 2005 marketing year was in a "state of flux". Due to price disparity, processors of beer, cereal and snack foods were considering shifting additional raw product volume from medium grain to other commodities or long grain. Ultimately, we did sell a limited volume of our rice at prices comparable to our average export price for the year.

It is interesting to note that total use of rice as an ingredient is growing nationally. We are presently working with several smaller food processing companies who are developing new uses for short and medium grain rice.

We continue to focus on this market as a means of providing stable income to our members by improving our value to buyers through downstream processing and special varieties.

Prices in the export market have historically changed very rapidly, both up and down. The 2005 crop was no exception.

Export prices for California's WTO mandated markets in North Asia were soft at the beginning the 2005 crop marketing year. A number of factors contributed to that situation including available milling time and the Japanese allowing "old crop" to be sold on the September 2005 tenders at a time when there was a material quantity of old crop rice remaining in the California inventory. FRC strategically took an extremely firm position pricing the initial tenders, but other firm's lower offers prevailed. As additional tenders became larger and more frequent, milling time became tighter opening the window for us to raise our bid prices in October and November in line with our original target and were successful on several cargoes.

Tender prices in late November began to decline steadily through the end of the export season as select exporters advantaged themselves at the expense of others. Most observers never considered a troublesome carryout to be a factor for California, and the 2005 crop did in fact clear with very little old crop inventory at the end of the marketing year. FRC sold several cargoes, November forward, during this declining price period.

California exports to the Middle East declined as buyers had significant stocks remaining from the record 2004 California crop. FRC maintained shipments of milled rice to key customers in the Middle East and Oceania at prices comparable to the consumer products market. We are pleased with our progress at developing value added brands and relationships in these markets and continue to believe they will give us a better return over the long haul than the competitively bid export market.

Our 2005 crop return is an accurate reflection of last year's marketing effort and at the high end of our forecast. Nobody at FRC is satisfied with the return being high enough given the escalating cost of producing rice and competitive options.

## 2006 Outlook

We believe the prospects for the 2006 crop, a marketing year with some similar, yet distinctively different dynamics will be positive for FRC members.

The total supply of rice in California is in balance with what we see as firm demand for medium and short grain rice. There is a very firm domestic market contrasted by an export market still searching for direction.

Most observers project the California crop at approximately 40 million cwts; 525,000 acres at an average yield of 76 cwts per acre. When combined with the carry-in, California has about the same total supply as last year. The medium grain crop in the Southern U.S. is approximately the same as last year with a smaller carry-in and the Australian crop is again impacted by drought and is officially projected to be 40% of normal, at best. The Egyptian crop is viewed as normal; the Chinese have been mostly absent from the market in medium and short grain with the exception of exports to North Asia, Australia and Puerto Rico.

We have a reasonably tight supply both domestically and internationally for medium grain rice, which is selling for a \$100-200 per ton premium to long grain internationally.

In the consumer products market, demand has been very consistent and prices are starting the year at elevated levels, particularly when compared to last year. FRC initiated price increases with new crop shipments, with most of our competitors following suit. This is an extremely positive factor for FRC.

The food processor business is returning to a more normal status; reasonable pricing on full year contracts with reliable, quality suppliers. At FRC, we have booked significant sales to our core food processor customers at prices we believe will produce excellent returns. Our customer group recognizes the value of relationships with a high quality, reliable supplier like FRC.

The export segment of the market is off to a slow start and has yet to find any definitive direction. To date there have been eight cargoes sold to Japan, two of which were old crop. Only one export sale has been consummated with Korea, none with Taiwan, largely due to continuing issues on GMO testing and exporters financial responsibility. While we view Taiwan's and Korea's tactics to be at least partially politically motivated, we expect the situation to be resolved. Each delay creates uncertainty in this market sector. The practice of these government buyers to establish artificial "ceiling prices" with each tender and available industry milling time will likely have a significant influence on the profitability of this market sector moving forward.

FRC has sold two cargoes to Japan. Considering the competition in this market sector, we are pleased to have done this business. Incidentally, these two cargoes will be packed with our new automated export bagging system, which was installed this fall. This new line improves our cost efficiencies on our export business by about 20 cents/cwt.

We expect our commercial exports to the Middle East and Oceania to continue on a similar pace to last year. This business is sold in our Diamond G bag as well as exclusively supplied private label brands. Prices in this market typically parallel our consumer product prices, which as I stated earlier, are starting the marketing year at lofty levels compared to last year.

We have a long way to go in this marketing year, but we believe we are off to a very strong start. Consumer product prices are starting the year at very respectable levels, the food processor business is booked at very strong prices, our commercial exports are on schedule and we have sold our first Minimum Access cargoes to Japan.

We have increased our 2006 crop member advances to \$3.50 over price support loan, almost \$10/cwt on this year's very high quality medium grain, and we fully expect another progress payment in January.

## Enhancing Member Value

As reported at the Annual Meeting there are two basic ways FRC can enhance member value, i.e., competitive returns and innovative membership programs.

This management team and Board of Directors is strongly focused maximizing your return. On the cost side, we have made good strides in improving our operating efficiencies and managing our fixed costs. We are committed to looking for additional cost effective opportunities.

On the revenue side of our business, FRC's marketing staff is rarely the low price seller. We do have a mutual fund approach to our marketing strategy. We believe this approach gives us the best opportunity to provide you with a higher return over the long haul. We flex this strategy on the margins annually to take advantage of the opportunities, realizing that in any given year, we will have some under performing components, some average performing components and some above average components. This market allocation, much like investment advisors talk about asset allocation, lowers your risk to fluctuations in a particular market sector. We believe this continues to be the right approach for FRC in the long run, but see value in further refinement.

I can assure you we have got the message. With your higher costs, you need higher returns. The ball is in our court to make the appropriate modifications in our operation of your company to produce acceptable results. We are committed to working with the Board on developing the potentialities.

Under the direction of your Chairman and the hard work of Director Rick Nelson and the Membership Committee, we spent considerable time this past year investigating opportunities to enhance member programs. Many of you participated in that process providing input at our pocket meetings last winter. Our primary goal was to develop a package of programs which had potential benefits to each and every member.

- For new members, we established an equity relief program allowing for a smaller initial investment.
- For all members, we modified our past practice, paid a dividend on all member equity and increased the dividend rate to 3.5%.
- For all members, we increased our marketing of special varieties, which gives FRC and its' members the opportunity to earn incremental income.
- For all members, we established the Early Season Advance Program, which paid a \$100 per acre advance after planting. Approximately 60% of our members took advantage of this new program. This program should be even more beneficial for the 2007 crop when your initial FSA Direct Payment advance will be reduced to 20%, half of what it was last year.

- We initiated an improvement in information flow with our Member Information Program. This program allowed small groups of members from throughout the Cooperative to interact with staff and learn more about FRC. Members received an in depth look at how and where their rice is marketed. At the mill, members saw first hand how capital improvements increased our efficiencies.
- For our dryer customers, we maintained our dry rates, modified our freight rebate for some, and expanded our receiving hours. Our view was that through enhanced services we could increase our drying volume, and we did.
- For all members, we are pleased to have a new program you won't find elsewhere, the Domestic Production Activities Deduction. As owners of this company, you will receive benefits directly from this new federal tax law. The benefit to you, subject to final determination by our tax advisor, is approximately a 25-cent per cwt deduction on your federal income taxes. The deduction is scheduled to double in the next three years. We will be sending additional information to you in early December.

Our Membership Committee is continuing to meet to work on further enhancements to our programs. They will meet again in early December and we will solicit your input at our pocket meetings in January. The goal is well defined; develop programs which enhance your membership value in FRC.

We obviously have a lot going on at FRC and we have a lot more work to do. Our goal remains to maximize your return on a sustainable basis.

In closing, I want to thank our members for your continued support and confidence. To our employees, thank you for your many contributions to FRC's success. To our Board of Directors, thank you for your hard work on behalf of the members and staff of FRC.

We would also like to thank Ed Meyer and Chuck Adams, two retiring Board Members from Butte County. Both men have served the Cooperative well. We welcome two new directors to the Board, Drew Rudd and Ralph Wilkerson, both of Gridley. We look forward to their input, guidance and wisdom.

As always, please do not hesitate to call if you have any questions or comments.

Sincerely,



Michael Sandrock  
President & CEO