

# FRC Monitor

## 60th Annual Membership Meeting Special Edition



*FRC celebrated its 60th Anniversary this year. Joining us for the observance was long-time President and Chief Executive Officer Ralph Newman who spoke at the member's luncheon after the business meeting.*

### President's Report

It was a pleasure to see so many FRC members and guests at our 60<sup>th</sup> Anniversary Annual Meeting. Nearly 600 people attended, the largest turnout of members and guests in recent years, helping us observe such an important milestone in the history of this Cooperative. FRC can be proud of its achievements. We hope that all of you who attended the meeting enjoyed our program.

We are pleased to send this 60<sup>th</sup> Anniversary newsletter summarizing my remarks together with some photos taken at the meeting of members and guests.

### Important Recognitions

To our members, thank you once again for your continued confidence and support. The special relationship that has developed between the Cooperative and our membership truly differentiates FRC from the pack of other marketing firms in California. We take our responsibilities to you very seriously and sincerely appreciate your continued support.

To our staff, thank you for your many contributions. Chairman Holzapfel and I have frequently commented about the professional quality of our staff and their passion for FRC.

This year I would like to comment on a group of employees who are due special recognition, our field staff and our drier managers, Rob Paschoal and the field reps (Randy, Kurt, Brice, John), Joe Alves at the Stegeman Drier and Bill Gill at the West Sacramento Drier, did an exemplary job of not only taking care of our historic drier customers, but making sure that every one of our members had a home for their 2004 crop. This dedication to the Cooperative is prevalent throughout all our employees.

To our Board of Directors, thank you for your hard work and diligence on behalf of the members and employees of FRC. Our Board has a very interactive role with Senior Management in setting the direction for this Cooperative. You expect your Board to be well informed and interactive. We appreciate that expectation and are committed to making your Board the best-informed, most involved group, in the U.S. rice industry.

I would also like to personally thank Ralph Newman for being with us on our 60<sup>th</sup> Anniversary. Ralph hired most of the Senior Staff, and we all are indebted to his many contributions to FRC.

On a personal note, Larry Randle, our Director of Manufacturing, retired October 1<sup>st</sup>, after 32 years of service. We wish Larry the best in retirement.

### 2003 Operating Results

Today I will report to you on the following areas:

The results of the 2003 crop.  
The prospects for the 2004 crop.  
Opportunities for California rice.

You received your Annual Report the week before this meeting. The report summarizes the results from the 2003 crop marketing year. You have also received frequent updates from us. If you have any questions, please give me a call.

### Challenges

The 2003 crop presented the Cooperative with a new set of challenges.



*Some of the “movie” stars in our 60th Anniversary video presentation were Chester and Maria Spooner, long-time FRC members from Williams. Mr. Spooner talked about the early days of rice production compared to today.*

Our members were challenged by unprecedented late rains which delayed ground preparation and planting. Fortunately, a warm 2003 summer followed, leading to slightly reduced yields on fewer than normal acres, but exceptional milling quality.

Our staff was challenged in two ways; manage our costs under a reduced volume scenario and maximize the income potential of our members rice, given a very dynamic and volatile marketplace.

Our operations staff continued their focus on cost effectiveness. FRC’s high standards of quality and service could not be compromised. Our marketing staff worked more intimately than ever with our customers to insure fair values in this tumultuous market.

### ***2003 Results***

FRC’s marketing of your 2003 crop began well before you planted your first seed. It was very apparent by mid-winter that Australia would have a drastically reduced rice harvest. When it was evident California would have less than a normal crop, Australia’s cutback became an international supply event. In April of 2003, FRC led the industry by raising package rice prices with seven subsequent increases over the following 12 months. By August of 2003, we started contracting with food processors at appreciably higher prices, almost double, the previous year.

Fall exports to the WTO mandated markets of Japan, Korea and Taiwan began on time, but pricing was more competitive and subsequently never reached the domestic market levels. By January 2004, it became apparent that the California crop was somewhat larger than earlier forecasted and some fundamental demand,

particularly to the breweries and the Middle East, was well below traditional levels.

Severe price cutting reduced export prices over \$200 per metric ton from February to the market bottom, the June Taiwan tender. While export prices recovered some during the summer, the remaining export sales were just slightly above price support loan levels.

Two-thirds of FRC’s 2003 crop was sold in the domestic market. Our consumer products area grew by 3% and achieved record prices during the year. While our sales volume to food processors declined some due to significantly lower U.S. long grain prices, returns obtained in this category were comparable to consumer products.

We can all be proud of some very positive FRC achievements from the past year.

- The highest grower returns in over 20 years.
- FRC concluded an exclusive supply agreement with our largest customer, Japan Foods Corporation. This insures FRC members will be growing premium medium grain rice well into the foreseeable future.
- We completed the latest stage of automation in our domestic packaging plant with the installation of an automatic case packer and two robotic palletizers.
- We concluded our hull contract with Wadham Energy and recontracted the 40,000 tons of hulls at substantially better values. Other strategic changes in our by-product area will accrue substantially higher benefits.
- We sold 100% of our export sales direct, including the Tiger Brand, which is the leading Calrose brand in Jordan.
- In our field services area, we invested additional capital in seed and drying enhancements at Stegeman and made advances in our varietal development program with the introduction of two new varieties for seed propagation and market testing.

FRC’s marketing strategy and continued focus on cost effectiveness yielded the highest returns in more than 20 years. We are pleased with these returns and believe, once again, have set the standard in the industry.

### ***2004 Crop – New Challenges***

Let’s talk about the prospects for the 2004 crop and a whole new set of challenges.



*Mrs. Evelyn Cooling, wife of founding member John Cooling, has never missed an FRC Annual Meeting. Mrs. Cooling joined in our 60th Anniversary observance with nice comments about the Cooperative and its founding members.*

Last year at this meeting when we addressed the prospects for the 2003 crop, we referenced some basic Supply and Demand economics. A very tight supply situation, both internationally and in the U.S., complimented by reasonable demand would generate greatly elevated grower returns.

This year we are challenged by some similarities to last year and some distinct differences.

On the international supply side, we see the following factors:

- International rice stocks (all types) are projected to be at the lowest levels in 20 years.
- The Australia crop harvested last spring recovered some from the previous year, but is still projected at a dismal 535,000 MT paddy. As you may recall, the Aussies had averaged well over 1.0 million MT paddy previous to their devastating 2003 crop drought. All indications are the 2005 crop to be harvested next spring will also be well below normal given the continuation of drought conditions in Australia.
- The Chinese, who grow Japonica type rice in Northern China, have withdrawn from the export market due to very tight local supplies. Last year, the Chinese sold over 400,000 MT of Japonica type rice in direct competition with California. While I am not predicting the Chinese are out of the export market permanently, all indications are the Chinese have a pressing need to rebuild internal stocks of all grains.
- The Egyptian crop, another international medium grain competitor, is about average. The Egyptians

have become big competitors of California, particularly in the Middle East and Taiwan, where they dominated private imports last year.

- The Turkish crop is below average.
- The European Union has significantly reduced their export subsidies affecting Japonica production in Italy, which has historically competed with U.S. exports in the Mediterranean.
- While the Southern U.S. long grain crop is record setting, the Southern medium grain production was slightly down from the previous year and considering domestic and Puerto Rican demand, is considered manageable.

That's all good news!

### ***2004 Crop Supply***

In California, with near perfect conditions at planting and a very temperate summer, we have a record crop! Most industry analysts peg the acreage at approximately 600,000 acres and the yield at 88 cwts/acre.

That's almost 53 million cwts of production. That's a huge crop!

### ***2004 Crop Demand***

California historically markets approximately 22 – 24 million cwts paddy basis domestically. Last year sales declined when the breweries and several food processors shifted to much cheaper Southern Long grain. With more competitively priced Calrose this year, domestic demand should return to more historic levels.

On the export side, California historically markets approximately 18 – 20 million cwts paddy basis annually. That consists of a combination of sales to the WTO mandated markets of Japan, Taiwan, and Korea as well as business to the Middle East and Europe. As many of you may recall, sales to Turkey last year were virtually nil as Turkey imposed a ban on imported rice for most of the marketing year. Given that the ban has been partially lifted and Turkey's reduced domestic production, California sales this year to Turkey are probable.

Fortunately, California is also supplying some export markets previously supplied by Australia. California will likely ship in excess of 50,000 MT of milled rice to Jordan this year. Sales to Lebanon, Israel, Syria, and other Mediterranean destinations are also emerging. New markets in the South Pacific, also formerly supplied by the Australians, are also evolving. With more competitive pricing, private sales to Taiwan are being recaptured after a year's hiatus.



Many guests attended our 60th Annual Meeting including Ellie Fairclough, Yolo County field representative for Congressman Mike Thompson, a longtime friend of FRC. FRC's Kirk Messick, VP-Marketing talks with Ms. Fairclough after the business session.

Given our core export business to North Asia and these new export opportunities I just described, California should export approximately 20 million cwts paddy basis this year.

So what's this all add up to? Here's how the math works:

**Supply:**

October 1, carry in	5 mil cwts
2004 California crop	53 mil cwts
Total supply	58 mil cwts

**Demand:**

Domestic	23 mil cwts
Export	20 mil cwts
Total Demand	43 mil cwts

October 1, 2005, potential carry out 15 mil cwts

That's a formidable California carryout projection. To put it into perspective, it is the equivalent to 1/3 of our average total demand. To put it another way, it's equal to California's annual sales to Japan, Korea and Taiwan.

**Likely Scenario**

To move the crop, market prices, particularly in the export market, will be a bargain all year. With bargain prices, new demand typically develops. With new demand, we move more of the crop than anyone can forecast today, and therefore end up with a lower carryout. We are also likely to have a reduction in plantings next year, given the price prospects and the potential for water sales.

Will there be enough of an adjustment in production, demand, and another factor, marketing loan benefit, to make this situation a single year event? Keep in mind, that the marketing loan benefit (LDP) has declined almost \$3/cwt in the last two years.

It's just too early to call. But as I said last year, "the cure for high prices is high prices, and the cure for low prices, in this case, is low prices." You move more of the crop, production adjusts, things normalize. Grower returns? Also too early to call. For pools with minimum guarantees, they'll pay the guarantees. For uncontracted cash rice, and there appears to be a considerable amount, I wouldn't discount the possibility of loan forfeitures or at a minimum, very low cash prices. For FRC members, we will make you as much money as possible. This is not the time to take our eye off the ball and lose sight of the goal.

**Current Outlook**

Domestic package prices are at reasonable levels. Demand has been outstanding. We have contracted a good share of our food processor business. Prices, while down from last year, are reasonable given the alternatives. We have been very busy in export with sales to Taiwan, the Mediterranean and the South Pacific.

We had a record year at our driers, which will add some incremental contribution to our operations.

We obviously have a long way to go and a whole lot can happen. We will know more as the market develops, and as usual, we will keep you posted.

**Long-Term Outlook**

Now that we have frankly discussed the prospects for a 53 million cwt 2004 crop, let's step back a moment, and consider the longer term prospects for California rice and FRC.

California has solid markets for 40 million cwts of rice, and if you think back over the last half dozen years, every time we produce 40 million cwts or less, you get a pretty decent grower return. Future demand looks promising. Our current WTO negotiations with the Republic of Korea will likely produce additional export volume for California. Australia's situation is producing additional export volume for California. Domestic utilization of medium grain, particularly in the package market as consumers turn to Calrose, is growing. We have had a distinct tightening of excess milling capacity this year with the closure of the ARI mill. We may lose a few more competitors this year, and that's not all bad for the industry.

## ***FRC Outlook***

At FRC, we are well positioned to take advantage of these opportunities. We have a highly qualified staff that is passionate about FRC. We have modern, state-of-the-art facilities with the newest available technology. We have a strong financial position with in excess of \$18 million dollars in working capital and our strategic marketing plan, our mutual fund, is continuing to evolve and pay greater dividends. We are growing our package business in both Diamond G and private labels. As I mentioned earlier, we have a new supply agreement for Nishiki with JFC. Our food processor business continues to evolve with more and more business sold directly by FRC staff. Our export business, while still heavily reliant on bulk commodity type sales, is becoming more specialized and in container quantities. The in-roads we make this year given Australia's production short fall will have long lasting effects. Much of the business we are doing in the South Pacific, for example, is in FRC's Diamond G bags. The strategic alliances we've formed over the past few years with companies like Kraft for rice grits flour and General Mills for stabilized rice bran are rewarding our efforts.

We have the resources in people, facilities, financing, markets and most importantly, a dedicated membership, to succeed. Thank you for your continued support and my congratulations to the FRC family on our 60<sup>th</sup> anniversary.

Michael Sandrock  
President & CEO



The popular FRC Holiday Gift Packs are available now from the Cooperative. This year's distinctively styled box contains many of the products produced by Farmers' Rice for its wide range of customers. Members recently received information and labels for the purchase of this year's gift packs. If anyone needs more information about our Holiday Gift Pack program, please contact Rhiannon Buono at (916) 923-5100.