CALAVO GROWERS INC
Form 10-Q
March 12, 2007

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

FORM 10-Q

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

For the quarterly period ended January 31, 2007

OR

o **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	**33-0945304**
(State of incorporation)	(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 þ No o

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 o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Registrant s number of shares of common stock outstanding as of January 31, 2007 was 14,292,833

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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 d 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, 2006, 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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	January 31, 2007	October 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 191	$ 50
Accounts receivable, net of allowances of $1,933 (2007) and $1,833 (2006)	26,472	24,202
Inventories, net	12,399	10,569
Prepaid expenses and other current assets	4,865	4,934
Advances to suppliers	3,545	1,406
Income tax receivable	1,524	2,268
Deferred income taxes	2,348	2,348
Total current assets	51,344	45,777
Property, plant, and equipment, net	21,239	19,908
Investment in Limoneira	41,140	33,879
Investment in Maui Fresh, LLC	261	229
Goodwill	3,591	3,591
Other assets	4,012	4,110
	$ 121,587	$ 107,494
Liabilities and shareholders equity		
Current liabilities:		
Payable to growers	$ 2,745	$ 6,334
Trade accounts payable	2,675	4,046
Accrued expenses	15,562	13,689
Short-term borrowings	4,791	3,804
Dividend payable		4,573
Current portion of long-term obligations	1,308	1,308
Total current liabilities	27,081	33,754
Long-term liabilities:		
Long-term obligations, less current portion	22,406	10,406
Deferred income taxes	7,066	4,391
Total long-term liabilities	29,472	14,797
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.001 par value; 100,000 shares authorized; 14,293 (2007) and 14,293 (2006) issued and outstanding	14	14
Additional paid-in capital	37,117	37,109
Notes receivable from shareholders	(2,264)	(2,430)
Accumulated other comprehensive income	10,879	6,293

Retained earnings	19,288	17,957
Total shareholders equity	65,034	58,943
	$ 121,587	$ 107,494

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

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

	Three months ended January 31, 2007	Three months ended January 31, 2006
Net sales	$ 57,293	$ 50,647
Cost of sales	50,325	47,275
Gross margin	6,968	3,372
Selling, general and administrative	4,631	4,406
Operating income (loss)	2,337	(1,034)
Other expense, net	(156)	(75)
Income (loss) before provision (benefit) for income taxes	2,181	(1,109)
Provision (benefit) for income taxes	850	(444)
Net income (loss)	$ 1,331	$ (665)
Net income (loss) per share:		
Basic	$ 0.09	$ (0.05)
Diluted	$ 0.09	$ (0.05)
Number of shares used in per share computation:		
Basic	14,293	14,352
Diluted	14,359	14,352

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

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

	Three months ended January 31, 2007	2006
Net income (loss)	$ 1,331	$ (665)
Other comprehensive income (loss), before tax:		
Unrealized holding gains (losses) arising during period	7,260	(6,050)
Income tax (expense) benefit related to items of other comprehensive income (loss)	(2,674)	2,399
Other comprehensive income (loss), net of tax	4,586	(3,651)
Comprehensive income (loss)	$ 5,917	$ (4,316)

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

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

	Three months ended January 31, 2007	2006
Cash Flows from Operating Activities:		
Net income (loss)	$ 1,331	$ (665)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	548	514
Income from Maui Fresh LLC	(32)	
Stock based compensation	8	72
Provision for losses on accounts receivable	40	12
Effect on cash of changes in operating assets and liabilities:		
Accounts receivable	(2,310)	(4,327)
Inventories, net	(1,830)	(1,180)
Prepaid expenses and other assets	138	(670)
Advances to suppliers	(2,139)	553
Income taxes receivable	744	(439)
Payable to growers	(3,589)	4,987
Trade accounts payable and accrued expenses	329	567
Net cash used in operating activities	(6,762)	(576)
Cash Flows from Investing Activities:		
Acquisitions of and deposits on property, plant, and equipment	(1,677)	(1,099)
Net cash used in investing activities	(1,677)	(1,099)
Cash Flows from Financing Activities:		
Payment of dividend to shareholders	(4,573)	(4,564)
Proceeds from (payments on) term borrowings, net	12,987	6,417
Exercise of stock options		130
Retirement of common stock		(1,200)
Collection on notes receivable from shareholders	166	
Payments on long-term obligations		(3)
Net cash provided by financing activities	8,580	780
Net increase (decrease) in cash and cash equivalents	141	(895)
Cash and cash equivalents, beginning of period	50	1,133
Cash and cash equivalents, end of period	$ 191	$ 238
Supplemental Information		
Cash paid during the period for:		
Interest	$ 300	$ 238

Income taxes	$	115	$	2
Noncash Investing and Financing Activities:				
Tax benefit related to stock option exercise	$		$	36
Construction in progress included in trade accounts payable	$	173	$	157
Unrealized holding gains (losses)	$	7,261	$	(6,050)

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

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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. We procure avocados principally from California, Mexico, and Chile. Through our operating facilities in southern California, Texas, New Jersey, and Mexico, we sort, pack, and/or ripen avocados for distribution both domestically and internationally. Additionally, we also distribute other perishable foods, such as Hawaiian grown papayas, and prepare processed avocado products. We report our operations in two different business segments: (1) fresh products and (2) processed products.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of adjustments of a normal recurring nature necessary to present fairly the Company s financial position, results of operations and cash flows. The results of operations for interim periods are not necessarily indicative of the results that may be expected for a full year. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended October 31, 2006.

Recent Accounting Standards

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS No. 158 requires company plan sponsors to display the net over- or under-funded position of a defined benefit postretirement plan as an asset or liability, with any unrecognized prior service costs, transition obligations or actuarial gains/losses reported as a component of other comprehensive income in shareholders equity. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. We will adopt SFAS No. 158 as of the end of fiscal 2007. We are currently assessing the impact the adoption of SFAS No. 158 will have on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value in generally accepted accounting principles, clarifies the definition of fair value and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, the application of SFAS No. 157 may change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We will adopt SFAS No. 157 in the first quarter of fiscal 2009. We are currently assessing the impact the adoption of SFAS No. 157 will have on our financial position and results of operations.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108 on Quantifying Misstatements. SAB No. 108 requires companies to use both a balance sheet and an income statement approach when quantifying and evaluating the materiality of a misstatement, and contains guidance on correcting errors under the dual approach. SAB No. 108 also provides transition guidance for correcting errors existing in prior years. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged. We do not believe that the adoption of SAB 108 will have a significant 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 that 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.

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.

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.

In December 2006, our Board of Directors approved the issuance of options to acquire a total of 20,000 shares of our common stock to two members of our Board of Directors. Each grant to acquire 10,000 shares vests in increments of 2,000 per annum over a five-year period and have an exercise price of $10.46 per share. Vested options have a term of five years from the vesting date. The market price of our common stock at the grant date was $10.46. The estimated fair market value of such option grant was approximately $40,000, based on the following assumptions:

Expected dividend yield	3.10%
Expected stock price volatility	22.19%
Risk free interest rate	3.25%
Expected life (in years)	5.5

The expected stock price volatility rates are based on the historical volatility of the Company s common stock. The risk free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant for periods

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approximating the expected life of the option. The expected life represents the average period of time that options granted are expected to be outstanding, as calculated using the simplified method described in the Securities and Exchange Commission s Staff Accounting Bulletin No. 107.

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. There were no options granted during the three month period ended January 31, 2006.

2. Information regarding our operations in different segments

We 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, as well as other non-operating income/expense items, are evaluated by our president in the 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.

(All amounts are presented in thousands)

	Fresh Products	Processed products	Inter-segment eliminations	Total
	(All amounts are presented in thousands)			
Three months ended January 31, 2007				
Net sales	$ 51,159	$ 10,982	$ (4,848)	$ 57,293
Cost of sales	47,433	7,740	(4,848)	50,325
Gross margin	$ 3,726	$ 3,242		$ 6,968

	Fresh Products	Processed products	Inter-segment eliminations	Total
	(All amounts are presented in thousands)			
Three months ended January 31, 2006				
Net sales	$ 46,242	$ 9,280	$ (4,875)	$ 50,647
Cost of sales	44,765	7,385	(4,875)	47,275
Gross margin	$ 1,477	$ 1,895		$ 3,372

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

	Three months ended January 31, 2007			Three months ended January 31, 2006		
	Fresh products	Processed products	Total	Fresh products	Processed products	Total
Third-party sales:						
California avocados	$ 9,263	$	$ 9,263	$ 9,658	$	$ 9,658
Imported avocados	28,163		28,163	23,587		23,587
Papayas	1,135		1,135	1,267		1,267
Specialties and Tropicals	3,850		3,850	2,405		2,405
Processed food service		7,932	7,932		7,335	7,335
Processed retail and club		2,860	2,860		2,331	2,331
Total fruit and product sales to third-parties	42,411	10,792	53,203	36,917	9,666	46,583
Freight and other charges	5,720	139	5,859	5,847	136	5,983
Total third-party sales	48,131	10,931	59,062	42,764	9,802	52,566
Less sales incentives	(10)	(1,759)	(1,769)	(6)	(1,913)	(1,919)
Total net sales to third-parties	48,121	9,172	57,293	42,758	7,889	50,647
Intercompany sales	3,038	1,810	4,848	3,484	1,391	4,875
Net sales before eliminations	$ 51,159	$ 10,982	62,141	$ 46,242	$ 9,280	55,522
Intercompany sales eliminations			(4,848)			(4,875)
Consolidated net sales			$ 57,293			$ 50,647

3. Inventories

Inventories consist of the following (in thousands):

	January 31, 2007	October 31, 2006
Fresh fruit	$ 5,771	$ 4,961
Packing supplies and ingredients	2,726	2,380
Finished processed foods	3,902	3,228
	$ 12,399	$ 10,569

During the three month periods ended January 31, 2007 and 2006, 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 $1,135,000, and $1,267,000 for the three months ended January 31, 2007 and 2006, resulting in gross margins of approximately $93,000 and $112,000. Amounts payable are approximately $170,000 and $213,000 at January 31, 2007 and October 31, 2006 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 three months ended January 31, 2007 and 2006, the aggregate amount of avocados procured from entities owned or controlled by members of our Board of Directors was $1.2 million and $1.6 million. Amounts payable to these board members were $0.6 million and $0.6 million as of January 31, 2007 and October 31, 2006.

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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 $354,000 at January 31, 2007), brand name intangibles of $275,000 and other identified intangibles totaling $2,000 (accumulated amortization of $2,000 at January 31, 2007). The customer-related intangibles are being amortized over five years. The other identified intangibles are fully amortized as of January 31, 2007. 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 $88,000 for the remainder of fiscal 2007 and approximately $118,000 per annum for fiscal 2008, with the remaining amortization expense of approximately $30,000 recorded in fiscal 2009.

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 fiscal 2007. Outstanding options would not be impacted by such termination.

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 January 31, 2007 and 2006, we recognized approximately $8,000 and $13,000 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, 2006 and January 31, 2007	49	$ 7.00	$ 180