

# FRC Monitor

## 61st Annual Membership Meeting Special Edition

### President's Report

More than 550 FRC members and guests attended our 61<sup>st</sup> Annual Meeting Friday, November 18<sup>th</sup> on what was a gorgeous fall day in Sacramento. We certainly appreciated the wonderful turnout of members and their families. I want to thank all of you for joining us.

This newsletter summarizes my remarks and those of other speakers on our program together with some photos taken during the meeting and the luncheon following the business meeting. It was a "no potatoes" day and we proudly served our new portabella risotto rice for the first time at an FRC Annual Meeting. This product will be available in foodservice on the east and west coast.

### Recognitions

As I told those attending, your Board of Directors and management want to thank you for your continued support and confidence. We spent a little extra time together this past year at various grower meetings as we tried to keep you abreast of the market conditions during what was a difficult year financially for all California rice farmers. Communications is a key ingredient in the valuable relationship FRC has with all of its members.

As always, I want to extend my sincere appreciation to your Board of Directors for standing tall and their hard work and diligence on behalf of the members. Certainly, we again want to acknowledge and thank our employees for their many contributions to the Cooperative's success during a year in which we had a record crop, handled record receipts at our driers, and had the largest milling year in the past 10 years. We had a minimal number of operational issues given a tremendous increase in business with several new customers and record shipments. The quality and dedication of our employees is second to none.

### 2004 Operations

As reported in our Annual Report, California rice producers were blessed with near perfect weather for planting of the



*FRC President Michael Sandrock discusses the outlook for 2005 crop export sales with FRC members Robert Amarel, Jr. and his son John Amarel following the member's luncheon at the 61<sup>st</sup> FRC Annual Meeting in Sacramento..*

2004 crop and a very moderate climate during the growing season. The net result was almost 51 million cwts of statewide production with record field yields. FRC handled 11.5 million cwts of the 2004 crop.

The outcome of this past marketing year was textbook supply and demand; record acreage and record field yields which led to an extremely competitive market situation and significantly lower returns.

Unfortunately, the stage was set in the spring and early summer of 2004 when export prices declined almost \$200/ton, hitting bottom with the infamous June 2004 Taiwan tender. As I said at the meeting, traditional and prospective buyers retracted from the market expecting prices to decline even further and by the time the 2004 crop was harvested any material export demand surplus to our traditional markets of Japan, South Korea and Taiwan, all had vanished.

As you can imagine, given the lack of export alternatives, pricing on the WTO business to North Asia became extremely competitive. As that occurred, new demand for California rice materialized from Jordan, the South Pacific and Turkey and by the spring of 2005 prices began to show

some very minimal recovery, but the majority of the 2004 crop had already been priced. It also was becoming apparent that the 2005 crop would be much smaller because of wet spring weather and growers reducing their planted acreage.

### ***FRC Developed New Markets***

With most exporters focused on North Asia, FRC diversified its 2004 crop export marketing mix into less traditional markets and through direct selling. Over 30% of our exports were sold this past year in consumer packages in the Middle East and the South Pacific. We established a presence in those markets and we believe they will continue to deliver incremental value, albeit at smaller volumes, in the future.

### ***FRC Domestic Markets***

The domestic market continued to be the cornerstone of our marketing program. Domestic packaged sales volume increased by 15% and prices we received remained significantly above export prices most of the year. While our food processor sales declined some as a few buyers chose to convert to less expensive southern long grain, prices in this market were also above export prices.

FRC's marketing mix was key in offsetting the depressed export market that remained only slightly above USDA price support loan values most the year. Of our 11.5 million cwts in 2004 crop receipts, 50% by volume was marketed domestically and 50% by volume was exported.

### ***Our 2004 Return***

In the end, our 2004 crop final return was higher than our previous forecast due to increased year-end revenues and slightly lower year-end expenses. While we are never satisfied with the absolute value of the return, our return accurately reflects the earnings of last year's market.

### ***2005 Crop Outlook***

The prospects for the 2005 crop look very good given a whole new set of dynamics. First of all, the supply and demand situation is much more balanced. The marketing year is off to a very good start and is moving at significantly higher prices.

On the medium grain supply side, the California crop is estimated, by most observers, to be about 37 million cwts. That's compared to 51 million cwts last year, 39 million cwts the year before and below what we call the "demand balancing mark" of around 40 million cwts.

The Southern medium grain crop is minimal while the southern long grain crop is near record, which predictable has severely depressed southern long grain prices. The 2005 Australian crop was very small due to conditions of drought; however, their 2006 crop is expected to be more normal. The Egyptian crop, which competes with California, is about normal and the Chinese are currently out of the medium grain market. The 2004 crop carry-in supply of medium grain, both here and in the south, is manageable.

All in all, a fairly tight U.S. and international medium grain supply situation is fueling higher price levels than a year ago.

### ***2005 Export Demand Outlook***

The demand outlook, for the moment, is good. Japan and Taiwan have both purchased 2005 crop rice at prices that are approximately \$200 per metric ton higher than last year. FRC has participated in this business having sold four cargoes, three to Japan and one to Taiwan. Japan and Taiwan are expected to continue to buy and fulfill their WTO trade obligations.

Korean, another important WTO trading partner, has yet to purchase any 2005 crop due to internal political difficulties in gaining final approval of their recently completed new WTO trade agreement by their National Assembly. Fortunately, the Korean National Assembly finally approved the agreement last week and we expect South Korea will begin purchasing rice soon.

The balance of the export market, in our opinion, is less certain. We have noted that regular shipments to the Middle East, the South Pacific, and South Asia are continuing; however, at significantly reduced volumes now that price levels for California rice are much higher. Further price increases without corresponding increases from other origins, like Egypt, may further reduce California's potential.

The important Turkish market is also an uncertainty at this time. Turkey purchased about 2.5 million cwts of 2004 crop California paddy rice in late summer and is not expected to be a buyer this year of any significant quantity. Puerto Rico, which purchased some California rice this past year, is rumored to be shopping in Egypt. Given the U.S. price differential with Egypt, even with the additional cost of ocean freight, it is a strong possibility that Puerto Rico will buy Egyptian medium grain this year.

***Continued on page 5***

## **WTO and the 2007 Farm Bill**

Donald Bransford, a Colusa County rice grower and Chairman of the California Rice Producers' Group gave FRC members an in-depth update on the current World Trade Organization – Doha Round trade negotiations and current information about the development of the 2007 Farm Bill. Bransford serves as the designated California representative to the USA Rice Producers' Group, one of the founding members of the USA Rice Federation. He along with several other California growers are active participants in Farm Bill policy discussions within the U.S. rice industry.

### ***The Budget Outlook and Farm Program Expenditures***

In his report, Mr. Bransford set the stage by pointing out that Federal budget deficits are currently running between \$300 and \$400 billion annually, that direct government payments to program crops (such as rice) are estimated to be \$22.7 billion this year, up from \$13.3 billion in 2004 and with budget reconciliation now pending before Congress, he predicted there will be cuts in farm program expenditures during the next five to ten years.

In analyzing the budget reconciliation situation, Mr. Bransford pointed out that the House of Representative's have proposed cuts to price support programs of \$1.07 billion over five years while the Senate proposes to cut payments by \$1.73 billion over the same time period. These proposed cuts in Federal expenditures are in response to Congress effort to rein in deficit spending.

He reported that a Conference Committee would be appointed soon to iron out differences between the proposed House and Senate cuts. Mr. Bransford predicted that the cuts in program expenditures would be closer to the Senate proposal than the House of Representatives. If correct, rice producers and those producing other program crops may have all payments cut by approximately 2.5%.

### ***The WTO-DOHA Round Trade Negotiations***

As for the WTO – Doha Round negotiations, Mr. Bransford said the United States. has pledged to reform its domestic agricultural support policies in exchange for significant market access abroad. He noted that negotiations are ongoing in preparation for the December 13<sup>th</sup> meeting of WTO trade ministers in Hong Kong. He said the U.S. has proposed the complete elimination of all agriculture subsidies and tariffs by 2023. If the Bush Administrations proposal were adopted, it would involve a two-stage process:

- Phase 1 would require a tariff and subsidy reduction plan phased in over 5-years.
- There would then be an interlude for 5-years for review to determine if the program was meeting the goal and objective.
- Phase 2 would kick in after 10-years and involve further reductions in tariffs and subsidies culminating in the elimination of all tariffs and subsidies by 2023.

Despite media reports to the contrary, Mr. Bransford said that progress is being made in the trade discussions and that he believes an agreement will be completed by the first quarter of 2007 in order for Congress to consider a new WTO trade agreement in the spring of 2007.

Mr. Bransford predicted that the outcome of the WTO – Doha Round negotiations would be lower farm spending in the U.S., dropping from \$20+ billion to somewhere between \$12 to \$15 billion. Additionally, if a new agreement is successfully negotiated, Mr. Bransford said it would put more focus on conservation, research, and infrastructure spending in future U.S. farm policy and less on direct subsidies such as those now available to growers. On the plus side, he said there would be greater market access to foreign markets for all U.S. producers.

## *The Effect of the WTO-DOHA Agreement on Future U.S. Farm Policy*

In describing the 2007 Farm Bill situation, Mr. Bransford described it as “a perfect storm” because of Federal budget constraints, the WTO – Doha Round agreement and new entrants in the equation who would want a share of the Federal farm spending pie for their respective programs. He noted that the fruit and vegetable industry is looking for Federal dollars to assist their industries and animal rights/welfare advocates want money for their programs as well as other participants who would want greater funding for rural development, nutrition programs, and U.S. government assistance to developing countries.

### *Other Farm Bill Challenges*

Mr. Bransford also reviewed other Farm Bill challenges that likely could affect the outcome of the next Farm Bill debate. He noted, for instance, payment data for each major program crop as listed below:

#### Payment Data by Crop, 2004/05FY

	<u>Payments</u> (Mil. \$)	<u>Market Price</u> (\$/unit)	<u>Market Value of Production</u> (Mil. \$)	<u>Payment per Acre</u> (\$/ac.)	<u>Payment as a % of Market Value</u>
<b>Corn</b>	7,436	2.05	24,204	101.0	30.7
<b>Sorghum</b>	481	1.70	774	74.0	62.2
<b>Barley</b>	224	2.50	698	56.0	32.1
<b>Oats</b>	5	1.45	168	2.8	3.0
<b>Wheat</b>	1,215	3.40	7,337	24.3	16.6
<b>Upland Cotton</b>	3,685	0.43	5,485	287.7	67.2
<b>Rice</b>	687	7.40	1,708	206.9	40.2
<b>Soybean</b>	901	5.40	16,961	12.2	5.3
<b>Peanuts</b>	204	0.185	788	146.3	25.9

He noted that rice was second only to Upland Cotton on a payment per acre basis and that the government subsidy accounted for 40.2% of grower income in fiscal year 2004/05, the latest year for which data is complete.

### *Farm Bill Process*

Mr. Bransford said that the U.S. Department of Agriculture’s “Listening Sessions” have just been completed. USDA Secretary Michael Johanns has said that his department will be submitting a “Farm Bill” recommendation to Congress next year; however, Mr. Bransford noted that if history repeats itself, the USDA proposal would be “dead on arrival” in Congress.

The House and Senate Agriculture Committees will begin hearings next year in preparation for writing a new Farm Bill. Mr. Bransford expects the respective committee’s would markup up their respective farm policy bills in the late spring of 2007 with final adoption likely in late 2007 to be effective for the 2008 crop.

### *Farm Bill Outcome*

In summary, Mr. Bransford told FRC members that he expects overall funding for the commodity title in the next Farm Bill to be cut about 25% after an intense debate and inter-family fight over funding for nutrition, conservation, and funding for expansion of Federal expenditures for other crops such as fruits, vegetable and nuts, with more focus on green payments, i.e., payments for environmental friendly farming practices and conservation, and lower payment caps for producers. He said the payment limit issue would not go away, that Senator Charles Grassley and others would raise it again during the upcoming debate.

## *President's Report Continued*

### *2005 Domestic Demand Outlook*

Consumer product market prices have increased over \$5 per cwt on a milled rice basis in the last 60 days with additional price increases announced. All things being equal, the demand in this market is relatively insensitive to higher prices and should continue to show moderate growth.

The industrial market is in a state of flux. We see a situation that is very much like the 2003 crop-marketing year when prices were high. There is a limited amount of medium grain available anywhere, and for the second time in three years, southern long grain prices are significantly lower than medium grain. Substitution (long for medium) is a real possibility in the industrial market, given the \$6-\$8 per cwt milled rice differential in medium and long grain prices. The same scenario exists for the brewery market, which currently utilizes medium grain, but might switch to lower priced long grain.

As we assess all of this, we believe:

- There is very good potential in the consumer products market.
- Industrial and brewery offers good demand, but given the price differentials, there remains some questions about this market segment this year.
- Total domestic demand for California rice is expected to be 18 million cwts on the low side and possibly as much as 21 million on the high side.

### *So What's This All Add Up To?*

For firms like FRC with access to the consumer products market, Japan, Taiwan, Korea, and a few select commercial export markets as well as the industrial market, it offers much higher returns. For FRC, with our long established relationships with key markets and with our ability to flex our marketing mix to take advantage of the best opportunities, 2005 will be a good year.

### *Our 2005 Crop Outlook*

We fully expect to be advancing additional 2005 crop proceeds in January and have competitively high returns for the marketing year. It is too early to make a return outlook, however, as has been our policy, we will keep you informed as the marketing outlook develops.

### *Operational Achievements*

There were some significant operational accomplishments this past year.

We finally solved our Risotto manufacturing issues and now have sales on the books. We have distributors appointed on the east coast and in California and we are in the process of expanding this product into Arizona and Nevada. While we have only made small steps, we continue to believe this product has great potential and are ramping up our marketing efforts. The DoubleTree Hotel, by the way, now serves FRC's Risotto on its regular menu at its Sacramento hotel.

FRC is currently in discussion with one of our "special process" partners about doubling their investment in your rice mill. That will likely double the production of the product we make for them.

We are actively pursuing some new customers and new applications for our specialty products. Our special process activity (sake milling, stabilized rice bran, rice flour, grits, quick cooking brown rice, and musenmai) are unique among most California rice mills and offers us tremendous opportunity for the future.

Our technology and marketing personnel continue to work with core customers to improve their product specifications and service requirements as a means to further differentiate ourselves from other suppliers.

### *FRC Cost Effectiveness*

We are also pleased to report further improvements in our cost effectiveness efforts. During the year, we consolidated several management positions in our milling and drying operations and expanded our resources in engineering and process control in support of customer expectations.

We have made additional reductions in our cost structure, successfully appealing our property taxes with Yolo County for an annual savings of \$150,000 and we incorporated a new voluntary PG&E power program for an annual saving of \$250,000.

Our managers are working on additional ways to improve our cost effectiveness, every one of them have been challenged to think "outside the box". While we have made significant progress in our cost structure, more improvement needs to be achieved and it will be.

Our Membership Committee is working on some new and improved ways to deliver member programs and the Audit and Finance Committee is currently investigating the "equity question" and ways to improve our marketing base capital plan.



*FRC Chairman Herb Holzapfel and John Weiler of Oji Bros. Farm of Yuba City visit following the annual membership meeting at the DoubleTree Hotel. Oji Bros. grow rice in Sutter County.*



*Donald Bransford, Chairman of the California Rice Producers' Group gave an excellent presentation on the World Trade Organization's DOHA round trade negotiations and a briefing on the development of the 2007 Farm Bill.*

Finally, we have field-tested several new FRC proprietary varieties developed by our agronomist Dr. Dave Jones. These varieties have been in development for several years and show promise for our members and our largest customer, JFC.

### *In Conclusion*

We obviously have a lot going on at FRC and we know we have a lot more work to be done. While these tasks may be complex, the goal is simple: maximize your return on a sustainable basis.

If any member wishes to discuss any of our programs or would like to discuss our outlook for the new marketing year, please give me a call or as I offered at the Annual Meeting just call and I will meet you up country.

*Michael Sandrock*

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.

## **Chairman's Comments**

FRC Chairman Herb Holzapfel focused his comments to members this year on "Why are we in FRC?" His comments are as follows:

- Competitive Returns, FRC has been on the high end for the last ten years!
- Lending institutions do not count the Cooperative as high risk, but stable and reliable.
- Member programs:
  - Drying, competitive pricing, great service, green freight program.
  - Seed, competitive pricing, high quality, a successful credit program for members who buy from FRC.
  - Special varieties, largest program in the state, fair allocations, competitive premiums put another \$3.5 million in members' pockets.
  - Trucking, FRC growers now haul 45% of all upcountry transfers.
  - Communications, newsletters, meetings, website, honest answers to your questions.
  - Member service, an example was the 2004 record crop when FRC helped its member find adequate drying space.

Most importantly, Farmers' Rice Cooperative is the only firm in California that "has its members best interests at heart and the tools to deliver." A firm where a grower can be heard, a grower can become a member of the Board of Directors, a grower can become Chairman of the Board.

We wish to thank all members for their support. We are committed to the goal of maximizing your return on a sustainable basis.