

## Cal-Maine Foods, Inc (CALM)

No cracks yet in this ag story

March 24, 2008

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### Investment Highlights

- CALM will earn \$5.69 in the next 12 months, up 43% YOY
- Dividend payments will rise from \$.05 in TTM to \$1.90 in the next 12 months
- 102% of free float is sold short
- Industry egg supply will be constrained due to new cage requirements

### Research Analyst:

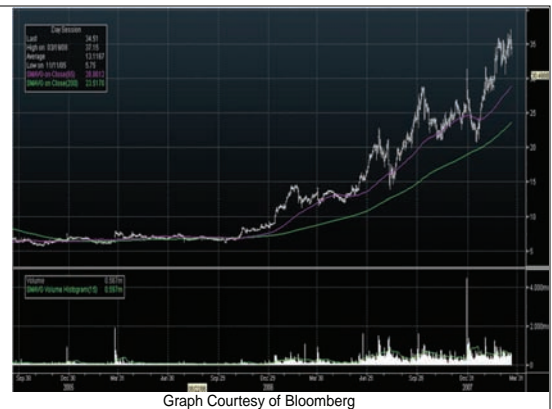
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### Executive Summary

- We expect Cal-Maine to earn \$5.69 in the next 12 months and pay \$1.90 in dividends from their newly-revised dividend program.
- We estimate that feed costs (primarily corn and soy meal), the largest input cost for egg farmers, will rise 75% in 2008.
- Feed cost inflation has caused short-sellers to build a massive short position in the stock.
- Wholesale egg prices need to rise 21% in 2008 to pass along the feed cost inflation.
- Wholesale egg prices are currently up 34% YOY.
- Environmental regulations and new cage size standards dragged down total shell egg supply 1.3% in 2007, and supply is down so far in 2008.
- We anticipate supply growth will remain flat until early 2010 when new cage size standards are fully in effect.
- We believe eggs will gain competitively verses other food products as grain inflation works its way through the food chain.

### Financial Summary and Statistics

Current Price: \$34.59	Book Value/Share:	\$9.02	
Price Target: \$46.00	Sales/Share (ttm):	\$25.42	
Market Cap: \$820mln	Forward PE (e):	6.1X	
	<b>F2006</b>	<b>F2007</b>	<b>F2008e</b>
Revenues	\$ 477,555	\$ 598,128	\$ 916,623
Cost of Sales	\$ 415,338	\$ 479,504	\$ 649,907
Gross Profit	\$ 62,217	\$ 118,624	\$ 266,715
SG&A	\$ 57,702	\$ 60,394	\$ 66,227
Operating Income	\$ 4,515	\$ 58,230	\$ 200,488
Other	\$ (5,993)	\$ (1,969)	\$ 6,410
Taxes	\$ (465)	\$ 19,605	\$ 71,880
Net Income	\$ (1,013)	\$ 36,656	\$ 135,018
EPS (Dilluted)	\$ (0.05)	\$ 1.55	\$ 5.69
Shares out	23,540	23,569	23,717



Unit Economics LLC

## Company Background

Cal-Maine Foods, Inc. is the largest shell egg producer in the country, producing, grading, marketing and distributing shell eggs throughout the southern, central and eastern United States. In their last fiscal year, FY2007 (June), they sold approximately 685 mln dozens of shell eggs, roughly a 15.50% domestic market share. The company currently has approximately 22.8 million mature female chickens, or “layers”.

Cal-Maine operates 2 breeding facilities, 2 hatcheries, 16 feed mills, 29 shell egg production facilities; 19 pullet-growing facilities (“pullets” are young female chickens under 20 weeks of age); 28 processing and packing facilities, and 4 wholesale distribution facilities. They also own an interest in 2 egg products facilities and 1 hen processing facility that are consolidated in their financial statements. To begin to put the scale of their operations into perspective, consider that they own 17,000 acres of land (26.5 square miles) and are producing 15,639 eggs every minute.

The company was founded in 1969. By 1988, Cal-Maine had grown production to 117 mln dozen shell eggs annually. Since 1988 Cal-Maine has completed thirteen acquisitions. Additionally since 1988, the company has built 7 new “in-line” shell egg production and processing facilities and one pullet-growing facility. The construction of new, efficient facilities to replace existing facilities and reduce unit costs is essential to their strategy. Cal-Maine's employee count, with 1,450 workers (out of 1,600 total) concentrated in shell egg production, is a hallmark of the company's efficiency.

Management has differentiated their egg production and increased margins by focusing on the specialty egg business. Cal-Maine's specialty products include reduced cholesterol, cage-free and organic eggs sold under the Land's Best and Farmhouse brands. Wholesale pricing achieved in the specialty egg segment has ranged from 1.7X to 2.2X the wholesale price of traditional eggs. Management believes that 2.0X the traditional egg prices will be the long-term pricing premiums for specialty eggs. Specialty eggs were 15% of total revenues in FY2007.

Fred Adams, Jr. has served as the Chairman and CEO of Cal-Maine since their formation in 1969. He is a director and past chairman of the National Egg Company, United Egg Producers, Mississippi Poultry Association, U.S. Egg Marketers, Inc. and Egg Clearinghouse, Inc. Richard K. Kooper, Vice Chairman of the board, has been employed by Cal-Maine since 1974 and was a past chairman of the American Egg Board and U.S. Egg Marketers. Adolphus B Baker, COO and son-in-law of Mr. Adams, has been with Cal-Maine since 1986.

Cal-Maine is a controlled company, as Chairman/CEO Fred Adams, Jr. and his spouse own 36.1% of the common shares outstanding. In addition, Mr. Adams owns 90.1% of the Class A common stock, which has ten votes per share, giving Mr. Adams and his spouse 64.8% of the total voting rights. Adolphus B. Baker owns 1.6% of the common shares outstanding and 9.9% of the Class A common stock, giving him 6.0% of the total voting rights.



## The 'Unit Economics'

Cal-Maine Foods, Inc. primarily sells shell eggs in the southern and eastern United states to resellers and distributors at wholesale prices. In FY2007 they sold 685.4 mln dozen eggs and in FY2008 we expect them to sell 687.6 mln dozen eggs. In general, based on our calculations, wholesale prices have been relatively constant at 62.5% of published benchmark retail prices. It is important to note that in some cases Cal-Maine's distribution agreements with large customers such as Wal-Mart and Sam's Club, require Cal-Maine to purchase eggs from third-party farms to be resold. Eggs purchased for resale are a significant portion of overall revenues, with Wal-Mart and Sam's Club accounting for 36.9% of FY07 sales. Cal-Maine's acquisitions, however, have recently reduced third-party purchases from 25% to 20% of eggs sold. Specialty egg sales also boost revenues. In FY2007, specialty egg products accounted for 8.7% of Cal Maine's shell sales and 15% of revenues.

Feed costs have averaged between 32.47% to 43.04% of the total cost of sales in the past 2 years. Their feed is made in-house with raw materials, primarily corn (65%) and soy meal (17%), purchased on the open market. The bears believe feed costs will drive egg producers into losses in 2008. Our estimates of feed cost price inflation seem to confirm this, with feed costs expected to climb 75.27%, assuming corn and wheat prices hold at current levels through 2008. In reality, on a per unit basis feed costs are expected to increase from \$.279 per dozen over the past year to \$.489 in the next 12 months. The wholesale egg price received by Cal-Maine during the past 12 months, adjusted to exclude specialty eggs sales was \$1.0065 per dozen. To offset a 75.67% increase in feed costs, Cal-Maine only needs a 21% increase, or \$.21 per dozen, in wholesale egg prices. Relative to other food product price increases, this is a reasonable amount and so far in 2008 we have already realized a \$.349 per dozen increase, or 33.94%. A simple rule of thumb is: for every \$.01 change in egg shell margins, Cal-Maine's earnings change by \$.05 per quarter fully taxed. We doubt the bears are looking for \$.50 in increased earnings YOY this Q for Cal-Maine due to higher margins.

SG&A costs per dozen eggs, excluding stock options expense from a defunct stock options grant program, have generally held steady at \$.088 per dozen - plus or minus a couple of tenths of a cent per dozen. It appears that the primary cause of variability in SG&A per dozen, excluding stock options expense, is the volume of egg output.

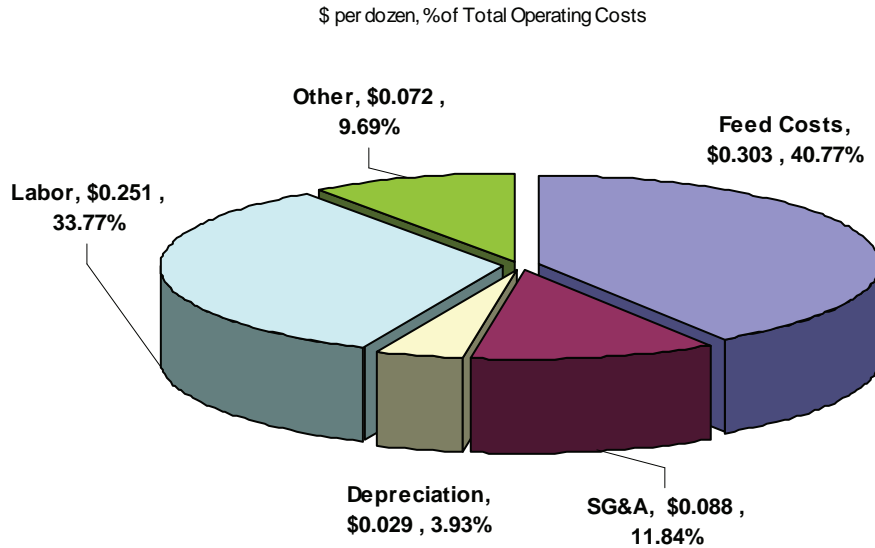
Depreciation per dozen eggs has been steady, averaging \$.0299 for the past eight quarters. Despite management's focus on process automation and technology investments in the past few years, total net assets are currently \$195.7 mln. Annualizing revenues from the most recent quarter, net fixed asset turnover is a surprisingly robust 4.57X.

All other costs per dozen have remained in a range of \$.282 per dozen to \$.323 per dozen for the past two years. We estimate that the vast majority of these costs are labor costs as there are 1,450 (of a total of 1,600) workers classified as 'production employees'. At an estimated fully-loaded (benefits, taxes) cost of \$50,000 per



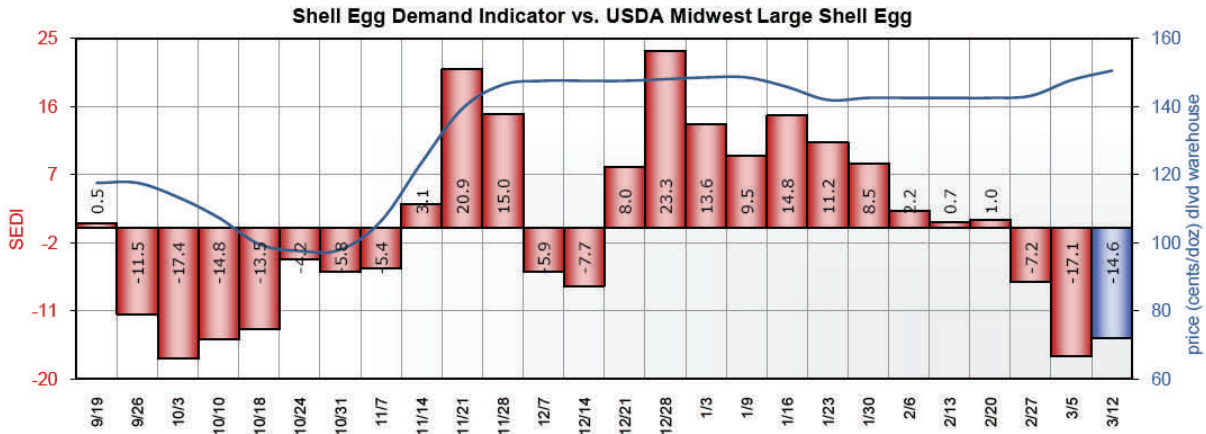
employee per year, direct labor costs would be \$.251 per dozen, leaving \$.072 in costs per dozen related to utilities, fuel, delivery charges, etc.

If we examine the total operating costs per dozen in the most recent quarter, adjusting SG&A for one-time exceptions, we can create the following pie chart:



Two things immediately jump out. First, feed costs related to total costs are not as large as one would imagine. Chickens are very efficient in converting feed to protein, especially compared with the production of meat. A chicken only has to be kept alive for seventeen days to produce a dozen eggs. Many other animals typically must be kept alive for years to produce protein (meat). Second, feed costs are the only category that is really a variable cost. Everything else is relatively fixed and benchmarked generally to inflation.

Barring further acquisitions, Cal-Maine is a very straightforward company to model. The monthly CPI data for ‘South Urban Grade A, Retail Eggs’ has proven a reliable indicator for Cal-Maine egg prices, with an average quarterly variance using a model around this data of 4.04%. The USDA releases national pricing data for eggs (the blue line seen on the chart on the next page), as well as demand calculations (the red bars). The USDA also provides layer flock estimates, breeder estimates, and projections for the number of incubated eggs that will produce new layers.



We expect quarterly earnings per share in the FY2008 Q3 to be announced before the open on March 31 to be \$1.84, +/- \$.07 given the historical variance in our model. The market may be positively surprised with the new dividend policy, a payout of 33% of net income, which begins this quarter with an estimated dividend of \$.61 per share. In the next 4 quarters, we expect Cal-Maine to earn \$5.69 per share and distribute \$1.90 per share in dividends, for a forward PE of 6.07X and a forward dividend yield of 5.51%. Given that Cal-Maine traded at a 8X trailing multiple in 2004, our price target is \$46.00, which would provide a total return of 38.5% from today's closing price, including estimated dividends.

Ongoing structural changes in agricultural markets will continue to push prices of all food-related goods upward for the next several years (see the Ag Thesis Summary on pg 8). Investors might be tempted to place a premium on Cal-Maine relative to its trading history (as they have recently with fertilizer stocks) because Cal-Maine is a very rare agricultural pure-play. Moreover, the market cap should reach the magical \$1 bln level, attracting investor attention. Currently, no major street firm covers Cal-Maine and over 100% of the float is sold short.

We do not expect a supply response from egg producers until 2010. The weak US dollar will likely prolong the upsurge in exports (up 42% in 2006, principally to Asia), further heightening demand. The most dangerous words in finance are 'this time it is different,' but for the shell egg market these words may ring true. Just don't tell the bears quite yet...

Financials

Model Inputs

Dozens of eggs sold (in millions)  
Adj Market Egg Price  
Feed Cost/Dozen (75% corn, 25% soymeal)

Change these variable to control earnings

	173.2	174.2	175.2	176.2
\$	1.414	1.241	1.253	1.377
\$	0.510	0.470	0.480	0.499

Income Statement

	FY08 End				FY07 End				FY06 End					
	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08) (e)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)	Q4 (Jun 06)	Q3 (Mar 06)	Q2 (Dec 05)	Q1 (Sep 05)
Net Sales	272,588	240,493	244,317	270,012	223,696	178,598	169,872	175,211	137,737	115,308	129,404	130,107	138,288	79,756
Cost of Sales	191,572	174,662	178,842	190,383	147,664	133,018	128,792	131,029	112,782	106,901	111,929	104,134	120,479	78,796
Gross Profit	81,016	65,831	65,475	79,629	76,032	45,580	41,080	44,182	24,955	8,407	17,475	25,973	17,809	960
Selling, General and Administrative Expense	15,342	15,311	15,283	15,267	17,029	18,648	14,564	16,902	14,458	14,470	14,563	15,493	16,729	10,917
Operating Income	65,674	50,519	50,192	64,362	59,003	26,932	26,516	27,280	10,497	(6,063)	2,912	10,480	1,080	(9,957)
Other Income (expense)														
Interest Expense, net	(109)	(699)	(827)	(1,227)	(1,377)	(1,647)	(677)	(1,639)	(1,764)	(1,795)	313	(1,906)	(2,294)	(1,695)
Other	1,900	1,900	1,900	3,906	3,744	1,938	1,289	1,956	824	(143)	(1,500)	1,346	182	(449)
INCOME (LOSS) BEFORE TAXES	67,465	51,720	51,265	67,041	61,370	27,223	27,108	27,597	9,557	(8,001)	1,725	9,920	(1,022)	(12,101)
Income tax Expense (benefit)	23,613	18,102	17,943	23,464	21,216	9,257	8,825	10,194	3,156	(2,570)	1,935	1,930	(337)	(3,993)
Net Income (loss)	43,852	33,618	33,322	43,576	40,154	17,966	18,283	17,403	6,401	(5,431)	(210)	7,990	(685)	(8,108)
Net income (loss) per share														
Basic	1.852	1.420	1.407	1.840	1.696	0.761	0.777	0.740	0.272	(0.231)	(0.009)	0.340	(0.029)	(0.345)
Diluted	1.849	1.418	1.405	1.838	1.693	0.757	0.775	0.738	0.271	(0.231)	(0.009)	0.337	(0.029)	(0.345)
Weighted avg Shares Outstanding														
Basic	23,681	23,681	23,681	23,681	23,681	23,599	23,526	23,519	23,503	23,503	23,496	23,497	23,495	23,490
Diluted	23,714	23,714	23,714	23,714	23,714	23,724	23,599	23,578	23,597	23,503	23,496	23,680	23,495	23,490
Dividend Per share	0.61	0.47	0.46	0.61	0.013	0.013	0.013	0.013	0.013	0.013	0.013	0.013	0.013	0.013

Balance Sheet

Assets	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08) (e)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)	Q4 (Jun 06)	Q3 (Mar 06)	Q2 (Dec 05)	Q1 (Sep 05)
<b>Current Assets:</b>														
Cash And Equivalents	86,915	73,081	59,264	37,071	28,535	23,117	15,032	15,134	11,364	16,717	13,295	14,139	12,956	25,186
Investments	59,250	59,250	59,250	59,250	59,250	46,951	28,600	28,600	10,000	10,000	25,000	24,600	9,000	20,995
Trade and Receivables	70,873	62,528	63,522	70,203	68,888	45,051	37,096	40,525	43,745	30,753	23,804	27,842	40,389	18,528
Recoverable Income Taxes	-	-	-	-	-	-	-	836	1,086	3,596	1,177	1,152	11,214	10,270
Inventories	100,858	88,982	90,397	99,904	69,403	66,310	62,208	62,855	60,369	57,310	57,843	57,794	57,866	43,766
Other	-	-	-	-	-	-	1,084	-	-	-	1,151	-	-	-
Prepaid Expenses and Other	1,500	1,500	1,500	1,500	881	1,596	1,390	1,266	1,544	2,403	3,408	1,995	1,679	1,117
<b>Total Current Assets</b>	<b>319,396</b>	<b>285,342</b>	<b>273,934</b>	<b>267,929</b>	<b>226,957</b>	<b>183,025</b>	<b>156,310</b>	<b>149,216</b>	<b>128,108</b>	<b>120,779</b>	<b>125,678</b>	<b>127,522</b>	<b>133,104</b>	<b>119,862</b>
Notes Receivable and Investments	-	-	-	-	9,893	8,373	7,913	8,241	8,496	7,975	8,316	8,900	7,546	9,544
Goodwill	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,195	4,016	4,016	4,016	4,402	4,402	3,147
Other Assets	7,476	7,476	7,476	7,476	7,476	7,476	2,560	2,550	2,652	2,700	2,833	2,929	2,944	1,393
Property, Plant and Equipment	395,560	394,971	394,374	393,769	393,155	383,798	377,875	363,209	346,805	340,870	350,850	341,194	337,627	277,165
Less Accumulated Depreciation	214,251	208,840	203,437	198,042	192,656	187,627	184,285	178,278	172,271	167,887	174,575	164,628	159,681	153,210
<b>TOTAL ASSETS</b>	<b>512,376</b>	<b>483,144</b>	<b>476,542</b>	<b>475,326</b>	<b>449,020</b>	<b>394,698</b>	<b>364,568</b>	<b>349,133</b>	<b>317,806</b>	<b>308,453</b>	<b>317,118</b>	<b>320,319</b>	<b>325,942</b>	<b>257,901</b>
					1.31%	0.88%	1.65%	1.73%	1.29%					
<b>Liabilities and Stockholder's Equity</b>														
<b>Current Liabilities</b>														
Accounts payable and Accrued Expenses	82,376	75,105	76,902	85,673	75,581	62,127	45,051	53,482	44,325	42,539	41,526	46,210	51,835	31,593
Current Maturities of Purchase Obligation	10,758	10,758	10,758	10,758	10,758	6,769	5,435	5,435	5,435	5,435	-	-	-	10,195
Current Maturities of Long-Term Debt	8,447	9,797	10,472	11,822	11,661	13,126	13,442	13,610	12,930	12,248	11,902	10,956	10,610	10,995
Deferred Income Taxes	12,136	12,136	12,136	12,136	12,136	12,633	11,830	11,610	11,690	11,895	11,450	8,800	10,450	9,240
<b>Total Current Liabilities</b>	<b>113,717</b>	<b>107,796</b>	<b>110,268</b>	<b>120,389</b>	<b>110,136</b>	<b>94,655</b>	<b>75,758</b>	<b>84,137</b>	<b>74,390</b>	<b>72,117</b>	<b>64,878</b>	<b>65,966</b>	<b>72,895</b>	<b>51,028</b>
Long-Term debt, Less current maturities	62,572	72,572	77,572	87,572	92,572	97,437	99,410	94,383	90,650	90,004	92,010	95,047	100,918	71,091
Minority Interest	888	888	888	888	888	1,194	1,894	923	752	782	-	-	-	-
Purchase obligation, less current maturities	9,600	9,600	9,600	9,600	9,437	5,848	9,867	9,673	9,479	9,284	-	-	-	-
Other non-current liabilities	2,200	2,200	2,200	2,200	2,210	2,180	2,150	3,701	3,920	3,890	21,530	19,468	19,165	1,971
Deferred Income Taxes	19,867	19,867	19,867	19,867	19,867	19,879	19,750	18,705	18,355	18,280	18,925	19,590	20,440	20,310
<b>TOTAL LIABILITIES</b>	<b>208,844</b>	<b>212,923</b>	<b>220,395</b>	<b>240,516</b>	<b>235,110</b>	<b>221,193</b>	<b>208,829</b>	<b>211,522</b>	<b>197,536</b>	<b>194,357</b>	<b>197,343</b>	<b>200,071</b>	<b>213,418</b>	<b>144,400</b>
<b>Stockholders Equity</b>														
Common Stock at \$0.1 Par	351	351	351	351	351	351	351	351	351	351	351	351	351	351
Class A Common Stock \$0.1 Par	24	24	24	24	24	24	24	24	24	24	24	24	24	24
Paid-In Capital	29,747	29,667	29,587	29,507	29,427	29,179	29,043	28,955	28,809	28,755	28,700	28,676	28,655	28,655
Retained Earnings	308,548	279,167	256,643	234,317	205,121	165,262	147,663	129,679	112,569	106,449	112,183	112,686	104,989	105,966
Common Stock in Treasury	(20,693)	(20,773)	(20,853)	(20,933)	(21,013)	(21,311)	(21,346)	(21,398)	(21,483)	(21,483)	(21,483)	(21,489)	(21,495)	(21,495)
<b>Total Shareholders Equity</b>	<b>317,977</b>	<b>288,436</b>	<b>265,752</b>	<b>243,266</b>	<b>213,910</b>	<b>173,505</b>	<b>155,739</b>	<b>137,611</b>	<b>120,270</b>	<b>114,096</b>	<b>119,775</b>	<b>120,248</b>	<b>112,524</b>	<b>113,501</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>526,821</b>	<b>501,359</b>	<b>486,147</b>	<b>483,782</b>	<b>449,020</b>	<b>394,698</b>	<b>364,568</b>	<b>349,133</b>	<b>317,806</b>	<b>308,453</b>	<b>317,118</b>	<b>320,319</b>	<b>325,942</b>	<b>257,901</b>

Statement of Cash Flows

	Q2 (Dec 08) (e)	Q1 (Sep 08) (e)	Q4 (Jun 08) (e)	Q3 (Mar 08) (e)	Q2 (Dec 07)	Q1 (Sep 07)	Q4 (Jun 07)	Q3 (Mar 07)	Q2 (Dec 06)	Q1 (Sep 06)	Q4 (Jun 06)	Q3 (Mar 06)	Q2 (Dec 05)	Q1 (Sep 05)
<b>Cash Provided by Operations</b>	<b>52,725</b>	<b>51,131</b>	<b>57,609</b>	<b>42,636</b>	<b>29,114</b>	<b>29,687</b>	<b>22,765</b>	<b>34,614</b>	<b>207</b>	<b>2,138</b>	<b>7,309</b>	<b>26,290</b>	<b>(4,441)</b>	<b>(8,227)</b>
<b>Cash Provided by (used in) Investing Activities</b>	<b>(9,000)</b>	<b>(9,000)</b>	<b>(9,000)</b>	<b>(9,000)</b>	<b>(12,300)</b>	<b>(7,450)</b>	<b>(10,900)</b>	<b>(18,600)</b>	<b>-</b>	<b>15,000</b>	<b>(400)</b>	<b>(15,600)</b>	<b>11,995</b>	<b>14,389</b>
Net Decrease in Investments	-	-	-	-	-	-	(10,901)	(1,152)	-	-	48	-	(23,804)	-
Acquisitions of Businesses net of cash	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Purchases of Property, Plant and Equip.	(6,000)	(6,000)	(6,000)	(6,000)	(7,641)	(4,530)	(6,401)	(5,006)	(6,827)	(5,238)	(5,433)	(4,101)	(1,189)	(1,649)
Payments Received on Notes and Investments	300	300	300	300	481	91	607	286	232	328	533	322	15	1,418
Increase in Notes Receivable and Investments	-	-	-	(300)	(17)	(651)	(22)	(150)	-	(1,030)	(1,529)	-	33	(552)
Net Proceeds from Disposal of PP&E	200	200	200	200	1,914	173	101	125	-	277	1,001	69	28	1,540
<b>Net Cash Provided by (used in) Investing Activities</b>	<b>(14,500)</b>	<b>(14,500)</b>	<b>(14,500)</b>	<b>(14,800)</b>	<b>(17,563)</b>	<b>(12,367)</b>	<b>(27,516)</b>	<b>(24,497)</b>	<b>(6,595)</b>	<b>9,337</b>	<b>(5,780)</b>	<b>(19,310)</b>	<b>(12,922)</b>	<b>15,146</b> </

## Critical Accounting Policies

From FY2007 10K:

**Critical Accounting Policies.** The preparation of financial statements in accordance with U.S. generally accepted accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Management suggests that our Summary of Significant Accounting Policies, as described in Note 1 of the Notes to Consolidated Financial Statements, be read in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations. We believe the critical accounting policies that most impact our consolidated financial statements are described below.

**Allowance for Doubtful Accounts.** In the normal course of business, we extend credit to our customers on a short-term basis. Although credit risks associated with our customers are considered minimal, we routinely review our accounts receivable balances and make provisions for probable doubtful accounts. In circumstances where management is aware of a specific customer's inability to meet its financial obligations to us (e.g. bankruptcy filings), a specific reserve is recorded to reduce the receivable to the amount expected to be collected. For all other customers, we recognize reserves for bad debts based on the length of time the receivables are past due, generally 100% for amounts more than 60 days past due.

**Inventories.** Inventories of eggs, feed, supplies and livestock are valued principally at the lower of cost (first-in, first-out method) or market. If market prices for eggs and feed grains move substantially lower, we would record adjustments to write-down the carrying values of eggs and feed inventories to fair market value. The cost associated with flock inventories, consisting principally of chick purchases, feed, labor, contractor payments and overhead costs, are accumulated during the growing period of approximately 22 weeks. Capitalized flock costs are then amortized over the productive lives of the flocks, generally one to two years. Flock mortality is charged to cost of sales as incurred. High mortality from disease or extreme temperatures would result in abnormal adjustments to write-down flock inventories. Management continually monitors each flock and attempts to take appropriate actions to minimize the risk of mortality loss.

**Long-Lived Assets.** Depreciable long-lived assets are primarily comprised of buildings and improvements and machinery and equipment. Depreciation is provided by the straight-line method over the estimated useful lives, which are 15 to 25 years for buildings and improvements and 3 to 12 years for machinery and equipment. An increase or decrease in the estimated useful lives would result in changes to depreciation expense. When property and equipment are retired, sold, or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations. We continually reevaluate the carrying value of our long-lived assets, for events or changes in circumstances, which indicate that the carrying value may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) are less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the long-lived asset to the estimated fair value of the asset.

**Investment in Affiliates.** We have invested in other companies engaged in the production, processing and distribution of shell eggs and egg products. Our ownership percentages in these companies range from less than 20% to 50%. Therefore, these investments are recorded using the cost or the equity method, and accordingly, not consolidated in our financial statements. Changes in the ownership percentages of these investments might alter the accounting methods currently used. Our investment in these companies amounted to \$6.4 million at June 2, 2007. The combined total assets and total liabilities of these companies were approximately \$24 million and \$11 million, respectively, at June 2, 2007. We are a guarantor of approximately \$4.8 million of long-term debt of one of the affiliates.

**Goodwill.** At June 2, 2007, our goodwill balance represented 1.2% of total assets and 2.7% of stockholders' equity. Goodwill relates to the fiscal 1999 acquisition of Hudson Brothers, Inc., the fiscal 2006 acquisition of Hillandale Farms, LLC, and the fiscal 2007 acquisition of Green Forest Foods, LLC. We adopted, as of June 3, 2001, Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). Under SFAS 142, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually or more frequently if impairment indicators arise, for impairment. An impairment loss would be recorded if the recorded goodwill exceeds its implied fair value. We have only one operating segment, which is our sole reporting unit. Accordingly, goodwill is tested for impairment at the entity level. Significant adverse industry or economic changes, or other factors not anticipated could result in an impairment charge to reduce recorded goodwill.



## Grain and Ag Thesis Summary

Thomas Malthus, a British economist, noted in 1798 that populations grow exponentially, while food production grows arithmetically. He predicted food production would eventually become a constraint on population growth. Many market participants focus on Hubbert's peak, but perhaps investors should be worrying about Malthus's peak!

The media is quick to blame ethanol production for the rapid appreciation in soft commodity prices. In reality, global demand for wheat, coarse grains and rice has outstripped supply for the past ten years, leaving current inventories at 30-year lows. Historically, global population has chiefly driven global food demand. Today, global income growth is the primary driver of grain demand. From 2000 to 2005, global per capita income rose from \$5,251 to \$7,016. As populations prosper worldwide, average calorie consumption per capita increases. The consequent shift in consumer diets from basic grains to meats and vegetable oils further strains grain demand.

Total world grain area harvested actually peaked in 1981 and has since declined by over 8%. Grain yields per acre have made up for the declines in grain areas, but there are signs that yield growth is slowing. Examining crop yield data over the last seventy years, it is apparent that the widespread adoption of irrigation is responsible for a large part of the yield growth. Currently 40% of the world's food supply is grown on irrigated farmland. China grows 52% of their food on irrigated land. The struggle to improve yields will intensify as aquifers are depleted and rivers are polluted or run dry.

There are several obvious investment implications of this research, foremost that food inflation is likely to persist in coming years, as agricultural production struggles to keep pace with demand. Protein prices will also accelerate their ascent in 2008; feed cost pressures are now inflicting sharp losses on many protein producers. In the past few weeks, layoffs and plant closures have been announced at both cattle feed lots and chicken producers, most notably Pilgrim's Pride, Inc. Cal-Maine Foods, Inc. is the first research report of several to be issued by Unit Economics in coming weeks to capitalize on the agriculture secular story, while generating alpha from stock-specific ideas.

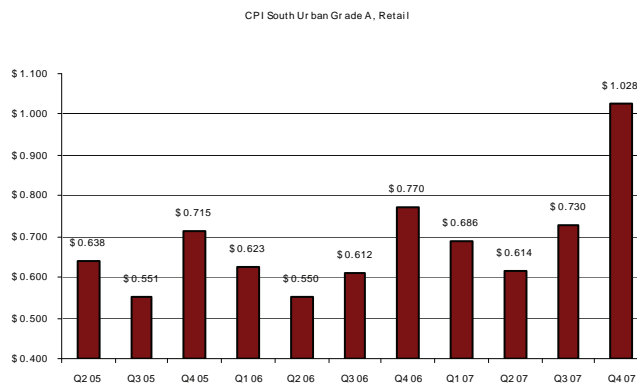
Please see the full report on our Ag Thesis published March 24, 2008 entitled "Malthus's Peak: Recent Grain Price Increases are Structural, not Cyclical."

## Shell Egg Market Overview

According to the USDA, “Eggs are among the most nutritious foods on earth”. The process of egg production starts with the “breeders” - male and female birds used to produce fertile eggs to be incubated (21 days) and hatched for egg production flocks. Layers - hens used to lay shell eggs - take from 20 to 22 weeks to mature. The entire time from ovulation to laying is about 25 hours. A hen can begin producing another egg within 30 minutes of laying. An average egg-laying hen at an egg farm can lay 240 eggs per year given proper conditions. Food is the most important factor. Chicken feed, normally 65% corn and 17% soy meal, is provided to hens via automated feeders. When eggs are laid, they are collected by hand or automated conveyer belts. The eggs are transported to packing facilities in refrigerated trucks. In the case of Cal-Maine, nearly all of their farms have in-line packing facilities.

Once eggs arrive at a packing facility, they are washed and covered in a mineral oil used to preserve freshness. The eggs are then passed over a high intensity light and inspected for cracks in a process known as ‘candling’. The term originated from the time when eggs were inspected by candlelight. Next the egg is graded for interior and exterior qualities, with grades of AA, A, B or C being assigned. Most eggs in the United States are graded AA or A. Last, the eggs are weighed for their final classification. Those weighing 30 ounces or more per dozen are classified as ‘Jumbo’; 27 ounces per dozen and up are ‘Extra Large’; 24 ounces plus per dozen are ‘Large’, with sizes falling to ‘Medium’, ‘Small’ and ‘Pee Wee’ down to 15 ounces per dozen. After the eggs are sized, they are placed in cartons and then packaged into 30-carton cases. From the packing plant the eggs are generally delivered to a warehouse facility or a local store via refrigerated trucks.

Egg prices increased steadily for two years before finally spiking upwards at the end of 2007. Consumers’ continuing acceptance of general food cost inflation has enabled egg producers to pass along feed cost inflation. Eggs are one of the least expensive protein sources. Three eggs have 22 grams of protein and cost a total of \$.50 at \$2.00 a dozen. A quarter pound of 90% ground beef has 22 grams of protein and costs \$1.13 today, yet beef producers are currently losing money! Quarterly wholesale egg prices, based on southern U.S. urban consumer price indices (the market most relevant for Cal-Maine) from Q2 2005 to Q4 2007 are shown below:

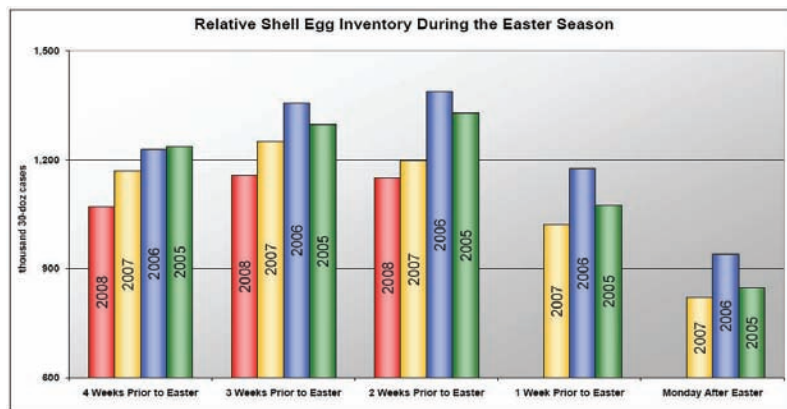


Despite record prices, table egg output drooped 1.3% in 2007, versus 2006, due largely to new requirements from the United Egg Producers. The UEP's revisions dictate that average cage space per layer be expanded to 67 square inches, for all 196 mln cage spaces in its program, by 2010. This represents a 33% increase from 2002 levels. To date, compliance is estimated to have cost the industry 37 mln cage spaces. By April 2010, when full-compliance is required, an additional 19.5 mln cage spaces will be lost.

Farmers have also been reluctant to pay the \$12+ per cage to expand production in the face of several states' attempts to place bans on chicken cages. Connecticut recently had a measure defeated in committee, New Hampshire had a cage ban voted down by the legislature, and measures in California and Delaware are pending. In the UK, legislation is already in effect to ban cages in 2012 and pressure is on EU member states to follow with similar measures. While these legislative risks must be monitored closely by industry investors they, they will also minimize supply growth in the face of recent record egg shell prices.

Egg production centers face a continuous barrage of environmental pressures and complaints—from flies to wastewater runoff issues. Not only do these issues make life difficult for existing farms, but the permitting and planning process adds months to any expansion plans. One industry insider said the total process to enact a meaningful layer expansion takes 18 to 24 months.

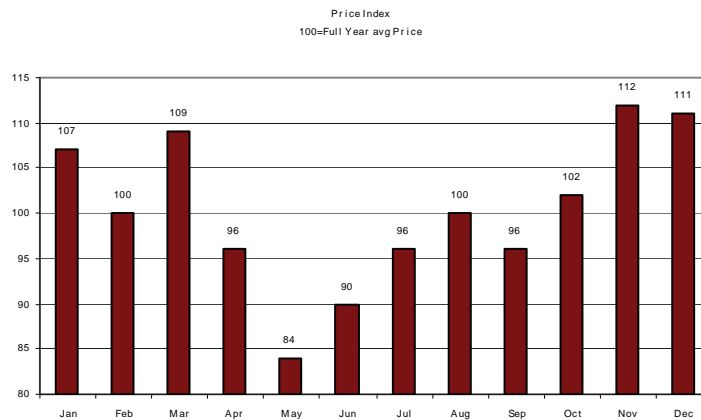
The USDA expects egg supply to rise 1.2% in 2008, but the number of layers is currently down 2% from 2007. The number of eggs laid per chicken, however, is up nearly 2% as farms are likely trying to maximize current production during this strong trend in pricing. "Excess" production is often unsustainable, however, because the stress and calcium depletion suffered by layers produces inferior eggs. Some of the current excess production is due to a relatively low number of layers that are "molting". This natural shedding of feathers typically occurs after 13 months of age, and again after 2 years of age where hens rest by ceasing egg production for a period of time - usually 6 weeks. Despite the increased egg production per hen, egg inventories pre-Easter are down from 2007 as can be seen on the following USDA table:



Egg farmers experienced terrible margins in 2005 and 2006 and do not seem overly optimistic about egg prices going forward. In a recent survey published by Watt Poultry, 47.2% of producers expect shell egg prices to fall in 2008. More than half of those surveyed think the number of layers will increase in 2008. So far this appears doubtful. The USDA is an excellent resource for the diligent investor to monitor the number of eggs in incubators to be hatched, as well as the number of layers in production.

Per capita egg consumption in the United States had steadily declined from a peak 402 per year in 1945 to 236 by 1995. Consumption has since rebounded, currently estimated to be 254 per capita in 2008. Table egg exports in 2007 reached 78.8 mln dozen, up 42%. U.S. exports to Hong Kong and Canada, the top 2 export markets, totaled 42.8 mln dozen. Beginning in 2002, Radlo Foods, LLC began supplying Cuba with 830,000 dozen eggs per year and industry insiders say Cuba may be a major growth market in coming years. Now you can pitch CALM as a Cuba play!

Egg demand follows a predictable seasonal pattern with the highest demand running from November through Easter. Egg shell prices typically peak in November at 112% of the avg full year price and trough in May at 84% of the avg full year price. The following table shows the typical monthly price seasonality:



As you can see, the shell egg market appears to have several great factors driving demand (relative pricing, protein pricing, exports); while environmental regulations and new cage size limitations are simultaneously constricting supplies. We expect this favorable supply/demand environment to continue into early 2010 and look forward to following shell egg price developments.

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